

**RESPARCS FUNDING II LIMITED PARTNERSHIP**  
**ANNUAL REPORT AND AUDITED FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31ST DECEMBER 2017**

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**RESPARCS FUNDING II LIMITED PARTNERSHIP**

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## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **REPORT OF THE GENERAL PARTNER**

The General Partner, European Capital Investment Opportunities Limited, presents its annual report and the audited financial statements of RESPARCS Funding II Limited Partnership (the "Partnership") for the year ended 31st December 2017.

#### **PARTNERSHIP**

The Partnership was established on 17th April 2003 and is registered as a limited partnership in Jersey under the Limited Partnerships (Jersey) Law 1994 for an unlimited duration. The Partnership commenced activities on 26th May 2003, with the issue of €500,000,000 nominal Re-Engineered Silent Participation Assimilated Regulatory Capital (RESPARC) Securities (the "RESPARC Securities", or "Capital Securities" or "Securities").

#### **ACTIVITIES**

The principal activity of the Partnership is to participate in financing activities arranged for HSH Nordbank Aktiengesellschaft ("HSH Nordbank AG" or the "Bank"). The Partnership has issued €500,000,000 nominal 7.5% RESPARC Securities, the proceeds from which have been used to acquire a silent capital interest (the "Silent Contribution") in the commercial enterprise of HSH Nordbank AG in the form of a "Stille Gesellschaft" under German law in the amount of €500,000,000. The market for the Silent Contribution and hence the RESPARC Securities issued by the Partnership, is limited to highly sophisticated investors who understand the risks and rewards associated with these financial instruments. The RESPARC Securities are listed on the Frankfurt Stock Exchange and the Official Segment of the stock market of Euronext Amsterdam N.V.

As at 31st December 2017 the fair value of the RESPARC Securities was 43.063% (31st December 2016: 15.5%) of the nominal value.

For further details on activity of the Partnership and events during the year please refer to note 2 and note 8.

#### **GOING CONCERN**

Due to the limited recourse nature of the structure and available liquidity facility, the General Partner is of the opinion that the Partnership will be able to meet its obligations as they fall due. Therefore the financial statements have been prepared on a going concern basis, notwithstanding the net liability position of the Partnership at the year end. Detailed information on the General Partner's assessment of going concern is disclosed in note 1.

#### **RESULTS FOR THE YEAR**

The profit for the year amounted to €405,671 (2016: profit of €217,422).

#### **DIRECTORS OF THE GENERAL PARTNER**

The Directors of the General Partner who held office during the year and subsequently were:

S.J. Hopkins  
J.D. Wiseman  
J.N. Pendergast

The Directors of the General Partner did not hold any interest in the Partnership during the year, or subsequently.

#### **REGISTERED OFFICE**

The registered office is 13 Castle Street, St Helier, Jersey, Channel Islands, JE4 5UT.

#### **INDEPENDENT AUDITORS**

KPMG Channel Islands Limited has expressed its willingness to continue in office.

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## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **REPORT OF THE GENERAL PARTNER - (CONTINUED)**

#### **SECRETARY OF THE GENERAL PARTNER**

Sanne Secretaries Limited

#### **STATEMENT OF GENERAL PARTNER'S RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS**

The General Partner is responsible for preparing the Report of the General Partner and the financial statements in accordance with applicable law, the Limited Partnership Agreement and International Financial Reporting Standards.

The General Partner is responsible for the preparation of financial statements for each financial year which give a true and fair view of the surplus or deficit of the Partnership for the year and of the state of affairs at the end of the year. In preparing the financial statements the General Partner should:

- \* select suitable accounting policies and then apply them consistently;
- \* make judgements and estimates that are reasonable and prudent;
- \* state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- \* assess the Limited Partnership's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- \* use the going concern basis of accounting unless the General Partner either intends to liquidate the Limited Partnership or to cease operations, or has no realistic alternative but to do so.

The General Partner is responsible for keeping accounting records which are sufficient to show and explain the Partnership's transactions and to disclose with reasonable accuracy, at any time, the financial position of the Partnership and enable them to ensure that the financial statements comply with the Limited Partnership Agreement and the International Financial Reporting Standards. The General Partner is also responsible for safeguarding the assets of the Partnership and hence for taking reasonable steps for the prevention and detection of fraud, errors and other irregularities.

The General Partner confirms that it has complied with the above requirements throughout the year and subsequently.

So far as the Directors of the General Partner are aware, there is no relevant audit information of which the Partnership's auditors are unaware, and each Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Partnership's auditors are aware of that information.

#### **STATEMENT OF PERSONS RESPONSIBLE WITHIN THE ISSUER**

With regard to Regulation 2004/109/EC of the European Union (the "EU Transparency Directive"), the Directors of the General Partner, whose names appear on page 2, confirm to the best of their knowledge that the audited financial statements for the year ended 31st December 2017 give a true and fair view of the assets, liabilities, financial position and deficit of the Partnership as required by the applicable accounting standards. The Report of the General Partner gives a fair review of the development of the Partnership's business, financial position and the important events that have occurred during the year and their impact on the financial statements. The principal risks and uncertainties faced by the Partnership are disclosed in note 13 of these financial statements.

  
Signed on behalf of

**European Capital Investment Opportunities Limited**

General Partner

Date: 30th April 2018



# Independent Auditor's Report to the Partners of RESPARCS Funding II Limited Partnership

## *Our opinion is unmodified*

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

In our opinion, the accompanying financial statements:

- give a true and fair view of the financial position of the Partnership as at 31 December 2017, and of Partnership's financial performance and the Partnership's cash flows for the year then ended; and
- are prepared in accordance with International Financial Reporting Standards (IFRS).

## *Basis for Opinion*

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Partnership in accordance with, UK ethical requirements including FRC Ethical Standards as applied to listed entities. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

## *Key Audit Matters: our assessment of the risks of material misstatement*

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In arriving at our audit opinion above, the key audit matters, were as follows:

<i>The risk</i>	<i>Our response</i>
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**Valuation of Silent Contribution**

Available for sale financial assets €215,300,000 or 99% of total assets; (2016: €77,500,000 or 99% of total assets)

Refer to accounting policy in note 1 and disclosures in note 2 and 13

**Basis:**

The Partnership issued €500,000,000 nominal 7.5% RESPARC Securities ("Securities"), the proceeds of which have been used to acquire a silent capital interest (the "Silent Contribution") in HSH Nordbank AG (the "Bank").

The Partnership classifies the Silent Participation as available for sale financial assets which are measured at fair value.

The Silent Contribution is valued based on the available price of the listed Securities issued by the Partnership on the basis that the two instruments have back-to-back terms and the Securities are limited recourse to the Silent Contribution held. The fair value price is determined from the Frankfurt Stock exchange and the Official Segment of the stock market of Euronext Amsterdam N.V.

As a result, the judgment required relates to the appropriateness of using its Securities price to estimate the fair value of the Silent Contribution.

**Risk:**

The judgment applied and assumptions made by the General Partner in estimating the fair value of the Silent Contribution may not be appropriate.

The amounts recorded in the statement of financial position may therefore not represent the fair value.

Our audit procedures included:

**Internal Controls:** Assessed the design and implementation of the control in place over the estimation of the fair value of the Silent Contribution.

**Assessing valuation approach and key inputs:** Obtained an understanding of the valuation methodologies adopted, the key assumptions made, and inputs used by the General Partner to estimate fair value and concluded on their appropriateness.

**Challenging observable data used by management:** Independently obtained the market prices of the Securities and assessed the appropriateness of using the observable prices for the fair value of the Silent Contribution.

**Assessing disclosures:** Assessed the fair value disclosures for the Silent Contribution in the financial statements for compliance with IFRS requirements.

The risk	Our response
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**Carrying amount of Capital Securities Basis:**

Capital securities issued  
 €341,323,164; (2016  
 €422,345,955)

Refer to accounting policy  
 in note 1 and disclosures  
 in note 8 and 13

The Partnership issued €500,000,000 nominal Securities having no mandatory maturity date. Coupon payments on the Securities are contingent on the receipt of the Silent Contribution Profit Participation income from the Bank.

The Partnership classifies the Securities as other liabilities measured at amortised cost.

The carrying amount of these Securities is based on an effective interest rate calculation value as amended for forecast cash flows.

A number of assumptions are used by the General Partner in relation to the calculation and timing of the future cash flows and therefore the carrying value of the Securities.

**Risk:**

The judgments applied and the assumptions made in estimating the forecast cash flows in determining the carrying value of the Securities is a significant area of our audit. The amount recorded in the statement of financial position may not represent carrying value.

**Our audit procedures included:**

**Internal Controls:** Assessed the design and implementation of the control in place over the calculation of the carrying value of the Capital Securities.

**Challenging assumptions and inputs:** Assessed the appropriateness of the inputs, assumptions and methodology used in the estimated future cash flows discounted using the effective interest rate, by:

- involving the auditor of the Bank to challenge the cash flow forecasts,
- reconciling the input data with the underlying contracts and profit and loss forecasts; and
- re-performing the calculations and discussing and challenging findings in order to form our conclusions on the carrying value of the Securities.

**Assessing disclosures:** Assessed the adequacy of relevant disclosures for the Securities in the financial statements for compliance with IFRS requirements

The risk	Our response
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*Use of the going concern assumption for preparation of the financial statements*

*Refer to disclosures in note 1.*

**Basis:**

In order to be able to continue as a going concern, the Partnership relies on support from HSH Nordbank Securities S.A. (the "Support Undertaking Agreement" counterparty) a subsidiary of the Bank, in its capacity as the guarantor (the "Guarantor") of the obligations to be met by the Partnership.

**Risk:**

There is a risk that the Partnership would no longer be a going concern if the Support Undertaking counterparty failed to honour its guarantee for the obligations of the Partnership if required.

*Our audit procedures included:*

**Challenging the Directors' assumptions in relation to going concern:** Obtained the General Partner's written going concern assessment and challenged the assumptions therein. Considered the coterminous 2017 audited financial statements of the Bank as the parent of the Guarantor, including the signed audit report, to evaluate activities at the Bank level that may impact the Bank's and the Guarantor's ability to honor the Support Undertaking Agreement.

**Assessing disclosures:** Assessed the going concern disclosures in the financial statements for compliance with IFRS.

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## *Our application of materiality and an overview of the scope of our audit*

Materiality for the financial statements as a whole was set at £2,159,000 determined with reference to a benchmark of Total Assets of £215,966,030 of which it represents approx. 1.0% (2016: 1.0%).

We reported to the Audit Committee any corrected or uncorrected identified misstatements exceeding £107,000 in addition to other identified misstatements that warranted reporting on qualitative grounds.

Our audit of the Partnership was undertaken to the materiality level specified above, which has informed our identification of significant risks of material misstatement and the associated audit procedures performed in those areas as detailed above.

## *We have nothing to report on the other information in the Report of the General Partner*

The General Partner is responsible for the other information presented in the Report of the General Partner together with the financial statements. Our opinion on the financial statements does not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.





Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information presented in the Report of the General Partner.

## *Respective responsibilities*

### *General Partner's responsibilities*

As explained more fully in their statement set out on page 3, the General Partner is responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Partnership's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless it intends to liquidate the Partnership or to cease operations, or has no realistic alternative but to do so.

### *Auditor's responsibilities*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

## *The purpose of this report and restrictions on its use by persons other than the Partners as a body*

This report is made solely to the Partners, as a body, in accordance with the terms of our engagement letter dated 17 January 2018. Our audit work has been undertaken so that we might state to the Partners those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Partnership and the Partners as a body, for our audit work, for this report, or for the opinions we have formed.

Brian Bethell

**For and on behalf of KPMG Channel Islands Limited**  
*Chartered Accountants, Jersey*

30 April 2018

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### STATEMENT OF FINANCIAL POSITION

AS AT 31ST DECEMBER 2017

	<u>Notes</u>	<u>31st Dec 17</u>	<u>31st Dec 16</u>
<b>ASSETS</b>			
<b>NON-CURRENT ASSETS</b>			
Available-for-sale financial assets	2	215,315,000	77,500,000
<b>CURRENT ASSETS</b>			
Trade and other receivables	3	479,726	2,500
Cash and cash equivalents	4	171,304	171,489
		651,030	173,989
<b>TOTAL ASSETS</b>	€	215,966,030	€ 77,673,989
<b>EQUITY AND LIABILITIES</b>			
<b>CAPITAL AND RESERVES</b>			
Capital account	6	1,000	1,000
Capital contribution	6	1,501,807	1,501,807
Retained deficit		( 3,980,909)	( 4,386,580)
Revaluation reserve		( 123,421,483)	( 343,368,162)
<b>TOTAL PARTNERS' DEFICIT</b>		( 125,899,585)	( 346,251,935)
<b>NON-CURRENT LIABILITIES</b>			
Capital securities issued	8	341,323,164	422,345,955
<b>CURRENT LIABILITIES</b>			
Loans payable	7	407,065	1,473,241
Trade and other payables	5	135,386	106,728
		542,451	1,579,969
<b>TOTAL LIABILITIES</b>		341,865,615	423,925,924
<b>TOTAL EQUITY AND LIABILITIES</b>	€	215,966,030	€ 77,673,989

The financial statements on pages 9 to 38 were approved and authorised for issue by the Board of the General Partner on the 30th day of April 2018 and were signed on its behalf by:



Director: John Pendergast

(The notes on pages 13 to 38 form part of these financial statements)

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### STATEMENT OF COMPREHENSIVE INCOME

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

	<u>Notes</u>	<u>1st Jan 17 to 31st Dec 17</u>	<u>1st Jan 16 to 31st Dec 16</u>
<b>FINANCE INCOME</b>			
Finance income:			
- effective income adjustment on Silent Contribution	2	-	29,987,370
- effective income adjustment on Capital Securities	8	81,022,791	-
Income from HSH Nordbank AG under Compensation Agreement	18	1,760,936	-
Unrealised gain on exchange		584	5,184
Other income		-	273
<b>TOTAL INCOME</b>		<u>82,784,311</u>	<u>29,992,827</u>
<b>EXPENDITURE</b>			
Support undertaking fees		121,333	121,667
Legal and professional fees		4,026	10,537
Administration fees		67,621	44,178
Management fees		3,057	4,301
Partnership fees		-	195
Audit fees		18,419	21,516
ISE fees		235	261
Bank charges		185	286
Non-recoverable withholding tax	18	46	-
Transaction fee		281	293
Expenses paid on behalf of General Partner and Trust		29,645	27,866
German fiscal fees payable		-	250
		<u>244,848</u>	<u>231,350</u>
<b>FINANCE EXPENDITURE</b>			
Finance costs:			
- effective income adjustment on Capital Securities	8	-	29,543,834
- effective income adjustment on Silent Contribution	2	82,131,679	-
Loan interest		2,113	221
<b>TOTAL EXPENDITURE</b>		<u>82,378,640</u>	<u>29,775,405</u>
<b>PROFIT FOR THE YEAR</b>		<u>405,671</u>	<u>217,422</u>
<b>OTHER COMPREHENSIVE INCOME</b>			
<i>Items that may be reclassified subsequently from other comprehensive income to profit or loss</i>			
Change in fair value of available-for-sale financial assets	2	219,946,679	( 102,822,370)
<b>TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR</b>	<b>€</b>	<u><u>220,352,350</u></u>	<u><u>€ ( 102,604,948)</u></u>

#### Other comprehensive income

There were no items that may not be reclassified subsequently from other comprehensive income to profit or loss.

*(The notes on pages 13 to 38 form part of these financial statements)*

**RESPARCS FUNDING II LIMITED PARTNERSHIP****STATEMENT OF CHANGES IN PARTNERS' EQUITY****FOR THE YEAR ENDED 31ST DECEMBER 2017**

	<u>Capital account</u>	<u>Capital contribution</u>	<u>Retained deficit</u>	<u>Revaluation reserve</u>	<u>Total</u>
	€	€	€	€	€
Balance at 1st January 2017	1,000	1,501,807	( 4,386,580)	(343,368,162)	(346,251,935)
Comprehensive income:					
- Profit for the year	-	-	405,671	-	405,671
- Other comprehensive income for the year	-	-	-	219,946,679	219,946,679
Balance at 31st December 2017	<u>1,000</u>	<u>1,501,807</u>	<u>( 3,980,909)</u>	<u>(123,421,483)</u>	<u>(125,899,585)</u>
Balance at 1st January 2016	1,000	1,501,807	( 4,604,002)	(240,545,792)	(243,646,987)
Comprehensive income:					
- Profit for the year	-	-	217,422	-	217,422
- Other comprehensive loss for the year	-	-	-	(102,822,370)	(102,822,370)
Balance at 31st December 2016	<u>1,000</u>	<u>1,501,807</u>	<u>( 4,386,580)</u>	<u>(343,368,162)</u>	<u>(346,251,935)</u>

*(The notes on pages 13 to 38 form part of these financial statements)*

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### STATEMENT OF CASH FLOWS

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

	<u>Notes</u>	<u>1st Jan 17 to 31st Dec 17</u>	<u>1st Jan 16 to 31st Dec 16</u>
<b>Cash flows from operating activities</b>			
Profit for the year		405,671	217,422
Increase in trade and other payables	5	28,658	24,927
Increase in trade and other receivables	3	( 477,226)	( 2,500)
Effective income adjustment on Silent Contribution	2	82,131,679	( 29,987,370)
Effective income adjustment on Capital Securities	8	( 81,022,791)	29,543,834
<b>Net cash generated from/(used in) operating activities</b>		<u>1,065,991</u>	<u>( 203,687)</u>
<b>Cash flows from financing activities</b>			
Amount (repaid)/drawn under liquidity facility		( 1,066,176)	203,402
<b>Net cash (used in)/generated from financing activities</b>		<u>( 1,066,176)</u>	<u>203,402</u>
<b>Net decrease in cash and cash equivalents</b>		( 185)	( 285)
<b>Cash and cash equivalents at the beginning of the year</b>		<u>171,489</u>	<u>171,774</u>
<b>Cash and cash equivalents at the end of the year</b>	4	<u>€ 171,304</u>	<u>€ 171,489</u>

#### Reconciliation of movement in net debt

	<u>Liabilities</u>	<u>Cash</u>	<u>Net Debt</u>
Opening balance as at 1st January 2017	( 423,819,196)	171,489	( 423,647,707)
Cash movement during the year	1,066,176	( 185)	1,065,991
Non-cash movement during the year	81,022,791	-	81,022,791
<b>Closing balance as at 31st December 2017</b>	<u>€ ( 341,730,229)</u>	<u>€ 171,304</u>	<u>€ ( 341,558,925)</u>

*(The notes on pages 13 to 38 form part of these financial statements)*

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **1. ACCOUNTING POLICIES**

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

###### **Basis of accounting**

These financial statements of Resparcs Funding II Limited Partnership (the "Partnership" or "Limited Partnership"), which give a true and fair view, have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB") and interpretations issued by the IFRS Interpretations Committee. The more significant accounting policies used are set out below.

These financial statements have been prepared on the historical cost basis, except for available-for-sale financial assets which are stated at fair value.

###### **Going concern**

The Partnership relies upon HSH Nordbank AG (the "Bank") to fund its ongoing expenses under the terms of the Support Undertaking. Accounting and measurement are based on the assumption that the Partnership is a going concern, which in turn, is based upon the assumption that the Bank is a going concern. The Bank's corporate planning forms the basis for the going concern assumption. Assessments, the basis for the corporate planning and in particular the planning for the movement in loan loss provisions take into account information available to the Bank at this point in time. These assessments are dependent on factors that are mostly outside the control of the Bank and are therefore subject to a significant degree of uncertainty. By way of example, material uncertainty factors with regard to the development of loan loss provisions include the development of the relevant market parameters such as freight and charter rates, ship values, the US dollar exchange rate and changes regarding macroeconomic trends.

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

Simultaneously with the successful conclusion of the share purchase agreement, HSH Nordbank AG concluded an agreement on the sale of an extensive portfolio consisting largely of non-performing loans (in particular ship financing) to a special-purpose entity from the sphere of the investors (the portfolio transaction). The closing of the portfolio transaction is subject, first of all, to the approval of the German Federal Cartel Office (Bundeskartellamt) and also depends on the closing of the share purchase agreement. The successful execution of this portfolio transaction and the associated reduction in the NPE ratio are key assumptions used in the Bank's corporate planning over and above successful privatisation.

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

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **1. ACCOUNTING POLICIES - (CONTINUED)**

###### **Going concern - (continued)**

However, as it is not possible to objectively predict the course and outcome of the privatisation process, the privatisation process involving HSH Nordbank AG creates significant uncertainty regarding the implementation of the corporate planning, as well as accounting and measurement, based on the assumption that the business activities are continued. Additional assumptions, uncertainties, opportunities and risks of corporate planning are discussed in the Group Management Report in the section Forecast, opportunities and risks report.

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

- \* the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria;
- \* the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement;
- \* the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF Luxembourg) each grants the necessary approvals;
- \* the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure;
- \* the German Savings Banks Association (DSGV) confirms that HSH Nordbank AG can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing);
- \* HSH Finanzfonds AöR submits a final settlement report on the second loss guarantee granted by HSH Finanzfonds AöR; and
- \* the bidders pay the portion of the purchase price attributable to them on the closing date.

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

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

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## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **1. ACCOUNTING POLICIES - (CONTINUED)**

**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**

European Capital Investment Opportunities Limited (the "General Partner") has assessed the impact, or potential impact, of all New Accounting Requirements. In the opinion of the General Partner, other than those listed below, there are no other mandatory New Accounting Requirements applicable in the current year that had any material effect on the reported performance, financial position, or disclosures of the Partnership. Consequently, no other mandatory New Accounting Requirements are listed. The Partnership has not early adopted any New Accounting Requirements that are not mandatory.

**IAS 7, "Statement of Cash Flows" (amendments) – effective retrospectively for accounting periods commencing on or after 1<sup>st</sup> January 2017**

IAS 7 has been amended to improve disclosure on an entity's liabilities. The amendments require disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flow and non-cash changes. One way to meet this new disclosure requirement is to provide a reconciliation between the opening and closing balances for liabilities arising from financing activities.

##### **Non-mandatory New Accounting Requirements not yet adopted**

The following applicable New Accounting Requirements have been issued. However, these New Accounting Requirements are not yet mandatory and have not yet been adopted by the Partnership. All other non-mandatory New Accounting Requirements are either not yet permitted to be adopted, or would have no material effect on the reported performance, financial position, or disclosures of the Partnership and consequently have neither been adopted, nor listed.

**IFRS 9, "Financial Instruments" (Replacement of IAS 39 — "Financial Instruments: Recognition and Measurement") – effective date 1st January 2018**

IFRS 9 addresses the recognition, classification and measurement of financial assets and financial liabilities and may be adopted to replace IAS 39.

IFRS 9 requires financial assets to be classified into the following measurement categories: (i) those measured at fair value through profit or loss; (ii) those measured at fair value through other comprehensive income; and, (iii) those measured at amortised cost. The determination is made at initial recognition. Unless the option to designate a financial asset as measured at fair value through profit or loss is applicable, the classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

IFRS 9 also replaces the "incurred loss" model in IAS 39 with an "expected credit loss" model for the measurement of impairment loss. The new model applies to financial assets that are not measured at fair value through profit or loss.

For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch.



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## RESPARCS FUNDING II LIMITED PARTNERSHIP

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### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

##### 1. ACCOUNTING POLICIES - (CONTINUED)

###### **IFRS 9, "Financial Instruments" (Replacement of IAS 39 — "Financial Instruments: Recognition and Measurement") – effective date 1st January 2018 - (continued)**

The mandatory effective date for application of IFRS 9 is for accounting periods beginning on or after 1st January 2018, but early adoption is permitted at any time. 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 RESPARC Capital Securities issued 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 RESPARC Capital Securities issued 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 RESPARC Capital Securities issued at amortised cost. Also upon adoption of IFRS 9, any movement in fair value caused by changes in credit risk will be recognised through profit or loss rather than other comprehensive income in order to eliminate the accounting mismatch which would otherwise arise. The Partnership intends to adopt IFRS 9 no later than the mandatory effective date.

Upon adoption of IFRS 9, the remaining revaluation reserve of available for sale financial asset will be transferred from equity reserves to profit and loss and be recognised as a net gain or loss in the Company's statement of comprehensive income. Subsequent to the adoption of IFRS 9, any gain or loss in relation to the movement in fair value for both the financial asset and financial liability will also be recognised in profit or loss in the statement of comprehensive income.

###### **Use of estimation, judgements and assumptions**

The preparation of financial statements in accordance with IFRS requires the General Partner to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the year. Actual results could differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised and in any future years affected.

The significant areas of uncertainty and critical judgements are as follows: (i) fair value estimation: further details in relation to the key assumptions made in determining fair value are disclosed in the "Fair value estimation" accounting policy and note 13; (ii) recognition and measurement of impairment: further details are disclosed in the "Impairment" accounting policy; and, (iii) revision of expected cash flows: further details are disclosed in the "Effective income adjustments" accounting policy.

###### **Available-for-sale ("AFS") financial assets**

The Partnership's investment in the Participation Agreement (the "Silent Contribution") has been classified as an AFS debt financial asset. AFS financial assets are measured initially at fair value plus transaction costs that are directly attributable to the acquisition of the asset. Subsequent to initial recognition they are measured at fair value and changes therein are recognised in other comprehensive income except for impairment losses, changes to carrying values resulting from the revision of estimated future receipts (see "Effective income adjustments" below) and foreign exchange gains and losses which are recognised directly as profit or loss in the statement of comprehensive income. The cumulative unrealised gains and losses arising from the fair valuation of Available-for-sale financial assets are reported as revaluation reserve in the equity section of the statement of financial position.

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **1. ACCOUNTING POLICIES - (CONTINUED)**

###### **Available-for-sale ("AFS") financial assets - (continued)**

AFS financial assets are derecognised when the rights to receive cash flows from the investments have expired or the Partnership has transferred substantially all risks and rewards of ownership. Any cumulative revaluation reserve attributable to derecognised AFS financial assets are transferred from other comprehensive income to the profit or loss in the statement of comprehensive income.

###### **Impairment**

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. An impairment is recognised if, and only if, there is objective evidence of impairment as a result of one or more 'loss events' that has an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

The Partnership received no profit participations during the year due to the continuing financial difficulties of HSH Nordbank AG. Indeed, the Partnership has received no profit participations from 2009 to date. The non-declaration of profit participation is considered by the General Partner to represent a 'triggering event' which is used as the first step under its impairment assessment as at the end of each reporting year, the second step being to consider whether or not a 'loss event' that had an impact on the estimated future cash flows had occurred (i.e. whether or not objective evidence of impairment existed in accordance with IAS 39.59). Such objective evidence that a financial asset is impaired includes observable data that may come to the attention of the General Partner about any of the following events: non-receipt of a declared profit participation on the Silent Contribution; permanent reduction or write down of principal, notional or redemption amounts; notice of default by or bankruptcy of HSH Nordbank AG.

Other indications of financial difficulties at HSH Nordbank AG, such as a credit rating downgrade or a significant and prolonged decrease in the fair value of the Silent Contribution may also be considered by the General Partner. However, when considering whether or not objective evidence of impairment of the Silent Contribution exists, the General Partner has considered and noted the following:

- i) the Partnership is not currently receiving profit participations on the Silent Contribution. However, whilst the non-declaration of profit participations on the Silent Contribution during the financial year or subsequently may be an indicator of impairment, it is unlikely that this alone would give rise to an impairment adjustment for a financial instrument such as the Silent Contribution. The Silent Contribution represents a subordinate interest in HSH Nordbank AG and the right to receive profit participations is contingent upon HSH Nordbank AG having sufficient distributable profits. In the absence of such, the Partnership is not entitled to receive any interest. Thus, the General Partner does not consider the non-declaration of profit participations as a loss event when considered in isolation;
- ii) the Silent Contribution is a perpetual instrument and the holder has no right to demand redemption, with redemption being at the option of HSH Nordbank AG; there is presently no indication that the full principal amount of the Silent Contribution will not be repaid eventually; and
- iii) upon profits arising at HSH Nordbank AG, the reductions in the carrying value of the Silent Contribution would be written back and consequently are not considered to be permanent.

Accordingly, no impairment has been recognised on the Silent Contribution.

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## RESPARCS FUNDING II LIMITED PARTNERSHIP

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### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

##### 1. ACCOUNTING POLICIES - (CONTINUED)

###### Impairment - (continued)

On 6th February 2013, an announcement was made by HSH Nordbank AG relating to financial planning which is expected to result in net losses for the business years 2013 and 2014. The financial results from the years 2015 to 2017, if any, will then be used to write up the hybrid instruments to par value. On 8th June 2016, an announcement was made by HSH Nordbank AG stating that HSH Nordbank AG expected that coupon payments on Silent Participations and Profit Participation capital would only take place in 2020 for the fiscal year 2019, at the earliest. On 28th February 2018 a further announcement was made stating that due to the signing of the privatization of HSH Nordbank AG and the upcoming transformation phase, HSH Nordbank AG will not be able to make distributions on the issued hybrid capital instruments until 2024 for the fiscal year 2023. Therefore in the General Partner's opinion, no loss events have occurred during the year ended 31st December 2017 or subsequently and the reductions in the nominal amount of the Silent Participation are not considered to be permanent. Also the non-payment of profit participation is not considered to be an impairment trigger as there is no obligation to pay such profit participation in the event that HSH Nordbank AG has insufficient distributable profits. Accordingly, no impairment is required to be recognised on the Partnership's investment in the Participation Agreement.

However, although no impairment has been recognised, an adjustment to the carrying value of the financial assets and liabilities has been made in the statement of comprehensive income in accordance with IAS 39.AG8 as further detailed in the "Effective income adjustments" accounting policy.

###### Capital Securities issued

Capital Securities issued are recognised initially at issue proceeds less attributable transaction costs. Subsequent to initial recognition, the Capital Securities issued are stated at amortised cost using the effective interest method in accordance with IAS 39. The scheduled redemption amount of the Capital Securities issued at the scheduled maturity dates will be the lesser of (i) the nominal amount invested; and (ii) the amount received by the Partnership in respect of the redemption of the Silent Contribution held by the Partnership.

The Capital Securities issued are derecognised when the obligations under the Capital Securities issued are discharged, cancelled or expired.

The General Partner has considered the characteristics of the Capital Securities issued and consider that the most appropriate classification of these securities is as other financial liabilities.

###### Effective income adjustments

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. The recalculated carrying amount results from computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The adjustments are recognised in the statement of comprehensive income as a component of finance income or finance costs as appropriate. Due to the forecast suspension, until 2024 (2016: 2020) for the fiscal year 2023, of Profit Participations from the Partnership's AFS financial assets (note 2) and interest payments on the Partnership's Capital Securities issued (note 8), the carrying amounts of these financial instruments have been adjusted accordingly. In subsequent years, if the carrying amounts of the financial instruments are adjusted again, the change will be reflected in the statement of financial position with the movement included in profit or loss in the statement of comprehensive income.

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## RESPARCS FUNDING II LIMITED PARTNERSHIP

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### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

##### 1. ACCOUNTING POLICIES - (CONTINUED)

###### Effective income adjustments - (continued)

Applying IAS 39.AG8 involves substantial assumptions, which are accompanied by uncertainties. The following assumptions have been used in the IAS 39.AG8 calculations: (i) payments of annual profit participation are assumed to recommence from 30th June 2024; (ii) repayment of principal is assumed to take place on 31st December 2033; and (iii) the cash flows have been discounted at the original effective interest rates for each instrument, being 7.65% for the Silent Contribution and 7.5% for the Capital Securities issued.

###### Fair value estimation

IFRS 13 "Fair Value Measurement" ("IFRS 13") defines a fair value hierarchy that prioritises the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under IFRS 13 are as follows:

Level 1 – Inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities at the valuation date.

Level 2 – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability either directly (as prices) or indirectly (derived from prices), including inputs from markets that are not considered to be active.

Level 3 – Inputs that are not based upon observable market data.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. However, the determination of what constitutes "active" and/or "observable" requires significant judgement by the Partnership. The Partnership considers observable data to be that market data which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, provided by multiple, independent sources that are actively involved in the relevant market. The categorisation of a financial instrument within the hierarchy is based upon the pricing transparency of the financial instrument and does not necessarily correspond to the Partnership's perceived risk inherent in such financial instrument.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e., the fair value of the consideration given or received). The fair value of financial instruments traded in active markets (such as the quoted investments) is based on quoted market prices at the end of the reporting year.

The estimated fair values of the Silent Participation and the Capital Securities issued are disclosed in note 13.

Periodic movements in the estimated fair value of the Capital Securities issued are not recognised within these financial statements owing to the measurement basis being amortised cost.

The Directors of the General Partner apply transfers between levels in the fair value hierarchy as at the end of each reporting year.

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**RESPARCS FUNDING II LIMITED PARTNERSHIP**

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**NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)****FOR THE YEAR ENDED 31ST DECEMBER 2017****1. ACCOUNTING POLICIES - (CONTINUED)****Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

**Loans payable**

Loans payable are initially recognised at fair value plus transaction costs, if any, and are subsequently measured at amortised cost using the effective interest rate.

**Foreign currencies***a) Functional currency and presentation currency*

Items included in the financial statements of the Partnership are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in Euro, which is the Partnership's functional and presentation currency.

*b) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss in the statement of comprehensive income.

**Employees**

The Partnership had no employees during the year ended 31st December 2017 (2016: none).

**Profit participation income and deposit interest income**

Profit participation income is accounted for on an effective interest rate basis. Deposit interest income is accounted for on an accruals basis.

**Interest expense**

Interest expense on Capital Securities issued and loans payable are accounted for on an effective interest rate basis.

**German withholding tax**

Profit participation income is received net of German withholding tax ("WHT"). The Partnership is refunded the amount of WHT deducted as part of the Loan Agreement and therefore investment income is shown gross.

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

##### 1. ACCOUNTING POLICIES - (CONTINUED)

###### Distributions

Distributions to partners are recorded on the date they are declared by the General Partner.

###### Segmental reporting

An operating segment is a component of the Partnership that engages in business activities from which it may earn revenues and incur expenses. The General Partner, as the chief operating decision-maker, performs regular reviews of the operating results of the Partnership and makes decisions using financial information at the entity level. Accordingly, the General Partner believes that the Partnership has only one operating segment (see note 15).

The General Partner is responsible for ensuring that the Partnership carries out business activities in line with the transaction documents. The General Partner may delegate some or all of the day to day management of the business including the decisions to purchase and sell securities to other parties both internal and external to the Partnership. The decisions of such parties are reviewed on a regular basis to ensure compliance with the policies and legal responsibilities of the General Partner. Therefore the General Partner retains full responsibility as to the major allocation decisions of the Partnership.

##### 2. AVAILABLE-FOR-SALE FINANCIAL ASSETS

**31st Dec 17**

**31st Dec 16**

###### Silent capital interest in the commercial enterprise of HSH Nordbank AG

Carrying amount based on effective interest rate IAS 39.AG8 calculation:

Opening balance	420,868,162	390,880,792
Effective income adjustment	( 82,131,679)	29,987,370
Closing balance	€ 338,736,483	€ 420,868,162

###### Fair value adjustment:

**31st Dec 17**

**31st Dec 16**

Opening balance	( 343,368,162)	( 240,545,792)
Movement during the year	219,946,679	( 102,822,370)
Closing balance	( 123,421,483)	( 343,368,162)

Fair value	€ 215,315,000	€ 77,500,000
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Notional amount outstanding at the year end	€ 500,000,000	€ 500,000,000
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## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **2. AVAILABLE-FOR-SALE FINANCIAL ASSETS - (CONTINUED)**

On 28th May 2003, the Partnership acquired a silent capital interest (the "Participation" or the "Silent Contribution") in the commercial enterprise (Handelsgewerbe) of Landesbank Schleswig-Holstein Girozentrale ("LB Kiel") with retroactive effect as of 1st January 2003. The Participation is in the form of a Stille Gesellschaft under German law pursuant to an agreement dated 23rd May 2003 (the "Participation Agreement") providing for an asset contribution by the Partnership to LB Kiel in the amount of €500,000,000. LB Kiel has now merged with Hamburgische Landesbank Girozentrale ("Hamburg LB" or "HLB") into HSH Nordbank AG.

Under the Participation Agreement the Partnership is entitled to receive Profit Participations on the Silent Contribution. Profit Participations accrue for Profit Periods running from 1st January to 31st December with the exception of the first Profit Period, which ran from 28th May 2003 to 31st December 2003 and the last Profit Period, which runs from 1st January of the year in which the Termination Date occurs and ends on the Termination Date.

Profit Participations are receivable annually in arrears on the later of (i) 30th June in the year following the end of the relevant Profit Period, and (ii) the business day following the date on which HSH Nordbank AG's annual financial statements have been adopted for the fiscal year of HSH Nordbank AG to which the relevant Profit Period relates. No Profit Participation shall accrue for the Profit Period in which the Termination Date occurs.

Profit Participations are received net of German withholding tax and any solidarity surcharge, if applicable (together "WHT"). European Equity Participation Management GmbH (the "Issuer Limited Partner") reclaims such WHT, to the extent that such amounts exceed the amount of German tax payable by the Issuer Limited Partner, and then pays the amounts reclaimed onto the Partnership under the terms of the Contribution Agreement. Under the Loan Agreement, HSH Nordbank AG is required to advance to the Partnership an amount equal to the WHT deducted. On this basis, the Partnership does not effectively suffer WHT on its profit participation, and accordingly the investment income is shown gross and the net amount of WHT suffered by the Partnership is shown in profit or loss in the statement of comprehensive income.

At the outset of the transaction it was agreed between the Partnership and HSH Nordbank AG that the Profit Participations for each year would consist of two elements: 50% relating to the first half of the relevant Profit Period and 50% relating to the second half of the relevant Profit Period, with the second element being payable only if the Partnership still remains a Silent Partner until the payment date.

Following the first Profit Period, subject to HSH Nordbank AG having sufficient distributable profits, Profit Participations accrue on the book value of the Silent Contribution at a rate of 7.65% p.a.

The Participation is a perpetual instrument. The Silent Contribution will only be repaid to the Silent Partner after termination of the Participation Agreement by HSH Nordbank AG. HSH Nordbank AG may only terminate the Participation Agreement if either (i) tax or regulatory changes occur but in no case before 31st December 2008, or (ii) on or after 31st December 2011, with 2 years' prior notice to the Silent Partner (with termination becoming effective on or after 31st December 2013) so long as HSH Nordbank AG's solvency ratio exceeds 9% on a sustainable, unconsolidated or consolidated basis.

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

##### 2. AVAILABLE-FOR-SALE FINANCIAL ASSETS - (CONTINUED)

HSH Nordbank AG is not currently permitted to make any payouts on profit participation capital and silent partnerships due to the Bank's net loss or balance sheet loss.

On 8th June 2016, a Press Release was issued by HSH Nordbank AG stating that a decision had been made by the EU commission on 2nd May 2016 to make a single payment of EUR 260 million to a holding company to be set up. The medium term financial plan includes the establishment of a special item for general banking risks according to section 340g German Commercial code (HGB) in order to strengthen the Bank's capital resources. On 28th February 2018 a further announcement was made stating that due to the signing of the privatization of HSH Nordbank AG and the upcoming transformation phase, HSH Nordbank AG will not be able to make distributions on the issued hybrid capital instruments in 2020 for the fiscal year 2019 as originally expected. Against this background HSH Nordbank AG now expects that coupon payments on silent participations and profit-participation capital will only take place in 2024 (31st December 2016: 2020) for the fiscal year 2023, at the earliest. This is consistent with the assumptions regarding future cashflows as outlined in the section on effective income adjustments disclosed in note 1.

Details regarding how the fair value of the Silent Contribution has been estimated are disclosed in note 13.

##### 3. TRADE AND OTHER RECEIVABLES

	<u>31st Dec 17</u>	<u>31st Dec 16</u>
Prepayments	-	2,500
Amounts receivable under Compensation Agreement	15,326	-
Withholding tax receivable	464,400	-
	<u>€ 479,726</u>	<u>€ 2,500</u>

##### 4. CASH AND CASH EQUIVALENTS

	<u>31st Dec 17</u>	<u>31st Dec 16</u>
HSH Nordbank AG - EUR accounts	€ 171,304	€ 171,489

##### 5. TRADE AND OTHER PAYABLES

	<u>31st Dec 17</u>	<u>31st Dec 16</u>
Administration fees payable	39,247	12,445
Loan interest payable	42,487	40,374
Support undertaking fees payable	30,333	30,333
Audit fee payable	23,037	23,282
Transaction fee payable	282	294
	<u>€ 135,386</u>	<u>€ 106,728</u>



## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **5. TRADE AND OTHER PAYABLES - (CONTINUED)**

As explained in note 2, there has been no Profit Participation income receivable during the year ended 31st December 2017 and the year-ended 31st December 2016. Since the coupon payments on the RESPARC Capital Securities issued are contingent on the receipt of Profit Participation income, no accrual has been made as at 31st December 2017 and 31st December 2016 in respect of interest payable. Please refer to note 17 for further details.

##### **6. PARTNERSHIP INTERESTS**

The following information provides a summary of the main rights of the General Partner and the Limited Partner. It does not attempt to provide details of all circumstances, terms and conditions, and reference should also be made to the detailed provisions contained within the Limited Partnership Agreement dated 17th April 2003 and the Limited Partnerships (Jersey) Law 1994.

###### **General Partner**

The General Partner is European Capital Investment Opportunities Limited, incorporated in Jersey, Channel Islands. The General Partner's Partnership share is 0.01%.

###### **Limited Partner**

The Limited Partner is European Equity Participation Management GmbH, incorporated in Germany. The Limited Partner's Partnership share is 99.99%.

###### **Partnership Profits and Losses**

The profits and losses of the Partnership shall belong to or be borne by the Partners in their respective partnership share subject to the fact that the total liability of the Limited Partner shall not exceed the Capital Contribution of the Limited Partner (i.e. €1,000).

###### **Additional Capital Contribution**

During 2010 the Partnership received a capital contribution of €1,330,249 from the Limited Partner. In 2013 the Partnership further received an additional capital contribution of €171,558 from the Limited Partner which became due following an additional payment of a tax refund to the Limited Partner.

##### **7. LOANS PAYABLE**

	<u>31st Dec 17</u>	<u>31st Dec 16</u>
Liquidity Facility	€ 407,065	€ 1,473,241

The Partnership was granted, by HSH Nordbank AG, a Liquidity Facility up to a maximum amount of €22,000,000. This was reduced to a maximum amount of €2,000,000 in December 2008. The Liquidity Facility is available until the termination date of the Participation Agreement, on which date any amounts advanced under the Liquidity Facility will become repayable. Interest is payable quarterly in arrears at the 12 month Euribor rate plus a margin of 0.3%.

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

8. CAPITAL SECURITIES ISSUED	31st Dec 17	31st Dec 16
<b>RESPARC Securities issued</b>		
Opening balance	422,345,955	392,802,121
Effective income adjustment	( 81,022,791)	29,543,834
Closing balance	€ 341,323,164	€ 422,345,955
Notional amount outstanding at the year end	€ 500,000,000	€ 500,000,000

On 28th May 2003 the Partnership issued €500,000,000 aggregate nominal amount of 7.5% Re-Engineered Silent Participation Assimilated Regulatory Capital (RESPARC) Securities (the "Capital Securities"), the proceeds from which have been used to acquire a silent capital interest (the "Silent Contribution") in the commercial enterprise of HSH Nordbank AG in the form of a "Stille Gesellschaft" under German law in the amount of €500,000,000. The nominal amount of each Capital Security is €1,000. The Capital Securities issued are listed on the Frankfurt Stock Exchange and the Official Segment of the stock market of Euronext Amsterdam N.V.

The RESPARC Capital Securities bear interest at a rate of 7.5% p.a., accruing from 28th May 2003, payable annually in arrears on the same date as the relevant Profit Participations are received by the Partnership. It is expected that the normal coupon date will be 30th June of each year, commencing 30th June 2004. Coupon payments are contingent on the Partnership's actual receipt of Profit Participation payments from HSH Nordbank AG under the Participation Agreement and advances from HSH Nordbank Luxembourg under the Loan Agreement.

The Capital Securities issued are perpetual securities, having no mandatory maturity date. However, the Capital Securities issued may be redeemed, at the option of HSH Nordbank AG, on the date on which the Silent Contribution is repaid in accordance with the Participation Agreement. The redemption amount will equal the Repayment Amount required to be paid by HSH Nordbank AG under the Participation Agreement. The Capital Securities issued will also be redeemable, in whole but not in part, at the option of the Partnership, on 30th June 2009 and annually thereafter. However, such early termination is only permissible if financing of the redemption of the Capital Securities issued at their nominal amount, plus any interest accrued thereon, has been secured through the issuance of similar debt securities or in any other way.

Hybrid instruments such as the Silent Contribution will participate in the balance sheet loss/net loss of HSH Nordbank AG. Coupon payments on the Capital Securities issued are contingent on the receipt of Profit Participation income. HSH Nordbank AG is not currently permitted to make any payouts on profit participation capital and silent partnerships due to the Bank's net loss or balance sheet loss.

Any change in expected cash flows following the non payment of the Silent Participation in the year and the likelihood of the non payment of the Silent Participation interest in the future result in an equal and opposite effect on the RESPARC Capital Securities issued. The RESPARC Capital Securities holders therefore bear the ultimate risk of the ability of HSH Nordbank AG to make payments on the Silent Participation.

The liabilities of the Partnership under the RESPARC Capital Securities issued are supported by HSH Nordbank Luxembourg under the Support Undertaking, as described in note 9. The holders of the RESPARC Capital Securities issued are therefore also exposed to the risk of default of HSH Nordbank Luxembourg.

As at 31st December 2017 the estimated fair value of the RESPARC Capital Securities issued was 43.063% (31st December 2016: 15.5%) of the nominal value. Details regarding how the fair value of the RESPARC Capital Securities issued have been estimated are disclosed in note 13.

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **8. CAPITAL SECURITIES ISSUED - (CONTINUED)**

Pursuant to an announcement made on 28th February 2018 as per note 2, HSH Nordbank AG expects that coupon payments on silent participations and profit-participation capital will only take place in 2024 for the fiscal year 2023, at the earliest.

##### **9. SUPPORT UNDERTAKING AND SUPPORT UNDERTAKING FEES**

The liabilities of the Partnership are supported by HSH Nordbank Luxembourg under a Support Undertaking dated 26th May 2003. HSH Nordbank Luxembourg has undertaken to ensure that the Partnership will at all times be in a position to meet its obligations. HSH Nordbank Luxembourg's payment obligations under the Support Undertaking are subordinated to all senior and subordinated debt obligations of HSH Nordbank Luxembourg in the same manner as HSH Nordbank's payment obligations under the Participation Agreement are subordinated. A Support Undertaking Fee is payable by the Partnership to HSH Nordbank Luxembourg, quarterly in arrears on 30th March; 30th June, 30th September and 30th December, calculated at 0.32% p.a. on a nominal amount of €37,500,000.

##### **10. TAXATION**

Any tax liability arising on the activity of the Partnership is borne by the individual Limited Partners.

##### **11. ULTIMATE CONTROLLING PARTY**

In the opinion of the General Partner, based on the terms of the Limited Partnership Agreement, European Equity Participation Management GmbH, incorporated in Germany, is considered to be the controlling party of the Partnership. However, the General Partner acknowledges that, under IFRS, HSH Nordbank AG is considered to be the ultimate controlling party of the Partnership.

##### **12. RELATED PARTIES**

Each of J.N. Pendergast, J.D. Wiseman and S.J. Hopkins is a Director of the General Partner.

Sanne Fiduciary Services Limited ("SFSL") and Sanne Secretaries Limited ("SSL") provide ongoing administration and/or secretarial services respectively to the General Partner and the Partnership at commercial rates. Each of SFSL and SSL is a member of the "Sanne Group" (where the "Sanne Group" means Sanne Group PLC and all of its subsidiaries and affiliates). Each of S.J. Hopkins, J.N. Pendergast and J.D. Wiseman is a Director and/or employee of SFSL and should be regarded as interested in any transaction with any member of the Sanne Group.

The Directors of the General Partner do not have any financial interest in the Partnership.

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

#### **12. RELATED PARTIES - (CONTINUED)**

The Partnership is consolidated within the HSH Nordbank group and therefore HSH Nordbank and affiliates are related parties in all transactions.

Fees incurred with Sanne Group during the year in respect of administration and management fees are disclosed on the face of the statement of comprehensive income. Fees owed at the year end are disclosed in note 5 to the financial statements. In the General Partners opinion, there are no material related party transactions that require disclosure, other than those in notes 2, 3, 4, 5, 6, 7, 8 and 9.

Expenses paid on behalf of the General Partner and the Limited Partner and their respective holding entities during the year are also disclosed on the face of the statement of comprehensive income.

#### **13. FINANCIAL INSTRUMENTS**

As stated in the Report of the General Partner the principal activity of the Partnership is limited to participation in financing activities arranged for HSH Nordbank AG. The Partnership has issued the RESPARC Capital Securities and the proceeds from which have been used to acquire the Silent Contribution in the commercial enterprise of HSH Nordbank AG. Therefore, the role of financial assets and financial liabilities is central to the activities of the Partnership; the financial liabilities provided the funding to purchase the Partnership's financial assets. Financial assets and financial liabilities provide the majority of the assets and liabilities.

The strategies used by the Partnership in achieving its objectives regarding the use of its financial assets and financial liabilities were set when the Partnership entered into the transactions. The Partnership has attempted to match the properties of its financial liabilities to its financial assets to avoid significant elements of risk generated by mismatches of investment performance against its obligations, together with any maturity, liquidity or interest rate risk.

##### **Determination of fair value**

The estimated fair values disclosed in these financial statements have been determined for the sole purpose of ensuring compliance with IFRS 13, which requires disclosure of such fair values in these financial statements.

Fair value is defined in accordance with IFRS 13 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants at the measurement date. The fair value of financial instruments may be determined on the basis of listed prices on an active market ("mark-to-market"), or if this is not possible on the basis of recognised valuation techniques or models ("mark-to-matrix" or "mark-to-model" respectively). The mark-to-market method is used if a market price is available at which a transaction could be performed or has been performed at, or reasonably close to, the reporting date. This is generally the case for securities traded on liquid markets. The mark-to-market method has been applied to measure both the fair value of the RESPARC Capital Securities issued, which are listed on the Frankfurt Stock Exchange and the Official Segment of the stock market of Euronext Amsterdam N.V, and the fair value of the available-for-sale financial assets.

The fair value of the RESPARC Capital Securities issued has been obtained from quoted market prices. The quoted market price of 43.063% (31st December 2016: 15.5%) was obtained from Bloomberg. The Silent Contribution is neither quoted nor traded in an active market. Consequently, no quoted market price exists for the Silent Contribution.

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

#### 13. FINANCIAL INSTRUMENTS - (CONTINUED)

##### Determination of fair value - (continued)

The terms of the available-for-sale financial assets are identical in all material respects to those of the RESPARC Capital Securities issued, except for the fact that the RESPARC Capital Securities issued bear interest at a fixed rate of 7.5% per annum, whilst the available-for-sale financial assets bears interest at a fixed rate of 7.65% per annum. Accordingly, in the General Partner's opinion, as no interest is currently receivable or payable on these financial instruments, the fair value of the available-for-sale financial assets is estimated to be approximately equal and opposite to the fair value of the RESPARC Capital Securities issued. Therefore the quoted market price of the RESPARC Capital Securities issued represents the best available objective estimate of the fair value of the Silent Contribution.

The table below presents the carrying values and fair values of the Partnership's financial assets and liabilities.

	<u>31st Dec 17</u>		<u>31st Dec 16</u>	
	Carrying value	Fair value	Carrying value	Fair value
<b>Financial assets:</b>				
Available-for-sale financial assets	€ 215,315,000	€ 215,315,000	€ 77,500,000	€ 77,500,000
<b>Financial liabilities:</b>				
RESPARC Capital Securities	€ 341,323,164	€ 215,315,000	€ 422,345,955	€ 77,500,000

In the General Partner's opinion the carrying amounts of cash and cash equivalents, loans payable, and trade and other payables are reasonable approximations of the fair value of such financial instruments. Consequently, in accordance with IFRS 7.29(a), no fair value disclosures are provided for such financial instruments.

The General Partner has reviewed the fair value of the RESPARC Capital Securities issued as at 31st December 2017 and considers that the market price reflects current adverse conditions affecting the financial position of HSH Nordbank AG to which the holders of the RESPARC Capital Securities issued are exposed, and is not representative of the likely termination value of the RESPARC Capital Securities issued.

The effects of market conditions and the future expected profitability of HSH Nordbank AG on the fair value of the RESPARC Capital Securities issued are further explained in note 17.

##### Fair value hierarchy

The following table analyses within the fair value hierarchy those of the Partnership's assets and liabilities (by class).

<u>31st December 2017</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>Financial assets:</b>				
Available-for-sale financial assets	€ -	€ 215,315,000	€ -	€ 215,315,000
<b>Financial liabilities:</b>				
RESPARC Capital Securities	€ -	€ 215,315,000	€ -	€ 215,315,000

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

#### 13. FINANCIAL INSTRUMENTS - (CONTINUED)

##### Fair value hierarchy - (continued)

31st December 2016	Level 1	Level 2	Level 3	Total
<b>Financial assets:</b>				
Available-for-sale financial assets	€ -	€ 77,500,000	€ -	€ 77,500,000
<b>Financial liabilities:</b>				
RESPARC Capital Securities	€ -	€ 77,500,000	€ -	€ 77,500,000

There were no transfers between Levels during the current year or prior year.

##### Market risk

##### Interest rate risk

Interest rate risk occurs when there is a mismatch between the interest rates of the Partnership's asset and liabilities.

The Partnership finances its operations through the issue of the RESPARC Capital Securities. The coupons payable on the RESPARC Capital Securities issued are matched by the Profit Participations receivable on the Silent Contribution. Accordingly, the General Partner believes that there is no significant net interest rate risk to the Partnership and/or to the holders of the RESPARC Capital Securities as the interest rates are effectively fixed.

The contractual interest rate profile of the Partnership's financial assets and financial liabilities is as follows. The Profit Participation on the available-for-sale financial assets and the interest on the RESPARC Capital Securities issued have been suspended as explained in notes 2 and 8.

		<u>31st Dec 17</u>		<u>31st Dec 16</u>	
	Interest charging basis	Effective interest rate %	Carrying value	Effective interest rate %	Carrying value
<b>Financial assets:</b>					
Available-for-sale financial assets	Fixed	7.65%	215,315,000	7.65%	77,500,000
Cash and cash equivalents	Floating	nil	171,304	nil	171,489
			€ 215,486,304		€ 77,671,489
<b>Financial liabilities:</b>					
Loans payable	Floating	12M Euribor + 0.3%	407,065	12M Euribor + 0.3%	1,473,241
RESPARC Capital Securities	Fixed	7.50%	341,323,164	7.50%	422,345,955
			€ 341,730,229		€ 423,819,196

## RESPARCS FUNDING II LIMITED PARTNERSHIP

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### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

#### 13. FINANCIAL INSTRUMENTS - (CONTINUED)

##### Market risk - (continued)

###### *Currency risk*

Currency risk occurs when there is a mismatch between the currencies of the Partnership's assets and liabilities. All of the Partnership's material financial assets and liabilities are denominated in Euro. Consequently, the General Partner believes that there is no significant net currency risk to the Partnership and/or to the holders of the RESPARC Capital Securities issued.

###### *Sensitivity analysis*

As disclosed above, in the General Partner's opinion, there is no material difference between the fair value of the RESPARC Capital Securities issued and the fair value of the available-for-sale financial assets. From the perspective of the Partnership, any change in the fair value of the RESPARC Capital Securities issued would be matched by an equal and opposite change in the fair value of the available-for-sale financial assets. Consequently the Partnership is not exposed to any net market price risk.

Also as disclosed above, in the General Partner's opinion, there is no material net interest rate risk to the Partnership, nor is there any significant net currency risk to the Partnership.

IFRS 7 requires disclosure of "a sensitivity analysis for each type of market risk to which the entity is exposed at the reporting date, showing how profit or loss and equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date." As stated, whilst the financial instruments held by the Partnership are separately exposed to interest rate risk and market price risk, the Partnership itself is not exposed to market risk overall. Furthermore, the General Partner observes that the total comprehensive income or loss reported by the Partnership each year results primarily from the mismatch in accounting treatment between the available-for-sale financial assets (at fair value) and the RESPARC Capital Securities issued (at amortised cost) as described in note 1. Given that the terms and conditions of the RESPARC Capital Securities issued are matched to those of the available-for-sale financial assets, there is no economic exposure of the Partnership to the total comprehensive income or loss resulting from this accounting mismatch. Therefore, in the General Partner's opinion, no sensitivity analysis is required to be disclosed.

###### **Credit risk**

Credit risk arises from the risk that HSH Nordbank AG and affiliates may not repay, if requested, all amounts due to the Partnership under the Silent Partnership Agreement and any withholding tax receivable. On the basis that the RESPARC Capital Securities issued by the Partnership are limited recourse in nature, with the amount payable to the holders limited to the amounts received under the Silent Participation Agreement, in the opinion of the General Partner, the Partnership has no material net credit risk and all credit risk is ultimately borne by the holders of the RESPARC Capital Securities issued.

On 25th August 2011, HSH Nordbank AG issued a Press Release stating that HSH Nordbank AG would not be servicing its Profit Participation certificates for the fiscal year 2011. On 6th February 2013, the Partnership was informed that HSH Nordbank AG would not be servicing its Profit Participation certificates until 2017. On 8th June 2016, HSH Nordbank AG issued an ad-hoc announcement stating that the Bank expected that coupon payments on silent participations and profit-participation capital would only take place in 2020 for the fiscal year 2019, at the earliest.

## RESPARCS FUNDING II LIMITED PARTNERSHIP

### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

#### 13. FINANCIAL INSTRUMENTS - (CONTINUED)

##### Credit risk - (continued)

However, on 28th February 2018 a further announcement was made stating that due to the signing of the privatisation of HSH Nordbank AG and the upcoming transformation phase, HSH Nordbank AG will not be able to make distributions on the issued hybrid capital instruments in 2020 for the fiscal year 2019 as originally expected. HSH Nordbank AG expects distributions to be made during 2024 for the fiscal year 2023.

For further details in respect of current market conditions and the credit quality of the financial assets held by the Partnership, please refer to note 17. As at 31st December 2017 and up to the date of approval of these financial statements, the RESPARC Capital Securities issued had a long term credit rating of Ca from Moody's (31st December 2016: Ca).

HSH Nordbank AG has a long term credit rating of Baa3 from Moody's (31st December 2016: Baa3).

##### Maturity of financial assets and liabilities

The maturity profile of the undiscounted contractual cash flows of the Partnership's financial assets and financial liabilities is set out below. The following table does not include contractual interest payable on the RESPARC Capital Securities issued nor Profit Participations receivable on the available-for-sale financial assets because such amounts are considered to be immaterial given that the RESPARC Capital Securities issued and available-for-sale financial assets may be redeemed on 30th June in any year.

	<u>2017</u>		<u>2016</u>	
	Financial Assets	Financial Liabilities	Financial Assets	Financial Liabilities
Less than one year	651,030	542,451	173,989	1,579,969
In more than five years	500,000,000	500,000,000	500,000,000	500,000,000
	<u>€ 500,651,030</u>	<u>€ 500,542,451</u>	<u>€ 500,173,989</u>	<u>€ 501,579,969</u>

In the opinion of the General Partner, given the above maturity profile and the limited recourse nature of the RESPARC Capital Securities issued and the existence of the Support Undertaking and the liquidity facility, the Partnership is not exposed to significant net liquidity risk. Liquidity risk is ultimately borne by the holders of the RESPARC Capital Securities issued.

#### 14. CAPITAL MANAGEMENT

The Partnership's transactions are designed to enable the Partnership to pay its liabilities as they fall due only, without realising a significant return on capital. The level of interest income receivable on the available-for-sale financial assets and interest expense payable on the RESPARC Capital Securities issued are fixed and were established on formation of the Partnership in order that the Partnership realises a margin that is sufficient to pay the on going operational expenses of the Partnership and any loan interest payable on the liquidity facility.



## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

#### **14. CAPITAL MANAGEMENT - (CONTINUED)**

As further explained in note 17, no profit participation income has been received since 2008 and therefore no margin has been realised. The operational expenses, loan interest and support undertaking fees of the Partnership will be provided by funding received from HSH Luxembourg under the Support Undertaking Agreement by virtue of the liquidity facility.

There were no changes to the Partnership's approach to capital management during the year.

The Partnership is not subject to externally imposed capital requirements.

#### **15. OPERATING SEGMENTS**

##### *Geographical information*

All of the Partnership's revenues and expenses are generated from external sources. The Partnership generated revenue of €nil during the year (2016: €nil).

##### *Non-current assets*

The Partnership does not have non-current assets other than the available-for-sale financial asset.

##### *Major investment company*

The Partnership's Profit Participation income is derived solely from HSH Nordbank.

#### **16. KEY MANAGEMENT PERSONNEL**

The key management personnel have been identified as being the Directors of the General Partner. The emoluments of the key management personnel are paid by the Partnership and are included in administration fees in the statement of comprehensive income.

#### **17. CURRENT MARKET CONDITIONS**

##### **HSH Nordbank**

As detailed in note 9 the Partnership benefits from a Support Undertaking from HSH Nordbank Luxembourg. The ability of HSH Nordbank Luxembourg to meet its obligations to the Partnership under the Support Undertaking are contingent upon the financial strength of HSH Nordbank Luxembourg, as well as the ability of the HSH Nordbank group to continue as a going concern.

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

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

#### **17. CURRENT MARKET CONDITIONS - (CONTINUED)**

##### **HSH Nordbank - (continued)**

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 HSH Nordbank AG have been approved in a legally binding manner.

Due to the progress made in the winding-down of risk positions, HSH Nordbank AG was able to reduce the second loss guarantee issued by the federal states of Hamburg and Schleswig-Holstein. The guarantee amount was reduced from an 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.

##### **2017: positive business development overshadowed by one-off effects relating to privatisation**

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

The purchase agreement signed on 28 February 2018 provides the basic prerequisite for the successful conclusion of the privatisation process, which has been ongoing for around 2.5 years. The Bank contributed to this process with its systematic restructuring strategy and its solid operating development, laying the necessary foundation for its successful privatisation. In the 2017 reporting year, the following aspects are particularly noteworthy:

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

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **17. CURRENT MARKET CONDITIONS - (CONTINUED)**

###### **2017: positive business development overshadowed by one-off effects relating to privatisation - (continued)**

- \* Significant reduction in wind-down portfolio: Even without the portfolio transaction, the Bank wound down around €11.6 billion EaD in the Non-Core Bank taking currency effects into account, i.e. more than planned, winding down non-performing legacy loans in the amount of €7 billion. The EaD is the expected loan amount outstanding, taking into account a potential partial drawdown of commitments and contingent liabilities that will adversely impact the risk-bearing capacity in the event of a default. The NPE ratio in the Group fell considerably as a result to 10.4 % as at the reporting date (31st December 2016: 17.5 %);
- \* Portfolio transaction agreed: In order to achieve the final elimination of a large part of its legacy burdens, the Bank sold further largely non-performing portfolios consisting mainly of ship financing in an amount of €6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28th February 2018, giving rise to one-off negative valuation effects as at 31st December 2017. This means that the NPE ratio is expected to drop to around 2 % (after the closing of the transaction);
- \* Systematic implementation of the cost programme: Planned potential for cost savings was exploited in line with the requirements, with administrative expenses being cut considerably from €634 million in 2016 to €515 million in 2017; and
- \* Capital and liquidity ratios at a high level: Key management indicators for capital and liquidity were still at a very solid level. The pro forma CET1 ratio, which is calculated excluding the regulatory RWA relief effect of the second loss guarantee (for explanatory information, see the section entitled "Management system") showed very positive development. It came to 15.4 % as at 31st December 2017 (31st December 2016: 12.6 %). The LCR came to 169 % (31st December 2016: 172 %).

###### **Privatisation process on the home stretch**

The signing of the share purchase agreement satisfied in a timely manner the central commitment set out in the formal decision of 2nd May 2016 in the EU state aid proceedings. In light of the share purchase agreement that has been concluded, the Bank expects the privatisation process to be finalised in the third quarter of 2018 at the latest, once all of the necessary conditions have been met. Within this context, the Bank is confident that it can forge ahead intensively with the necessary realignment of the Bank by continuing with its current restructuring course, allowing it to do everything in its power to contribute to an ultimately successful change of ownership. In addition, the Bank will provide constructive support in all matters that are to be discussed further among the relevant stakeholders in order to systematically promote the transformation process initiated by the Management Board to create a new bank that is geared to the private sector.

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

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## RESPARCS FUNDING II LIMITED PARTNERSHIP

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### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

#### 17. CURRENT MARKET CONDITIONS - (CONTINUED)

##### Satisfactory new business

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

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

##### Successful reduction of legacy assets due to the Bank's regular winding-down strategy

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

- \* After a pronounced market slump in 2016, developments on the shipping markets have been pointing for several quarters now towards a recovery trend that is better than expected. This trend was particularly evident in the container vessel and bulker segments in 2017 and is based first and foremost on a revival in demand for transportation capacities, brisk scrapping activities and the consolidation of shipping lines;
- \* Taking the favourable market environment in 2017 into account, the Bank has been adjusting its restructuring principles since the second half of 2017 and is focusing its restructuring strategies more on specific recovery prospects for each individual commitment. The implementation of the winding-down strategy, which has been accelerated by the factors set out above, also serves to reduce historical concentration risks and was facilitated mainly by the high coverage ratio of the non-performing legacy portfolio; and
- \* The development of the EUR/USD exchange rate also had a pronounced positive impact on the marked reduction in the portfolio of legacy burdens. This effect contributed €0.7 billion in the reporting period.

The Bank wound-down a total of €11.6 billion EaD in non-performing and non-strategic loans in the Non-Core Bank in 2017, €7 billion of this amount is attributable to the NPE legacy portfolio. The winding-down measures continued to focus on reducing non-performing ship financing transactions dating from the years before 2009 that were secured by the second loss guarantee of the federal state owners. As well as reducing the portfolio by implementing recovery strategies, receivables with a volume of €2.7 billion EAD relating to continental European real estate financing, as well as aircraft, solar and shipping financing, were sold in the reporting period as part of market portfolio transactions. The winding-down measures reduce the NPE ratio significantly to 10.4 % (31st December 2016: 17.5 %). In addition to the market portfolio transactions described above, the legal transfer of the loan portfolio sold to HSH Portfolio Management AöR in the 2016 financial year ("federal state portfolio transaction") was largely concluded as a structural measure in connection with the EU decision.

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## RESPARCS FUNDING II LIMITED PARTNERSHIP

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### NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)

#### FOR THE YEAR ENDED 31ST DECEMBER 2017

##### 17. CURRENT MARKET CONDITIONS - (CONTINUED)

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

In light of the future viability of the Bank and the good portfolio quality that it is aiming to achieve in this regard, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of €6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) within the context of the privatisation process. Broken down by asset classes, €4.3 billion of the portfolio is attributable to shipping, €1.0 billion to real estate, €0.6 billion to corporate clients and €0.4 billion to other loans. This allows the Bank to continue with its stringent winding-down strategy and to achieve, as a result of the sale, far-reaching relief from a large part of the non-performing legacy loans, as well as a smaller volume of other legacy portfolios of the Non-Core Bank.

The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time.

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

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

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

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **18. COMPENSATION AGREEMENT**

As no income has been received from the Participation since 2009, the Partnership relies on the Liquidity Facility to pay for ongoing operational costs and expenses. However, the Partnership has no means of settling this liability until income is received from the Participation which is not expected to resume until 2024 (see note 2). To rectify this situation, the Partnership entered into a Compensation Agreement (the "Agreement") with HSH Nordbank AG and the Limited Partner wherein the Partnership will receive an initial non-refundable compensation payment in an amount corresponding to the outstanding balance under the Liquidity Facility as at 30th June 2017. Subsequently, the Partnership will receive non-refundable compensation payments on a quarterly basis necessary to cover costs and expenses payable under the Support Undertaking, any interest payments accrued under the Liquidity Facility and other operational costs and expenses incurred by the Partnership and the Limited Partner in the ordinary course of business as approved by HSH Nordbank AG.

In accordance with the Compensation Agreement, the Partnership recognised an income in the amount of €1,760,935 consisting of €1,296,489 receivable from HSH Nordbank AG, €464,400 receivable equivalent to 99.99% of the withholding tax reclaimable by the Limited Partner and a small amount of non recoverable withholding tax of €46 equivalent to 0.01% of the withholding tax. The settlement of €1,236,283 relating to the initial non-refundable payment was made on 3rd July 2017 whereby the loan payable under the Liquidity Facility was reduced by the same amount. The withholding tax receivable will be received by the partnership from the limited partner upon receipt from the German tax authorities.

##### **19. EVENTS AFTER THE YEAR END**

In its decision of 2nd May 2016, the EU Commission approved the replenishment of the second loss guarantee based on a catalogue of commitments and conditions in the state aid proceedings in favour of HSH Nordbank AG. One essential commitment related, among other things, to the sale of HSH Nordbank by 28th February 2018. Within this context, the federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giro-verband für Schleswig-Holstein, sold their stake of 94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several investors on 28th February 2018 (signing). The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other.

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

## **RESPARCS FUNDING II LIMITED PARTNERSHIP**

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### **NOTES TO THE FINANCIAL STATEMENTS - (CONTINUED)**

#### **FOR THE YEAR ENDED 31ST DECEMBER 2017**

##### **19. EVENTS AFTER THE YEAR END - (CONTINUED)**

In addition, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of €6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28th February 2018, giving rise to one off negative valuation effects as at 31st December 2017. The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time.

In addition, an agreement has been reached as part of the privatisation negotiations between the parties that the second loss guarantee in an amount of €10 billion granted by the federal state owners to the Bank will be terminated prematurely immediately after the closing of the share purchase agreement. In this respect, a corresponding cancellation agreement has been signed between the guarantor, HSH Beteiligungs Management GmbH and the Bank. Under this agreement, the second loss guarantee will be terminated prematurely in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of €100 million, which will put pressure on the statement of income in the first quarter of 2018.

At the same time, HSH Finanzfonds AöR will make a payment to HSH Nordbank AG to compensate for the losses that have not yet been settled based on a separate settlement procedure. The signed cancellation agreement is subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.