2008

Annual Report 2007

Kreditanstalt für Wiederaufbau (KFW)

Annual Report 2007

kfw
BANKENGRUPPE

KEY FIGURES OF KFW BANKENGRUPPE.

Key financial figures of KfW Bankengruppe
EUR in billions

	2005	2006	2007
I. KfW Mittelstandsbank	**15.5**	**22.8**	**23.2**
Loan financing	10.7	10.1	11.2
"Unternehmerkredit"	*4.8*	*6.1*	*9.0*
Global loans to trade and industry	*5.4*	*3.6*	*1.4*
Mezzanine financing	0.6	2.1	1.2
Equity finance	0.3	0.3	0.3
ABS SME portfolio	–	0.8	0.4
Securitisations	4.0	9.5	10.0
II. KfW Förderbank	**38.7**	**35.6**	**43.5**
Housing investments	10.9	15.1	14.6
Global loans to the housing industry	*2.0*	*1.2*	*1.9*
Education	0.9	1.3	1.3
Municipal infrastructure	2.8	3.2	3.1
Environmental protection investments	4.2	4.6	7.2
Global credit lines to promotional institutions in the federal states	3.6	3.6	8.3
Securitisations	16.3	7.6	8.9
III. KfW IPEX-Bank	**12.1**	**15.0**	**16.1**
Industry, telecommunications, basic industries	4.9	5.6	4.7
Power, renewables and water	1.2	2.5	1.9
Transport and transport infrastructure	5.6	6.9	9.3
Other (AKA export loans, grants)	0.1	0.0	0.1
IV. KfW Entwicklungsbank	**1.9**	**2.4**	**3.0**
V. DEG	**0.7**	**0.9**	**1.2**
Total financing volume	**68.9**	**76.8**	**87.1**
Loans[1]	48.7	9.6	68.1
Securitisations	20.2	17.1	19.0
Environmental and climate protection[2]	**7.0**	**12.5**	**12.9**
Funding	**52.2**	**54.1**	**64.6**

Figures may not add up to totals due to rounding.
[1] Incl. guarantees, grants and ABS SME portfolio.
[2] Included in the total financing volume as general promotional business of KfW Mittelstandsbank and KfW Förderbank.

Key earnings figures of the KfW Group (IFRS)
EUR in billions

	2006	2007
Operating result before valuation	1,381	1,357
Operating result after valuation[1)]	1,542	– 6,182
Consolidated profit/loss	1,564	– 6,168
Comprehensive income	1,511	– 6,417
Comprehensive economic income	1,113	– 1,312

[1)] Incl. participation by the German banking associations in the risk protection for IKB.

Key balance sheet indicators of the KfW Group (IFRS)
EUR in billions and %

	2006	2007
Balance sheet total	334.4	354.0
Balance sheet equity	16.7	14.9
Balance sheet equity ratio	5.0 %	4.2 %
Business volume	405.9	417.0

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LETTER FROM THE BOARD OF MANAGING DIRECTORS.

Dear Readers,

2007 was a highly unusual year for the KfW Group – in more ways than one. Apart from significantly expanding our promotional business we have also managed several large-scale projects.

In March we bought a stake in EADS. The German Federal Government had asked us to buy this holding as part of a consortium of private and public banks in order to maintain the balance of power at EADS between Germany and France.

As at 1 July the reorganisation of the ERP Special Fund (ERP SV), which had been initiated by the German Government as agreed in the coalition agreement signed in November 2005, was completed. During the course of the transfer EUR 2 billion flowed into the federal budget; the annual promotional volume of the ERP Special Fund that is available to small and medium-sized enterprises will, however, remain intact.

On 28 and 29 July KfW, together with the banking industry, acted quickly and determinedly – also in the interest of stabilising the German financial market – to provide risk protection to IKB, which encountered existential problems in connection with subprime investments in the USA. The process of selling KfW's shares in IKB is under way.

In 2007 we were also in the final phase of the spin-off of KfW IPEX-Bank. This was quite a major project that we finished on time by 1 January 2008 as required by the European Commission in the so-called EU understanding II. Although KfW IPEX-Bank is not a promotional bank it remains committed to KfW's official mandate and continues to be one of the key pillars of KfW. For decades it has been a reliable partner for the German economy, which depends heavily on exports, and a guarantor of long-term financing. The profits it generates in its commercial business will continue to support KfW's promotional activities, e.g. in the SME sector or in climate protection.

In view of these challenges it is even more noteworthy that our promotional activities were so successful in 2007. In terms of our promotional performance 2007 was the best year in KfW's almost 60-year history!

DEVELOPMENT OF KFW'S FINANCING ACTIVITIES.

In 2007 KfW's total volume of financing increased by over 13 % to EUR 87.1 billion. That is over EUR 10 billion more than in the previous year. At EUR 68.1 billion the greatest share of commitments was for lending operations. Even though the securitisation market is generally under heavy pressure as a consequence of the crisis in the financial markets, securitisations reached a volume of EUR 19 billion.

This result tells us that we have chosen the right strategy. We identified issues of future relevance early on and joined hands with policymakers and associations to develop the necessary promotional programmes. In 2007 we set two particular priorities for our promotional business – small SMEs and climate protection – that are especially important for the economy and society. Of course the increase in our financing volume in 2007 reflects not only our attractive products but also the economic upswing in Germany and Europe. The companies have invested heavily. In 2008 we expect less economic dynamism and a more moderate increase in corporate investment.

KFW MITTELSTANDSBANK.

KfW Mittelstandsbank committed EUR 23.2 billion last year for the promotion of small and medium-sized enterprises. Our support thus remains at a high level. Our promotional activities targeted small SMEs in particular, and in this context we also launched our "Small SMEs" initiative. Enhancing the support for small businesses continues to be a matter of urgency since although the financing conditions for SMEs have improved these past few years, micro enterprises are still unable to fully benefit from them, if at all. We therefore reduced the interest rates in our *StartGeld* (start-up funds) and *Mikrodarlehen* (microloan) programmes by one-third at the beginning of 2007. This enabled us to increase our commitments for very small business under these programmes by 40 % over the previous year. Demand for the *Unternehmerkredit*, or entrepreneurial loan, our flagship in SME finance, again rose strongly in 2007. In July we added a 50 % exemption from liability to this programme. This 'risk partnership' was very well accepted by the market. Since we share the default risk with the banks on-lending the funds, they are more willing to join in the financing for investments by SMEs. In the year 2007 KfW again contributed substantially to strengthening Germany's equity capital market. Although our equity finance business accounts for only a small portion of our total commitments, the very fact that KfW participates in about half of all SME equity finance activities underlines the important role we play in this field. Our promotion is particularly important for the structure and quality of the products offered in the market because we are active primarily in the early stage. Private investment in this stage is far too low because it involves risk.

KFW FÖRDERBANK.

KfW Förderbank also made a major contribution to the success of the Group as a whole. In 2007 a financing volume of EUR 43.5 billion was achieved. This marks a rise over the previous year of 22 %. The KfW Group commits a considerable portion of its lending volume to investments in environmental and climate protection. There is now not a single business area within KfW that disregards climate protection objectives. Some 20 %, or approx. EUR 16.6 billion, of total commitments are since flowing into environmental financing operations. This makes KfW Germany's number one environmental bank and an important cornerstone of the "Integrated Energy and Climate Programme" of the German Government. A central part of this programme is our promotional initiative entitled "Housing, Environment, Growth", which we developed jointly with the Federal Government. The 'hard core' of this initiative is the programme component "energy-efficient construction and rehabilitation". The promotional initiative was already a great success in its starting year, 2006. The commitment volume was again very high in 2007. Many private households in Germany were able to save energy by renewing their energy systems. The investments that were initiated in the years 2006 and 2007 alone will sustainably reduce CO_2 emissions by over 1.6 million tonnes per annum. Another effect was that, according to preliminary estimates, these investments created or safeguarded nearly 440,000 jobs for one year in 2007 alone. This result proves that the promotional initiative is also an excellent economic programme – not least for SMEs and for the skilled crafts. These examples illustrate the close relationship between KfW Förderbank and KfW Mittelstandsbank, as many of the activities of KfW Förderbank benefit the SME sector both directly and indirectly. Environmental and climate protection are topics of intense debate in the area of transport as well. This is why we are supporting the purchase of low-emission heavy commercial vehicles via low-interest loans whose rates are reduced even further by the Federal Ministry of Transport, Building and Urban Affairs (BMVBS). During the first three months after this measure took effect, already around 25,000 low-emission heavy commercial vehicle purchases were financed. We are strongly committed to financing renewable energies and are one of the main sources of financing worldwide. At the same time we place high demands on the sustainability of our own actions. For instance, as from 2006 we have made the entire Group CO_2 neutral. It is not only in climate protection, however, that we set standards. We are working on firmly incorporating sustainability thinking in all of our core processes.

Education finance remained at a similarly high level as in 2006. Since the start of the KfW Student Loan programme in April 2006, for instance, we have granted some 37,000 loans.

KFW ENTWICKLUNGSBANK AND DEG.

In 2007 KfW Entwicklungsbank again increased its commitment volume in developing and transition countries over the previous year to help to sustainably reduce poverty in these countries and to boost their economies. This steady growth in our promotional business is only possible because we add funds of our own to those provided by the federal budget for Development Cooperation. More than half of all commitments now originate from KfW funds. This enables KfW Entwicklungsbank to combine the instruments available to it as a credit institution with its development-policy competence and to assist the German Government in augmenting its Official Development Assistance quota.

One example of this is our "Mobilising capital for the poor" initiative. Its purpose is to strengthen the financial sector in developing countries, the poor performance of which is often an obstacle to economic growth. As a leading global micro finance provider, KfW is familiar with these problems. Poor people cannot find a way out of poverty on their own unless they have the opportunity to access credit at fair conditions. Our subsidiary DEG complements the product range of KfW Entwicklungsbank with financing and advisory services that are tailored to the needs of private companies. In 2007 it again substantially increased its financing volume for private-sector investment in developing and transition countries and passed the EUR 1 billion mark for new commitments. At EUR 1.2 billion, the volume of new business of DEG was around 30 % higher than in 2006.

KFW IPEX-BANK.

KfW IPEX-Bank obtained legal independence at the beginning of 2008. We are pleased that the spin-off of international project and export finance went so smoothly in the given time frame. Not only did KfW IPEX-Bank start on time, but it did so under the best conditions. It was approved as an advanced IRB bank, which means that its control and management systems meet the highest and strictest regulatory requirements. Two renowned rating agencies assigned it a rating of AA minus, clearly confirming the business model. Yet in the midst of these changes KfW IPEX-Bank remains closely intertwined with the overall group strategy and will continue to be an integral part of the Group. KfW IPEX-Bank successfully continued its business during the final phase before gaining independence. At year-end EUR 16.1 billion in new business stood in the books, around EUR 1.1 billion more than in 2006. KfW IPEX-Bank will maintain its position as one of the top addresses in international project and export finance in the future as well and will continue to be a reliable partner of German industry. This aim is bolstered by its successful business strategy and by its employees' expertise and long experience.

FUNDING.

In terms of funding, 2007 was a successful year. The turbulence in the international capital markets had little impact on our funding. On the contrary: our good standing as a reputable and reliable issuer manifested itself in a positive way. We issued bonds in 25 different currencies in over 550 transactions in the international capital markets. Altogether we raised EUR 64.6 billion in funds. This figure is higher than in past years due to extraordinarily strong demand for our promotional loans. We are expecting a funding volume of about EUR 70 billion for 2008 since we will now also refinance promotional loans and other loans out of the ERP Special Fund.

RISK PROTECTION FOR IKB DEUTSCHE INDUSTRIEBANK AG, DÜSSELDORF.

In July 2007 KfW held 37.8 % of IKB's shares. KfW initially assumed a stake in IKB of approx. 1 % in 1985 at the request of the German Government because Stiftung Industrieforschung was unable to exercise its subscription rights during a capital increase. In 2001 the Board of Managing Directors of IKB at the time asked KfW to purchase the 33.2 % share package being offered by Allianz and Münchner Rück in order to fend off a pending divestiture of IKB. KfW's stake was thus increased to maintain IKB's role as a key provider of SME finance. The purchase was approved unanimously by KfW's Board of Supervisory Directors. At that time, other credit institutions had no serious interest in buying and maintaining IKB as a financing institution for SMEs. In the course of its merger with DtA in the year 2003, KfW increased its stake by another 3.6% – which had been in DtA's portfolio – to a total of 37.8%.

At the end of July 2007 IKB was faced with an existential crisis. The trouble was caused by disastrous developments in the US subprime mortgage market, which had a massive impact on IKB and other banks through investments in this field. In order to avoid a sudden moratorium of IKB, which at the time was one of Germany's best rated banks, and to prevent the crisis from spreading shock waves into the German financial sector, KfW and the three German banking associations (deposit insurance fund of the Bundesverband deutscher Banken [BdB], the Bundesverband der Deutschen Volks- und Raiffeisenbanken [BVR] and the Deutscher Sparkassen- und Giroverband [DSGV]) decided at the end of July 2007 to take concerted action and offer IKB risk protection. The risk protection measures rest on three pillars:

- assumption by KfW of the rights and obligations under the liquidity lines granted by IKB to the Rhineland conduit,
- sub-participation in risks entered into by IKB in the special purpose entities Havenrock I & II, and
- default guarantees for IKB to cover balance sheet risks arising from structured securities.

At the time of the decision on 28 and 29 July 2007 the losses from the total risk protection were expected to reach EUR 3.5 billion, with KfW assuming 70% and the banking associations 30%. While the banking associations limited their contribution to a maximum of EUR 1 billion, KfW entered into the obligations of the liquidity lines of IKB, which was a prerequisite for the risk protection for IKB, thus necessarily assuming the risk for the overall sum of the liquidity line. This measure, however, did not include the possibility of actively managing the Rhineland conduit securities attributable to the liquidity lines. This will not be possible until the securities are released from the conduit. With all short-term refinancings of the conduit Rhineland having been repaid on schedule and in full in the form of asset-backed Commercial Paper in January, KfW is now conducting in-depth talks with a total of 49 parties on the closing of the conduit.

During the months of October and November 2007 the dire situation in the US subprime mortgage market deteriorated even further, leading to downgrades on an unprecedented scale. As a consequence of these events, additional risks of EUR 350 million from the Havenrock structure had to be hedged for IKB (EUR 150 million provided by KfW) and the estimated loss for the conduit Rhineland had to be corrected upwards considerably. Overall, this led to a rise in the risk provisions in KfW's balance sheet from EUR 2.5 billion to EUR 4.95 billion by the end of November.

In mid-January 2008 KfW opened a structured and nondiscriminatory bidding process to sell its IKB shares.

As part of the restatement of its 2006/2007 financial statements, in early 2008 IKB also revaluated the structured products reported in its balance sheet. As market developments remained highly negative, further valuation losses became apparent within IKB. These losses exceeded the risk protection that had been offered to cover the balance sheet risks and would have caused the equity ratio to fall below the minimum required by supervisory law. To fend off another pending moratorium of IKB as well as the associated risks for the financial sector and the German economy, in mid-February 2008 the German Government commissioned KfW to implement capital measures to ensure IKB had an adequate equity base. The additional loss risks incurred through these measures of approx. EUR 1.5 billion will be borne mostly by the German Government (EUR 1.2 billion). The Bundesverband deutscher Banken agreed to provide another EUR 300 million in support. Since KfW had carried the biggest burden by far under the first two packages of risk protection measures, it was unable to assume further charges for the new support measures as this would have jeopardised its promotional capacity and put the substance of the ERP Special Fund at risk. In March 2008 the US Financial Guaranty Insurance Company (FGIC) filed a USD 1.875 billion lawsuit in New York against IKB, the impact of which could not yet be fully assessed at the time of writing.

In the first quarter of 2008 the deterioration of the US real estate market fundamentals continued unabated. Default rates of subprime borrowers rose again significantly and the decline in the prices of homes started to accelerate. In this environment the drop in the prices of mortgage-backed securities accelerated further. In consistent application of our conservative valuation approach we have taken into account the market developments of the current year, which are treated as adjusting events, in the risk provisions we made for the liquidity lines for the Rhineland conduit in the 2007 annual statements and increased our risk provisions by another EUR 1.8 billion. As a result we made write-downs on the revaluation of around 90 % on the Rhineland conduit. To cover most of the charges arising in connection with the risk protection for IKB, KfW applied EUR 5.3 billion from its fund for general banking risks, which serves as risk provision for the Group.

RESULTS FROM FINANCIAL YEAR 2007.

The 2007 business result was affected by the enormous charge resulting from the risk protection measures applied to IKB, which had run into existential difficulties. Risks taken over by KfW by participating in the liquidity lines of IKB for the Rhineland conduit in July 2007 accounted for a significant portion of these measures. The continuing negative developments in the securities held by the conduit in the first quarter of 2008 led to much higher impairment requirements for these liquidity lines than had been expected in December. This trend is fully recognised in the 2007 financial year. The overall charge from the IKB crisis for KfW now amounts to EUR 7.2 billion, of which EUR 6.8 billion from the various risk protection instruments and EUR 0.4 billion in write-offs on KfW's shareholding in IKB. The credit lines (liquidity lines) for Rhineland Funding are now 90 % written off. We are pursuing a conservative measurement approach and providing for early transparency of the charges KfW has incurred from rescuing IKB by incorporating adjusting information from the first quarter 2008 in the 2007 balance sheet.

The results of operative business such as interest and commission income and the risk position in the bank's core business remained stable. Risk provisioning without including the extraordinary effects of the risk protection for IKB continued at a low level even as the lending volume expanded.

In KfW's individual financial statements, which are prepared in accordance with the German Commercial Code, the bank incurred a net loss of EUR 1.4 billion for the year. Most of the risk protection provided for IKB was covered by our fund for general banking risks which, as part of our risk provisioning, serves to maintain our promotional capacity in stress situations. In the first quarter of 2008, however, the deterioration of the US real estate market continued unabated. Yet this loss could no longer be covered by our fund. The net loss for the year will be recognised as loss carried forward in KfW's balance sheet and offset against net income generated in coming years. The consolidated financial statements were prepared according to the international accounting standards IFRS for the first time. Contrary to German Commercial Code accounting standards, under which the burden resulting from the risk protection can be compensated in large part by dissolving the fund for general banking risks – with the corresponding effect on results – this is not possible under IFRS. Accordingly, under IFRS the risk protection for IKB had a full negative impact on profit, so the Group reported a net loss of approx. EUR 6.2 billion for 2007. This burden was then partly compensated through the fund for general banking risks and recognised directly in equity, so the Group reported a balance sheet loss directly in equity of EUR 1.4 billion.

OUTLOOK.

In 2007 we significantly broadened our support again and achieved very good results. Owing to the turmoil on the financial markets and the possible impacts on the real economy, the future development is difficult to forecast, especially for securitisation. In order to protect IKB against risks and thus to stabilise the financial markets in Germany, KfW has taken on an extraordinarily heavy burden. Nevertheless, we will fulfil our promotional mandate with dedication in the future, too. The promotional capacities of the ERP Special Fund are secure. In the programmes for which we use our own funds to make terms and conditions more favourable we will stay the course of improving efficiency in programme implementation and design, for example by aligning the terms and conditions more closely with those prevailing in the capital market. In these endeavours we will focus not only on expanding but also on enhancing the quality of our promotional programmes. We will maintain the promotional priorities of "small SMEs" and "environmental and climate protection" which we established in recent years.

KFW INITIATIVE "SMALL SMES".

Providing promotional support to small SMEs has been and still is a key focus of our activities. There have already been numerous positive changes for the SME sector. The financing conditions have generally seen good improvement. Of course the good economic situation in the past two years played a role in this. Yet, the situation remains difficult for small and micro enterprises. Although it has become easier for them to obtain an investment loan, micro businesses are still much more apt to hear 'no' from their bank than large companies. This makes it all the more important for us to ease the extension of promotional loans for credit institutions. This year we intend to vigorously continue the promotional and advisory programmes which we already introduced last year.

SUPPORT FOR CLIMATE PROTECTION.

We will continue our commitment to climate and environmental protection in the future as well. For instance, we plan to carry on with the "Housing, Environment, Growth" initiative. There is great potential for saving energy in the commercial sector as well. Unfortunately, not enough small and medium-sized enterprises have realised that ecology and economy do not have to be opposites. With targeted advice and investment companies can realise their energy-saving potential, significantly reduce their costs and strengthen their competitive position. Our new "Special Fund Energy Efficiency for SMEs" answers to this need. A very important area is the promotion of renewable energies. In addition to the tried and tested technologies of wind power and photovoltaics, we are developing measures for tapping additional renewable energies. After all, climate change does not stop at national borders. This is why protecting resources and the climate is both a national and a global task. We will therefore continue participating in the EU's energy efficiency facility for new member states. In addition, KfW Entwicklungsbank will launch a climate and environmental protection initiative together with the Federal Ministry for Economic Cooperation and Development (BMZ). Over the next four years we plan to finance investments in industrialising countries that have particularly fast impacts.

In 2008 KfW will again focus all its efforts and abilities on its promotional business.

Dr Peter Fleischer

Dr Norbert Kloppenburg

Wolfgang Kroh
(Speaker from 7 April 2008)

Detlef Leinberger

Ingrid Matthäus-Maier
(Spokeswoman until 7 April 2008)

MANAGING DIRECTORS AND DIRECTORS OF THE KFW GROUP.

BOARD OF MANAGING DIRECTORS.

Dr Günther Bräunig (seat is dormant during his appointment as Chairman of the Management Board of IKB)
Dr Peter Fleischer Dr Peter Klaus (until 30 April 2007) Dr Norbert Kloppenburg
Wolfgang Kroh (Speaker from 7 April 2008) Detlef Leinberger
Ingrid Matthäus-Maier (Spokeswoman until 7 April 2008)

DIRECTORS.

Dr Stefan Breuer	Rainer Hartje	Joachim Rastert
Dr Frank Czichowski	Klaus Klüber	Ludolf Rischmüller
Helmut Gauges	Doris Köhn	Wolfgang Roßmeißl
Werner Genter	Werner Möller	Dr Jürgen Schneider
Dr Dieter Glüder	Dr Hanns-Peter Neuhoff	Dr Bernd Schreiber
(seat is dormant during his	Klaus Neumann	Dietrich Suhlrie
appointment to the Board of	Werner Oerter	Klaus Weirich
Managing Directors of IKB)	Uwe Ohls	Bruno Wenn
Dr Volker Groß	Christiane Orlowski	Dr Christian Zacherl

BOARD OF MANAGING DIRECTORS OF KFW IPEX-BANK.

Michael Ebert Heinrich Heims (Speaker) Dr Peter Klaus (Speaker until 30 April 2007)
Christian Murach Markus Scheer

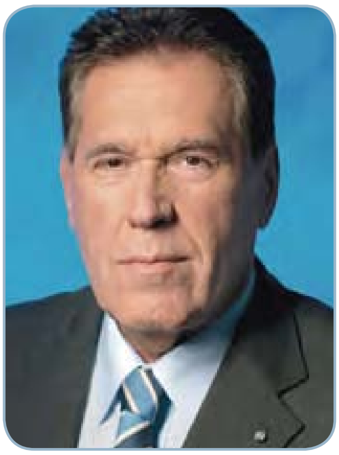
The business areas of project and corporate finance in Germany and international project and export finance were regrouped to form KfW IPEX-Bank. Since the beginning of the year 2008 it has been a legally independent subsidiary of the KfW Group and subject to the German Banking Act (KWG) and banking supervisory regulations.

BOARD OF MANAGEMENT OF DEG – DEUTSCHE INVESTITIONS- UND ENTWICKLUNGSGESELLSCHAFT MBH.

Johannes-Jürgen Bernsen Dr Michael Bornmann Dr Winfried Polte (Chairman)

DEG was founded in 1962 and has been a 100 % subsidiary of the KfW Group since 2001. DEG is one of the largest European development finance institutions for long-term project and corporate financing. For over 40 years DEG has been financing investments by private companies in developing and transition countries.

REPORT OF THE BOARD OF SUPERVISORY DIRECTORS.



Michael Glos
Federal Minister of Economics and Technology

The Board of Supervisory Directors has continually supervised the conduct of KfW's business and the administration of its assets. For this purpose, in particular to take decisions on the provision of financing and the issuing of guarantees according to the conditions set forth in the Law concerning KfW and the By-Laws, several regular and – owing to the subprime crisis in the US property market and its impacts on the financial market in Germany and particularly on IKB Deutsche Industriebank AG – several extraordinary meetings of the Board of Supervisory Directors and its committees were held during the financial year.

At those meetings the Board of Managing Directors provided the Board of Supervisory Directors with information about the business activities and current developments in KfW's individual fields of activity, about the Group's net assets, profit or loss and risk situation as well as about special activities such as the risk protection afforded to IKB Deutsche Industriebank AG.

In its reports on the activities of KfW Mittelstandsbank and KfW Förderbank, the Board of Managing Directors placed special emphasis on KfW's "Small SMEs" initiative and KfW's target topic of climate and environmental protection, mentioning in particular the programmes to finance energy-efficient construction and rehabilitation, the planned "Special Fund Energy Efficiency for SMEs" and financing for the purchase of low-emission heavy commercial vehicles. In reporting on the activities of KfW Entwicklungsbank the Board of Managing Directors focused especially on the new initiatives for climate change and environmental protection (IKLU) and on financial sector development ("Mobilising capital for the poor"). The Board of Supervisory Directors was also informed about securities management and the progress made in the spin-off of KfW IPEX-Bank GmbH as at 1 January 2008 as well as the transfer of promotional reserves of the ERP Special Fund to KfW as at 1 July 2007. A key topic that was also the centre of intense discussion at several extraordinary meetings of the Board of Supervisory Directors was the risk protection provided for IKB Deutsche Industriebank AG that became necessary as a result of the US property crisis and in which KfW is participating together with the German banking industry. The Board of Managing Directors always informed the Board of Supervisory Directors without delay of developments concerning the risk protection and involved it in decision-making as stipulated in the Law concerning KfW and in the By-Laws. In the course of these decisions the Board of Supervisory Directors commissioned the Board of Managing Directors to move ahead quickly with the process of selling IKB Deutsche Industriebank AG. The Board of Supervisory Directors stressed the importance of having the German banking industry and the other shareholders of IKB participate in the risk protection measures. Two essential prerequisites formed the basis for every decision: KfW's promotional capacity remains assured and the ERP Special Fund is exempt from the charges resulting from the IKB crisis. The Board of Supervisory Directors also discussed the formation of an executive and an audit committee, which was passed in February 2008 in the form of an amendment of the By-Laws.

The Loan Approval Committee concerned itself primarily with the loan commitments that have to be presented under the Law and By-Laws as well as with the risk report of the KfW Group. An extraordinary meeting was convened immediately (early August) after the crisis arose at IKB to discuss risk protection measures for IKB.

The Legal and Administrative Committee mainly discussed staff issues and the audit of the annual financial statements including the appointment of the auditors and made corresponding recommendations to the Board of Supervisory Directors. It also considered amending the By-Laws to establish an executive and an audit committee and made a corresponding recommendation to the Board of Supervisory Directors.

The Advisory Council for Promotional Measures in the New Federal States discussed the business activities of KfW during 2006 and focused specifically on the new federal states. It also concerned itself with the activities of the business start-up centre *(Unternehmensgründerbüro)* in Leipzig and the Microfinance Fund Germany.

As was agreed, in my capacity as Federal Minister of Economics and Technology I have assumed the position of Chairman of the Board of Supervisory Directors for 2008.

In the period under review Rüdiger Dorn, Dr Thomas R Fischer, Stefan Ortseifen, Jörg-Otto Spiller and Erwin Teufel left the Board of Supervisory Directors. The Board of Supervisory Directors would like to thank these former members for their work on the Board. New members are Dr Siegfried Jaschinski, Waltraud Lehn, Dr Helmut Linssen and Alexander Rychter.

PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, who were appointed auditors by the supervisory authority, the Federal Ministry of Finance (BMF), in consultation with the Federal Audit Office following the proposal by the Board of Supervisory Directors, have examined and unconditionally confirmed the annual financial statements and the management report of KfW as well as the consolidated financial statements and the group management report of the KfW Group, all of which were prepared by the Board of Managing Directors. The financial statements and the management report were prepared in accordance with the provisions of the German Commercial Code (HGB) and the consolidated financial statements and the group management report were prepared in accordance with International Financial Reporting Standards (IFRS) as applicable within the European Union.

The Board of Supervisory Directors accepted the result of the audits. At its meeting on 7 April 2008 the Board of Supervisory Directors approved the financial statements and the consolidated financial statements, both of which were prepared by the Board of Managing Directors, as stipulated in Article 9 (2) of the Law Concerning KfW following a recommendation by the Audit Committee.

Frankfurt am Main, 7 April 2008

THE BOARD OF SUPERVISORY DIRECTORS

Chairman

BOARD OF SUPERVISORY DIRECTORS.

DUTIES OF THE BOARD OF SUPERVISORY DIRECTORS.

The Board of Supervisory Directors supervises the conduct of KfW's business and the administration of its assets. It approves larger loans and the annual financial statements. The Board of Supervisory Directors consists of 37 members. Its Chairman is the Federal Minister of Economics and Technology and the Deputy Chairman is the Federal Minister of Finance.

Michael Glos
Federal Minister of Economics and Technology
Chairman
(from 1 January 2008)
Deputy Chairman
(until 31 December 2007)

Peer Steinbrück
Federal Minister of Finance
Deputy Chairman
(from 1 January 2008)
Chairman
(until 31 December 2007)

Dr Günter Baumann
Member of the Board of Managing Directors of the Association of German Chambers of Industry and Commerce (DIHK)
Representative of Industry

Anton F Börner
President of the Federation of German Wholesale and Foreign Trade (BGA)
Representative of Trade

Dr Uwe Brandl
President of the Bayerischer Gemeindetag
Representative of the Municipalities

Frank Bsirske
Chairman of ver.di – Vereinigte Dienstleistungsgewerkschaft
Representative of the Trade Unions

Prof Dr Ingolf Deubel
Minister of Finance of the State of Rhineland-Palatinate
Member appointed by the German Bundesrat

Rüdiger Dorn
Attorney and notary public
Law offices of Dorn, Metzler, Jäger & Partners
Representative of the Housing Industry
(until 31 December 2007)

Prof Dr Kurt Faltlhauser
Minister of Finance (retired) of the Free State of Bavaria
Member appointed by the German Bundesrat

Dr Thomas R Fischer
Former Chairman of the Board of Managing Directors of WestLB
Representative of the Mortgage Banks
(until 2 August 2007)

Sigmar Gabriel
Federal Minister of the Environment, Nature Conservation and Nuclear Safety

Heinrich Haasis
President of the Deutscher Sparkassen- und Giroverband
Representative of the Savings Banks

Peter Jacoby
Minister of Finance of the State of Saarland
Member appointed by the German Bundesrat

Dr Siegfried Jaschinski
Chairman of the Board of Managing Directors of Landesbank Baden-Württemberg
Representative of the Mortgage Banks
(from 5 December 2007)

Bartholomäus Kalb
Member of the German Bundestag
Member appointed by the German Bundestag

Roland Koch
Minister President of the State of Hesse
Member appointed by the German Bundesrat

Jürgen Koppelin
Member of the German Bundestag
Member appointed by the German Bundestag

Oskar Lafontaine
Member of the German Bundestag
Member appointed by the German Bundestag

Waltraud Lehn
Member of the German Bundestag
Member appointed by the German Bundestag
(from 1 January 2008)

Dr Helmut Linssen
Minister of Finance of the State of North Rhine-Westphalia
Member appointed by the German Bundesrat
(from 1 January 2008)

Claus Matecki
Member of the Federal Executive Board of the Confederation of German Trade Unions (DGB)
Representative of the Trade Unions

Dr Michael Meister
Member of the German Bundestag
Member appointed by the German Bundestag

Franz-Josef Möllenberg
Chairman of the Gewerkschaft Nahrung-Genuss-Gaststätten
Representative of the Trade Unions

Hartmut Möllring
Minister of Finance of the State of Lower Saxony
Member appointed by the German Bundesrat

Klaus-Peter Müller
President of the Association of German Banks
Representative of the Commercial Banks

Stefan Ortseifen
Former Spokesman of the Board of Managing Directors of IKB Deutsche Industriebank AG
Representative of the Industrial Loan Banks
(until 30 July 2007)

Matthias Platzeck
Minister President of the State of Brandenburg
Member appointed by the German Bundesrat

Dr Christopher Pleister
President of the Bundesverband der Deutschen Volks- und Raiffeisenbanken e.V. (BVR)
Representative of the Cooperative Banks

Alexander Rychter
Managing Director of the Bundesverband Freier Immobilien- und Wohnungsunternehmen e.V. (BFW)
Representative of the Housing Industry
(from 1 January 2008)

Christine Scheel
Member of the German Bundestag
Member appointed by the German Bundestag

Hanns-Eberhard Schleyer
Secretary-General of the Zentralverband des Deutschen Handwerks
Representative of the Skilled Crafts

Horst Seehofer
Federal Minister of Food, Agriculture and Consumer Protection

Michael Sommer
Chairman of the Deutscher Gewerkschaftsbund
Representative of the Trade Unions

Gerd Sonnleitner
President of the Deutscher Bauernverband e.V.
Representative of Agriculture

Jörg-Otto Spiller
Member of the German Bundestag
Member appointed by the German Bundestag
(until 31 December 2007)

Dr Frank-Walter Steinmeier
Federal Minister of Foreign Affairs

Ludwig Stiegler
Member of the German Bundestag
Member appointed by the German Bundestag

Erwin Teufel
Minister President (retired) of the State of Baden-Württemberg
Member appointed by the German Bundesrat
(until 31 December 2007)

Jürgen R Thumann
President of the Bundesverband der Deutschen Industrie e.V. (BDI)
Representative of Industry

Wolfgang Tiefensee
Federal Minister of Transport, Building and Urban Affairs

Heidemarie Wieczorek-Zeul
Federal Minister for Economic Cooperation and Development

A versatile promoter.

KfW Bankengruppe gives impetus to economic, social and ecological development worldwide. As bankers we seek to work efficiently every day. As promoters we stand for the sense and sustainability of what we do. The profits we generate are channelled back into promotion and used to safeguard our promotional potential over the long term. As a creative bank, we not only encourage innovation but also increasingly develop new financing instruments for our customers and partners. Our expertise and experience are packaged as five strong brands. We raise most of our promotional funds in the capital market, and the results of our efforts flow back entirely into our promotion and into securing our goals on a long-term basis.

Board of Managing Directors of the KfW Group:
Dr Günther Bräunig (dormant seat since 1 August 2007), Ingrid Matthäus-Maier (Spokeswoman until 7 April 2008), Wolfgang Kroh (Speaker from 7 April 2008), Detlef Leinberger, Dr Peter Fleischer, Dr Norbert Kloppenburg

AN INTERVIEW WITH THE KFW BOARD OF MANAGING DIRECTORS.

2007 was an eventful year for KfW. How do you assess the development of the past months and the achieved result?

Matthäus-Maier: The year 2007 certainly was extraordinary for KfW – in more ways than one. First of all, we generated the best promotional result in KfW's history. Second, we mastered a number of large, challenging projects. These mainly included the spin-off of KfW IPEX-Bank as a legally independent bank, the transfer of the ERP Special Fund to KfW and the simultaneous allocation of EUR 2 billion to the federal budget. The reigning topic, however, was the risk protection put together with the Federal Government and the banking associations that was afforded to IKB, which had encountered existential difficulties. All in all, it was an unforgettable year.

Which priorities did you set for your promotional business and how did they contribute to the promotional result?

Dr Fleischer: We identified issues of future relevance such as environmental protection early on and joined hands with policymakers and associations to design the necessary promotional programmes. Another priority was the small enterprise sector. Time and again our studies showed that small, frequently owner-managed businesses in particular still struggle with difficult overall conditions when they want to finance investment projects. Our excellent promotional result tells us that we chose the right strategy. We intend to continue our activities in this area in the new year.

What promotional results are you expecting in the coming year?

Kroh: Our promotional business in 2007 was excellent. Last year's high lending volume reflects not only our attractive offers, but also the upswing in the German and European economy. In general, though, we are expecting a slight economic decline and lower growth in corporate investment in 2008.

Together with the Federal Government and the banking associations KfW is providing risk protection measures to IKB. If IKB had gone bankrupt unexpectedly, what impact would this have had on KfW and on the financial markets?

Matthäus-Maier: A sudden bankruptcy of IKB would have had serious consequences for Germany's overall status as a financial location. After all, at the time IKB had a rating of AA- and was one of Germany's best rated banks. It would have turned into a debt moratorium overnight. The loss of confidence in the German banking industry would have been enormous. What is more, apart from liabilities to customers – who are insured through the deposit insurance fund of the private banks – IKB also has liabilities due to other banks and institutions. Finally, a sudden collapse of IKB would have impacted the banking sector in Germany and, thus, also KfW by leading to stricter refinancing conditions and less risk provisioning, which would in turn have had unforeseeable macro-economic effects.

Can KfW be accused of wrong-doing in connection with the emergence of the IKB crisis?

Matthäus-Maier: No, such an accusation is not correct. Neither IKB's annual report nor the audit certificates of its auditors hinted at any particular risks for IKB. In a special audit carried out in mid-October 2007 the accounting firm PwC confirmed that prior to 27 July, i.e. the day on which the Board of Managing Directors informed the Board of Supervisory Directors of the emerging crisis, there was no evidence signalling to the Board of Supervisory Directors that IKB's subprime investments could jeopardise the bank's existence. At the time there was no reason to doubt the reports, especially since the Board of Supervisory Directors and the Finance and Audit Committees all had renowned experts among their members in the past few years. And as late as 20 July 2007 a press release was issued in which the chairman of IKB at the time declared that "practically no impacts" were to be expected as a result of the uncertainties in the US mortgage market.

Why does KfW even hold shares in IKB?

Kroh: KfW initially assumed a stake of around 1% in IKB at the request of the German Government because Stiftung Industrieforschung was unable to exercise its subscription rights during a capital increase. In 2001 Allianz and Münchener Rück offered to sell their package of IKB shares of 33.2%. Since no other German bank was interested and IKB would have faced the risk of a divestiture had an international investor entered the scene, the Board of Managing Directors of IKB urgently asked KfW to purchase this share package. KfW ceded to this request in order to maintain IKB's status as a key provider of SME finance in the long term. The successive purchase of the shares, which began in 1985, always received a unanimous vote of the Board of Supervisory Directors.

What can be learned from the subprime crisis, which has affected banks all over the globe?

Matthäus-Maier: We have been striving for more transparency of complex financial products for quite some time already. Among others, this means that finance vehicles such as the Rhineland conduit belong in the balance sheet, or that the risks associated with them ought to be portrayed adequately. Yet it is equally important to reduce the complexity of such transactions, which can develop into an immense risk, as we have seen. Furthermore, the originator of a securitisation transaction has to take responsibility for the transaction and participate in the risk – as far as possible via the first loss piece. Every bank manager should ensure that the ratio of the bank's risks to its equity is appropriate. Last but not least, auditors and rating agencies have to ask themselves what they can change in the future to retain their credibility.

What consequences do KfW's Managing Directors draw from the IKB crisis for risk management at KfW?

Dr Fleischer: For KfW systematic risk management is a precondition for maintaining the bank's risk-bearing capacity and for attaining its promotional objectives on a long-term basis. In this sense KfW Bankengruppe attaches great impor-

tance to the quality of its risk management processes and methods and has significantly expanded its range of instruments over the last few years. Not only does KfW's management approach meet regulatory requirements in full, but it is also based on demanding models from banking practice. The Federal Audit Office and accountants have confirmed this. Another "quality seal" is the licence granted to KfW IPEX-Bank to operate as an advanced IRB bank, and the requirements set forth in the Basel II guidelines also govern risk management at the Group level. But our efforts do not stop there. KfW will continue to develop its risk measurement and controlling instruments, especially since the introduction of innovative products and the changes that can be observed in the financial and capital markets bring with them new requirements for valuation and control procedures.

The risk protection afforded to IKB incurs heavy costs for KfW. Could you define them more precisely?

Matthäus-Maier: In order to protect IKB against risks and therefore to stabilise the financial markets in Germany, KfW has taken on an extraordinarily heavy burden. KfW's overall charge from the IKB crisis now amounts to EUR 7.2 billion, with EUR 6.8 billion attributable to the various risk protection instruments and EUR 0.4 billion to write-offs on KfW's shareholding in IKB.

How do these charges affect KfW's result?

Leinberger: In KfW's individual financial statements, which are prepared according to the German Commercial Code (HGB), the bank reports a net loss of EUR 1.4 billion for the year. The risk protection measures for IKB were covered mainly by withdrawing EUR 5.3 billion from the fund for general banking risks, which had grown over the years. This fund serves as the bank's risk provision for extraordinary situations.

KfW prepared its consolidated financial statements according to the international accounting standards IFRS for the first time. What impact did this have?

Leinberger: Contrary to German Commercial Code accounting standards, under which the burden resulting from the risk protection for IKB is largely reduced by the dissolution of the fund for general banking risks – with the corresponding effect on results – this is not possible under

IFRS. Instead, the risk provisions have a full negative impact on the Group's results. Accordingly, the Group reported a net loss of approx. EUR 6.2 billion for 2007 under IFRS. For the most part this is offset through a reduction in the fund for general banking risks posted under equity.

And what does this result mean for the bank?

Matthäus-Maier: What is important is that the results of operative business such as interest and commission income remained stable despite an increase in promotional lending. In KfW's core business the good risk situation is particularly satisfactory. Here the need for risk provisions remains low. KfW's operations are strong and its promotional strategy is well positioned.

How is KfW protected against risks now that the fund for general banking risks has been dissolved?

Dr Fleischer: The use of the fund was made necessary by an extraordinary event that was not connected with KfW's original business. The Group's need for risk provisions – putting aside the risk protection afforded to IKB – remains at a low level. Value adjustments in our promotional lending business and in the business area of export and project finance are still minimal. KfW will carry on with its cautious business policy.

How will this affect KfW's individual promotional capacities in the future?

Kroh: In spite of the immense burden placed on us last year we will continue to actively perform our promotional mission in the future. The promotional capacity of the ERP Special Fund is assured. As regards the programmes in which our own funds make the terms and conditions more favourable, we will stay the course of improving the efficiency of programme implementation and design, partly by aligning the terms and conditions more closely with those prevailing in the capital market. After all, what counts are not just the quantitative but also and above all the qualitative aspects of our promotional programmes.

What are your plans for 2008?

Dr Fleischer: Our aim is to keep offering special support to small SMEs. We will actively continue the measures that we already introduced last year and add three facets. The new *KfW Startgeld* programme combines the two preceding programmes *Mikrodarlehen* and *StartGeld*. Second, we plan on adding financing windows to the various programmes offered by KfW Mittelstandsbank that cater especially to small enterprises. Third, we want to make it easier for small businesses to access mezzanine capital. Since it is common knowledge that financing is not a start-up entrepreneur's only worry, we will carry on with our advisory programme entitled "Start-up coaching in Germany".

Leinberger: Apart from our SME programmes we will carry on with our commitment to global climate and environmental protection together with the Federal Government. Here I can mention

the "Energy-Efficient Construction and Rehabilitation" initiative, the new ERP Energy Efficiency Programme, which taps into the considerable energy savings potential in the SME sector through targeted advice and favourable financing offers, measures that mitigate the risk associated with finding sources of geothermal heat, and the launch of another extensive initiative to support climate and environmental protection in emerging countries. Over the next four years we want to finance investments in these countries that will have particularly fast impacts.

Recently you set the goal of making the instrument of securitisation available to smaller banks. How and when will this be implemented?

Leinberger: KfW, being a promotional bank, indeed wants to make its banking expertise and its standardised securitisation platforms available to smaller banks in particular. Securitisation is still an important instrument for spreading risk in a targeted manner and for reducing a business' equity charge. It gives banks greater freedom to grant more loans. However, the market has to function in order for the transactions to be successful.

The ERP Special Fund – why was it merged into KfW? What are the advantages?

Matthäus-Maier: Transferring the ERP Special Fund to KfW provided the federal budget with an additional EUR 2 billion. The reorganisation of the ERP Special Fund also made sense because it generated a direct organisational simplification by shortening the onlending chain – KfW has always onlent the funds for the ERP loans to ultimate

borrowers through the channels of central institutions, local banks and savings banks. Nothing will change for the ultimate borrowers, the small and medium-sized enterprises. And – this is especially important – the primacy of politics will not change, either. The budget for the ERP support will still be passed into law by the Bundestag.

KfW Entwicklungsbank again has higher commitment figures. What role do innovative financing instruments play in this regard?

Kroh: KfW Entwicklungsbank has broadened its commitments in partner countries by adding own funds in order to satisfy a greater need for funds required to bolster its development efforts. To this end we are combining funds raised by KfW with budget funds from the Federal Government in different ways. By using these funds in better-performing partner countries we are assisting the Federal Ministry for Economic Cooperation and Development (BMZ) in creating more scope for focusing scarce budget funds more strongly on poor countries – first and foremost in Africa. For this reason, since 2007 the BMZ has been providing more funds especially to reduce the interest rates of KfW's own loans. In 2007 these funds added up to some EUR 89 million. As the federal budget has earmarked an additional EUR 200 million, this figure is set to rise in 2008.

How is the reorganisation of the institutions active in development cooperation progressing?

Kroh: The decisions that need to be made in the discussions surrounding the reorganisation of German Development Cooperation are taken in Berlin. However, we would welcome any changes aimed at improving the efficiency of our daily work in developing and transition countries.

Since 1 January 2008 KfW IPEX-Bank has been active in the market as a legally independent bank. What does this mean for KfW Bankengruppe?

Kloppenburg: The spin-off of KfW IPEX-Bank was an extraordinarily complex and demanding project. Not only did we implement the understanding reached with the European Commission – the so-called EU Understanding II – smoothly and on schedule – we also gave our customers in international project and export finance an efficient partner.

What goals are you pursuing and what are you expecting of this new bank?

Kloppenburg: We want to firmly establish KfW IPEX-Bank as one of Europe's leaders in international project and export finance and to expand this role. Our intention is backed by a successful business strategy and the know-how and long experience of our staff. KfW IPEX-Bank is starting under the best conditions: its risk management and control instruments meet up-to-date requirements. The rating agencies Standard & Poor's and Moody's gave it a rating of AA-, thus expressly confirming its business model.

What role does KfW IPEX-Bank play within KfW Bankengruppe?

Kloppenburg: KfW IPEX-Bank is an integral part of KfW Bankengruppe and will remain closely intertwined with the overall group strategy in the future as well. The taxable profits it will generate in its commercial business will contribute significantly to KfW's promotional activities in the SME sector, for instance, or in climate protection, and will remain one of the Group's supporting pillars. Beyond that, KfW IPEX-Bank is a vital source of know-how for the Group because, being a bank that faces competition, it gives us valuable input for the further development of our products and processes.

How do KfW IPEX-Bank and KfW's official promotional mission fit together?

Kroh: Although KfW IPEX-Bank is not a promotional bank, it is still committed to KfW's official mission to provide support. KfW IPEX-Bank with its long-term financing is an essential and, above all, a reliable partner for the German economy, which is heavily dependent on exports, and its products round off KfW's offers to the German economy.

How will KfW's funding activities develop during the course of 2008?

Kroh: We already raised EUR 64.6 billion in 2007. This figure was higher than in past years due to extraordinarily strong demand for our promotional loans. We are expecting a funding volume of about EUR 70 billion for 2008 since we will also be refinancing promotional and other loans out of the ERP Special Fund.

Why does KfW issue so many foreign currency bonds?

Kroh: Given the sheer volume of our refinancing, it is wise to seek as many investors as possible. Last year we issued bonds in 25 different currencies in the international capital markets in over 550 transactions. The range of currencies we offer, which has grown to considerable proportions, enables us to reach many new investors all over the world – allow me to underscore at this point that our books do not contain any currency risks. As an innovative issuer, KfW taps into up-and-coming markets for its refinancing, which will benefit the bank in the long term.

Did the staff count change in 2007?

Matthäus-Maier: In the year 2007 some 4,200 people worked for the Group at all its locations – in Frankfurt, Bonn, Berlin and at our offices throughout the world. The share of female staff remains at a high level. We are also pleased that the share of women in management positions is increasing. KfW was able to master the extraordinary challenges of the year 2007 so well mainly because of the commitment, motivation and dedication of our staff. In the name of the entire Board of Managing Directors I would like to thank them for their excellent work.

LEGAL INDEPENDENCE FOR KFW IPEX-BANK GMBH.

As at 1 January 2008 KfW IPEX-Bank GmbH gained legal independence. KfW thus complied with the 2002 understanding reached with the European Commission on the restructuring of the promotional banking landscape. As a key 100 % subsidiary, KfW IPEX-Bank will continue to be closely integrated in KfW's overall strategy. KfW IPEX-Bank is an essential and above all reliable partner for the German economy, which is heavily dependent on exports. KfW IPEX-Bank rounds off KfW's offers for the German economy. KfW IPEX-Bank GmbH was equipped with tier 1 capital amounting to a good EUR 2.3 billion and with tier 2 capital of approx. EUR 1.2 billion.

OVER 1 MILLION TONNES OF CO_2 REDUCTIONS ANNUALLY – MORE THAN 220,000 JOBS SAFEGUARDED.

KfW Förderbank and the German Federal Ministry of Transport, Building and Urban Affairs (BMVBS) evaluated the impact of their promotional measures. The result: investments financed in 2006 alone led to a reduction in CO_2 emissions of over 1 million tonnes per annum. Another result confirmed by the study was that more than 220,000 jobs were safeguarded in Germany in the year 2006 as a result of financed investments. In 2006 some 130,000 loans with a total volume of nearly EUR 7 billion were granted under the promotional programmes. These loans sparked a volume of investment of around EUR 12 billion.

KFW'S FIRST THAI BAHT BOND ISSUED IN THE LOCAL CAPITAL MARKET IN THAILAND.

KfW issued its first bond for the local capital market in Thailand. The bond had a volume of THB 3 billion and a term of 3 years. The coupon was fixed at 3.87 % p.a. and is payable twice a year. The bond specifically targeted Thai institutional investors and banks. On the day of issue the entire bond was placed with this group of investors. KfW is the first non-Asian international issuer in this market. The bond was very well received by the Thai investors.

CORPORATE FINANCE ON THE UPSWING - KFW STUDIES FOCUS ON SMES.

Access to credit by small and medium-sized enterprises in Germany continued to improve in 2007 – this is the main result of the representative company survey conducted by the KfW Group again in collaboration with 26 professional and regional business associations. Yet it is mainly small businesses that continue to complain disproportionately often about deteriorating conditions in corporate finance. SMEs were also the focus of various analyses conducted by KfW's economists during 2007. The bank demonstrated its SME expertise in the form of regular publications on financing requirements, innovation behaviour, the cyclical situation of SMEs and start-up activity, among others.

KFW GROUP EARNS AWARD FOR FAMILY-FRIENDLY STAFF POLICY.

The KfW Group received an award for its family-friendly staff policy. In Berlin Ursula von der Leyen, Federal Minister for Family Affairs, presented the certificate on the "audit berufundfamilie®" (occupation and family audit) to Detlef Leinberger, member of KfW's Board of Managing Directors. KfW operates and sponsors child care facilities, supports individual part-time solutions, home teleworking, flexible working hours, advice through the family service and job sharing at the junior management level. The "audit berufundfamilie®" is a strategic management instrument which assists employers in striking a feasible and economically viable balance between corporate objectives and staff interests.

KFW BONDS EXCHANGEABLE FOR SHARES IN DEUTSCHE POST CONVERTED.

Nearly all of the KfW bonds exchangeable for shares in Deutsche Post AG have been converted. The bonds were issued with a volume of EUR 1.15 billion and a maturity until 8 January 2007. This bond exchange transaction finally placed some 55.8 million shares held by KfW in the market. The exchange price per share was EUR 20.54, corresponding to a premium of 30% over the closing share price at the time of the bond issue in 2003. Through the bond, the number of Deutsche Post shares held by KfW decreased by 4.64% from approx. 424 million to currently around 368.3 million shares. KfW now holds 30.6% of the share capital of Deutsche Post AG.

COOPERATION BETWEEN KFW AND VNESHECONOMBANK INTENSIFIED.

In October 2007 the KfW Group and the Russian Vnesheconombank agreed to work together in the market for emission credits. The cooperation between the two banks mainly covers the identification and development of emission reducing projects in accordance with the Kyoto Protocol (Joint Implementation) in the Russian Federation. With this new agreement KfW and Vnesheconombank are building on the cooperation that has existed between them since 2003, with the focus on investment finance, primarily for small and medium-sized enterprises, and on project and export finance. KfW played an advisory role in the establishment of the new Russian promotional bank, particularly in institutional and organisational matters.

CORNERSTONE LAID FOR NEW, ENERGY-EFFICIENT KFW BUILDING.

On 7 May the mayor of the city of Frankfurt, Petra Roth, and the Spokeswoman of the Board of Managing Directors of the KfW Group, Ingrid Matthäus-Maier, laid the cornerstone for the "West Arcade", KfW's new office building along Frankfurt's Zeppelinallee. From 2009 it will provide office space for 700 employees. A double-skin façade with regulated ventilation will help to ensure that the building meets top energy efficiency standards. The use of geothermal heat will help to reduce the amount of primary energy required to operate the building down to 100 kilowatt hours a year. The building, located on the grounds of the former Deutsche Bibliothek, is being constructed according to plans by the Berlin architect Professor Sauerbruch (sauerbruch hutton).

The name says it all.

KfW Mittelstandsbank brings together all KfW's offers for business start-ups and small and medium-sized enterprises, thus promoting commercial investments over the entire life cycle of an enterprise. Its SME financing products are structured according to three pillars: loans, mezzanine and equity capital. In addition to investment finance, KfW Mittelstandsbank provides relevant information and advice. In promoting investment by German companies in Germany and abroad, KfW Mittelstandsbank acts as a bank behind credit institutions and other financial intermediaries, working with them as a partner. KfW Mittelstandsbank is continuously developing its promotional instruments and adjusting them to changes in the market.

MITTELSTANDSBANK

Environmental protection and a business-man who does more than put it to paper.

Paper is patient, as the saying goes. Mr Schenkelberg from the Schenkelberg Stiftung & Co. KGaA printing plant obviously saw things differently and invested heavily in modernisation. A brand new printing press three stories high now proudly reaches to the roof in the spotless production hall. The offset rotation machine, which is worth several million euros, can print two newspapers at once. The higher quality Mr Schenkelberg can now produce enables him to seek new customers. Above all the new machine woos with its intrinsic qualities, which, contrary to its printing output – require a second glance: 20 % less energy consumption, 15 % less water and, with an automatic colour refill via

integrated tanks, significantly less cleaning. What is more, paper consumption in the start-up phase is cut roughly in half for newspapers. The bottom line is that greater efficiency and higher environmental compatibility are the main arguments that speak in favour of the new investment. KfW Mittelstandsbank financed the project with over EUR 9 million through both the ERP Environmental Protection and Energy Saving Programme and the KfW Environmental Protection Programme. Both promotional programmes encourage small and medium-sized enterpreneurs to invest more in environmental protection. And they enabled the Schenkelberg printing plant to put excellent results down on paper.

A start-up entrepreneur whose business is heading up.

Stepping into self-employment offers excellent opportunities for career advancement. It is helping Markus Berg to climb up a special career ladder. The sports graduate set up his own high ropes course in Nettersheim, a city in Germany's Eifel region. The idea occurred to him while talking with a former fellow student about climbing. He then planned the project together with the former deputy mayor and finally implemented it with assistance from KfW Mittelstandsbank, which provided financial support under its StartGeld (start-up funds) programme. KfW's StartGeld covers financing requirements of up to EUR 50,000. Business founders can use these funds for up to 100 % of their total cost.

The young entrepreneur's ropes course has since been built up to include nine different stations. His clients naturally include many excursionists and school classes, but his team training has also helped a few managers to prepare for the ups and downs of management careers. Markus Berg is satisfied with how his business is developing. This is good news not only for his family of five but also for the community since the high ropes course attracts more visitors to Nettersheim. That, in turn, also makes business for the region's hotel and restaurant industry climb.

"SMALL SMES" INITIATIVE: BETTER CONDITIONS FOR SMALL ENTERPRISES AND START-UPS.

At the beginning of 2007 KfW Mittelstandsbank reduced the interest rates for its "StartGeld" (start-up funds) and "Mikro-Darlehen" (microloan) programmes by around one-third in order to give small enterprises and start-ups easier access to financing. As at 1 January 2008 both programmes were combined to form the new "KfW StartGeld" programme. KfW Mittelstandsbank continues to offer the on-lending banks 80% exemption from liability.

NEW RISK PARTNERSHIP BETWEEN KFW AND COMMERCIAL BANKS IN ENTREPRENEUR LOAN PROGRAMME.

Since July 2007 KfW has also been offering 50% exemption from liability in the Entrepreneur Loan (*Unternehmerkredit*) programme. This risk sharing between KfW and the commercial banks on-lending the funds is designed to make loans more accessible to SMEs. SMEs do not incur any extra cost if they apply for exemption from liability since their bank and KfW share the risk margin included in the interest rate. The 50% exemption from liability KfW offers under its Entrepreneur Loan programme is available for investment projects by SMEs and self-employed professionals who have been active in the market for at least two years.

NEW ONLINE CONSULTING OFFERS FOR SMES.

In accordance with Basel II, credit institutions have introduced complex rating procedures to improve their assessment of risk. Many businesses are unaware of the consequences of such rating procedures. KfW's rating advisor informs them about the impact of ratings on a bank's loan decisions. In addition, the advisor explains ways in which businesses can improve their rating. This information is now available in the internet (currently in German only) at www.kfw-mittelstandsbank.de.

START-UP COACHING LAUNCHED IN GERMANY.

"Start-up coaching in Germany" is a new promotional programme of the Federal Government and KfW Mittelstandsbank. Young entrepreneurs can receive a grant of up to EUR 4,500 to pay for the services of a management consultant. Whereas the federal states focus their promotional offers on the pre-start-up phase, the Government's start-up coaching concentrates on the first five years after a business is founded. This new programme marks the first time that uniform, coordinated promotion is being offered jointly by the Federal Government and the federal states.

GERMAN EQUITY FORUM IN DÜSSELDORF.

Once again KfW Mittelstandsbank and Deutsche Börse AG organised the German Equity Forum, which took place on 19 April 2007 in Düsseldorf. Participants met with 150 venture capital and private equity investors. They had the opportunity to present their business and to make new contacts. Since the Forum was launched, more than 1,500 companies have made use of it, and one out of two have succeeded in finding an investment or cooperation partner.

KFW MITTELSTANDSBANK.

In 2007 KfW Mittelstandsbank made commitments totalling EUR 23.2 billion. This figure even surpassed the previous year's very high lending volume. Commitments included securitisation transactions, which were, at EUR 10.0 billion, slightly higher than in 2006. The total volume of promotional lending business – loans, mezzanine and equity finance, including the ABS SME portfolio worth EUR 13.2 billion – fell slightly below the result of the previous year as investments under the ABS SME portfolio declined by EUR 0.4 billion, or nearly one-half.

STRONG DEMAND FOR LOAN PROGRAMMES – FEWER GLOBAL LOANS.

The lending operations of KfW Mittelstandsbank exceeded the previous year's result by 10%, with commitments totalling over EUR 11.2 billion. Business with global loans is subject to pronounced fluctuations, however, so that although the figure for 2007 – EUR 1.4 billion – was lower than the previous year's total of EUR 2.2 billion, this result is still very good.

The programme loans are a welcome indication that SMEs again invested more in their business last year. Demand for loans rose substantially. With commitments totalling EUR 9.0 billion, KfW's basic promotional programme for small and medium-sized enterprises, the KfW Entrepreneur Loan, made a major contribution to the good result achieved in SME promotion. Compared with 2006 commitments even increased by 48%.

The Entrepreneur Loan (*Unternehmerkredit*), is a core component of KfW's corporate finance lending. Since its introduction in September 2003 the Entrepreneur Loan available from KfW Mittelstandsbank has proved more than 100,000 times to be a low-interest and reliable source of financing for SMEs, self-employed professionals and start-up entrepreneurs. Altogether KfW has thus granted some EUR 26 billion in loans under this promotional programme since it was launched. This support benefits Germany's entrepreneurs and business founders as well as the economy as a whole. Long loan terms, favourable interest rates and initial repayment-free years ensure that companies can afford to make necessary investments. Through its Entrepreneur Loan KfW refinances a large share of the programmes offered by the promotional credit institutions of the federal states. As a result, the investment finance made available by the Federal Government and the federal states can be combined, providing ultimate borrowers with one-stop financing.

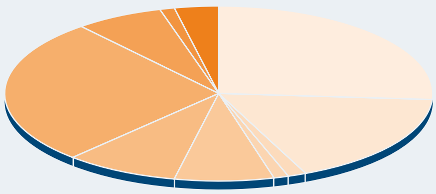
SURGE IN VENTURE CAPITAL – MORE MODERATE INCREASE IN MEZZANINE CAPITAL.

In the field of mezzanine finance commitments declined by nearly EUR 1 billion in 2007 over 2006, falling to EUR 1.2 billion. This decrease was ascribed primarily to the ERP Innovation Programme, which had been reintroduced in the year 2006 and generated strong demand one year later through especially favourable interest terms and conditions coupled with the possibility to eliminate an investment backlog.

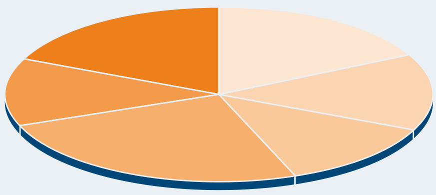
In 2007 KfW again played a significant role in strengthening Germany's equity capital market. Overall the bank provided approx. EUR 340 million (previous year: EUR 280 million) in equity finance for start-ups, young technology businesses and established SMEs. Although equity finance business accounts for only a small share of the commitments, it is particularly important because KfW is active primarily in the early phase, where there is far too little private investment due to the high degree of risk involved. Here KfW serves mainly as co-investor in order to leverage private capital and make financing possible. The mere fact that KfW is involved in about half of all SME equity financing operations clearly demonstrates the key role the bank plays in this area of financing.

Commitments by KfW Mittelstandsbank in 2007, by federal state[1)]

Western Germany



Eastern Germany



Federal state	Volume, EUR in millions[2)]
Baden-Württemberg	2,628
Bavaria	1,705
Bremen	128
Hamburg	127
Hesse	755
Lower Saxony	836
North Rhine-Westphalia	2,687
Rhineland-Palatinate	668
Saarland	108
Schleswig-Holstein	327
Western Germany	**9,970**
Berlin	211
Brandenburg	167
Mecklenburg-Western Pomerania	147
Saxony	297
Saxony-Anhalt	149
Thuringia	216
Eastern Germany	**1,186**
Other[3)]	172
Total	**11,328**

1) Not including global loans to commercial banks/ABS SME portfolio/securitisations.
2) Differences in the totals are due to rounding.
3) Not attributable to a federal state.

REGIONAL DISTRIBUTION.

The main regional focus of promotional activities was, as expected, on the large federal states of North Rhine-Westphalia, Baden-Württemberg and Bavaria. These three states accounted for three-fifths of all commitments made under lending programmes. Yet the eastern federal states also deserve mention. Loan commitments in these states rose by 50 % over the previous year to EUR 1.2 billion. This strong growth benefited Berlin, Mecklenburg-Western Pomerania and Saxony-Anhalt most of all, where commitments doubled in 2007.

“SMALL SMES” INITIATIVE.

Surveys and analyses carried out by KfW have shown that last year there was a clear improvement, not only in the economy and the business climate but also in the financing conditions for enterprises. This benefited the entire spectrum of SMEs. Yet businesses with less than EUR 1 million in turnover – which mainly seek small-scale loans, where the high share of fixed costs makes lending more difficult – still encounter difficulty much more frequently in obtaining financing.

KfW launched its “Small SMEs” initiative to continue improving the financing conditions for start-ups, small and micro enterprises. It encompasses an entire package of measures, including greater assumption of risk by KfW, additionally reduced interest rates, further development of equity finance offers and the expansion of advisory services. The following measures were already applied in 2007:

- Business start-ups and young enterprises make a vital contribution to economic growth. They create jobs and strengthen Germany’s international competitiveness. This is why KfW offers these programmes, under which businesses and young entrepreneurs are able to apply with their main business bank for a loan to help them get started. These primarily include the Mikro-Darlehen (microloan) and StartGeld (start-up funds) promotional programmes, in which KfW relieves the commercial banks of 80 % of the risk. To further strengthen this segment, at the beginning of 2007 KfW Mittelstandsbank reduced interest rates by one-third. As a result, the commitment volume under these two programmes increased by around two-fifths year-on-year. In early 2008 both programmes were combined to form the new KfW StartGeld programme.
- Through its mezzanine and equity finance programmes, KfW Mittelstandsbank has been helping to strengthen the equity base of German SMEs, which is still too low in international comparison. For this reason, at the start of the year KfW launched its KfW Equity-Mezzanine Programme. The particular feature of this programme is that the hybrid capital is shown in the balance sheet as equity, but for tax purposes the interest is treated as operating expenditure. The programme is offered to SMEs through investment firms.
- Since July 2007 KfW has been offering 50 % exemption from liability in its Entrepreneur Loan programme. This risk sharing between KfW and the commercial banks makes lending easier, benefiting SMEs. KfW and the bank or savings bank that ultimately grants the Entrepreneur Loan to the SME assume equal shares of the default risk. The SME does not incur any additional costs by applying for exemption from liability. If exemption from liability is approved, the applicant’s bank and KfW share the risk margin included in the interest rate. The interest rates for the Entrepreneur

Loan are risk-adjusted and agreed individually, as in the past, depending on the SME's creditworthiness and the value of the collateral provided. KfW Mittelstandsbank offers the 50 % exemption from liability offered in the Entrepreneur Loan programme as additional support for investment projects by SMEs and self-employed professionals who have been active in the market for at least two years. The extended promotional programme is open to entrepreneurs planning corporate investments such as financing for property and buildings, construction and rehabilitation measures, machines, office and other equipment. KfW also offers to share the risk for foreign investments financed under "Unternehmerkredit Ausland" (Entrepreneur Loan for investments outside Germany).

- Special business start-up programmes that include risk sharing by KfW Mittelstandsbank are available to start-ups and young enterprises. Having easier and broader access to mezzanine capital is vital for small businesses. This cross between debt finance and equity finance in the form of subordinated loans enables businesses to increase their equity ratio in the medium term and, ultimately, to improve their creditworthiness.

ENCOURAGING TECHNOLOGY TRANSFER AND START-UP DYNAMICS.

As an export-oriented, high-wage country, Germany needs a high degree of technological innovative capability and efficiency in order to remain internationally competitive and to create long-term jobs. Owing to the growing complexity of modern technologies, innovation activity is becoming increasingly concentrated in so-called clusters. A cluster is a geographical concentration of research institutes, intermediaries and companies from the same industry. These technological zones are characterised by diverse and intensive cooperation between industry and the sciences, thus contributing significantly to the transfer of technology.

As there are numerous start-ups in the high-tech field, and since the level of innovations by companies in this field is above average, cluster zones have a particularly high need for innovation and equity finance. One way to support the projects of business founders and innovators is to build up an innovation finance network. It uses available KfW instruments for start-up and innovation finance while increasing their profile in high-tech regions. The pilot project that was launched in 2007 will initially be tested for 18 months in four pilot regions (Magdeburg/Halle, Hamburg/Bremen, eastern Ruhr Basin, Rhine-Neckar region).

COOPERATION WITH SPECIAL CREDIT INSTITUTIONS OF THE FEDERAL STATES.

For years KfW has been cooperating closely and intensively with the special credit institutions of the federal states to the benefit of German SMEs. Pooling the promotional support offered by KfW and that of the state credit institutions improves the conditions for the individual state programmes through a contribution by the Federal Government and by the federal state. Their 'common' customer benefits whenever the loan programmes are congruent in terms of their priority support areas and target groups. The joint refinancing of promotional products is also clearly stated in outside communication.

KfW Mittelstandsbank offers the state promotional institutions programme-based, reduced-interest refinancing for promotional loans in the form of global loans.

To date global loan agreements have been concluded between 14 state credit institutions and KfW Mittelstandsbank for a volume of EUR 17 billion, nearly one-third of which (EUR 5.3 billion) in 2007.

GLOBAL LOANS TO COMMERCIAL LOANS IN GERMANY AND WESTERN EUROPE REMAIN KEY FACTORS IN SME FINANCE.

Extending global loans to commercial banks in Germany and western Europe remains a cornerstone of KfW's support for the SME sector. Altogether, global loan agreements with a volume of EUR 1.3 billion were concluded in the year under review. The main regional focus of these agreements was Germany. Apart from expanding existing partnerships, in 2007 the primary aim was to find new partner banks. As a result, three contracts were signed with business partners who had not yet received any global loans from KfW. Thus, KfW's support for the SME sector throughout Europe now has a broader base.

GLOBAL LOANS TO BANKS IN CENTRAL AND EASTERN EUROPE ARE WELL POSITIONED TO SUPPORT SMES.

For many years KfW Mittelstandsbank has been offering global loans to refinance local commercial and promotional banks in Central and Eastern Europe. In this way it contributes to the development of the local financial sector and, through various promotional programmes, helps SMEs in these countries to meet the challenges of a growing European market. Altogether EUR 213 million in global loans was committed in 2007. Of this amount, EUR 178 million went to support SMEs.

THE EU'S SME FINANCE FACILITY.

The Finance Facility for small and medium-sized enterprises is an essential part of KfW's financing for SMEs in Central and Eastern Europe. The cooperation with the EU Commission and the Council of Europe Development Bank (CEB) began in the year 2000. The loans offered by local banks to SMEs in the new Member States could be improved through this facility.

For this purpose, global loans from the CEB/KfW are combined with grants from the EU Commission. Since 2000, a total of 50 projects worth EUR 725 million have been concluded with grants totalling over EUR 81 million. In the year 2007 KfW carried out six projects for altogether EUR 62 million that were combined with EUR 7.9 million in EU grants.

Under the Preparatory Action Plan, in 2007 KfW concluded a further project in Poland for EUR 5 million that focuses on microlending. This promotional programme, which was launched in 2005 by the European Commission, CEB and KfW, aims at improving the credit supply for small and micro businesses.

SECURITISATION.

Despite the crisis afflicting the securitisation markets since summer 2006, in 2007 KfW Mittelstandsbank was able to achieve a record volume of approx. EUR 10 billion in synthetic securitisations of SME loans on its PROMISE platform. Since summer 2007 it has become extremely difficult for banks to carry out securitisation transactions. Compared with past years, in the overall market a far smaller volume of transactions was conducted at far higher prices.

Numerous banks have since shifted their business model toward securitisation. Placing SME risks in the international capital market enables the securitising banks to offer their SME clients not only more loans but also better conditions. A bank that applies securitisation as part of its active risk management strategy can concentrate on its core business, namely SME lending, and serve as a reliable financing partner for its small and medium-sized clients. In its 2007 "Round Table between Banks and SMEs" report the European Commission expressly praised the positive effects of securitisation on the supply of credit available to the SME sector.

In the difficult situation that pervaded the year 2007, the asset class "German SMEs" gave a solid performance. The losses from PROMISE transactions, which had been minimal, remained within expectations.

To avert any negative impact on lending for SMEs, the securitisation markets must recover as soon as possible. KfW, being a promotional bank, plays a key role in stabilising the primary and secondary markets in order to ensure loan financing for its target groups.

In addition to synthetic securitisation, KfW also invests in selected SME ABS under its ABS SME portfolio. In 2007 it assumed risks totalling some EUR 445 million from ten SME securitisation transactions, always making sure that the transactions were transparent and well structured.

Since the year 2000 a total of 26 transactions have been conducted via the synthetic securitisation platform PROMISE in which the risks from approx. 104,000 SME loans with a volume of EUR 46 billion have been transferred to the capital market. This enabled KfW Mittelstandsbank to play a vital role in developing Germany's securitisation market. In difficult situations, as is currently the case, KfW remains a reliable partner for the banks. It supports SME securitisation, partly through its PROMISE platform and partly through selected investments in mezzanine tranches under its ABS SME portfolio. KfW's aim is to help reopen the securitisation channel so that banks are able to place risks in the capital market while continuing to offer SMEs loans at favourable conditions.

Promotion of the German and European economy by KfW Mittelstandsbank

Commitments, EUR in millions[1)]

Programmes	2006	2007	Purpose
Volume of promotional funding KfW Mittelstandsbank	22,816.0	23,248.3	
1, Promotional loans KfW Mittelstandsbank	13,346.5	13,210.0	
a) Loan financing	10,145.5	11,211.8	
■ Unternehmerkredit (Entrepreneur Loan)	6,096.2	8,992.1	Investment financing for start-ups and SMEs
■ Global loans to commercial enterprises in Germany and Europe	3,631.9	1,437.0	Global loans to banks to finance SMEs
■ KfW Acquisition Finance	77.7	232.0	Financing for corporate takeovers
■ StartGeld (start-up funds) and Mikro-Darlehen (microloan)	107.6	150.6	Financing for start-ups and small enterprises
■ ERP Programmes	227.1	400.2	Improvement of the regional economic structure, funds for guarantee banks
b) Mezzanine financing	2,139.6	1,214.0	
■ Unternehmerkapital (Entrepreneur Capital)	506.2	506.8	Mezzanine finance to support start-ups and SMEs
■ ERP Innovation Programme	1,633.5	707.2	Mezzanine finance to support innovative projects by small and medium-sized enterprises
c) Equity finance	280.8	339.4	
■ KfW Venture Capital Programme (financing for equity participation funds)	141.8	164.0	Participations in enterprises through venture capital funds co-financed by KfW
■ ERP Programmes	120.5	160.5	Private equity for small and medium-sized enterprises
■ Other	18.6	14.9	Financing for corporate takeovers, profit participation capital, venture capital
d) ABS SME portfolio	780.6	444.8	Investments in securitisation transactions of SME loans
2. Guarantees and securitisations KfW Mittelstandsbank	9,469.5	10,038.3	Hedging and securitisation of SME loans
■ Securitisations	9,442.4	10,022.3	
■ Promotional loan guarantees	27.2	16.0	

[1)] Differences in the totals are due to rounding.

FINANCING ADVICE.

KfW Mittelstandsbank supports small and medium-sized enterprises by offering not only favourable financing but also individual advice. This assistance covers all stages of business development, ranging from the start-up to the growth phase and from the succession question to crises. Targeted advice is known to improve business performance, thus making it easier for enterprises to access capital. For this reason, since October 2006 KfW has been pooling all of its advisory activities in one area in order to even more effectively inform companies, multipliers such as chambers and associations as well as distribution partners in the banking industry about financing opportunities. For entrepreneurs and business founders KfW Mittelstandsbank offers up-to-date information on its financial products through practically all channels.

The main medium for providing information remains KfW Mittelstandsbank's website at www.kfw-mittelstandsbank.de. The site contains detailed information on the topics of financing and advice. More than one million visitors to the virtual start-up centre have received practical tips on becoming self-employed or, under "Loans", have studied detailed examples of financing through the loan programmes offered by KfW Mittelstandsbank.

Additionally, KfW Mittelstandsbank's Infocentre offers interested callers individual advice. Last year nearly 110,000 callers followed up on this offer. For all those who prefer person-to-person advice, KfW Mittelstandsbank offers the opportunity to seek advice on its products at its locations in Berlin, Bonn and Frankfurt. In 2007 some 1,300 clients visited the advisory centres at all three locations.

KfW Mittelstandsbank also offers personal advice nationwide at more than 50 locations. Together with chambers of industry, commerce and trade and business promotion associations, KfW offers this service to business founders and young entrepreneurs but also to companies that have already been active in the market for quite some time. The broad network of advisory offers made it possible to answer clients' questions about financing in over 2,300 personal advisory sessions.

START-UP COACHING IN GERMANY – A NEW PROMOTIONAL PROGRAMME.

The "Start-up coaching in Germany" programme was launched in October 2007. This new promotional programme is a joint venture by the German Federal Ministry of Economics and Technology and KfW Mittelstandsbank. It furnishes young businesses with grants financed by the European Social Fund (ESF) for up to five years after their start of business to cover the costs of a suitable management consultant. Not only does it make entering self-employment easier, but it also encourages companies to seek advice from top-quality consultants, which in turn reinforces the growth and innovative strength of the SME sector. Nearly 600 commitments have been made since the start of the programme.

At round tables self-employed entrepreneurs and SMEs obtain much-needed support in times of trouble. At these meetings professional crisis managers identify possibilities for a turnaround. Participating enterpreneurs do not incur any costs for this advice – they are covered by KfW Mittelstandsbank. Last year alone nearly 3,000 businesses attended the round tables.

SPECIAL ADVISORY SERVICES.

Apart from the two priorities of advice and advisory support, KfW Mittelstandsbank also makes supplementary offers. For instance, KfW supports businesses in their search for a suitable advisor, a liquid investor, a partner or an adequate successor.

This includes the internet platform www.nexxt-change.de, which provides advice on all issues relating to business succession. Innovative, fast-growing enterprises can present themselves on an internet platform of the German Equity Forum to find potential equity investors. The online service 'KfW Consultant Exchange' was devised in collaboration with the Federal Ministry of Economics and Technology. This exchange enables SMEs from all over Germany to search for a suitable advisor for their company from among some 10,000 experts. In early 2007 KfW undertook an extensive evaluation of its Consultant Exchange (www.kfw-beraterboerse.de) from a user's perspective. The results of this study show that especially chamber advisors rate the KfW Consultant Exchange highly, and two-thirds consider it to be a useful instrument that helps to arrange business advice. The users surveyed also assigned a high rating to the concept of allowing the clients to evaluate their advisors once the advice has been completed.

The "Startothek" is a further offer open to up-and-coming entrepreneurs to clarify all legal issues that arise in connection with the foundation of a business.

KfW Mittelstandsbank is also involved in providing further training for staff from banks, chambers of commerce and consulting firms. Various seminar series by the KfW Academy provide expert knowledge on current SME topics. Last year around 1,500 people took part in 27 academy events.

Giving credit to commitment.

KfW Förderbank provides financing in the areas of environmental protection, housing, infrastructure and education. Funds are available to municipalities, enterprises and private individuals in Germany. For example, KfW Förderbank provides funds for private housing construction, the renovation and modernisation of residential property and the use of renewable energies. Funds are also available to finance academic studies and further vocational training. In the KfW Environmental Protection Programme and the ERP Environment and Energy Conservation Programme, support is provided for investments by small and medium-sized enterprises carrying out environmental protection measures. In the field of infrastructure, finance is provided for all types of municipal investment as well as housing and non-profit projects and institutions.

Two managers who are bringing a highrise to the lowest energy level.

The renovation and modernisation of the double highrise in Berlin Lichtenberg was concluded in March 2007. The renovation of the building belonging to the Berlin housing company HOWOGE Wohnungsbaugesellschaft took place as part of the joint pilot project of the German Government, dena and KfW entitled "Efficient Homes" and was financed by KfW Förderbank with funds from its CO_2 Building Rehabilitation Programme. Funding was also provided through KfW's Housing Modernisation programme for repair and modernisation work performed in the building. HOWOGE managers Hans-Jürgen Adam and Bernd Kirschner are proud of the results. The old prefabricated concrete building with its 296 flats

and 18,000 m^2 of floor area meets modern environmental standards and has become Germany's largest low-energy building. New insulation, triple-glazed windows, state-of-the-art ventilation technology with heat recovery, new heating surfaces and the installation of a block heat and power unit all reduced energy costs by about 50 %. 100% of the units are now rented. This benefits the investor and residents. With average modernisation costs of 77 cents/m^2, even after the renovation the tenants are still seeing green. Through its support KfW has built a bridge between ecological necessity and economic feasibility – banking on the fact that many other building owners will be taking the green road, too.

An energy manager who goes through the roof for climate protection.

Bringing together economic and ecological interests is not always easy - unless you take part in the KfW Carbon Fund, which has become an established part of the European Emissions Trading System. KfW purchases emission certificates from climate protection projects worldwide for companies that produce more CO_2 than they are allowed, or that would have to pay far more to further reduce their CO_2 emissions. One such company is HEAG Südhessische Energie AG (HSE). For Dr Henning Prüß, Head of Asset Management – Systems, technically the CO_2 emissions of HSE's five fossil-fired production systems can hardly be reduced any further. Yet in order for the company to fulfil its obligations under the EU's Emissions

Trading System, with the help of the Carbon Fund HSE is buying emission certificates from developing countries to offset its CO_2 emissions. HSE also invested heavily in environmentally friendly energy production at its own facility. By increasing its own production capacity and by investing some EUR 400 million in renewable energies, the company is setting an example. A showcase project of its subsidiary NATURpur is the largest solar system in the city of Darmstadt – installed on the roof of the Darmstadtium, the city's well-known Science and Congress Centre. 408 solar modules covering 564 m^2 generate up to 73.44 KW of energy that is fed into the grid. The system reduces CO_2 emissions by around 33 t every year.

37,000 STUDENTS IN GERMANY BENEFIT FROM THE KFW STUDENT LOAN.

KfW Förderbank introduced the Student Loan in April 2006. Within one year, already more than 23,000 students were using it to finance their education and, by the end of 2007, this figure grew to nearly 37,000. Monthly repayments become due once the student begins his or her career. Depending on the income situation, repayment can be extended over a period of up to 25 years. KfW Förderbank has been financing investments in basic and advanced training and education for young adults for over 10 years. During this time more than 500,000 students and qualified experts have been able to finance their education and training with KfW's help.

EUR 1.3 BILLION FOR SOLAR POWER.

Commitments under KfW Förderbank's "Solar Power Generation" programme have reached the EUR 1.3 billion mark. The funds were granted to private investors for over 40,000 small photovoltaic systems. 338 MW systems have thus been financed since 2005 and produce enough to supply more than 77,000 households with power. Larger facilities are co-financed through the ERP Environmental Protection and Energy Saving Programme and the KfW Environmental Protection Programme. Municipalities can obtain financing for their photovoltaic systems under the KfW Municipal Loan Programme.

2007 KFW ENERGY EFFICIENCY AWARD FOR COMMERCIAL BUILDINGS.

In Frankfurt KfW Förderbank presented its 2007 KfW Energy Efficiency Award, which ran under the motto "Modernisation of energy systems in commercial buildings". Total prize money of EUR 15,000 was split among three companies to commend their innovative solutions for the modernisation of energy systems. The measures they introduced significantly reduce their energy consumption. The aim of this award is to encourage other companies to identify and exploit energy saving potentials.

KFW AWARD FOR URBAN LIVING.

For the fifth time KfW Förderbank granted the KfW Award for innovative, promising projects by private builders. The motto for the 2007 award, which was worth EUR 27,000, was "Rediscovering the city – urban living in your own home". The jury selected projects in which private investment in new buildings, conversion or renovation helped raise the value of an entire city district.

SUPPORT FOR ENVIRONMENTALLY FRIENDLY HEAVY COMMERCIAL VEHICLES.

Starting 1 September 2007 KfW Förderbank has been offering loans for the purchase of low-emission heavy commercial vehicles. The loan interest rate is further reduced by up to 1.5 percentage points through funds from the BMVBS. Non-redeemable grants of up to EUR 4,250 are also available. The funds are being provided for the purchase of heavy lorries with a total permissible load of 12 tonnes and more which are intended solely for goods transport and, when first registered in Germany, comply with an emissions standard that is higher than the one currently in force.

KFW FÖRDERBANK.

KfW Förderbank is committed to many fields. It combines the most diverse activities under one roof – from residential and municipal infrastructure financing to support for environmental and climate protection measures all the way to financing for initial and further education and training. KfW Förderbank's commitments in 2007 reached the sum of EUR 43.5 billion, the highest ever. This result exceeded the previous year's by 22 %. The promotion of the purchase of low-emission, heavy commercial vehicles and the granting of global loans in Germany and Europe contributed significantly to this increase. Of the total commitments, around EUR 7.2 billion were provided for industrial pollution control and EUR 1.3 billion for investment in education. EUR 14.6 billion were committed for housing and EUR 3.1 billion for municipal investment. EUR 8.3 billion in global loans for general refinancing of the promotional institutions in the German federal states and various securitisation transactions amounting to EUR 8.9 billion overall were added to the loan programmes.

Commitments of KfW Förderbank in 2007, by federal state
EUR in millions[1)]

Federal state	KfW Förderbank[2)]			
	Total	Environmental financing	Housing Investments	Minicipal infrastructure
Baden-Württemberg	3,242	860	1,984	398
Bavaria	3,954	1,242	2,378	334
Bremen	202	49	112	41
Hamburg	837	50	382	405
Hesse	1,636	486	924	227
Lower Saxony	2,092	797	1,086	209
North Rhine-Westphalia	4,496	891	3,039	566
Rhineland-Palatinate	1,103	412	585	106
Saarland	246	123	108	15
Schleswig-Holstein	983	392	504	87
Western Germany	**18,792**	**5,302**	**11,102**	**2,388**
Berlin	809	53	437	320
Brandenburg	968	551	340	77
Mecklenburg-Western-Pomerania	438	259	148	30
Saxony	776	349	352	74
Saxony-Anhalt	755	418	206	131
Thuringia	414	205	157	52
Eastern Germany	**4,160**	**1,834**	**1,640**	**685**
Outside Germany	**66**	**66**	**–**	**–**
Total	**23,018**	**7,203**	**12,742**	**3,073**

1) Differences in the totals are due to rounding
2) Excluding education finance, global loans to commercial banks, general refinancing for promotional institutions of the federal states and securitisations

INITIATIVE TO PROMOTE 'HOUSING, ENVIRONMENT, GROWTH' CONTINUED SUCCESSFULLY.

The Federal Government launched the promotional initiative "Housing, Environment, Growth" together with KfW in February 2006. It is part of the Government's Growth and Employment Programme. The initiative was a success in 2007, too. In addition to the loan programmes aimed at promoting municipal infrastructure, it also covers KfW's housing programmes. Energy-efficient construction and renovation is at the core of the initiative. In 2007 KfW Förderbank committed 220,000 loans for a total of EUR 15.8 billion under this initiative. Investments in housing were financed with 218,000 loans totalling EUR 12.7 billion. These notable results also demonstrate that German homeowners are quite willing to make a double contribution – to saving energy as well as to protecting the climate. This way they contribute significantly to the German Government's climate protection programme, too. KfW Förderbank supports their efforts.

PROMOTION OF ENERGY-EFFICIENT CONSTRUCTION AND REHABILITATION.

KfW Förderbank granted loans for EUR 5 billion under its "energy-efficient construction and rehabilitation" programmes in 2007. Activities were expanded and improved in several areas this year.

At the start of the year, for example, a grant variant was added to the KfW CO_2 Building Rehabilitation Programme. Private owners of single or two-family houses have since been eligible for grants to complement the financeable investment costs.

Additionally, since the end of December owners of single-family and two-family houses can apply to KfW Förderbank for a grant towards construction supervision if the building project is being financed either as a loan or as a grant variant under the CO_2 Building Rehabilitation Programme. The success of the projects will depend very much on whether they are of high quality. To qualify, the building must be rehabilitated at least at new-property level in accordance with the German Energy Conservation Ordinance (EnEV) or at an even better energy level.

Due to its great importance for the German Federal Government's climate protection goals, the Federal Cabinet decided last August in Meseberg to continue the programme package for 'energy-efficient construction and rehabilitation' at its current level until 2011. Under the CO_2 Building Rehabilitation Programme, the energy conservation of existing urban structures is to be optimised in cooperation with the housing and energy industry.

KfW Förderbank and the German Federal Ministry of Transport, Building and Urban Affairs commissioned two studies to evaluate the impact of their promotional measures. These were the CO_2 Building Rehabilitation, the Housing Modernisation (ÖKO-PLUS variant) and the Ecological Construction programmes, which are combined under the sphere of energy-efficient building and renovation. The studies were performed by a scientific consortium headed by Bremer Energie Institut (BEI) and by the Fraunhofer Institute for Building Physics (IBP). According to their evaluation, the investments financed in 2006 alone achieved a long-term reduction in CO_2 emissions of over 1 million tonnes per annum. Together with the measures promoted in 2007, annual CO_2 emissions were reduced sustainably by some 1.6 million tonnes. Figures for 2007 are based on a preliminary estimate. A further scientific study is currently under way to determine more accurately the CO_2 reductions achieved in 2007. Continuing the programme will thus contribute significantly to achieving the energy and climate targets set in Meseberg. Without these targets, which are an indispensable component of Germany's climate protection efforts, the international commitments cannot be met.

Among the KfW programmes for energy-efficient building and rehabilitation, the CO_2 Building Rehabilitation Programme particularly stands out. Three-fourths of rehabilitation projects were related to heating modernisation, and in roughly one-third of these cases biomass boilers were installed. Thermal solar systems were fitted in roughly 30 % of the buildings as part of the upgrading process. Almost all coal-fired heating systems and night storage heaters, which are particularly harmful to the climate, were replaced under the measures to upgrade heating systems. External wall insulation was the target of financing for 66 % of the borrowers. All in all, the renovation measures promoted in 2006 led to annual energy savings of more than 40 %. As a result, the programme not only enhances the energy efficiency of the buildings but also advances the use of renewable energies in the heating sector.

The studies also revealed the positive impacts on the German job market - the investments that were financed secured more than 220,000 jobs in 2006, mostly in the small and medium-sized construction and crafts industry.

In general, the results of the studies show that the programmes in the sphere of energy-efficient building and renovation generate a threefold return. First, they bring about a distinct reduction in the emission of harmful greenhouse gases – which protects the climate. Second, they lead to a reduction in the consumption of expensive fossil fuels such as oil and natural gas. This reduces household energy costs and makes Germany less dependent on oil and gas imports, which are steadily becoming more expensive. Third, the renovation measures stimulate domestic demand. This creates new jobs, especially in the crafts sector, which consists predominantly of SMEs.

FINANCIAL SUPPORT FOR OWNER-OCCUPIED HOUSING.

KfW's home finance continues to attach high priority to supporting owner-occupied housing. A large number of people consider owning their own home a fundamental building block of private retirement plans. Under its Home Ownership Programme KfW committed 92,000 loans in 2007 – an overall volume of EUR 5.3 billion. Most of the loans were granted for the purchase and modernisation of second-hand houses and apartments. The commitment volume thus grew by one-fifth over the previous year despite the removal of tax concessions for homeowners and the restrained mood in the new construction industry. Owner-occupied housing also plays a special role in urban development. In 2007 we therefore dedicated the annual KfW award "Rediscovering the City – Living Urban Style in your own Home" to owning a home in the city. The award was given for forward-looking projects for new homes or conversions implemented by private homeowners who opted for a home in the city in the past five years, thus contributing to enhancing the value of the cities. More information is available at www.kfw-foerderbank.de/EN.

MUNICIPAL INFRASTRUCTURE.

A well-developed municipal infrastructure is a prerequisite for a country's economic prosperity. What enhances the value of a location is not only the extensive technical networks that provide water and energy, sewerage and transport but, in particular, local infrastructure facilities such as child daycare centres, schools, hospitals and sports or cultural facilities. Municipalities and their investment in regional infrastructure therefore form the basis for growth in Germany.

KfW supports municipalities in their investment projects. The "KfW Municipal Loan" targets municipal investors to finance these infrastructure measures. The programme "Municipal Investment" supports enterprises that are majority owned by municipalities while the KfW programme "Social Investment" provides funds to non-profit investors for the improvement of social infrastructure. In 2007 these three programmes financed more than 1,600 projects with a volume of around EUR 3.1 billion.

In order to continue reducing energy consumption KfW further developed the promotional initiative "Housing, Environment, Growth". Both infrastructure programmes "KfW Municipal Loan" and "Social Investment" now have a further window entitled "Energy-saving Rehabilitation of Buildings". This window offers financing at particularly favourable conditions for measures that reduce the energy consumption and CO_2 emissions of buildings.

INDUSTRIAL POLLUTION CONTROL AND CLIMATE PROTECTION.

KfW finances pollution control as well as climate and resource protection measures applied by commercial investors under the ERP Environmental Protection and Energy Conservation Programme and the KfW Environmental Protection Programme. The co-financed projects range from energy-saving measures to the use of renewable energy sources all the way to investment in air pollution control, sewage treatment and solid waste prevention. In 2007 the volume of loan commitments under the two programmes was EUR 4.5 billion overall, an increase of approx. 12% on the year.

With the aim of reducing pollution caused by road transport, KfW defined an additional promotional priority in 2007. The objective is to support the procurement of low-emission, heavy commercial vehicles. Since 1 September 2007 KfW Förderbank has been supporting the procurement of new lorries with a maximum total permissible load of up to 12 tonnes. The vehicles must be intended solely for goods transport, and, when first registered in the Federal Republic of Germany, comply with an emissions standard that is higher than that currently in force (at present the EURO V emissions category). They can be financed either in the form of low-interest loans from the ERP Environmental Protection and Energy Conservation Programme together with interest reductions provided by the Federal Ministry of Transport, Construction and Urban Affairs (BMVBS) or, alternatively, from non-repayable grants provided by the BMVBS. Both cases give owners or holders of heavy commercial vehicles an incentive for modernising their vehicle fleet very early by purchasing low-emission vehicles despite added costs. The attempt has been successful, with around 25,100 lorries financed under the new promotional programme in the first four months. As demand for the promotional programme has been high and the available budget funds are limited, KfW had to suspend commitments in January 2008 until further notice. The BMVBS is working on a solution together with the Federal Ministry of Finance and the parliamentary groups of the coalition in order to continue this support.

Together with the Federal Ministry for Economics and Technology KfW launched the "Special Fund for Energy Efficiency in SMEs" in the first quarter of 2008 to support small and medium-sized enterprises in enhancing their energy efficiency. Advice and financing are closely linked under this programme. KfW provides grants for qualified energy advice in order to better inform SMEs on their energy saving potential. KfW offers reduced-interest loans under the new ERP Energy Efficiency Programme in order to provide commercial enterprises with an incentive to invest in energy conservation.

THE PROMOTION OF RENEWABLE ENERGIES – A CROSS-CUTTING TASK.

KfW supports the expansion of renewable energies with an entire range of promotional programmes. All of them aim to reduce harmful greenhouse gas emissions, to create new jobs and to reduce Germany's dependence on fossil fuel imports. Therefore, EUR 3.8 billion in loans at favourable interest rates were committed to promote renewable energies in 2007. This was a year-on-year increase in the lending volume of nearly one-fifth.

The use of renewable energies for heating is a key element towards sustainable energy supply.

The Federal Cabinet decided on 5 December 2007 to significantly increase and expand the programme of market incentives for renewable energies in an effort to meet this objective faster. The programme consists of a KfW component – namely the KfW Renewable Energies programme – and a component from the Federal Office for Economics and Export Control (Bundesamt für Wirtschaft und Ausfuhrkontrolle/BAFA). It has already become the central instrument for promoting the expansion of renewable energies in the heating sector. Up to EUR 350 million are available in 2008 for the market incentive programme [EUR 213 million in 2007]. From 2009 the Federal Government will make available up to EUR 500 million. This increase and the additional budget funds will enable KfW to significantly improve its promotion of deep geothermics and heating networks in 2008. The promotion of large solar collectors for hot water, room heating, process heat or refrigeration, which was introduced last year, will also continue. Owners of particularly low-emission biomass heating systems will be eligible for a bonus. The promotion of heat-led CHP biomass plants and large innovative heat storage facilities will be expanded as well. In addition, plants for upgrading biogas into natural gas quality and biogas pipelines for unprocessed biogas are to be promoted in the future.

KFW CARBON FUND.

In 2007 the Member States of the European Union submitted to the EU Commission their national allocation plans for the second phase of the European Emissions Trading Scheme. As a result of intensive negotiations the plans provide for some considerable cutbacks in comparison with the first phase. This applies to the energy sector in particular, but also to the industries covered by the emissions trading scheme. For the first time the allocation of emission rights is no longer free of charge. In Germany, initially 40 million emission rights are to be sold in the market or auctioned by 2010 at the latest. The Federal Government commissioned KfW to manage the sale.

The use of carbon certificates from foreign projects expands the scope of enterprises substantially. All Member States have considered this option in their allocation plans. In Germany 20 % of the emission rights requiring substantiation can be covered by foreign certificates. This represents a volume of 90 million tonnes of CO_2 per year. Throughout the EU around 280 million tonnes of CO_2 can be covered by certificates. In the future these certificates will thus play an important role in the enterprises' CO_2 strategy.

KfW increased the sale of such certificates further in 2007. It acts in the interest of companies wishing to use them to fulfil their obligations under the European Emissions Trading Scheme. KfW thus provides services principally to companies that have no access to foreign projects or that do not intend to develop such capacities of their own.

By the end of 2007 the first tranche of the KfW Carbon Fund with a volume of approx. EUR 84 million was utilised in full for projects that will generate some 8.2 million certificates for the participating companies up to 2012. Overall, around 10 million emission certificates were purchased in 2007. They are being used to finance around 30 projects implemented primarily in the areas of renewable energies and energy efficiency. The sale of these certificates is an important source of income without which such projects would usually not be possible. A second purchase programme was launched together with the European Investment Bank (EIB) in 2007. It has a volume of EUR 100 million. This second programme is to be fully implemented by the end of 2008.

The further development of the market will ultimately be determined by the prospects beyond the year 2012. Whereas the Climate Change Summit held in Bali in December 2007 failed to send out clear signals, the EU Commission has committed itself repeatedly to continuing emissions trading beyond the year 2012. KfW and the EIB have decided to establish the Post-2012 Carbon Fund together with other European promotional banks. This fund will buy up emission certificates that will be generated after 2012. It will start operating in spring 2008. The fund will offer environmental projects a reliable basis for planning which they urgently need while sending out a clear confidence-building signal to the commercial actors in the market.

KfW's activities already support the Federal Government's climate protection programme as well as German and European industry in applying the instruments established for commercial enterprises under the Kyoto Protocol. KfW therefore intends to increase its purchase activities over the coming years as well and to continue focusing on innovative areas.

EDUCATION FINANCE – KFW STUDENT LOAN IS FIRMLY ESTABLISHED.

KfW has a broad range of education finance products on offer. In addition to the so-called Meister-BAföG that provides assistance for master craftsmen trainees, the "Bildungskredit," or Education Loan, and the BAföG bank loans for education and training, the KfW Studienkredit, or Student Loan, plays a particular role. In 2007 the Student Loan again accounted for the largest share of KfW's education finance, with commitments made to more than 18,000 students. Thus, since the programme was launched in April 2006 around 37,000 students in Germany have financed their living expenses with support from KfW Förderbank. The Student Loan improves educational opportunities and shortens study times because it makes it easier for young people to finance their studies. KfW grants the Student Loan irrespective of the field of study and parental income. Disbursed monthly in the range of EUR 100 – 650 for a maximum of ten semesters, it supplements the classic sources of funds, such as parents, BAföG or scholarships. Students can now concentrate fully on their studies without having to earn a living by doing odd jobs that often draw out the time they need to complete their studies.

On behalf of several federal states KfW Förderbank also offers financing to cover the cost of tuition. In the reporting year KfW signed agreements with two more federal states, so that around 11,000 tuition fee loans were extended in Bavaria, Lower Saxony, Hamburg and Saarland in 2007.

The introduction of the KfW Student Loan shifted demand away from the Education Loan, which finances students nearing the end of their studies. Commitments for this type of loan declined by more than half to around 7,900.

The overall volume of education finance made available in 2007 amounted to EUR 1.3 billion. Since it started to offer education finance KfW has committed loans totalling EUR 7.2 billion. Almost 580,000 students and trained experts have since applied for these loans.

COOPERATION WITH LANDESFÖRDERINSTITUTE.

KfW has been cooperating intensively and trustfully with the promotional institutions in the German federal states. It pursues the goals of pooling federal and state promotion as well as making the promotional landscape more transparent and more attractive for the ultimate borrowers. Global loans fulfil various purposes such as making promotional measures more favourable, for instance for the construction of housing and infrastructure and for energy-efficient building rehabilitation. In the reporting year KfW Förderbank signed 28 agreements with 11 promotional institutions of the federal states for a volume of EUR 7.4 billion, thus achieving an overall volume of EUR 28.9 billion so far.

The activities of a promotional bank also include intensive and close cooperation with the special credit institutions of the federal states. Apart from programme-based 'KfW funding' we also offer them funds for their promotional projects within the context of so-called 'general financing'. In this way, federal and state support is combined and rendered more effective. Demand for such general financing was strong in 2007 – our commitments more than doubled over 2006, reaching EUR 8.3 billion.

This KfW funding offer was particularly well received by the special credit institutions of the eastern German federal states. They accounted for EUR 2.5 billion of the global loan volume.

INTENSIFIED COOPERATION WITH EASTERN EUROPEAN PROMOTIONAL BANKS.

In July 2007 KfW signed agreements with the development banks of Poland, Latvia and Estonia. KfW will advise these development banks and the respective governments in the structuring and implementation of broad-based loan programmes aimed at promoting energy efficiency investment in existing homes. The new EU Member States are eligible for financing in the form of EU structural funds for the first time since the beginning of the year. These funds enable the promotional financing to be applied in combination with attractive lending conditions in a sustainable way. If the development banks or governments introduce such broad-based promotional programmes, the energy savings achieved in existing homes in Central and Eastern Europe would make an important contribution to protecting the climate.

GLOBAL LOANS FROM KFW FÖRDERBANK WILL FOCUS ON CLIMATE PROTECTION IN THE FUTURE.

In 2007 KfW granted global loans totalling EUR 1.9 billion to commercial banks in Germany and Western Europe. In the future the entire global loan business will focus on KfW's promotional themes of reducing CO_2 emissions and enhancing energy efficiency. Many banks in Europe intended to become more active in this field. KfW therefore supports lenders with its funding instruments and long-standing experience in financing environmental protection investment.

FINANCE FACILITIES OF THE EU IN CENTRAL AND EASTERN EUROPE – FOCUSING ON ENERGY EFFICIENCY.

Cooperation among the European Commission, the Council of Europe Development Bank (CEB) and KfW was further enhanced by the development of an energy efficiency programme in 2007. Complementing the existing financing option for municipal infrastructure, the main purpose of the new facility is to finance investment aimed at rational energy use and CO_2 reduction. The programme is being offered in Romania, Bulgaria and Croatia. It is composed of global loans combined with EU grants. In March 2007 a framework agreement was signed with the European Commission and the CEB for a loan volume of EUR 92 million and a grant volume of EUR 23 million.

The EU finance facility for municipal infrastructure projects also developed successfully. A total of 12 projects with a global loan volume of EUR 185 million and grants amounting to EUR 18 million have already been implemented.

SECURITISATION.

In spite of the crisis in the securitisation market KfW Förderbank concluded four transactions totalling EUR 8.9 billion in 2007. Two transactions were concluded in the second half of 2007. Since 2001 the risks of around 1.2 million real estate loans amounting to around EUR 75.9 billion have been transferred to the capital market through the synthetic securitisation platform PROVIDE in a total of 42 transactions. This has given the originators considerable scope for new lending to their customers without the synthetic securitisation impairing customer relations. The reason is that in KfW's synthetic loan securitisation the securitised loans remain in the bank's balance sheet. Only the loan risks are passed on to the capital market.

KfW Förderbank's securitisation transactions generally performed well overall. The transactions are based on loans which German and European banks granted to their customers in the private housing sector and infrastructure finance against very stringent lending standards. This is reflected by correspondingly low default rates. So far losses from the underlying loan portfolios have only affected the first lost pieces. In a general view of all transactions, losses are in line with expectations overall. Most of the PROVIDE transactions have a high rating stability. Besides, the German real estate market proved to be resistant to signs of overheating, which were evident in other real estate markets over the past years. This ultimately supported PROVIDE transactions, which are primarily based on German mortgage loans.

In addition to the tried and tested securitisation of real estate loans, KfW Förderbank expects to see demand for public-private partnership projects and for securitisation in the areas of renewable energies, environmental and resource protection in 2008. New asset categories, however, can only be established on KfW's securitisation platforms if investors regain confidence and the banks are able to place their securitisation transactions in the capital market again at acceptable conditions. KfW will make the synthetic securitisation platforms more flexible and will increase its support for smaller-scale transactions as well in order to continue supporting lending to its groups of customers.

Promotion of the German and European economy by KfW Förderbank
Commitments, EUR in millions[1)]

Programmes	2006	2007	Purpose
Volume of promotional financing KfW Förderbank	35,548.1	43,526.0	
1. Promotional loans KfW Förderbank	27,906.6	34,592.6	
a) Environmental protection investments	4,609.6	7,203.1	
■ KfW Environmental Protection Programme	1,185.2	1,507.3	Environmental protection projects
■ ERP Environmental Protection and Energy Conservation Programme	2,870.5	3,031.3	Environmental protection projects in Germany
■ Solar Power Generation/KfW Programme to Promote Renewable Energies	553.8	415.5	Photovoltaic systems/measures to promote renewable energies
■ Acquisition of low-emission commercial vehicles	–	2,249.1	Low-emission lorries
b) Housing	15,147.4	14,642.4	
■ Housing Modernisation	3,868.6	3,278.3	Modernisation and rehabilitation of housing
■ KfW Home Ownership Programme	4,397.3	5,262.5	Construction and purchase of owner-occupied housing
■ CO_2 Building Rehabilitation Programme	3,472.2	2,100.5	Packages of measures to reduce CO_2 emissions in old residential buildings
■ Ecological Construction	2,208.6	2,101.2	Construction of new low-energy houses
■ Global loans for housing in Germany and Europe	1,200.0	1,900.0	Global loans to banks to finance housing investment
c) Municipal infrastructure	3,211.7	3,111.8	
■ KfW Municipal Loan/Social Investment/ Municipal Investment	3,167.9	3,044.4	Infrastructure measures by municipalities, non-profit organisations and municipal enterprises
■ KfW Municipal Loan/Social Investment/ Energy Rehabilitation	–	28.5	Energy rehabilitation and energy conservation measures in municipally-owned buildings, non-profit organisations and municipal enterprises
■ Global loans for infrastructure abroad	43.8	39.0	Global loans to promotional and commercial banks in Europe
d) Education	1,341.8	1,314.3	Initial and further training
e) Global credit lines to promotional institutions in the federal states	3,596.0	8,321.0	Global loans to fund the special credit institutions of the federal states
2. Securitisations KfW Förderbank	7,641.5	8,933.4	Hedging and securitisation of mortgage loans

[1)] Differences in the totals are due to rounding.

FINANCING ADVICE.

Private customers and business partners are the focus of KfW Förderbank's advisory services. By providing information on the internet, through telephone contact with our Infocenter or during private discussions at KfW's Advisory Centres, KfW makes use of all possible channels to provide information about its promotional programmes and financing opportunities.

SPECIFIC ADVICE FOR MUNICIPAL CUSTOMERS AND THE HOUSING SECTOR.

The promotional initiative entitled "Housing, Environment, Growth", which is supported jointly by the Federal Government and KfW, entered its second year in 2007. Under the initiative KfW stepped up its intensive advice for important customers in the housing sector and the municipalities. The comprehensive advisory and support services are directed at municipalities and their enterprises, municipal associations, housing and other municipal enterprises as well as operators of aged care and nursing homes and administrators of housing and real estate. The introduction of the financing windows "Energy-Saving Building Rehabilitation" in the programmes "Social Investment" and "KfW Municipal Loan" as well as the introduction of the grant variant in the CO_2 Building Rehabilitation Programme raised the target group's information needs considerably.

KfW held around 200 regional conferences and lectures across Germany to inform these customers in 2007. At these events it also established direct contacts between loan experts and investors. In over 40 bank workshops with credit institutions KfW Förderbank also supported the cooperation with sales partners in the financing programmes for housing and infrastructure. The number of events held in 2007 nearly doubled against 2006.

KFW BANKENGRUPPE ON THE INTERNET.

KfW has been using the internet for years to provide its customers and partners with first-hand, up-to-date information. The good response to its website is evidenced by the further increase in the number of visitors. In 2007 KfW counted around 12.5 million visitors to its website, marking a 20 % increase. Promotional business (KfW Förderbank, KfW Mittelstandsbank and Advisors' Forum) accounted for almost 90 % of the more than 87 million page views (+10 %). At www.kfw-foerderbank.de/EN visitors can obtain full information on construction, housing, energy saving, environmental protection, education and infrastructure. Apart from the great demand for housing programmes, the continuing high interest in the KfW Student Loan is, in particular, the cause of high visitor traffic. Exclusive information is also available for business partners in the KfW Advisors' Forum at www.kfw-beraterforum.de.

KfW's overall website is to be made even more user-friendly. Since the beginning of 2008, for example, KfW Förderbank has been presenting itself with an optimised user interface in a new design as the first of the six portals of KfW Bankengruppe.

KFW INFOCENTER FOR TELEPHONE ADVICE.

In 2007 the Infocenter advisors handled a total of 580,000 telephone calls from customers and business partners. Around 280,000 telephone contacts dealt with housing while education finance was the reason for over 300,000 calls.

ENERGY EFFICIENCY ADVICE FOR SMES.

Not only the surveys conducted by KfW Förderbank demonstrated clearly that small and medium-sized enterprises in particular are often not even aware of how much energy their operations could save. KfW Förderbank introduced a new advisory service under the "Special Fund for Energy Efficiency" in early 2008 to provide professional independent energy advice in two stages (initial and detailed advice). Its purpose is to support enterprises in tapping this energy-saving potential. The advisory services include specific proposals for commercially sound energy efficiency measures. The programme forms part of the Federal Government's action plan for climate protection and energy policy. It is conducted with federal budget funds on behalf of the Federal Ministry of Economics and Technology.

PERSONAL ADVICE.

The Advisory Centres in Berlin, Bonn and Frankfurt also offer KfW customers the possibility of personal financing advice in their locality. In the reporting year, 1,350 customers took advantage of the opportunity to consult KfW experts directly on the programmes offered by KfW Förderbank. Builders, architects, energy consultants and bank advisors were also able to obtain individual consultations with KfW Förderbank experts at construction and housing fairs and training and information events throughout Germany.

A strong competitor in international finance.

KfW IPEX-Bank GmbH is in charge of KfW's business area of export and project finance. This includes export finance, project finance, acquisition and other corporate finance for enterprises from Germany and other European states, as well as infrastructure finance worldwide. Following KfW's legal mandate, the bank supports projects that are in the interest of both the German and the European economy, as well as in the interest of the European community of states, with products which it offers in response to the market and in competition with other international banks and finance institutions.

KfW IPEX-Bank has been operating as a legally independent subsidiary of KfW since 1 January 2008. It focuses on long-term partnerships with its customers as a relationship bank that has been present in the international market for export, project and corporate finance for nearly 50 years.

An engineering executive from India who flies on European products.

The preparations for any good deal's take off include secure financing. In the aviation industry this is crucial. Together with another bank, KfW IPEX-Bank arranged and financed 22 of 43 Airbus aircraft which Indian Airlines ordered at the end of 2005. Twelve of these aircraft were already delivered by January of this year. The operation gave the airline, which has now merged under the umbrella of the National Aviation Company of India, the financial thrust its needed to expand. It is part of more than 30 years of cooperation between KfW IPEX-Bank and the airline. The financing covers the procurement costs of the aircraft, jet engines and spare parts. A significant portion of the financing package

has now been successfully placed with international banks. The aircraft, which India's fast-growing market urgently needs, ultimately give wings to German industry, too. The Hamburg Airbus factory is the site of assembly, final inspection and delivery to customers of Airbus A319 and A321 aircraft. Mr Raghunathan, the Executive Director Engineering, knows all too well that aviation components must meet the highest safety standards. With this first-class financing package, KfW IPEX-Bank was able to land what has been an excellent deal for all parties.

A project that amalgamates German, American and Russian interests.

A good production process makes a product look as if cast from a single mould. At the brand new SeverCorr steel plant in Columbus, Mississippi, manager John Correnti follows this maxim to the letter. The plant does not cast steel into slabs that cool off and then have to be reheated, wasting huge amounts of energy. Instead, at SeverCorr the freshly cast steel can be processed immediately. What makes this efficient process possible is finest German metallurgical and rolling mill technology from SMS Demag. After all, the electric arc melting furnace, a joint venture between Severstal of Russia and Steelcorr of the USA, makes the plant one of America's most modern. It was financed under the lead

management of GE Commercial Finance Corporate Lending. As it contains a high proportion of German supplies KfW committed more than USD 213 million to this project. The state-of-the-art steel plant produces quality flat steel for the local automotive industry. When production started in October 2007 the plant was already producing 60,000 tonnes of flat steel. John Correnti, one of the people who gave the business its name, is proud of what it has achieved. Strong financing can indeed weld many enterprises together across national boundaries.

GOODS WAGGON LEASING IN RUSSIA – A SWISS-RUSSIAN JOINT VENTURE.

In Russia more than 80 % of goods are transported by rail. 70 % of the waggons are owned by the Russian state railway operator RZD. As its fleet is about 25 years old on average, it is in urgent need of modernisation. The Swiss AAE Cargo and the Russian VKM Group, wanting to seize this opportunity, decided to launch a joint venture: with the support of KfW IPEX-Bank both companies, acting under the name "Ortanio", were able to purchase nearly 1,100 new goods waggons for a total value of USD 65 million and lease them to the state railway RZD.

SHIP FINANCE FOR GERMAN SHIPPING COMPANY.

Hapag-Lloyd AG has received a KEIC-covered loan for USD 660 million. The loan, which was arranged by KfW IPEX-Bank together with other banks, enables Hapag-Lloyd to purchase 6 container ships. These ships, with a capacity of 8,750 containers each, are being built at Hyundai Shipyards in South Korea and are scheduled for delivery in the first half of 2010. Hapag-Lloyd, a German enterprise, is one of the leading shipping companies in international container shipping. Its fleet of over 140 ships sails on practically every trade route all over the globe.

FRAPORT BUYS AIRPORT TERMINALS IN ANTALYA.

KfW IPEX-Bank is taking part in a financing project for the airport in Antalya. The financing, which was structured by Unicredit, WestLB and Garantibank, is partially secured through DiA coverage. The funds are provided for the purchase of a concession running through 2019 for the operation of the terminals – except for Terminal 2 – by a consortium led by Fraport AG. The EUR 600 million financing package comprises a secured tranche of EUR 195 million, an additional tranche of EUR 390 million with DiA coverage, and a non-syndicated working capital facility amounting to EUR 15 million.

GERMAN TECHNOLOGY FOR UKRAINIAN BREWERY.

The Ukrainian Obolon brewery is the outcome of a privatisation carried out in the 1990s. With 12 million hectolitres of output in the year 2007, Obolon, which has since become the market leader in Ukraine, is a step ahead of the local subsidiaries of the western beer giants Inbev and Carlsberg. All of Obolon's core technical equipment was built by German mechanical engineers. In order to also provide smaller German exporters with financing opportunities, in January 2007 KfW IPEX-Bank offered Obolon a credit line for EUR 28 million with Hermes coverage. By the end of 2007 this line had been used to finance five individual orders from German exporters.

A VERY SUCCESSFUL BUSINESS YEAR - IN TWO RESPECTS.

In 2007 KfW IPEX-Bank committed EUR 16.1 billion in new lendings. Several large deals contributed substantially to this very good result. The business areas of shipping, basic industries, energy and transport accounted for a major share. At the same time, the bank completed all steps required on the road to legal independence successfully and on schedule.

THE SPIN-OFF PROCESS IS COMPLETED.

The Promotional Bank Restructuring Act (*Förderbankenneustrukturierungsgesetz*) of 2003 obligated KfW to hive off its international project and export finance activities into a legally independent bank by 1 January 2008. KfW IPEX-Bank has thus been operating as a new credit institution since the start of the year. In accordance with company law it now carries the name suffix GmbH (limited liability company). By no means, however, does it regard itself as a new market player. Instead, it is a separate entity responsible for a business area in which KfW has almost 50 years of experience - international project and export finance.

Chronology of the last steps taken in 2007:
In April 2007 the bank was entered in the German Commercial Register as a GmbH (limited liability company). Early establishment as a GmbH was necessary because a number of agreements to be signed under company law had to be concluded between KfW and KfW IPEX-Bank - including agency contracts. The banking licence was issued immediately after establishment. Business operations started on 1 January 2008.

Also in April, the German Federal Financial Supervisory Authority (BaFin) began its review for licensing as an IRBA bank. Being an internal rating-based bank according to the advanced approach enables the bank to apply its own rating methods to appraise its customers' credit quality. This results in advantages regarding the minimum capital requirements established by the Basel II guidelines. The licence to operate as an IRBA bank was issued on 1 January 2008. It also confirms that the bank is up-to-date with its rating instruments.

Management talks with the leading rating agencies began in October 2007. Standard & Poor's awarded the bank a rating of AA-. Moody's followed with the equivalent rating of Aa3.

In November 2007 KfW also initiated the transfer of staff from KfW to KfW IPEX-Bank GmbH. This step was endorsed by 99 % of the employees. The management considers this as an outstanding sign of trust in the business model of KfW IPEX-Bank. At the end of 2007 KfW IPEX-Bank employed a staff of 420 professionals.

The bank's system of executive bodies was finalised at the constitutive meeting of its Board of Supervisory Directors in December 2007. It now comprises the shareholders' meeting, the Board of Managing Directors and the Board of Supervisory Directors. The Board of Supervisory Directors is composed of:

- Dr Norbert Kloppenburg, member of the Board of Managing Directors of KfW Bankengruppe and Chairman of the Board of Supervisory Directors of KfW IPEX-Bank
- Wolfgang Kroh, member of the Board of Managing Directors of KfW Bankengruppe (Speaker of the Board of Managing Directors since 7 April 2008)

- Ingrid Matthäus-Maier, member of the Board of Managing Directors of KfW Bankengruppe (Spokeswoman of the Board of Managing Directors until 7 April 2008)
- Dr Axel Nawrath, State Secretary in the Federal Ministry of Finance
- Dr. Bernd Pfaffenbach, State Secretary in the Federal Ministry of Economics
- Dr. Jürgen Rupp, member of the Board of Managing Directors of RAG Aktiengesellschaft
- Karl-Heinz Stupperich, Chairman of the Board of Supervisory Directors of GWE (Gesellschaft für wirtschaftliche Energieversorgung mbH)
- Kurt F Viermetz, Chairman of the Board of Supervisory Directors of Deutsche Börse AG, Frankfurt; Chairman of the Board of Supervisory Directors of Hypo Real Estate Holding AG, Munich

KfW IPEX-Bank started operating on 1 January 2008 with a commitment volume of EUR 61.8 billion. Business conducted for its own account totalled EUR 25.7 billion. The difference consisted of trust activities being handled on behalf of KfW. The tier 1 capital of KfW IPEX-Bank is just over EUR 2.3 billion and its tier 2 capital around EUR 1.2 billion. The total regulatory capital of KfW IPEX-Bank amounts to EUR 3.5 billion.

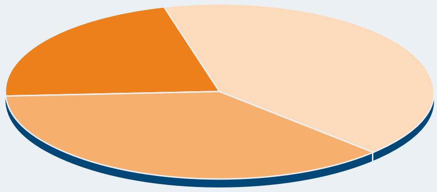
From the perspective of risk, KfW IPEX-Bank's loan portfolio is well diversified. It derives its quality from a combination of high quality counterparties and valuable collateral. Political risks have so far played a minor role in its portfolio. In addition to the loan portfolio, the bank is building up a securities portfolio to ensure liquidity at all times. It will be investing in investment grade securities only. In the market for back-up facilities for commercial paper programmes or similar products it will invest only minor amounts. The bank will act exclusively for German industrial counterparties of the highest credit quality.

The business area of export and project finance again contributed substantially to the overall result of KfW Bankengruppe in 2007.

BUSINESS DEVELOPMENT.

The international market environment was predominantly favourable although it became somewhat more difficult as the year progressed. The turbulence in the international financial markets did not hamper the bank's business, however. Even the securities of banks that enjoy a good credit rating were regarded by international investors with somewhat more caution, which led to higher refinancing costs. On the other hand, customers also showed renewed interest in classic financing instruments. This trend accommodated the orientation of KfW IPEX-Bank as a credit bank.

Within this trend, the business areas of Transport, Energy and Raw Materials showed particularly dynamic growth. Continuing growth in global trade is prompting rising demand for transport logistics and services. Moreover, the demand of a growing world population for energy and raw materials needs to be met. KfW IPEX-Bank is traditionally well positioned in these industrial sectors, not least because it works closely with renowned German and European enterprises active in these sectors.



Total: EUR 16.1 billion

New business by region

Europe	41.5 %
Other regions	36.9 %
Germany	21.6 %

This year the share of domestic business was slightly down on the previous year, at 22 %. The figure for the rest of Europe is 41 %, with regions outside Europe accounting for 37 %.

With a total of EUR 3.5 billion in new commitments, financing for German shipping companies accounted for the largest share in domestic business. It was followed by financing for manufacturing, trade and health care services. Most of that business was corporate financing. The bank was also involved in some acquisition financing transactions.

Development in the business sectors, Germany
EUR in millions

Sectors	Total	Main focus
Shipping	1,284	Container ships
Manufacturing Industries, Commerce, Health	830	Automotive engineering, specialised chemicals
Power, Renewables and Water	534	Electricity generation and transmission plants, environmental technology
Rail and Road Transport	355	Rail transport
Basic Industries	241	Raw materials projects, chemicals, steel
Airports and Ports	212	Airport and seaport terminals
Aviation	20	Airbus aircraft
Total	3,477	

With more than EUR 6.7 billion in new commitments, financing transactions in road and rail transport, basic industries, shipping and energy contributed particularly large shares in European business.

Development in the business sectors, Europe
EUR in millions

Sectors	Total	Main focus
Rail and Road Transport	1,706	Rail transport
Basic Industries	1,159	Raw materials projects, chemicals, steel
Shipping	1,088	Container ships
Power, Renewables and Water	849	Electricity generation and transmission plants, environmental technology
Manufacturing Industries, Commerce, Health	650	Automotive engineering, specialised chemicals
Airports and Ports	465	Airport and seaport terminals
Telecommunications and Media	351	Mobile communication systems
Aviation	259	Airbus aircraft
AKA	137	
Sum total	6,663	

With EUR 5.9 billion in new commitments, in the regions outside Europe ship and other transport finance were also in the lead. That confirms once again the large and growing worldwide need for transport logistics.

Development in the business sectors, outside Europe
EUR in millions

Sectors	Total	Main focus
Shipping	2,430	Container ships
Aviation	934	Airbus aircraft
Basic Industries	854	Raw materials projects, chemicals, steel
Power, Renewables and Water	523	Electricity generation and transmission plants, environmental technology
Rail and Road Transport	392	Rail transport
Manufacturing Industries, Commerce, Health	330	Automotive engineering, specialised chemicals
Telecommunications and Media	303	Mobile communication systems
Airports and Ports	157	Airport and seaport terminals
AKA	5	
Sum total	5,928	

BUSINESS STRATEGY – SECTOR AND MARKET EXPERTISE COMBINED WITH A TARGETED INTERNATIONAL PRESENCE.

Over the past years KfW IPEX-Bank has been asserting its status as one of the leading providers of international project and export finance. Financial guarantees as well as interest and currency hedging schemes concluded in the customers' interest have been added to the medium and long-term financing instruments, underscoring this position. Much of the good business development is a result of these products. The financing instruments in the short-term segment - such as raw materials trade - are being expanded further. This also includes the sectoral division of the front offices, which pools sector expertise and market insight. The continuing good business development confirms the underlying overall strategy of KfW IPEX-Bank.

The regional business strategy still focuses on financing transactions in Europe. Yet in accordance with KfW's legal mandate the bank naturally represents European interests in other parts of the world, too.

Here KfW IPEX-Bank focuses on growth markets and regions with which it has been conducting business for decades in some cases. It is also approaching new emerging markets. These markets have special growth potential that is of particular interest to German and other European suppliers.

In recent years KfW has set up offices in Bangkok, Istanbul, London, Moscow and New York to support its international business operations. These offices will be transferred gradually to KfW IPEX-Bank GmbH in 2008. Their main purpose will be to accompany new business transactions.

We traditionally lay great store by business in Asia. Operations in this region in 2007 focused on India in particular. Among them was an aircraft finance transaction with Indian Airlines, now Air India, which was arranged for more than USD 1 billion and then syndicated together with other banks. In order to tap the dynamic Indian market more effectively, in the summer of 2007 KfW opened a representative office in Mumbai. It did not take long for this office to make a substantial contribution to the good result of our business with India.

In 2008 the bank also plans to open a representative office in Singapore in order to show even greater presence in the most important Asian financial markets. In the Gulf region, preparations to open an office in Abu Dhabi are also under way.

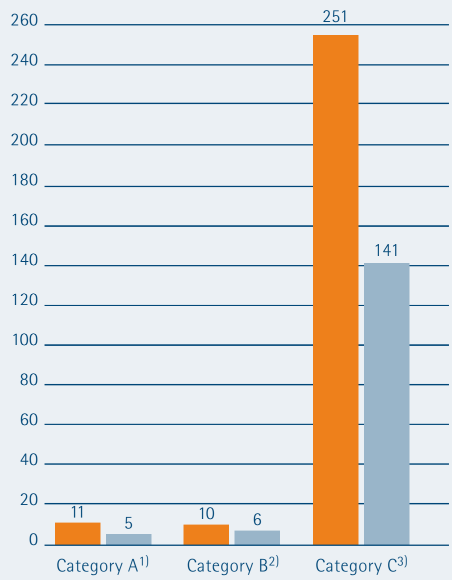
Another, newer target region is southern Africa. Here the bank sees good potential for development, for example in the energy and raw materials sector, where it is well positioned to contribute its specific skills to the business success of German and other European enterprises. KfW IPEX-Bank is therefore preparing to open a representative office in Johannesburg in order to be able to perform in this region directly.

In the UK market KfW IPEX-Bank will go one step further in 2008 and transform the London representative office into a branch office with additional staff that will conduct business operations, too. The UK market is of great importance. In recent years the focus here was on transport sector projects. As Europe's leading financial centre, however, London will primarily give KfW IPEX-Bank access to other enterprises with global business. Finally, the city on the Thames is, of course, an important location for syndication business.

RESPONSIBILITY FOR ENVIRONMENTALLY AND SOCIALLY SOUND LENDING.

KfW IPEX-Bank continues to take responsibility for environmentally and socially sound lending. In 2000 it was one of the first banks in Germany to adopt environmental guidelines for its international business. They were subsequently expanded to take account of possible social impacts and sustainability aspects in projects financed by KfW IPEX-Bank. The guidelines were last updated at the end of 2007 by adding an explicit reference to the Equator Principles, which the bank will also adopt. Actually, however, it has already been following these principles and has even applied more stringent standards in some respects.

The guidelines require all loan applications for projects to be assigned to one of three environmental and social categories:



Environmental and social aspects in the project and export finance business of KfW IPEX-Bank

- Total number of porjects
- Projects in the EU or other OECD countries

[1] Category A: potentially considerable negative environmental or social impact.
[2] Category B: potentially negative environmental or social impact.
[3] Category C: no or only minor environmental or social impact

Category A and B projects are subject to an appraisal of impacts by the technical experts and experts of KfW's Central Sustainability Unit. An appraisal is not conducted for projects that are to be carried out in an EU country or another OECD country with established environmental protection laws and stable social regulations. In the reporting year these were mainly thermal power plants, raw materials extraction and some transport infrastructure projects. All projects that were subjected to in-depth appraisals complied with internationally accepted environmental and social standards.

Category C includes mainly aircraft and ship finance projects, as well as commitments for telecommunications facilities and standard products of the capital goods industries. They all must meet the generally accepted standards.

The bank was especially committed to environmentally sound or environment-friendly projects. This project category applied to more than EUR 2 billion of the commitments made in the year under review. The main focus of these financing operations was on railway sector investments. These were financed with loans totalling more than EUR 1.4 billion. The bank extended a good EUR 0.4 billion for renewable energy projects. These included a solar park in Spain and a further wind farm in Taiwan. Wastewater and waste management projects were financed with EUR 0.2 billion.

Effectively advancing development.

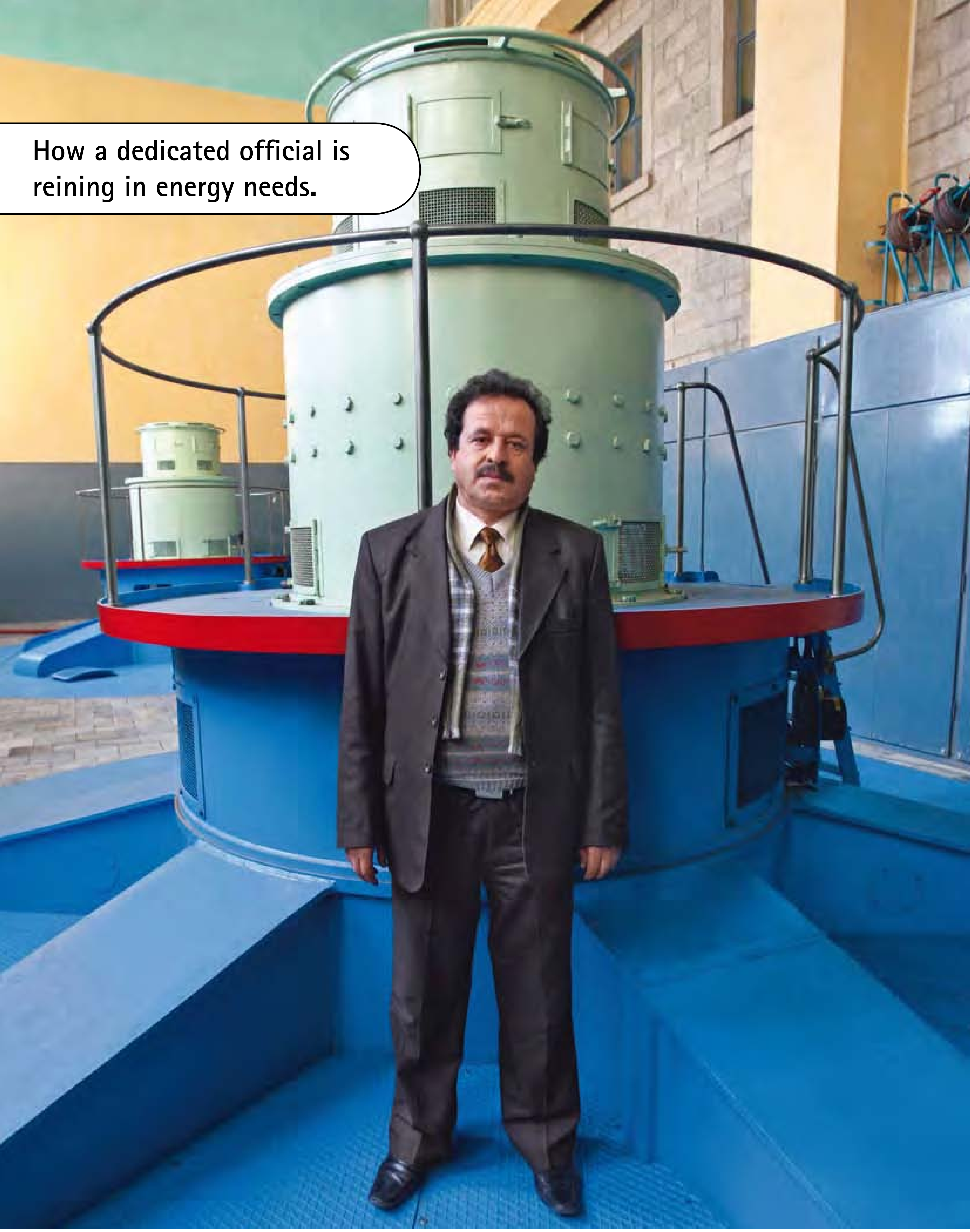
KfW Entwicklungsbank focuses primarily on providing the public sector in developing and transition countries with support to expand the social and economic infrastructure, to protect the environment and resources and to build up efficient financial systems. Its aim is to bring about a sustainable improvement in the living conditions of the people in developing countries. Reducing poverty, enhancing long-term economic efficiency and advancing structural change are key promotional tasks. As far as possible KfW Entwicklungsbank adds funds of its own to the loans and grants provided from federal budget funds, thus helping the German Federal Government to meet its Official Development Assistance (ODA) quota.

How development assistance helps a small farmer in Vietnam gain ground.

The economy of many developing countries is literally on uncertain ground. This is the case in Vietnam, too. The war and, later on, the rampant clearing of trees have significantly decimated the country's forests. Where there were once dense forests, at the beginning of the 1990s only around 27 % of the land was woodland – more or less heavily damaged. The consequences of deforestation are, however, far more serious than these figures. Soil erosion and reduced water storage robbed forestry and agriculture of their most important fundamentals. Luckily, the trend has since been reversed. Not least because KfW Entwicklungsbank has been supporting afforestation, natural regeneration

and sustainable forest management since 1995. This also benefits Mr Ly Nam Bang, a farmer from the village of Na Ngan in Lang Son province. The afforestation is being carried out in collaboration with small, family-run farms and private nurseries from the region. In this way, the majority of the investments flow directly back to the region's inhabitants. In addition, savings books are opened for the annual payment of forest conversion support to the farmers. The recultivation generates considerable success. Trees are once again growing on 38 % of the area. Through 2010 this share is to be increased to 42 %. The inhabitants of Lang Son province are pleased about the new growth.

How a dedicated official is reining in energy needs.



The two hydropower plants Mahipar and Sarobi together meet nearly half of the energy needs of the Afghan capital, Kabul. But what is rising after decades of civil war is not just the water level but an urgent need for repairs at these plants. The engineer Humayoun Kohestani, Deputy Head of Afghanistan's Energy Agency, is compensating the persistent risk of a power cut with his own personal energy input. And he is taking part in a concept for rehabilitating the plants. KfW Entwicklungsbank is supporting the maintenance of the hydropower plants in the form of investment finance thus far amounting to EUR 20.5 million. Along with the power supply, these funds are helping to get life in

the crisis-ridden region back into calmer waters. Sarobi and Mahipar provide far more than their total installed capacity of 88 MW. They also play a major role in ensuring reliable energy supply, which ultimately serves as the basis for a rising number of economic and social activities for the country's development. Schools, hospitals, public administration and the rebuilding of local commerce are benefiting most. Initial success and the prospect of additional support continue to reassure the people at the Energy Agency around Humayoun Kohestani. They give them energy to keep swimming against the current.

GOOD OPPORTUNITIES FOR MICRO ENTREPRENEURS IN SUB-SAHARAN AFRICA.

2007 was a successful year for the Microfinance Initiative for Sub-Saharan Africa (MIFSSA). Supported by KfW Entwicklungsbank, the first four of nine planned microfinance institutions opened their doors. Micro and small entrepreneurs in Madagascar, Sierra Leone, Tanzania, DR Congo, Ghana and Senegal, most of whom are poor, will have access to financial services at fair conditions. This will enable small businesspeople to put their own business ideas into practice and generate permanent employment and income for themselves and their workers. The initiative benefits women in particular.

GIRLS IN AFGHANISTAN ARE BACK AT SCHOOL.

KfW Entwicklungsbank has been supporting the reconstruction of Afghanistan since the overthrow of the Taliban in January 2002. It is promoting the education sector through the construction and rehabilitation of schools and teacher training centres, for which it has so far committed EUR 27 million. More than 70 schools have been repaired or equipped with furniture and teaching material in the greater Kabul area and the western Afghan provinces of Badghis and Herat between 2002 and 2006. Once the schools reopened, children rushed to attend them in numbers that surprised all the experts. Almost 100,000 pupils are benefiting from the new schools, and 40% of them are girls.

BANGLADESH HOMES TAP SOLAR PANELLED ROOFS FOR ELECTRICITY.

For around 750,000 people in Ramchandrapur, a small village 80 km north of the capital Dhaka, life has changed noticeably. Where dim kerosene lamps used to burn in the evenings because the village was not connected to the power grid, electric lights shine brightly thanks to solar panels on the roofs. Shops are open longer and shop owners appreciate the increased patronage and higher turnovers. Electric light permits children to do their homework and women to do handicrafts in the evenings to raise the family income. One photovoltaic unit costs EUR 280. Families and businesspeople can purchase it with a micro-loan which they repay in monthly instalments over three years. The solar energy programme with its small photovoltaic systems, which KfW Entwicklungsbank has been financing together with other donors since 2002, has become one of the most successful of its kind throughout the world.

ADDITIONAL FUNDS FOR POVERTY REDUCTION.

The German Federal Ministry for Economic Cooperation and Development and KfW Entwicklungsbank launched the “Mobilising capital for the poor” initiative in Berlin on 15 November 2007. It is designed to strengthen financial systems in developing countries and thus create basic preconditions for economic growth and prosperity. KfW will use funds of its own in structured financings under this initiative. By involving private investors, the purpose is to make a significant contribution to supplying disadvantaged small and micro enterprises with credit and other financial services.

OVERVIEW.

In 2007 KfW Entwicklungsbank and DEG succeeded once again in increasing their record business volume of the previous year. They committed a total of EUR 4.2 billion for development projects in Asia, Europe and the Caucasus, sub-Saharan Africa, Latin America, North Africa and the Middle East. Funds were provided for investment in renewable energies, rural water supply and resource protection programmes, among other areas. Another major focus was on preventing the spread of HIV and tuberculosis, expanding microcredit and decentralisation measures, and on supporting industry and trade.

KFW ENTWICKLUNGSBANK – DEVELOPMENT COOPERATION ACTIVITIES.

KfW Entwicklungsbank carries out Germany's Financial Cooperation (FC) on behalf of the German Federal Government. The overarching objective of German Financial Cooperation is and remains the promotion of global sustainable development. It covers four goals set by the German Government: to reduce poverty all over the world, bring more fairness into globalisation, secure peace and protect the environment. As part of this mission KfW Entwicklungsbank promotes investment in economic and social infrastructure, in the establishment of efficient financial systems, in safeguarding natural resources and in protecting the environment and the climate. It advises the German Government and local partners on development issues, participates in selecting, preparing and appraising projects, and monitors these on its own responsibility. In the implementation of projects and programmes it supports its partners in overcoming structural obstacles and pursuing economically viable and sustainable development. It also helps them to protect the environment and natural resources and work towards social equality. Finally, KfW Entwicklungsbank supervises the proper utilisation of the funds provided and assures that the support is as effective as possible.

As a general principle, the projects and programmes being promoted form an integral part of the partner countries' development strategies. They are closely coordinated with the projects of German Technical Cooperation (TC) and of other bilateral and multilateral donors.

Today KfW Entwicklungsbank adds a substantial volume of funds it raises in the capital market to the funds provided from the federal budget for development cooperation. In 2007 the share of KfW funds in the overall commitments totalled 57 %, or EUR 1.7 billion. KfW Entwicklungsbank thus made an important contribution to realising the developmental objectives of the German Government.

The partner countries usually obtain the funds in the form of grants and loans, but also in the form of equity. A very strong financial effort has to be made to achieve the Millennium Development Goals (MDGs). KfW Entwicklungsbank supports the German Government through a wide range of financial instruments. Being a development organisation and a bank in one enables it to considerably expand the scope of development cooperation by combining federal budget and capital market funds. Of the so-called "development loans", reduced-interest loans, in particular, have great potential – for every single euro that it commits as a grant KfW Entwicklungsbank is able to provide loan funds of up to seven euros which are recognisable as Official Development Assistance. This enables it to increase support for the partners at attractive terms while reducing the strain on the federal budget.

Furthermore, beyond official Development Cooperation KfW Entwicklungsbank supports sustainable projects undertaken in partner countries with its so-called FC promotional loans. These are loans made available by KfW without a grant element from the federal budget. This way KfW Entwicklungsbank promotes developmentally valuable projects that are also economically viable. Current examples are the microcredit lines provided in Bangladesh and Albania and the development of renewable energies in Uganda.

COMMITMENTS BY KFW ENTWICKLUNGSBANK.

In 2007 KfW Entwicklungsbank committed EUR 3,002 million in loans and grants. The commitment volume again surpassed the high level of the previous year (EUR 2,483 million).

Commitments by KfW Entwicklungsbank 2003–2007
EUR in millions

	2003	2004	2005	2006	2007
FC standard loans[1)]	227	271	307	280	277
FC grants[1)]	740	703	751	864	803
FC development loans	287	782	492	704	579
budget funds	*101*	*321*	*157*	*198*	*131*
KfW funds	*189*	*461*	*336*	*507*	*448*
FC promotional loans	246	160	247	512	1,263
Delegated cooperation	77	19	84	85	80
Total FC	**1,577**	**1,934**	**1,881**	**2,445**	**3,002**
Memo item: interest subsidies	17	10	19	38	37

[1)] Differences in previous years result from adjustments of interest grants.

The high level of commitments in 2007 mostly resulted from the increased allocation of KfW's own funds for FC development loans and FC promotional loans. The share of KfW funds was considerably higher than in the previous year.

COMMITMENTS BY REGION.

Traditionally, Asia/Oceania accounts for the greatest share in overall commitments, which amounted to EUR 1,368 million in 2007, representing 46 % of the total. It was followed by eastern Europe and the Caucasus, which received EUR 676 million (23 %). The third largest region by overall volume of commitments was sub-Saharan Africa. Commitments for this region increased by around one-third against the previous year to EUR 488 million. Most of this was financed from federal budget funds, which were increased by 25 % over the previous year. This was the second highest increase after the region Asia/Oceania. Commitments for Latin America were slightly higher than in the year before, at EUR 270 million. North Africa/the Middle East received approx. EUR 200 million, somewhat less than in 2006.

Commitments by region in 2007
EUR in millions and %

	Dederal budget funds		Overall commitments	
	EUR in millions	in %	EUR in millions	in %
Asia and Oceania	438	36	1,368	46
Sub-Saharan Africa	385	32	488	16
Europe and Caucasus	116	10	676	23
Latin America	121	10	270	9
North Africa/Middle East	150	12	202	7
Total commitments	**1,210**	**100**	**3,002**	**100**

COMMITMENTS BY PRIORITY SECTOR.

Social and economic infrastructure were the sectors (based on OECD/DAC) that took the greatest share of commitments in 2007, accounting for 33 % of the total volume. Financial sector projects received 26 % of the funds.

Projects aimed at improving the social infrastructure were conducted in the classic priority areas of water supply, sanitation, waste disposal (EUR 431 million), health care and population policy (EUR 172 million) and education (EUR 102 million). In addition, financing was increasingly made available to promote projects in the area of governance and civil society (EUR 274 million). They were aimed at decentralisation and the development of municipalities and peripheries of large cities.

Around half of the commitments for economic infrastructure went to the energy sector (EUR 479 million). The majority of projects were implemented to promote energy efficiency and renewable energies as well as urban electrification. The bank provided a further EUR 490 million for the transport sector, for example to finance investments aimed at reducing emissions in public mass transport.

The financial sector projects mostly pursued structural objectives to promote economic reform and develop a market economy. These included the long-term promotion of micro, small and medium-sized enterprises as well as projects aimed at reinforcing local financial markets.

Commitments by priority sector 2006–2007
EUR in millions and %

	2006		2007	
	EUR in millions	in %	EUR in millions	in %
Social infrastructure	734	30	979	33
Economic infrastructure	724	29	978	33
Financial sector	600	24	775	26
Producing sector[1)]	186	7	77	3
Others[2)]	238	10	193	6
Total	**2,483**	**100**	**3,002**	**100**

1) Primarily projects in forest protection and in irrigation.
2) Primarily resource protection and emergency projects and the promotion of poverty reduction programmes (PRSP).

The commitments made in 2007 again focused on important cross-cutting development cooperation objectives. 56 % of the projects contributed directly or indirectly to reducing poverty. Protecting the environment and natural resources actively or contributing to its improvement as an important secondary objective was an intended outcome of 36 % of all projects supported.

Gender equality is also an important goal of development cooperation. All over the world poverty affects women much more strongly than men. This is why 49 % of all projects supported in 2007 pursued gender equality as a main or important secondary objective.

DISBURSEMENTS BY KFW ENTWICKLUNGSBANK.

In the year under review KfW Entwicklungsbank disbursed EUR 2,038 million for projects and programmes in developing and emerging countries. This was an increase year-on-year of 37 % (2006: EUR 1,485 million). Of this sum EUR 1,143 million were financed from federal budget funds (2006: EUR 1,095 million).

DEBT CONSOLIDATIONS, DEBT CANCELLATIONS AND CONVERSIONS FOR ENVIRONMENTAL PROTECTION AND POVERTY REDUCTION.

Under certain conditions, the German Federal Government grants highly indebted partner countries relief on the repayment of development cooperation loans. This is done in the form of debt consolidations or cancellations. These arrangements are based on agreements reached with the international donor community in the Paris Club. They are concluded, for example, under the so-called HIPC Initiative (Heavily Indebted Poor Countries), which is assisted by the International Monetary Fund (IMF). KfW participates in the negotiations on the German side.

Debtor countries, however, are not released from repayment unless they have previously committed themselves to investing the funds thus freed up to promote poverty reduction, environmental protection, education or the prevention of HIV/AIDS, or have already implemented projects that pursue these objectives.

In 2007 KfW signed debt consolidation and cancellation agreements with the DR of Congo, the Republic of Congo and Montenegro for a total of EUR 31 million.

KfW Entwicklungsbank also concluded debt conversion agreements with Egypt, Ecuador, Georgia and Indonesia for a total of EUR 73 million. Following implementation of the corresponding projects by the debtors KfW Entwicklungsbank cancelled debt worth more than EUR 102 million, part of which had already been agreed in previous years.

TROPICAL FORESTS STABILISE THE GLOBAL CLIMATE.

Tropical forests have multiple functions: they protect the climate, store fresh water, guarantee biological diversity, act as a gene pool, supplier of medicine and timber, and constitute a unique cultural and natural habitat. The world is only beginning to grasp their importance. What is certain, however, is that public interest in protecting tropical forests is growing as the debate on climate protection continues. The protection of tropical forests was also an important subject at the Climate Change Conference held in Bali in December 2007. It was here that the mandate was issued to lay the foundations for counting forest protection measures towards the developing countries' national emission reduction objectives in the future. This arrangement is one of the greatest successes of the conference.

The protection of rainforests and biological diversity is one of KfW Entwicklungsbank's day-to-day activities. Deforestation accounts for 20 % to 25 % of global greenhouse gas emissions. For example, Indonesia's ruthless exploitation of its forests has earned it the reputation of being the world's fourth worst climate polluter. For this reason KfW Entwicklungsbank has been committed to protecting tropical forests, preserving nature and biodiversity and promoting erosion control and ecologically sound land-use projects for 15 years. On behalf of the German Government KfW Entwicklungsbank therefore is supporting projects in the forestry sector all over the world with more than EUR 900 million. This support includes over 100 projects in more than 40 countries. This makes it the most important bilateral development institution in this area. The main goal of forest projects is to (re)forest these areas, to preserve them and to manage them on a sustainable basis. Projects aimed at preserving biological diversity mainly involve the management of protected areas such as national parks and reserves and the bordering areas. Cooperation with experienced non-governmental organisations such as the World Wide Fund For Nature (WWF) and Conservation International (CI) and the International Union for Conservation of Nature (IUCN) plays an important role. However, KfW Entwicklungsbank also works with many local organisations that are hardly known internationally but reach the local population more easily.

GROWTH AND RESPONSIBILITY – THE G8 SUMMIT AND ITS IMPORTANCE FOR KFW ENTWICKLUNGSBANK.

"Growth and Responsibility" was the core theme of Germany's 2007 G8 presidency. The German Government's choice of topics sent out a clear message that also has deep meaning for KfW. The decisions made by the G8 confirmed the business priorities of KfW Entwicklungsbank both in environmental and climate protection and in the promotion of sustainable economic development. This applies to financial system development in particular. KfW Entwicklungsbank will continue its commitment in Africa and contribute more of its sector and banking expertise to this continent.

The G8 Summit emphasised the great importance of joining efforts to combat climate change and the role of promoting energy efficiency while ensuring energy security. This acknowledges not only the intensive work of KfW Bankengruppe on these topics in Germany but also the commitment of KfW Entwicklungsbank in the partner countries of German Development Cooperation. It also underscores the relevance of the technical and professional skills that have been built up in the area of environmental and climate protection over the years. In the past decade alone, KfW Entwicklungsbank has made commitments totalling EUR 7.0 billion to environmental and climate protection measures across all sectors. As KfW has now been requested to enhance its activities in this area, it will provide intensive advice and finance at the national as well as international level.

The additional funds pledged by the German Government for Development Cooperation at the G8 Summit are an important step towards more development, as the need for investment in the partner countries is still enormous. The volume of funds alone, however, does not secure development success. Rather, wide-ranging skills are needed as the basis for ensuring that the funds can be be used efficiently with a view to intelligent and sustainable strategies. This is what KfW Entwicklungsbank is striving for.

As was announced by the German Government, alternative forms of financing are necessary to complement the provision of budget funds. KfW is already making a substantial contribution from funds of its own (EUR 1.7 billion in 2007). Furthermore, the initiatives of the Regional Microfinance Fund for Africa (REGMIFA) and the Currency Exchange Fund (TCX), which were explicitly embraced in the G8 Summit Declaration, provide important development stimuli. They create the necessary preconditions for an improved investment climate in the partner countries and for development based on self-reliance and ownership. KfW Entwicklungsbank initiated or largely helped to design both funds. REGMIFA is a central initiative aimed at promoting Africa's economic development. Its objective is to strengthen microfinance institutions in order to provide several hundred thousand small and medium-sized enterprises with access to credit. This fund is to be endowed with a total of EUR 250 million. Germany intends to participate with EUR 50 million from budget funds and a further EUR 20 million from KfW's own funds. KfW Entwicklungsbank has taken the lead in establishing the fund. It will draw on the experience it acquired in setting up a similar microfinance fund which was established successfully for southeastern Europe several years ago. In addition to providing refinancing funds, KfW also helps the microfinance institutions develop their institutional and professional capacities by providing them with capable advice.

DEVELOPMENT COOPERATION HAS A WIDE RANGE OF IMPACTS.

Development cooperation often has to change structures so that its impacts will be sustainable. People's behaviour and the overall environment also play an important role. KfW Entwicklungsbank and DEG take these aspects into account by diligently designing and implementing the projects they finance.

High-impact orientation in development cooperation is therefore a pivotal requirement set out in the Paris Declaration, which was signed by the international donors in 2005. Ensuring this is a prime concern of the German Government. This is why KfW Entwicklungsbank and DEG chose the topic of "The Efficacy of German Financial Cooperation" as their annual theme for 2007.

All programmes and projects financed by KfW Entwicklungsbank are designed in such a way that they produce a wide range of impacts. For example, a project not only serves its own purpose – such as supplying a village with water or electricity – but also aims for improvements that go beyond this objective. This includes developing more efficient structures, greater equality for women, health improvements, preserving the natural bases of life, furthering the democratisation of social structures, providing greater educational opportunities, establishing stable financial systems and a strong private sector.

An illustrative example of this is the water sector, in which German Financial Cooperation is particularly active all over the world. Clean drinking water not only ensures people's survival but also improves their health. Better rural water supply also enables women to generate additional income for their families. Instead of having to fetch water from distant wells they can now spend more time caring for crops and selling their produce. The time they now have on their hands and the additional money they now earn also benefit their children. A water supply project in Tanzania led to a 12% rise in school enrolment. Girls in particular, who used to be in charge of fetching water, finally had the chance to attend school.

Commitments by DAC country in the year 2007
Commitments, EUR in millions

Rank	Country	BMZ budget funds	KfW funds	Funds of other donors	DEG (own risk)
1	India	90.34	276.84	0.00	77.06
2	PR of China	83.92	403.71	0.00	99.29
3	Afghanistan	68.12	0.00	0.61	0.00
4	Tanzania	63.00	0.00	50.00	0.00
5	Mozambique	60.56	0.00	0.00	0.00
6	Palestinian Territories	36.79	0.00	0.00	0.00
7	Zambia	34.18	0.00	0.00	7.54
8	Nepal	29.70	0.00	0.00	0.00
9	Vietnam	29.13	0.00	0.00	0.00
10	Burkina Faso	29.00	0.00	0.00	0.00
11	Mali	28.48	0.00	0.00	0.00
12	Kyrgyzstan	28.22	0.00	0.00	0.21
13	Egypt	28.07	16.11	0.00	0.00
14	Yemen	24.73	0.00	0.00	0.00
15	Bangladesh	23.81	14.47	0.00	16.58
16	Jordan	21.91	0.00	0.00	0.00
17	Albania	21.20	0.00	0.00	10.00
18	Indonesia	21.00	0.00	0.00	21.81
19	Colombia	20.16	0.00	0.00	0.00
20	Serbia	20.00	20.00	0.00	0.00
21	Niger	20.00	0.00	0.00	0.00
22	Bolivia	18.61	0.00	0.00	0.00
23	Kazakhstan	17.67	61.14	0.00	76.16
24	Malawi	17.63	0.00	0.00	1.50
25	Chile	16.23	19.23	0.00	0.00
26	Namibia	14.80	0.00	0.00	0.00
27	Philippines	14.74	34.11	0.00	0.00
28	El Salvador	13.99	0.00	0.00	11.16
29	Morocco	13.35	26.00	0.00	0.00
30	Ethiopia	13.00	0.00	0.00	0.00
31	Benin	10.50	0.00	0.00	0.00
32	Uzbekistan	10.20	0.00	0.00	25.00
33	Ghana	10.00	0.00	0.00	25.58
34	Lebanon	10.00	0.00	0.00	0.00
35	Nigeria	10.00	0.00	0.00	50.47
36	Macedonia	9.73	0.00	0.00	0.00
37	Paraguay	9.20	0.00	0.00	0.00
38	Uganda	9.15	11.18	4.30	24.55
39	Madagascar	9.00	0.00	0.00	3.00
40	Mexico	8.69	62.55	0.00	13.37
41	Montenegro	8.50	44.00	0.00	0.00
42	Syria	8.00	0.00	0.00	0.00

(cont.)

Rank	Country	BMZ budget funds	KfW funds	Funds of other donors	DEG (own risk)
43	Pakistan	7.50	0.00	0.00	63.53
44	Ukraine	7.30	23.99	0.00	40.82
45	Cameroon	7.00	0.00	0.00	0.00
46	Armenia	6.90	2.08	0.00	7.40
47	Tunisia	6.88	10.23	0.00	0.00
48	Cambodia	6.00	0.00	0.00	23.19
49	Dominican Republic	5.50	0.00	0.00	0.00
50	Kenya	5.15	0.00	0.00	4.49
51	Bosnia and Herzegovina	5.11	0.00	0.00	15.00
52	Guinea	5.00	0.00	0.00	0.00
53	Chad	5.00	0.00	0.00	0.00
54	Rwanda	4.75	0.00	0.00	4.23
55	Peru	4.50	7.56	0.00	28.22
56	Burundi	4.50	0.00	0.00	0.00
57	Laos	4.40	0.00	0.00	0.00
58	Mongolia	3.00	0.00	0.00	0.00
59	Togo	3.00	0.00	0.00	0.00
60	DR Congo	1.75	0.00	0.00	8.24
61	Moldova	1.70	0.00	0.00	5.00
62	Lesotho	1.50	0.00	0.00	0.00
63	Senegal	1.46	0.00	0.00	21.25
64	Turkey	0.50	0.00	0.00	116.37
65	Azerbaijan	0.38	30.00	0.00	12.21
66	Croatia	0.00	167.61	0.00	0.00
67	South Africa	0.00	25.00	0.00	9.13
68	Panama	0.00	14.96	0.00	0.00
69	Georgia	0.00	10.87	0.00	5.59
70	Mauritius	0.00	8.91	0.00	0.00
71	Belarus	0.00	2.40	0.00	0.00
72	Angola	0.00	0.00	0.00	6.82
73	Gabon	0.00	0.00	0.00	3.23
74	Sri Lanka	0.00	0.00	0.00	0.35
75	Argentina	0.00	0.00	0.00	13.14
76	Brazil	0.00	0.00	0.00	54.00
77	Costa Rica	0.00	0.00	0.00	7.49
78	Ecuador	0.00	0.00	0.00	10.16
79	Guatemala	0.00	0.00	0.00	13.94
80	Honduras	0.00	0.00	0.00	11.15
81	Nicaragua	0.00	0.00	0.00	17.48
82	Uruguay	0.00	0.00	0.00	5.83
Supra-national		76.19	418.81	24.74	234.74
Total		**1,210.28**	**1,711.75**	**79.65**	**1,206.27**

Our business is development.

DEG (Deutsche Investitions- und Entwicklungsgesellschaft mbH), a subsidiary of KfW Bankengruppe, is a development finance institution committed to promoting the private sector in developing and emerging countries. To that end it offers private enterprises and banks long-term investment finance, thereby strengthening the market economy in the partner countries. Projects that are co-financed by DEG must make developmental and business sense and be both environmentally and socially acceptable. They are carried out in all economic sectors that are open to private enterprise. DEG's products provide long-term investment capital at market terms and conditions. In dialogue with its clients, the institution designs solutions that are tailored specifically to each individual project, the current market situation and the risk situation in the corresponding country.

DEG
KFW BANKENGRUPPE

FUNCTIONS AND ROLE OF DEG.

DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH has been part of the KfW Group since 2001. Together with KfW Entwicklungsbank it is committed to the promotion of developing countries. It supports the development policy objectives of the German Government by helping to establish and expand private enterprise in developing countries and emerging markets. By providing co-financing and advisory services for corporate investment in other countries DEG is contributing to sustainable economic growth and is thus creating a firm basis for improving the living conditions of the people in these countries.

Since its foundation in 1962 DEG has provided over EUR 9 billion in financing overall, with some EUR 4 billion in the past five business years alone. This growth dynamism is what enables DEG to implement its development strategy so successfully.

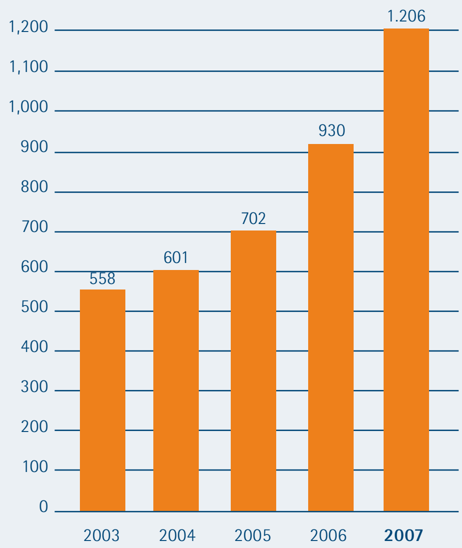
DEVELOPMENT OF DEG'S FINANCING BUSINESS.

The overall economic and political conditions for private investment in developing and emerging countries remained good. This positive environment also had a noticeable impact on private equity markets. As a result, DEG's business continued to develop very well in 2007 despite the global financial market crisis. DEG was thus able to significantly expand its financing business yet again. It reached the billion-euro mark for the first time with a volume of EUR 1,206 million (2006: EUR 930 million), its highest commitment volume yet. That corresponded to a year-on-year increase of nearly 30%. The share of risk sub-participations amounted to EUR 75 million (EUR 12 million).

At EUR 858 million, its disbursements were also considerably above the previous year's figure of EUR 788 million; risk sub-participations accounted for EUR 69 million of this amount (EUR 12 million).

Its entire portfolio (net commitments) rose by 17 % to EUR 3,582 million (EUR 3,051 million), with both its country and credit risk structure undergoing further improvement. Its project portfolio involved 493 companies in 84 partner countries. This enabled DEG to further establish itself as one of Europe's largest development finance institutions specialised in supporting the private sector in developing and emerging countries.

Last year DEG committed EUR 215 million for the financing of participations. Loans amounted to EUR 958 million, with EUR 234 million provided in the form of quasi-equity loans. Thus the use of venture capital for private equity and mezzanine financing added up to EUR 449 million, or 37 % of all new business (2006: 30 %). DEG committed a total of EUR 33 million for guarantees.



DEG commitments 2003–2007
EUR in millions

Total, including risk sub-participations by third parties.

NEW COMMITMENTS BY REGION AND SECTOR.

DEG financed projects in 44 partner countries in the year under review. For the first time, it provided funds for projects in Angola, the Republic of Moldova and Uzbekistan. The list of least developed countries to which DEG is committed in Asia included Bangladesh and Cambodia and, in Africa, Angola, the Democratic Republic of Congo, Madagascar, Malawi, Rwanda, Zambia, Senegal and Uganda.

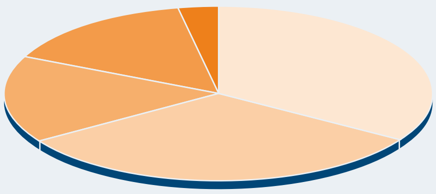
Its main focus was the region of Asia/Oceania, which accounted for EUR 407 million (34 %) of all activity. It was followed by Europe/the Caucasus/Turkey with commitments totalling EUR 385 million (32 %) and Latin America, which received commitments of EUR 194 million (16 %). Sub-Saharan Africa accounted for EUR 187 million (15 %), the highest annual volume of finance provided by DEG for the region.

In the year under review DEG further extended its commitment in the financial sector in its partner countries. The funds committed to this sector added up to EUR 596 million and accounted for nearly 50 % of new business. Its main focus was on cooperating with local and regional commercial banks in order to supply small and medium-sized enterprises, including those in remote areas, with long-term investment capital and to further support housing construction. Its promotional spectrum also encompassed leasing companies, institutions specialised in financing infrastructure measures and motor vehicles, equity participation funds, investment banks and development banks. Together with KfW Entwicklungsbank DEG participated in a hedge fund for local currency loans that was initiated by the Dutch development bank FMO. This fund gives mainly borrowers who are not generating foreign currency on their own better access to domestic investment finance that meets their needs while avoiding price risks. Key elements of its financial sector development also included sustainable contributions to institution building and to good corporate governance.

DEG channelled 23 % of its financing commitments to manufacturing enterprises. It mainly financed investments in the areas of food supply, chemicals, motor vehicle construction and paper. Infrastructure projects experienced another considerable rise to a new high of EUR 218 million, with 18 % of new commitments going towards projects in the fields of telecommunications, energy and water supply, transport and storage management as well as health care. In the energy sector the use of renewable energies played an important role. By co-financing a run-of-river power plant in Uganda, for example, not only could a bottleneck in the local power supply that was hindering development be overcome, but a positive climatic effect could also be achieved through a reduction in CO_2 emissions. Other services, including trading enterprises and an industrial park, accounted for 8 % of new business.

The share of agricultural production (excluding the processing agro-industry) in the promotional volume was 1 %; together with upstream processing projects, primarily in the food industry, agrobusiness represented a considerably higher total commitment at 7 % altogether.

DEG own-risk commitments by region in 2007
EUR in millions and %



Total: EUR 1,206 million

Asia and Oceania	407	34 %
Europe, Turkey and Caucasus	385	32 %
Latin America/Caribbean	194	16 %
Africa	187	15 %
Supra-regional	33	3 %

ADVISORY AND PROMOTIONAL PROGRAMMES.

DEG's advisory services assist its customers and partners with planning and preparing investments. In addition to its specific country and sector know-how, first and foremost it draws on its financial expertise for improving the quality of investment projects on a sustainable basis through optimal structuring of the total financing package.

In the year under review the German Federal Ministry for Economic Cooperation and Development (BMZ) allocated EUR 1.1 million in budget funds for technical assistance to enhance the developmental impact of DEG's financing. DEG then added another EUR 1.2 million of its own funds. As a result, in 2007 a total of 36 complementary measures were financed in order to strengthen the economic, social and ecological sustainability of the projects and take account of the particular significance of private investment in developing countries, which pose a special challenge. These promotional efforts focused on the sector priorities of environmental protection and resource conservation, financial sector development, food security and support for rural areas.

In the year under review DEG financed 47 projects under the Public Private Partnership (PPP) programme set up by the BMZ for development partnerships with the private sector. It committed EUR 10.3 million to these projects from federal budget funds. Its partner enterprises and third parties invested EUR 17.9 million, making it possible for a total project volume of EUR 28.2 million to be achieved in 2007. Providing funds for HIV/AIDS projects in Africa was one of the main targets of the PPP financing in 2007.

Strategic alliances forged in connection with PPP funding proved to be particularly successful. This applies especially to the cooperation with the TÜV Rheinland Group for financing climate protection projects in developing countries as well as the quality and marketing initiative "Cotton made in Africa", for which PPP financing has since been extended until early 2010.

Under the PPP Study Facility, in 2007 nine financing commitments were made for project preparatory measures in the fields of infrastructure and financial sector support.

To offer start-up entrepreneurs in Afghanistan easier access to adequate financing, DEG launched a credit guarantee fund project. The BMZ and the US development aid organisation USAID together provided USD 7.0 million for the project. Two selected local partner banks extend loans to young Afghan entrepreneurs and small and medium-sized enterprises. These loans are backed by guarantees provided by the fund. In the year under review 184 guarantees were offered to cover a loan volume of USD 4.1 million, as a result of which some 2,500 jobs could either be created or safeguarded.

Overall, EUR 14.9 million was made available in promotional funds from the German federal budget (2006: EUR 10.9 million), yet this volume will decrease considerably in the coming year.

EUROPEAN COOPERATION.

DEG maintains close ties with its partner institutions throughout Europe in the organisational alliance EDFI (European Development Finance Institutions), which has its seat in Brussels. Of a total of 16 EDFI members, twelve have joined the European Investment Bank (EIB) in becoming partners of the co-financing instrument European Financing Partners. One of them is DEG. The EFP support private investment in developing countries in Africa, the Caribbean and the Pacific (ACP states). At year-end, nearly 50% of the EUR 330 million available under the facility was committed to projects.

Cooperation with the Dutch FMO and the French PROPARCO grew much tighter during 2007. In the year under review 34 projects for a total volume of EUR 917 million were financed, with DEG accounting for 46%.

DEVELOPMENTAL IMPACT OF DEG'S FINANCING.

The developmental quality of DEG's new commitments reached its best level yet during the reporting year. This result was confirmed by a qualified evaluation procedure carried out by the internal corporate policy project rating (GPR), which was introduced in 2002. The current (ex ante) evaluations show that around 28,000 new jobs are being created as a result of the investments financed in 2007 together with other partners. The DEG project companies co-financed in the reporting year are currently safeguarding some 131,000 jobs. Added to this are another 268,000 workers involved in financial sector projects through supply relationships within production facilities and through their ties with sub-borrowers.

These project companies will also contribute more than EUR 600 million in taxes to annual public revenues and generate direct net foreign exchange revenues amounting to approx. EUR 1.7 billion p.a. In view of the current budget deficits and often insufficient foreign exchange receipts, for many developing countries these effects are extremely important.

The companies financed by DEG are more than willing to accept social responsibility. 53% of them offer above-average pay. Many also contribute to society in other ways, for instance by equipping health stations, covering additional retirement or health insurance premiums, building schools and kindergartens or providing low-cost housing – all examples of corporate social responsibility in the truest sense of the expression.

Around half of the projects co-financed during the reporting year contributed directly to achieving at least one of the eight international Millennium Development Goals (MDGs).

RESULT.

At EUR 131 million, profit from operating activities was slightly above the excellent result of the previous year (EUR 130 million). Rising investment income – higher dividends and sales proceeds – were a major contributing factor. The share of current and one-time income from shareholdings in total earnings from operations thus increased from 26% in the previous year to 37%.

Risk provisions were increased via a net addition of EUR 17 million following a net reversal of the risk provisions in the amount of EUR 19 million in the previous year. Key to this development was that, following a long phase marked by high stability, the bank's risk situation returned to a normal level.

After tax the profit for the year amounted to EUR 117 million (EUR 115 million) and, after deducting withdrawals from the special-purpose reserve established for technical assistance for private investment in countries posing a special challenge, a balance sheet profit of EUR 118 million (EUR 110 million) could be reported. Owing to the positive reaction, the special-purpose reserve is to be increased to cover complementary measures that encourage development, which will in turn further reinforce the developmental quality of DEG's financing business. The remainder of the balance sheet profit will be added to other retained earnings as required by the by-laws.

OUTLOOK.

The growth dynamism in the majority of the markets relevant for DEG in industrialising and developing countries will continue in 2008, albeit at a slightly lower pace. As demand for its services remains strong, for 2008 DEG will strive for new business of at least EUR 1 billion. In the medium term it is aiming for portfolio growth of 8–10 % annually. This moderate growth scenario will be accompanied by additional efforts to maintain the high quality of its promotional support.

DEG plans to increase the share of equity finance and mezzanine finance in new business to 40 % overall. As such financing is scarce, this segment has great developmental relevance. What is more, although the impact of venture capital on DEG's earnings situation is subject to considerable fluctuation, it is nonetheless very important. Through active participation in equity finance and the assumption of supervisory mandates DEG can, in collaboration with its co-financiers, exercise key control and management rights and work towards introducing international corporate governance standards.

DEG will increase marketing aimed at medium-sized German enterprises to promote private investment in Africa. In Germany it will also continue with the political information and support initiatives propounded at the G8 summit. Since demand by African businesses for venture capital has grown, DEG will also focus its acquisition on this area. It will broaden its local presence by establishing an office for West Africa to be located in Accra, Ghana.

To help protect the climate DEG will again heighten its efforts significantly and aim for a project volume of approx. EUR 100 million. The main focus will be on energy efficiency projects since they offer manifold untapped potential.

As regards cooperation with the European Development Finance Institutions (EDFI) DEG will continue to actively participate in the harmonisation process. Apart from the standardisation of environmental and social standards, which has already taken place, and the identification and assessment of developmental impacts, one future focus will also be on reconciling the legal documentation in its project business. Additionally, DEG will expand its cooperation with strategic partners in order to broaden access to hitherto insufficiently tapped customer groups in the private sector – particularly SMEs – and to further develop its developmental lending business.

FUNDING.

EVEN IN CHALLENGING TIMES KFW BONDS IN DEMAND WORLDWIDE.

In the international capital markets, the two halves of the year 2007 were quite different. In the first two quarters the economic data were robust and capital market development was positive, whereas the last two quarters were marked by turmoil caused by the crisis in the subprime mortgage market in the USA. A first-class issuer thanks to the explicit guarantee of the Federal Republic of Germany, KfW more than held its own in this difficult situation. The heightened risk awareness of institutional investors and their "flight into quality" brought about a noticeable increase in investments in top-quality credit risks. KfW, with its top-notch AAA/Aaa/AAA rating from Standard & Poor's, Moody's Investor Service and Fitch Ratings, also benefited from this shift.

In 2007 KfW raised long-term funds equivalent to EUR 64.6 billion (2006: EUR 54.1 billion) in the international capital markets. As a result of the considerable expansion of its lending business, the bank had already revised its expected funding needs upwards in July to approx. EUR 60 billion. This rise of a good EUR 10 billion compared to the previous year's volume was achieved mainly by raising additional funds in euro (EUR 3 billion) and pounds sterling (EUR 5 billion). It became obvious that investors throughout the world were anxious to diversify their bond portfolios during 2007. They were keen on finding new investment opportunities outside the main reserve currencies, the euro and the US dollar. KfW responded to this development and was thus able to broaden its refinancing base. With 570 individual transactions (526 in 2006) in 25 currencies (23 in 2006), in 2007 KfW was active in more markets than ever before.

Funding in 2006/2007 by instrument[1)]
EUR in billions and in %

	2006		2007	
	EUR in billions	in %	EUR in billions	in %
Securities	**51.0**	**94**	**62.1**	**96**
Benchmark bonds	21.7	40	27.5	43
Other public bonds	23.4	43	26.6	41
Private placements	5.8	11	8.0	12
Loans	**3.0**	**6**	**2.5**	**4**
Credit-linked notes	2.2	4	2.2	3
Other	1.0	2	0.3	1
Total	**54.1**	**100**	**64.6**	**100**

[1)] Differences in the totals are due to rounding. The adjustments in the calculation method may lead to differences in some of the previous year's figures compared with past publications.

BENCHMARK PROGRAMMES EXPANDED.

KfW's funding activities are based on a three-pillar strategy. The first pillar is the largest in terms of volume and comprises the two Benchmark Programmes in euro and US dollars. KfW offers its investors all over the globe bonds in both currencies with large issue volumes and benchmark maturities. The funds raised with these highly liquid bonds amounted to EUR 27.5 billion in 2007, accounting for 43 % of KfW's funding activities (2006: 40 %). The heavy oversubscription of the KfW Euro Benchmark Bonds and the record USD 4 billion issue volume of a 2-year USD global bond issued in September confirm that each issue was well timed. They also indicate that in an uncertain capital market, KfW is an issuer in high demand. To offer its capital market products, KfW has created internal processes that enable it to respond swiftly to market trends. Investment banks that market KfW's benchmark bonds value this high flexibility. It is the only way to place issue volumes of up to EUR 5 billion per bond all over the world, sometimes on only one business day. Central banks remain the largest group of investors in the KfW Benchmark Programmes.

The second pillar of KfW's funding combines other public bonds offered outside the Benchmark Programmes in a number of different currencies. These include bonds in all core currencies such as the euro and the pound sterling as well as local currency bonds that enable KfW to position itself early on as a first-class bond issuer in up-and-coming markets. Altogether KfW raised 41 % of its long-term funds (43 % in 2006) in this second pillar. The average issue volume of all 170+ transactions in this category is nearly EUR 155 million.

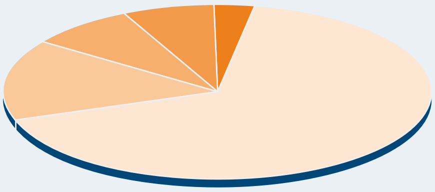
Loans and privately placed KfW bonds that are tailored to the specific demands of institutional investors make up the third pillar of KfW's funding. In 2007 they accounted for 16 % (2006: 17 %) of the total refinancing volume. The average issue amount of the nearly 390 transactions undertaken in this pillar was a good EUR 27 million.

€ Benchmark Programme in 2007

	EUR in billions	Term	Interest rate in %
KfW € Benchmark I/2007	5.0	10 years	4.125
KfW € Benchmark II/2007	5.0	3 years	3.875
KfW € Benchmark III/2007	5.0	5 years	4.625
KfW € Benchmark IV/2007	3.0	15 years	4.625

US$ Programme in 2007

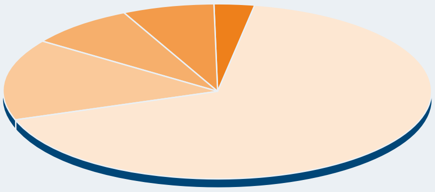
	EUR in billions	Term	Interest rate in %
KfW $ Benchmark I/2007	3.0	10 years	4.875
KfW $ Benchmark II/2007	3.0	5 years	4.750
KfW $ Benchmark III/2007	3.0	3 years	5.000
KfW $ Benchmark IV/2007	4.0	2 years	4.500



Placement of KfW € Benchmark Bonds in 2006/2007

Pie chart for figures for 2007

	2006	2007
Other Europe	67 %	67 %
Germany	24 %	15 %
Asia	5 %	8 %
Other regions	3 %	7 %
North America	1 %	3 %



Placement of KfW $ Benchmark Bonds in 2006/2007

Pie chart for figures for 2007

	2006	2007
Asia	36 %	24 %
Other Europe	33 %	44 %
North America	20 %	29 %
Other regions	11 %	1 %
Germany	< 1 %	2 %

CORE CURRENCIES – RECORD ISSUE VOLUME IN POUNDS STERLING.

The main core currencies in KfW's refinancing activities are the euro, US dollar, pound sterling and Japanese yen. In 2007 KfW raised 89 % (2006: 88 %) of its funds in these currencies. KfW avoids currency risks by concluding corresponding hedging transactions.

The euro remains by far the most important funding currency for KfW. At 39 % of the total funding volume (2006: 41 %), its share was slightly below the previous year's level. Funds raised in euro added up to EUR 25.3 billion (EUR 22.4 billion in 2006). KfW thus raised an additional EUR 7.4 billion outside the € Benchmark Programme.

The US dollar has traditionally been KfW's second most important funding currency, albeit at a far second. The bank again experienced very strong demand for its USD bonds. This high demand enabled KfW to issue a USD global bond with an issue volume of USD 4 billion for the first time. Overall the bank raised USD 22.9 billion – the equivalent of EUR 16.9 billion – in the USD capital market. Of this amount, USD 1.7 billion (USD 1.0 billion in 2006) was raised through the US Medium-Term Note Programme. This programme is an issuing platform created in 2006 especially for US investors. It enables KfW to respond to demand from investors in the USA for structured bonds both flexibly and efficiently. The healthy rise in volume over the previous year is an indication that this product was extremely well received in the market. The US dollar accounted for a total of 26 % (29 % in 2006) of the long-term funds raised by KfW.

Of KfW's core funding currencies, the pound sterling posted the strongest growth in 2007. An attractive yield coupled with portfolio shifting by international investors towards the pound sterling were the main drivers behind this significant increase. In 2007 KfW raised 7.5 billion (2006: GBP 4.2 billion) in this currency, which has since become the third most important reserve currency in the world. This figure, the equivalent of EUR 11.0 billion (EUR 6.2 billion in 2006), accounted for 17 % of the 2007 funding volume (2006: 12 %). KfW thus reinforced its market position as one of the largest issuers in GBP. The year had barely begun when KfW issued a new 5-year bond in the market that was subsequently increased to GBP 2.1 billion (EUR 3.1 billion) due to heavy investor demand. KfW also increased a 3-year bond issued shortly after to a total of GBP 1.5 billion (EUR 2.2 billion). KfW is expecting the attractive yields to keep demand for British pounds at a high level. KfW will thus remain an active issuer in this currency.

The Japanese capital market and issues denominated in Japanese yen (JPY) are another important source of funding for KfW. The growth in demand for bonds denominated in Japanese yen during 2006 rose yet again in 2007. This development prompted KfW to issue yen bonds for a volume of approx. JPY 660 billion (2006: JPY 500 billion), the equivalent of approx. EUR 4.1 billion (2006: EUR 3.4 billion). This sum was the result of nearly 280 (2006: 220) structured private placements with Japanese institutional investors and one new global bond (2006: 3). KfW also offered 12 (2006: 11) so-called Uridashi bonds for the equivalent of EUR 867 million (2006: EUR 654 million). These are bonds offered by non-Japanese issuers that cater specifically to Japanese retail investors. They may be denominated in Japanese yen or in another currency. In 2007 KfW issued most of its Uridashi bonds in Japanese yen and the rest in Australian and New Zealand dollars.

Australian, Canadian and New Zealand dollars as well as Swiss francs are the other core funding currencies in which KfW refinances itself. As they account for only 1-2 % (EUR 0.7-1.2 billion) of total borrowings, however, they play a minor role in comparison. In these markets KfW, as in 2006, again issued large-volume bonds during 2007, the largest being a 5-year bond under its Kangaroo Programme. In response to strong demand the bond volume was increased several times to a total volume of AUD 1 billion.

Borrowings in 2006/2007 by currency[1)]
EUR in billions and in %

	2006		2007	
Currency	EUR in billions	in %	EUR in billions	in %
EUR	22.4	41	25.3	39
USD	15.7	29	16.9	26
GBP	6.2	12	11.0	17
JPY	3.4	6	4.1	6
Other core currencies (AUD, CAD, CHF, NZD)	3.2	6	3.7	6
Other currencies	3.1	6	3.6	6
European currencies (e.g. NOK, RUB, TRY)	*2.2*	*4*	*2.4*	*4*
African currencies (EGP, NGN, ZAR)	*0.4*	*1*	*0.5*	*1*
Asian currencies (e.g. MYR, THB)	*0.2*	*< 1*	*0.2*	*< 1*
Latin American currencies (BRL, MXN)	*0.3*	*1*	*0.4*	*1*
Total	**54.1**	**100**	**64.6**	**100**

1) Differences in the totals are due to rounding. The adjustments in the calculation method may lead to differences in some of the previous year's figures compared with past publications.

OTHER CURRENCIES – FOCUS ON DEVELOPMENT OF LOCAL CAPITAL MARKETS.

In addition to its core currencies KfW also issues bonds in a number of other currencies in order to establish an investor base that is as broad and diversified as possible. In the reporting year these currencies accounted for 6 % (2006: 6 %) of all funds raised by KfW, corresponding to EUR 3.6 billion (2006: EUR 3.1 billion). By carrying out parallel hedging transactions, the bank avoids currency risks when it issues bonds in these other currencies. KfW is one of the world's main issuers in the emerging markets. These include the up-and-coming capital markets in Asia, Europe, Latin America and Africa.

KfW issues these bonds for institutional investors which need to invest in these non-core currencies without incurring issuer default risk. In this way, KfW gives them the opportunity to achieve currency gains or to take advantage of particularly attractive interest rates for these currencies. Buyers of these KfW bonds, which can generally be traded on the stock exchanges in Frankfurt and Luxembourg, are mainly investors outside the respective country. During 2007 KfW placed bonds denominated in the Bulgarian lev, Nigerian naira, Indonesian rupee and Russian rouble for the first time. In the reporting year the largest of these bonds was a 3-year global bond issued in South African rand for the equivalent of a good EUR 230 million. In addition, a 5-year bond for the equivalent of approx. EUR 125 million was the largest and longest running bond of a foreign issuer in Egyptian pounds.

In selected capital markets KfW targets local investors. Special issues cater to interested investors seeking the reliability and security offered by an AAA issuer. KfW tailors these bonds to the needs of local investors, for instance by publishing documentation in accordance with local laws or by issuing bonds that can be traded on the stock exchange of the respective country. In this way KfW also contributes to the development of the capital market in these countries. In Thailand, for example, KfW issued its first bond in Thai baht with an issue volume equivalent to approx. EUR 65 million. KfW will continue to play an active role in tapping additional emerging markets in the future. Given the dynamic economic growth in these countries, KfW expects to raise a larger share of the funds it needs in these markets in the future.

CONTINUED HIGH LEVEL OF FUNDING IN MONEY MARKET.

The crisis in the US subprime mortgage market in the second half of 2007 put a firm stamp on the market environment. In spite of this, KfW's business activities in the money market showed pleasing growth. The bank raised funds totalling EUR 98.3 billion under its two Commercial Paper Programmes. The results of both were close to those for 2006. Both programmes are key components of the liquidity management strategy pursued by the KfW Group.

The Multicurrency Commercial Paper Programme is the most important source of short-term funds for the KfW Group and, with a total issue volume of EUR 44.2 billion, increased substantially over the previous year (EUR 28.3 billion). This marked rise can be attributed to two main factors: first, owing to an overall greater need to borrow funds resulting from a rise in KfW's promotional activities in a positive macroeconomic environment, the programme volume was increased in mid-2007 from originally EUR 12 billion to currently EUR 20 billion. This increase was accompanied by heightened issuing activity. Second, due to its excellent credit rating KfW benefited from the market difficulties in the second half of 2007 in the form of greater demand for its Multicurrency Commercial Paper Programme and, at the same time, a considerable improvement in funding rates. KfW offered its papers in all common currencies and has a well-diversified investor base. In this market segment it has been asserting its status for years as one of the world's leading issuers. At the beginning of the reporting year KfW's Multicurrency Commercial Paper Programme earned the STEP (Short-Term European Paper) label. It is awarded by an independent initiative of European financial market participants and attests to the fulfilment of established standards for harmonising the short-term paper programmes of various issuers in the European money market.

In the US market the US Commercial Paper Programme offered by KfW International Finance experienced negative growth overall. During the year 2007 papers worth USD 73.7 billion were issued, corresponding to a 19 % decline over the previous year. Unlike the situation in the euro zone, the US Commercial Paper market almost came to a complete standstill in certain phases due to the crisis affecting the US subprime mortgage market. KfW was, however, able to carry on with its issuing activities at a comparatively high level, as a result of which it achieved very attractive funding rates in this programme as well. At the beginning of 2008 KfW replaced the programme of KfW International Finance Inc., Delaware/USA, with another programme in which KfW acts as issuer. This gives the bank a more uniform market presence in the USA. Once all issues made under the US Commercial Paper Programme through the end of 2007 have been redeemed, the business activities of KfW International Finance Inc. will cease indeterminately. The main programme modalities such as the programme volume of currently USD 10 billion will remain unchanged, however.

EXCELLENT SUSTAINABILITY RATING FOR KFW.

Investors who value sustainability, also called socially responsible investors (SRI), do not just take financial assessment criteria into account when making their investment decision but also consider the ecological and social actions of the issuer. Owing to its statutory mission, business model and self-image, KfW issues bonds that are especially suitable investments for this group of investors. This is also reflected in the assessments by specialised independent agencies, published in the form of sustainability ratings. For instance, in 2007 the sustainability rating agency Scoris raised its rating for the KfW Group to 72.3 points on a scale of 0 to 100 points. KfW thus ranks third among the 56 bond issuers from all over the world that were included in the assessment. This result simultaneously assigns KfW the top spot among German issuers and places it significantly above the 45.1 point average for the assessed institutions.

In the future KfW will continue to take on social responsibility and, with this as a basis, to seek a dialogue with socially responsible investors. In the reporting year, for example, KfW paid targeted visits to investors in Paris and London and is planning to broaden its activities in this area during 2008.

2008: FLEXIBLE AND GROWING.

For the coming year KfW is expecting an increase in its funding volume. The total is expected to reach approx. EUR 70 billion, driven mainly by the bank's continuing strong lending business. In view of the solidity of the German economy, KfW is expecting its lending volume to increase overall for 2008 and, along these same lines, its funding requirements to rise accordingly. Since mid-2007, when the ERP economic development scheme was reorganised, KfW has been responsible for meeting the funding requirements for the ERP promotional programmes as well. What is more, in the reporting year KfW assumed all rights and obligations under the liquidity lines granted by IKB Deutsche Industriebank AG to the Rhineland Funding conduit. As a result, in 2007 KfW experienced an outflow of funds of already nearly EUR 7 billion from its liquidity reserves. KfW will carry on with its conservative liquidity management in 2008 in order to replenish these reserves.

To raise the funds, KfW will turn to its tried and tested mix of benchmark bonds, other public bonds and private placements. The EUR and USD benchmark programmes will constitute – at an ever increasing rate - its main source of funding. At least four benchmark bonds each in EUR and USD are planned. For both currencies KfW has set itself the goal of covering the complete yield curve again in 2008. Therewhile the market situation and investor demand will remain the key determinants for choosing the currency, the time of issue and the maturity of a benchmark bond. Thanks to its high flexibility KfW sees itself in a position to respond to opportunities for issuing bonds at short notice. This is all the more important given that the market environment is expected to remain volatile.

The pound sterling and the Japanese yen will also remain key currencies and markets. As it is striving for more diversification, KfW is also expecting to again expand its spectrum of issue currencies in the emerging markets.

KfW anticipates that the international capital markets will continue feeling the impact of the turbulence triggered by the crisis affecting the US mortgage market. The resulting risk aversion of institutional investors and their "flight into quality" should lead to greater demand for top-rated investments. Being the top choice for such investors all over the world is and remains KfW's goal.

PRIVATISATION OF DEUTSCHE TELEKOM AND DEUTSCHE POST.

In January 2007 the process of converting an exchangeable bond into Deutsche Post shares was completed, reducing KfW's holdings from 410.5 million to 368.3 million shares. Apart from this conversion, no other privatisation transaction was carried out in the past financial year. Therefore, KfW's holdings in Deutsche Telekom and Deutsche Post of 735.7 million shares and 368.3 million shares, respectively, did not change during the rest of the year. They represented 16.9 % and 30.5 % of the share capital of the respective enterprise as at 31 December 2007.

STRUCTURE AND MANAGEMENT OF KFW'S SECURITIES PORTFOLIOS.

With regard to its financial investment activities, KfW maintains a number of different securities portfolios. These are primarily used to either maintain sufficient liquidity and support efficient liquidity management or are related to the investment of KfW's equity capital. The bulk of these financial investments are managed internally (direct securities investment). For the purpose of strategic asset allocation, in turn, external investment companies have been mandated to invest in specialised funds (as defined in the German Investment Act).

Direct investment in securities is used primarily to maintain the liquidity of KfW Bankengruppe. Investment is in bonds only. Liquidity is maintained by selling liquid securities in the market when necessary. On the other hand, most of KfW's direct securities investments are regularly deposited with the European Central Bank (ECB), giving KfW access to the equivalent volume of primary liquidity. At the end of 2007 direct investment in securities reached a nominal volume of around EUR 30.7 billion.

Investment in special funds is used partly to maintain liquidity and partly to invest KfW's equity capital. These two investment motives are taken into account in differing investment guidelines. On the basis of modern portfolio theory, KfW uses strategic asset allocation (SAA) to distribute its fund investments, not only on a long-term basis but also efficiently among the different asset classes and market segments. This modern approach to portfolio optimisation takes account of earnings requirements as well as risk propensity or the ability to sustain risk, with both resulting in risk-adjusted and internationally broadly diversified portfolios. Individual investment segments are managed by specialised asset management companies. In the case of fund-related securities, liquidity may be achieved by selling securities from the different funds. At the end of 2007 securities investments in special funds totalled around EUR 7.0 billion.

The concept of strategic equity allocation is a further development of KfW's equity capital management. Return on equity is an important earnings component for KfW; its long-term optimisation and stabilisation serves to safeguard KfW's promotional capacities and has high priority for the Group. It is therefore appropriate to exploit the positive impact on earnings and risk achieved by diversifying investment over a variety of investment classes and market segments. The management concepts for all portfolios are constantly being further developed and optimised in terms of liquidity, earnings and risk.

KfW also takes sustainability aspects into consideration in its investment decisions. The Group underlined this commitment by joining the "Principles for Responsible Investment" initiative of the United Nations and by signing the "Carbon Disclosure Project". Moreover, KfW has developed a sustainability definition for its own securities investments that comprises all three dimensions – environment, social concerns and corporate governance. Sustainability criteria focusing on environment issues are also based on this definition. From 2008 onward they will be taken into account in addition to the credit quality of selected issuers for internally managed securities portfolios.

TASKS RELATED TO GERMAN UNIFICATION.

KFW MANAGES OUTSTANDING CLAIMS PASSED TO THE FEDERAL REPUBLIC OF GERMANY IN THE PROCESS OF GERMAN UNIFICATION.

KfW administers outstanding claims that passed to the Federal Republic of Germany in the process of German unification. The original volume of approximately EUR 3.3 billion has since been reduced to around EUR 21 million. As the legal representative, KfW also manages the accounts of unidentified creditors. At present around 900 such accounts are still open.

CLAIMS RESULTING FROM FOREIGN TRADE BY THE FORMER GDR.

On behalf of the Federal Government KfW handles claims against a number of other countries resulting from their foreign trade with the former GDR. KfW also handles claims on German exporters for reimbursement arising out of amounts wrongly offset against transfer rubles. KfW was able to collect around EUR 32.8 million from these two areas for the Federal Government during the reporting year.

CURRENCY COMPENSATION EQUALISATION FUND.

KfW has been mandated to conduct agency business for the Currency Compensation Equalisation Fund. The Fund was established in connection with German monetary union. EUR 45.6 billion in compensation claims had been paid in full by 31 December 2007. The compensation liabilities added up to EUR 1.9 billion. After deduction of the redemption payments already made, EUR 8.4 million in compensation liabilities against the Inherited Debt Fund are still outstanding.

FUB.

The Finanzierungs- und Beratungsgesellschaft (FuB) handles business on behalf of the Federal Agency for Special Tasks arising from Unification (BvS). This includes contract management for the purpose of supervising and fulfilling the obligations under the privatisation agreements, handling participations for companies that are being wound up, and dealing with reprivatisation, including handling restitution claims.

A clear reduction in the number of cases outstanding in all areas was achieved in the period under review. There were thus only 124 privatisation contracts and 43 enterprises to be wound up as at 31 December 2007.

The FuB also handles special tasks relating to the currency conversion, especially identifying persons entitled to make claims on foreign currency accounts held at the time. In 2007 another approx. 650 credit balances totalling around EUR 0.5 million were paid out to previously unidentified creditors or transferred to the Compensation Fund at the Federal Office for the Settlement of Open Property Questions. As at 31 December 2007 only about 3,400 accounts representing a total of around EUR 4.0 million remained.

Finally, FuB assumed the handling of business for the State Insurance Company of the GDR in Liquidation (SinA) on 1 January 2007. KfW was appointed its legal successor as from 1 January 2008. The handling of business includes the settlement of claims incurred in the period prior to 31 December 1990. Around 2,100 claims remained outstanding as at 31 December 2007.

OTHER SERVICES.

COMPENSATORY FUND FOR SECURITIES TRADING COMPANIES.

In 1998 KfW set up the Compensatory Fund for Securities Trading Companies (EdW) as a Federal Government Special Fund without legal capacity. The EdW insures small investors against loss on their claims arising from securities transactions up to the minimum amount laid down by law. To date the EdW has dealt with 2,600 claims for compensation and has paid 1,700 investors some EUR 13 million in total.

FOUNDATIONS.

In the reporting year KfW also managed the Contergan Foundation for handicapped people and the foundation which provides humanitarian aid for people infected with HIV through blood products ("Humanitäre Hilfe für durch Blutprodukte HIV-infizierte Personen") on behalf of the Federal Government. In 2007 KfW paid out EUR 25 million in compensation to 3,500 beneficiaries.

In addition, in the reporting year the Contergan Foundation provided a total of EUR 1.6 million to support seven projects aimed at improving the social participation of disabled persons. A multiyear mentoring project initiated by the Contergan Foundation in partnership with the Hildegardis-Verein deserves particular mention. Among other activities, this initiative appoints Contergan handicapped persons as mentors to guide handicapped female students during their academic studies.

THE MEN AND WOMEN ON OUR STAFF.

DEVELOPMENT OF STAFF NUMBERS AND STRUCTURE.

KfW again increased its staff in the reporting year. In doing so, it maintained a strict balance among its staff policy goals: ensuring that staff growth is commensurate with the volume of business, keeping staff costs in check, and safeguarding existing jobs. At the same time it had to keep an eye on the long-term impacts of the demographic shift.

At year-end KfW employed 3,798 people. Compared with 3,580 in the previous year, its staff count thus increased by 6.1 % (2006: 3.7 %). This above average growth was attributed to the buildup of KfW IPEX-Bank, which has been operating in the market as an independent bank since 1 January 2008. A particularly important development in the year under review was the disproportionately large expansion of risk management. The areas of "information system development and consulting" and "financial markets, treasury, capital markets, investments" played a major role as well. The other staff and lending departments also saw positive development. The staff numbers did not increase quite as much, however. The staff count of KfW Entwicklungsbank, which had remained constant in previous years, finally rose again during the year under review. Owing to new development policy challenges in Germany, Development Cooperation took on new tasks requiring more staff. In addition, the bank fulfilled its social obligations towards the younger generation in a special way, namely by significantly increasing the number of its trainee positions for school and university graduates.

The share of women at KfW remained high at 48.6 % (previous year: 48.5 %). The share of staff not covered by collective agreements was nearly constant at 64.3 % compared to 64.4 % in 2006. There was a minimal increase in the share of women among staff not covered by collective agreements from 39.1 % to 39.2 %. Individual assessments of potential coupled with the special promotion of qualified female employees again led to a steady growth in the number of women in management positions. This is all the more important since the junior management level serves as the basis from which more women can be recruited for senior management. The share of women at all management levels thus increased in the reporting year by a full percentage point to 23.8 % (from 22.9 % in 2006).

The overall share of part-time employees was 16.4 % (previous year: 16.1 %), with various part-time work models being applied. By offering such models KfW is helping its staff to strike a balance between work and family.

The number of disabled employees rose along with the staff count. Percentage-wise this figure remained nearly constant at 5.9 % (6.1 % in 2006). Once again KfW's commitment to integrating disabled persons into working life clearly exceeded the statutory 5 % mark. Above and beyond this KfW makes a great effort to integrate disabled persons in all areas of working life. At 7.3 % their share in vocational training, for instance, was quite satisfactory.

DEVELOPMENT OF PERSONNEL AT KFW IPEX-BANK, ADDITION OF REPRESENTATIVE OFFICES AND TRANSFER OF BUSINESS.

In 2007 KfW IPEX-Bank again appointed more new staff in the field of international project and export finance. At the end of the year it employed 420 people compared with 400 the year before. It met its staffing requirements by tapping both the internal and external labour market (direct hires and graduate trainees). In the year 2008 KfW IPEX-Bank is expecting to fill approx. 30 more positions.

To provide support for its international business activities, KfW has representative offices in Bangkok and São Paulo as well as in New York, Istanbul, Mumbai and Moscow that will successively be transferred to KfW IPEX-Bank. Further office openings are planned for Johannesburg, Singapore and Abu Dhabi. The London representative office will be converted into a branch office in 2008.

The human resources policy of KfW IPEX-Bank during 2007 was fully oriented to the pending transfer of business as at 1 January 2008 to KfW IPEX-Bank GmbH. The bank and the staff council negotiated a staff agreement on the transfer of personnel that regulated all labour law and staff policy issues. Additionally KfW made initial proposals for a new pay programme for the new KfW IPEX-Bank GmbH.

MANAGEMENT REINFORCEMENT.

In the reporting year KfW reinforced its junior management staff with a number of measures. For example, fireside chats with the member of the Board of Managing Directors in charge of staffing issues were organised for the management staff of all of the bank's locations. During these chats corporate policy and staffing policy matters were discussed. By organising these discussion rounds, first and foremost the bank showed its appreciation for the executive staff as managers of the KfW Group. There are plans to continue these highly valued discussions in 2008.

NUMBER OF TRAINING PLACES FOR SCHOOL LEAVERS AND UNIVERSITY GRADUATES CONTINUES AT A HIGH LEVEL.

KfW has traditionally laid great store by its training programmes. Given its status as a member of the training pact concluded by the German Federal Government and business, and particularly as a public law institution, the KfW Group fulfilled its obligations in a special way. Having provided far more training places than required in 2006, in 2007 it again trained more young people than it actually needed.

Overall, 54 young people began a vocational training course at KfW. At the start of the new training year in autumn 2007, a total of 184 young people (previous year: 157) began their first vocational training. At the end of the year under review some of them had concluded their vocational training and been hired, leaving 164 (2006: 139) trainees still in the programme. At the same time the number of KfW's graduate trainees increased to 103 (previous year: 72). This rise was mainly due to the greater need for younger staff in risk management and at KfW Entwicklungsbank. The number of young people in vocational training thus increased to 267 (previous year: 229), corresponding to a training ratio of 7.0 % (2006: 6.4 %). KfW thus exceeded the industry average.

PARTNER OF THE "BERLIN ALLIANCE FOR FAMILIES".

Having already joined the "Frankfurt alliance to promote the family" in 2005, KfW is now also a supporting partner of the "Berlin alliance for families". The Berlin alliance aims to offer people the proper framework for a goal-oriented life plan in both spheres of life – work and family. This is an important social task that cannot be fulfilled by the State or an employer alone. Through its work and family-oriented staffing policy, the bank seeks to share its experiences within this alliance, passing them on to both companies and communities. In return, KfW is hoping to benefit from the experiences of others. One of the alliance's projects is a nursery which is operated by a local network comprising KfW, Deutsche Bundesbank and the city of Frankfurt.

"OCCUPATION AND A FAMILY" AUDIT CONFIRMED.

In the year under review KfW's certificate from the "Occupation and a Family" audit, awarded by the non-profit Hertie foundation, was confirmed. It marked the second time that the bank was commended for its family-oriented staffing policy. The main factor considered was child care, including nurseries, a kindergarten and after-school care. The "family service", which also makes flexible part-time work models possible for executive staff, and heightened awareness that part-time work is not a career obstacle also play key roles. In the year under review the bank created additional child care opportunities at its Bonn branch. The measures also included pilot projects with part-time job-sharing models. Flexible working hours without core times, home teleworking, insistence on equal opportunities, and support for persons with severe disabilities round off what the bank has to offer. Apart from the "Occupation and a Family" offer from the year 1994, which regulates the working hours for parents raising children even beyond parental leave, enables staff to care for their next of kin and offers sabbaticals, KfW's staffing policy today aims to bring its staff back into working life as soon as possible after the birth of their child. Frequently this involves an individually designed combination of part-time work, home teleworking and partial presence in the office.

THANKS TO THE MEN AND WOMEN OF OUR STAFF, THE EQUAL OPPORTUNITIES OFFICER AND THE STAFF COUNCILS.

We would like to thank all members of staff for the contribution they have made to fulfilling the promotional mission of the KfW Group.

All current staffing, social, organisational and economic issues were discussed at regular meetings with the competent Staff Councils and with the Equal Opportunities Officer. We thank the General Staff Council, the local Staff Councils and the Equal Opportunities Officer for the good and trustful cooperation during the past year.

IN MEMORIAM.

We were saddened by the death in 2007 of our active staff members Lydia Kullmann, Gabriele Schalwat, Karl-Ludwig Frank, Peter Geisler and Hans-Ulrich Zoll. We also mourn the death of our retired members of staff Else Christl, Margarete Kastl, Hildegard Kempter, Erika Nerlich, Elly Perez, Ursula Riede, Karin Schörnick, Maria Spohr, Margret Zander, Ulrich Gutzeit, Heinz Hoppen, Rudolf Jahr, Wolfgang Kuhboht, Willi Lausen, Frieder Opitz, Erwin Picht, Hubert Riebartsch, Alfred Rühl, Kurt Schmilewski, Helmut Wolff and Reiner Zabel.

We will always remember them with gratitude.

FINANCIAL REPORTING.

Financial reporting.

The Annual Report presents the group income statement, the group balance sheet and the economic and risk report of the group management report. The complete consolidated financial statements including the group management report are contained in our Financial Report, which is available for download from our website. The annual financial statements and the management report of KfW are also available for download. The auditing firm Pricewaterhouse Coopers AG Wirtschaftsprüfungsgesellschaft issued an unqualified opinion on both the consolidated and the individual financial statements as at 12 March/2 April 2008.

Income statement
EUR in millions

	2007 EUR in millions	2006 EUR in millions	Change EUR in millions
Interest income	27,578	23,688	3,890
Interest expense	25,823	21,934	3,889
Net interest income	**1,755**	**1,754**	**1**
Risk provisions for lending business	– 6,409	–12	– 6,397
Net interest income after risk provisions	**– 4,655**	**1,741**	**– 6,396**
Commission income	388	369	19
Commission expense	178	169	9
Net commission income	**209**	**200**	**10**
Net gains/losses from hedge accounting	73	–17	91
Net gains/losses from other financial instruments at fair value through profit or loss	–1,953	172	– 2,125
Net gains/losses from securities and investments	–421	19	– 440
Administrative expense	607	573	34
Net other operating income	1,189	32	1,157
Profit/loss from operating activities	**– 6,164**	**1,574**	**– 7,738**
Taxes on income	4	10	–6
Consolidated profit/loss	**– 6,168**	**1,564**	**– 7,732**

Assets
EUR in millions

	31 Dec. 2007 EUR in millions	31 Dec. 2006 EUR in millions	Change EUR in millions
Cash reserves	26	26	0
Loans and advances to banks	205,738	191,228	14,510
Loans and advances to customers	100,267	93,262	7,005
Risk provisions for lending business	– 7,671	–1,964	– 5,707
Value adjustments from macro fair value hedge accounting	–1,295	219	–1,514
Derivatives used for hedge accounting	5,570	3,196	2,374
Other derivatives	3,166	3,977	– 812
Securities and investments	45,745	41,802	3,943
Property, plant and equipment	801	778	23
Intangible assets	69	59	11
Other assets	1,579	1,806	– 227
Total	**353,997**	**334,389**	**19,608**

Liabilities and equity
EUR in millions

	31 Dec. 2007 EUR in millions	31 Dec. 2006 EUR in millions	Change EUR in millions
Liabilities to banks	13,366	17,990	– 4,624
Liabilities to customers	37,121	41,958	– 4,837
Certificated liabilities	260,315	240,086	20,229
Value adjustments from macro fair value hedge accounting	– 423	– 329	– 94
Derivatives used for hedge accounting	4,091	5,009	– 919
Other derivatives	17,114	9,013	8,100
Provisions	1,545	996	549
Other liabilities	2,185	2,462	– 277
Subordinated liabilities	3,747	500	3,247
Equity	14,936	16,702	-1,766
Total	**353,997**	**334,389**	**19,608**

ECONOMIC REPORT.

OVERVIEW OF THE KFW GROUP.

KfW's consolidated financial statements for the past financial year were prepared in accordance with International Financial Reporting Standards (IFRS) for the first time. The comparative figures for the previous year were also prepared on the basis of IFRS.

The KfW Group consists of KfW and six consolidated subsidiaries. In addition, five special funds responsible for strategic asset management have been included in the consolidated financial statements in accordance with the requirements of SIC 12. The development of the Group's business is largely dependent on the performance of KfW.

Composition of the KfW Group
Balance sheet total (EUR in millions) before consolidation

	2007 EUR in millions	2006 EUR in millions
KfW	353,153	332,905
Subsidiaries		
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH (DEG), Cologne	3,254	2,739
KfW International Finance Inc. (KfW Finance), Delaware, USA	2,782	3,007
KfW Beteiligungsholding GmbH, Bonn	1,107	1,437
tbg Technologie-Beteiligungs-Gesellschaft mbH (tbg), Bonn	600	644
KfW IPEX-Beteiligungsholding GmbH, Frankfurt	219	33
Finanzierungs- und Beratungsgesellschaft mbH (FuB), Berlin	48	48
Special purpose entities required to be consolidated		
Five special funds	7,417	6,554
Investments accounted for using the equity method		
Movesta Lease and Finance GmbH, Düsseldorf (50 %)	193	259
IKB Deutsche Industriebank AG, Düsseldorf (37.8 %)	–	53,262
Assets held for sale (IFRS 5)		
IKB Deutsche Industriebank AG, Düsseldorf	63,538	–

GENERAL ECONOMIC ENVIRONMENT.

The global economy continued to grow rapidly in 2007. According to the data available to date, worldwide GDP increased by just under 5 % in real terms. Thus, the high level of growth of the previous year remained nearly constant. Led by China and India, emerging and developing countries recorded extremely strong growth, which was slightly higher than in the previous year. In contrast, growth slowed in the Eurozone and the United States. The rate of growth in Germany was somewhat slower than in the previous year. However, the 2.5 % increase in price-adjusted GDP was still well above the long-term average for the reunited Germany. On average, small and medium-sized enterprises rated the business climate during 2007 as the most positive since reunification, although confidence tailed off as the year progressed. The major growth drivers for the economy as a whole – in addition to the strong stimulus from exports – were government expenditures and, most importantly, gross fixed capital formation. On the other hand, growth in housing construction was slower than in the previous year, when a number of one-off factors generated increased construction activity in this market segment. For example, the announcement of an increase in VAT due at the start of 2007 led to efforts to award housing construction contracts earlier than planned in 2006. Purchases of consumer goods in private households were stimulated for the same reason, resulting in weaker and even moderately dwindling private consumption in 2007.

In contrast to the generally healthy situation in the real economy, the environment for the financial markets deteriorated significantly during the course of 2007. This was caused by the mounting problems in the subprime segment of the US mortgage market. As a result of falling demand in the US property market and interest rate adjustments to mortgages, a growing number of US private households ran into payment difficulties, which led to a significant rise in default rates, especially in relation to variable subprime loans. The number of bankruptcies among subprime mortgage lenders consequently rose during the first quarter of 2007. In the summer, the problems in the US subprime segment spread to become a crisis of confidence affecting the international banking system, following the downgrading of mortgage-backed securities (MBS), collateral debt obligations (CDO) and MBS/CDO securities by the ratings agencies and reports of liquidity difficulties at some hedge funds. As a result of uncertainties about the distribution of risks, risk premiums in money markets rose substantially and securitisation markets effectively dried up. The biggest problem for the financial system, however, proved to be off-balance sheet special purpose entities which had refinanced long-term mortgage securities by issuing short-term commercial paper. When this financing channel became no longer viable because of the lack of demand for such commercial paper, the banks that had granted liquidity facilities to these conduits were also drawn into the crisis.

In the first quarter of 2008 the deterioration of the US real estate market fundamentals continued unabated. Default rates of subprime borrowers are still rising strongly, the number of foreclosures is climbing to levels last seen in the early 1980s, and the decline in the prices of homes is starting to accelerate. The drying up of liquidity, in particular, is turning out to be problematic. As most banks and mortgage lenders have withdrawn from the business segment the borrowers attributed to the subprime segment are practically no longer able to obtain new loans even if they have adequate solvency. The Federal Reserve's interest rate cuts and the rescue measures introduced by the US Government have not yet shown any effect on the real estate market.

In this environment the drop in the prices of mortgage-backed securities in the first quarter accelerated further, and default risks continued to increase. In the meantime, the rating agencies have also made massive adjustments to their models, which has led to further dramatic and hitherto unparalleled downgrades, particularly for subprime ABS and subprime ABS CDOs.

Prior to the emergence of this crisis of confidence, capital market interest rates in the United States and the Eurozone had risen on balance until around the middle of 2007. In the second half of the year, the turbulence in the financial markets and a downward revision of expectations for the US economy resulted in greater demand for fixed-interest government bonds and a corresponding decline in capital market interest rates, which fell more significantly in the United States than in the Eurozone. In response to the increased risk to the economy and the loss of confidence among participants in the money markets, the US Federal Reserve's base rate was cut by a total of 100 basis points in the last four months of 2007 while the ECB made no further increases in its base rate in the second half of the year. Nevertheless, as a result of the lack of confidence, interest rates on the money markets after August were considerably higher than would have been justified by the level of base rates.

DEVELOPMENT OF THE KFW GROUP.

In 2007, the Group increased its promotional business volume by 13 % to EUR 87.1 billion, particularly as a result of strong growth in its domestic promotional loan business. The assets, financial position and earnings position of the Group were primarily influenced by the one-time effects of the reorganisation of the ERP promotion programme and the risk protection provided to IKB Deutsche Industriebank AG (IKB), Düsseldorf.

When the Act for the Reorganisation of ERP Economic Promotion *(Gesetz zur Neuordnung der ERP-Wirtschaftsförderung)* came into effect, the ERP Special Fund contributed equity capital amounting to EUR 4.65 billion and subordinated loans of EUR 3.25 billion to KfW as at 1 July 2007.

Income generated from the newly contributed equity capital may only be used for the purposes of the ERP economic promotion and – together with promotional subsidies provided by the ERP Special Fund – covers the expenses incurred by KfW in implementing the ERP economic promotion. Income from the pre-existing share of the ERP Special Fund in KfW's equity will continue to be used to preserve the substance of the ERP Special Fund.

IKB, which had encountered existential problems due to the US subprime crisis and in which KfW held a 37.8 % interest as at the balance sheet date, has been receiving financial backing in the form of risk protection from KfW together with three associations of the German banking industry (associations) since the end of July 2007. This risk protection was increased at the end of November 2007 to include coverage of the remaining risks from the "Havenrock structure". KfW is thus making a significant contribution to the stabilisation of the financial markets and of Germany as a financial centre. Charges from the risk protection amounted to EUR 6.8 billion at year-end.

These charges include the current market developments of the first quarter 2008 which are treated as an adjusting event after the balance sheet date. In consistent application of its conservative valuation approach, KfW has taken these developments into account and, accordingly, revalued the portfolio at the end of March.

IKB was protected from both on-balance sheet and off-balance sheet risks through a variety of measures:

- KfW assumed the rights and obligations under IKB's liquidity lines for the purpose of refinancing the Rhineland Funding Capital Corporation (RFCC), New York/USA, conduit, which required KfW to provide for potential loan losses in the form of individual impairments.
- KfW assumed risks in the amount of USD 1.5 billion through credit derivatives in connection with the reverse hedge provided to other liquidity providers for RFCC (Havenrock structure). These instruments gave rise to write-downs on revaluation.
- KfW assumed IKB's risks from its structured securities portfolios by way of financial guarantees and credit derivatives. This risk protection measure is capped at EUR 1.0 billion.

Since KfW's Board of Supervisory Directors resolved as at 30 November 2007 to move forward with a prompt sale of IKB, KfW's equity investment in IKB is no longer reported as an associate but rather according to accounting rules for assets held for sale. Accordingly, KfW wrote down its IKB shares to market value based on the share price as at 31 December 2007, taking into consideration the costs expected in connection with a sale of the interest in IKB. This write-down resulted in an additional expense of EUR 0.4 billion at year-end.

In order to fund a significant portion of the charges arising from the IKB crisis, which amount to EUR 7.2 billion in total, KfW applied EUR 5.3 billion from its fund for general banking risks. Under IFRS, this fund is a component of equity, so this application did not impact the income statement.

In the second half of 2007, the problems in the US subprime segment spread to become a general crisis of confidence in the financial markets. High risk premiums even for highly-rated issuers and the drying-up of the securitisation markets led to severe market disruptions.

Due to the Group's conservative investment policy, the fluctuations in value recorded were comparatively modest given the Group's large securities portfolio of approximately EUR 44 billion. The valuation losses of securities held by the Group, largely considered temporary, totalled just under EUR 0.6 billion. Of this amount, EUR 0.2 billion was reported under revaluation reserves directly in equity. The share of the expenses recorded in the income statement and in equity from ABS securities held directly by KfW with generally high creditworthiness amounted to EUR 0.2 billion.

The following key figures provide an introductory overview of the developments in the 2007 financial year:

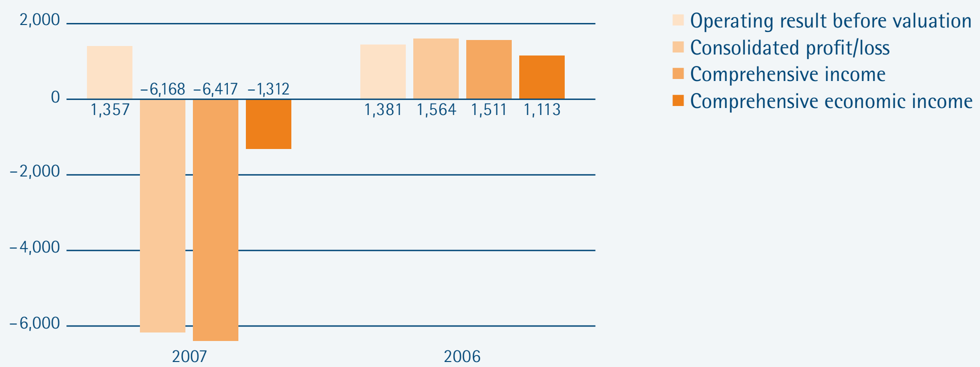
KfW Group key financial figures

	2007	2006
Balance sheet key figures	**EUR in billions**	**EUR in billions**
Total assets	354	334
Volume of lending	341	327
Contingent liabilities	6	7
Irrevocable loan commitments	39	45
Assets held in trust	19	19
Business volume	417	406
Equity	15	17
Income statement key figures	**EUR in millions**	**EUR in millions**
Operating result before valuation	1,357	1,381
Operating result after valuation[1)]	– 6,182	1,542
Consolidated profit/loss	– 6,168	1,564
Economic income statement key figures	**EUR in millions**	**EUR in millions**
Comprehensive income	– 6,417	1,511
Comprehensive economic income	– 1,312	1,113
Key capital figures	**%**	**%**
Equity ratio	4.2	5.0

[1)] Including the participation of the associations in the risk protection provided to IKB.

The consolidated total assets of the KfW Group rose by EUR 19.6 billion (5.9 %) to EUR 354.0 billion in financial year 2007. Loans and advances (EUR 285.8 billion), in particular, developed positively with an increase in volume of EUR 27.7 billion. Financial assets also rose significantly by EUR 3.9 billion to EUR 45.7 billion. Growth was mainly funded by increased issuing activities. The volume of certificated liabilities, at EUR 260.3 billion, was EUR 20.2 billion higher than in the previous year.

Operating result before valuation, consolidated profit/loss, comprehensive income and comprehensive economic income
EUR in millions



The operating result before valuation was EUR 1,357 million, which was slightly lower than the previous year's figure of EUR 1,381 million.

The charges arising in connection with the risk protection for IKB and the write-down of KfW's equity interest in IKB led to a consolidated loss for 2007 of EUR 6,168 million. In the previous year, the Group recorded a EUR 1,564 million profit.

From an economic perspective, additional expenses resulted from valuation losses on securities carried directly in equity that are taken into account for the comprehensive income.

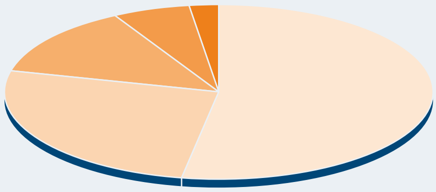
Excluding charges in connection with the IKB crisis that were covered by the application of the fund for general banking risks – which the Group uses to provision for risks – and other IFRS effects not deemed economically reasonable, the Group recorded negative comprehensive economic income of EUR – 1,312 million in 2007 after a strong business performance in 2006.

This decline was mainly due to the charges resulting from the IKB crisis that were not covered by the fund and the largely temporary expenses resulting from fair value accounting for securities portfolios, amounting to EUR 0.6 billion. On the other hand, the encouraging performance of the promotion of equity participations, in particular, had a positive impact. Risk provisions for the remaining lending business remained low.

DEVELOPMENT OF ASSETS.

The Group's core business is lending to banks and customers. 79 % of the Group's assets in 2007 were attributable to its lending business.

Assets 2007



	2007	2006
Net loans and advances to banks	53 %	49 %
Net loans and advances to customers	26 %	27 %
Securities and investments	13 %	13 %
Other receivables to banks/customers	6 %	8 %
Derivatives	2 %	2 %
Other assets	0 %	1 %

The volume of lending rose by EUR 13.5 billion, or 4 %, to EUR 340.9 billion. The increase would have been even higher if not for the weakness of the US dollar.

Volume of lending
EUR in millions

	2007 EUR in millions	2006 EUR in millions	Change EUR in millions
Loans and advances	285,805	258,136	27,669
Risk provisions for lending business	– 7,671	– 1,964	– 5,707
Net loans and advances	**278,134**	**256,172**	**21,962**
Contingent liabilities from financial guarantees	5,850	6,731	– 881
Irrevocable loan commitments	38,462	45,162	– 6,700
Loans and advances held in trust	18,440	19,371	– 931
Total	**340,887**	**327,436**	**13,450**

The growth in loans and advances of EUR 27.7 billion to EUR 285.8 billion was largely driven by the domestic promotional loan business with its Entrepreneur Loan *(Unternehmerkredit)* programme and the "Housing, Environment, Growth" initiative. Liquidity lines granted as part of the risk protection provided to IKB also increased loans and advances. Risk provisions relating to IKB were primarily responsible for the increase in risk provisions for lending business by EUR 5.7 billion to EUR 7.7 billion. Net loans and advances in total represented 82 % of the volume of lending, or EUR 278.1 billion.

Contingent liabilities from the Group's financial guarantee business declined year on year to EUR 5.9 billion, accounting for 2 % of the volume of lending. Irrevocable loan commitments declined by EUR 6.7 billion to EUR 38.5 billion due to the high level of loans in 2007. Within assets held in trust, the volume of loans and advances held in trust, which mainly comprise loans promoting developing countries and financed by budget funds of the Federal Republic of Germany, declined by 5 % year on year and amounted to EUR 18.4 billion.

Other receivables to banks and customers, which consists mostly of short-term funds, declined by EUR 6.2 billion from the previous year's figure of EUR 26.4 billion.

Bonds and other fixed-income securities increased by EUR 5 billion to EUR 42.3 billion, while the volume of money market securities declined by EUR 1.1 billion to EUR 0.4 billion. In addition, the volume of securities held in special funds for strategic investment purposes increased to EUR 7.4 billion as at 31 December 2007. The total amount of securities and investments of EUR 45.7 billion increased by 9 % compared to the previous year.

Securities and investments
EUR in millions

	2007 EUR in millions	2006 EUR in millions	Change EUR in millions
Bonds and other fixed-income securities	42,787	38,933	3,853
Shares and other non-fixed income securities	1,526	1,529	– 3
Equity investments	1,205	731	474
Shares in affiliated entitites not included in the consolidated financial statements	18	12	6
Investments accounted for using the equity method	5	597	– 592
Shares in held for sale affiliated entities	204	0	204
Total	**45,745**	**41,802**	**3,943**

As at 31 December 2007 securities and investments included ABS with a carrying amount of EUR 6.4 billion held directly by KfW.

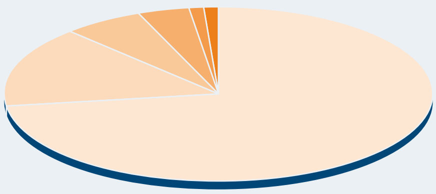
The volume of derivatives with positive fair values increased by EUR 1.6 billion to EUR 8.7 billion.

Value adjustments from macro hedging for the portfolios of underlying balance sheet assets declined by EUR 1.5 billion.

There were only minor changes to the other balance sheet items.

DEVELOPMENT OF FINANCIAL POSITION.

Funds raised in the form of certificated liabilities, which represented 74 % of the balance sheet total, continued to account for the majority of the Group's sources of funding.



Funding structure 2007

	2007	2006
Certificated liabilities	74 %	72 %
Liabilities to banks/customers	14 %	18 %
Derivatives	6 %	4 %
Equity	4 %	5 %
Subordinated liabilities	1 %	0 %
Other liabilities	1 %	1 %

Borrowings rose by EUR 13.8 billion, or 5 %, to EUR 313.5 billion and were the primary source of funding for the expansion of the volume of business.

Borrowings
EUR in millions

	2007 EUR in millions	2006 EUR in millions	Change EUR in millions
Short-term funds	23,550	16,285	7,264
Bonds and other fixed-income securities	241,437	230,015	11,422
Other borrowings	44,739	52,916	– 8,177
Subordinated liabilities	3,747	500	3,247
Total	**313,473**	**299,716**	**13,756**

Funds raised in the form of issues of medium and long-term bonds and other fixed-income securities of KfW represented the Group's principal source of funding. In 2007, such funds amounted to EUR 241.4 billion, representing an increase of EUR 11.4 billion and accounting for 77 % of borrowings. Short-term issues of commercial paper rose by EUR 8.8 billion, to EUR 18.9 billion. The total amount of short-term funds raised amounted to EUR 23.6 billion. Other borrowings by KfW, in addition to promissory note loans by banks and customers, which declined by EUR 3.5 billion to EUR 25.4 billion compared with the previous year, consisted mainly of liabilities to the federal budget.

The volume of derivatives with negative fair values rose by EUR 7.2 billion to EUR 21.2 billion as at year-end.

Provisions increased by EUR 0.5 billion to EUR 1.5 billion – in particular, due to risk provisions for guarantees assumed as part of the risk protection provided to IKB.

As part of the reorganisation of the ERP economic promotion programme, the ERP Special Fund granted EUR 3.25 billion in subordinated loans to KfW. The total volume of subordinated liabilities thus amounted to EUR 3.75 billion.

There were only minor changes to the other balance sheet items.

The changes in equity were in particular influenced by the Act for the Reorganisation of ERP Economic Promotion *(Gesetz zur Neuordnung der ERP-Wirtschaftsförderung).* The net reduction of the Group's fund for general banking risks and the balance sheet loss had an offsetting effect. In total, equity was EUR 1.8 billion below the previous year's level, at EUR 14.9 billion. The equity ratio based on reported equity amounted to 4.2 % compared with 5.0 % in the previous year.

Equity
EUR in millions

	2007 EUR in millions	2006 EUR in millions	Change EUR in millions
Paid-in subscribed capital	**3,300**	3,300	0
Capital reserve	**6,254**	1,604	4,650
including promotional reserves from the ERP Special Fund	*4,650*	*0*	*4,650*
Reserve from the ERP Special Fund	**804**	757	47
Retained earnings	**5,862**	5,584	278
Fund for general banking risks	**200**	5,300	– 5,100
Revaluation reserves	**– 92**	157	–249
Balance sheet loss	**–1,393**	0	–1,393
Total	**14,936**	**16,702**	**–1,767**

The capital reserve increased by EUR 4.65 billion to EUR 6.25 billion due to the transfer of promotional reserves of the ERP Special Fund as part of the reorganisation of ERP economic promotion. EUR 5.3 billion was applied from the fund for general banking risks in 2007 in order to cover the charges arising in connection with the IKB crisis. The fund for general banking risks totaled

EUR 0.2 billion as at 31 December 2007 after an addition of the same amount from current profit.

Valuation losses recognised directly in equity relating to available-for-sale financial assets resulting primarily from the negative conditions affecting international financial markets were responsible for a decline in revaluation reserves of EUR 0.2 billion.

The reserve from the ERP Special Fund and retained earnings increased by a total of EUR 0.3 billion. An amount corresponding to KfW's unconsolidated net loss of EUR 1.4 billion for 2007 was reported as a balance sheet loss.

DEVELOPMENT OF EARNINGS POSITION.

The earnings position is comparable with the previous year's figures only to a limited extent because of the impact of the IKB crisis.

Earnings position
EUR in millions

	2007 EUR in millions	2006 EUR in millions	Change EUR in millions
Net interest income	1,755	1,754	1
Net commission income	209	200	9
Administrative expense	607	573	34
Operating result before valuation	**1,357**	**1,381**	**– 24**
Risk provisions for lending business	– 6,409	– 12	– 6,397
Net gains/losses from hedge accounting and other financial instruments at fair value through profit or loss	–1,880	155	–2,035
Net gains/losses from securities and investments	–421	19	– 440
Operating result after valuation	**– 7,353**	**1,542**	**– 8,895**
Net other operating income	1,189	32	1,157
Profit/loss from operating activities	**– 6,164**	**1,574**	**– 7,738**
Taxes on income	4	10	– 6
Consolidated profit/loss	**– 6,168**	**1,564**	**– 7,732**
Net gains/losses recognised in equity	– 249	– 53	– 196
Comprehensive income	**– 6,417**	**1,511**	**– 7,928**
Adjustment for temporary net gains/losses from economically unjustified changes in derivatives value and hedge accounting	5	– 131	136
Additions to the fund for general banking risks	– 200	– 267	67
Application of the fund for general banking risks to charges related to the IKB crisis	5,300	–	5,300
Comprehensive economic income	**– 1,312**	**1,113**	**– 2,425**

The operating result before valuation was EUR 1,357 million, which was slightly lower than the previous year's figure of EUR 1,381 million.

The Group's main source of income is net interest income. Net interest income amounted to EUR 1,755 million and was virtually unchanged from the previous year's level. Expenses from measures to reduce interest rates for the increased promotional loan business were compensated by income from the investment of higher non-interest-bearing liabilities from the equity contribution by the ERP Special Fund.

Net commission income increased slightly by 4.8 % to EUR 209 million (previous year: EUR 200 million). In particular, income from the PROMISE and PROVIDE securitisation platforms and from credit derivatives contributed to this increase.

Administrative expense amounted to EUR 607 million, representing a EUR 34 million, or 5.9 %, increase above the comparable figure for the previous year. Personnel expense rose slightly by EUR 14 million to EUR 349 million due to salary increases because of collective pay agreements and improved performance while employee headcount increased by 4 %. A EUR 20 million increase in non-personnel expenses to EUR 258 million related in particular to other administrative expenses, among other factors, from increased expense for the administration of externally held special funds and for services provided by third parties.

Excluding the extraordinary effect of the risk protection provided to IKB, expenses for risk provisioning in the past financial year remained low at EUR 129 million, while the volume of lending grew significantly, keeping in line with the trend of the previous year. The recognition of portfolio valuation allowances, particularly to account for existing concentration risks in the financial sector in KfW's business model, had a negative effect. The provision for immediate credit risks was reduced.

The provisions for losses on loans and advances and the fund for general banking risks cover all immediate and latent risks and reflect the consistent implementation of our conservative risk policy.

The income statement was impacted by expenses of EUR 6.3 billion for the provisions for losses on loans and advances made in connection with KfW's assumption of the rights and obligations under the liquidity lines granted to the special purpose entities of Rhineland Funding Capital Corporation, New York/USA, and for the provision made for the guarantee to hedge the balance sheet risks as part of the risk protection afforded to IKB.

In addition to the extraordinary effect of EUR 1.7 billion charge from the valuation of credit derivatives from the risk protection provided to IKB, net gains/losses from hedge accounting and other financial instruments at fair value through profit or loss in 2007 also reflected the fluctuations on the financial markets which occurred following the US subprime mortgage crisis.

Net gains from micro and macro fair value hedge accounting amounted to EUR 73 million. The successful application of hedge accounting eliminates one-sided and high volatilities not deemed economically reasonable from derivatives used solely for hedging purposes from the group income statement.

Financial instruments at fair value through profit or loss in the form of debt instruments issued, including the associated hedging derivatives, generated expenses of EUR 45 million. Triggered by the crisis in the financial markets, improved funding spreads applied in fair value accounting for borrowings caused a temporary expense for KfW.

The contribution to earnings from hedges not qualifying for hedge accounting under IFRS amounted to a charge of EUR 29 million, compared with a gain of EUR 87 million in the previous year.

Equity finance business recorded at fair value through profit or loss performed well again, following the positive results in the previous year (EUR 130 million), and contributed EUR 193 million to earnings. In addition to equity investments, this item includes valuation gains and losses on ancillary agreements in equity finance business (risk commissions/profit participations).

Securities recorded at fair value through profit or loss, including fair value accounting for gains and losses on special funds, gave rise to an expense of EUR 328 million. In addition to the profit and loss components realised, this item primarily includes valuation gains and losses, largely considered temporary, arising from the negative conditions in the financial markets. Directly held ABS instruments recorded at fair value through profit or loss led to EUR 137 million in expenses.

Net losses from securities and investments of EUR 421 million (previous year: net gains of EUR 19 million) primarily reflected the write-down of the value of KfW's equity interest in IKB, amounting to EUR 356 million. During the reporting year, the interest in IKB was recorded using the equity method until, as at 30 November 2007, the Board of Supervisory Directors of KfW resolved to move forward with a prompt sale of IKB. The resulting expenses amounted to EUR 279 million. Since 1 December 2007, IKB is no longer accounted for as an associate but instead as a held-for-sale asset in accordance with IFRS 5. As a result, KfW's equity interest in IKB was written down to market value based on the share price less the expected costs of sale. This write-down led to a further charge of EUR 77 million.

Disposals and valuations of securities and equity investments not accounted for at fair value through profit or loss led to net expenses totalling EUR 67 million.

EUR 216 million in valuation losses recognised directly in equity relating to financial assets was charged to revaluation reserves. Of this amount, EUR 56 million was attributable to ABS products.

Net other operating income primarily reflects the one-off income from the participation of associations of the German banking industry in the risk protection afforded to IKB.

Overall, a consolidated loss of EUR 6,168 million was recorded, compared with a consolidated profit of EUR 1,564 million in the previous year.

Comprehensive income includes changes in revaluation reserves in addition to the consolidated profit/loss reported in the income statement. At a loss of EUR 6,417 million, comprehensive income was significantly below that for the previous year, due in particular to the impact of the IKB crisis. The item included the higher short-term changes in value for financial assets recognised directly in equity, a charge of EUR 216 million, and the derecognition of the pro-rata revaluation reserve recognised directly in equity due to IKB's status as an associate.

The comprehensive economic income is based on the comprehensive income determined in accordance with IFRS and supplements the Group's income statement. KfW uses comprehensive economic income for two reasons:

- The companies within the Group are not trading institutions. Derivative financial instruments are entered into for hedging purposes. Under IFRS, the requirements for recognition and valuation of derivatives and hedges nevertheless give rise to effects which are reflected in the income statement. In the opinion of KfW, these effects do not adequately reflect that its hedges are economically effective for hedging purposes.

- As a result of its statutory responsibility as a promotional bank with a long-term business perspective, KfW pursues a risk policy of building sufficient reserves to meet potential risks in a fund for general banking risks. This risk policy adequately reflects the sustainable and long-term nature of the promotional approach and takes into account particular stress phases in the market. In the opinion of KfW, it is not possible to adequately reflect the effects of this policy in providing for potential risks under IFRS since they cannot be reported in the income statement.

The following adjustments were made in respect of the accounting treatment of hedges:

- Temporary gains and losses from micro and macro hedge accounting were eliminated. All of the Group's hedges are economically effective and do not give rise to any net gain or loss over the entire period to maturity.
- Temporary gains and losses from the fair value accounting for debt instruments issued using the fair value option in order to avoid an accounting mismatch were eliminated together with the associated hedging derivatives. These economically effective hedges do not give rise to any net gain or loss over the entire period to maturity.
- Temporary gains and losses from the fair value accounting of hedges with high economic effectiveness but not qualifying for hedge accounting in accordance with IFRS were eliminated. These hedges do not give rise to any net gain or loss over the entire period to maturity.

The following adjustment was made with respect to the accounting treatment of the Group's required risk provisioning:

- Additions to and reductions of the fund for general banking risks are reported in the economic income statement.

In the economic income statement, various temporary effects from the accounting treatment of hedges in accordance with IFRS in 2007 were largely offset after a gain of EUR 131 million was adjusted in the previous year.

Excluding the application of EUR 5,300 million from the fund for general banking risks to charges resulting from the IKB crisis and the addition of EUR 200 million to the fund from current profit, the negative comprehensive economic income of EUR –1,312 million was EUR 2,425 million below the previous year's figure.

This decline was mainly due to charges resulting from the IKB crisis that were not covered by the fund for general banking risks and valuation losses in the income statement and in equity from securities, triggered primarily by the general crisis of confidence in the financial markets.

MATERIAL EVENTS AFTER THE BALANCE SHEET DATE (AS AT 12 MARCH 2008).

Since 1 January 2008, KfW IPEX-Bank, the wholly-owned subsidiary of KfW, has conducted its business as the legally independent KfW IPEX-Bank GmbH. This step implements the understanding on the restructuring of the promotional banking system reached with the EU Commission in 2002.

As part of the risk protection granted to IKB, KfW will, upon contractual implementation of the restructuring of the RFCC conduit, gain control over assets attributable thereto under the liquidity lines funded by KfW. These assets will be transferred to two new special purpose entities operated by KfW. These entities will be refinanced exclusively by KfW. The two special purpose entities will be consolidated in financial year 2008 upon the transfer of control over the assets.

In January 2008, as part of the risk protection granted to IKB, KfW acquired a one-year convertible bond for EUR 54.3 million issued by IKB. The bond was converted on 28 February 2008. With the conversion, the Group increased its interest in IKB by 5.6 percentage points.

In order to provide additional risk protection for IKB, the Federal Government mandated that KfW, in accordance with § 2 (4) of the Law Concerning KfW (KfW Law), implement capital measures up to an amount of EUR 2.3 billion for the benefit of IKB. The Board of Supervisory Directors confirmed this in its meeting as at 13 February 2008. In connection with a planned cash capital increase of IKB of up to EUR 1.487 billion, KfW will ensure that IKB receives at least EUR 1.25 billion. Additionally, KfW has increased IKB's mandatory core capital by EUR 600 million thus far since 19 February 2008. Currently recognisable risks arising from this transaction are to be borne by the German Federal Government and other parties involved.

RISK REPORT.

BASIC PRINCIPLES AND OBJECTIVES OF RISK MANAGEMENT.

Measuring and controlling the risks incurred in the context of its promotional objectives is of major importance for the KfW Group[1]. Only with well-planned risk management is KfW able to use its resources optimally to realise its promotional objectives. Systematic risk management is a precondition for maintaining the Group's risk-bearing capacity and for sustainably achieving promotional objectives in the future. The KfW Group operates in various market segments. This results in a heterogeneous loan portfolio with returns and risks that need to be managed group-wide. Group risk/return management takes into account the special characteristics of a promotional bank. The main purpose of KfW's risk management approach is to maintain its risk-bearing capacity. The KfW Group works to ensure that the economic capital tied up by credit, market and operational risks is at all times covered by the Group's available financial resources in order to ensure the desired solvency level. Banking supervisory requirements, such as the minimum requirements for risk management (MaRisk), constitute important secondary requirements for KfW's risk management structures and procedures.

The KfW Group's business areas operate in a dynamic environment. Product innovation therefore requires continuing development of risk measurement methods and systems. At the same time, changing banking supervisory and economic parameters place higher demands on the quality of risk management procedures and methods. KfW is meeting these challenges through targeted development of its risk management and controlling. Having established and validated both the required risk measurement and controlling procedures and the organisational bases for these procedures in accordance with supervisory requirements in the preceding years, KfW's focus in this reporting year was on further development and validation of methods. In addition KfW analysed its credit and market risks under stress conditions in 2007.

In order to establish risk management and controlling competence within the organisation of the bank, KfW offers training courses which include a modular programme on risk topics. This training program enables employees and management staff from the entire Group to acquire orientation knowledge or to deepen their expert know-how.

[1] The Group considers both KfW and its subsidiaries in its risk management.

ORGANISATION OF RISK MANAGEMENT AND MONITORING.

RISK MANAGEMENT BODIES AND FUNCTIONAL ASPECTS OF RISK MANAGEMENT.

KfW's Board of Managing Directors determines the bank's risk principles and guidelines as part of its overall responsibility. KfW's supervisory bodies – the Board of Supervisory Directors and the Federal Ministries of Finance and of Economics and Technology, which take turns in providing the chairman and deputy chairman of the Board of Supervisory Directors – are regularly informed of the Group's risk situation.

Risk management within the KfW Group is exercised by closely intertwined decision-making bodies. They are headed by the Risk Management Committee (RMC), which is responsible for the entire Group's risk profile. The RMC includes all members of the Board of Managing Directors along with representatives of KfW's business areas, some central staff departments and subsidiaries of the KfW Group. The RMC adopts major changes to existing risk principles, drafts new risk principles, and deals with risk strategy, adjustments to global limits and similar topics relating to risk management. The RMC also receives information on matters such as the development of lending business, liquidity and limit utilisation and the changes to the risk principles adopted in the Sub-Committees (SCs). The RMC is headed by the KfW board member in charge of risk controlling. Sub-Committees for credit risks, market price risks and, going forward, for operational risks do preparatory work for the RMC. Heads of business areas and divisions are represented on the Sub-Committees in order to ensure that SC decisions are taken independently. SC meetings are prepared at the working level to ensure their efficiency.

The Market Price Risk Sub-Committee (SCM) deals with decision papers on subjects relating to market risk, liquidity and asset management. These papers include reports on the liquidity and funding situation, assessment of currency risks and interest rate risks and discussion of the interest hedging strategy to be pursued in funding. The Credit Risk Sub-Committee (SCK) deals with credit risk methods and credit portfolio management, for example by taking decisions on the development of rating methods and on the design of systems for limit management and collateral assessment and by preparing decisions on global limits and portfolio guidelines for the RMC. Several working groups have been established under the Sub-Committees.

The Working Group Country Rating is the central forum for assessing country risks. It is composed of economists from the regional departments of KfW Entwicklungsbank and representatives of KfW IPEX-Bank, DEG and KfW's Transaction Management Department. It is chaired by the ratings officer in charge in the Risk Management Department. The working group meets quarterly or more often as required. The role of the Working Group Country Rating is to identify, analyse and assess political and economic risks (and rewards) in the global economy and particularly in the countries in which the KfW Group is doing or planning to do business. Proposals for risk ratings assigned to developing, transition and emerging countries are made by the departmental regional economists while proposals for the rating of industrial countries are submitted by the Risk Management Department. Countries are ultimately assigned to risk categories on the basis of discussions conducted within the Working Group Country Rating. If no consensus is reached, a vote of the Risk Management Department is decisive. The Risk Management Department then presents the results of the meetings directly to the Board of Managing Directors and justifies the decisions taken.

The Working Group Trading Activities is the central platform for exchanging opinions on matters relating to counterparty default risks arising from trading activities. This working group was established chiefly for two reasons: first, to address the more stringent requirements of the regulation on capital adequacy of institutions, groups of institutions and financial holding groups *(Verordnung über angemessene Eigenkapitalausstattung von Instituten, Institutsgruppen und Finanzholdinggruppen)* or Solvency Regulation *(Solvabilitätsverordnung)* on risk management procedures; and, second, to control and document the risks associated with the use of credit risk mitigation techniques. The main task of the Working Group Trading Activities is to prepare the implementation of group-wide standards and decisions, particularly for keeping procedures and disclosures compliant with regulatory requirements and for generating and managing standards for framework agreements. In addition the working group provides proposals for dealing with questions of how to apply credit risk mitigation techniques at KfW, identifies gaps in the provisions and suggests possible alternatives and solutions.

The Working Group Collateral is the group-wide platform in the area of collateral management for lending business. It is composed of representatives from various business areas and departments. The central functions of the Working Group Collateral include assessment of new valuation procedures and relevant decisions, revision of existing valuation procedures, definition of generally acceptable[1)] types of collateral, further development of acceptability policy, and provision of standard texts for collateral agreements.

In most cases, the collateral agreement and the first steps towards the provision of the collateral are the responsibility of the various credit departments. The collateral and transaction management departments are in charge of the final provision, valuation, ongoing administration, release and realisation of collateral. For cost/benefit reasons, KfW does not recognise any collateral in on-lending operations in which the on-lending bank is released from its liability. Accepted collateral is revaluated in regular intervals, at least annually, in the course of loan management. Collateral is re-examined on a case-by-case basis in the intensive loan management and problem-loan processing stages and as soon as the bank detects any substantial deterioration in its value.

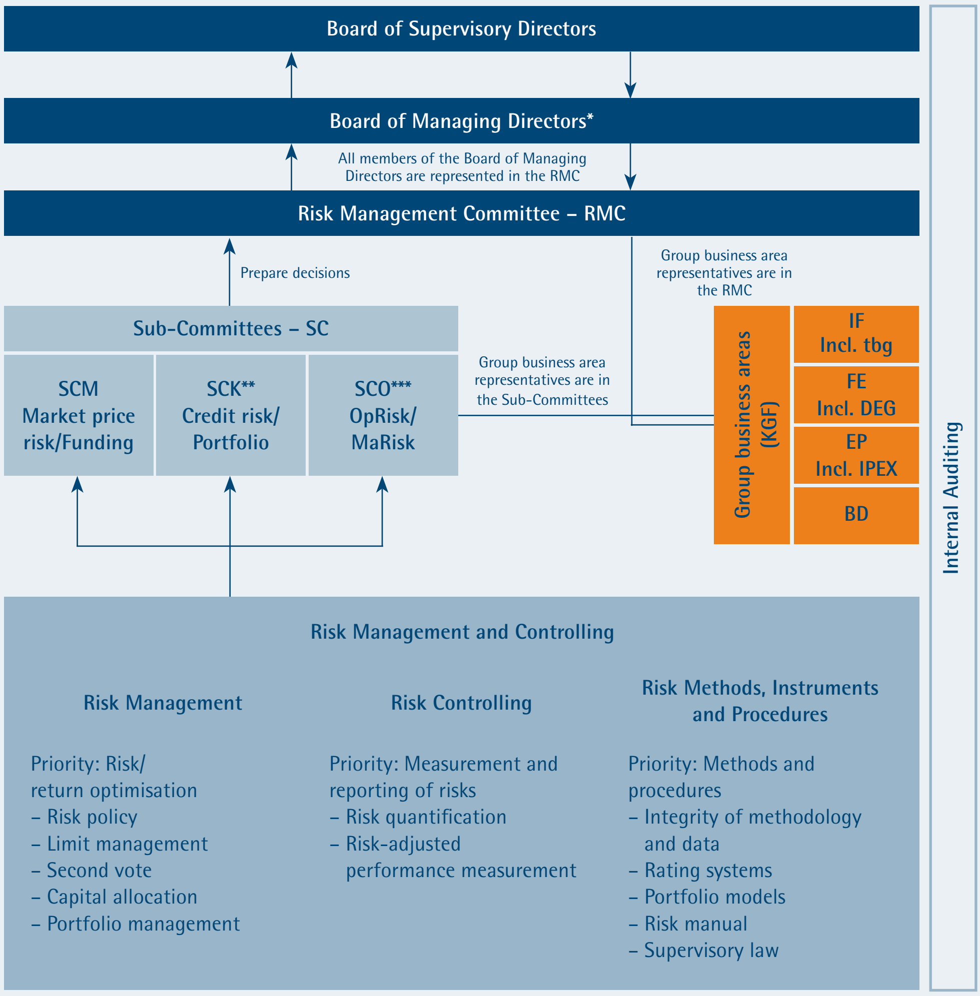
The Working Group Rating Systems is a central, group-wide body which ensures sufficient understanding of all essential aspects of the rating systems within the KfW Group. The term rating system refers to all methods, procedures, and data collection and processing systems that are applied to evaluate counterparty risks, to map the derived risk assignments to (creditworthiness) categories or retail pools, or to assign default and loss rate estimates to specific types of assets. The Working Group Rating Systems prepares management decisions or takes decisions within its defined range of competency. These decisions include evaluating and accepting reports on validation and further development as well as deriving, planning and coordinating recommendations for measures to enhance rating systems. The Working Group Rating Systems includes representatives of all users of the rating systems, risk management and controlling, and KfW's Internal Auditing Department.

The Working Group Portfolio Management is headed by the risk management unit and is a communication platform as well as a body for preparing group-wide portfolio management decisions. Its main objective is to initiate and coordinate measures designed to improve the risk

[1)] Collateral is examined for acceptability at the KfW Group against the criteria set out in the German Solvency Regulation.

structure. The working group discusses approaches to identifying, analysing and measuring credit (portfolio) risks. It then evaluates alternative risk transfer instruments across all business areas against balance sheet, legal, business policy and risk policy criteria, adopts specific measures and recommends them to the Credit Risk Sub-Committee.

Risk management bodies



* The Working Group Country Rating reports to the Board of Managing Directors.
** The Working Groups Collateral, Portfolio Management, Trading Activities and Rating Systems contribute of the SCK.
*** The SCO is currently being established.

IF – Investment financing in Germany and Europe
EP – Export and project finance
FE – Promotion of developing countries
BD – Shareholdings, treasury and services

The subsidiaries of the KfW Group and the organisational units exercise their own control functions within the group-wide risk management system. In these cases, too, group-wide projects and working groups ensure a coordinated approach, for example in the rollout of rating instruments to subsidiaries or the management and valuation of collateral.

Responsibility for developing and assuring the quality of the risk management and controlling procedures lies outside the credit departments, entirely with the Risk Management and Controlling Department. A comprehensive risk manual has been prepared for this purpose and is continually updated. The rules and regulations laid out in the risk manual are binding for the entire Group and are accessible to all employees. Risk principles (i. e. normative rules for loan and risk management procedures) and portfolio guidelines (e. g. prohibitions and collateral requirements) make up the core of the risk manual. The risk principles and portfolio guidelines serve as the framework for the operating activities of all business areas. The risk manual ensures that uniform procedures are applied throughout the group to identify, measure, control and monitor risks. In addition, group-wide regulations are supplemented in individual business areas by specific rules which the Risk Management and Controlling Department monitors as part of a decentralised compliance review.

RISK MANAGEMENT.

The primary task of the Risk Management Department is to optimise risks and returns. For this purpose, it formulates and regularly reviews the Group's risk strategy. The risk strategy builds on the existing risk situation and establishes a framework for the assumption and management of risks within the Group. A variety of instruments are used to implement the risk strategy. Management measures applied to individual counterparties and portfolios (e. g. second vote for loan approvals, a limit management system and portfolio guidelines) ensure risk-bearing capacity and prevent an undesirable expansion of concentrated risks. Stress tests are conducted to maintain the ability to respond even when cyclical conditions deteriorate substantially. The active use of credit derivatives also contributes to improving the risk profile and expanding the range of business options. In order to optimally use available capital while preserving the Group's risk-bearing capacity, the Risk Management Department proposes, at the group planning level, the allocation of capital to the various business areas (capital budgets). This capital is then made available to the individual business areas as equity for both ongoing and new operations.

RISK CONTROLLING/METHODS AND PROCEDURES.

The Risk Controlling Department and the Methods and Procedures Department perform further central functions alongside the Risk Management Department. The Risk Controlling Department is in charge of measuring and reporting all risks of the KfW Group. A comprehensive risk report, issued quarterly to the Risk Management Committee and supervisory bodies of KfW in accordance with regulatory requirements (MaRisk), is the basis of risk reporting for the Group. The Methods and Procedures Department ensures that consistent risk analysis methods are applied throughout the Group. These two departments are responsible for the correctness and completeness of all key risk variables used in the management of the bank (methodological and data sovereignty). The instruments and methods applied are regularly validated and subject to continued development. The Risk Controlling and Methods and Procedures Departments are responsible for the operative procedures for group business area planning to determine the key performance indicators of the bank and the methods and applications used in measuring these indicators. Risk controlling monitors and reports in regular intervals on the achievement of the targets defined in group business area planning for the use of capital and value creation, and promotion in the individual business areas (performance reporting, comparison of targets and results). The use of economic capital budgeted in the planning process is also monitored so that it is possible to intervene whenever necessary (e. g. capital reallocation). Finally, performance reporting serves as a performance evaluation in the individual business areas.

INTERNAL AUDITING.

As an instrument of the Board of Managing Directors, the Internal Auditing Department is not bound by directives and works independently of Group procedures. It generally audits all of KfW's processes and activities to identify the risks involved. The Internal Auditing Department reports directly to the Board of Managing Directors.

The procedure for risk-oriented planning of internal audits was further developed in 2007. The economic capital requirements of the operations to be audited are taken into account when determining the audit cycles for the individual audit areas.

In addition to promotional business, auditing activities focused on the risk management procedures and methods in 2007. The risk management audits focused on the internal rating systems as well as on the methods and processes for measuring and assessing market price risks and operational risks.

The Internal Auditing Department monitored important projects, particularly the IT development projects, while retaining its independence. As in previous years, in 2007 the Internal Auditing Department monitored the further development of risk measurement procedures by participating in meetings (guest status) of decision-making bodies.

The Internal Auditing Department also performed the coordination and management tasks of a group auditing department. It incorporates the internal auditing departments of the subsidiaries in the group-wide audit reporting. In addition, it coordinates and manages the establishment and development of instruments, methods, procedures and standards applied in the auditing work within the Group.

THE KFW GROUP'S RISK MANAGEMENT APPROACH.

Risk management within the KfW Group chiefly serves to preserve the Group's risk-bearing capacity. In conducting its business, the Group only takes risks for which capital is available. An analysis of the risk-bearing capacity must measure risks and match them against risk-covering potential. Potential financial losses are measured with the aid of two central risk-measuring tools: expected loss and economic capital, which is a measure to cover unexpected loss.

Expected loss refers to losses that are expected to arise on a statistical average over a number of years. Expected losses along with other parameters are important when credit is priced. Expected losses are defined as the product of:

- the probability of a borrower's default (probability of default),
- the expected amount of the loan outstanding at the time of the potential default (exposure at default) and
- the magnitude of likely loss on the exposure (loss given default).

The probability of default is estimated for each borrower with the aid of rating methods. The result of the rating measures is an estimate of the probability that a counterparty will be unable to fulfil its obligations within the next 12 months. In particular, collateral and guarantees have to be evaluated to estimate the magnitude of the likely loss. Expected losses are not backed by capital as they are offset in a means calculation by the risk margins (insurance principle).

In cases where the losses for an individual year exceed the expected loss, such losses must be covered by the bank's own resources (risk-covering potential). The loss potential to be backed by capital (unexpected loss) is quantified by the Risk Controlling Department with the aid of statistical models. For credit risks, the loss potential is computed using a credit portfolio model and the risk measure credit value-at-risk at a prescribed confidence level. The difference between credit value-at-risk and expected loss is referred to as the economic capital requirement.

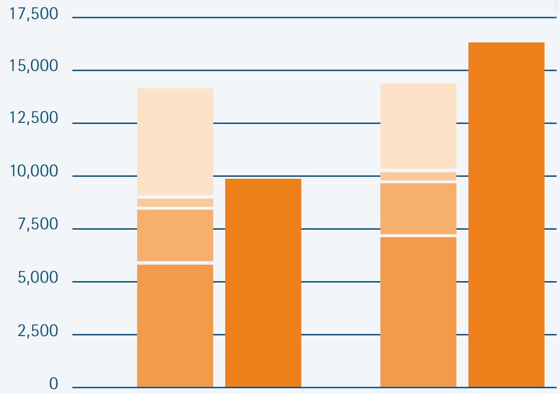
KfW's approach to market price risks is similar, as the value-at-risk is computed using statistical models. For market price risks, the value-at-risk also represents the economic capital requirement.

The forecast period for both risk categories is one year. The confidence level used for calculating the economic capital requirement is 99.99 %, which corresponds to triple-A standard. The capital requirement for credit and market price risks is aggregated, taking diversification effects into account. The capital requirement for operational risks is calculated using the regulatory standard approach according to Basel II.

In addition, the KfW Group applies a risk buffer, which is also determined in accordance with very conservative standards, in the calculation of its overall capital requirements. The risk buffer covers potential additional economic capital requirements for the loan portfolio that might result from stress tests conducted for an assumed severe recession scenario. It can also be used to cover additional economic capital requirements for interest rate risks while the solvency level defined by the group management is maintained. The overall risk capital requirement[1)] (economic capital or ECAP) is matched against the risk covering potential (available financial resources, or AFR). The AFR essentially result from KfW's recognised equity. Parts of the equity (reserves) that are attributed to DEG or the ERP Special Fund are included in AFR only to the extent that DEG or ERP Special Fund operations themselves require economic capital. Subordinated liabilities are not considered.

[1)] KfW does not cover liquidity risk with risk capital as it is not a loss risk to be covered on the liabilities side but a payment risk to be covered on the assets side.

Risk-bearing capacity
EUR in millions



	31 Dec. 2007 (Basis IFRS)	31 Dec. 2006 (Basis German Commercial Code)
Risk buffer	5,000	4,000
Operational risk	354	317
Market price risk[1)]	2,419	2,291
Credit risk	5,777	7,336
Available financial resources	9,917	16,178

[1)] Taking into account the volatility of the present value of equity-funded assets

Despite the burdens resulting from the risk protection for IKB, which resulted in a significant decline in available financial resources, the economic capital required for credit, market price and operational risks was always matched by an adequate risk covering potential throughout 2007. Taking into account the above-mentioned burdens, EUR 1.4 billion (or 27 %) of the risk buffer is covered. This permits an increase of the economic capital required for risks by up to 15 %. KfW addresses liquidity and other risks by monitoring appropriate key figures and by regularly controlling the processes of the banking operations.

Both KfW's Board of Supervisory Directors and the Risk Management Committee are informed on a quarterly basis about all major risks and the overall risk situation of the KfW Group in connection with (MaRisk) risk reporting. Events of major importance to the bank's risk situation are promptly communicated to the decision-makers.

Based on the primary goal of ensuring risk-bearing capacity, promotion and growth are the further objectives of (RAROC-based) group business area planning. For the KfW Group, growth means generating returns on a sustainable basis so as to be able to continue its promotional activities in the future. The main elements of group business area planning are group-wide strategic planning and its quantification in the planning of risks and earnings. Central top-down guidelines set by the Board of Managing Directors for key management variables, taking into account KfW's system of objectives, form the basis for planning in individual business areas. On this basis the business areas formulate planning scenarios that are presented and discussed in a planning dialogue. The Board of Managing Directors subsequently decides on the strategy of each business area and on the overall group strategy. Strategy implementation and central management variables are monitored throughout the year.

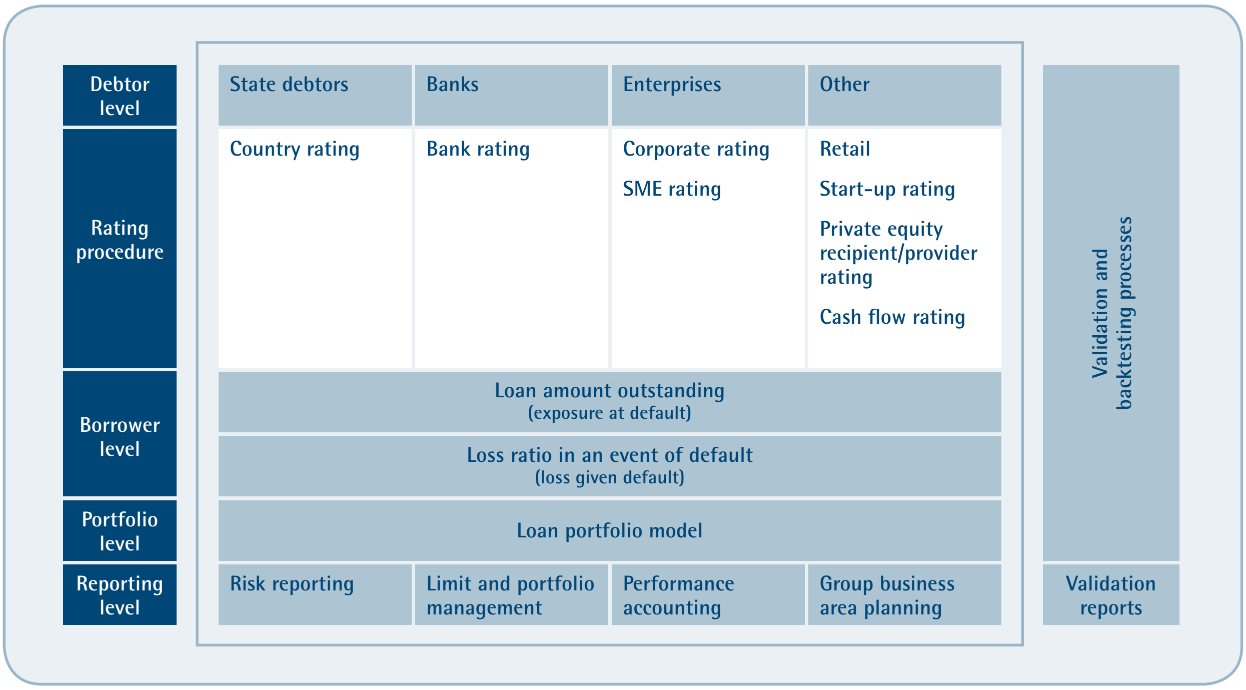
KfW's management approach is based on state-of-the-art models used in banking practice. However, each model represents a simplification of a complex reality and builds on the assumption that risk parameters observed in the past can be considered representative of the future. Not all possible influential factors and their complex interactions can be identified and modelled for the risk development of a portfolio. This is one reason why KfW carries out stress tests both in the credit risk models and in the market risk models. The Group works continually to refine its risk models.

TYPES OF RISKS.

COUNTERPARTY DEFAULT RISK.

The KfW Group assumes counterparty risks[1)] in the context of its promotional mandate. In its domestic promotional lending business the main risks are in the areas of start-up finance and financing of small and medium-sized enterprises, promotional loans channelled through on-lending banks, and equity finance. In addition, KfW assumes risks in the context of export and project finance as well as, increasingly, promotional loans extended under Financial Cooperation.

[1)] Counterparty default risk is defined as the risk of financial loss that can occur if the borrower or counterparty fails to meet contractual payment obligations. Counterparty default risk also includes country risk, which is composed of transfer, conversion and political risks.



Default risks of lending operations are rated by estimating probabilities of default and loss given default. The KfW Group applies internal risk rating procedures in which country risks and individual corporate or project-related risks are assessed separately. It uses computer-based rating procedures adapted to the largely homogeneous customer segments and types of financing. KfW uses specific rating procedures for banks, corporations, small and medium-sized enterprises, private equity providers, private equity recipients, start-up businesses and countries. These procedures are based on scorecards and follow a uniform and consistent model architecture. For project financings, KfW applies a cash-flow based rating method. Under this method, the projection of cash flow generated by the financed object determines the credit risk. The rating procedures are calibrated to a one-year default probability. The ratings for new customers are conducted in the credit departments with follow-up ratings for existing clients conducted in the transaction management departments and always controlled and checked by a second loan officer. This procedure also ensures compliance with section 18 of the German Banking Act *(Kreditwesengesetz/KWG)* (supervision of ongoing disclosure).

Depicting the default probability on a master scale which is uniform for the entire KfW Group ensures the consistency of the individual rating procedures. The master scale consists of 20 different classes that can be summarised into four groups: investment grade, non-investment grade, watch list and default. Each master scale class is based on an average default probability which undergoes a validation procedure that takes into account the different rating procedures. Specific organisation regulations, which mainly specify the responsibilities, competencies and control mechanisms associated with a particular rating, apply to each rating procedure. The external ratings are mapped to the KfW master scale to ensure comparability of internal ratings of the KfW Group with ratings of external rating agencies. It is important, however, to ensure that the proper external rating type is used when making comparisons. The separate report of the debtor's probability of default, the transfer risk, the expected loss severity in the event of default, and the term applied by the external rating must be taken into account, along with other factors. Periodic validation and further development of the rating procedures ensure that KfW is able to rapidly respond to changes in overall conditions. The aim is to continuously improve the selectivity for all rating procedures. Rating instruments and procedures largely meet the minimum requirements of the prevailing regulatory standards (MaRisk/Basel II).

Exposure and valuation of collateral are heavily weighted in determining loss severity. In connection with the valuation of acceptable collateral, the expected net revenue from collateral realisation in case of loss is estimated over the entire loan term. This estimate takes into account discounts based on the probability of default in case of personal collateral[1)] and the magnitude of loss incurred by the collateral provider. For other collateral the discounts are chiefly attributable to fluctuations in market prices and devaluation resulting from depreciation. The determined value is an important element in estimating loss given default within the KfW Group. Depending on data availability, the various valuation procedures for individual types of collateral are based on internal and external historical loss data and expert estimates. The valuation parameters undergo a periodic validation procedure. For individual collateral this guarantees a reliable valuation of the collateral position. At the level of the collateral portfolio, KfW is currently developing a concept that permits concentration risks to be measured, valuated and managed.

The KfW Group has various portfolio guidelines to limit risks from new business. They form the basis for the second vote on lending transactions and serve as an orientation guide for loan approvals. They are also designed to ensure adequate quality and risk structure of KfW's portfolio[2)]. These guidelines distinguish between types of counterparties and product variants and define conditions under which business transactions generally may be conducted. A risk principle for loan collateral regulates uniform management, valuation and recognition of collateral across the Group. The risk of default on investments in securities and in derivatives is also limited by the conservative selection of counterparties and by collateral agreements.

Existing higher-risk exposures are divided into a "watch list" and a list for non-performing loans. The watch list serves to identify potential problem loans early and, if necessary, to make preparations for handling these loans. For this purpose, KfW closely monitors the economic and financial environment of the respective bor-

[1)] Due to KfW's business model, personal collateral (especially guarantees provided by the Federal Republic) is common.
[2)] These guidelines take into account the specific features of KfW's promotional lending business.

rower. It regularly reviews and documents the economic situation and the collateral provided and formulates proposals for remedial action. Depending on the status of a problem loan, the Special Assets Group advises on measures to be implemented or takes over the problem loan completely from the credit department. This process ensures that specialists are involved at an early stage to ensure professional management of problem loans.

RISK PROVISIONING.

The KfW Group takes appropriate measures to address all identifiable default risks in its lending business by making risk provisions for loans. These risks also include political risks of financing transactions abroad. For loans with immediate risk of default (i. e. non-performing loans) KfW sets up individual impairments or provisions for undisbursed portions. Immediate risks of default arise when the series of payments due under a financial instrument is adversely affected by one or more events. These events are identified on the basis of criteria that meet both Basel II and IFRS requirements. Criteria include the identification of considerable financial difficulties on the part of the debtor, payment arrears, concessions made to the debtor owing to its financial situation (for example, in the context of restructuring measures), conspicuous measures undertaken by the debtor to increase its liquidity, and a substantial deterioration in the value of collateral taken. These criteria are further specified in KfW's risk manual. Individual impairments are determined by means of an impairment tool. The calculation of individual impairments is also based on an individual assessment of the borrower's ability to make payments in the future. The calculation also takes into account the scope and value of the collateral. A simplified impairment prodedure is performed for small and standardised loans on the basis of homogeneous sub-portfolios.

Risk provisions for latent risks (portfolio impairment) are derived from the valuation of loan receivables in the context of annual rating procedures and collateral valuations. The basis for this is the expected loss model described above. For the purposes of IFRS the components exposure at default (EAD) and loss given default (LGD) were adjusted as follows: instead of the estimated exposure at default, the recognised (gross) exposure of the financial instrument is used for the calculation of the risk provisions. As a result, KfW recognises risk provisions only for losses already incurred as at the reporting date and not for losses expected in the future ("losses incurred but not yet reported"). Moreover, the loss given default has been adjusted by eliminating all imputed and internal costs. Risk provisions for irrevocable loan commitments are set up using the same method of calculation.

Portfolio impairment also includes provisions for risks from portfolio concentration in the financial sector that result from the business model of extending promotional loans through the banking sector (on-lending business). The KfW Group is, as a result, dependent on the financial development of the banking industry with its specific risks. KfW forms separate risk provisions to take account of this.

According to IFRS 7.36, the maximum exposure to credit risk for the KfW Group arising from financial instruments is theoretically the total loss of the respective risk exposures. This exposure also takes into account contingent liabilities and irrevocable loan commitments. These exposures are reduced by the risk provisions made. Payment arrears were reported only in Loans and advances to banks and customers. Individual impairments were also reported under Securities and investments as well as under Contingent liabilities and Irrevocable loan commitments.

Maximum exposure
EUR in millions

	Loans and advances to banks		Loans and advances to customers		Value adjustments from macro fair value hedge accounting		Derivatives used for hedge accounting; Other derivatives		Securities and investments		Contingent liabilities, irrevocable loan commitments	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
Carrying amount as equivalent for maximum risk of default	205,253	190,772	93,082	91,753	0	219	8,736	7,173	45,745	41,802	44,516	52,092
Risk provisions	485	455	7,186	1,509	0	0	0	0	80	13	530	65
Neither past due nor impaired	*204,490*	*190,263*	*88,301*	*87,394*	*0*	*219*	*8,736*	*7,173*	*45,631*	*41,775*	*43,919*	*52,036*
*With conditions renegotiated (in the reporting year)**	*7*	*0*	*4*	*0*	*0*	*0*	*0*	*0*	*3*	*4*	*0*	*0*

* Includes financial instruments that would be overdue or impaired without renegotiation of conditions.

Financial instruments past due and not individually impaired
EUR in millions

	Loans and advances to banks		Loans and advances to customers	
	2007	2006	2007	2006
Less than 90 days past due	576	195	971	1,030
90 days and more past due	41	109	1,721	844

Individually impaired financial instruments
EUR in millions

	Loans and advances to banks		Loans and advances to customers		Securities and investments		Contingent liabilities, irrevocable loan commitments	
	2007	2006	2007	2006	2007	2006	2007	2006
Exposure	145	205	2,088	2,484	115	27	597	56
Individual impairments	71	95	6,858	1,322	80	13	446	21

In the 2007 financial year EUR 2.9 billion (net after deduction of risk provisions; previous year: EUR 2.8 billion) was classified as individually impaired out of EUR 397 billion (previous year: EUR 384 billion) in financial instruments outstanding. Potential losses are conservatively estimated, and individual impairments have been formed in the sum of EUR 7.4 billion (previous year: EUR 1.4 billion). This strong increase is due to the risk protection provided to IKB.

In addition to provisions for immediate risks of default, the KfW Group makes provisions for latent risks of default (economic and political risks). As at 31 December 2007, risk provisions for performing business totalled EUR 826 million (previous year: EUR 591 million). These provisions include EUR 357 million (previous year: EUR 301 million) for concentration risks in the financial sector. On average, though, more than 75 % of the loans in the KfW Group's portfolio for performing loans are collateralised.

In 2007 the KfW Group did not take possession of any asset previously held as collateral.

STRESS TESTS.

To prepare for a significant increase in default risks that can be neither foreseen nor ruled out, the KfW Group conducts stress tests to determine whether higher economic capital is required for specific scenarios. A scenario covers potential deteriorations that may occur (scenario 1) short-term and cyclically (mild recession scenario) or (scenario 2) annually in view of critical developments during one year (severe recession scenario). As at 31 August 2007 the economic capital rose under stress tests by 52 % for a mild recession scenario and by 82 % for a severe recession scenario. 27 % of the additional economic capital requirement can be covered by the available capital buffer.

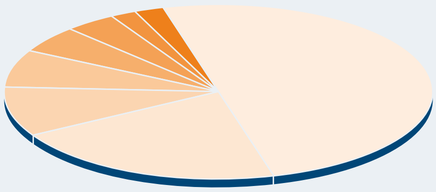
PORTFOLIO STRUCTURE.

The contribution of individual commitments to the KfW Group's loan portfolio risk is assessed with the aid of an internal portfolio model. Concentrations of individual borrowers or groups of borrowers give rise to the risk of major losses that could jeopardise a bank's existence. On the basis of the economic capital concept, the Risk Controlling Department measures the risk concentrations by individual borrower, industry and country. Concentrations are measured primarily by the extent to which they require economic capital. This ensures that not only high risk volumes but also unfavourable probabilities of default and inconvenient risk correlations are taken into account. The results form the basis for managing the loan portfolio and are included in the limit management system to contain concentration risks. On the basis of the limit management system, the KfW Group defines global limits which prevent losses that would put the continuation of the bank at risk. These limits are accordingly derived from KfW's risk-bearing capacity. The global limits provide a framework for managing counterparty risks. KfW reduces concentration risks under its risk management and active portfolio management in a targeted manner. To achieve this KfW uses credit derivatives (single name credit default swaps) and other instruments to hedge against individual counterparty risks. The use of single name credit default swaps permitted KfW to release economic capital of EUR 122.7 million in 2007 (previous year: EUR 113.8 million).

REGIONS.

As at 31 December 2007 the Eurozone accounted for 71 % of the KfW Group's loan portfolio in terms of economic capital, the same relative percentage as in the previous year. Within the Eurozone the German share rose slightly, owing to a particularly strong increase in domestic lending business.

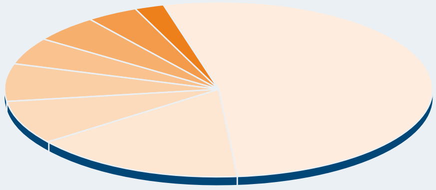
Economic capital by region



	2007	2006
Germany	54 %	50 %
Eurozone countries (without Germany)	17 %	21 %
EU countries without Eurozone countries	7 %	9 %
Europe outside the EU	9 %	7 %
Asia (incl. Australia and New Zealand)	5 %	4 %
Latin America	4 %	5 %
North America	2 %	2 %
Africa	2 %	2 %

SECTORS.

The high share of the financial industry in the overall economic capital for credit risks is due to the KfW Group's promotional mandate. By far the greatest portion of the Group's domestic promotional lending business consists of loans that are on-lent through banks. For the finance industry the relative economic capital decreased from 53 % to 51 % against the previous year. This result was largely due to improved average collateralisation ratios and the remodelling of risks from money-market trading, where the short-term nature of money market exposures was taken into account more closely. The relative increase in economic capital requirements for the manufacturing industry and land-based transport was mainly due to rating adjustments. The heavy concentration in the finance sector is also reflected in terms of individual counterparties. The ten largest borrower units of the KfW Group require a total of 24 % (previous year: 18 %) of the total economic capital for credit risks. This percentage includes a disproportionately high share of banks.

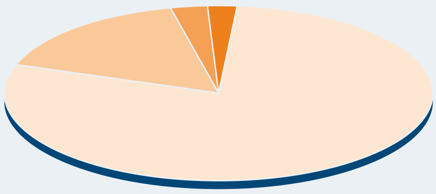


Economic capital by sector

	2007	2006
Financial industry	51 %	53 %
Private equity investment firms	8 %	8 %
Manufacturing industry	8 %	7 %
Shipping	5 %	5 %
Basic industries	4 %	4 %
Aviation	3 %	5 %
Land-based transport	4 %	2 %
Rest	17 %	16 %

CREDIT QUALITY.

As credit quality itself enters into the calculation of the economic capital, it is appropriate, particularly in analysing the credit quality structure, to examine the distribution of net exposures by credit quality category. Measured by net exposure, 79 % (previous year: 86 %) of our portfolio is composed of investment-grade debt. This drop is primarily due to the above-mentioned effects from money-market trading operations which the KfW Group conducted exclusively with investment grade counterparties. Operations declined over the year, and the changes outlined above led to lower risk being recorded. Only 2 % (previous year: 1 %) of the net exposure is categorised as a default/probable loss and 3 % (previous year: 2 %) is assigned to the watch list portfolio (increased risk of default). The Group's loan portfolio continues to have a very good credit quality structure.



Credit quality by net exposure

	2007	2006
Investment grade (M1–M8)	79 %	86 %
Non-investment grade (M9–M15)	16 %	11 %
Watch list (M16–M18)	3 %	2 %
Default (M19–M20)	2 %	1 %

RISK PROTECTION FOR IKB DEUTSCHE INDUSTRIEBANK AG, DÜSSELDORF.

To support IKB Deutsche Industriebank AG, Düsseldorf, which encountered existential problems in the wake of the US subprime crisis, KfW and the three German banking associations (associations) assumed risks of IKB at the end of July 2007. For this purpose risk protection measures were agreed upon that rest on three pillars:

- KfW assuming the rights and obligations under the liquidity lines granted by IKB to the special purpose entities of the financing conduit Rhineland Funding.
- Reverse hedging of 25 % of the first losses from risk sub-participations entered into by IKB in the special purpose entities Havenrock I & II.
- Hedging of default risks from a specified portfolio of structured securities on IKB's balance sheet up to a maximum amount of EUR 1 billion.

As at 31 December 2007 the risk protection amounted to EUR 9.3 billion. Based on the nominal volume of the positions as at 30 July 2007, EUR 269 million has since been repaid and EUR 521 million has been saved owing to exchange rate effects that were hedged at year-end. The amount contributed to the risk protection by the banking associations is limited to EUR 1.2 billion. The following table shows the volume covered by the risk protection and the loss estimate as at the balance sheet date. Hedge positions in US dollars were converted at the closing rate of 1.4721 USD/EUR.

IKB risk protection: Volume of protection and estimated loss
EUR in billions and %

	Total as at 31 Dec. 2007	Estimated loss	
	EUR in billions	EUR in billions	%
Rhineland			
■ CDO	6.5[1)]	5.8	89.2
■ Customer receivables	0.6	–	–
Havenrock	1.2	1.2	100.0
IKB balance sheet assets	1.0[2)]	1.0	100.0
Total	**9.3**	**8.0**	**86.0**

1) without commitments
2) including risk cap

After deduction of the risk sub-participation of EUR 1.2 billion provided by the banking associations (15 %), the estimated loss of EUR 8.0 billion led to a charge of EUR 6.8 billion for KfW (85 %). As at 31 December 2007, there was no need to write off or use risk provisions owing to realised losses.

Within the Rhineland conduit, individual special purpose entities have acquired debt owed to IKB from SME customers. With a total amount of EUR 563 million, this portion of the Rhineland conduit is not impaired and was sold to a third party bank in early 2008, such that no specific risk provisions were recorded.

In order to account for the effects of IKB risk protection on the Group's risk-bearing capacity, the risk provisions for lending business stated in the balance sheet and the negative market values of the credit derivatives used for the risk assumption were deducted in full (EUR 6.8 billion) from the available financial resources.

MARKET PRICE RISK.

Market price risks result primarily from potential losses that may arise from changes in:

- interest structure (interest rate risks)
- exchange rates (currency risks) and
- other market prices (e.g. share prices or raw materials prices).

KfW and its subsidiaries are not required by the German Commercial Code to keep a trading book; consequently, their market price risks are limited to the banking book.

INTEREST RATE RISKS.

The main market risk component in the KfW Group is interest rate risk. The Group assumes limited interest rate risks in order to seize opportunities for returns. This enables KfW to make use of diversification possibilities with credit risks in the context of overall risk. Additionally, interest rate risks arise from the special architecture of the domestic lending business with its off-schedule repayment options. KfW takes this into account in its risk management by including the estimated volume of future off-schedule repayments in its funding strategy.

In the identification of interest rate risks in its banking book, KfW uses standard software that is connected to all data relevant for risk assessment. The current balances of interest rate maturities (euro, US dollar and British pound) are determined with the aid of this standard software. On this basis, KfW regularly performs value-at-risk calculations to assess its interest risk position. The applied simulation-based method is based on a two-factor Cox-Ingersoll-Ross model[1], which is used to estimate the distribution of risk positions in the Group given possible changes in market interest rates and based on an assumed holding period of three months. A so-called Monte Carlo simulation is run to determine 100,000 risk distributions. Out of the simulated losses, the tenth largest loss is defined as economic capital requirement and thus an estimate of a loss that will, with a likelihood of 99.99 %, not be exceeded over a one-year period. Periodic stress tests supplement this calculation to estimate possible losses under extreme, stand-

[1] Each of the factors consists of a money-market interest rate and a capital-market interest rate. The parameters required for the model are estimated from past data.

ardised market conditions. Apart from a parallel shift in the yield curve, these tests include scenarios such as a twist in the yield curve and an extension of the holding period.

CURRENCY RISKS.

Foreign currency loans are generally funded in the same currency or secured by appropriate foreign currency hedging instruments. This also applies to individual impairments for which the corresponding replacement assets are provided. In addition, KfW has decided to make portfolio provisions in US dollars to hedge against contingent exchange rate risks from a potential default on existing debt denominated in US dollars. The earnings components generated in US dollars in the year under review were accumulated for this purpose. In addition, KfW increased holdings of US dollars by USD 4 billion in 2007 and USD 1.1 billion in early 2008 as a currency hedge under the IKB risk protection. The revaluation of the IKB risk protection at the end of March 2008 requires a further increase in USD holdings by USD 2.4 billion, which is to be effected promptly in April.

Margins and commissions received over time in other currencies are always converted into euros without delay to avoid currency risks.

Risks from open currency positions remaining at the balance sheet closing date are measured by a variance/covariance approach in the form of a value-at-risk with the required parameters (variances and correlations) estimated from past data.[1)]

OTHER MARKET PRICE RISKS.

In addition to shares traded on the stock exchange under asset allocation and the participation in IKB, KfW's other market price risks include CO_2 certificates kept by the KfW Group in its books. Risks arise from CO_2 certificates because KfW has decided to act as an intermediary between sellers and buyers of CO_2 certificates. KfW also keeps certificates in its own books for these purposes.

The risks from the remaining market price risks are measured under variance/covariance approaches in the form of a value-at-risk (99.99 % percentile) with the parameters derived from historic data. The assumed holding period in risk measurement is three months, as for all other types of market risk, and the capitalisation period is one year. The models applied within the KfW Group to estimate market price risks are reviewed annually during backtesting.

The Risk Management Committee manages the market risks on the basis of the evaluation and analysis of the interest and currency position, the remaining market risks and the stress tests for interest rate risks. The objective of this is the long-term management of a reasonable market risk position for the bank and the investment of own funds. The strategy pursued in light of this management is defined annually in the context of the group business planning and monitored with the aid of a global limit system.

The Board of Managing Directors has imposed general conditions in line with market standards for the transaction, handling and settlement of trading activities in accordance with the minimum requirements for risk management.

[1)] The holding period in this case is three months.

The market price risks within the KfW Group required a total of EUR 1,544 million in economic capital as at 31 December 2007. This position is composed of the following individual risks:

Total economic capital for market price risk
EUR in millions

	31 Dec. 2007	31 Dec. 2006
Interest rate risks	1,120	1,175
Currency risks	51	0
Other market price risks	373	226
Market price risk	1,544	1,401

Minor changes were observed in the interest rate risks, which required economic capital of EUR 1,120 million for the debt-financed book as at the reporting date.

As at 31 December 2007, there was an open currency position in the balance sheet in the equivalent of EUR 759 million, of which around EUR 747 million was attributed to the USD position (31 December 2006: EUR 151 million). This open position results from the risk protection for IKB and was fully closed in early 2008. The economic capital for currency risks was EUR 51 million as at the balance sheet closing date. In addition, the revaluation of the IKB risk protection at the end of March resulted in an open currency position as at the balance sheet closing date in the equivalent of EUR 1.7 billion, which is to be covered promptly in April 2008.

With respect to the remaining market risks, the economic capital increased by EUR 147 million compared with the previous year. This increase was mostly due to KfW's new indirect investment in EADS through Dedalus GmbH & Co. KGaA in 2007.

VOLATILITY OF PRESENT VALUE OF ASSETS FUNDED BY EQUITY.

Assets financed by equity are not actively managed in the context of interest risk management because they are a long-term investment. Interest rate risks nevertheless exist for these assets as changes in interest rates impact the present value of equity-funded assets. To cover the risk resulting from the volatility of the present value of these assets, KfW calculates economic capital (EUR 875 million as at 31 December 2007; previous year: EUR 890 million) using the two-factor Cox-Ingersoll-Ross model presented above.

LIQUIDITY RISK.

A variety of instruments and criteria are applied to manage the liquidity position and funding requirements within the KfW Group. The procedures to be applied in liquidity management are defined by specific risk guidelines. These guidelines include the definition of risk, objectives for liquidity management, the various instruments used in internal liquidity management and key parameters applied to meet statutory and regulatory requirements.

The KfW Group's risk definition breaks down liquidity risks into institutional and market liquidity risks. Institutional liquidity risks comprise the risk of being unable to meet existing payment obligations at all, in due time and/or in the required amount. Market liquidity risks, in turn, comprise risks associated with the market price losses of assets in the event of a necessary sale and the risk of being incapable of raising necessary funds in due time and/or in sufficient volume or of obtaining them only at a disproportionately high funding rate.

The primary objective of liquidity management is to ensure that the KfW Group is at all times capable of meeting its payment obligations. KfW's subsidiaries are principally responsible for ensuring and managing their own liquidity and complying with the existing regulatory requirements. KfW, however, is available as a contractual partner for all commercial transactions of its subsidiaries, particularly for their funding. For this reason the liquidity requirements of the subsidiaries are included both in KfW's funding schedule and in the liquidity maintenance strategy.

The basis for managing the liquidity position and determining the funding requirements within the KfW Group is a computer-based liquidity management system that evaluates all known current and future payments. Additional expected payment flows (e.g. disbursements under new lending transactions, off-schedule repayments and exercise of termination rights) are added to the known payment flows. On this basis KfW performs liquidity management and planning in daily, monthly and annual intervals. Additional analyses can be performed promptly as required.

KfW also monitors its liquidity position for compliance of the KfW Law, which requires the proportion of short-term to long-term obligations to be determined in order to ensure compliance with the 10% threshold. It also voluntarily determines the key parameters on a monthly basis according to the requirements of the Liquidity Regulation. All key liquidity figures are regularly above the minimum requirements.

To maintain liquidity KfW holds an adequate stock of money-market instruments and liquid securities that are Category I securities eligible as collateral with the European Central Bank, both for overnight funding and for regular open-market transactions. Liquid USD securities are also held as a liquid reserve for USD business. The required liquidity cushion is reviewed regularly and calculated in such a manner that KfW's operations can continue as planned even if a hypothetical extraordinary market disruption occurs and affects its funding options. For purposes of monitoring and communicating liquidity risks, the two key liquidity parameters and the mid-term liquidity planning are reported to the Risk Management Committee monthly and the long-term planning at least annually. The committee also decides on the measures to be taken when a need for action is determined. Responsibility for monitoring the liquidity situation and prompt reporting lies with the Treasury Department.

The table below shows the contractual payment obligations (principal and interest) of the KfW Group arising from financial instruments by maturity range.

Contractual payment obligations from financial instruments by maturity range as at 31 December 2007[1)]
EUR in millions

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	5 years and more	Total
Liabilities to banks and customers	5,298	7,449	6,889	21,605	37,578	78,819
Certificated liabilities	7,389	7,603	37,709	143,437	133,499	329,637
Net liabilities under derivative financial instruments	645	1.357	2.091	3.743	– 8.760	– 924
Subordinated liabilities	0	0	666	584	3.617	4,867
Liabilities under on-balance financial instruments	**13,332**	**16,409**	**47,355**	**169,369**	**165,934**	**412,399**
Contingent liabilities	6,054	0	0	0	0	6,054
Irrevocable loan commitments	38,462	0	0	0	0	38,462
Liabilities under off-balance financial instruments	**44,516**	**0**	**0**	**0**	**0**	**44,516**
Liabilities under financial instruments	**57,848**	**16,409**	**47,355**	**169,369**	**165,934**	**456,915**

[1)] Payment obligations arising from derivatives are offset against the opposite payment claims under the contracts, and irrevocable loan commitments and contingent liabilities are assigned flat to the first maturity range.

Contractual payment obligations from financial instruments by maturity range as at 31 December 2006[1)]
EUR in millions

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	5 years and more	Total
Liabilities to banks and customers	6,332	5,622	5,606	24,260	39,072	80,892
Certificated liabilities	5,554	11,675	37,799	133,578	126,348	314,954
Net liabilities under derivative financial instruments	558	945	376	1,593	– 9,564	– 6,092
Subordinated liabilities	0	0	20	520	0	540
Liabilities under on-balance financial instruments	**12,444**	**18,241**	**43,801**	**159,950**	**155,857**	**390,293**
Contingent liabilities	6,930	0	0	0	0	6,930
Irrevocable loan commitments	45,162	0	0	0	0	45,162
Liabilities under off-balance financial instruments	**52,092**	**0**	**0**	**0**	**0**	**52,092**
Liabilities under financial instruments	**64,536**	**18,241**	**43,801**	**159,950**	**155,857**	**442,385**

[1)] Payment obligations arising from derivatives are offset against the opposite payment claims under the contracts, and irrevocable loan commitments and contingent liabilities are assigned flat to the first maturity range.

Finally, in light of the current situation in the financial markets, KfW's funding situation may be summarised as follows: despite the difficult market environment characterised by the financial market crisis, KfW's funding situation continues to be very positive and was not, at any time, negatively affected. The general uncertainty prevailing in the market since the end of July prompted many investors to seek out "safe havens", which has benefited KfW particularly in terms of its short-term funding activities through the multicurrency commercial paper programme. Both the issuing volume and the funding costs achieved under this programme have developed clearly to KfW's advantage. The programme volume was increased from its original EUR 12 billion to EUR 20 billion in the middle of the year. The main reason for this was that KfW aimed to increase its funding flexibility overall in order to be able to optimally cover increasing funding needs resulting from its expanding promotional activities. For 2008, KfW expects its capital market funding needs to be approximately EUR 70 billion (previous year: EUR 65 billion). Only a minor portion of this increase will result from the replenishment of its liquidity reserves, which were used in the course of 2007 to meet the liquidity obligations assumed from IKB with respect to Rhineland Funding. Most of the increase is due to the expanding promotional activities of KfW, including new ERP business.

OPERATIONAL AND OTHER RISKS.

The KfW Group defines operational risk as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risks but does not include strategic risks.

Control of operational risks is performed centrally by the Risk Management and Controlling Department. Operational risks are managed by the individual operational departments. Furthermore, the central OpRisk Controlling is in charge of operational continuity management, which supports the risk management.

In accordance with the definition laid out in the Solvency Regulation, operational risks at the KfW Group are integrated into its economic management as part of a holistic management approach. Risk management is based on loss data collection, OpRisk assessments and the identification and monitoring of measures.

Operational risks are quantified and capital requirements are determined using the regulatory standard approach according to Basel II and the Solvency Regulation.

Loss data collection has been further optimised. The first bank-wide survey of OpRisk assessments was completed in 2007. Since then assessments have been conducted in regular intervals. Both OpRisk instruments are supported by data processing systems specially tailored to the needs of the KfW Group. The management of measures was technically designed in 2007. A technical platform was developed for the MaRisk-compliant monitoring of measures derived from the OpRisk assessments or the ascertainment of losses. This platform supports risk management and will be implemented in the beginning of 2008. Comprehensive management reporting of risk events was introduced in 2007. Quarterly reporting to the departments and the

Board of Managing Directors of KfW has been established. A project has been launched for the technical development of early warning indicators. A survey of initial risk indicators is scheduled to take place within the Group in the first half of 2008.

At the operative level, operational risks within the KfW Group are limited by an internal control system. The IT system is under permanent development and business processes are constantly being analysed and optimised. For risks that can arise from unforeseeable events, the bank has put appropriate contingency plans in place (for IT system disruptions) and has sufficient insurance coverage (e.g. for fire and water damage).

The Group addresses legal risks by involving its in-house legal department early in the process and by cooperating closely with external legal advisers in Germany and abroad. Contracts may be entered into only on the basis of unambiguous and correctly-documented arrangements. Moreover, current operations are concluded using standard contracts (e.g. ISDA contracts).

A crisis management group has been established for operational continuity management. Crisis, emergency and early warning procedures have also been defined. A technical solution has already been implemented for the early warning procedures. Preparations are currently underway to optimise the technical support for the planning of crisis and emergency procedures.

SUMMARY AND OUTLOOK.

The KfW Group will continue to attach great importance to enhancing its set of risk measurement and management instruments. The main focus for 2008 will be on further developing and validating KfW's rating methods and stress test instruments. Another major focus will be continuously improving and speeding up the risk management and controlling procedures. The bank has launched, along with others, projects that establish procedures for securing and improving data quality and integrity of KfW's risk models more firmly with the IT systems.

The KfW Group plans to further expand the active management of its loan portfolio. It plans to implement innovative portfolio management concepts, an infrastructure for the overarching management of securities portfolios and the integration of market and credit risks.

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