

DIRECTORS' REPORT

For the year ended December 31, 2015

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)
John Zimmerman (appointed July 4, 2012, resigned November 30, 2015)
Michael Carter (appointed November 30, 2015)
Laura Chisholm (independent) (appointed January 29, 2013).

The Directors held no interests in the Company as at December 31, 2015.

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 31, 2015 amounted to US\$1,013,975,081 (December 31, 2014: to 1,040,158,305).

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 31, 2014: 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 (June 30, 2014: 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. On 8th June 2016, an announcement was made by HSH Nordbank stating that HSH

Nordbank expects that coupon payments on Silent Participations and Profit Participation capital will only take place in 2020 for the fiscal year 2019, at the earliest. Therefore in the Company's opinion, no such loss events have occurred during the year ended December 31, 2015 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\$57,710,936 (December 31, 2014: US\$30,944,736) 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

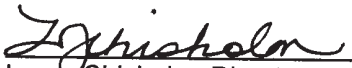
The financial statements of the Company have been prepared by management. Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining 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 December 31, 2015, 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 29 June, 2016


Laura Chisholm, Director

Financial Statements of

HSH N FUNDING II

December 31, 2015

HSH N FUNDING II

Table of Contents

	<u>Page</u>
Independent Auditors' Report to the Directors	1-2
Statement of Financial Position	3
Statement of Comprehensive Income	4
Statement of Changes in Equity	5
Statement of Cash Flows	6
Notes to Financial Statements	7 - 30



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Independent Auditors' Report to the Directors

We have audited the accompanying financial statements of HSH N Funding II ("the Company"), which comprise the statement of financial position as at December 31, 2015, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the financial statements 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2015, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



Independent Auditors' Report to the Directors (continued)

Emphasis of Matter

Without qualifying our opinion, we draw attention to Notes 1, 7 and 12 to 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.

A handwritten signature of the KPMG firm, written in blue ink.

June 29, 2016

HSH N FUNDING II

Statement of Financial Position

December 31, 2015

(stated in United States dollars)

	Note	2015	2014
Assets			
Available-for-sale financial assets			
Silent Contribution	3,7,8	150,868,129	161,353,027
Loans and receivables			
Loan receivable	4,7,8	553,000,000	553,000,000
Cash and cash equivalents	7,8	9,272,794	9,272,794
Total assets	US\$	713,140,923	723,625,821
Liabilities and Equity			
Liabilities			
Class B preference shares	5,8	368,941,081	395,124,305
Other liabilities		1,528	1,528
		368,942,609	395,125,833
Equity			
Share capital	6	10,000	10,000
Class A preference shares	6	645,034,000	645,034,000
Revaluation reserve	2(c)(viii)	(302,024,189)	(296,288,379)
Retained earnings		1,178,503	(20,255,633)
		344,198,314	328,499,988
Total liabilities and equity	US\$	713,140,923	723,625,821

See accompanying notes to financial statements.

Approved on behalf of the Board of Directors on June 29, 2016

Laura Chisholm Director

Yun Zheng Alternate Director

HSN FUNDING II

Statement of Comprehensive Income

For the year ended December 31, 2015
(stated in United States dollars)

	Note	2015	2014
Income			
Net change in revised discounted cash flows (Class B preference shares)	2(c)(viii),5	26,183,224	-
Net change in revised discounted cash flows (Silent Contribution)	2(c)(viii),3	-	21,377,971
Interest income on loan	4,7	36,276,800	36,276,800
		62,460,024	57,654,771
Finance costs			
Net change in revised discounted cash flows (Silent Contribution)	2(c)(viii),3	4,749,088	-
Net change in revised discounted cash flows (Class B preference shares)	2(c)(viii),5	-	26,710,035
		4,749,088	26,710,035
Net income for year	US\$	57,710,936	30,944,736
Other comprehensive (loss)/income			
Net change in fair value of available-for-sale financial assets	2(c)(viii),3	(5,735,810)	22,495,730
		(5,735,810)	22,495,730
Comprehensive income for year	US\$	51,975,126	53,440,466

See accompanying notes to financial statements.

HSN FUNDING II

Statement of Changes in Equity

For the year ended December 31, 2015
(stated in United States dollars)

	Note	Share Capital	Class A Preference Shares	Revaluation Reserve	Retained Earnings	Total
Balance at January 1, 2014	US\$	10,000	645,034,000	(318,784,109)	(14,923,569)	311,336,322
Net income for year		-	-	-	30,944,736	30,944,736
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	-	-	22,495,730	-	22,495,730
Balance at December 31, 2014	US\$	10,000	645,034,000	(296,288,379)	(20,255,633)	328,499,988
Net income for year		-	-	-	57,710,936	57,710,936
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	-	-	(5,735,810)	-	(5,735,810)
Balance at December 31, 2015	US\$	10,000	645,034,000	(302,024,189)	1,178,503	344,198,314

See accompanying notes to financial statements.

HSH N FUNDING II

Statement of Cash Flows

For the year ended December 31, 2015
(stated in United States dollars)

	2015	2014
Cash provided by/(applied in):		
Operating activities		
Net income for year	57,710,936	30,944,736
Add/(deduct) net changes in non-cash operating balances:		
Net change in revised discounted cash flows (Class B preference shares)	(26,183,224)	26,710,035
Net change in revised discounted cash flows (Silent Contribution)	4,749,088	(21,377,971)
Increase in cash and cash equivalents during year	36,276,800	36,276,800
Financing activities		
Class A dividends paid	(36,276,800)	(36,276,800)
Increase in cash and cash equivalents during year	-	-
Cash and cash equivalents at beginning of year	9,272,794	9,272,794
Cash and cash equivalents at end of year	US\$ 9,272,794	9,272,794
Supplementary information on cash flows from operating activities:		
Interest received	36,276,800	36,276,800

HSH N FUNDING II

Notes to Financial Statements

For the year ended December 31, 2015
(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 is based on the following:

- (i) the agreements required for the implementation of the formal 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 formal 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 sales price in an open, nondiscriminatory, competitive and transparent process not involving state aid before February 28, 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure.

HSH N FUNDING II

Notes to Financial Statements

For the year ended December 31, 2015
(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 of significant unexpected outflows of funds (e.g. in the scenario described above), measures must be taken to strengthen the liquidity position. 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 and that the expected recovery of the shipping markets materialises.

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. 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").

HSH N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

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. In this connection 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, 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.

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.

HSN FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(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).

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.

HSN FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(iv) Determination of Fair Values (continued)

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)

For the year ended December 31, 2015
(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 or 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. 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 13 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 significance 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 quoted 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)

For the year ended December 31, 2015
(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 an available-for-sale asset.

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 unrealised gains and losses arising from a change in fair value of available-for-sale instruments are recognised 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.

On February 6, 2013, a press release was issued stating that HSH Nordbank would not be servicing its profit participation certificates until 2017, therefore no profit participation income has been accrued as at December 31, 2015 or 2014. Payment is expected to resume for 2017, with the profit participation income payable in June 2018.

On October 19, 2015, a press release was issued stating that HSH Nordbank has to implement a dividend ban (this does not prevent dividend payments from the operating company to the holding company) and a hybrid capital payout ban on existing hybrid

HSH N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(viii) Specific instruments (continued)

Silent Contribution (continued)

capital instruments. Subject to successful completion of the privatization procedure, the Bank expects to pay dividends as well as distributions under the hybrid capital instruments for the 2018 fiscal year in 2019 at the earliest. 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.

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 (2014: 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 (2014: US\$500,000,000).

HSB N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(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, 2015 the fair value of the level 2 investments, comprising solely of the Silent Contribution, was US\$150,868,129 (2014: US\$161,353,027).

	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, 2014	500,000,000	92,034,722	(155,771,287)	(318,784,109)	117,479,326
Profit participation for the year	-	-	-	-	-
AG.8 and fair value movements	-	-	21,377,971	22,495,730	43,873,701
Balance at December 31, 2014	500,000,000	92,034,722	(134,393,316)	(296,288,379)	161,353,027
Profit participation for the year	-	-	-	-	-
AG.8 and fair value movements	-	-	(4,749,088)	(5,735,810)	(10,484,898)
Balance at December 31, 2015	500,000,000	92,034,722	(139,142,404)	(302,024,189)	150,868,129

HSH N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(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 December 31, 2015 the balance of the Class B preference shares was US\$ 368,941,081 (2014: US\$395,124,305) comprising the initially issued amount of US\$500,000,000 and the net adjustments due to IAS 39.AG8 of US\$(131,058,919) (2014: US\$(104,875,695)).

	Class B preference shares USD	Net results from revised discounted cash flows USD	Total USD
Balance at January 1, 2014	500,000,000	(131,585,730)	368,414,270
Result of revised discounted cash flows for the year	-	26,710,035	26,710,035
Balance at December 31, 2014	500,000,000	(104,875,695)	395,124,305
Result of revised discounted cash flows for the year	-	(26,183,224)	(26,183,224)
Balance at December 31, 2015	500,000,000	(131,058,919)	368,941,081

HSN FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(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)

For the year ended December 31, 2015
(stated in United States dollars)

6. Share capital

	2015	2014
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 December 31, 2015 and 2014, there were no changes to issued and fully paid Ordinary Shares.

Rights attaching to Ordinary shares:

- 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.
- 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.
- 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:

	2015 Number of shares	2015 US\$	2014 Number of shares	2014 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

HSN FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(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)

For the year ended December 31, 2015
(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	2015	2014
Statement of Financial Position:			
Silent Contribution	3	150,868,129	161,353,027
Loan receivable	4	553,000,000	553,000,000
Cash and cash equivalents		9,272,794	9,272,794
Statement of Comprehensive Income:			
Interest income on loan	4	36,276,800	36,276,800
Other interest income		-	-

HSH Nordbank AG's audited financial statements for the year end December 31, 2015 and 2014 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):

December 31, 2015	Note	Carrying Amount	Fair Value	Difference
Silent Contribution	3	150,868,129	150,868,129	-
Loan Receivable	4	553,000,000	743,344,204	190,344,204
Cash and cash equivalent		9,272,794	9,272,794	-
Class B preference shares	5	368,941,081	160,440,000	(208,501,081)
Other Liabilities		1,528	1,528	-

HSH N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

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

December 31, 2014	Note	Carrying Amount	Fair Value	Difference
Silent Contribution	3	161,353,027	161,353,027	-
Loan Receivable	4	553,000,000	788,201,903	235,201,903
Cash and cash equivalent		9,272,794	9,272,794	-
Class B preference shares	5	395,124,305	180,305,000	(214,819,305)
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)

For the year ended December 31, 2015
(stated in United States dollars)

9. Credit, liquidity and market risk (continued)

Credit risk (continued)

As at December 31, 2015 and December 31, 2014 the Company's financial assets exposed to credit risk amounted to the following:

	Note	2015	2014
Silent Contribution	3	150,868,129	161,353,027
Loan receivable	4	553,000,000	553,000,000
Cash and cash equivalents		9,272,794	9,272,794
	US\$	713,140,923	723,625,821

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\$5,735,810) and an AG8 adjustment of (US\$4,749,088) (2014: US\$22,495,730 and US\$21,377,971 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)

For the year ended December 31, 2015
(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, 2015

Amendment to IAS 24 Related Party Disclosures:

IAS 24 clarifies where an entity receives management personnel services from a third party (a management entity), the fees paid for those services must be disclosed by the reporting entity, but not the compensation paid by the management entity to its employees or directors. This amendment has no impact on the Company.

Amendment to IFRS 13 Fair Value Measurement:

IFRS 13 clarifies that the portfolio exception in IFRS 13 (measuring the fair value of a group of financial assets and financial liabilities on a net basis) applies to all contracts within the scope of IAS 39 or IFRS 9. This amendment has no impact on the Company.

HSN N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

11. New pronouncements (continued)

There were no other standards, interpretations or amendments to existing standards that are effective during 2015 that have a significant impact on the Company.

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2015 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.

The standard is not expected to have a significant impact on the Company's financial position or performance as it is expected that the Company will continue to classify Silent Contribution at fair value through profit or loss.

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.
- 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, 2016. The standard is not expected to have a significant impact on the Company's financial position or performance.

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)

For the year ended December 31, 2015
(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 recapitalisation 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 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.

Informal agreement reached with EU Commission

On October 19, 2015 the majority owners of HSH Nordbank, Hamburg and Schleswig-Holstein, the Federal Republic of Germany and the EU Commission reached an informal agreement in the pending EU state aid proceedings to provide relief to the Bank's operating business from the adverse impact of legacy portfolios and guarantee fees, which, following the implementation of the individual measures, should improve the financial and risk situation and form the basis for a sustainable and viable structure of the Bank. It is also envisaged that the Bank be privatised by the year 2018. The Bank and its majority owners have been thoroughly preparing for the implementation of the informal agreement over the past few months.

HSH N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

12. Current market condition (continued)

Formal Decision in the EU state aid proceedings

On May 2, 2016 the EU Commission issued a formal decision in the current EU state aid proceedings and thereby approved the replenishment of the second loss guarantee provided by the federal states from € 7.0 billion to € 10.0 billion. The formal decision confirms the informal agreement and defines it in principle in concrete terms. It is based on a catalogue of conditions and commitments provided by the Federal Republic of Germany to the EU Commission.

Sale of non-performing loans of up to € 8.2 billion

Under the informal agreement the Bank is to be relieved of some of its troubled legacy portfolios. Following the informal agreement, the Bank was able to transfer non-performing loans in the amount of up to € 6.2 billion at market prices to the federal state owners and to sell an additional portfolio volume of € 2 billion in the market. Any resulting losses should be charged against the second loss guarantee under the current conditions of the guarantee agreement and would therefore result in a higher drawdown of the guarantee. The aim is that the volume of non-performing loans will decrease clearly thanks to these measures. The largest portion of the portfolios to be sold is accounted for by nonperforming shipping loans, which should reduce the impact of the very difficult shipping market and volatile US dollar on the Bank's operating performance.

Further points relating to the sale of non-performing loans were specified as part of the formal decision taken in May 2016. Accordingly, it is planned to transfer portfolios of an initial amount of € 5 billion to the federal states in the middle of 2016. The transfer will be made at market values determined by the EU Commission from a state aid point of view. Furthermore, it is planned on the basis of the formal decision of the EU Commission to sell portfolios of up to € 3.2 billion in the market.

The portfolio remaining at the Bank under the guarantee will continue to be hedged by the continuing guarantee facility in the proven way. This will continue to provide increased stability in the income statement and regulatory capital backing even under crisis market conditions.

Reduction in guarantee fees and establishment of a holding structure

A further key point of the informal agreement with the EU Commission is the future structure of the guarantee fees together with the establishment of a holding company and a subsidiary, which will comprise the Bank's operating business and is to be privatised. The operating company is to pay a significantly lower level of guarantee fees in the future. The base premium for the guarantee is to decrease by 1.8% to 2.2% (from a current 4%) and is solely payable on the portion of the guarantee not made use of, i.e. drawn down, and no longer on the guarantee facility of € 10 billion. The base premium of currently about € 400 million is to decrease over the coming years as planned after the portfolio transactions have been implemented.

HSB N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

12. Current market condition (continued)

In the new structure the current additional premium for the guarantee shall no longer apply to the operating company. The reduction in guarantee fees should significantly ease the strain on the results of the Bank's operating company. This company would be structurally in a much better position in future to strengthen its capital from own resources and therefore meet the increasing banking supervision and market requirements. As the assets to be sold will mainly comprise US dollar transactions, the sensitivity of capital ratios to the volatile US dollar will also decrease noticeably.

Furthermore, the operating company's funding requirements, particularly in the US dollar business, will also decrease due to the sale of the loan portfolios. This will also strengthen the Bank's liquidity position affected by movements in the US dollar in the future.

The holding company still to be formed is to significantly relieve the operating company of all other fee components of the second loss guarantee - base premium on the portion of the guarantee drawn down, base premium of 1.8% on the portion of the guarantee not drawn down and the current additional premium.

It was further specified in the formal decision that the Bank provides the holding company with liquidity of € 50 million to ensure its operations. Furthermore, the operating company must make a one-off payment of € 210 million to the holding company.

Privatisation of the operating company

Under the formal agreement, a period of 24 months following the binding decision of the EU Commission was provided for the sale of the operating company. Delays for reasons outside the control of the Bank or the federal states were meant to allow extending the period by up to six months.

The federal states of Hamburg and Schleswig-Holstein may retain a shareholding of a maximum of 25% for up to four years following the sale. The success of the sales process was meant to be assessed by the EU Commission as part of a further future decision in the light of the privatisation, in which the Commission would analyse and assess the viability of the newly established entity following the sale.

The company to be sold is to be reorganised in such a way that a successful sales process is promoted. Further cost savings and measures to strengthen the capital base will be implemented for this purpose. According to the informal agreement, a dividend ban was to apply during the privatisation period and a distribution ban on the issued hybrid instruments during the entire restructuring period.

HSH N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

12. Current market condition (continued)

Under the formal decision a deadline of February 28, 2018 is set for the sale of the operating company (i.e. up to the signing of the acquisition agreement). This divestiture period may be extended by up to 6 months with the agreement 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 sale will be executed as part of an open, non-discriminatory, competitive and transparent process. The participating bidders, who must be independent of HSH and the public sector, must have the necessary financial resources and proven sector expertise to manage the operating company as a profitable and active competitor. A sale to other Landesbanks is possible. Public savings banks may also take a minority interest in an acquisition by a private third party or by one or several Landesbanks.

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 will be subject to a viability assessment of the new corporate structure by the EU Commission prior to implementation and has to be approved by the EU Commission.

The formal decision of the EU Commission also provides for setting out the informal agreement in more detail regarding the dividend and distribution ban: During the divestiture period the operating company may not make any payments on profit-related equity instruments (such as hybrid financial instruments and profit participation certificates), unless such are contractually or legally owed. These instruments are also to participate in losses, if the balance sheet of the operating company were to disclose a loss excluding the reversal of reserves. Furthermore, the operating company will not pay any dividends until the sale is completed. The exceptions to this are dividend payments in the amount permitted by law from the operating company to the holding company to be formed.

Based on the information available as at the balance sheet date and on its own planning, 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.

HSH N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

12. Current market condition (continued)

Further key points of the formal decision pursuant to the catalogue of conditions and commitments

Under the catalogue of conditions and commitments set out in the formal decision the operating subsidiary will maintain the regulatory liquidity ratios net stable funding ratio ("NSFR") and liquidity coverage ratio ("LCR") in a range of 80% to 120% at the year end of the 2016 and 2017 financial years, respectively. Furthermore, provisions regarding the reduction in total assets and business model (including expansion of the business approach in the area of corporate clients compared to the previous list of EU conditions under the original EU proceedings and continuation of the ban on proprietary trading and asset-based aircraft financing and setting of a maximum possible new business volume in Shipping) are to be complied with and the restriction on external growth through the acquisition of control in other companies is also to be observed.

Implementation of the informal agreement and inclusion in the 2015 Group financial statements

In November 2015 the federal states of Hamburg and Schleswig-Holstein confirmed in a binding statement to the Bank that they will implement the informal agreement as quickly as possible and initiated - as far as needed - the necessary parliamentary legislative procedures. These parliamentary legislative procedures were completed last year with the consent of the parliaments of Hamburg (Bürgerschaft) and Schleswig-Holstein (Landtag). The impact of the informal agreement and the binding undertaking of the federal states of Hamburg and Schleswig-Holstein on net assets, financial position and results of operations was taken into account in the 2015 annual and Group financial statements in accordance with the accounting rules to be applied.

Creation of the holding structure

The planned legal separation of the Bank into an operating company and a holding company and associated reduction in guarantee fees is to be achieved by the Bank's existing shareholders contributing their shares to a new holding company to be established. This holding company will in future bundle together the shares contributed by all owners.

In addition to the principal owners, Hamburg and Schleswig-Holstein, minority shareholders have also confirmed to the Bank that they will contribute shares to the holding company. It is intended that the 5.3% shareholding in the Bank held by the Savings Banks Association for Schleswig-Holstein (Sparkassen- und Giroverband) and the 4.2% shareholding held by private investors advised by J.C. Flowers & Co. LLC be transferred to the holding company. Furthermore, the private investors advised by J.C. Flowers & Co. LLC are to hold a 5.1% shareholding directly in the operating company.

HSB N FUNDING II

Notes to Financial Statements (continued)

For the year ended December 31, 2015
(stated in United States dollars)

12. Current market condition (continued)

Start of the privatisation process

In view of the time limit the first steps for the sales process have already been initiated in addition to the preparations and specifications for the implementation of the planned structural measures. In the first half of 2016 an investment bank is to be appointed by the federal states to support a successful sales process. An investment bank will also be appointed by the Bank to provide support in this process.

Further strategic and operational improvements are planned at the Bank over and above the implementation of the structural measures. The foundations of a permanently viable business model and the starting point for a successful privatisation of the Bank have been further improved by these additional optimisations.

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 June 29, 2016.