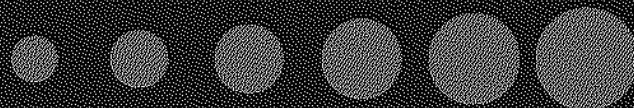
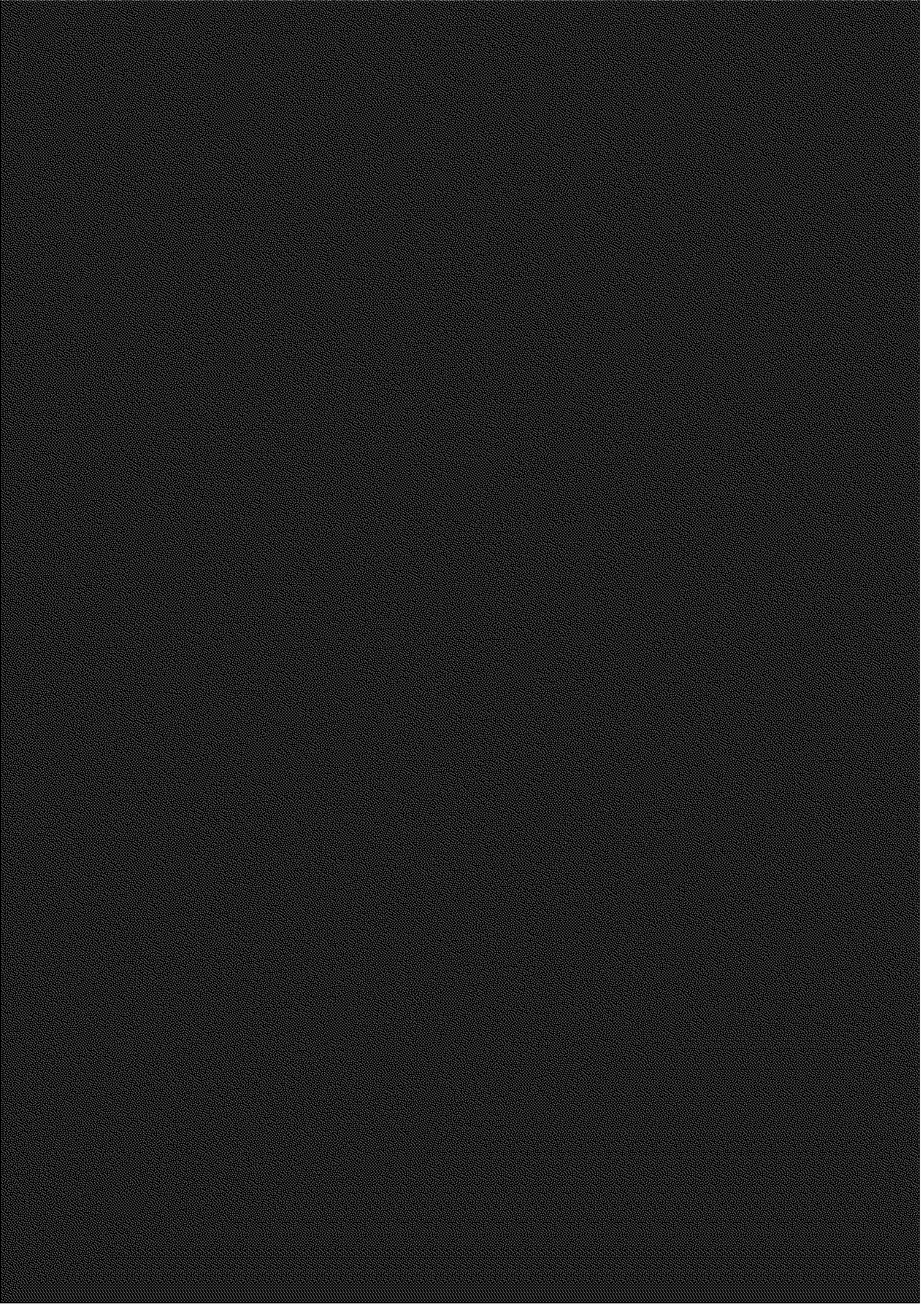


Annual Report 2006





# KEY FIGURES FOR KfW BANKENGRUPPE.

## Key figures for KfW Bankengruppe In EUR million

	2004	2005	2006
<b>I KfW Mittelstandsbank</b>	<b>14,971.2</b>	<b>15,520.1</b>	<b>22,827.2</b>
Loan financing	9,269.9	10,673.7	10,156.7
<i>of which: Entrepreneur Loan</i>	5,740.6	4,769.4	6,096.2
<i>of which: Global loans to trade and industry</i>	2,764.8	5,353.7	3,643.7
Mezzanine financing	618.8	583.1	2,139.6
Equity financing	344.1	300.1	280.8
ABS SME portfolio <sup>1)</sup>	-	-	780.6
Securitisations	3,738.4	3,963.2	9,469.5
<b>II KfW Förderbank</b>	<b>34,468.9</b>	<b>38,687.5</b>	<b>38,548.1</b>
Housing investment	11,929.5	10,903.6	15,147.4
<i>of which: Global loans to the housing industry</i>	2,887.0	2,008.0	1,200.0
Education	811.6	875.0	1,341.8
Municipal infrastructure	4,195.3	2,770.4	3,211.7
Environmental protection investments	2,165.5	4,241.6	4,609.6
Global credit lines for promotional institutions in the federal states	3,936.5	3,625.2	3,596.0
Securitisations	11,430.6	16,271.7	7,641.5
<b>Investment finance in Germany and Europe</b>	<b>48,440.1</b>	<b>54,207.6</b>	<b>58,375.3</b>
<b>III KfW IPEX-Bank</b>	<b>11,914.7</b>	<b>12,148.1</b>	<b>15,000.8</b>
Industry, telecommunications, raw materials	5,180.4	4,939.8	5,595.6
Power, renewables, water	1,224.2	1,224.8	2,452.6
Transport and transport infrastructure	5,240.4	5,558.0	6,931.9
Other (AKA export loans, grants)	269.7	425.5	20.7
<b>IV KfW Entwicklungsbank</b>	<b>1,943.9</b>	<b>1,899.7</b>	<b>2,482.8</b>
Budget funds	1,304.5	1,233.0	1,379.7
KfW funds	620.9	582.6	1,018.5
Other donors' funds	18.5	84.1	84.6
<b>V DEG</b>	<b>562.8</b>	<b>671.8</b>	<b>929.8</b>
<b>Total financing volume</b>	<b>62,861.5</b>	<b>68,927.2</b>	<b>76,788.5</b>
Loans	44,440.6	45,660.4	54,001.4
Securitisations	17,039.1	21,594.7	20,073.2
<b>Business volume</b>	<b>426,484</b>	<b>454,201</b>	<b>485,317</b>
<b>Balance sheet total</b>	<b>328,596</b>	<b>341,143</b>	<b>359,606</b>
<b>Capital and reserves</b>	<b>11,655</b>	<b>13,599</b>	<b>15,328</b>
<b>Net income for the year</b>	<b>368</b>	<b>625</b>	<b>974</b>
<b>Employees</b>	<b>3,697</b>	<b>3,740</b>	<b>3,946</b>

Differences in the totals are due to rounding.

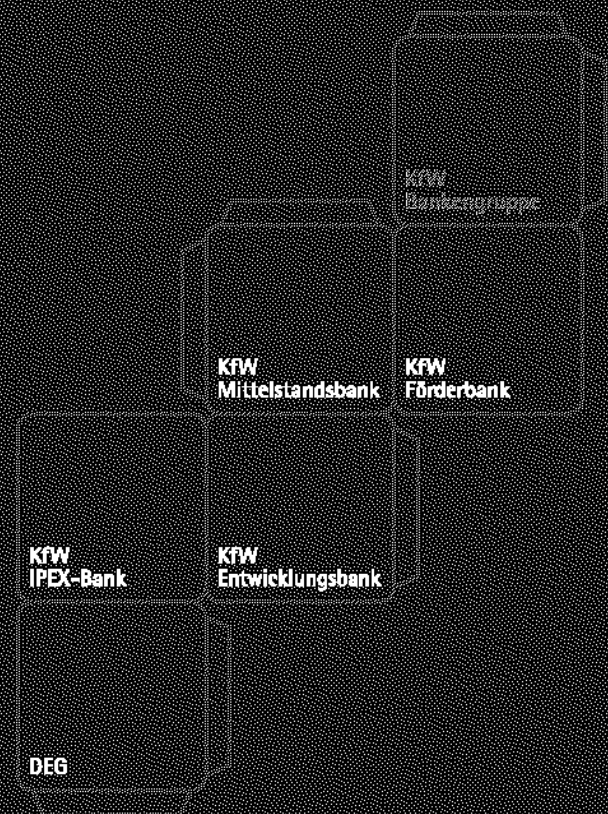
<sup>1)</sup> Until 31 December 2005 recorded under promotional loans/global loans.

<sup>2)</sup> Excluding risk sub-participations.

*KfW Bankengruppe – a multifaceted promoter.*

KfW Bankengruppe provides stimulus for the economy, society and the environment throughout the world. As bankers we work efficiently every day. As promoters we stand for the validity 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. Our expertise and experience are packaged as five strong brands.

Good ideas have great power. KfW supports them with liquid funds so that this power can be forged into economic strength. With this financial thrust KfW sets processes in motion and helps to bring the most varied types of economic, social and ecological projects to a successful conclusion. As a creative bank, we not only encourage innovation but also increasingly develop new financing instruments for our customers and partners.



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# LETTER FROM THE BOARD OF MANAGING DIRECTORS.

*Dear Readers,*

2006 was a good year for KfW Bankengruppe – we achieved a lot! We also have a number of plans for 2007. KfW will be sticking to its well-established strategy, carrying on with what has proved successful and, at the same time, striking out along new paths. Continuity and innovation – a mixture of the two is our motto and our strength. In 2006 KfW Bankengruppe's total volume of financing increased by 11% to EUR 76.8 billion. As at 31 December 2006, the Group balance sheet total was EUR 360 billion – an increase of more than 5% on 2005. The 2006 operating result also provides an impressive confirmation of our self-image as a promotional bank – at one and the same time long-term promoters and efficient bankers.

KfW Bankengruppe's financing volume is made up primarily of loans and securitisations. Our loan volume developed particularly well last year, rising to EUR 59.7 billion. That means over EUR 11 billion more than in the previous year for the promotion of the SME sector, environmental and climate protection, our children's

education, the infrastructure, the German and European economy and, not least, developing and transition countries. The increase is partly attributable to some new promotional programmes that we launched in 2006. On the other hand, the positive development of the economy also played a role. Enterprises are investing again and the upturn has finally reached the SME sector.

The securitisation business again made a substantial contribution – EUR 17.1 billion – to our financing volume. With a volume of EUR 9.5 billion, once again more SME loans were securitised than in the previous years. KfW Förderbank achieved a securitisation volume of EUR 7.6 billion. This means that KfW has now placed more than EUR 100 billion in loan risks in the capital market via its securitisation platforms. In addition, around EUR 800 million from the newly created ABS SME framework was invested in SME securitisation as a means of providing specific support for market creation and new lending business.

## KFW MITTELSTANDBANK.

Last year we provided EUR 22.8 billion in support for the SME sector – an increase of 47% in the overall volume. Securitisation transactions accounted for EUR 9.5 billion. Loan commitments alone increased by 16%. With a commitment volume of EUR 6.1 billion, there was a particularly marked year-on-year increase in the basic programme for small and medium-sized enterprises – the KfW Entrepreneur Loan. A clear upturn was also experienced by mezzanine financing. At EUR 2.1 billion, commitments were almost four times the 2005 figure. In particular,

outstanding commitment figures were achieved in the ERP Innovation Programme, in which budget funds are used to keep interest rates low. The ABS SME portfolio, with which we invest in securitisation transactions primarily with German SME risks, achieved a volume of EUR 800 million in 2006. These securitisations enable banks, savings banks and leasing companies to obtain specific relief from the risks arising from their SME business. This creates scope for new lending to small and medium-sized enterprises.

## KFW FÖRDERBANK.

At EUR 28 billion, the volume of loans extended by KfW Förderbank increased by around one-quarter on the year. This strong growth was due, in particular, to the promotional initiative "Housing, Environment, Growth", which we launched in February on behalf of the federal government. The aim of the initiative is to reduce CO<sub>2</sub> emissions through energy rehabilitation in the housing sector and at the same time to strengthen the German domestic economy. In other words, our aim is better quality housing, more climate protection and more jobs. In 2006 we approved around 260,000 loans, a volume of over EUR 17 billion. The loans provided out of budget funds and with interest reduced by KfW itself triggered around EUR 28 billion in invest-

ment and a sustainable reduction of 1.5 million tonnes in CO<sub>2</sub> emissions was achieved. In the real estate sector, the Housing, Environment, Growth initiative is thus currently the most effective and durable climate protection measure in Germany if not worldwide. It is also giving a huge boost to the SME construction and construction-related industry and thus secured around 400,000 jobs for at least a year.

The highlight in education financing in 2006 was the launch of the KfW Student Loan in April. Last year this new product enabled us to provide support for 19,000 students. Overall, EUR 1.3 billion in promotional funds have been channelled into initial and further training.

## KFW IPEX-BANK.

KfW IPEX-Bank continued on its success course in 2006 – with regard to both its business figures and preparations for independence. At EUR 15 billion, there was a distinct increase in its new business. One-third of that amount was attributable to new commitments in Germany, while investment financing in Europe accounted for another third, and investment financing in other countries for the final third. This is the last year in which KfW IPEX-Bank will operate as a division of KfW Bankengruppe – as a bank within the bank. Application has been made for a banking licence as well as for approval as an advanced IRB bank. Very good progress was also made in the preparations for KfW IPEX-Bank to

be given a separate initial rating by the leading international rating agencies. Carrying out the complex procedure of establishing an independent bank while continuing to do business and to maintain high commitment figures is no mean feat and something of which we are very proud. However, even after its spin-off as a legally independent company, KfW IPEX-Bank will continue to play an important role in the Group. Its support for German and European customers in complex financing transactions in Germany and abroad and its contribution to the Bank's income will help KfW Bankengruppe to fulfil its public mandate.

## KFW ENTWICKLUNGSBANK AND DEG.

Our second international mainstay is Financial Cooperation with developing and transition countries. In 2006 we provided just under EUR 2.5 billion for projects intended to sustainably reduce poverty in those countries, to boost the economy and to develop structures – 30% and hence over EUR 500,000 more than in 2005. We have made a considerable increase in the share of our own funds that we use to supplement budget funds for development promotion. Now almost one euro in two spent on projects in the partner countries comes from KfW's own financial resources. We can only achieve this high volume of financing because, as a credit institution, we have the required financial potential and the developmental expertise. This allows us to adopt innovative approaches to ensure the renewed strong expansion of our promotional potential. We derive particular benefit from the close cooperation and mutual enrichment between various parts of KfW Bankengruppe. Overall, KfW Entwicklungsbank – far in excess of its quantitative promotional volume – is of major significance for the reputation, the promotional bank character, the innovative drive and the performance of KfW Bankengruppe as a whole.

With its wide range of financing instruments, KfW Entwicklungsbank supports the German fed-

eral government by providing additional financial resources for official development assistance (ODA) to complement funds from the federal budget. As a bank and a development organisation in one, it can mix budget funds and KfW funds which it refinances in the capital market. The overall volume of finance is thus considered ODA. This enables KfW Bankengruppe to increase support for the partners at attractive terms while reducing the strain on the federal budget.

The range of products offered by KfW Entwicklungsbank is supplemented by the financing and consulting services specifically tailored to the needs of private enterprises that are provided by our subsidiary DEG. DEG has developed positively since its integration into KfW Bankengruppe and has clearly expanded financial support for private sector commitment in developing and transition countries. In 2006 it committed over EUR 918 million, 37% more than in the previous year. Together, KfW Entwicklungsbank and DEG are making a substantial developmental impact, which is contributing to ensuring the sustainability of development in the partner countries.

## FUNDING / CAPITAL MARKETS.

KfW's funding operations were again very successful in 2006. With more than 500 transactions in the international capital markets, we issued bonds in 23 different currencies, further diversified our funding and gained access to new investor groups. A total of EUR 54.2 billion was raised. In 2006 we continued our privatisation activities with two transactions. The one was the sale of around 4.5% of the Telekom shares (191.7 million shares) to the US financial

investor Blackstone in April 2006; this transaction represented a volume of EUR 2.68 billion. The other was the sale of some 73 million Deutsche Post shares to institutional investors in July 2006. The volume of around EUR 1.5 billion was the equivalent of a 6.1% share in the capital of Deutsche Post. We therefore now still have a holding of around 16.9% in Deutsche Telekom and 34.1% in Deutsche Post (as on 31 December 2006).

## OUTLOOK.

In 2007 we intend to strengthen our commitment primarily in the following two promotional areas.

### CLIMATE PROTECTION.

KfW Bankengruppe has been financing environmental and climate protection measures for the past 20 years. With a loan volume of more than EUR 3.7 billion for investment in the use of renewable energies, in 2006 KfW was again one of the largest, if not the largest, financier of renewable energies in the world. The promotional initiative "Housing, Environment, Growth" constitutes a further milestone in the area of environmental finance. However, we need to do a lot more to meet the existential challenges in the sphere of climate protection. We therefore

intend to increase the promotion of energy conservation, energy efficiency and CO<sub>2</sub> reduction, while at the same time expanding the promotion of renewable energies. All KfW business areas are actively committed to protecting the climate and the environment. The major efforts that have been made and the great success that we have encountered justify our demanding position. It has already made us the number one environmental bank in Germany – CO<sub>2</sub> neutral, of course.

### KfW INITIATIVE FOR SMALL SMES.

The financing conditions for small and medium-sized enterprises have improved. However, the main beneficiaries are medium-sized and large enterprises, while smaller and young SMEs continue to report considerable difficulties. At the same time, however, small SMEs are the main job engine in Germany. Our current task is therefore to increase support for small businesses to enable them to operate successfully in the market. That is why we launched the KfW "Small SMEs" initiative. A package of measures is intended to improve the financing situation of new businesses and small SMEs. We enjoy helpful and

successful working relations with all three pillars of the banking industry and the promotional institutions in the federal states.

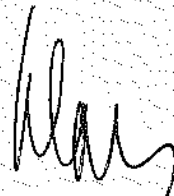
KfW Bankengruppe has always considered it important not merely to support the German and European economy by providing suitable promotional measures but also to encourage social development. We are in a position to do that because we have a broad base and bring together a number of different perspectives. We aim to put this strength to good use in the future, too.



Dr Günther Bräunig



Dr Peter Fleischer



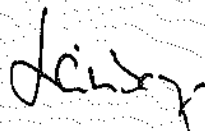
Dr Peter Klaus



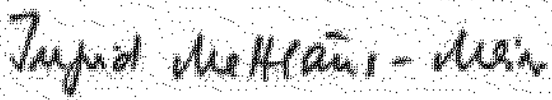
Dr Norbert Kloppenburg



Wolfgang Kroh



Detlef Leinberger



Ingrid Matthäus-Maier (Spokeswoman)

# MANAGING DIRECTORS AND DIRECTORS OF KfW BANKENGRUPPE.

## BOARD OF MANAGING DIRECTORS.

Dr Günther Bräunig    Dr Peter Fleischer    Dr Peter Klaus    Dr Norbert Kloppenburg    Wolfgang Kroh  
Detlef Leinberger    Ingrid Matthäus-Maier (Spokeswoman)

## DIRECTORS.

Dr Stefan Breuer	Doris Köhn	Wolfgang Roßmeißl
Dr Frank Czichowski	Werner Möller	Dr Jürgen Schneider
Helmut Gauges	Dr Hanns-Peter Neuhoff	Dr Bernd Schreiber
Werner Genter	Klaus Neumann	Dietrich Sublrie
Dr Dieter Glüder	Werner Oerter	Klaus Weirich
Dr Volker Groß	Christiane Orfowski	Bruno Wenn
Rainer Hartje	Joachim Rastert	Dr Christian Zacherl
Klaus Klüber	Ludolf Rischmüller	

## BOARD OF MANAGING DIRECTORS OF KfW IPEX-BANK.

Michael Ebert    Heinrich Heims    Dr Peter Klaus (Spokesman)    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 1 January 2004 KfW IPEX-Bank has been operating as a legally independent "bank within the bank". As from 2008 it will be a legally independent subsidiary of KfW Bankengruppe and will be subject to the German Banking Act (KWG) and to banking supervision.

## 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 KfW Bankengruppe 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 financed investments by private companies in developing and transition countries.

# REPORT OF THE BOARD OF SUPERVISORY DIRECTORS.



Peer Steinbrück  
Federal Minister of Finance

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 pursuant to the conditions set forth in the Law and the By-Laws, several meetings of the Board of Supervisory Directors and of its committees were held during the year under review.

At those meetings the Board of Managing Directors provided the Board of Supervisory Directors with information about the business activities and current developments in the Bank's fields of activity and about the Group's assets and earnings.

In particular, the Board of Managing Directors reported on the activities of KfW Förderbank, whose range of products now includes the promotional initiative "Housing, Environment, Growth" and the KfW Student Loan, on improved conditions for the lending banks, especially with regard to loans for small enterprises, and on plans for new programmes and products in this segment. At the request of the Board of Supervisory Directors, the Board of Managing Directors also presented full details of risk management at KfW. Further items on the agenda were the formal decision to establish KfW IPEX-Bank and the presentation of the Sustainability Report.

The Loan Approvals Committee concerned itself primarily with the loan commitments that have to be presented in accordance with the Law and the By-Laws. Furthermore, it was given an overview of the future financing of KfW IPEX-Bank, a report on new developments in micro-finance as an instrument used to promote the financial sector in developing and transition countries, and a detailed presentation of the risk report of KfW Bankengruppe.

The meeting of the Advisory Council for Promotional Measures in Eastern Germany was postponed until January 2007.

As agreed, in my capacity as Federal Minister of Finance I will chair the Board of Supervisory Directors in 2007.

In the period under review, Dietrich Austermann, Dr Ulrich Brixner, Professor Hans-Günter Henneke, Dr Dietrich H Hoppenstedt, Professor Wolfgang Methling, Dr Horst Metz, Margret Mönig-Raane and Heinz Putzhammer resigned from the Board of Supervisory Directors. The Board of Supervisory Directors would like to thank these former members for their cooperation and valuable commitment to the concerns of the Bank. New members are Dr Uwe Brandl, Frank Bsirske, Professor Ingolf Deubel, Heinrich Haasis, Peter Jacoby, Claus Matecki, Matthias Platzeck and Dr Christopher Pleister.

With effect from 1 January 2007, the Board of Supervisory Directors has appointed Dr Norbert Kloppenburg to the Board of Managing Directors of KfW Bankengruppe.

PwC Deutsche Revision AG, Frankfurt am Main, who were appointed auditors by the Supervisory Authority following the proposal by the Board of Supervisory Directors, have examined and unconditionally confirmed the Annual Financial Statements drawn up by the Board of Managing Directors as at 31 December 2006. The Board of Supervisory Directors approved the Annual Financial Statements in accordance with section 9.2 of the KfW Law at its meeting on 30 March 2007.

Frankfurt am Main, 30 March 2007

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 the bank's business and the administration of its assets. It approves the larger loans and the Annual Financial Statements. The Board of Supervisory Directors consists of 37 members. The Chairman is the Federal Minister of Finance and the Deputy Chairman is the Federal Minister of Economics and Technology.

### Peer Steinbrück

Federal Minister of Finance  
Chairman  
(From 1 January 2007)  
Deputy Chairman  
(Until 31 December 2006)

### Michael Glos

Federal Minister of Economics  
and Technology  
Deputy Chairman  
(From 1 January 2007)  
Chairman  
(Until 31 December 2006)

### Dietrich Austermann

Minister of Science,  
Economics and Transport of the  
State of Schleswig-Holstein  
Member appointed by the  
German Bundesrat  
(Until 31 December 2006)

### 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  
(From 1 January 2007)

### Dr Ulrich Brixner

Chairman of the Board of Managing  
Directors of DZ BANK AG (retired)  
Representative of the Cooperative  
Banks  
(Until 31 December 2006)

### Frank Bsirske

Chairman of ver.di - Vereinigte  
Dienstleistungsgewerkschaft  
Representative of the Trade Unions  
(From 1 October 2006)

### Prof Dr Ingolf Deubel

Minister of Finance of the  
State of Rhineland-Palatinate  
Member appointed by the  
German Bundesrat  
(From 1 January 2007)

### Rüdiger Dorn

President  
Haus & Grund Deutschland  
Representative of the Housing Industry

### Prof Dr Kurt Faltlhauser

Minister of Finance of the Free State  
of Bavaria  
Member appointed by the  
German Bundesrat

### Dr Thomas R Fischer

Chairman of the Board of Managing  
Directors of WestLB  
Representative of the Mortgage Banks

### 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  
(From 1 July 2006)

### Prof Dr Hans-Günter Henneke

Managing Director of the  
Deutscher Landkreistag  
Representative of the Municipalities  
(Until 31 December 2006)

### Dr Dietrich H Hoppenstedt

President of the Deutscher  
Sparkassen- und Giroverband e.V.  
(retired)  
Representative of the Savings Banks  
(Until 30 June 2006)

### Peter Jacoby

Minister of Finance  
of the State of Saarland  
Member appointed by the  
German Bundesrat  
(From 1 January 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 Bundestag

### 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

### Claus Matecki

Member of the Federal Executive  
Board of the Confederation of  
German Trade Unions (DGB)  
Representative of the Trade Unions  
(From 1 January 2007)

### Dr Michael Meister

Member of the German Bundestag  
Member appointed by the  
German Bundestag  
(From 1 January 2007)

### Prof Dr Wolfgang Methling

Minister of the Environment of the  
State of Mecklenburg-West Pomerania  
Member appointed by the  
German Bundesrat  
(Until 31 December 2006)

### Dr Horst Metz

Minister of Finance of the Free State  
of Saxony  
Member appointed by the  
German Bundesrat  
(Until 31 December 2006)

### 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

### Margret Mönig-Raane

Deputy Chairperson of ver.di e.V.  
Representative of the Trade Unions  
(Until 30 September 2006)

### Klaus-Peter Müller

President of the Association of  
German Banks  
Representative of the Commercial  
Banks

### Stefan Ortseifen

CEO, Board of Managing Directors of  
IKB  
Deutsche Industriebank AG  
Representative of the Industrial Loan  
Banks

### Matthias Platzeck

Minister President of the State of  
Brandenburg  
Member appointed by the  
German Bundesrat  
(From 1 January 2007)

### Dr Christopher Pleister

President of the Bundesverband  
der Deutschen Volks- und  
Raiffeisenbanken e.V. (BVR)  
Representative of the Cooperative  
Banks  
(From 1 January 2007)

### Ronald Pofalla

Member of the German Bundestag  
Member appointed by the  
German Bundestag  
(Until 31 December 2006)

### Heinz Putzhammer

Member of the Federal Executive  
Board of the Confederation of  
German Trade Unions (DGB)  
(Until 27 June 2006, deceased)

### Christine Scheel

Member of the German Bundestag  
Member appointed by the  
German Bundestag

### Hanns-Eberhard Schleyer

Secretary-General of the German  
Confederation of Skilled Crafts (ZdH)  
Representative of the Skilled Crafts

### Horst Seehofer

Federal Minister of Food, Agriculture  
and Consumer Protection

### Michael Sommer

Chairman of the Confederation of  
German Trade Unions (DGB)  
Representative of the Trade Unions

### Gerhard 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

### 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

### 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 multifaceted promoter.

Throughout the Group we are continuously adapting to the demands of changing markets. We put our knowledge of the market to use in developing products for tomorrow's needs. Within the bank itself our ongoing endeavour is to optimise our processes so as to make them highly transparent, flexible and cost-effective. The twofold thrust of our promotional work and the task of generating returns sets us apart as a powerful generator of impulses. What ultimately drives our development, however, is the personal initiative and creativity of our staff. They enable us to go from strength to strength as a partner of business and politics. We raise most of our promotional funds in the capital market, and the results of our efforts flow back 100% into promotion and into securing our goals over the long term.





AN INTERVIEW WITH THE KfW BOARD OF MANAGING DIRECTORS.

How did 2006 go for KfW Bankengruppe and what can we expect from you in 2007?

**Ms Matthäus-Maier:** We can look back on an extremely successful year that also saw some major changes. A large number of new promotional activities, such as the highly successful promotional initiative Housing, Environment, Growth were launched. Not least because of that initiative, we achieved a clear increase of more than 11% in our promotional volume, taking it to EUR 76.8 billion. That is beneficial to economic development in Germany. And it has the advantage of allowing us to provide support for more enterprises and people.



There are been some changes internally, too. We are operating with a new team on the Board of Managing Directors. We are committed to the common goal of implementing our promotional mission successfully – to provide support for the economy, society and the environment and stimulate innovative developments. We will be adhering to our well-established strategy, carrying on with what has proved successful and, at the same time, striking out along new paths.

What does that mean in practice?

**Ms Matthäus-Maier:** A key challenge for the years ahead will be climate protection and energy conservation. KfW has been promoting commercial environmental protection, CO<sub>2</sub> reduction

in residential buildings and the expansion of renewable energies for more than 20 years in Germany and worldwide. This makes KfW Germany's number one environmental bank! We are planning to expand this commitment further! Only by increasing our efforts can we counter global climate change.

What further promotional focuses are planned for 2007?

**Ms Matthäus-Maier:** Although financing conditions for SMEs have generally improved in recent years, the main beneficiaries have been medium-sized and large enterprises. Small businesses, business start-ups and young enterprises still face serious difficulties. We will therefore be increasing our support for small SMEs and are launching the "Small SMEs" initiative. Through innovative and market-based instruments such as loan securitisation and mezzanine financing, we have already charted a clear course for SME financing. We plan to continue to stimulate the further development of the financial markets. Of course, we will be keeping to our established on-lending principle.

What is included in the "Small SMEs" initiative?

**Dr Fleischer:** It involves several measures to deal with the key issues, high processing costs in small-scale loan transactions and the high risk associated with seed capital. For example, together with the banking industry we are working on a standard KfW loan which reduces processing costs for the on-lending institution. As financing risk is particularly high in the start-up and early stage of a business, something else we are doing is planning to assume more risk in the future. We are going to combine the Start Money and Microloan Programmes and relieve the local

banks of all default risk. We have already made a marked reduction in the interest rates charged in these programmes.

What is KfW doing for young, innovative technology businesses, which find it particularly difficult to gain access to financing?

**Mr Leinberger:** We offer these customers a tailor-made range of equity finance products. In the early stage area we are mobilising equity capital by means of the ERP Start Fund, for example. In addition, we are committed to the High-Tech Start-up Fund, which adopts an innovative public private partnership approach to providing equity capital. We are also providing support for the provision of equity capital for the broad SME sector, e.g. with the new KfW equity-mezzanine programme.

Do all enterprises, regardless of their size, have equal access to modern financing instruments?

**Dr Bräunig:** SME financing has become more capital market based in recent years. This has so far been of benefit primarily to larger enterprises. We want to change that.



For example, we will be opening our securitisation platforms up to smaller-scale transactions. Securitisation will thus become attractive for smaller institutions with smaller loans, too. However, we, too, are investing in mezzanine tranches of selected transactions via our ABS SME portfolio, thus tapping markets and developing them further.



Are there any other areas in addition to lending where you see a need to take action with regard to SME promotion?

**Dr Fleischer:** In addition to money, people setting up in business and those running small SMEs are in particular need of advice.

For us, these two things belong together. That is apparent from advisory measures such as the Startothek, Round Table and start-up coaching. In the future we will be intensifying our advisory efforts through the new Information and Consulting Department.

In 2006 the focus was on the promotional initiative Housing, Environment, Growth. What are its objectives?

**Ms Matthäus-Maier:** The aim was – and still is – to reduce CO<sub>2</sub> emissions through energy rehabilitation in the housing sector and at the same time to strengthen the German domestic economy. In other words, our aim is better quality housing, more climate protection and more jobs. And it is working. In 2006 we initiated around EUR 28 billion in investment, safeguarded more than 400,000 jobs and at the same time achieved a sustainable reduction of 1.5 million tonnes in CO<sub>2</sub> emissions. This is more than one-fifth of the reduction that the federal government has approved for the private sector on the basis of the Kyoto Protocol.

Can we expect further innovations?

**Ms Matthäus-Maier:** On 1 January 2007 we improved the CO<sub>2</sub> Building Rehabilitation Programme and added a grant variant. In addition, there are now also special promotional opportunities for municipalities, charitable and non-profit organisations wishing to rehabilitate their schools, sports halls or day nurseries.



What plans does Germany's leading environmental bank have for 2007?

**Mr Leinberger:** To strengthen the promotion of environmental and climate protection in the commercial sector and to extend our energy efficiency and renewable energies programmes. There is considerable potential for increasing the energy efficiency of small enterprises. Entrepreneurs can reduce CO<sub>2</sub> emissions and save considerable energy costs.

Is KfW Bankengruppe setting a good example in its day-to-day operations?

**Mr Leinberger:** In 2006 KfW Bankengruppe was the first bank in Germany to go CO<sub>2</sub> neutral! Thanks to building technology and a construction concept that are geared to protecting the environment, we have achieved a marked reduction in CO<sub>2</sub> emissions. The remaining 30,000 tonnes in emissions are being offset by purchasing emission credits from climate protection projects in development countries through the KfW Carbon Fund.

KfW Förderbank is also active in the field of education – with the KfW Student Loan, for example. Why?

**Ms Matthäus-Maier:** In comparison with other OECD countries, relatively few young people study in Germany – and even fewer complete their studies. Two out of every three students have to do odd jobs to finance their studies. The KfW Student Loan enables students to concentrate fully on their university studies rather than on their job. What is more, it also gives some talented young people the opportunity to take up a course of study in the first place.

Are you satisfied with the launch of the Student Loan?

**Dr Fleischer:** Yes, definitely. Between April and December we issued around 19,000 student loans. The demand makes it clear to us that many students need a source of financing for their living



expenses that is not dependent on their parents or the BAföG.

We also take the matter of young people running up debt very seriously. For that reason we make clear reference on the KfW website to what it will cost per month to repay the loan. We encourage all students to ask themselves whether they really need a loan? We also refer to more favourable government programmes such as the BAföG or the Education Loan. Students can also use our repayment calculator to find out the amount that they will have to pay back later if they take out a loan.

KfW Entwicklungsbank is a familiar name in developing and transition countries. What role does it play?

**Mr Kroh:** For 45 years KfW Entwicklungsbank has been a competent, frequently used contact point for the BMZ in matters of poverty reduction, securing peace and helping to shape globalisation. We are working intensively with other international donors and the partner countries. A good example of successful development cooperation is microfinance. We see the award of the Nobel Peace Prize to Professor Yunus and Grameen Bank in Bangladesh – which has received EUR 24 million in support from KfW Entwicklungsbank – as acknowledging our long-term developmental commitment in this field.

What is KfW doing to overcome the shortage of development cooperation funds?

**Mr Kroh:** In 2006 almost one euro in two that we used for projects in the partner countries came from our own funds. In addition, we are meeting with repeated success in achieving a strong expansion in the promotional potential with the help of innovative approaches, not least thanks to the mutual enrichment process between the various areas of KfW Bankengruppe.



The first securitisation of microloans in the world, which took place in Bangladesh in 2006, is a good example of this successful cooperation.



KfW IPEX-Bank is active internationally. What tasks does it carry out?

**Dr Klaus:** The wide range of business areas include international project and export financing as well as business, trade and acquisition finance and structured financing for major projects all over the world. The field of business will be spun off into a legally independent bank on 1 January 2008.

Extensive preparations undoubtedly need to be made before that step can be taken. How has your business developed during that phase?

**Dr Klaus:** Establishing a legally independent bank while continuing normal business operations is indeed an extremely complex procedure which places great demands on the Bank as a whole. The fact that in 2006 we increased new commitments to EUR 15 billion and achieved a good income is a tremendous accomplishment and is due to the active commitment of our staff, which is well above average and allows us to look to the future with confidence and optimism. I therefore have no fears about retiring in 2007 and passing the responsibility for the business area on to my successor.

Dr Kloppenburg, you are that successor, aren't you?

**Dr Kloppenburg:** Yes, and I am already really looking forward to the job. As a member of the Board of Managing Directors of KfW Bankengruppe, I will have oversight of KfW IPEX-Bank but will not take up office as the Spokesman of the Board of Managing Directors of KfW IPEX-Bank. The dual function will no longer be relevant just before the spin-off.

In the last year of the spin-off phase, there is probably still a lot of work to be done.



**Dr Kloppenburg:** That is absolutely true. Establishing a bank is a major challenge. However, our preparations are well on target and we are absolutely certain that we will also be successful in passing the last two milestones – the IRBA review, which starts in April, and discussions with the rating agencies towards the end of the year.

What role will KfW IPEX-Bank assume from 2008?

**Ms Matthäus-Maier:** As an independent bank, KfW IPEX-Bank will still remain an indispensable integral part of KfW Bankengruppe. Its expertise constitutes invaluable capital for us. Moreover, KfW IPEX-Bank is firmly established as a generator of income for the fulfilment of our promotional mission as KfW Bankengruppe.

KfW Bankengruppe is the first choice for investors seeking blue chip shares and is considered an innovative issuer. What role does refinancing play in your promotional mission?

**Dr Bräunig:** In order to meet its promotional objectives, KfW needs long-term reliable funding. The annual volume of capital required, around EUR 55 billion, is still a challenge. We pay a great deal of attention to maintaining a broad position on the international capital markets. If it is to attract investors, an issuer must be flexible, reliable and innovative and convey this in a credible manner to the capital market participants. We work with an eye to the future and think long term whenever we tap new markets, such as in Asia.

KfW Bankengruppe now employs around 3,900 people. Will there be further staff increases in 2007?

**Ms Matthäus-Maier:** We have grown over the years and will continue to do so if necessary. Today we have a strong team doing excellent work in various fields of business. Sometimes, and particularly when so many changes are being made, the demands made on staff can be very high. However, we are at the same time very actively committed to our employees, for example with regard to combining a family and a career. Our greatest strength is the high degree of identification by the members of staff with the objectives of KfW Bankengruppe. In my opinion, this constitutes a vital cornerstone of our success.

#### NEW STRATEGIC SHAREHOLDER FOR DEUTSCHE TELEKOM.

Further progress has been made in the privatisation of Deutsche Telekom AG (DTAG). The private equity company Blackstone, another important shareholder with a long-term outlook, has purchased a stake in the German telecommunications corporation. Blackstone purchased 4.5% of the registered share capital of Deutsche Telekom AG (191.7 million shares) from KfW for just under EUR 2.7 billion. With this transaction KfW's shareholdings in DTAG at the end of the year dropped to 16.9%, with the Federal Republic continuing to hold 14.8% of DTAG and diverse shareholders holding the remaining shares.



#### RECORD DEMAND FOR 15-YEAR EURO BENCHMARK BOND.

KfW issued its first 15-year EUR 5 billion benchmark bond. As investor demand for longer-term bonds was rising, driven by regulatory changes implemented for pension funds and insurance companies, this transaction turned out to be a huge success – the order book passed the EUR 10 billion mark within a single day.



#### FIRST KfW BOND IN THE MALAYSIAN CAPITAL MARKET.

With the issue of a seven-year 500 million ringgit bond, KfW became active for the first time as a local currency issuer in one of the emerging Asian capital markets. Through its commitment KfW's aim is to contribute to the further development of the Malaysian capital market. Asia's emerging capital markets are also attractive to KfW – with an annual funding volume of around EUR 50 billion KfW is continuously working to diversify its sales markets and to broaden its investor base.



#### FURTHER PROGRESS IN THE PRIVATISATION OF DEUTSCHE POST.

In 2005 KfW successfully placed 73.1 million Deutsche Post AG (DPAG) shares worth a total of EUR 1.5 billion with institutional investors. In addition, almost all the KfW bonds exchangeable for shares in DPAG which were issued in December 2003 were exchanged in January 2007. With this bond exchange transaction, around 55.8 million shares held by KfW were finally placed in the market. This transaction reduced the volume of DPAG shares held by KfW to around 30.6%. At the same time the free float of the shares increased from some 64.7% to around 69.4%.



### BUSINESS START-UPS IN FIGURES.

According to the KfW Start-up Monitor 2006, around 1,390,000 people started their own full-time or part-time business in 2005. This was a slight decline of 40,000 against the previous year. Around 10% of the start-up projects can be described as innovative. These, in particular, are expected to have a positive impact on economic growth and employment. Besides, judging from the financing need and the number of employees, there appears to be a trend towards increasingly smaller start-up projects. Despite their generally minor financing requirements, around 140,000 people, or 10% of all start-ups, had to struggle with financing difficulties as they ventured into self-employment. It is therefore important to keep the door to financing opportunities open for business start-ups.



### THE SME SECTOR IS THE JOB ENGINE OF THE GERMAN ECONOMY.

While large corporations cut more than 100,000 jobs between 2003 and 2005, the SME sector created more than 400,000 new ones. This was established by the KfW SME Panel 2006. Investment turned out to be the crucial driving force behind new hirings. German SMEs thus reaffirmed their great importance for the creation of new jobs. KfW will therefore continue to support SMEs in financing their investment activities.



### INGRID MATTHÄUS-MAIER NEW SPOKESWOMAN OF KfW BANKENGRUPPE.

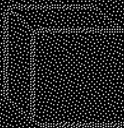
Ingrid Matthäus-Maier assumed the position of Spokeswoman of the Board of Managing Directors of KfW Bankengruppe as of 1 October 2006. She succeeded Hans W Reich, who retired at the age of 65 after 40 years with KfW Bankengruppe. Ms Matthäus-Maier is responsible for staff departments such as Executive and Legal Affairs and Corporate Strategy, the Secretariat of Domestic Credit Affairs, Communication and Internal Auditing, as well as operational business units in the areas of domestic lending and the Regional Department Europe, North Africa and the Middle East in KfW's financial cooperation segment. She also has oversight of the Berlin Branch. Ms Matthäus-Maier joined the KfW Board of Managing Directors in July 1999.



### KfW BANKENGRUPPE & YOUNG.EURO.CLASSIC – EUROPEAN MUSIC SUMMER IN BERLIN.

KfW Bankengruppe is one of the three main sponsors of the unique music festival "young.euro.classic – European Music Summer" in Berlin, which is now a well-established event. Around 1,500 amazingly professional young musicians from various countries meet every August to play in their youth orchestras. The two-week festival in Berlin is an exciting major event for musicians and the audience alike.


# KFW MITTELSTANDSBANK.



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. The SME financing products are structured according to the three pillars of loan, 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 partners. KfW Mittelstandsbank is continuously developing its promotional instruments and adjusting them to changes in the market.

KFW MITTELSTANDSBANK

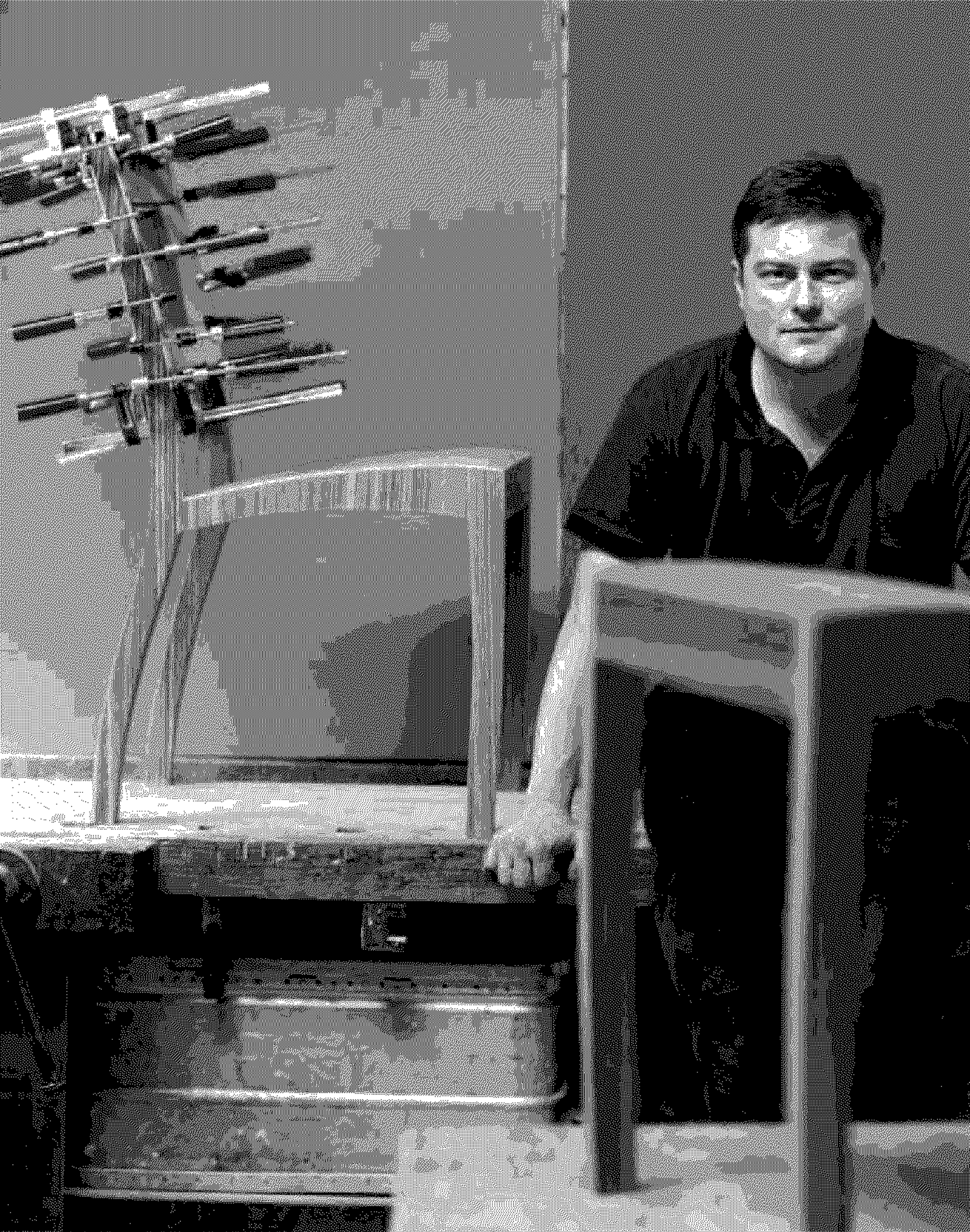


Where the outlines of a good idea emerge,  
we provide the funds.

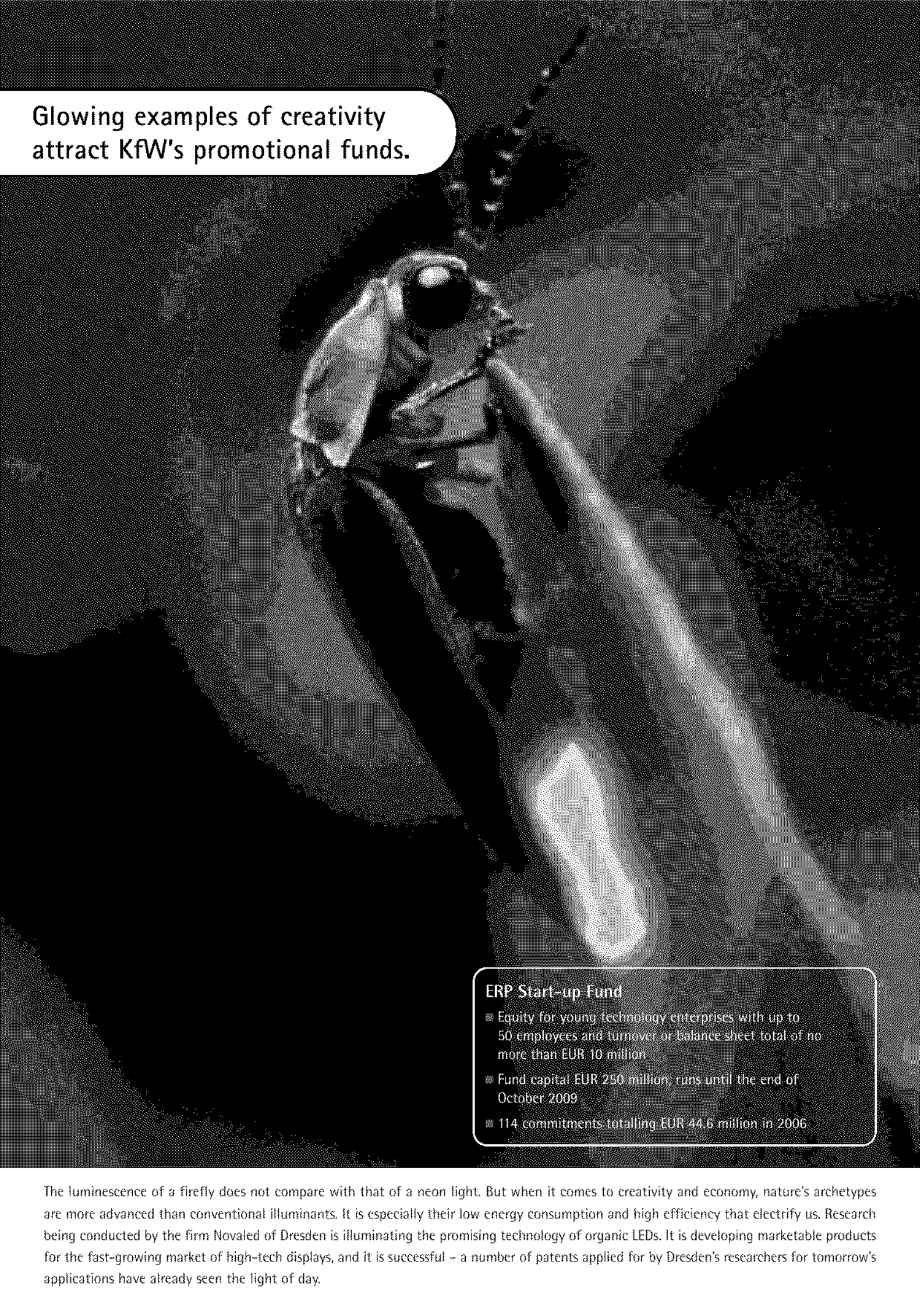
#### Entrepreneur Capital for start-ups and enterprises

- Mezzanine financing form
- Financing share up to 50% of funding requirement
- Repayment-free start-up years and moderate interest
- Can be combined with other financing programmes

To see what an enterprise is made of, just look at its plans. An entrepreneur's vision is still an economy's greatest capital. KfW Mittelstandsbank provides the necessary funds. We support present and future entrepreneurs – large and small – in realising their business idea. A cabinetmaker with an excellent idea ready to go large scale is one of them. His plan started with only a rough outline. It evolved into a first prototype for early production. The last leg was the signature on the loan approval.



KfW Mittelstandsbank's innovative product family Entrepreneur Capital is an important financing instrument for SMEs. It is a subordinate loan, so the lender's claims rank behind those of all other financiers. Usually it requires practically no collateral. Entrepreneur Capital therefore resembles equity and so improves the enterprise's creditworthiness. With it start-ups, self-employed professionals or SMEs have every opportunity to use the right tool in order to put their enterprise back on a solid financial footing.

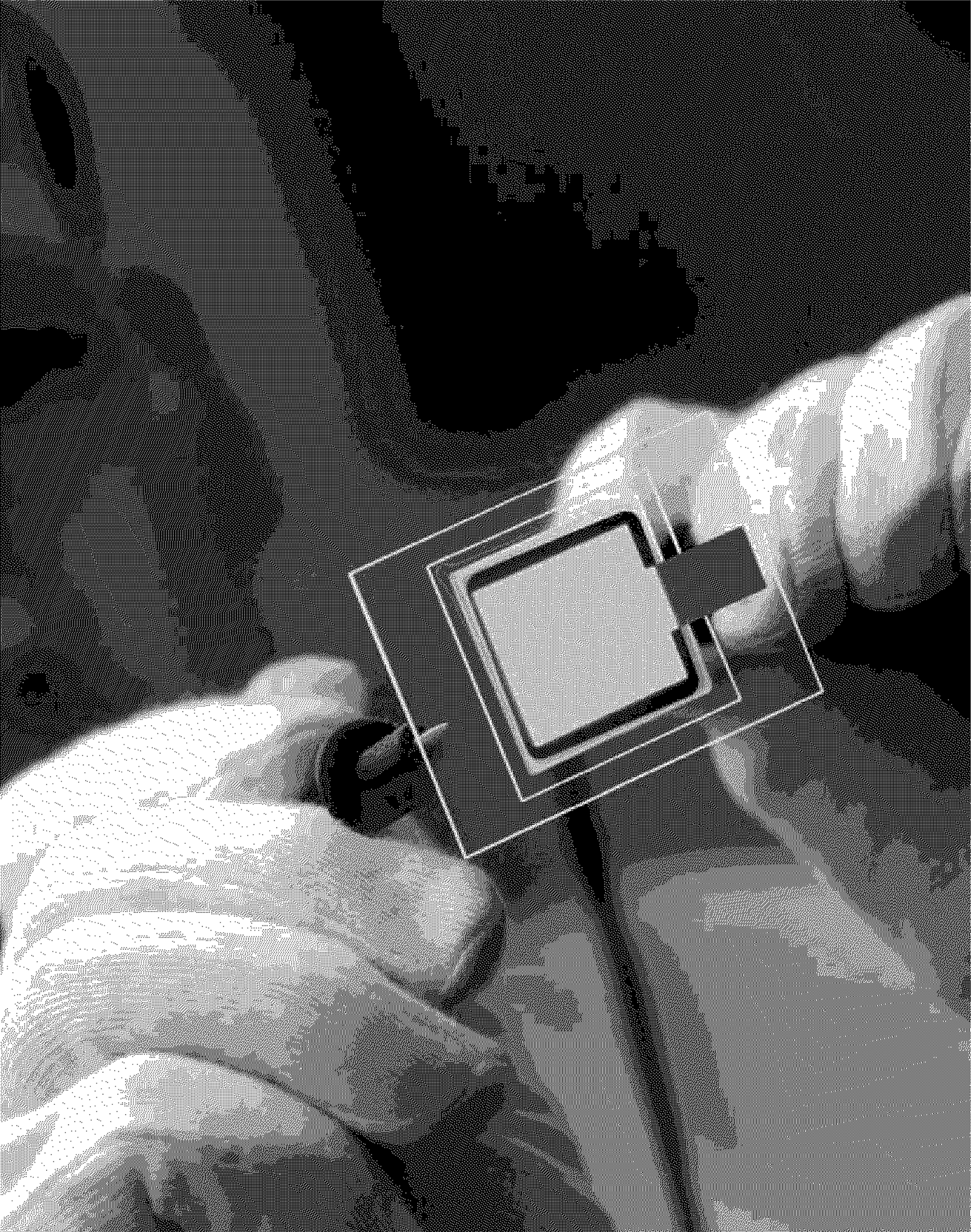
A black and white, halftone-style photograph of a firefly. The firefly is the central focus, glowing brightly against a dark, textured background. Its body is illuminated, showing its head, thorax, and abdomen. The background has a grainy, dotted texture, suggesting a night scene with a forest floor or similar natural setting. The firefly's light creates a soft glow around it, contrasting with the dark surroundings.

Glowing examples of creativity  
attract KfW's promotional funds.

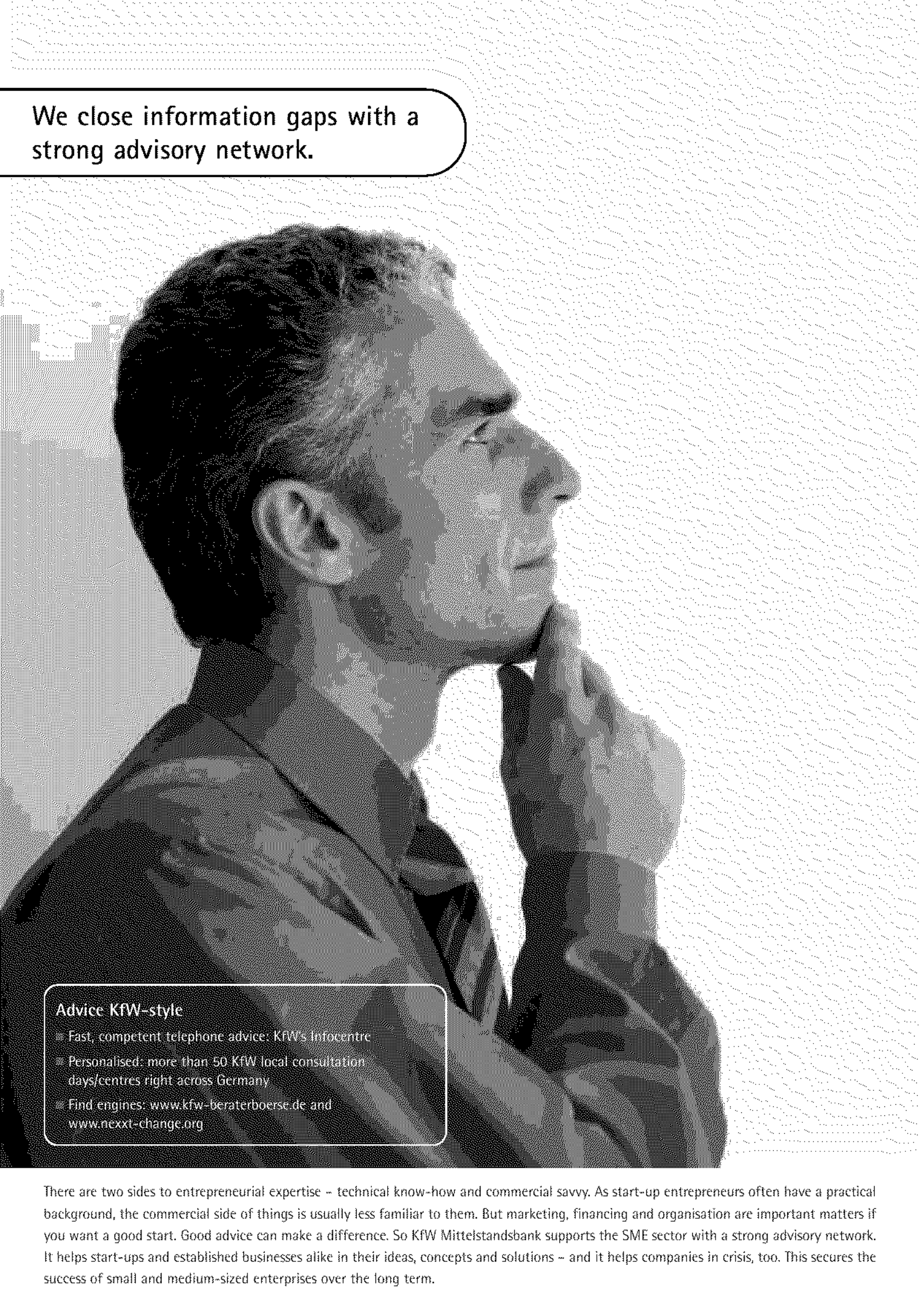
#### ERP Start-up Fund

- Equity for young technology enterprises with up to 50 employees and turnover or balance sheet total of no more than EUR 10 million
- Fund capital EUR 250 million; runs until the end of October 2009
- 114 commitments totalling EUR 44.6 million in 2006

The luminescence of a firefly does not compare with that of a neon light. But when it comes to creativity and economy, nature's archetypes are more advanced than conventional illuminants. It is especially their low energy consumption and high efficiency that electrify us. Research being conducted by the firm Novalod of Dresden is illuminating the promising technology of organic LEDs. It is developing marketable products for the fast-growing market of high-tech displays, and it is successful – a number of patents applied for by Dresden's researchers for tomorrow's applications have already seen the light of day.



KfW has examined the financial situation of the young technology firm and is supporting it with liquidity. The earnings position and balance sheet situation already point to a profit in the coming business year. In the meantime the 70 employees will have sufficient funds at their disposal for further development activities under an equity model financed through the ERP Start-up Fund. It helps to prepare the fast-growing enterprise for a bright future on the technology market.



We close information gaps with a strong advisory network.

#### Advice KfW-style

- Fast, competent telephone advice: KfW's Infocentre
- Personalised: more than 50 KfW local consultation days/centres right across Germany
- Find engines: [www.kfw-beraterboerse.de](http://www.kfw-beraterboerse.de) and [www.nexxt-change.org](http://www.nexxt-change.org)

There are two sides to entrepreneurial expertise – technical know-how and commercial savvy. As start-up entrepreneurs often have a practical background, the commercial side of things is usually less familiar to them. But marketing, financing and organisation are important matters if you want a good start. Good advice can make a difference. So KfW Mittelstandsbank supports the SME sector with a strong advisory network. It helps start-ups and established businesses alike in their ideas, concepts and solutions – and it helps companies in crisis, too. This secures the success of small and medium-sized enterprises over the long term.



All start-ups, self-employed professionals and small and medium-sized enterprises have access to professional advice from KfW staff or freelance consultants, a significant portion of which is funded by KfW Mittelstandsbank. The advisory services range from information on promotional schemes offered by KfW through strategic coaching for enterprises to the arrangement of business contacts for a company's further development. With these options KfW Mittelstandsbank provides the entire range of modern advisory services to help small and medium-sized enterprises develop successfully.

### KfW'S CONSULTANT EXCHANGE OFF TO A SUCCESSFUL START.

KfW Mittelstandsbank's online Consultant Exchange was launched successfully. Business founders and established entrepreneurs can use the new service to look up around 4,400 registered consultants from various disciplines all over the country. Around 4,000 queries a month illustrate the great interest shown by start-ups and other enterprises. The new scoring system available to clients to assess the service quality is also being widely used.



### STARTOTHEK – A VALUABLE TOOL FOR START-UP ADVICE.

The internet-based "startothek" provided by KfW Mittelstandsbank has proved to be a valuable tool for consultants – it supports their consulting services for up-and-coming new businesses. More and more start-up consultants are using the advisory portal. Just one year after it was launched, around 650 users have acquired a licence for the platform, which provides a comprehensive overview of all current regulations contained in the laws on setting up new businesses in over 370 sectors in industry, trade and the professions.



### PILOT PROJECT MICROFINANCE FUND GERMANY.

The Microfinance Fund Germany, set up by KfW in cooperation with the BMWi, the BMAS and GLS Bank, has made a successful start. The fund is for young enterprises and start-ups with a low capital requirement of up to EUR 10,000. It operates like a guarantee fund and, for a fee, relieves banks that extend short-term microloans to start-ups or young enterprises of the entire credit default risk.



### EUR 1 BILLION FOR SMES.

Deutsche Bank and KfW signed a EUR 1 billion global loan agreement. This global loan is designed to give SMEs an additional financial boost. Last year KfW Bankengruppe used this instrument to extend around EUR 2.0 billion to German commercial banks. The two institutions are thus continuing their successful cooperation for the promotion of small and medium-sized enterprises.



### FIRST EASTERN EUROPEAN SYNTHETIC SECURITISATION TRANSACTION CONCLUDED.

KfW concluded the first Eastern European synthetic securitisation transaction with Raiffeisen Bank Polska S.A and Raiffeisenbank a.s., Polish and Czech affiliates of the Raiffeisen International Bank-Holding AG, which is a member of the RZB Group. The transaction was arranged by Dresdner Kleinwort and Raiffeisen Zentralbank Österreich AG. The combined portfolio has a volume of EUR 450 million. It provided a total of 1,256 Polish and Czech SMEs with an average loan amount of EUR 360,000 each.

#### STRONG INCREASE IN THE FINANCING VOLUME OF KfW MITTELSTANDBANK IN 2006.

There are around 3.5 million SMEs in Germany. According to the KfW SME Panel, they accounted for an investment volume of EUR 168 billion in 2006 alone and are the main job engine in the German economy. Between 2003 and 2005, 400,000 new jobs were created at SMEs, while, on balance, 100,000 jobs were cut at large companies and in the public sector. According to KfW surveys, in 2006 SMEs wanted to take on an additional 500,000 new staff. The decisive driving force for new jobs is investment. As investments are only made if sufficient financial resources are available, KfW's SME financing is particularly important. It ensures that SMEs have access to low-interest loans, mezzanine finance and equity capital.

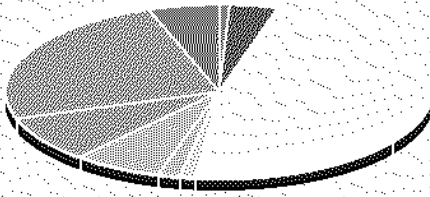
In 2006 the volume of KfW Mittelstandsbank's loan commitments was EUR 22.8 billion, over EUR 7 billion more than in the previous year. The cyclical tailwind prompted SMEs to invest more strongly again in 2006 and there was a clear increase in demand for investment finance under KfW's promotional programmes. KfW's basic

promotional programme for start-ups, the professions and small and medium-sized enterprises, the KfW Entrepreneur Loan, was a prime example; commitments totalled EUR 6.1 billion, 28% more than in 2005. Demand was very strong for KfW Mittelstandsbank's mezzanine financing offer, which has been extended and improved with the new ERP Innovation Programme; at EUR 2.1 billion, the volume of commitments was more than three times that in 2005 (EUR 0.6 billion).

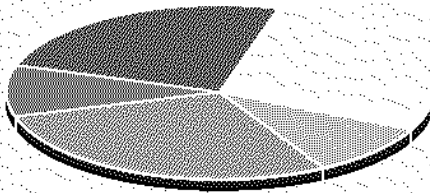
The development of KfW's guarantees and securitisation transactions was particularly pleasing. The volume grew by more than half again to EUR 9.5 billion. With investments in the ABS SME portfolio amounting to EUR 0.8 billion, KfW Mittelstandsbank made another contribution to the further development of the securitisation market. Small and medium-sized enterprises benefit indirectly from KfW's securitisation activities; securitisation relieves banks of risks involved in SME loans as the risks are transferred to the capital market. Credit institutions thus gain greater scope to grant new loans.

Commitments by KfW Mittelstandsbank in 2006, by federal state<sup>2)</sup>

Western Germany



Eastern Germany



Federal state Volume in EUR million<sup>1)</sup>

Baden-Württemberg	2,413
Bavaria	1,365
Bremen	98
Hamburg	133
Hesse	539
Lower Saxony	685
North Rhine-Westphalia	1,971
Rhineland-Palatinate	429
Saarland	61
Schleswig-Holstein	291
<b>Western Germany</b>	<b>7,984</b>
Berlin	104
Brandenburg	111
Mecklenburg-West Pomerania	76
Saxony	222
Saxony-Anhalt	74
Thuringia	190
<b>Eastern Germany</b>	<b>776</b>
Other <sup>3)</sup>	173
<b>Total</b>	<b>8,934</b>

<sup>1)</sup> Differences in the totals are due to rounding.

<sup>2)</sup> Excluding global loans.

<sup>3)</sup> Not attributable to a federal state.

HIGH GROWTH IN PROMOTIONAL LOAN PROGRAMMES –  
REDUCED GLOBAL LENDING TO COMMERCIAL BANKS IN GERMANY.

KfW Mittelstandsbank committed a volume of EUR 10.2 billion in loan financing, almost matching the previous year's level. The lower result was mainly due to the decline in global loan commitments to commercial banks, which to-

talled EUR 3.6 billion; in 2005 the exceptionally high level of EUR 5.4 billion had been reached. By contrast, the volume of the promotional loan programmes increased by 22% on the year.

RISK-ADJUSTED INTEREST RATE SYSTEM WELL ESTABLISHED IN THE MARKET.

With regard to individual loans, the risk-adjusted interest rate system proved its value. The system was introduced by KfW in 2005 for the KfW and ERP commercial loan programmes and ensures that banks and savings banks are able to cover the cost and risk involved in offering loans to SMEs and to make promotional loans available to a larger number of SMEs.

The credit institutions are now taking advantage of the full range of price categories in the risk-adjusted interest rate system. Just under 37% of all loan commitments made by KfW

Mittelstandsbank were approved at an interest rate that could not be covered under the previous standard interest rate system. Under the new system almost 20% of all enterprises obtained loans at a more favourable rate of interest.

Numerous promotional institutions in the federal states have now adopted KfW's risk-adjusted interest rate system for their own regional programmes. The response of the credit institutions to the risk-adjusted interest rate system has been extremely positive.

#### MICROLOANS FOR BUSINESS START-UPS AND YOUNG ENTERPRISES.

One important area at KfW Mittelstandsbank is that of supporting business start-ups and young enterprises. They mainly need small-scale loans, which are rarely of interest to credit institutions. Loans to micro start-ups and young enterprises take time to process and carry a fairly high risk of default. However, this business segment provides the foundation for the future growth of SMEs and is therefore instrumental in determining German economic development. For this reason KfW is particularly committed to start-ups and young enterprises as a customer group, seeking to offset the drawbacks for banks in this segment by assuming risk and guaranteeing higher handling fees for the banks.

In 2006 KfW Mittelstandsbank committed EUR 108 million under the special Microloan and Start-up Money programmes for business founders with a limited need for capital. Even more effective support for microbusinesses is planned for the future. At the start of 2007, the interest rates in the two special programmes were reduced considerably – by around 30%. In the medium term, KfW's aim is to package the programmes as a single new product and to relieve the onlending banks entirely of default risk. This is intended to improve business founders' access to financial resources further still.

#### MICROFINANCE FUND GERMANY.

In September 2006 KfW Mittelstandsbank took part in an innovative pilot project regarding risk transfer in start-up financing. Together with the German Federal Ministry of Economics and Technology (BMWi), the Federal Ministry of Labour and Social Affairs (BMAS) and GLS Bank, it set up the Microfinance Fund Germany. The Microfinance Fund operates like a guarantee fund and assumes the full loan default risk incurred by banks that grant start-ups and young enterprises microloans of up to EUR 10,000 with short maturities (approximately two years). Microlending is closely linked with business start-up and management advice.

The consultant concerned identifies and assesses business concepts and recommends promising projects to the banks as potential borrowers. The consulting institution participates in the loan default risk, primarily by assuming 20% of the liability for the microloans that it has recommended. Involving a consultant reduces the bank's loan processing costs as the bank is relieved of some of the burden of preparing the loan, ongoing monitoring and action that may need to be taken in the event of default.

#### ADDITIONAL MEZZANINE FINANCING OFFER STRENGTHENS INNOVATION ACTIVITY.

High innovative dynamism creates new sales and earnings opportunities and has a positive effect on investment activity. For Germany – a country that has few raw materials and depends heavily on exports and technology – it is a decisive competitive factor. It is therefore particularly important to bolster innovation in the SME sector.

There is still a lot to be done in this area. KfW analyses show that, on the one hand, innovative activities are declining in Germany while, on the other, international competitors are catching up fast. In order to raise the low – and declining – level of enterprises' innovative activities, KfW and the federal government together redesigned the ERP Innovation Programme. It now provides mezzanine finance in the form of

subordinate loans to fund innovation. This new financing structure takes account of the high risk involved in innovative projects while providing incentives for their implementation by offering very favourable interest rates.

The programme was launched in December 2005 and was very well received in the market. The volume of EUR 650 million originally budgeted for 2006 had already been fully committed by April. Commitments for 2006 as a whole amounted to EUR 1.6 billion.

Overall, KfW Mittelstandsbank's mezzanine financing commitments, including the Entrepreneur Capital programme family, increased from EUR 0.6 billion in 2005 to EUR 2.1 billion in 2006, i.e. 3.5 times.

EQUITY FINANCE – SUPPORT FOR HIGH-TECH START-UPS AND IMPROVEMENT IN THE EQUITY BASE OF SMES.

The total volume of equity finance at KfW Mittelstandsbank in 2006 was around EUR 281 million, just short of the 2005 level of EUR 300 million. In recent years equity finance has been clearly expanded in the early stage segment. The ERP Start-up Fund, introduced in 2004, and the High-Tech Start-up Fund launched by the German government, KfW Bankengruppe and industrial enterprises support the high-technology start-ups that are so important for the innovation system. In the year under review, the High-Tech Start-up Fund made 59 commitments totalling EUR 28.5 million and the ERP Start-up Fund 104 commitments totalling EUR 44.6 million.

KfW's fund activities to promote technological enterprises include a new fund, which was established primarily to support the implementation of the research results of the Fraunhofer-

Gesellschaft (FhG). KfW has become an anchor investor. Further private investors were subsequently attracted, taking the fund capital to around EUR 51 million.

In December 2006 the KfW Equity-Mezzanine Programme was introduced as an extension of the regional fund approach under the initiative "Equity capital for the broad SME sector". The programme is available through investment companies. KfW covers up to 50% of the financing and risk. The KfW Equity-Mezzanine Programme is geared to SMEs requiring between EUR 0.5 million and EUR 5 million in capital and wishing to improve their equity base by raising quasi-equity which can be shown on the balance sheet and, for tax purposes, regarded as debt capital.

SUCCESS MODEL FOR SME FINANCING COOPERATION BETWEEN KfW AND PROMOTIONAL INSTITUTIONS IN THE FEDERAL STATES WITH REGARD TO GLOBAL LOANS UNDER THE ENTREPRENEUR LOAN PROGRAMME.

KfW has set itself the goal of increasing transparency and consistency in the area of promotional financing, generating synergies between national and state-level financing, and improving efficiency in the area of refinancing. KfW is therefore working with all promotional institutions in the federal states. This type of cooperation has now become a model for success as it has distinct advantages for all parties concerned.

In this context, KfW issues global loans to promotional institutions in the German federal states. However, the priorities and target groups must be in line with the loan programme of the

relevant promotional institute. In addition, the federal states make a substantial promotional contribution of their own, which may take the form, for example, of an additional interest rate reduction. Promotional financing at the national and state levels can thus be amalgamated, making it more advantageous for SMEs. To date global loan agreements have been concluded between 14 promotional institutions in the federal states and KfW Mittelstandsbank, representing a volume of EUR 11.7 billion, EUR 3.4 billion of which was accounted for in 2006.

#### PLEASING LEVEL OF GLOBAL LOAN TRANSACTIONS WITH COMMERCIAL BANKS IN GERMANY AND WESTERN EUROPE.

The global loan business in Germany continued to develop in a pleasing manner, the total volume of global lending reaching EUR 9.6 billion. In past years, an average of around EUR 1.9 billion per annum in global loans to commercial banks was allocated to SMEs in Germany in order to finance investment. The volume of global loans

concluded in 2006 – around EUR 2 billion – confirmed the positive trend.

In 2006 around EUR 1.4 billion in global loans were approved in Western Europe. In addition to new business, this was mainly due to the development of business relations with the West European partner banks.

#### GLOBAL LOANS TO SMES IN CENTRAL AND EASTERN EUROPE STILL IN GREAT DEMAND.

For more than ten years KfW has been using global loans to refinance a variety of promotional programmes of local banks in Central and Eastern Europe. It thus contributes to the development of the local finance sector and, in particular, helps SMEs in those countries to meet the challenges of European harmonisation. A total of EUR 320 million was committed in 2006. Of

this amount, EUR 270 million was allocated to SMEs. The regional focus was on the countries affected by EU eastern enlargement, particularly the Baltic states, Poland and Hungary. In addition to the refinancing of classic investment loans for local SMEs, refinancing through other financial instruments such as leasing is gaining in importance.

#### EU SME FINANCING FACILITY.

The Financing Facility for smaller and medium-sized enterprises in the EU is an important part of KfW's funding offer for SMEs in Central and Eastern Europe. KfW has been working with the European Commission and the Council of Europe Development Bank (CEB) since 2000, the aim being to bring about a sustainable improvement in local banks' loan programmes for SMEs in this region. To this end, global loans by KfW/CEB are

linked to European Commission subsidies. Overall, more than 45 projects amounting to EUR 693 million with more than EUR 79 million in subsidies have been concluded. The Facility has thus been successfully implemented in the ten new EU member states in a short time. Future tasks relate to the accession countries of Bulgaria, Romania and the candidate country of Croatia.

#### NEW EU PROGRAMME FOR MICROLOANS.

In 2006 KfW conducted its first project under the EU Preparatory Action Plan. This promotional programme, which was launched in 2005 by the European Commission, CEB and KfW, aims at improving the credit supply for small and microbusinesses, in particular through microloans.

#### INTEGRATION OF EUROPEAN PROMOTIONAL FUNDS INTO KfW'S LOAN PROGRAMMES FOR SMES.

The EU's new seven-year financing period began in January 2007. A major EU objective is to promote innovative young enterprises. In expert discussions in Brussels, KfW and promotional banks from Western and Eastern Europe have been working towards establishing an effective link between the European promotional programmes and national promotional programmes for SMEs. For example, KfW uses a European Investment Fund (EIF) counter-guarantee to grant loans to business start-ups and small enterprises. In implementing European promotional programmes, KfW is working closely with the European Commission, the European Investment Bank and the EIF.

#### SECURITISATION.

The securitisation activities of KfW Mittelstandsbank reflect the development of the German securitisation market. In terms of both the volume of securitisations and the securitised products this is an area of dynamic growth. At around 30%, SME financing, which, alongside commercial property loans, is the main focus of German securitisation transactions, is the clear "winner" in this trend. There is a distinct correlation between securitisation activities and the increase in loans to SMEs. Germany has now become a key player in the European securitisation market. In the year under review, securitisation activities at KfW Mittelstandsbank achieved an absolute peak value of EUR 9.5 billion (following EUR 3.9 billion in 2005), a record since the introduction of the PROMISE platform at the end of 2000. The securitisation of German SME risks, which were transferred from German banks to the capital market, was the focus of attention and enabled capacities for further lending to be tapped. In the year under review, the most importance transactions included "ROOF CEE 2006-1" – the first ever synthetic multiseller transaction for SME loans in Central and Eastern Europe.

Since starting its securitisation activities, KfW Mittelstandsbank has supported around 79,000 loans in 23 transactions representing a total volume of EUR 36 billion. The stable performance of the transactions to date is still an important factor in the success of the PROMISE platform. In recent years performance has held up extremely well despite what was in part a difficult economic environment.

KfW not only provides standardised securitisation platforms but also helps the securitisation market to mature. This is achieved primarily through its involvement in True Sale International GmbH (TSI) as well as through its own investment in mezzanine tranches of selected transactions under its ABS SME portfolio.

In addition to synthetic securitisation, the ABS SME portfolio provides the second main component – since the programme was launched at the end of 2005 KfW has invested a total of EUR 685 million in 11 transactions.

These activities are important because asset backed securities (ABS) have now become a key element of SME financing. The ABS market is growing from one year to the next. In terms of recourse to the international capital market as a means of providing loans for SMEs, Germany, along with Spain, is now in the lead in Europe. In 2006, for instance, Germany accounted for 12 of a total of 20 SME securitisations. KfW sees the observable change in SME financing as unreservedly welcome as it adds capital market fi-

nance to the principle of working through the local bank. The SME sector thus gains access to a wider range of loans and better conditions. SMEs can already choose from a variety of new and differentiated financing offers, including, for example, equity-mezzanine programmes. KfW has set itself the target of bringing about a further maturing of the market so that the entire SME sector can benefit from the new forms of financing. At present, many offers are geared particularly to larger SMEs. Enterprises with a comparatively poor credit standing have few opportunities to find financing that is in line with their actual development potential. KfW is continuing to work on developing this potential.

Promotion of the German and European economy by KfW Mittelstandsbank  
Commitments in EUR million<sup>b)</sup>

Programmes	2005	2006	Purpose
<b>Volume of promotional funding KfW Mittelstandsbank</b>	<b>15,520.1</b>	<b>22,827.2</b>	
<b>1 Promotional loans KfW Mittelstandsbank</b>	<b>11,556.9</b>	<b>12,577.1</b>	
<b>(a) Loan financing</b>	<b>10,673.7</b>	<b>10,156.7</b>	
<i>of which</i> Entrepreneur Loan	4,769.4	6,096.2	Investment financing for start-ups and SMEs
▣ Global loans to commercial enterprises in Germany and Europe	5,353.1	3,643.1	Global loans to banks to finance SMEs
▣ KfW acquisition finance	134.0	77.7	Financing for corporate takeovers
▣ Start-up Money and Microloans	124.0	167.6	Financing for start-ups and small enterprises
▣ ERP programmes	282.6	227.1	Improvement of the regional economic structure, market-based research and development and marketing of innovations, funds for guarantee banks
<b>(b) Mezzanine financing</b>	<b>583.1</b>	<b>2,139.6</b>	
<i>of which</i> Entrepreneur Capital	511.6	606.2	Mezzanine finance to support start-ups and SMEs
▣ ERP Innovation Programme	71.5	1,633.5	Mezzanine finance to support innovative projects by small and medium-sized enterprises
<b>(c) Equity finance</b>	<b>300.1</b>	<b>280.8</b>	
<i>of which</i> KfW Venture Capital Programme (financing for equity participation funds)	108.5	141.8	Participations in enterprises through venture capital funds co-financed by KfW
▣ KfW Private Equity Programme	56.6	18.6	Financing for corporate takeovers
▣ ERP programmes	113.3	120.5	Private equity for high-tech start-ups and SMEs
<b>2 ABS SME portfolio</b>		<b>780.6</b>	Investments in securitisation transactions for SME loans
<b>3 Guarantees and securitisations KfW Mittelstandsbank</b>	<b>3,963.2</b>	<b>9,469.5</b>	Hedging and securitisation of SME loans
Securitisations	3,934.8	9,442.4	
Guarantees	28.3	27.2	

<sup>b)</sup> Differences in the totals are due to rounding.

#### FINANCING ADVICE.

KfW Bankengruppe supports SMEs in all business development stages by providing comprehensive information and advice, thus ensuring the sustainability of its financial promotion. Investment projects can only be implemented if an appropriate volume of financial resources are available. Enterprises, multipliers such as chambers of commerce and professional associations, and sales partners in the banking sector must therefore also be kept informed. KfW Mittelstandsbank provides up-to-date information on its financial products through virtually all channels.

KfW Mittelstandsbank's website has become a key source of information. Under [www.kfw-mittelstandsbank.de](http://www.kfw-mittelstandsbank.de), it provides a full and quickly accessible set of information on all aspects of its financing and advisory products. More than one

million users have found practical help on becoming self-employed in the virtual start-up centre or have studied, under "Loans", detailed examples of financing through KfW Mittelstandsbank's loan programmes.

At the KfW Infocentre, KfW Mittelstandsbank provides individually tailored telephone advice on specific cases – on nearly 80,000 different occasions last year. Over 2,000 customers took advantage of the opportunity of obtaining personal advice at the KfW Advisory Centres in Berlin, Bonn and Frankfurt. In the year under review, around 2,500 young entrepreneurs attended the KfW Consultation Days held on the local premises of our cooperation partners (e.g. chambers of commerce, promotional institutions in the federal states, business promotion companies).

#### BUSINESS DEVELOPMENT ADVICE.

Professional consultants can help small and medium-sized enterprises to develop their business positively and hence improve their access to financing and its conditions. KfW therefore subsidises the use of independent consultants. In 2006 around 800 start-ups and young businesses took advantage of KfW start-up coaching, drawing on expertise at the start of self-employment. Support for SMEs and self-employed persons in crisis situations is provided by the

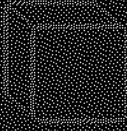
Round Tables, which identify ways of bringing about a turnaround. In 2006 alone, 3,000 companies took advantage of this offer. KfW Mittelstandsbank's "Turn Around" advisory services are a means of ensuring the durability of the Round Table success. In the year under review almost 1,000 enterprises applied for these advisory services with a view to benefiting from the expertise of professional business consultants.

#### SPECIAL ADVISORY SERVICES.

KfW Mittelstandsbank's advisory services also include target group oriented services such as the KfW Consultant Exchange and the "startothek". Advice on special topics completes the portfolio. This includes, for example, advice on matters relating to business succession on the internet platform [www.nexxt-change.de](http://www.nexxt-change.de). Mention should also be made of the German Equity Forum, a platform for innovative, fast-growing companies on the look-out for equity capital.

In addition, KfW Mittelstandsbank is also involved in the further training of staff from banks, chambers of commerce and consultancy companies. Various seminar series by the KfW Academy provide expert knowledge on current SME topics. Last year around 1,400 people took part in 26 Academy events.

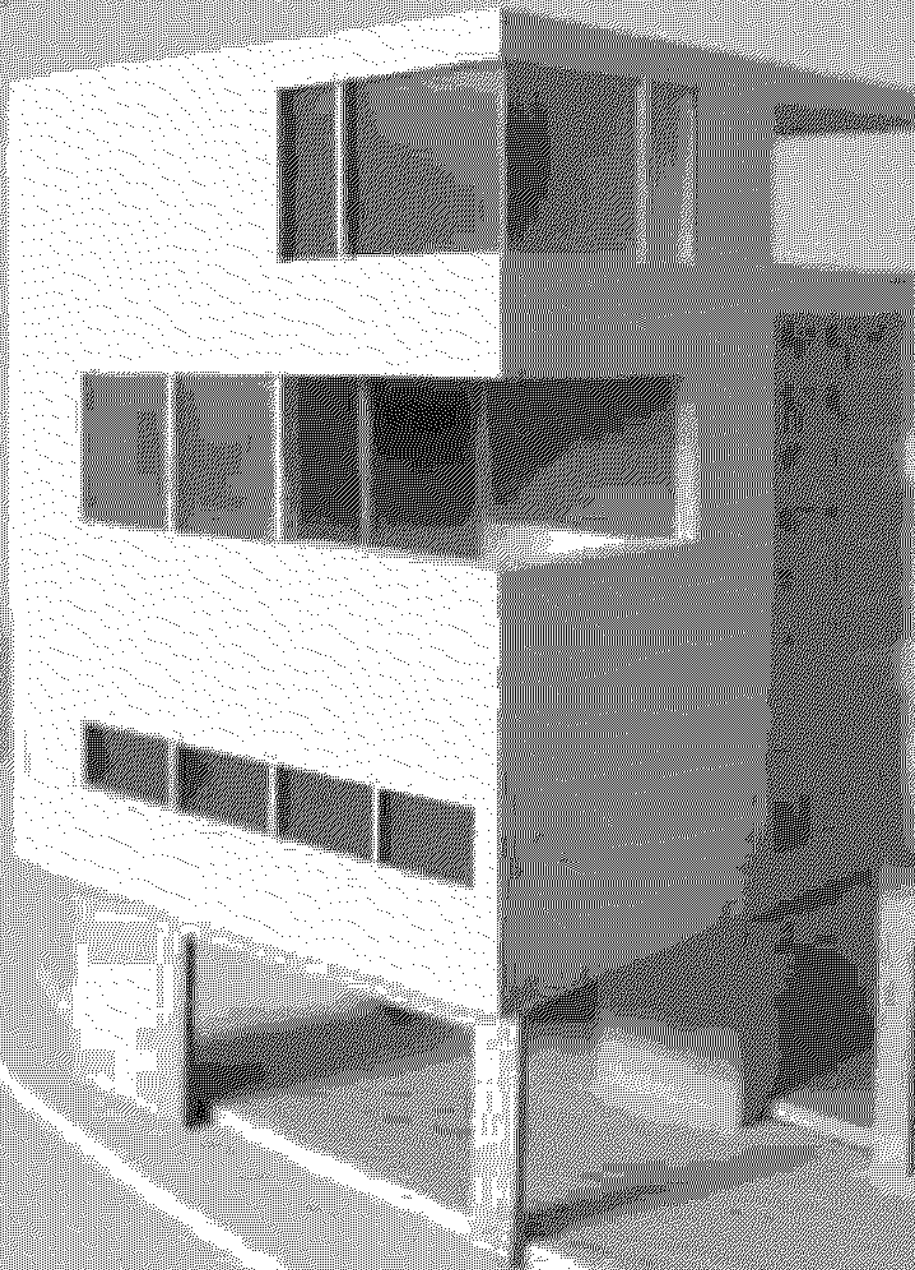
# KFW FÖRDERBANK.



## *Commitment pays off.*

KfW Förderbank's promotional financing covers the environment, housing, infrastructure and education and is geared 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 provided to finance academic studies and advanced vocational training. In the KfW Environmental Protection Programme and the ERP Environment and Energy Conservation Programme, support is provided for investment by small and medium-sized enterprises in environmental protection measures. In the field of infrastructure, finance is provided for all types of municipal investment as well as non-profit projects and institutions.

We have the right financing models  
for new energy concepts.



**Promotional initiative "Housing, Environment,  
Growth"**

- Start of the initiative 1 February 2006
- Runs until 2009
- Commitments in 2006: more than 260,000 loans totalling some EUR 17 billion

KfW promotes model ideas. Together with the federal government it therefore launched the promotional initiative "Housing, Environment, Growth" on 1 February 2006. It provides financial incentives for real estate owners and investors to apply the principles of bioclimatic building design and modernisation. In addition to home ownership and infrastructure promotion, the three main pillars of KfW's promotional initiative – the CO<sub>2</sub> Building Rehabilitation Programme and the Housing Modernisation and Ecological Construction programmes – have been successfully supporting construction projects. In 2006 KfW Förderbank committed a total of some EUR 17 billion in loans – enough to turn a strong idea into a full-scale project.



KfW's promotional initiative was a model for the energy-saving house as well. It combined modern technology with advanced features and low energy consumption under one roof. The latest heating technology and loans from KfW Förderbank provide for economic and ecological efficiency. The investments pay for themselves after a short while. With an energy consumption of 40 kWh per square metre the KfW energy-saving house 40 is one of the most energy-efficient. Over the coming years public funds are to support the construction in North Rhine-Westphalia of 50 solar developments which will make intensive use of renewable energies.

A promotional bank that gives momentum  
to environmentally sound ideas.



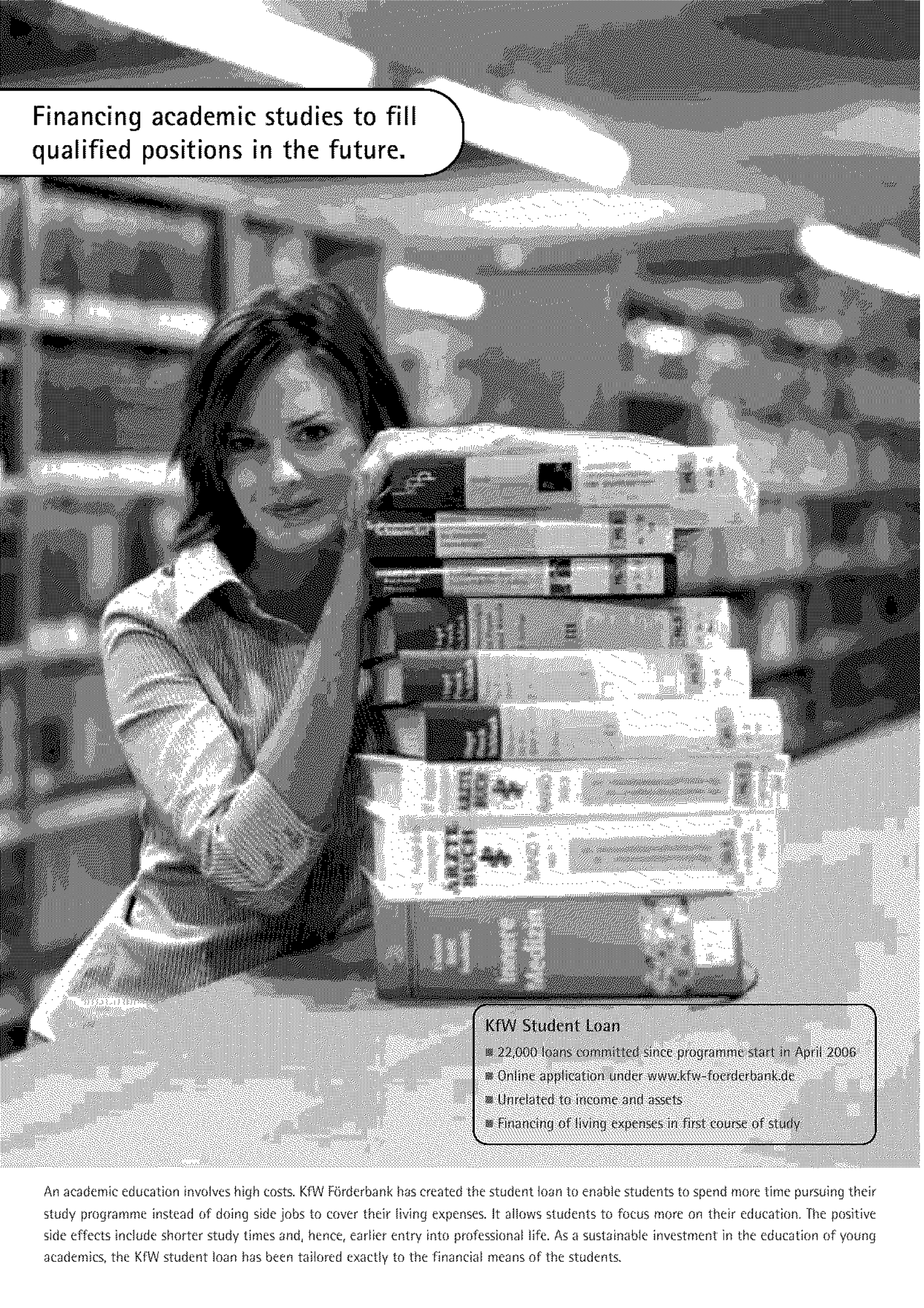
#### KfW Carbon Fund

- On the market since 2004
- Acquisition of cost-effective emission credits
- Additional income for climate protection projects
- Second tranche is in preparation

KfW welcomes winds of change. Winds at the Zafarana wind farm in Egypt reach an average speed of nearly 10 metres per second – truly stormy conditions. The fourth stage of a multi-year German-Danish-Egyptian cooperation project has now started on the Red Sea coast. It has been financed from FC funds since 2000. The project benefits not only the operator, the Egyptian Ministry for Energy and Electricity, but also the environment. After all, the windfarm has already reduced CO<sub>2</sub> emissions by 168,000 tonnes annually. It has therefore successfully weathered the odds to become a milestone for the future development of comparable projects with KfW.



The Zafarana wind farm tapped into an additional source of income through the sale of 550,000 emission credits to the KfW Carbon Fund in 2006. This has triggered new climate protection projects and is promoting the transfer of high technology to developing countries. The fund is a programme for the purchase of emission certificates through which German and European enterprises can meet their emission requirements at a favourable cost. Rising CO<sub>2</sub> emissions and the scarcity of resources are a global wake-up call to revise energy policies. Because actions speak louder than words, KfW Förderbank is responding with innovative instruments.

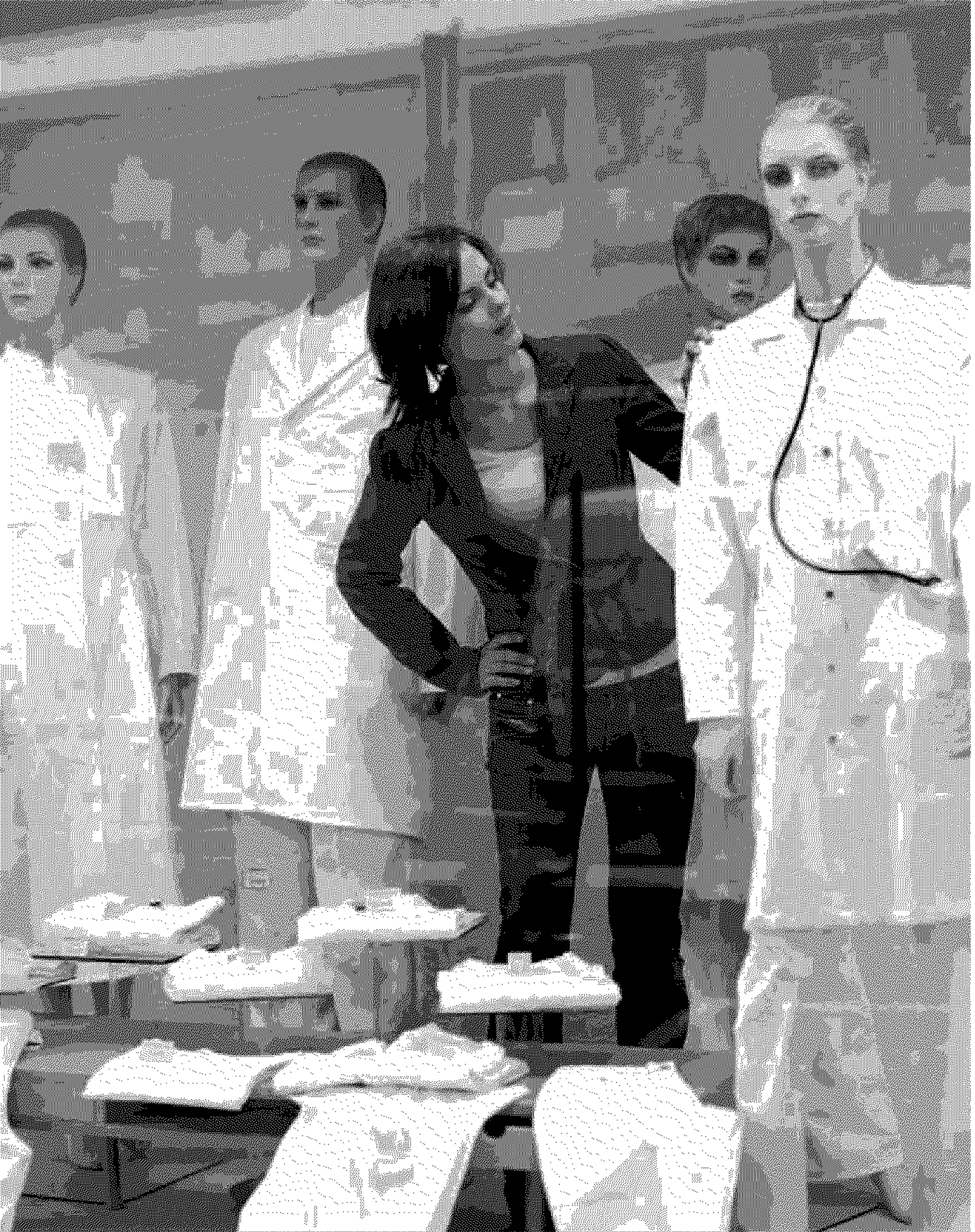


Financing academic studies to fill qualified positions in the future.

#### KfW Student Loan

- 22,000 loans committed since programme start in April 2006
- Online application under [www.kfw-foerderbank.de](http://www.kfw-foerderbank.de)
- Unrelated to income and assets
- Financing of living expenses in first course of study

An academic education involves high costs. KfW Förderbank has created the student loan to enable students to spend more time pursuing their study programme instead of doing side jobs to cover their living expenses. It allows students to focus more on their education. The positive side effects include shorter study times and, hence, earlier entry into professional life. As a sustainable investment in the education of young academics, the KfW student loan has been tailored exactly to the financial means of the students.



Education – forming human capital. Students have been able to apply for the new KfW Student Loan since April 2006. They can choose monthly disbursements of between EUR 100 and EUR 650 regardless of their course of study and their parents' income and assets. The loan interest is variable and adjusted semi-annually. Every borrower is guaranteed an interest rate cap for a period of 15 years which gives them a reliable basis on which to plan their academic education. Repayment starts with the beginning of employment but not later than 18 months after the last disbursement. It can be extended over a period of up to 25 years.

#### KfW ANNOUNCES WINNERS OF THE KfW AWARD 2006.

KfW Förderbank presented the KfW Award 2006 in Berlin. The contest ran under the motto "Generation 50 Plus – New Ideas for Senior-Friendly Owner-Occupied Housing". The entries demonstrated a range of different ways of responding to the housing needs of older citizens. The award winners not only considered construction aspects but also developed solutions for ensuring the continued integration of senior citizens into social and family life in later years. The related KfW Symposium was held in October. Around 100 experts from the world of politics, associations, industry and the media exchanged ideas and visions. The symposium focused on the housing challenges faced by senior citizens. This is a highly topical issue as today only about 5% of all people over the age of 50 live in homes that are suited to their age, and already one in every five Germans is of retirement age.



#### KfW HOME OWNERSHIP PROGRAMME – TEN YEARS ON.

Through the KfW Home Ownership Programme the Bank has made a significant contribution to increasing the share of owner-occupied housing in Germany and has given greater prominence to private homes as a component of retirement provision. Since the programme was launched ten years ago more than 820,000 people have realised their dream of owning a home of their own and more than EUR 40 billion in loans granted for that purpose. The loans provide low-interest long-term financing for building or purchasing homes in Germany for private use by their owners.



#### INVESTMENT INITIATIVE TO STRENGTHEN THE CITIES.

The Panel of Experts on Urban Development, composed of nearly all relevant actors from the area of urban development and set up on the initiative of KfW, proposed an investment initiative entitled "Strengthening the Cities". The financial support schemes offered by the German government and the federal states for investment in urban development and renewal are to be increased significantly under the existing KfW programmes. The aim is to equip the municipalities to meet the challenges posed by the demographic trend, structural problems and budget constraints. The support is designed to improve the social situation of the citizens, to enhance their quality of life and to boost Germany's competitiveness as a business location.



#### THE KfW ENERGY EFFICIENCY AWARD 2006.

KfW Förderbank presented the KfW Energy Efficiency Award 2006 in Berlin. This was the third time that the competition had been held, this year under the motto "Modernisation of energy systems in commercial buildings". A total of EUR 15,000 in prize money was awarded to the three best entries. The winning enterprises were chosen for their exemplary solutions for achieving energy savings in the modernisation of commercial buildings.

## OVERVIEW.

KfW Förderbank brings the most diverse promotional areas under its umbrella. They extend from residential and municipal infrastructure financing through support for environmental and climate protection measures to financing for initial and further education and training. In 2006 the total volume of promotional loans was EUR 27.9 billion, approximately 25% up on the previous year. The housing finance programmes made a particularly decisive contribution to this increase because, under the new initiative to promote housing, the environment and growth, the federal government and KfW made a further distinct improvement to the conditions applicable in the field of housing and in the municipal

infrastructure programmes. Altogether around 262,000 loans totalling EUR 17 billion were granted under these programmes. Housing investment accounted for around EUR 14 billion of this amount, with municipal investment accounting for the remaining EUR 3 billion. In addition, EUR 4.6 billion was committed to commercial environmental protection and EUR 1.3 billion to support educational investment. EUR 3.6 billion in global loans for general refinancing purposes at the promotional institutions in the German federal states and various securitisation transactions amounting to EUR 7.6 billion overall were added to KfW Förderbank's loan programmes.

### Commitments of KfW Förderbank in 2006, by federal state

In EUR million<sup>1)</sup>

Federal state	KfW Förderbank <sup>2)</sup>			
	Total	Environment	Housing	Infrastructure
Baden-Württemberg	3,201	562	2,162	478
Bavaria	3,937	836	2,804	297
Bremen	167	9	110	47
Hamburg	713	15	349	349
Hesse	1,447	220	968	259
Lower Saxony	1,941	506	1,238	197
North Rhine-Westphalia	4,444	414	3,329	702
Rhineland-Palatinate	982	258	611	112
Saarland	188	21	119	49
Schleswig-Holstein	1,088	409	554	65
<b>Western Germany</b>	<b>18,108</b>	<b>3,309</b>	<b>12,245</b>	<b>2,554</b>
Berlin	777	18	410	349
Brandenburg	718	335	312	70
Mecklenburg-West Pomerania	320	124	159	37
Saxony	597	109	440	48
Saxony-Anhalt	811	551	193	67
Thuringia	355	124	188	43
<b>Eastern Germany</b>	<b>3,578</b>	<b>1,261</b>	<b>1,703</b>	<b>614</b>
Other <sup>3)</sup>	40	40		
<b>Total</b>	<b>21,725</b>	<b>4,610</b>	<b>13,947</b>	<b>3,168</b>

<sup>1)</sup> Differences in the totals are due to rounding.

<sup>2)</sup> Excluding educational finance, global loans and global credit lines to promotional institutions in the federal states.

<sup>3)</sup> Not attributable to a federal state.

PROMOTIONAL INITIATIVE "HOUSING, ENVIRONMENT, GROWTH"  
OFF TO A GOOD START

The federal government launched the promotional initiative "Housing, Environment, Growth" together with KfW in February 2006. It is part of the government's EUR 25 billion Growth and Employment Programme. In addition to municipal infrastructure financing, this initiative includes KfW's housing programmes at distinctly improved conditions. The principle applied is that the more energy and resources are saved through the measures, the more favourable the loan conditions.

The aim of the initiative is not only to make rented and owner-occupied homes more comfortable but also to contribute to protecting the climate and safeguarding employment. Until 2009 the government will provide KfW approximately EUR 1 billion a year for the purpose of reducing interest rates on loans and allowances. The sum is topped up with KfW's own funds. In addition, the rehabilitation of older buildings leads to a substantial reduction in energy costs.

The promotional initiative developed very well in the first year, with KfW Förderbank granting a total of 262,000 loans amounting to EUR 17 billion in 2006. The previous year's volume of loans for rehabilitation measures and the ecological modernisation of private homes and municipal facilities increased by over 34%. The loans

triggered around EUR 28 billion in investments. Approximately 400,000 jobs were safeguarded for at least one year, which was of particular benefit to the SME-dominated construction industry and associated trades.

With regard to climate protection, the German government has undertaken to reduce CO<sub>2</sub> emissions by private households, transport and the trade, commerce and services sector by 7 million tonnes per annum between 2008 and 2012. The investments financed in 2006 alone cut CO<sub>2</sub> emissions by around 1.5 million tonnes a year. Roughly one-fifth of the total reduction stipulated in the national allocation plan can thus be attributed solely to KfW programmes in the year under review. They were by far the most effective and most significant emission reduction measures for buildings in Germany. The promotional initiative is also regularly updated. For instance, on 1 January 2007 special financing windows for the energy-saving rehabilitation of schools, day nurseries, club accommodation and similar buildings were introduced. Private home owners who do not need a promotional loan under the CO<sub>2</sub> Building Rehabilitation Programme can receive support in the form of a subsidy instead.

#### PROMOTION OF ENERGY-EFFICIENT RESIDENTIAL BUILDINGS.

A total of 150,000 loans amounting to EUR 7.3 billion were granted for the rehabilitation of existing housing under the KfW CO<sub>2</sub> Building Rehabilitation and Housing Modernisation Programmes. The increase of more than 150% compared with 2005 reflects the more intensive promotion provided through the "Housing, Environment, Growth" initiative. Furthermore, KfW's Ecological Construction Programme supported the construction of 32,500 new particularly innova-

tive, low-energy buildings. The loan volume of EUR 2.2 billion was more than five times that of the previous year. This sum was used mainly to promote energy-saving houses and passive houses with energy consumption levels well below the limits set by the Energy Conservation Ordinance. In the field of new ecological buildings, the improved loan conditions have led to a substantial increase in demand.

#### PROMOTION OF HOME OWNERSHIP.

Home ownership is increasingly becoming an important instrument for private retirement provision. In addition, home owners make a decisive contribution to the development of their districts and towns. This is just one of many reasons why financing owner-occupied housing has long been one of KfW Förderbank's key tasks. Under the Home Ownership Programme more than 70,000 loans were committed in 2006 – an overall volume of EUR 4.4 billion. The decline of around 20% on the previous year is due, on the one hand, to the improved financing for particularly energy-efficient new buildings, with many projects being financed at the conditions specifically geared to such buildings under the Ecological Construction Programme. On the other hand, a special effect led to increased demand in 2005, when the pending abolition of the home owner bonus triggered preemptive action.

There is an encouraging tendency to pay greater attention to ecological aspects when building a new house. In addition, however, the demographic development and an ageing population present new challenges for house and apartment owners. This goes beyond merely designing an apartment to be barrier free; first and foremost, it entails meeting the multiple individual and social needs of older people in the area in which they live. KfW focused on this forward-looking topic for its annual award, which went by the motto "Generation 50 Plus – New Ideas for Senior-Friendly Owner Occupied Housing". The prizewinners were pioneering new building or conversion projects that were carried out by private home owners to provide intelligent solutions for homes occupied by senior citizens. More detailed information is available on the KfW Förderbank website under [www.kfw-foerderbank.de](http://www.kfw-foerderbank.de).

## PROMOTING THE MUNICIPAL INFRASTRUCTURE.

A well-functioning infrastructure is a necessary precondition for a nation's economic development. This involves not only technical components such as roads, local public transport systems or water and sewage systems but also social facilities. When selecting a business location, the provision of childcare establishments, schools or sports facilities play at least as great a role. KfW offers three programmes to finance municipal infrastructure measures. While the KfW Municipal Loan is geared to municipal authorities, the Municipal Investment Programme is available to enterprises majority-owned by municipalities. KfW Förderbank provides loans under its Social Investment Programme as a means of supporting non-profit organisations wishing to invest in the municipal infrastructure. In the year under review the lending volume of all three programmes combined was approximately EUR 3.2 billion, which was used to co-finance around

1,450 projects. The volume was thus 16% up on the year.

Owing to the demographic development, immigration and economic and social problems in towns and cities, there has been a considerable increase in the need for municipal action and investment in recent years. In order to evaluate the current range of financing and promotional offers for urban development, a panel of urban development experts was set up on the initiative of KfW. Virtually all major players in the field of urban development were represented. The working group proposed several ways of improving the promotion of urban development and redevelopment, bringing it into line with the challenges of the future. The final report of the Panel of Experts entitled "Current and future challenges for urban development and how to finance it" is available on the internet (in German only) under [www.kfw-foerderbank.de](http://www.kfw-foerderbank.de).

## COMMERCIAL ENVIRONMENTAL AND CLIMATE PROTECTION.

KfW provides support for investors from industry and commerce in financing measures intended to improve the protection of the environment, the climate and natural resources. To that end the ERP Environmental Protection and Energy Saving Programme and the KfW Environmental Protection Programme were set up. The co-financed projects range from energy-saving measures through the use of regenerative energy sources to investment in air pollution control, sewage treatment and solid waste prevention. In 2006 the volume of loan commitments under the two programmes was EUR 4.1 billion overall, an increase of 21 % on the year. Climate protection accounted for a considerable share of the overall volume – promotion of the commercial use of renewable energies and energy-saving measures represented around 90 % of the volume of commitments. A further promotional priority was investment in waste management. However, commercial environmental programmes are used not only to improve the environmental

situation in Germany. They also help enterprises to reduce their operating expenditure for energy and materials by using resources more efficiently, and hence to enhance their competitiveness.

Unfortunately, many enterprises still underestimate the potential for saving energy and materials. An effective instrument used by KfW throughout Germany to draw attention to the possibilities of operational energy saving is the KfW Energy Efficiency Award. KfW Förderbank has awarded the EUR 15,000 prize each year since 2004. The competition acknowledges enterprises which have carried out exemplary measures to reduce energy consumption, the aim being to achieve a substantial reduction in their carbon dioxide emissions, and thus made considerable expenditure savings. Each year the KfW Energy Efficiency Award has a different theme. In 2006 the competition motto was "Modernisation of energy systems in commercial buildings".

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

KfW has a number of different promotional programmes through which it supports the expansion of renewable energies. Their aim is to reduce harmful greenhouse gas emissions, to create new jobs and to reduce Germany's dependence on fossil fuel imports.

In 2006 EUR 3.3 billion in loans at favourable interest rates was committed for renewable energies. The environmental programmes for trade

and industry made a major contribution to this success. Wind power (EUR 1.3 billion) and photovoltaics (EUR 1.2 billion) accounted for the largest share of KfW's commitments. Compared with the previous year, there was a very positive development of commitment volumes for solar collector units (+ 111 %), biogas (+ 62 %), biomass (+ 42 %) and geothermal energy (+ 32 %).

## KfW CARBON FUND.

The adoption of the national allocation plans for the period from 2008 to 2012 means that the EU member states are now preparing for the second phase of the European Emission Trading Scheme. In order to achieve the targets established in the Kyoto Protocol, CO<sub>2</sub> producing enterprises must meet more demanding emission criteria. Emission credits from climate protection projects in developing countries therefore play an ever greater role in enterprises' CO<sub>2</sub> strategy.

With its own Carbon Fund, KfW has established itself successfully as a purchaser of these emission certificates. It acquires the necessary certificates on a trust basis on behalf of enterprises which wish to use them to meet obligations under the European Emission Trading Scheme. KfW is thus available as a service provider for these enterprises which have no independent access to projects abroad to offset their own emissions or do not wish to expand their own capacities in this respect.

The first tranche of the KfW Carbon Fund was closed successfully with a volume of around EUR 84 million at the end of the first quarter of 2006. By the end of the year more than half

this volume had been implemented in purchase agreements under which around six million emission certificates recognised by the UN Climate Secretariat were acquired. The credits will be distributed to the enterprises participating in the KfW Carbon Fund over the years up to 2012, thus widening their scope in emissions trading.

KfW will further expand its purchasing activities in the years ahead. A purchase programme for around 7 million tonnes of CO<sub>2</sub> equivalents per annum has already been decided. It is within this framework that, *inter alia*, the second tranche of the KfW Carbon Fund will be offered. KfW actively supports the federal government's climate protection programme through its work and takes account of the interests of the German and European economy.

By using the market-economy instruments of the Kyoto Protocol, KfW is making an important contribution to the realisation of the climate protection projects and to sustainable development in the host countries. For the projects as such, certificate sales mean an additional source of income without which they could generally not be carried out.

## EDUCATION – AN INVESTMENT IN THE FUTURE.

Since April 2006 KfW Förderbank has been offering the KfW Student Loan to finance students' living expenses. The Student Loan is intended to improve educational opportunities and to reduce the length of time spent studying; it also makes it easier for young people to finance their studies without having to alter their plans radically. The KfW Student Loan is granted irrespective of the field of study and parental income. As a monthly disbursement of between EUR 100 and EUR 650 for a maximum of ten semesters, it supplements the classic sources of funds (parents, BAFög, scholarships, part-time jobs). Students can now concentrate fully on their studies without having to earn a living by doing odd jobs. The KfW Student Loan made a good start. The volume of loans amounted to EUR 505 million in the first year, the largest share of KfW educational financing. Both in our public relations activities and in the application procedure, we endeavour to dispel fears that the Student Loan could cause young people to run up excessive debts. The debt risk is

pointed out to potential applicants on our website and in the loan agreement itself. In 2006 the total volume of education financing was around EUR 1.3 billion. The KfW Student Loan also made a decisive contribution to increasing educational loan commitments by around 44% again on the year.

In addition to the Student Loan, KfW Förderbank's range of instruments also includes the Meister-BAFög which is used to finance career enhancement training, loans for schoolchildren, students and apprentices in advanced stages of training, and the BAFög loan. Overall, KfW Förderbank has granted around EUR 5.9 billion in educational loans over the years. KfW's financing offers have been taken up by more than 490,000 schoolchildren, students and experts. On behalf of some federal states, KfW Förderbank will also be offering financing to help with academic fees. The first agreements were signed with Lower Saxony and Bavaria in the year under review.

#### COOPERATION WITH PROMOTIONAL INSTITUTIONS IN THE FEDERAL STATES.

KfW has maintained good, intensive, partnership-based working relations with the promotional institutions in the federal states for many years. These working relations cover two areas.

First, in the context of its promotional programmes, KfW issues global loans to promotional institutions in the federal states. This allows national and state promotional finance to be combined, the transparency of the promotional landscape is enhanced and the loans are made more attractive to customers. These programme-based global loans constitute an important mainstay of the promotional landscape. KfW Förderbank uses such global loans primarily to refinance investment in the municipal infrastructure and for home-ownership measures. To date, global loan agreements have been signed with 12 promotional institutions in the federal states, representing a volume of EUR 7.7 billion.

Second, since 2002 KfW has been offering promotional institutions in the federal states standard-rate funding in the form of global loans for state-level promotional purposes, for which no KfW loan programmes are used. That primarily allows small promotional institutions in the federal states to benefit from KfW's very favourable funding conditions. The high level of demand has led to the conclusion of 25 contracts with an overall volume of EUR 13.5 billion. In order to make this product even more attractive, different maturities were introduced in 2006. For shorter-term lending this gives the promotional institutions in the federal states more favourable funding conditions. The response has so far been very positive.

#### GLOBAL LOANS TO COMMERCIAL BANKS FOR THE CONSTRUCTION OF PRIVATE HOUSING HAVE AN ESTABLISHED PLACE AT KfW FÖRDERBANK.

Although global loans are a relatively new feature of KfW's business as a promotional bank, their volume is stabilising at a firm average annual level of nearly EUR 1.7 billion. Since the

market launch of the product in 2002, global loan agreements for a total volume of more than EUR 11.3 billion have been concluded in Germany and in Western Europe.

## EU FINANCING FACILITY FOR THE MUNICIPAL INFRASTRUCTURE IN CENTRAL AND EASTERN EUROPE

Cooperation between the European Commission, CEB and KfW under the EU's municipal infrastructure facility continued successfully in 2006. With the aid of global loans from CEB/KfW on the one hand and grants from the EU budget on the other, the aim of this programme is to further develop the market for financing small infrastructure projects in Central and Eastern Europe. The total volume of credit granted

under this facility is EUR 150 million, EUR 14 million of which is accounted for by grants.

In addition, the European Commission, CEB and KfW are planning a new energy efficiency programme for 2007. The intention is for it to help the accession and candidate countries to bring about a sustainable increase in energy efficiency.

## SECURITISATION.

In 2006 KfW Förderbank concluded four transactions for a total volume of EUR 7.64 billion. Since the launch of the securitisation platform PROVIDE in 2001, 1.1 million loans in 38 transactions, a volume of EUR 67 billion, have been securitised.

"primus MULTI HAUS 2006" was the first transaction conducted through KfW under which the risks of a portfolio of loans extended exclusively to housing companies in Eastern Germany were transferred. The transaction adheres to the same standards as established under the PROVIDE and PROMISE platforms. The rating agencies and investors thus found it easier to evaluate the transactions. This form of standardisation has huge advantages particularly when new asset categories are introduced into the market.

In 2006, through EPIC II, KfW Förderbank supported the placement of a multinational portfolio of public private partnership loans for the third time. They are used primarily to finance hospitals, schools and other projects in the public infrastructure.

The promotion of smaller-scale transactions is one of the key topics for the year ahead. KfW's aim is to provide leaner and hence more cost-effective transactions so that securitisation is made attractive for smaller credit institutions, too. The synthetic securitisation platforms are an essential part. However, KfW is intending to make the medium more flexible and to open it up for new asset classes.

Promotion of the German and European economy by KfW Förderbank  
Commitments in EUR million<sup>1)</sup>

Programmes	2005	2006	Purpose
<b>Volume of promotional funding KfW Förderbank</b>	<b>38,687.5</b>	<b>35,548.1</b>	
<b>1 Promotional loans KfW Förderbank</b>	<b>22,415.8</b>	<b>27,906.6</b>	
(a) Environmental protection investments	4,241.6	4,609.6	
<i>of which</i> KfW Environmental Protection Programme	919.5	1,185.2	Environmental protection projects
ERP Environmental Protection and Energy Conservation Programme	2,436.1	2,970.5	Environmental protection projects in Germany
Solar Power Generation/KfW Programme to Promote Renewable Energies	885.9	553.8	Photovoltaic systems/ measures to promote renewable energies
(b) Housing	10,903.6	15,147.4	
<i>of which</i> Housing Modernisation	1,318.6	3,668.6	Housing modernisation and rehabilitation
KfW Home Ownership Programme	5,560.9	4,397.3	Construction and purchase of owner-occupied housing
KfW CO <sub>2</sub> Building Rehabilitation Programme	1,195.1	3,472.2	Packages of measures to reduce CO <sub>2</sub> emissions in old residential buildings
Ecological Construction	387.5	2,208.6	Construction of new low-energy houses
Global loans for housing in Germany and Europe	2,008.0	1,200.0	Global loans to banks to finance housing investment
(c) Municipal infrastructure	2,770.4	3,213.7	
<i>of which</i> KfW Infrastructure Programme KfW Municipal Loan/Social Investment/ Municipal Investment	2,648.6	3,166.5	Infrastructure measures by municipalities, non-profit organisations and municipal enterprises
Global loans for infrastructure abroad	120.2	43.8	Global loans to promotional and commercial banks in Europe
(d) Education	875.0	1,341.8	Initial and further training
(e) Global credit lines to promotional institutions in the federal states	3,625.2	3,596.0	Global loans to fund the promotional institutions in the federal states
<b>2 Securitisations KfW Förderbank</b>	<b>16,271.7</b>	<b>7,641.5</b>	Hedging and securitisation of mortgage loans

<sup>1)</sup> Differences in the totals are due to rounding.

#### FINANCING ADVICE.

Our private customers and business partners are the focus of KfW Förderbank's advisory services. Initial information on the internet, telephone contact with our Infocentres or private discussions in KfW's Advisory Centres ... KfW makes use of all possible channels to provide information about the promotional programmes and financing opportunities of KfW Förderbank.

#### KfW BANKGRUPPE ON THE INTERNET.

KfW has been using the internet for many years as a means of providing up-to-date, relevant initial information for its customers and business partners. The good response to KfW's website is evidenced by the further increase in the number of visitors.

In 2006, for example, the KfW website was visited around 10.5 million times, an increase of 35%. Most visits – 75% of the total – were to the KfW Förderbank portal [www.kfw-foerderbank.de](http://www.kfw-foerderbank.de), where a variety of interactive advisory services are also available.

This is where visitors obtain full information on construction, housing, energy saving, environmental protection, education and infrastructure. Apart from the great demand for housing programmes, interest in the KfW student loan is, in particular, the cause of high visitor numbers. More detailed information is also available for business partners in the KfW Advisers' Forum at the same address.

#### KFW INFOCENTRE FOR TELEPHONE ADVICE.

The number of consultations in KfW Förderbank's Infocentre achieved a new record in 2006: Infocentre staff answered questions from customers and business partners on 630,000 occasions. In a survey conducted by TNS Emnid, the staff were given a very good customer rating for their helpful approach and their knowledge. Overall, the quality of the advice was thus well above the sector level.

The exceptionally strong response to the promotional initiative "Housing, Environment, Growth" was a particular challenge for KfW's Advisory Centres. In the field of housing construction alone, the number of telephone consultations in 2006 – around 400,000 – was more than twice the 2005 figure (191,803). Information on the Student Loan, which has been available since April 2006, was also in particular demand, with around 230,000 customer contacts.

#### 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 year under review, 1,700 customers took advantage of the opportunity to consult KfW experts directly on the programmes offered by KfW

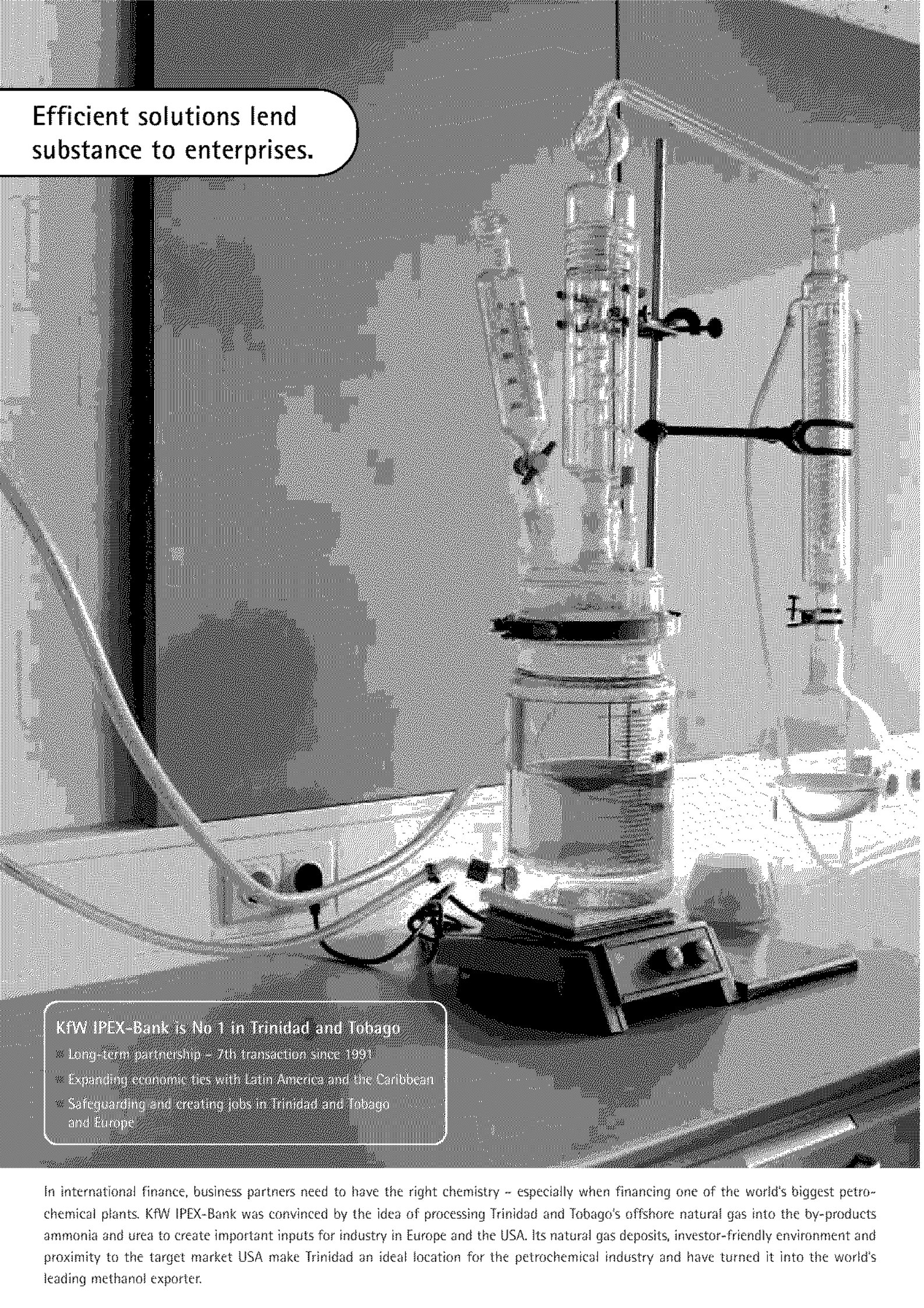
Förderbank. Would-be builders, architects, energy consultants and bank advisers were also able to obtain individual consultation with KfW Förderbank experts at construction and housing fairs and training and information events throughout Germany.

# KFW IPEX-BANK.

## *Strong position in international competition.*

In the business area of export and project finance, KfW finances exports by German and European companies as well as corporate and infrastructure investments all over the world. In accordance with its legal mandate, it thus supports projects in the German and European interest. In implementation of the Promotional Bank Restructuring Act, KfW is spinning off its commercial project and export financing business, in which it competes with other banks, to form KfW IPEX-Bank. KfW IPEX-Bank will begin trading independently on 1 January 2008 as a GmbH (private limited company) wholly owned by KfW.

As part of KfW Bankengruppe, KfW IPEX-Bank has over 40 years of experience as a well-established competitor in the field of international corporate, project and export financing. As a relationship bank, it focuses on developing long-term partnerships with its customers. Building on comprehensive sector and market know-how, it works with its customers to develop tailor-made financing solutions for international investment projects.



Efficient solutions lend  
substance to enterprises.

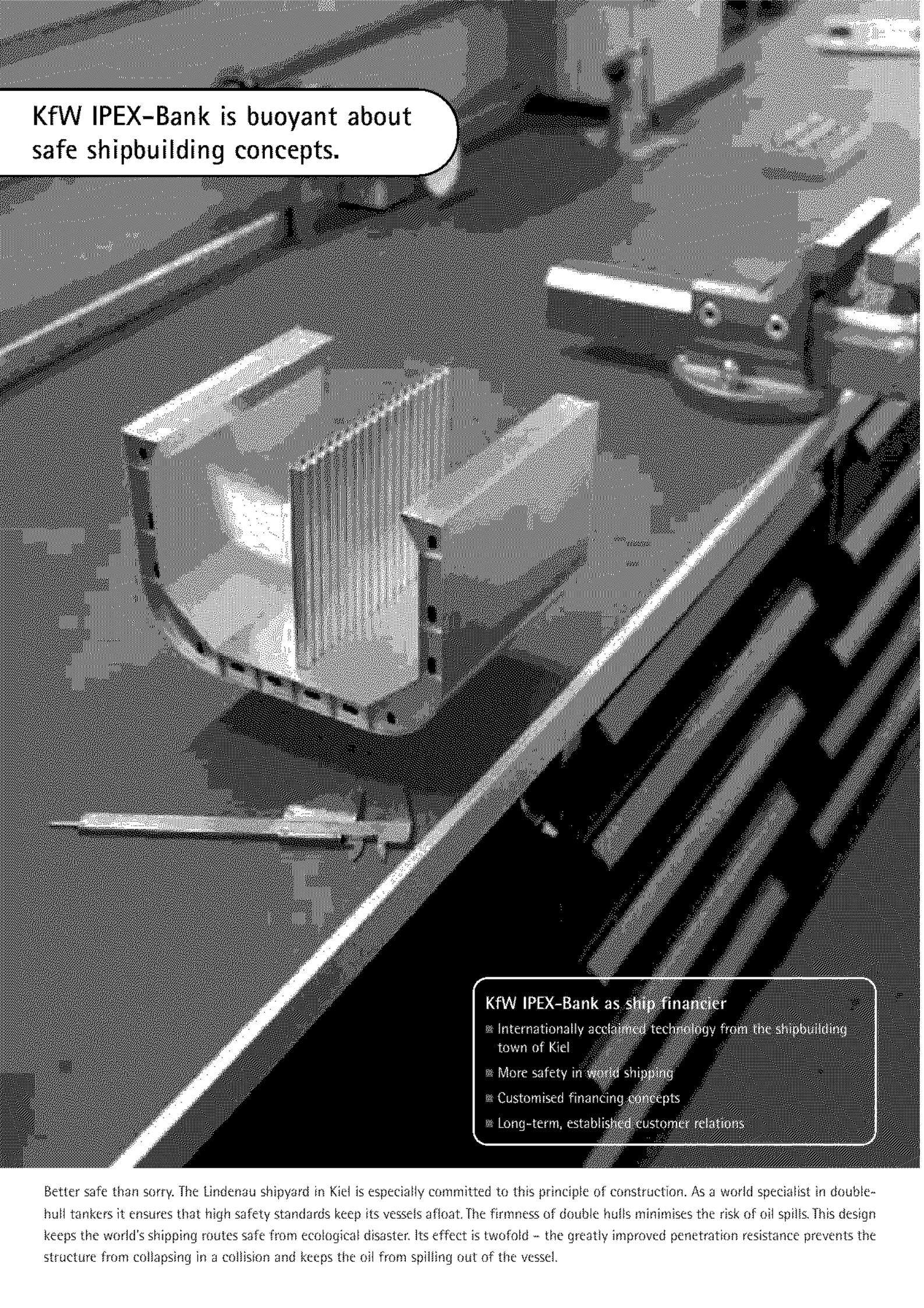
**KfW IPEX-Bank is No 1 in Trinidad and Tobago**

- ⌘ Long-term partnership – 7th transaction since 1991
- ⌘ Expanding economic ties with Latin America and the Caribbean
- ⌘ Safeguarding and creating jobs in Trinidad and Tobago and Europe

In international finance, business partners need to have the right chemistry – especially when financing one of the world's biggest petrochemical plants. KfW IPEX-Bank was convinced by the idea of processing Trinidad and Tobago's offshore natural gas into the by-products ammonia and urea to create important inputs for industry in Europe and the USA. Its natural gas deposits, investor-friendly environment and proximity to the target market USA make Trinidad an ideal location for the petrochemical industry and have turned it into the world's leading methanol exporter.



The plant is being planned and built by the German MAN Ferrostaal AG on behalf of Methanol Holdings (Trinidad) Ltd, Point Lisas, Trinidad and Tobago. It is expected to produce up to 1.48 million tonnes of liquid fertiliser and around 60,000 tonnes of melamin each year, a substance used for the coating of furniture surfaces, among other applications. The most recent complex at this location is being financed with USD 1.25 billion, making it the island state's biggest private-sector transaction. It was structured by KfW IPEX-Bank as the sole arranger. In 2006 KfW IPEX-Bank made new commitments totalling EUR 15 billion. Its operations created strong bonds not only in the chemical industry.



KfW IPEX-Bank is buoyant about safe shipbuilding concepts.

**KfW IPEX-Bank as ship financier**

- ✎ Internationally acclaimed technology from the shipbuilding town of Kiel
- ✎ More safety in world shipping
- ✎ Customised financing concepts
- ✎ Long-term, established customer relations

Better safe than sorry. The Lindenau shipyard in Kiel is especially committed to this principle of construction. As a world specialist in double-hull tankers it ensures that high safety standards keep its vessels afloat. The firmness of double hulls minimises the risk of oil spills. This design keeps the world's shipping routes safe from ecological disaster. Its effect is twofold – the greatly improved penetration resistance prevents the structure from collapsing in a collision and keeps the oil from spilling out of the vessel.



The Seychelles shipping company Seychelles Petroleum is a major KfW IPEX-Bank customer. As a project and export financier the bank is supporting the acquisition and operation of modern double-hull tankers. It is thereby making an important contribution to keeping the seas safe. The double effort benefits both Seychelles Petroleum and the shipbuilders of Kiel. Their order books are full. After the "Seychelles Pride" and the "Seychelles Pioneer" the Lindenau shipyard has launched the third vessel that now sails the seven seas under the flag of this island republic – the "Seychelles Progress". Two more tankers are on order.

### IKB IMMOBILIEN LEASING BECOMES MOVESTA LEASE AND FINANCE GMBH.

Movesta Lease and Finance GmbH is the new name of the former IKB Immobilien Leasing GmbH, whose head office is in Düsseldorf. After more than 30 years of experience in the market, the company has now been under the joint management of IKB Deutsche Industriebank and KfW Bankengruppe, represented by KfW IPEX-Bank, for a year. The change of partner and the expanded strategic orientation made the name change necessary. Movesta's activities focus on the structuring of complex investment solutions for real estate and large movables.



### WATER AND ENERGY FOR BAHRAIN.

KfW IPEX-Bank is financing the acquisition of the Al Hidd energy and water project in Bahrain together with other banks. The gas-fired power plant has a total capacity of 910 MW and the existing seawater desalination plant produces a total of 30 million gallons of fresh water a day. The new plant is to produce more than 60 million gallons more each day. The price of USD 738 million makes it the biggest privatisation project in the country's history. The international investor consortium will sell the electricity and water obtained back to the government of Bahrain over a period of 20 years.



### EXPANDING THE INFRASTRUCTURE IN INDIA.

KfW IPEX-Bank extends a long-term loan of more than USD 25 million to the Indian company SREI Infrastructure Finance Ltd. SREI is India's market leader for the leasing of infrastructure construction equipment such as building machinery, diggers and lorries, some of which are European-manufactured. Its customers include many SMEs, but also some large Indian construction firms. The financing supports the Indian government's objective of accelerating the infrastructure expansion in order to make better use of existing growth potential.



### NEW REPRESENTATIVE OFFICE IN MOSCOW.

KfW IPEX-Bank has opened a representative office in Moscow. With this step the Bank has confirmed the increasing importance of economic relations between the Russian Federation and Germany and the significance that it attaches to its own business with Russia. Currently KfW IPEX-Bank holds a portfolio of loans to Russia worth EUR 1.2 billion. It intends to double this portfolio in the next few years. The new representative office is to contribute to further intensifying business with Russia, particularly with the private sector.



### CONTINUING COOPERATION WITH VNESHECONOMBANK.

KfW Bankengruppe and Russia's Vnesheconombank have affirmed the continuation of their cooperation with the signing of a EUR 75 million framework agreement on the occasion of the Saint Petersburg Dialogue. These funds are to be used to refinance imports of capital goods from the EU, particularly in connection with infrastructure projects in Russia.

#### ANOTHER VERY SUCCESSFUL BUSINESS YEAR.

KfW IPEX-Bank brings together all business activities of KfW Bankengruppe which involve competing with other banks. As a consequence of the Promotional Bank Restructuring Act of 2003, KfW Bankengruppe will hive these activities off into a legally independent bank as from 1 January 2008. KfW IPEX-Bank will be established as a GmbH (private limited company) wholly owned by KfW.

In 2006 the volume of new business of KfW IPEX-Bank reached EUR 15 billion. Compared with previous years this is an above average result which is mainly due to some large-scale

transactions to which KfW IPEX-Bank committed large individual sums. This includes transactions in which the Bank acts as syndicate arranger underwriting large portions. This new business has been entered in KfW IPEX-Bank's books but substantial amounts will be syndicated at a later stage. The volume of new business includes loans worth EUR 1.2 billion committed for KfW on a trust basis. These are transactions which, according to the Promotional Bank Restructuring Act, can be classified as promotional loans.

#### PREPARATIONS FOR LEGAL INDEPENDENCE LARGELY CONCLUDED.

Its operations running dynamically and successfully, KfW IPEX-Bank has passed major milestones on the way to legal independence. It has applied to the German Financial Supervisory Authority (BaFin) for a banking licence and has also applied for a licence as an advanced IRB bank in accordance with Basel II. As an advanced IRB bank it can optimise its capital base, which is not possible under the standard approach. This requires sophisticated internal evaluation and control instruments. These instruments have been developed within the bank itself and are being continuously validated and adapted to new requirements. The assessment for licensing as an advanced IRB bank will be carried out by the Deutsche Bundesbank and BaFin in the first half of 2007.

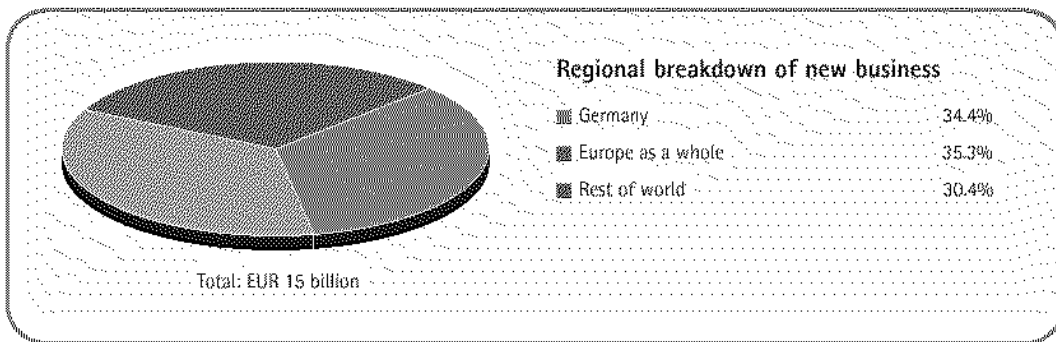
Good progress has also been made in the preparations for KfW IPEX-Bank to be given a separate initial rating by the leading international rating agencies. Concrete talks on the initial rating are expected to begin in the second half of 2007. KfW IPEX-Bank is confident that it will achieve the target rating of AA minus or A plus.

Once the articles of association have been drawn up, as a subsidiary of KfW Bankengruppe KfW IPEX-Bank will have a system of executive bodies composed of a board of managing directors and a board of supervisory directors. The board of managing directors will comprise four managing directors. The board of supervisory directors will include representatives of KfW Bankengruppe as well as representatives of the federal government and trade and industry.

NEW BUSINESS: ONE-THIRD GERMANY, ONE-THIRD EUROPE,  
ONE-THIRD WORLDWIDE.

Germany, the rest of Europe and the remaining overseas markets each account for roughly one-third of new business operations. This division means that KfW IPEX-Bank's regional business strategy has been implemented precisely. The bank's European perspective includes Turkey and Russia. It still pursues the same unchanged busi-

ness policy of operating in all regions of the world that are of relevance to the economy in Germany and the rest of Europe. The bank remains true to this commitment even in difficult countries and markets and even in difficult times.



Domestic operations, with new commitments totalling EUR 5 billion, were primarily concerned with corporate and project financing, although short-term trade financing operations were also

carried out. The latter were mostly supply and service guarantees as well as forfeitings. The share of these products in new domestic business was around 30% in 2006.

In Germany a substantial share of new commitments in 2006 focused on the energy sector and manufacturing.

**Development in the business areas, Germany**  
Commitments in EUR million<sup>1)</sup>

Business area	Total	Main focus
Manufacturing Industries, Commerce, Health	1,680	Automotive engineering, specialised chemicals
Power, Renewables, Water	1,642	Electricity generation and transmission plants, environmental technology
Shipping	917	Container ships
Rail and Road	362	Rail transport
Basic Industries	276	Raw materials projects, chemicals, steel
Airports and Ports	235	Airport and seaport terminals
Telecommunications and Media	73	Mobile communication systems
<b>Sum total</b>	<b>5,156</b>	

<sup>1)</sup> Differences in the totals are due to rounding.

Along with two other German banks, KfW IPEX-Bank arranged the financing for the Duisburg-Walsum hard coal-fired power plant, a joint project of STEAG AG and Austria's EVN AG. In terms of the volume of financing, this is the largest project financing ever in the German electricity business. The construction of this highly efficient thermal power plant ushers in the renewal of Germany's power plant infrastructure. Given the options available to Germany for its electricity generation mix in the near future the power plant, which will replace older capacities, is also important for its high efficiency in the area of climate protection.

In Andernach (Rhineland-Palatinate), KfW IPEX-Bank is financing a modern industrial thermal power plant to generate combined heat and electricity for the investor group GWE. The power off-taker is the tinplate producer Rasselstein GmbH. Besides natural gas, the power plant can be fired with alternative fuels made from processed waste materials. This means savings in primary energy sources, which also helps to reduce climate-damaging emissions.

In Ebeleben in Thuringia, KfW IPEX-Bank is financing the construction of a biodiesel plant. The second plant of its kind, it is being built and operated by the Irish company, Bioverda Ltd. The

enterprise wants to use it to tap into the growth potential of the market for reproductive raw materials. A stable sales market has thus been created for agriculture in the state of Thuringia.

KfW IPEX-Bank's foreign business continues to focus on Europe. However, this does not mean that it in any way neglects the good business relations that have been maintained with North America, Latin America and Asia for decades. In recent years the bank has been very successful in the Gulf region as well. In the United Arab Emirates it has financed three large-scale natural gas-fired power plants with integrated seawater desalination plants since 2001. In one of those transactions KfW IPEX-Bank was the mandated lead arranger. A further project of this type was added in the year under review – Al Hidd in Bahrain.

In sectoral terms, financing operations in the raw materials sector, shipping and rail and road transport took a particularly high share of the bank's foreign business.

In the transport sector KfW IPEX-Bank again participated, for example, in financing the rehabilitation of the rail network in Croatia. In the year under review, the bank financed the third and final construction phase for upgrading the Zagreb-Split railway line. This continued the long-standing successful commitment to improving the rail and road infrastructure in Croatia.

In the shipping sector, the persistently strong demand for sea transport services is evident. According to the International Monetary Fund, trade all over the world has been growing at more than twice the rate of world production for decades, and commercial shipping has the most

**Development in the business areas, abroad**  
Commitments in EUR million<sup>1)</sup>

Business area	Total	Main focus
Basic Industries	2,338	Raw materials projects, chemicals, steel
Shipping	1,909	Cruise and container ships, ferries
Rail and Road	1,821	Rail transport
Aviation	949	Airbus deliveries
Power, Renewables, Water	810	Electricity generation and transmission plants, environmental technology
Airports and Ports	769	Airport and seaport terminals
Telecommunications and Media	631	Mobile communication systems
Manufacturing Industries, Commerce, Health	597	Trade finance
Others	21	Mezzanine finance, etc
<b>Sum total</b>	<b>9,845</b>	

<sup>1)</sup> Differences in the totals are due to rounding.

significant share of this growth. However, other segments of maritime transport are also doing well, particularly the tourism segment. German and other European shipyards therefore have plenty of orders, representing demand from container, bulk carriers or product tanker operators as well as ferries and cruise ship operators. Among other operations, in the year under review the bank financed the purchase of rapid ferries for supraregional transport for the city of Istanbul, Turkey. These loans were arranged in cooperation with the European Investment Bank.

KfW IPEX-Bank financed the construction of two state-of-the-art double-hull tankers by a German shipyard for a shipping firm in the Seychelles.

KfW IPEX-Bank is well aware of the risks posed by the volatile market development in this transport sector, however, and is responding to them with a well thought through expansion strategy.

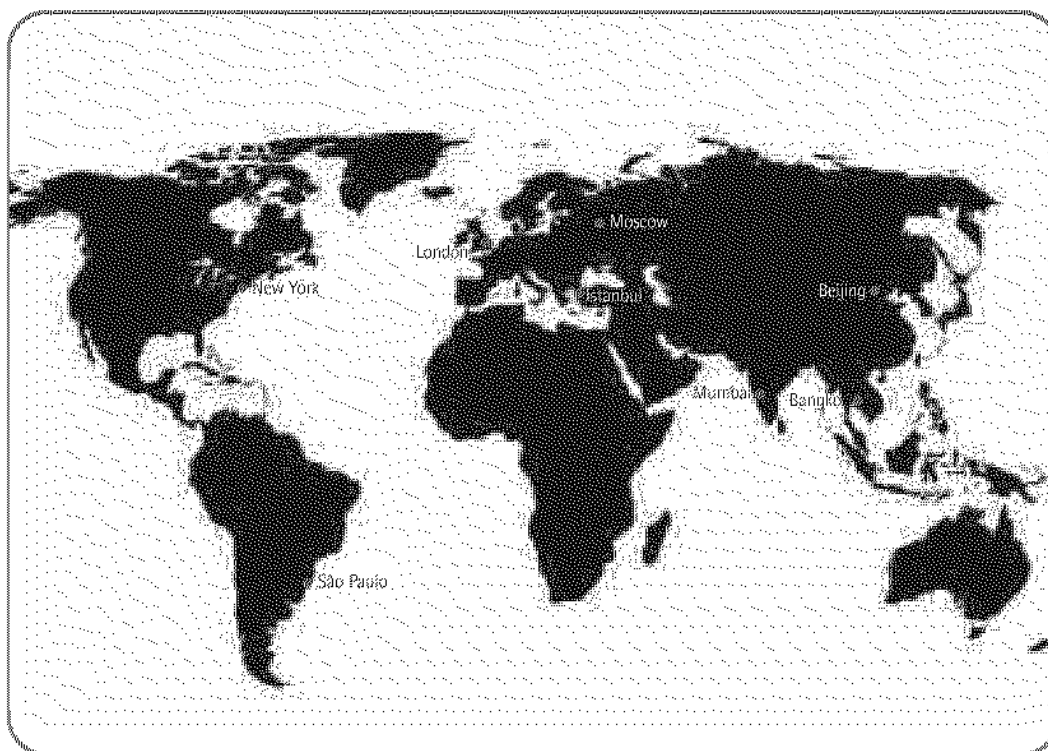
A large-scale methanol project in Trinidad and Tobago, a region with rich offshore natural gas reserves, is an important example of the bank's financing operations in the raw materials industry. After having financed several predecessor projects, it extended a loan for the construction of the world's largest fertiliser production plant on the island of Trinidad. It was built by MAN Ferrostaal AG.

#### FOREIGN REPRESENTATIVE OFFICES.

Over the past years KfW IPEX-Bank has established representative offices in various regions which it considers particularly important for its foreign operations.

The official opening of an office in Moscow took place in the year under review. The representative office in Turkey was moved from Ankara to Istanbul. An office in Mumbai, India, was added. In 2007 KfW IPEX-Bank will open a

further representative office in the Gulf region. These strategically oriented foreign representative offices will enable the bank to address the main target market in Asia, North America and Latin America, Russia, Turkey, India and the Gulf region directly. They will make it easier to cultivate existing customer contacts and develop new business relationships.



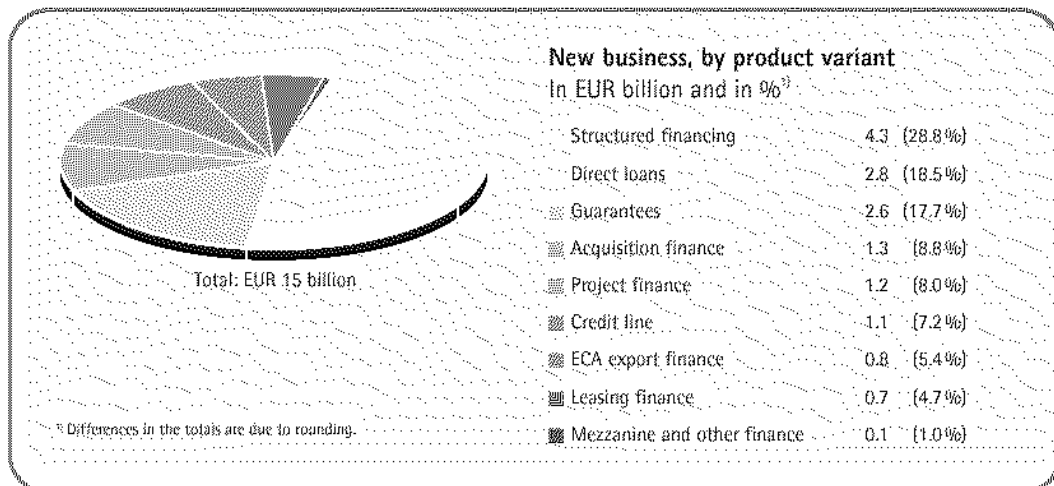
## EXPANDING THE PRODUCT RANGE.

The product strategy has been implemented as planned. In the past two years KfW IPEX-Bank expanded its product range particularly by adding shorter-term commercial instruments.

Nevertheless, KfW-Bank remains a bank whose core business is the medium and long-term loan. It has demonstrated its competence in this field over decades through tailor-made financings. It rounds off its product range with shorter-term products, particularly guarantees and forfaiting transactions, to meet the interests of customers who also require short-term instruments to com-

plement their basic financing, which they need particularly for classic export transactions. In this way the bank can provide them with a one-stop financing source with all necessary loan and guarantee instruments.

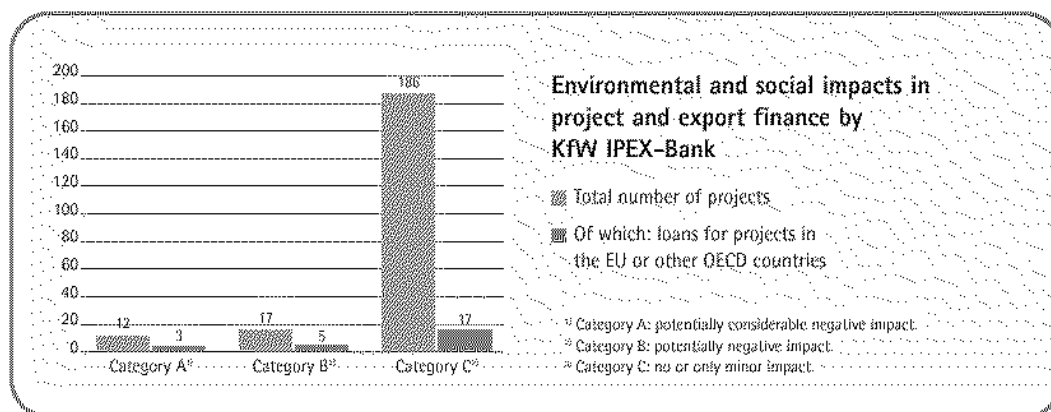
Through Movesta Lease and Finance GmbH, a joint venture with IKB Deutsche Industriebank, the bank has added leasing finance to its product range. This cooperation has been expanded successfully. One example is the joint leasing structure that was implemented for the use of rolling stock for English Welsh and Scottish Railways Ltd.



## RESPONSIBILITY FOR ENVIRONMENTALLY AND SOCIALLY SOUND OPERATIONS.

KfW IPEX-Bank continues to assume its responsibility for environmentally and socially sound operations. In 2000 it was one of Germany's first banks to adopt environmental guidelines for its international business. These guidelines were subsequently expanded to take explicit account of possible social impacts and sustainability aspects in projects financed by KfW IPEX-Bank.

The guidelines require all loan applications for international financing operations to be screened for the environmental and social impacts of the projects to be financed. In the year under review 215 new loans submitted for approval were screened in this way. The screening distinguishes between three project categories, as indicated on the next page.



Category A and B projects are subjected to an in-depth appraisal by the technical and environmental experts of KfW Bankengruppe unless they are to be implemented in an EU country or another OECD country with established environmental legislation and practice. In the year under review these were mainly raw materials projects, thermal power plants and petrochemical projects. All cases that were subjected to in-depth appraisals comply with internationally acknowledged environmental standards.

Category C includes aircraft, ships, telecommunications facilities and standard products of the capital goods industries that meet generally accepted standards.

KfW IPEX-Bank extended loans totalling EUR 2.1 billion for projects designed to protect the environment and contribute to sustainable development. These include waste treatment plants

and renewable energies. In Brazil it has again financed several biomass power plants and in Taiwan a second wind farm. This wind farm is being financed in local currency. This is important for the operator because the revenue from the sale of electricity will be generated in local currency. As higher power output fluctuations are normal for wind turbines, the exchange rate would be an additional risk for the commercial success of the project if financing were provided in foreign currency. However, the bank also financed a number of projects in the area of non-renewable energy that are designed to improve efficiency through modernisation measures and hence contribute to more sustainability.

At EUR 1.8 billion, rail transport projects accounted for the largest share of total financing operations for environmentally sound or compatible projects.

## 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. Wherever possible KfW Entwicklungsbank adds its own funds to those provided from the German federal budget in the form of loans and grants and helps the federal government to achieve the target ratio for Official Development Assistance (ODA).



Promotional strategies for healthy growth  
are gaining ground in Madagascar.

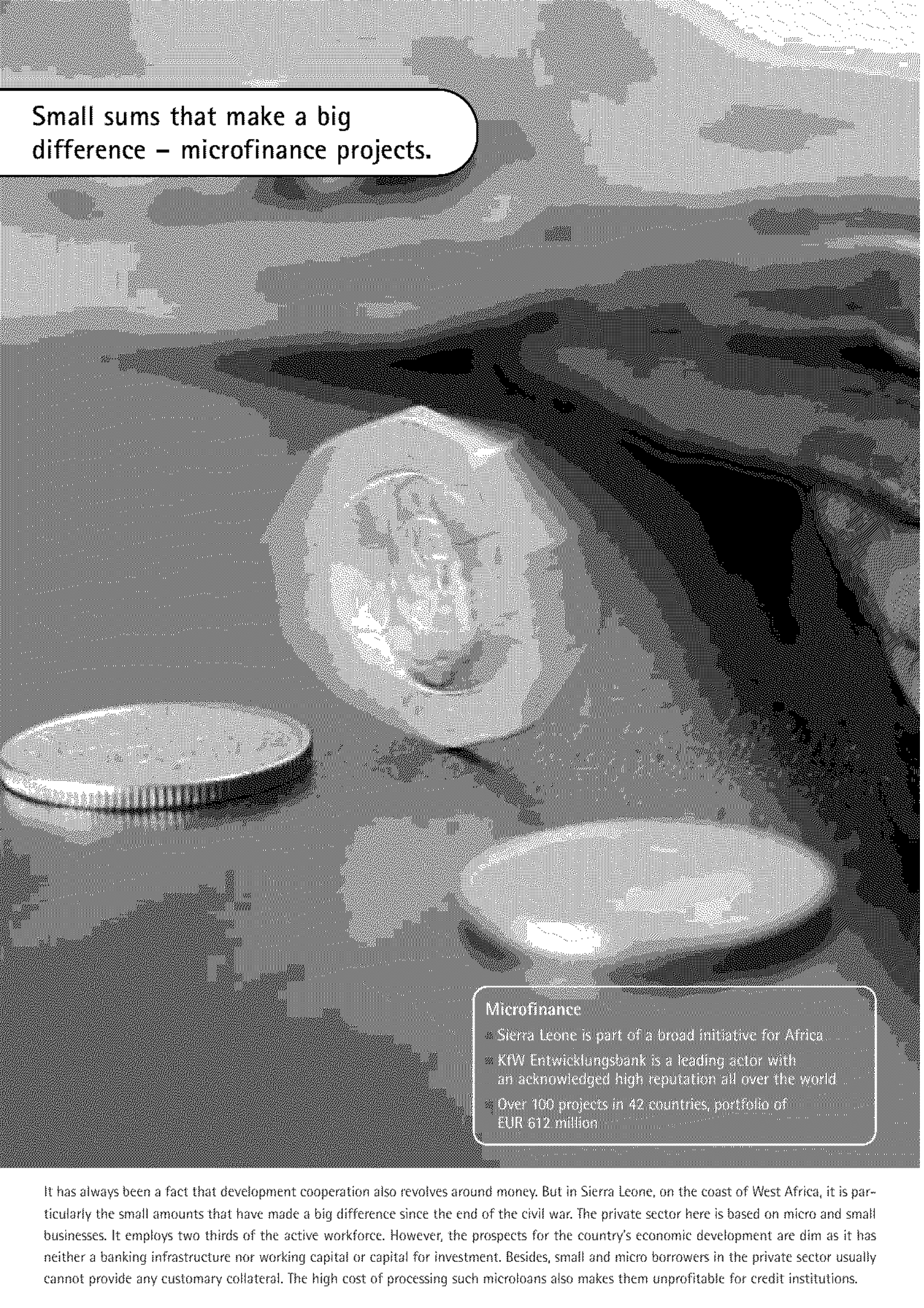
**KfW Entwicklungsbank in Madagascar**

- Promoting national parks and environmental education
- Financing a foundation for the environment
- Microcredit in nature tourism
- National erosion control programme

Without sustainable development cooperation, wells would run dry in many countries. In Madagascar, which used to be thickly forested, rapid population growth is consuming vast areas of land – with serious consequences. Uncontrolled use of land has destroyed forests, leading to loss of biodiversity and vital water resources. In a one-of-a-kind project, KfW Entwicklungsbank together with the WWF, GTZ and many international partners is combining modern nature conservation methods with sustainable promotion of traditional agriculture. Just in time, as the rice farmers were about to deprive themselves of their own water source by continuing to clear the trees in the nature reserve.



The Ankrafantsika Reserve is situated upstream of the important Betsiboka rice plateau. Its untouched vegetation is the main water reservoir for traditional rice farming. By financing the Madagascar Foundation for Protected Areas and Biodiversity with federal budget funds KfW Entwicklungsbank is safeguarding the survival not only of the national park but also of the population. Tourism has been emerging as a new industry, bringing many jobs to the region which benefit the locals directly. As the keepers of their own water reservoirs the rural population of Madagascar now has a new source of income to draw on.



Small sums that make a big difference – microfinance projects.

#### Microfinance

- Sierra Leone is part of a broad initiative for Africa
- KfW Entwicklungsbank is a leading actor with an acknowledged high reputation all over the world
- Over 100 projects in 42 countries, portfolio of EUR 612 million

It has always been a fact that development cooperation also revolves around money. But in Sierra Leone, on the coast of West Africa, it is particularly the small amounts that have made a big difference since the end of the civil war. The private sector here is based on micro and small businesses. It employs two thirds of the active workforce. However, the prospects for the country's economic development are dim as it has neither a banking infrastructure nor working capital or capital for investment. Besides, small and micro borrowers in the private sector usually cannot provide any customary collateral. The high cost of processing such microloans also makes them unprofitable for credit institutions.



Together with international partners KfW Entwicklungsbank has developed a solution that will bring about lasting improvements for small and micro businesses. It has set up a EUR 7.8 million fund for the refinancing of microcredit institutions that extend loans to micro and small businesses. And it has worked. The number of these micro borrowers rose from 16,000 to 43,000 from the end of 2004 to the end of 2006. The loan volume increased from USD 1.2 million to USD 4.1 million. The average share of delinquent loans (up to 30 days overdue) dropped from 25% to less than 4%. Now the working people of Sierra Leone are repaying the trust that is placed in them in the same currency.

### STRONG DEMAND FOR ENERGY PROMOTION PROGRAMME FOR DEVELOPING COUNTRIES.

Efficient energy use is a key factor in reducing the burden on the world's climate and in lowering climate risks particularly for poor countries. Under the Special Facility for Renewable Energies and Energy Efficiency ("4E") KfW Entwicklungsbank, acting on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ), is providing developing countries with up to EUR 500 million in low-interest loans between 2005 and 2009. Demand from the partner countries for these loans has been stronger than expected. In the first two years EUR 300 million has already been provided from this facility. The funds are to be used to finance around 50 environmentally sound investment projects such as solar power systems, hydropower plants or consumer-based energy conservation measures.



### POSITIVE SIGNAL – RECONSTRUCTION OF SCHOOL INFRASTRUCTURE IN LEBANON.

Acting on behalf of the BMZ, KfW Entwicklungsbank is providing EUR 3 million for the rehabilitation and reconstruction of vocational schools in Lebanon that were destroyed or damaged during the war. War damage has directly affected almost half of all 30,000 students studying at vocational schools in Lebanon. More than one-third of the 90 vocational schools across the country have been damaged by detonations or use as refugee quarters. The first reconstruction achievements were visible at the end of 2006; at the end of October 33 rehabilitated schools reopened for classes. In 2007 work is to begin on rebuilding two further badly damaged schools.



### PROPER HEALTH CARE IN KENYA.

Thousands of women and children die in Kenya each year because they have no or only inadequate health care. Unsafe home birth, inadequate prenatal care and excessively short intervals between births are just some of the causes of these deaths. The distribution of vouchers entitling poor women to professional health care started in June 2006 and is being subsidised by KfW Entwicklungsbank with federal budget funds. The programme is being very well accepted. Just three months after it started, a significantly higher number of women sought obstetric health services from one of the hospitals participating in the programme.



### NO DEVELOPMENT WITHOUT WATER.

In Bolivia 64% of the population lives in poverty or extreme poverty, particularly the farmers in rural areas. Relief is provided by the irrigation programmes financed by KfW Entwicklungsbank on behalf of the BMZ in Bolivia. Federal Minister Heidmarie Wieczorek-Zeul emphasised the exemplary nature of these programmes and their impact during her visit to Bolivia in April 2006. The constant supply of water enables crops to be grown even in dry periods and permits crop diversification. Farmers can reap two or more harvests a year and grow more profitable crops such as vegetables instead of maize. This leads to higher income and less migration during the dry season. With their living conditions improving, the farmers can now look to a brighter future.

## OVERVIEW.

In 2006 the volume of business of KfW Entwicklungsbank and DEG was much higher than expected. A total of EUR 3.4 billion was committed to development projects and programmes in Asia, Europe and the Caucasus, sub-Saharan Africa, Latin America, North Africa and the Mid-

dle East. Funds were provided, inter alia, for investment in renewable energies, rural water supply, resource protection programmes, HIV and tuberculosis prevention, microfinance development, decentralisation measures and trade and industry.

## DEVELOPMENT COOPERATION ACTIVITIES

KfW Entwicklungsbank carries out Germany's Financial Cooperation (FC) on behalf of the German federal government. It uses federal budget funds to finance investment in the economic and social infrastructure, in the establishment of efficient financial sectors and in the management of natural resources. KfW Entwicklungsbank now adds to these funds a considerable volume of financial resources which it raises in the capital markets. The Federal Ministry for Economic Cooperation and Development (BMZ) increasingly provides support for "programme-based approaches" through KfW Entwicklungsbank. Together with other bilateral and multilateral donors it supports cross-cutting and sector-specific reform and investment programmes in the partner countries. As a knowledge bank, KfW Entwicklungsbank advises the BMZ as a decision-making body and the local partners.

The fight against poverty, even under difficult conditions, is the overarching objective of Financial Cooperation (FC). In this context KfW Entwicklungsbank works to relieve social tension and economic problems and to reduce risks to the environment, thus making an important contribution to securing worldwide peace. The projects and programmes supported are embedded in the development strategies of the part-

ner countries and are closely coordinated with the promotional activities of German Technical Cooperation (TC) and other bilateral and multilateral donors.

The partner countries usually receive the funds provided out of the federal budget in the form of grants or loans but also in the form of equity participations. Achieving the Millennium Development Goals (MDGs) requires an enormous financial input. With its attractive combination of instruments KfW Entwicklungsbank supports the German federal government by providing additional financial resources to complement funds from the federal budget; being both a bank and a development institution, it can mix federal budget funds with KfW funds which it refinances in the capital market. These so-called FC development loans give it considerably more scope in its financial cooperation activities. 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 EUR 7 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.

One example of this is the 4E Facility, a special programme created by the German federal government in cooperation with KfW Entwicklungsbank for the purpose of promoting renewable energies and enhancing energy efficiency. Demand for loans under this programme was

much higher in 2005 and 2006 than originally expected. EUR 300 million in low-interest loans was committed at the government level for nine new projects in these two years. Only EUR 46.5 million of this sum was provided from the federal budget.

#### COMMITMENTS BY KfW ENTWICKLUNGSBANK.

In 2006 KfW Entwicklungsbank committed EUR 2,483 million in loans and grants (2005: EUR 1,900 million).

	2002	2003	2004	2005	2006
FC standard loans	182	227	298	307	280
FC grants	680	757	685	770	902
FC development loans	249	287	782	492	704
<i>of which budget funds</i>	109	101	321	157	198
<i>of which KfW funds</i>	140	186	461	336	507
FC promotional loans	41	246	160	247	512
Delegated cooperation	139	77	18	84	85
<b>Total FC</b>	<b>1,291</b>	<b>1,594</b>	<b>1,944</b>	<b>1,900</b>	<b>2,483</b>

The strong rise against 2005 is mostly due to the increased commitment of FC development loans and FC promotional loans from funds raised by

KfW. Their share in overall commitments rose to 41% (EUR 1,018 million; 2005: EUR 583 million).

#### KFW ENTWICKLUNGSBANK COMMITMENTS BY REGION.

With KfW committing more of its own funds, it can considerably increase the volume of FC commitments without using the scarce federal budget funds – which can then be used to benefit poorer regions.

This process is well illustrated by the development of the Asia/Oceania region. Having received a higher amount of FC development loans and FC promotional loans, the region contributed most to last year's growth, accounting for 41 % of overall commitments and a volume of EUR 1,015 million (2005: EUR 678 million). At the same time its share in committed federal

budget funds declined to 36.6% against 38% in 2005. Sub-Saharan Africa, which received 22% of all federal budget funds, accounted for a share of 15% of total commitments. Owing to a special effect, commitments to North Africa and the Middle East rose by around two-thirds, reaching 18% of all commitments. Europe and the Caucasus as well as Latin America received around one-third more FC funds than in the previous year. Their percentage shares, however, remained nearly identical at 17% and 10% respectively.

**KfW Entwicklungsbank commitments by region in 2006**

	Federal budget funds		Overall commitments	
	In EUR million	In %	In EUR million	In %
Asia and Oceania	506	37	1,015	41
Sub-Saharan Africa	309	22	363	15
Europe and Caucasus	131	9	428	17
North Africa / Middle East	328	24	435	18
Latin America	106	8	242	10
<b>Total commitments</b>	<b>1,388</b>	<b>100</b>	<b>2,483</b>	<b>100</b>

## KfW ENTWICKLUNGSBANK COMMITMENTS BY PRIORITY SECTOR.

Measures aimed at developing the social infrastructure were again the main focus of cooperation in 2006, accounting for around 30% of the commitment volume of KfW Entwicklungsbank. Nearly as important was the promotion of the economic infrastructure at 29% (2005: 29%) and financial sector projects at 24% (2005: 26%). Projects aimed at improving the social infrastructure were mainly conducted in the priority areas of water supply, sanitation, waste disposal (EUR 324 million), healthcare and population policy (EUR 272 million) and education (EUR 96 million). The financial sector projects mostly pursued structural objectives to promote economic reform and develop a market economy, such as the long-term promotion of micro, small and medium-sized enterprises and the strengthening of the local financial markets.

Around half the commitments for economic infrastructure measures were in the energy sector (EUR 365 million) and involved energy efficiency, renewable energies and rural electrifica-

tion measures. A further EUR 360 million was invested in the transport sector.

The commitments focused on the core objectives of development cooperation. Accordingly, 60% (2005: 65%) of commitments were dedicated to poverty reduction. The share of commitments directed at protecting the environment and natural resources or in which environmental and resource protection was a secondary objective rose to 40% (2005: 36%). The overall commitment volume for all environmental and resource protection projects and programmes also increased by 44% to EUR 984 million (2005: EUR 684 million).

Gender equality is also an important goal of development cooperation. After all, all over the world women are much more strongly affected by poverty than men. This is why 44% of the commitments made by KfW Entwicklungsbank in 2006 pursued gender equality as the main or secondary objective.

### KfW Entwicklungsbank commitments by priority sector 2005-2006

	2005		2006	
	In EUR million	In %	In EUR million	In %
Social infrastructure	574	30	734	30
Economic infrastructure	556	29	724	29
Financial sector	487	26	600	24
Production sector	85	5	186	7
Other	198	10	238	10
<b>Total</b>	<b>1,900</b>	<b>100</b>	<b>2,483</b>	<b>100</b>

#### DISBURSEMENTS BY KfW ENTWICKLUNGSBANK.

In the year under review KfW Entwicklungsbank disbursed EUR 1,485 million (2005: EUR 1,386 million) for operations in developing and transition

countries, of which EUR 1,055 million (2005: EUR 880 million) was from federal budget funds.

#### RESCHEDULINGS AND DEBT CONVERSIONS FOR ENVIRONMENTAL PROTECTION AND POVERTY ALLEVIATION.

For highly indebted partner countries that are willing to undertake reforms, the federal government is prepared, under certain conditions, to ease the repayment of development loans or to write off part of such loans. Pledges of this kind are made in coordination with the international community of donors in the Paris Club or through the HIPC Initiative, which is managed by the International Monetary Fund (IMF) as an approach to debt reduction for poor, highly indebted countries. KfW participates in the negotiations on the German side.

To provide debt relief for partner countries, in 2006 KfW concluded debt rescheduling and cancellation agreements totalling EUR 278 mil-

lion with Cameroon, the Dominican Republic, Georgia, Nigeria, Senegal and Sri Lanka.

Under debt conversions debtor countries are released from repayment if they have previously committed themselves to investing the funds thus released in poverty reduction and environmental protection projects. In 2006 KfW Entwicklungsbank concluded debt conversion agreements amounting to EUR 88 million with Bosnia and Herzegovina, Indonesia, Jordan and Serbia. After various projects had been implemented by the debtors, KfW Entwicklungsbank cancelled more than EUR 66 million in debt under agreements made in previous years.

#### IMPACT OF FINANCIAL COOPERATION.

KfW Entwicklungsbank regularly examines whether the funds disbursed under German Financial Cooperation are invested properly and whether they have initiated a sustainable development process. For this purpose, back in 2000 it created an independent evaluation unit which reports directly to the Board of Managing Directors. This evaluation unit conducts a new review of each and every project individually on site three to five years after the investment has been completed to determine whether the expected developmental impact has actually occurred. The experience gathered from these evaluations flows back into the project work and is systematically incorporated into new projects.

The results of the evaluations are published every two years. In November 2006 the ninth evaluation report on the years 2004 and 2005 was presented. It demonstrated that most of the

projects and programmes that were financed were efficacious despite the high risks and often difficult conditions under which they were carried out – 71% of the 177 projects and programmes evaluated in 54 countries were rated developmentally successful, and in relation to the volume of funds invested this rate even reached 76%. By international comparison, too, this is a very good result.

The report shows that development cooperation is also defined by the fact that it tackles development obstacles under difficult conditions and that it is ready to take calculated, high risks in return for high development impacts. It illustrates that for KfW Entwicklungsbank the main focus is on the potential and development opportunities which the people themselves have to find their way out of poverty.

#### WORLDWIDE ACKNOWLEDGEMENT OF THE DEVELOPMENT WORK.

The development work performed by KfW Entwicklungsbank is internationally acknowledged and affirmed. In the area of microfinance, for example, the renowned CGAP (Consultative Group to Assist the Poorest) has rated the activities of KfW Entwicklungsbank in the financial sector as very good. It has described them as exemplary because they not only open up a direct path out of poverty for the people but also work to create the necessary structures.

The Grameen Bank in Bangladesh, which was awarded the Nobel Peace Prize in December 2006,

was given a total of EUR 24 million in support by KfW in the 1980s and 1990s. KfW Entwicklungsbank is one of the world's leading protagonists in the area of microfinancing and has also made a substantial contribution to advancing the establishment of innovative microfinance funds. It takes up innovative financing approaches and promotional strategies and consistently develops them further. At the end of 2006 it was financing a total of 100 microfinance projects in 39 countries, providing 12 million people with access to savings facilities and credit.

#### THE POWER TO INNOVATE – AS PART OF KfW BANKENGRUPPE.

The integration into KfW Bankengruppe and the close exchange between the group's business areas enables KfW Entwicklungsbank to take up innovative financing concepts early in development cooperation and to consistently develop them further. One example of this is the securitisation of microloans in Bangladesh in the summer of 2006, which gave a non-governmental organisation scope to extend the equivalent of as much as EUR 180 million in new microloans. The combination of development expertise and the potential of a bank yielded a unique solution that has given many thousands of people new future prospects.

These strengths of the knowledge bank and the many years of experience in development policy, coupled with its competency as a credit institution with far-reaching expertise from all areas of KfW Bankengruppe, are major factors which, in 2006, KfW Entwicklungsbank put to good use in the process of optimising the efficiency and efficacy of German development cooperation. KfW Entwicklungsbank thus supports the German federal government in its efforts to further improve the innovative power and visibility of German development cooperation at the international level.

## GOOD GOVERNANCE FOR SUCCESSFUL DEVELOPMENT.

Responsible government action, protection of property, involvement of the people in political decisions and protection from arbitrary behaviour play a crucial role for a country's economic development – not only in industrialised countries. These conditions are lacking in many developing countries and this poses a formidable obstacle to development. For this reason KfW Entwicklungsbank chose "good governance" as the topic of the year in 2006 in order to stimulate debate in the development community.

The experience gained by KfW Bankengruppe in Financial Cooperation and in the promotion of the private sector shows that support cannot have a sustainable impact unless the necessary local conditions are met. Where the setting is not optimal, Financial Cooperation must contribute to bringing about improvements.

German Financial Cooperation is therefore not limited to transferring money and professional expertise. It also provides support in creating a transparent and efficient system of incentives, in strengthening decentralised decision-making structures, encouraging initiative and promoting social equality. In infrastructure projects, for instance, the focus is not only on supplying

electricity and water but also on transparent management, creating decentralised and, hence, usually more efficient structures, and involving the stakeholders. After all, structures that turn subsidy recipients, which strain public budgets, into economically efficient enterprises also spread to other areas.

The reforestation programmes in Asia and Latin America are good examples that illustrate the crucial role of good governance. They are being financed by KfW Entwicklungsbank on behalf of the BMZ. These programmes provide farmers with secure, long-term land use titles and new sources of income. They actively involve the farmers and communities and strengthen their self-organisation, and the impact is visible – the creation of local institutions in which the farmers pull together and influence events is an integral part of the projects. Municipalities benefit from the participation of farmers in, for instance, the drafting of zoning plans. Given the chance to influence the outcome of events themselves, the stakeholders develop a greater sense of commitment, which ultimately ensures greater project success.

**Financing commitments in 2006, by BMZ budget funds and country**  
In EUR million

Position	Country	BMZ budget funds	Other donors' funds	KfW funds	DEG (own risk)
1	Egypt	102.39	0.00	55.32	0.00
2	China, People's Republic	92.80	0.00	301.70	78.30
3	Indonesia	85.63	0.00	0.00	103.16
4	Morocco	83.29	0.00	52.09	0.00
5	India	80.42	0.00	155.37	46.60
6	Bangladesh	65.00	0.00	5.49	13.17
7	Yemen	61.50	0.00	0.00	0.00
8	Pakistan	51.19	0.00	0.00	47.02
9	Palestinian Territories	50.02	0.00	0.00	0.00
10	Afghanistan	48.40	0.00	0.00	7.90
11	Peru	38.80	0.00	15.13	6.82
12	Congo, Democratic Republic	38.00	0.00	0.00	0.00
13	Azerbaijan	32.40	10.00	4.16	7.40
14	Mozambique	30.00	0.79	0.00	0.00
15	Vietnam	27.64	0.00	7.45	0.00
16	Ghana	22.60	3.44	0.00	0.00
17	Georgia	21.58	2.10	13.63	8.43
18	Kenya	21.56	0.00	25.45	12.81
19	Nicaragua	18.93	0.00	0.00	29.38
20	Zimbabwe	17.90	0.00	0.00	0.00
21	Zambia	17.50	0.00	0.00	22.55
22	Uganda	17.10	0.00	0.00	5.40
23	Kyrgyzstan	16.00	0.00	0.00	0.04
24	Albania	14.97	1.35	0.00	0.00
25	El Salvador	13.53	0.00	7.94	0.00
26	Tanzania	13.00	0.00	0.00	9.00
27	Benin	12.20	0.00	0.00	0.00
28	Sierra Leone	12.00	0.00	0.00	0.00
29	Côte d'Ivoire	11.66	0.00	0.00	0.00
30	Jordan	11.52	0.00	0.00	0.00
31	South Africa	11.20	0.00	0.00	41.66
32	Philippines	11.00	0.00	0.00	0.00
33	Namibia	10.32	0.00	0.00	0.00
34	Sudan	10.00	0.00	0.00	0.00
35	Chad	10.00	0.00	0.00	0.00
36	Montenegro	9.59	0.00	10.00	10.00
37	Burkina Faso	9.50	0.00	0.00	0.00
38	Bolivia	9.25	0.00	0.00	0.00
39	Ukraine	9.00	0.00	0.00	40.81
40	Senegal	8.81	0.00	0.00	0.00

(cont.)

Position	Country	BMZ budget funds	Other donors' funds	KfW funds	DEG (own risk)
41	Laos	8.75	0.00	0.00	0.00
42	Madagascar	8.50	0.00	12.00	1.35
43	Serbia	8.00	0.00	12.00	20.00
44	Burundi	7.96	0.00	0.00	0.00
45	Mali	7.31	0.00	0.00	0.00
46	Armenia	7.00	0.00	7.83	7.88
47	Cambodia	7.00	0.00	0.00	11.89
48	Honduras	6.80	0.00	0.00	3.03
49	Sri Lanka	6.60	0.00	0.00	12.47
50	Ethiopia	6.00	0.00	0.00	0.00
51	Malawi	6.00	0.00	0.00	0.00
52	Lebanon	5.00	0.00	0.00	0.00
53	Cameroon	4.00	0.00	0.00	28.13
54	Syria	4.00	0.00	0.00	0.00
55	Brazil	3.19	0.00	0.00	29.26
56	Tadjikistan	2.60	0.00	0.00	0.00
57	Uzbekistan	2.50	0.00	0.00	0.00
58	Turkey	0.69	49.00	0.00	36.39
59	Romania	0.60	0.00	13.07	22.50
60	Macedonia	0.50	0.00	0.00	0.00
61	Rwanda	0.47	0.91	0.00	0.00
62	Bulgaria	0.00	0.00	62.00	0.00
63	Kazakhstan	0.00	0.00	39.20	0.00
64	Chile	0.00	0.00	32.74	0.00
65	Russian Federation	0.00	2.20	25.82	41.22
66	Bosnia and Herzegovina	0.00	8.84	0.00	20.00
67	Mexico	0.00	0.00	6.25	33.44
68	Argentina	0.00	0.00	0.00	53.70
69	Croatia	0.00	0.00	0.00	11.07
70	Colombia	0.00	0.00	0.00	8.21
71	Singapore	0.00	0.00	0.00	7.10
72	Ecuador	0.00	0.00	0.00	6.25
73	Gabon	0.00	0.00	0.00	5.06
74	Uruguay	0.00	0.00	0.00	4.15
75	Dominican Republic	0.00	0.00	0.00	2.75
76	Mauritania	0.00	0.00	0.00	2.00
77	Poland	0.00	0.00	0.00	1.50
78	Costa Rica	0.00	0.00	0.00	0.27
	Supraregional commitments	48.01	5.98	165.83	57.75
	<b>Total</b>	<b>1,379.68</b>	<b>84.61</b>	<b>1,018.48</b>	<b>917.80</b>

## Our business is development.

DEG (Deutsche Investitions- und Entwicklungsgesellschaft mbH), a member 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, thus contributing to strengthening the market economy in the partner countries. Projects that are co-financed by DEG must make sound developmental and business sense and be both environmentally and socially acceptable. They are carried out in all economic sectors that are open to involving private business. 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 the individual project, the current market situation and the risk situation in the country in question.

#### THE TASKS AND ROLE OF DEG.

Together with KfW Entwicklungsbank, DEG is committed to providing support for developing countries. As a member of KfW Bankengruppe it supports the development policy objectives of the German federal government by helping to establish and expand private enterprise in developing and emerging countries. By providing co-financing and advisory services for corporate investment, DEG contributes to ensuring sus-

tainable economic growth and hence to improving the living conditions of the people in these countries.

Since it was founded in 1962, DEG has provided nearly EUR 8 billion in funding – more than EUR 3 billion in the past five business years alone. Becoming part of KfW Bankengruppe has enabled DEG to achieve dynamic growth.

#### DEVELOPMENT OF DEG'S FINANCING BUSINESS.

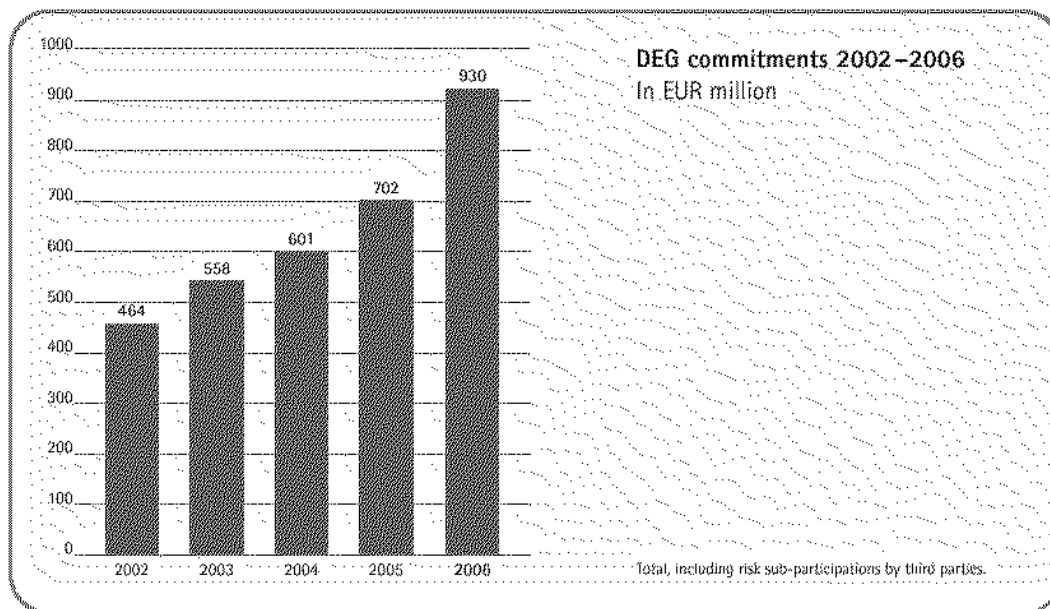
The ongoing underlying economic and political conditions in the main host regions made 2006 an encouraging business year for DEG. It again expanded its financing business considerably and achieved a record volume of commitments – EUR 930 million (2005: EUR 702 million), a year-on-year increase of 33%. EUR 12 million (2005: EUR 30 million) was mobilised through risk sub-participations.

DEG disbursed EUR 776 million at its own risk, far more than the EUR 514 million disbursed in 2005. Risk sub-participations enabled a further EUR 12 million (2005: EUR 35 million) to be channelled to various project companies.

The entire portfolio increased by more than 11% to EUR 3,051 million and further improve-

ments were achieved in risk structure and economic quality. The projects covered 496 enterprises in 80 partner countries, which makes DEG one of the largest European financing institutions that focus on promoting the private sector in developing and emerging countries.

In the context of the new business conducted at its own risk DEG committed EUR 123 million to finance participations in 2006. Loan commitments amounted to EUR 748 million, EUR 150 million of which was granted in the form of quasi-equity financing. The use of risk capital for private equity and mezzanine financings amounted to EUR 273 million, 30% of total new business. Commitments for guarantees totalled EUR 47 million.



#### REGIONAL AND SECTORAL DISTRIBUTION OF NEW COMMITMENTS.

In the year under review DEG financed projects in 40 countries, including, for the first time, Armenia. The least developed countries (LDCs) include, in Asia, Afghanistan, Bangladesh and Cambodia and, in Africa, Madagascar, Mauritania, Tanzania, Uganda and Zambia.

The main focus was the region of Asia/Oceania, which accounted for EUR 328 million (36%) of the new commitments. This was followed by Europe/the Caucasus/Turkey, which received EUR 235 million (25%) in commitments. Commitments in Latin America amounted to EUR 202 million (22%). In sub-Saharan Africa commitments totalled EUR 143 million (16%), the highest annual volume of finance that DEG had ever provided for that region. African partners were the main beneficiaries of a transregional project with a volume of EUR 10 million (1%).

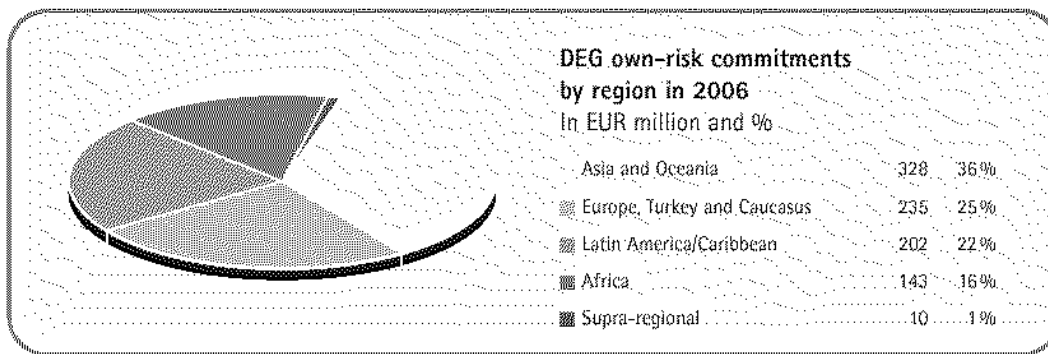
In the year under review DEG further extended its commitment in the financial sectors in the partner countries. The funds committed

for this sector accounted for 34% of new business. The main focus was on intensifying cooperation with local commercial and regional banks. This cooperation mainly improves investment opportunities for small and medium-sized enterprises in the partner countries. In addition, particular attention was given to promoting leasing companies and equity participation funds as well as institutions specialising in education and infrastructure finance. One example of a structure-building commitment is the co-financing of an agricultural financing institution in Mexico, which provides loans mainly for small and medium-sized enterprises with fewer than 200 employees and improves the financing opportunities in a sector that is neglected by commercial banks and heavily under-capitalised.

DEG channelled 27% of its promotional volume to manufacturing enterprises. The focus was on investment in the food, chemical, electrical and paper sectors. Infrastructure projects

in the areas of telecommunications, energy, transport, health and education accounted for 21% of new commitments. At nearly EUR 190 million, that was over EUR 100 million more than in 2005, a record volume. Other service sector

projects accounted for 12%. Investment in the agricultural sector, including forestry and fishery but excluding the processing agro-industry, accounted for 4%. Two mining projects represented a share of 2%.



#### ADVISORY AND PROMOTIONAL PROGRAMMES.

DEG's advisory services provided support in the area of investment planning and preparation not only for enterprises but also for institutions pursuing the objective of promoting private-sector cooperation in the partner countries. DEG draws on its specific country and sector knowledge and its financial expertise particularly in structural advice. It thus improves the quality of the approved investment projects

In the year under review the German Federal Ministry for Economic Cooperation and Development (BMZ) allocated EUR 0.75 million in budget funds to enhance the developmental impact of DEG financing. DEG matched this amount with funds of its own. This budget was used to finance 21 measures supplementing or accompanying DEG projects, particularly with the aim of broadening the impact and enhancing the structural effects of the projects. For the years ahead DEG has set up a reserve of EUR 5

million specifically for technical assistance. These accompanying measures will strengthen the economic, social and ecological sustainability of the projects and take account of the particular significance of private investment in difficult developing countries.

In the year under review DEG financed 52 projects under the Public Private Partnership (PPP) Programme set up by the BMZ for development partnerships with the private sector. Overall, EUR 9.4 million in government funds were provided. The partner enterprises and third parties invested EUR 18.8 million, enabling a project volume of EUR 28.2 million to be achieved in 2006. Since 1999 DEG has financed a total of 419 PPP projects. Around two-thirds were carried out in cooperation with small and medium-sized project partner firms. EUR 58.2 million in public funds were invested in these projects. The enterprises contributed EUR 117.9 million.

Under PPP financing, considerable importance is placed on the strategic alliances. The partnership with the TÜV Rheinland Group in establishing a competence network to promote climate protection projects in developing countries and the "Cotton made in Africa" initiative were of particular importance.

Under special loan programmes for business founders and young entrepreneurs, which have been offered since 1999 on behalf of the BMZ, roughly 180 loans at market conditions were approved as seed capital in 2006.

DEG has also been supporting new businesses in Afghanistan on behalf of the BMZ since 2002.

By 2006 some 330 projects had been financed, most of them in traditional handicraft businesses, with non-repayable equity assistance and complementary advisory services. Equity capital assistance was replaced in the course of 2006 by a loan guarantee fund project financed by the BMZ and USAID; this project undertakes to hedge loans by local banks to young entrepreneurs and small and medium-sized enterprises. In the year under review 75 guarantees for a loan commitment volume of more than USD 1.7 million were provided. Overall, these start-up commitments by DEG have created or safeguarded more than 7,400 jobs.

#### EUROPEAN AND INTERNATIONAL COOPERATION.

DEG intensified its cooperation within the framework of EDFI (European Development Finance Institutions), which is based in Brussels. Twelve of the 15 EDFI members – including DEG – have joined the European Investment Bank (EIB) in the European Financing Partners (EFP) co-financing instrument. In 2006 the partners provided EUR 175 million in additional funds to promote private investment by the EFP in the ACP states in Africa, the Caribbean and the Pacific. In 2005 EUR 140 million was provided for that purpose.

In November 2006 DEG signed a cooperation agreement with the French development finance institution PROPARCO. A similar agree-

ment already existed with the Netherlands Development Finance Company (FMO). In both cases the partners have set themselves the target of a coordinated, efficient strategy for developing and appraising projects and balanced risk sharing for larger transaction volumes.

In the non-European context, DEG also intensified its cooperation with partner institutions. Together with KfW Entwicklungsbank, DEG signed an agreement with the Corporación Andina de Fomento (CAF) at the World Bank Meeting in Singapore in 2006. The aim is to carry out more joint projects with larger financing volumes in Latin America.

#### DEVELOPMENTAL IMPACT OF FINANCING AT DEG'S OWN RISK.

The good developmental quality of all DEG's activities was maintained in the year under review. The share of project enterprises which endeavour to comply with the World Bank's international environmental standards and which have committed themselves to meeting the core labour standards set by the International Labour Organization (ILO) rose in the new business area to 100%. That was the result of recent evaluations by DEG's corporate policy project rating mechanism. An analysis of 111 projects revealed that around 32,600 new jobs were created through co-financed partner projects in 2006.

The DEG project enterprises co-financed in the year under review are currently providing a living for around 145,000 people. In addition, just under 300,000 more jobs have been created at production enterprises as a result of supply relationships and at sub-borrowers in financial sector projects. Overall, these project companies generate EUR 520 million in state revenues and EUR 2.2 billion in net foreign currency earnings each year.

#### RESULT.

The result of ordinary business operations was EUR 130 million, above the previous year's very high level (EUR 122 million). High investment income and the further net liquidation of risk provisions again made a major contribution. Risk provisions were reduced further, particularly because further improvements were achieved in the quality of the individual projects and the country ratings for large investment countries and no new, additional country risks had to be taken into account.

The net income for the year after tax was EUR 115 million (EUR 119 million). EUR 5 million of this amount was set aside to finance future accompanying measures to reinforce the developmental effects. The remaining EUR 110 million were allocated to other retained earnings, as required by the by-laws. The continuously improved equity base allows DEG to strengthen its risk-bearing capacity and to expand its promotional financing business.

## OUTLOOK.

Owing to the current positive underlying economic conditions in most markets relevant to DEG in developing and emerging countries, the opportunities to develop the private sector in these regions are still good. DEG's target for 2007 and 2008 is around EUR 0.9 billion in new business, which will permit an annual portfolio growth of 10%.

Despite high international liquidity, which has led to a distinct decrease in margins in various markets, there are still gaps in the market in the area of long-term finance and, in particular, in the availability of venture capital. DEG will therefore be extending its equity finance and mezzanine finance business further. It will not only be able to close significant financing gaps but also take account of important control and co-determination rights with other shareholders. In addition, these projects contribute to the introduction of international good corporate governance standards.

As far as its established positive structural impact is concerned, financial sector promotion is being continued at the previous level. The focus is on direct financial promotion of investment by small and medium-sized enterprises (SMEs) and

the expansion of local currency transactions. Africa is still an important strategic region for DEG. Given the difficult underlying conditions in the poorest countries on that continent, projects have to be devised in such a way as to render them eligible for financing and to strengthen their developmental impact. For economic development, co-financing in the European association and technical accompanying measures are of particular significance. By expanding the financing of renewable energies and projects with an impact in the area of climate protection, DEG is strengthening its environmental competence and promotes both the diversification of the energy approach in countries with a unilaterally high dependence on oil. For the particular advisory and structuring needs of German SMEs investing abroad, DEG continuously adapts its offer to customer requests.

Despite the ongoing good global development, DEG continues to operate in a business environment with potentially high project and country risks. It will therefore continue to develop its comprehensive risk strategy and can set its further business growth on a sound equity capital base.

# FUNDING.

## WORLDWIDE DEMAND.

The demand for KfW's bonds and notes from investors worldwide continued in 2006. The explicit guarantee from the Federal Republic of Germany and the AAA rating granted by Fitch Ratings, Moody's Investors Service and Standard & Poor's make KfW an absolutely safe issuer. At the same time KfW has made a name for itself in the capital market as providing maximum diversity in terms of instruments and currencies. It offers investors a broad range of securities. The spectrum covers bonds for Japanese private investors, Australian dollar bonds issued in KfW's Kangaroo Programme, bonds denominated in fairly exotic currencies such as the Botswana pula, bonds in the established Euro Benchmark Programme with a volume of up to EUR 5 billion and structured private placements specifically geared to institutional investors in the USA. To

provide this wide range of products, KfW has created internal processes which enable it to respond swiftly to market trends. Investment banks which monitor the placement of KfW's bonds appreciate KfW's high flexibility and prestige. In its issuing activities KfW always pursues the dual aim of responding optimally to market demand and providing the best funding for its promotional activities.

In 2006 KfW raised the equivalent of EUR 54.2 billion in longer-term funds in the international capital markets (2005: EUR 50.6 billion). This volume was precisely within the corridor of EUR 50 billion to EUR 55 billion which was announced at the end of the previous year. In the course of the year more than 500 individual transactions were launched in 23 different currencies.

**Issue volume in 2005/2006, by instrument<sup>1)</sup>**  
In EUR billion and in %

	2005		2006	
	EUR billion	%	EUR billion	%
<b>Securities</b>	<b>48.0</b>	<b>94.9</b>	<b>51.0</b>	<b>94.2</b>
Benchmark bonds	18.6	36.7	21.8	40.3
Other public bonds	22.2	43.9	23.4	43.2
Private placements	7.2	14.2	5.8	10.8
<b>Loans</b>	<b>2.6</b>	<b>5.1</b>	<b>3.1</b>	<b>5.8</b>
Credit Linked Notes	2.2	4.3	2.2	4.0
Other	0.4	0.8	1.0	1.8
<b>Total</b>	<b>50.6</b>	<b>100.0</b>	<b>54.2</b>	<b>100.0</b>

<sup>1)</sup> Differences in the totals are due to rounding.

**BENCHMARK PROGRAMMES REMAIN THE MOST IMPORTANT PILLAR.**

To place this variety of bonds in the market KfW pursues a three-pillar funding strategy. The first pillar comprises the two benchmark programmes in the euro and the US dollar. In both currencies KfW offers its investors highly liquid bonds with minimum issue volumes and benchmark maturities. In 2006 benchmark bonds accounted for 40% (2005: 37%) of the funds

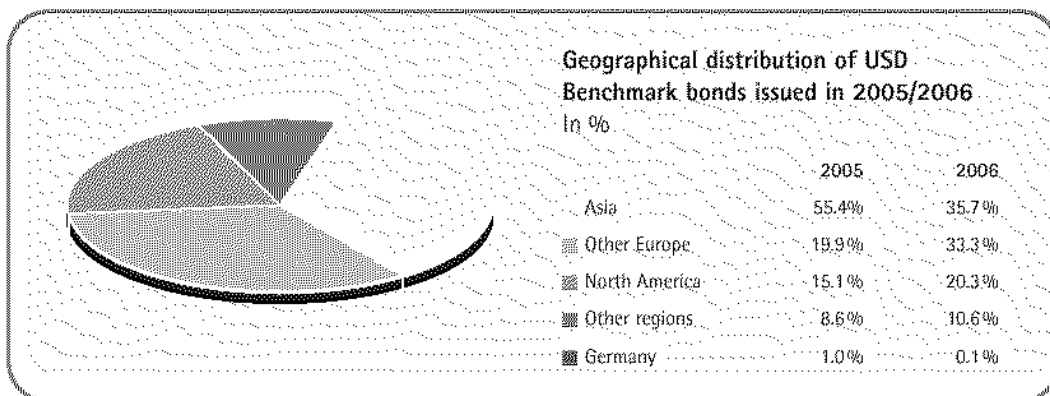
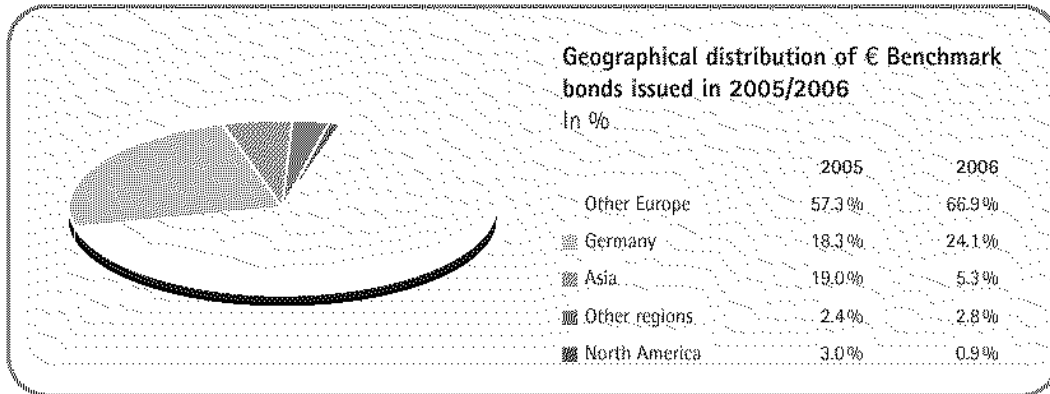
raised by KfW. Other public bonds outside the benchmark programmes in a number of different currencies form KfW's second funding pillar. KfW raised 43% of its long-term funding through these bonds (2005: 44%). The third funding pillar comprises private placements and loans and accounted for 17% of the total funding volume (2005: 19%).

**€ Benchmark Programme 2006**

	EUR billion	Maturity	Coupon in %
KfW € Benchmark I/2006	5.0	4 July 2021	3.500
KfW € Benchmark II/2006	5.0	15 July 2009	3.500
KfW € Benchmark III/2006	3.0	14 October 2011	3.750

**US\$ Programme 2006**

	USD billion	Maturity	Coupon in %
USD Global Bond I/2006	3.0	20 January 2011	4.625
USD Global Bond II/2006	2.0	14 March 2016	5.125
USD Global Bond III/2006	3.0	19 May 2009	5.250
USD Global Bond IV/2006	3.0	19 October 2009	4.875



**INCREASED CURRENCY DIVERSIFICATION AMONG INTERNATIONAL INVESTORS.**

The euro remains the most important currency, accounting for a share of 42%. A frequent phenomenon observed particularly in the European capital market was that pension funds invested increasingly in bonds with long maturities in order to hedge long-term payment obligations through capital investments that offer long-term security and stable interest earnings. KfW bonds, which are regarded as risk free because of the explicit state guarantee, are an investment instrument that is particularly suited to these investors. For this reason KfW issued a 15-year bond in the amount of EUR 5 billion for the first time. KfW's range of highly liquid bonds was thus extended to encompass maturities up to

2021. The bond met with overwhelming demand and was twice oversubscribed within a short period. In addition to the 15-year bond, a 3-year euro € Benchmark bond for EUR 5 billion and a 5-year bond for EUR 3 billion were placed in the market.

Besides US American and Asian investors, European investors, in particular, invested surprisingly heavily in the US dollar (USD) in 2006. KfW benefited from this demand and placed bonds worth a total of USD 19.7 billion (2005: USD 15 billion) in the USD capital market. This was 29% of KfW's total borrowings. The US dollar thus remained the second most important funding currency. KfW used the entire maturity

### Borrowings in 2005/2006, by currency<sup>1)</sup>

In EUR billion and in %

Currency	2005		2006	
	EUR billion	%	EUR billion	%
EUR	23.8	47.0	22.5	41.5
USD	12.0	23.7	15.8	29.2
GBP	6.5	12.8	6.3	11.2
JPY	2.4	4.8	3.4	6.3
Other	5.9	11.7	6.4	11.8
<b>Total</b>	<b>50.6</b>	<b>100.0</b>	<b>54.2</b>	<b>100.0</b>

<sup>1)</sup> Differences in the totals are due to rounding.

range of between two and thirty years in its funding activities. In the long-term segment a 30-year zero coupon bond in the amount of USD 3 billion and a 10-year global bond for USD 1 billion were issued in the market. The latter was increased by another USD 1 billion after a short period. In addition, in the framework of its USD Benchmark Programme KfW placed one 5-year and two 3-year global bonds for USD 3 billion each.

In 2006 KfW set up an issuing platform (US Medium-Term Note Programme) especially for US investors. This platform enables KfW to meet flexibly and efficiently the demand for structured bonds from investors domiciled in the USA. The programme was very well received by the market. In the first year 11 bonds worth more than USD 1 billion were issued.

KfW issued more than GBP 4.2 billion (EUR 6.1 billion or 11 % of the total funding volume) worth of bonds denominated in pounds sterling in 2006. KfW thus strengthened its position as one of the top three issuers of sterling bonds. At the beginning of the year KfW issued a 5-year bond, which, in response to strong investor demand, was increased to a total volume of GBP

1.2 billion in the course of the year. Besides British investors, who are naturally active in this market, KfW is observing growing demand from institutional investors not domiciled in the UK. Central banks, in particular, are increasingly using KfW bonds denominated in GBP to manage their currency reserves. As future prospects are positive, KfW will continue to be an active issuer in pounds sterling.

The situation was similar for the Australian and Canadian dollar markets. Accounting for 3% and 2% of borrowings respectively, they were less important for KfW's funding than the pound sterling. However, in these markets, too, there was a lively interest from non-domestic investors in government bond surrogates as offered by KfW. KfW's therefore also issued large volumes in these markets in 2006. KfW had already established a Kangaroo Programme in Australia in 1999.

The Japanese capital market and issues denominated in Japanese yen (JPY) are another important source of funding for KfW. In 2006 the increasingly positive economic development of the second largest economy in the world, the slightly rise in the interest rate level and the

positive view of the exchange rate fuelled the appetite for large-volume yen bonds. Against this background, KfW successfully placed three global bonds in Japanese yen with maturities of five, eight and twenty years in the capital market. In addition, in 2006 KfW again made more than 200 structured private placements totalling approximately JPY 250 billion (EUR 1.7 billion) with Japanese institutional investors. KfW again

offered Uridashi bonds for Japanese retail investors. These are bonds issued by issuers not domiciled in Japan especially for private investors. Eleven such bonds worth a total of EUR 600 million were issued in six different currencies. Most Uridashi bonds were issued in Australian and New Zealand dollars and for the first time bonds were also issued in Mexican pesos and the South African rand.

#### EMERGING MARKETS – CONTINUOUS FURTHER DEVELOPMENT OF LOCAL CAPITAL MARKETS.

In 2006 KfW further expanded its funding activities in the smaller and newly emerging capital markets in Asia, Europe, Latin America and Africa. Bonds were issued in four new currencies, including the Egyptian pound, the Romanian leu and the Botswana pula. These issues met with strong interest. In particular, investors domiciled outside of these countries covered their investment needs in these currencies or took advantage of the opportunity to make currency gains without incurring any default risk.

In certain countries, however, KfW specifically targets the local capital market and the investors domiciled there. For example, in 2006 KfW

launched the first Ringgit bond in Malaysia; it was purchased mainly by local Malaysian insurance companies.

With regard to lending, KfW has been cooperating with the countries in these regions sometimes for many decades and is currently engaged in talks on ways and means to make a contribution to the development of the regional capital markets by issuing bonds and notes in these countries. The commitment to local capital markets is a long-term project for KfW as it expects the dynamic economic growth in those countries to provide opportunities to refinance a larger share of its funding needs in the future.

#### HIGH LEVEL OF MONEY MARKET ACTIVITIES CONTINUED.

KfW's money market activities also developed positively. It raised a total of EUR 100.9 billion through its two commercial paper programmes, which is close to the previous year's level.

Although, the total issue volume of EUR 28.3 billion in the Multicurrency Commercial Paper Programme, KfW Bankengruppe's most important short-term source of funding, was down on the previous year's volume of EUR 50.5 billion, there was a clear extension of the maturities in the individual transactions. KfW offers paper in all common currencies and has a well-diversified investor base. It maintained its position as one of the largest global issuers in this market segment.

The USD Commercial Paper Programme implemented by KfW International Finance gained further ground in the US market. In 2006 paper worth a total of USD 91.1 billion was issued, a year-on-year increase of 26%. As demand from US investors has been growing for some years, the programme volume has been increased several times, the most recent increase – at the start of 2005 – taking it from USD 6 billion to USD 10 billion. Both programmes are key components of KfW Bankengruppe's liquidity management.

#### KFW BONDS – HIGHEST SECURITY FOR SOCIALLY RESPONSIBLE INVESTORS.

Socially responsible investors have recently been increasing their prominence in the capital market. Independent rating agencies have been commissioned by these investors to assess enterprises according to socially responsible investment (SRI) standards and to prepare specific analyses. KfW Bankengruppe is regularly assessed by several national and international rating agencies with regard to its socially responsible approach and has regularly attained top positions among the rated bond issuers. KfW can therefore offer extremely safe as well as sustainable investment opportunities.

At present, the market for sustainable investment in Germany is still relatively small but will become considerably more important in the future. This is particularly evident from the situation in Scandinavian countries, the Netherlands and the United Kingdom, where far more attention is being paid to SRI. Owing to KfW's specific statutory mission, its business model and its outstanding ratings, KfW bonds are predestined for purchase by this group of investors. Against that background, KfW will also be taking greater account of this investor group in the years ahead.

## 2007 – FURTHER ADVANCES IN DIVERSIFICATION.

For 2007 KfW Bankengruppe again expects a total funding volume of around EUR 55 billion in the capital markets. Borrowing will be continued with the established instruments. This applies in particular to the two benchmark programmes in EUR and USD. KfW expects that between 40% and 45% of its funding needs will be covered through benchmark bonds. The flexibilisation of the benchmark programmes already produced good results in the year under review and will be continued in 2007. In this process KfW will further take account of the investors' perspective and establish the preconditions ensuring good performance by the bonds. In the € Benchmark Programme, KfW plans to issue bonds with a minimum volume of EUR 3 billion. In the USD Programme KfW expects a minimum volume of USD 2 billion for maturities of up to five years and USD 1 billion for longer maturities. Another 40% to 45% of the total funding requirement is to be covered by other public bonds. The Bank expects private placements and loans to yield a share of 10% to 20%.

The euro is still by far the most significant refinancing currency for KfW. In the US dollar market, the largest capital market in the world, KfW will continue to offer its liquid benchmark bonds and to expand marketing of the US MTN Programme launched in 2006.

KfW expects the high interest in bonds in currencies other than the euro and the US dollar to persist, since currency diversification will most probably remain an important issue for many institutional investors. In particular, the demand for KfW bonds denominated in pounds sterling is expected to continue.

The Japanese market is becoming increasingly important and remains of major interest to KfW. In the smaller and upcoming capital markets, it is also currently examining opportunities to issue in other currencies.

In general, KfW will continue to react flexibly to market trends and use demand-oriented instruments in its funding activities. The objective pursued by KfW is, and will remain to be the first choice worldwide for investors looking for blue chip bonds.

# SHAREHOLDINGS, TREASURY AND SERVICES.

## PRIVATISATION OF DEUTSCHE TELEKOM AND DEUTSCHE POST.

In 2006 KfW took the privatisation of Deutsche Post and Deutsche Telekom a stage further with two successful transactions.

In April 2006 KfW sold around 4.5% of the Telekom shares to the US financial investor Blackstone for EUR 2.68 billion. This was the first time that a private equity investor was directly linked to KfW's privatisation activities. At the same time the transaction helped to redefine the role of private equity companies – also as minority shareholders – in the German private equity market. Market response to the transaction was extremely positive. As at 31 December 2006 KfW held a stake of around 16.9% in Deutsche Telekom (735.7 million shares).

The second transaction followed in July with the sale of Deutsche Post shares to institutional investors. The transaction involved 73.1 million shares with a volume of around EUR 1.5 billion

and was the equivalent of a share of 6.1% in the capital stock of Deutsche Post. The direct sale was completed at the end of the year with the exchangeable bonds issued in December 2003 (to mature on 8 January 2007) being successfully exchanged for Deutsche Post shares. The bond investors benefited from the positive development of Deutsche Post's share price and exercised their exchange right at the price of EUR 20.54 almost fully. As a result, the number of Deutsche Post shares held by KfW decreased by approximately 55.8 million.

At the end of the year KfW held a 34.1% stake in Deutsche Post (410.5 million shares). Once the exchange of the exchangeable bonds for Deutsche Post shares had been fully entered in the books, as at 8 January 2007 KfW's holding in Deutsche Post decreased to 368.3 million shares or 30.6%.

## 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 used to stabilise the price of its own bonds, 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, 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 and to replace time deposits. Investment is in bonds only. Liquidity can be maintained by selling liquid securities in the market when nec-

essary. 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.

Investment in special funds is used partly to maintain liquidity and partly for the investment of KfW's equity capital. These different investment motives are taken into account in differing investment guidelines. On the basis of the findings of modern portfolio theory, KfW uses strategic asset allocation (SAA) to distribute its fund investments efficiently and on a long-term basis 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 and results in risk-adjusted and internationally broadly diversified portfolios. The individual 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.

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 is of prime importance to safeguard KfW's promotional capacities. It is therefore appropriate to exploit the positive im-

pact 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.

In the field of securities investment, KfW operates in a socially responsible manner and will take account of ecological and social aspects in its future investment activities. For this reason it joined the UN initiative on Principles for Responsible Investment in 2006.

### TASKS RELATED TO GERMAN UNIFICATION.

KfW handles 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 now been reduced to around EUR 29 million. As a statutory representative, KfW also manages the accounts of unidentified creditors. At present around 1,500 of the original 10,000 accounts are still open.

Acting on behalf of the federal government, KfW processes claims against a number of other countries resulting from their foreign trade with the former GDR as well as reimbursement claims on German exporters arising out of amounts wrongly offset against transfer rubles. In the year under review KfW collected around EUR 31.1 million in these two areas for the federal government.

In addition, KfW has been mandated to conduct agency business for the Currency Compensation Equalisation Fund. The Fund was estab-

lished in connection with German monetary union. All compensation claims (EUR 45.6 billion) had been fully paid by 31 December 2006.

The compensation liabilities added up to EUR 1.9 billion. After deduction of the redemption payments already made, EUR 8.7 million in compensation liabilities against the Inherited Debt Fund are still outstanding.

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 207

privatisation contracts and 54 enterprises to be wound up still outstanding on 31 December 2006.

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 2006 approximately 800 credit balances totalling around EUR 0.8 million were paid out to previ-

ously unidentified creditors or transferred to the Compensation Fund at the Federal Office for Central Services and Unresolved Property Issues and the Currency Conversion Equalisation Fund. On 31 December 2006 only about 4,500 accounts representing a total of around EUR 5.0 million remained.

#### OTHER SERVICES.

In 1998 the Compensatory Fund for Securities Trading Companies (EdW) was set up at KfW 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.

In the year under review 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 2006 KfW paid out EUR 25 million in compensation to 3,500 beneficiaries.

In addition, in the year under review the Contergan Foundation provided EUR 1.15 million to support nine projects aimed at improving the social participation of disabled persons.

# ACTIVITIES IN OUR CENTRAL DEPARTMENTS.

The men and women on our staff.

## DEVELOPMENT OF STAFF NUMBERS AND STRUCTURE.

KfW made further moderate staff increases in the year under review. This growth was still contrary to the general trend in the banking sector and maintains the balance between three fundamental objectives – to ensure that staff increases are commensurate with the Bank's business situation, to keep staff costs in check and to safeguard existing jobs. At the end of 2006, 3,580 people were employed as opposed to 3,452 in the previous year. That is equivalent to a 3.7% growth. KfW IPEX-Bank recorded above-average staff increases, while the Bank also added to its staff in the credit departments at KfW Förderbank and KfW Mittelstandsbank. A particularly important development in the year under review was the expansion of risk management. Staffing in the management support departments and at KfW Entwicklungsbank remained virtually constant. In addition, the Bank fulfilled its obligations towards the younger generation by again making a distinct increase in the number of its training places for school-leavers and university graduates.

The share of employees not covered by collective wage agreements remained virtually constant at 64.4% (2005: 63.8%). At 48.5% (2005: 48.7%), the percentage of female staff at KfW was also virtually unchanged. However, the per-

centage of female staff not covered by collective wage agreements rose slightly from 38.2% to 39.1%. The potential assessment procedure, which was developed six years ago, and the special promotion of qualified female staff has led to a steady growth in the number of women in management positions. The slight percentage increase to 22.9% (2005: 22.4%) in the year under review was in line with the general staff increase. The overall percentage of part-time employees was 16.1% (2005: 15.5%) with various different part-time employment models being applied. Through these part-time models, the Bank provides a variety of ways to help its staff to strike a balance between work and the family.

Despite the general increase in staff numbers and the retirement of older disabled members of staff, there was a significant increase to 6.1% (2005: 5.4%) in the percentage of disabled employees at the Bank. KfW's commitment to integrating disabled persons into working life clearly exceeded the statutory 5% of the workforce. The Bonn office adopted a particularly noteworthy stance in this respect; the available training places were offered to disabled youngsters only and four were admitted to a vocational training course.

#### DEVELOPMENT OF KfW IPEX-BANK, ADDITION OF FURTHER REPRESENTATIVE OFFICES AND FURTHER STAFF TRAINING.

In 2006 KfW IPEX-Bank again appointed more new staff in the field of international project and export finance. At the end of the year its staff numbered 409 (2005: 346) – an increase of just under 20% since the start of the year. A further increase at KfW IPEX-Bank is planned for 2007. Staffing needs at KfW IPEX-Bank have been met through the internal and external labour markets, direct entry employees and graduate trainees. The Organisation and IT Coordination Division was also added to KfW IPEX-Bank's structure.

To provide support for its international business activities, KfW IPEX-Bank has representative offices in London, Bangkok, Beijing, São Paulo, New York, Moscow. Preparations are under way for further overseas offices in Dubai and Mumbai. To deal more intensively with the strong growth of the private sector in Turkey, the representative office was relocated from Ankara to Istanbul.

KfW IPEX-Bank geared its systematic staff development plans to its specific needs and introduced new internal as well as external further training opportunities.

#### MANAGEMENT REINFORCEMENT.

In many respects staff at the first management level have a particular responsibility. Change processes can only be implemented successfully if this management level not only supports decisions with conviction but also conveys them directly to the staff in a convincing manner. To be able to do this effectively, first-level man-

agement staff require comprehensive information on the planned changes as well as, first and foremost, a clear sense of being part of the management of KfW Bankengruppe. In the year under review, first-level management staff were therefore involved more closely in the information and discussion processes.

#### FURTHER DEVELOPMENT OF THE POTENTIAL ASSESSMENT SCHEME.

KfW has been using the potential assessment procedure to pinpoint future management staff since 1999. In the year under review, the procedure was revised on the basis of previous experience and new scientific insights. The criteria determining potential were thoroughly revised and brought into line with current challenges at KfW – the aim being to enable a clear decision regarding suitability to be taken at the end of the potential assessment procedure as well as to

involve management more intensively in the assessment and development of their staff's potential.

In order to enhance their objectivity and prediction capacity, the tests were standardised more thoroughly. However, the core components of the previous potential assessment procedure have been retained as this revised procedure has evolved.

#### HIGHER PERSONNEL EXPENDITURE.

In addition to the general increase in personnel expenditure as a result of tariff increases and reclassification, the clearest impact of the staff increase was on personnel expenditure, which went up 3.9% to EUR 315.1 million (2005: EUR 303.4 million). The expenditure item "wages and salaries" rose by 4.1% to EUR 239.1 million

(2005: EUR 229.7 million). Social insurance expenditure increased by 4.4% to EUR 34.8 million (2005: EUR 33.3 million). Pension expenditure was EUR 41.2 million (2005: EUR 40.5 million). EUR 26.2 million (2005: EUR 24.1 million) was paid to pensioners and surviving dependants.

#### LARGE NUMBER OF TRAINING PLACES FOR SCHOOL-LEAVERS AND UNIVERSITY GRADUATES.

KfW has traditionally laid great store by its training programmes. Given its particular responsibility as an institution established under public law and as a participant in the training pact between the federal government and business, KfW Bankengruppe has been particularly conscious of its obligations in this regard. Having created far more training places in 2005, in 2006 it again trained more young people than it actually required.

Overall, 55 young people began a vocational training course at KfW. At the start of the new training year in autumn 2006, a total of 157 young people (2005: 138) were taking part in the initial vocational training programme and 72 (2005: 59) in the graduate training programme. This took the total number of young people in vocational training to 229 (2005: 197), a training ratio of 6.4% (2005: 5.7%). KfW is thus exceeding the current training ratio in the banking industry.

#### NATIONWIDE LIST OF KfW TRAINING PLACES ON THE INTERNET.

In the year under review the Bank changed over to a web-based application procedure for training places. As soon as they log on, interested parties come face to face with online application aspects, depending on the requirements of their chosen vocational training course. In the future applications will be made solely via the training portal on KfW's website. This will allow the Bank to achieve capacity effects because

the entire process of initial compilation of applicant data is transferred to the applicants themselves as part of a self-service procedure.

This standardised selection procedure is part of KfW's preparation for the stiff competition for good trainees expected to occur in the years ahead as a result of declining birth rates and hence applicant numbers.

#### IMPLEMENTATION OF THE GENERAL EQUALITY ACT AND THE EQUAL OPPORTUNITIES PLAN.

The Equal Opportunities Plan is used to identify the areas at the Bank in which women are under-represented. The evaluation thus focuses on the number of women in the different salary bands and on the percentage of women in management positions. Overall, there has been a slight improvement in the share of women in all business areas. At KfW it is steadily increasing in the higher salary bands and in posts with managerial responsibilities. However, the rate of 50% stipulated in the Equal Opportunities Implementation Act (*Gleichstellungsdurchsetzungsgesetz*) – which also defines "under-representation" – has not yet been achieved. At best, it can be achieved over the medium to long term if staff numbers fluctuate only slightly and if staff expansion is controlled. It is a declared human resources policy objective to fill most management positions internally. The Equal Opportuni-

ties Plan and the Equal Opportunities Officers thus still provide crucial support with regard to enhancing women's career prospects.

In the past KfW had already taken steps to stave off any form of disadvantage for women. Many parts of the General Equality Act had thus been implemented long before it entered into effect. This mainly covers measures such as the participation of KfW in the audit on the "Occupation and a Family" project, the insistence on equal opportunities, the offer of flexible part-time working models, setting up or supporting crèches, day nurseries and after-school day care centres, support for disabled persons and the implementation of the concept of fair play at the workplace. All these are an expression of our commitment to guaranteeing equal opportunities and to effectively countering any possible disadvantages.

THANKS TO OUR STAFF, THE EQUAL OPPORTUNITIES OFFICERS AND  
THE STAFF REPRESENTATIVE BODIES.

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

All current personnel, social, organisational and economic issues were discussed at regular meetings with the competent staff representa-

tive bodies and with the relevant Equal Opportunities Officer. New Equal Opportunities Officers were elected in the year under review. We would like to thank the General Staff Council, the local Staff Councils and the Equal Opportunities Officers for the good and constructive cooperation during the past year.

IN MEMORIAM.

We were saddened by the death in 2006 of our active staff members Bernd Bär and Robert Heimerl. We also mourn the death of our retired members of staff Waltraud Behrend, Wilma Engler, Ute Franke, Anna Heller, Gertrud Janda, Edith Ladwig, Waltraud Lange, Ingrid Tasselkraut, Margot Werner, Egon Becherer, Otto Brost, Hans-Josef Feil, Friedrich Forell, Karl Josef Früh-

ling, Gerhard Fülbier, Emil Geppert, Werner Göpfert, Jörg Harmsen, Gerhard Klinger, Eberhard Krön, Wolfgang Longrée, Theodor Nonn, Dr Martin Otto, Hans Rick, Günther Schütze, Hans Senftleben, Oswald Urban, Günter Wagner and Theodor Weidmann.

We will always remember them with gratitude.

#### NEW STRATEGY IMPLEMENTED FOR KfW'S COMPUTING CENTRES.

The operation of computing centres must constantly be adjusted to the growth of the enterprise and to the most recent findings on operational risks.

A major milestone for the safety and growth of KfW's computing centres was thus reached in the first half of 2006. One of KfW's computing centres, which were already fully mirrored within KfW, has now been transferred to rooms located at a reasonable safe distance outside KfW.

In addition to providing scope for further growth, the physical separation significantly increases the safety and availability of the computing centres in the context of possible threat scenarios. Even if an entire computing centre were to break down, the critical IT systems of KfW would be back in operation within a very short time. Valuable office space on KfW's premises has been cleared, permitting additional cost advantages to be realised.

#### IN-HOUSE TELEPHONY WITH VOICE OVER IP.

The use of internet and intranet telephony is spreading. The development and application of voice over IP technology is driven by optimisations achieved in the close integration between PCs and telephones and by cost reductions in day-to-day operation. In August 2006 KfW Ban-

kengruppe started operating a new telephone system with approximately 4,500 telephones on the basis of these new technologies. The telephone system is run by KfW's computing centres, which are particularly well secured as they operate with redundant hardware.

#### KfW INTRODUCES INTERNET BANKING PLATFORM.

Since April 2006 customers have been able to apply for KfW loans online through an internet banking platform. The loans that are available through this platform are student loans channelled through an accredited marketing partner.

After the marketing partner has forwarded the applications to KfW, they are put through KfW's internal loan processing systems. For this purpose KfW has established a link to the automatic applications processing and approvals system.

In addition, students can use the portal to manage their loans online and send in their study records or address details and enter changes in their disbursement schedules. They are required to authenticate themselves by entering PINs and TANs.

The technology meets the highest safety and availability demands, making the internet portal available on a 24/7 basis.

# THE SITUATION OF KfW AND KfW BANKENGRUPPE IN 2006.

## SURVEY.

KfW Bankengruppe is composed of KfW and six affiliated enterprises. As before, the course of its business continues to be clearly dominated by KfW. Major deviations in the course of business and the situation of the KfW Bankengruppe and KfW are described below.

### Composition of KfW Bankengruppe

Balance sheet total in EUR million

	31 Dec 2006	31 Dec 2005
KfW	358,774	340,316
<b>Subsidiaries</b>		
Finanzierungs- und Beratungsgesellschaft mbH (FuB)	47	48
KfW International Finance Inc. (KfW-Finance)	3,008	22,693
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH (DEG)	2,672	2,221
tbg Technologie-Beteiligungs-Gesellschaft mbH (tbg)	600	718
KfW Beteiligungsholding GmbH	1,436	1,490
KfW IPEX-Beteiligungsholding GmbH	33	33
<b>Associated enterprises</b>		
IKB Deutsche Industriebank AG	44,788	39,503
Movesta Finance and Lease GmbH	1,842	1,902

## MACROECONOMIC DEVELOPMENTS.

The world economy again expanded strongly in 2006. According to preliminary data, global gross domestic product increased by around 5% in real terms. Thus, growth roughly remained at the high level of the last two years. Besides the robust growth in the USA and Japan and the further strong expansion in China and India, the economic recovery in the euro area also contributed to this.

In 2006 Germany experienced the strongest economic growth since the year 2000. The price-adjusted gross domestic product rose by 2.7%. The SME sector accounted for a large share of the dynamic upswing. This is reflected not only by the very strong improvement in the SME business climate, which reached a new record

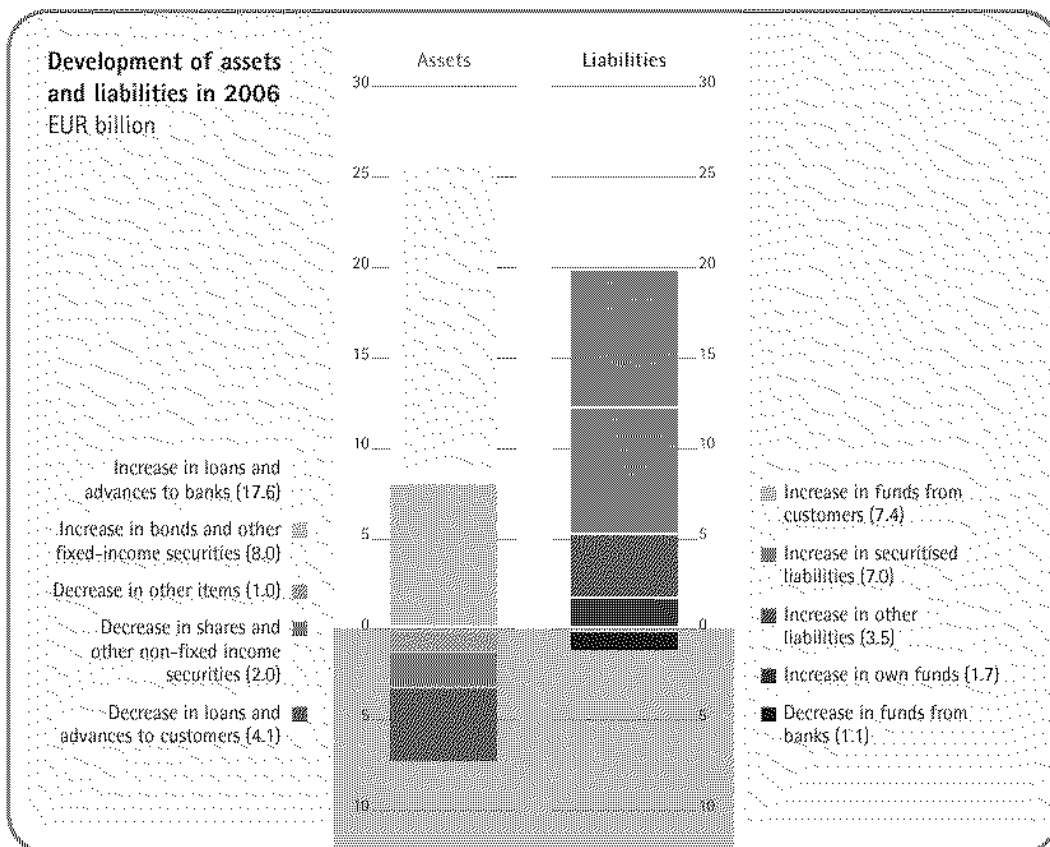
level compared to 2005, but also by the virtually balanced economic mood across all classes of company size. The SME sector is comparatively strongly geared to the domestic markets and, thus, benefited from the fact that domestic demand provided the biggest impulse to growth. This impulse was even stronger than the stimulus from exports, which has always been a reliable driver of growth in recent years and once again made a positive contribution to growth. Private consumption, which was negatively affected for many years by stagnant real wages, has noticeably increased in the course of the turnaround in the labour market, and capital investment even showed the strongest growth since German unification.

## DEVELOPMENT OF KfW BANKENGRUPPE.

During the 2006 business year the balance-sheet total of KfW Bankengruppe increased by EUR 18.5 billion (5%) to EUR 359.6 billion. Domestic investment loans accounted for most of the growth in the lending business; they were EUR 16.0 billion higher than in the previous year, at EUR 203.1 billion. Moreover, the volume of securities treated as fixed assets rose in the course of

the year, especially as a result of purchase of new fixed-income securities held for liquidity management purposes.

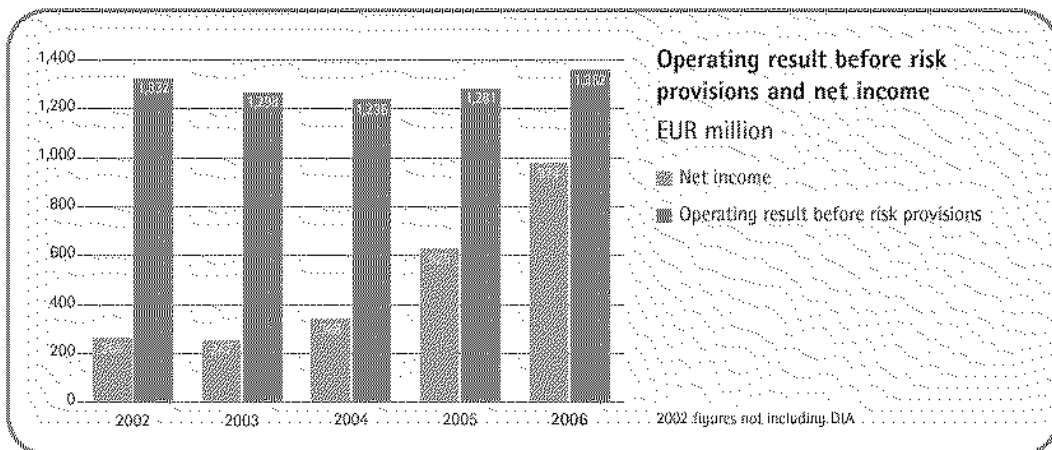
Due to the asset securitisation transactions conducted in the year under review and the increase in the volume of new loan commitments the volume of business rose by 7% to EUR 485.3 billion.



## The situation of KfW and KfW Bankengruppe in 2006.

KfW Bankengruppe looks back upon a very successful business year. The positive development of the Group's earnings position is marked by significantly lower risk provisions as the risk situation has generally improved, and by an increase in income from current operations. The Group's income from current operations before risk provisions was EUR 1.352 billion, thus exceeding the previous year's figure by EUR 71 million. Interest income and net commissions received were EUR 81 million higher than in the previous year. Administrative expenses rose moderately by EUR 12 million (2%) to EUR 594 million in the year under review. The result from

risk provisions and valuations improved substantially and reached EUR 306 million, which was EUR 297 million (49%) lower than in the previous year. The positive overall result is mainly due to the further improvement in the risk situation in the lending business, especially in export and project finance and private equity finance. Overall, as in previous years, careful account was taken of all identifiable risks. As a result of the improved risk situation net income for the year rose to EUR 974 million, a substantial increase over the previous year's figure of EUR 625 million.



## THE VOLUME OF LENDING.

The volume of lending of KfW Bankengruppe (loans and advances, including loans on a trust basis and guarantees) rose to EUR 344.9 billion (previous year: EUR 328.9 billion).

### Volume of lending of KfW Bankengruppe 2006

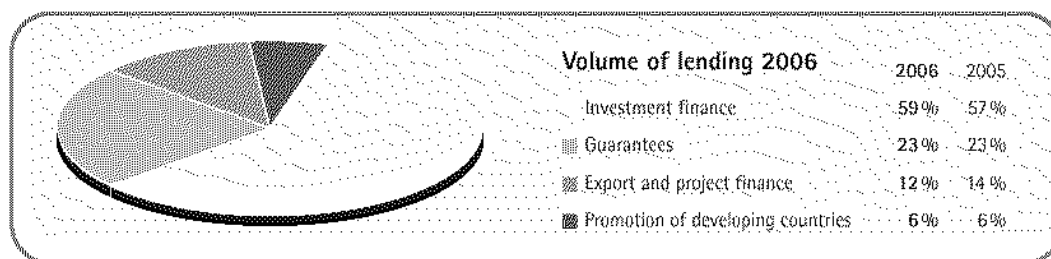
EUR million and %

	31 Dec 2006	31 Dec 2005		Change
	EUR million	EUR million	EUR million	in %
Promotion of the German economy				
▨ Investment finance	203,091	187,135	15,956	9
▨ Export and project finance	42,039	46,114	-4,075	-9
Loans to promote the developing countries	20,605	21,521	-916	-4
Guarantees	79,185	74,170	5,015	7
<b>Total volume of lending</b>	<b>344,920</b>	<b>328,940</b>	<b>15,980</b>	<b>5</b>
of which: loans on a trust basis	7,365	8,304	-940	-11

This increase was mainly the result of the increase of EUR 16.0 billion in investment loans to the German economy (to EUR 203.1 billion), which was mainly due to the high volume of commitments in the context of the promotional initiative "Housing, Environment, Growth". The share of domestic investment loans in the total lending volume of KfW Bankengruppe rose to 59%. Another growth factor was guarantees, which rose by EUR 5.0 billion to EUR 79.2 billion. As in 2005 guarantees, which are mainly related

to the securitisation activities of KfW, accounted for a share of 23% of the lending volume.

Despite the positive development of new commitments, the volume of export and project finance, which accounted for 12% of the lending volume, fell by EUR 4 billion to EUR 42 billion, due to the weaker US dollar. Loans to promote the developing countries (6% of the volume of lending) remained almost constant compared to the previous year.



## FUNDING.

In the year under review, too, the expansion of the volume of business of KfW was refinanced mainly through the issuance of bonds and notes in the capital market. In 2006 KfW Bankengruppe raised long-term funds in a total amount of EUR 54.2 billion, and was thus at the upper end of the corridor of EUR 50 to 55 billion announced in the previous year.

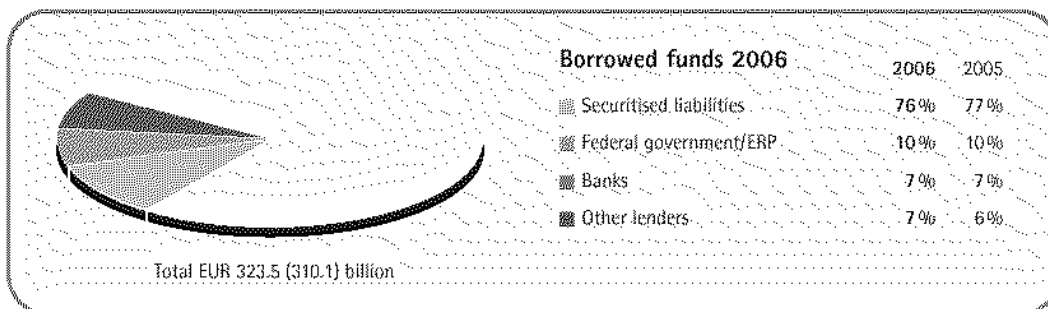
Bonds and notes issued were the main source of funds, accounting for EUR 246.0 billion (an

increase of EUR 7.1 billion) or 76% of borrowed funds (2005: 77%). Of this, EUR 3.0 billion was issued by KfW International Finance. The share of funds borrowed from banks and customers (without federal funds) remained almost unchanged at 14%. The funds provided from the federal budget and the ERP Special Fund amounted to 10% of borrowed funds as in the previous year.

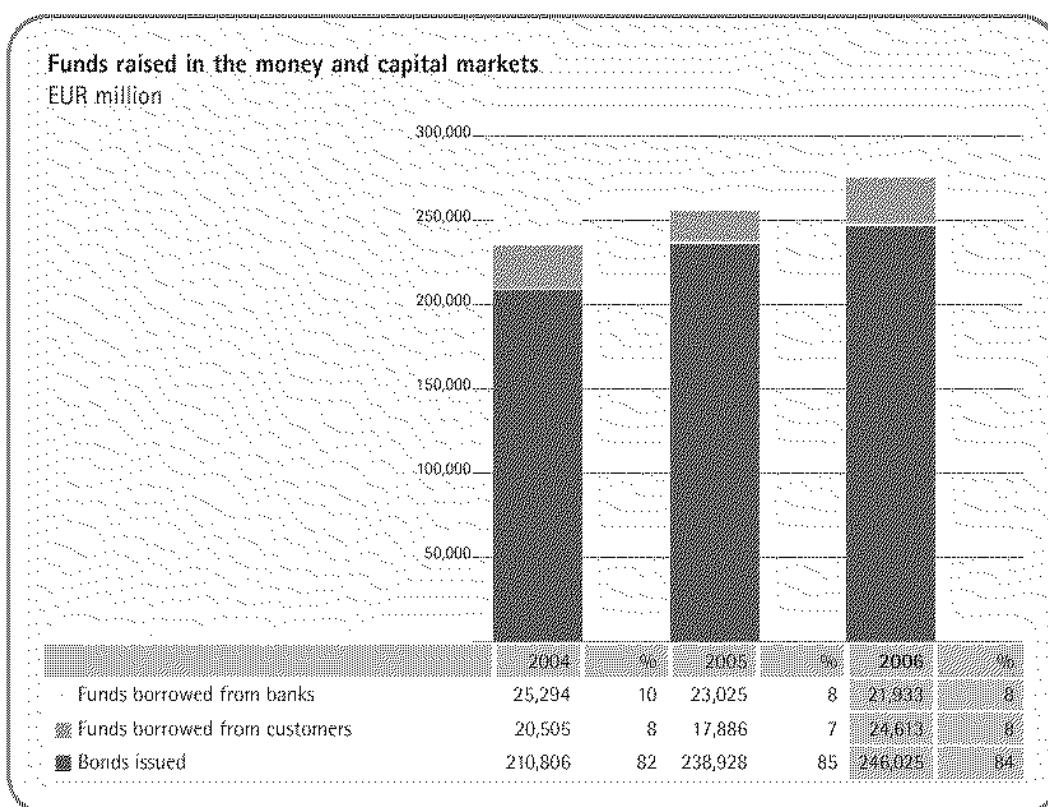
### Borrowed funds 2006

EUR million and %

	31 Dec 2006	31 Dec 2005		Change
	EUR million	EUR million	EUR million	in %
<b>Federal Republic of Germany</b>				
▣ ERP Special Fund	16,832	16,179	653	4
▣ Federal budget	14,089	14,071	18	0
	<b>30,921</b>	<b>30,250</b>	<b>671</b>	<b>2</b>
Other lenders	24,614	17,886	6,728	38
<b>Funds borrowed from customers</b>	<b>56,535</b>	<b>48,136</b>	<b>7,399</b>	<b>15</b>
<b>Funds borrowed from banks</b>	<b>21,933</b>	<b>23,025</b>	<b>-1,092</b>	<b>-5</b>
Bonds issued	81,847	101,854	-20,007	-20
Bearer securities (incl. Kassenobligationen and Commercial Paper)	160,079	133,258	26,821	20
Accrued interest	4,099	3,816	283	7
<b>Bonds and notes</b>	<b>246,025</b>	<b>238,928</b>	<b>7,097</b>	<b>3</b>
<b>Total</b>	<b>323,493</b>	<b>310,089</b>	<b>13,404</b>	<b>4</b>



The share of funds raised in the money and capital markets remained almost unchanged at 90%.



#### OWN FUNDS.

In the year under review KfW Bankengruppe continued to substantially increase its own funds (paid-in subscribed capital, reserves and the fund for general bank risks pursuant to § 340 g of the German Commercial Code). They now amount to EUR 15.3 billion. The increase of EUR 1.7 billion (13%) results from the allocation of EUR 55 million to the reserves from the ERP special fund, the allocation of KfW's net income of EUR 822 million to the special reserves and the increase of EUR 152 million in the other retained earnings through the inclusion of the

subsidiaries and the capital consolidation. In addition, in 2006 the amount of EUR 700 million was allocated to the fund for general bank risks, which is disclosed in the balance sheet, mainly through the reallocation of internal reserves set aside for risk provisioning, which did not affect the income position. KfW's own funds amount to a total of EUR 14.5 billion. The requirements on equity capital and reserves for banks operating internationally are well fulfilled by KfW and the Group.

#### Own funds 2006 EUR million

	31 Dec 2006	31 Dec 2005	Change
KfW's subscribed capital	3,750	3,750	0
Outstanding contributions, not requested	- 450	- 450	0
Capital reserves	1,604	1,604	0
Reserve from the ERP Special Fund	758	703	55
Retained earnings			
a) Statutory reserve under § 10 (2) KfW Law	1,574	1,087	487
b) Statutory reserve under § 10 (3) KfW Law	1,893	1,559	334
c) Statutory reserve under § 17 (4) DM Balance Sheet Law <sup>*)</sup>	48	48	0
d) Other retained earnings	851	699	152
Fund for general bank risks under § 340 g HGB	5,300	4,600	700
<b>Total</b>	<b>15,328</b>	<b>13,599</b>	<b>1,729</b>

<sup>\*)</sup> To be adjusted for the special loss account shown on the Assets side in accordance with § 17 (4) of the DM Balance Sheet Law (EUR 27 million).

## CHANGES IN OTHER MAJOR BALANCE SHEET ITEMS.

The holding of money market paper, bonds and debentures of other issuers increased by EUR 8.2 billion to EUR 33.4 billion. The majority of the securities are held for liquidity management purposes. These securities are assigned to the Treasury securities portfolios, which are maintained mainly in euros and to a small extent in US dollars. The securities of the euro portfolio can largely be used as collateral in funding operations with the European Central Bank. This applies to 84% of the total portfolio of money market paper, bonds and debentures. In addition to its Treasury securities portfolios, KfW holds a portfolio of asset-backed securities in connection with its securitisation activities.

For the purpose of supporting the price of its own issues KfW held EUR 4,622 million par value of its own bonds at the end of the year (EUR 4,821 million in the previous year). This was 2% of the bonds and notes issued by KfW Bankengruppe.

The item shares and other non-fixed income securities of KfW Bankengruppe fell in 2006 by EUR 2.0 billion to EUR 19.5 billion. This is mainly due to the sale of shares of Deutsche Telekom AG and Deutsche Post AG in the course of the privatisation of these companies (EUR 4 billion). The externally administered special und money

market funds held to ensure constant liquidity for KfW rose by EUR 2.3 billion to EUR 6.7 billion.

The major part of the prepaid expenses and deferred charges is interest expenditure mainly for leasing obligations in project finance applicable to the following period. The item also includes differences between issue amounts and repayment amounts incurred in the context of borrowing transactions (discounts and placing commissions). The item deferred income shows in particular the discounts from lending operations deferred over the loan terms.

Provisions increased by EUR 12 million to EUR 949 million against the previous year. Allocations to accrued estimated liabilities amounted to EUR 159 million, EUR 71 million of which was provisions for staff pensions and EUR 88 million was mainly unsettled bank operating and payroll expenses, provisions in KfW's lending and private equity finance business and provisions for tax. EUR 86 million was used while EUR 61 million was returned to income.

The assets on a trust basis (EUR 7.5 billion) fell by approximately EUR 0.9 billion against the previous year. The item comprises in particular loans on a trust basis extended in the context of the promotion of developing countries.

EARNINGS POSITION.

Earnings position 2006

EUR million and %

	2006	2005		Change
	EUR million	EUR million	EUR million	(in %)
Interest income <sup>1)</sup>	13,364	12,299	1,065	9
Interest expenses	11,669	10,661	1,008	9
<b>Net interest income</b>	<b>1,695</b>	<b>1,638</b>	<b>57</b>	<b>3</b>
Net commissions	227	203	24	12
Net earnings on financial transactions <sup>2)</sup>	-2	2	-4	-200
General administrative expenses	594	582	12	2
Other operating income and expenses	26	20	6	30
<b>Income from current operations before risk provisions/valuations</b>	<b>1,352</b>	<b>1,281</b>	<b>71</b>	<b>6</b>
Risk provisions/valuations, net <sup>3)</sup>	-306	-603	297	-49
<b>Income from current operations (= Income on normal business transactions)</b>	<b>1,046</b>	<b>678</b>	<b>368</b>	<b>54</b>
Contractual allocation of interest to the reserve from the ERP Special fund	55	49	6	12
Taxes on income and profits	17	4	13	325
<b>Net income for the year</b>	<b>974</b>	<b>625</b>	<b>349</b>	<b>56</b>

<sup>1)</sup> Balance of interest income on lending and money market transactions, fixed-income securities and debt register claims and current income from shares and other non-fixed income securities and investments.

<sup>2)</sup> Balance of gains and losses on currency conversion.

<sup>3)</sup> Including write-downs on the special loss account and allocation to the fund for general bank risks in accordance with § 340g HGB.

The Group's income from current operations before risk provisions and valuations was EUR 1,352 million, an increase of EUR 71 million over the previous year (KfW: increase of EUR 60 million or 5% to EUR 1,222 million).

Net interest received, which is the most important source of income of KfW Bankengruppe, developed positively and rose by EUR 57 million or 3% to EUR 1,695 (2005: EUR 1,638 million) though the US dollar was weaker than in 2005.

Net commissions received rose by EUR 24 million (12%) to EUR 227 million mainly as a result of higher guarantee commissions received and higher handling fees earned on export loans.

Administrative expenses amounted to EUR 594 million, which was 2% higher than in the previous year. This included a rise in personnel expenditure of EUR 11 million (3%) to EUR 362 million as a result of the growth in the number employed and adjustments of wages and salaries for staff on collectively agreed rates and performance-related rates. Expenditure on material and equipment rose slightly by EUR 1 million to EUR 231 million mainly due to consulting expenses relating to the implementation of regulatory requirements (among others, the change-over of accounting to IFRS, Basel II and the separation of KfW IPEX-Bank).

**Administrative expenses 2006**  
EUR million and %

	2006	2005	Change
	EUR million	EUR million	
Wages and salaries	270.3	260.1	3.9
Social security contributions	40.4	39.3	2.9
Expenses for pensions and support	51.7	51.7	0.0
<b>Expenditure on personnel</b>	<b>362.4</b>	<b>351.1</b>	<b>3.2</b>
Other administrative expenses	198.2	194.1	2.1
Depreciation on buildings and equipment	33.1	36.4	-9.3
<b>Expenditure on material and equipment</b>	<b>231.3</b>	<b>230.5</b>	<b>0.3</b>
<b>Administrative expenses</b>	<b>593.7</b>	<b>581.6</b>	<b>2.1</b>

## RISK PROVISIONS AND VALUATIONS.

The risk provisions and valuations are composed of the following items in the statement of income:

- write-downs and value adjustments on loans and certain securities and increase of allowances for possible loan losses (including allocation to the fund for general bank risks),
- write-downs and value adjustments on investments, shares in affiliated enterprises and securities treated as fixed assets,
- earnings on allocations to investments, shares in affiliated enterprises and securities treated as fixed assets.

The risk provisioning and valuation result improved substantially against the previous year and has almost halved at EUR 306 million (previous year: EUR 603 million).

This development was due to the generally improved risk situation in the lending business, especially in export and project finance and private equity finance. The net transfer to specific

loan loss provisions, which again decreased against the previous year, underscores this positive development. In addition, successful exits of equity investments of DEG again contributed to the improved valuation result in the year under review.

Compared with 2005, specific loan loss provisions and allowances for possible loan losses for the Group fell by EUR 0.1 billion to EUR 1.4 billion (previous year: EUR 1.5 billion). Again the bulk of provisions were for aircraft and equity finance. Net provisions made for the Group fell sharply to EUR 34 million (previous year: EUR 226 million). During the year under review non-performing loans and advances totalling EUR 356 million (2005: EUR 799 million) were written off. Payments received by KfW on claims that had been written off amounted to EUR 24 million in the year under review (previous year: EUR 34 million).

With a view to the forthcoming changeover of accounting to IFRS in 2007 KfW Bankengruppe has largely completed the reallocation of internal reserves to the fund for general bank risks, which was increased by EUR 700 million in the year under review. KfW made adequate provision for all acute and latent risks, while consistently pursuing its conservative risk policy and in observance of the high requirements on transparency under IFRS. Thus, the fund for general bank risks has attained at total volume of EUR 5.3 billion. In this way KfW ensures that it can cope with possible stress situations and still fulfil its promotional tasks on a sustainable basis.

After risk provisions and valuations the Group's income from current operations was EUR 1,046 million, a substantial increase of EUR 368 million (54%) over the previous year's result.

The Group's net income for the year is EUR 974 million compared with EUR 625 million in the previous year.

The positive development of the assets, financial and earnings situation is further evidence of the very good overall condition of KfW Bankengruppe. This gives the Group a solid foundation from which to continue its promotional activities in the future.

### EVENTS SINCE THE END OF THE BUSINESS YEAR.

The federal government is planning to reorganise the ERP Special Fund. In this context assets of the ERP Special Fund that have not yet been moved to KfW are to be transferred to KfW as liable capital (EUR 4.65 billion) and another part as subordinated capital. The corresponding draft bill was approved by the cabinet and will now go through the further legislative process. The reorganisation is planned to be implemented in mid-2007.

The draft bill stipulates that the transferred ERP capital has a sole and explicit purpose. Thus, earnings generated by KfW from the transferred funds may be used exclusively for the purpose of ERP economic promotion and to maintain the substance of the ERP Special Fund. The promo-

tional volume and intensity would be maintained without restrictions. The further involvement of politics would be ensured. As in previous years, the economic plan for the ERP promotion would be established by the Federal Ministry of Economics in agreement with the Federal Ministry of Finance and passed by the German Bundestag.

There have been no other events or incidents with a particular effect on the assessment of the assets, financial and earnings situation of KfW Bankengruppe since the end of the 2006 business year. The business development in the first months of 2007 has confirmed the statements made in the forecast report.

(as at 26 February 2007)

## RISK STRUCTURE AND RISK CONTROL.

### RISK MANAGEMENT AND CONTROLLING AS A CORE COMPETENCE IN KfW BANKENGRUPPE.

Measuring and controlling the risks incurred in the context of its promotional objectives is of major importance for KfW. Only if we deal with risk in a well-planned manner will we be able to use KfW's resources optimally to realise our promotional objectives. Systematic risk management is necessary to maintain our risk-bearing capacity and to achieve our promotional objectives on a sustained basis. KfW Bankengruppe is active in the most diverse market segments. In consequence, the bank has a heterogeneous loan portfolio, which has to be controlled throughout the Group on a risk/return basis. The main purpose of the management approach of KfW is the optimised use of the resource 'economic capital'. The available financial resources must cover the economic capital required to cover credit, market and operational risks to obtain the desired solvency level. Banking supervisory requirements, such as the minimum requirements for risk management (MaRisk), constitute secondary requirements for the risk management structures and processes of KfW Bankengruppe.

The business units of KfW are acting in a dynamic environment. Product innovation requires the continuing further development of

risk measurement procedures, and changing banking supervisory parameters place higher demands on the quality of risk management processes and methods. KfW is meeting these challenges by further developing its risk management and controlling in a target-oriented manner. While in previous years both the required risk assessment and control procedures and the organisational bases had been established in accordance with supervisory requirements, the focus in the year under review was on validating these methods. For this purpose the Bank further developed its backtesting procedures. In addition, in 2006 KfW for the first time carried out stress tests for its credit and market risks. In summary, the result of these stress tests is that KfW is in the position to bear its risks also in a difficult cyclical environment.

In order to impart knowledge on risk management and controlling further in KfW and to position it in the organisation of the bank, KfW offers training courses, among others, a module-type programme on risk topics. This enables employees and management staff from the entire Group to acquire orientation knowledge or to deepen expert know-how.

#### THE ORGANISATION OF RISK MANAGEMENT AND MONITORING.

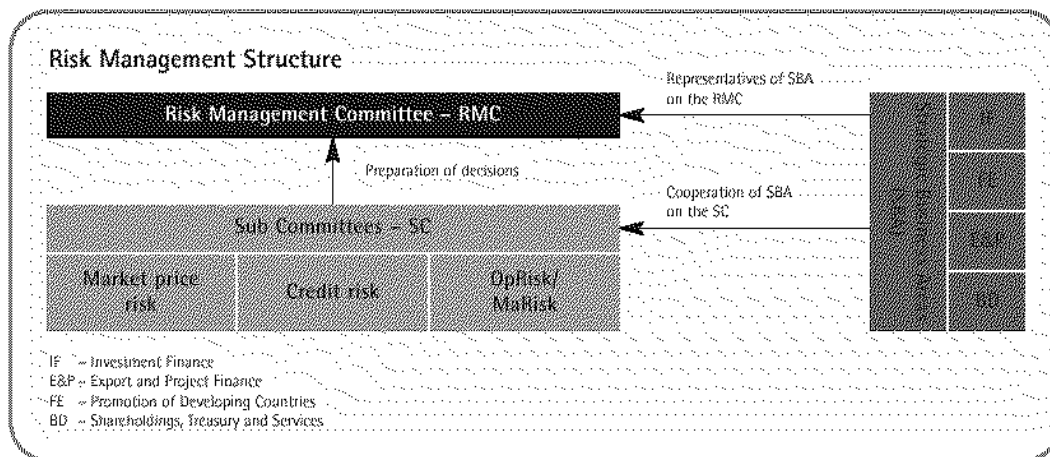
KfW's Board of Managing Directors lays down the risk principles and guidelines as part of its overall responsibility. The supervisory organs – the Board of Supervisory Directors and the Federal Ministry of Finance – are regularly informed of the Group's risk situation.

Risk management at KfW Bankengruppe is exercised by closely intertwined decision-making bodies. On top is the Risk Management Committee (RMC), which is responsible for the entire Group and on which the Board of Managing Directors and representatives from the business areas, some central staff departments and subsidiaries of KfW Bankengruppe are represented. The RMC adopts major changes to existing risk principles and drafts new risk principles, and deals with risk strategy, adjustments to global limits and comparable topics relating to risk management. The RMC receives information, among others, about the development of the lending business, liquidity and limit utilisation and the changes to the risk principles adopted in the subcommittees. The RMC is headed by the KfW Board member in charge of risk controlling. Preliminary work for the RMC is done by the subcommittees (SC) for credit risks, market price risks and in the future also for operational risks. Heads of departments and divisions are represented on the subcommittees in order to ensure that they take their decisions independently. SC

meetings are prepared at the working level; decision papers ensure that the meetings are efficient.

The Market Price Risk Subcommittee (SCM) prepares decision papers on subjects relating to market risk, liquidity and portfolio management. This includes reports on the liquidity and liability situation, the assessment of the interest rate risk and discussion of the currency strategy to be pursued in the funding. The Credit Risk Subcommittee (SCK) deals with credit risk and portfolio management, for example by taking decisions on the design of systems for limit management and collateral assessment and by preparing decisions on global limits and portfolio guidelines for the RMC.

In the context of risk measurement and controlling reports on the risks incurred and the risk-bearing capacity of KfW Bankengruppe are presented at least at quarterly intervals. In these reports the most relevant categories of risk (credit risk, market risk, operational risks) are quantified for the entire KfW Bankengruppe and matched against available financial resources. On this basis and with a view to the expected business and market developments recommendations for action are derived. On the basis of this information the committees assess the existing scope for KfW's business policy and decide about risk control measures.



Moreover, the subsidiaries of KfW Bankengruppe 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 behaviour, for instance in the roll-out of rating instruments to subsidiaries or the management and assessment of collateral.

The group-wide framework for dealing with risks is laid down in a risk manual, which is continuously being developed further and can be accessed by all employees at any time. The rules and regulations laid down in the risk manual are binding for the entire Group. The core of the risk manual are the risk principles (normative

rules for loan processes and risk management processes) and portfolio guidelines (e.g. prohibitions, collateral requirements, etc.). The risk principles and portfolio guidelines constitute the framework for the operating activities of all business units. The purpose of the risk manual is to ensure that uniform procedures are being applied to identify, measure, control and monitor risks. In addition, bank-wide regulations are supplemented by specifications for the individual business units, which are monitored in the framework of a decentralised application control by the Risk Management and Controlling department (RC).

### RISK MANAGEMENT.

The risk management department formulates and regularly reviews the risk strategy of KfW Bankengruppe. The risk strategy formulates the objectives pursued when entering into risks, provides the risk-policy framework (risk principles/portfolio guidelines) and specifies the implementation measures to be taken. Counterparty and portfolio-related control measures (the second vote for loan approvals, a limit management system, stress

tests, etc) ensure that new risks assumed are within acceptable limits, an undesired concentration of individual risks is avoided and the ability to act is maintained even if cyclical conditions deteriorate substantially. To improve the risk profile and to expand the scope for action the portfolio is actively managed through the use of credit derivatives.

### RISK CONTROLLING.

The risk controlling is responsible for the central measuring and reporting of all risks/risk groups at KfW Bankengruppe. The risk reporting is conducted in the framework of the risk report, which is drawn up quarterly in accordance with the regulatory requirements (MaRisk) and submitted to the Risk Management Committee and the supervisory bodies of KfW. In addition, the risk controlling ensures that the methods applied in the risk analysis are consistent throughout the Group. The risk controlling is responsible for the correctness and completeness of all key risk variables used in the management of the Bank (methodological and data sovereignty). For this purpose the risk controlling regularly validates the instruments and methods used and develops

them further. In the context of operative risk controlling activities, the achievement of the planning targets defined in the group-wide strategic business area planning is monitored at regular intervals (performance reporting). At the Group level it is monitored whether the planned balance between the income generated by the market operations and the expenditure for promotional purposes is being maintained. Moreover, the economic capital usage is monitored and compared with the budgeted capital and, if necessary, interventions can be made (e.g. reallocation of capital). In addition, the performance reporting forms the basis for assessing the performance of the individual areas of business.

### INTERNAL AUDITING.

The Internal Auditing Department, as an instrument of the Board of Management, is not bound by instructions and works independently of processes. It reviews all processes and activities of KfW using a risk-oriented approach and reports directly to the Board of Management. The focus is on the assessment of the effectiveness and suitability of the risk management and the internal control system. In 2006 the focus was on further developed procedures/methods to

measure, manage and control risks, the promotional business and the further development of IT. While maintaining its independence the Internal Auditing Department monitored important processes in the Bank. In its capacity as Group auditing department, the Internal Auditing Department of KfW coordinates and controls the establishment and further development of instruments, methods, procedures and standards applied in internal auditing at KfW Bankengruppe.

#### KFW'S RISK MANAGEMENT APPROACH.

Risk management at KfW pursues one central goal: Maintaining our risk bearing capacity. In the pursuit of its business activities KfW only takes as much risk as it can back up with capital. When analysing the risk-bearing capacity the risks are measured and matched against the available financial resources. The risk of loss is measured by means of two risk parameters, the expected loss and the required economic capital.

The expected loss is the average loss statistically expected to occur over a longer period of time. Expected losses only play a role in the quantification of the credit risk. Expected losses are calculated, among others, for the pricing and are covered by the risk margin. The expected loss is defined as the product of the probability of default of a borrower, the exposure at default and loss given default. The probability of default is estimated for every borrower by means of rating procedures. The central result of the rating procedure is a statement about the probability that a counterparty cannot meet its payment obligations in the next twelve months. The estimation of the loss given default is based in particular on the assessment of collateral value and guarantees. Expected losses are not backed by capital because they are, on average, offset by the risk margins on non-defaulting loans (insurance principle).

In case the losses incurred in any one year exceed the expected loss these losses are covered from the Bank's own resources. The risk controlling department quantifies the potential loss to be backed by capital by means of statistical models. For credit risks, the potential loss is calculated using a credit portfolio model and the risk measure 'Credit Value at Risk' at a given confidence level. The difference between the credit value at risk and the expected loss is the required economic capital.

KfW uses a similar procedure in the area of market price risk calculating the value at risk by means of statistical models. As it is not possible to calculate expected losses for the market price risk, the value at risk is equal to the required economic capital.

A one-year forecast period is used for both types of risk. The underlying confidence level is 99.99%, which corresponds to AAA standard. The capital required to cover credit and market price risks is aggregated taking into account diversification effects. The capital required to cover operational risks is calculated using the regulatory standard approach of Basel II. The required economic capital is matched against the available financial resources.

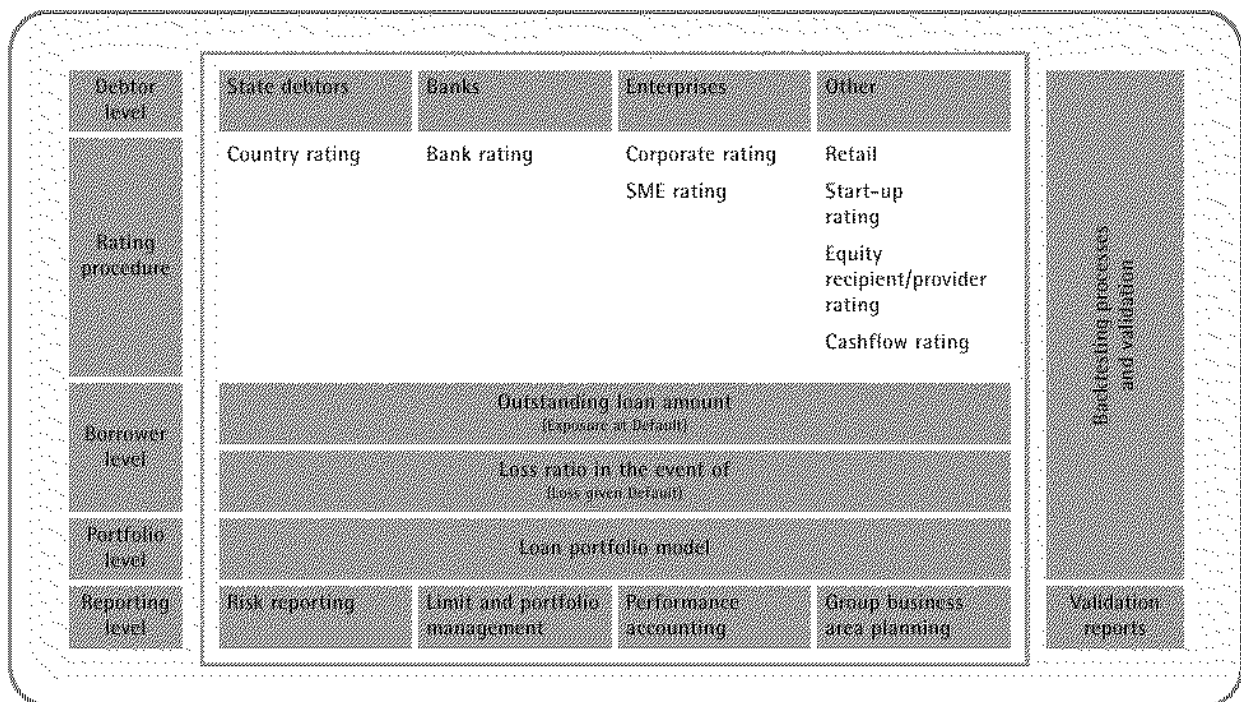
Throughout the business year 2006 the required economic capital was matched at any time by sufficient financial resources. In addition, KfW ensures in the framework of the Group business area planning that its risk-bearing capacity is maintained in the future, too. KfW covers liquidity and other risks by monitoring suitable key figures and through regular checks on processes in the Bank's operation.

KfW is continuously working to further develop its risk models. This is necessary because all models are subject to fundamental limitations when describing risks. This applies to both model assumptions in a narrower sense and the assumption that the risk parameters observed in the past will also be representative for the future. It is not possible to identify all possible influencing factors and their complex interactions with regard to the risk development of a portfolio and to include them in a model. For this reason, too, KfW uses stress tests in both the credit risk models and the market risk models.

THE COUNTERPARTY DEFAULT RISK.

KfW enters into counterparty default risks<sup>1)</sup> in the context of the bank's promotional task. In the 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 private equity finance. In addition, KfW enters into risks in particular in the context of export and project financing and increasingly also in Financial Cooperation by granting promotional loans.



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

The assessment of the default risk of the credit exposures is performed through internal rating procedures, in which the country risks and individual corporate or project-related risks are assessed separately. For the assessment of the credit risk KfW has a computerised rating procedure specially designed for each homogeneous customer segment or type of financing. KfW uses specific rating procedures for banks, corporates, small and medium-sized enterprises (SME), equity providers, equity recipients, business start-ups and countries. These procedures are based on scorecards and follow a uniform and consistent model architecture. A cashflow based rating procedure is used for project financings, in which the financial soundness of a project financed is determined on the basis of cashflow projections. The rating procedures are calibrated to a one-year default probability.

By showing the default probability on a master scale, which is uniform for the entire Group, it is possible to ensure the consistency of the individual rating procedures. The master scale is composed of 20 different classes, which can be combined into four groups (investment grade, speculative grade, watch list and default). Each master scale class is based on an average default probability which, taking into account the different rating procedures, is subject to a validation process. There are exact organisation regulations for each rating procedure, which specify in particular the responsibilities, competences and control mechanisms. By validating the rating procedures at regular intervals and developing them further it is ensured that there is a rapid response to any changes in framework conditions. The aim is to continuously improve the selectivity for all rating procedures. Our rating instruments and processes largely meet the minimum requirements of the applicable supervisory standards (MaRisk/Basel II).

The risk report contains risk information in an aggregated form on large parts of the portfolio, i.e. broken down by areas of business, industries, regions, etc. Detailed information is provided about important individual counterparties or credit exposures that entail a higher risk. This ensures that management is informed regularly and promptly of risk incurred. In individual cases, ad-hoc reporting is also possible. Higher risk exposures are subject to more intensive monitoring in order to reduce the risks to KfW. The instrument used in this context is the so-called watch list. If restructuring cannot be avoided, the problem loans are transferred to specialists for further treatment and the exposures are added to the list of non-performing loans.

The risk properties of KfW's individual exposures are assessed by means of an internal portfolio model. On the basis of the concept of economic capital, the risk controlling department assesses the risk concentrations by individual borrower, industry and country. The results form the basis for managing the loan portfolio and are included in the limit management system to limit concentration risks. On the basis of the limit management system global limits are defined, which are to prevent losses that put the continuation of the bank at risk. The respective limits are derived from the risk-bearing capacity of KfW. The global limits provide a framework for managing the counterparty risks.

In the framework of economic risk measurement stress tests with different stress scenarios were implemented for the first time in the year under review. The results of these stress tests are included in KfW's analyses on its risk-bearing capacity in order to ensure that KfW's capacity to act is maintained also in a difficult cyclical environment.

In addition, KfW uses further instruments to control the default risk. KfW has several portfolio guidelines to limit the 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 also have the tasks of ensuring an adequate quality and risk structure of KfW's portfolio<sup>21</sup>. Differentiated by types of counterparties and product variants the guidelines define conditions under which business transactions may in general be conducted. A risk principle for credit securities governs the group-wide uniform management, valuation and netting of securities. The default risks on securities investments and derivatives are limited by a restrictive choice of counterparties, all of whom are of first-class standing, and through collateral agreements.

Besides determining the risk-policy framework, risk control is also responsible for active portfolio management. One major objective is to reduce concentration risks. In this context credit derivatives (single name CDS) are used to hedge individual counterparty risks.

All identifiable acute and latent default risks in the lending business are adequately taken account of by making loan loss provisions. Specific loan loss provisions are made for exposures with acute risk of default (non performing loans<sup>22</sup>). Specific loan loss provisions are made by means of an impairment tool. The calculation of specific loan loss provisions is also based on the individual assessment of the borrower's ability to make payments in the future. Equally taken into account is the collateral provided and political risks, if any, in the event of financings abroad. The provision for latent risks is derived from the evaluation of the loans and advances, as part of the annual rating process.

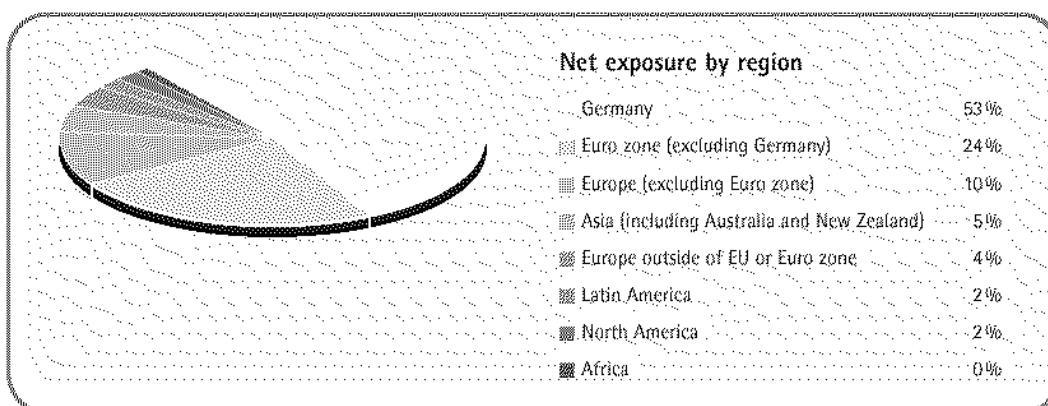
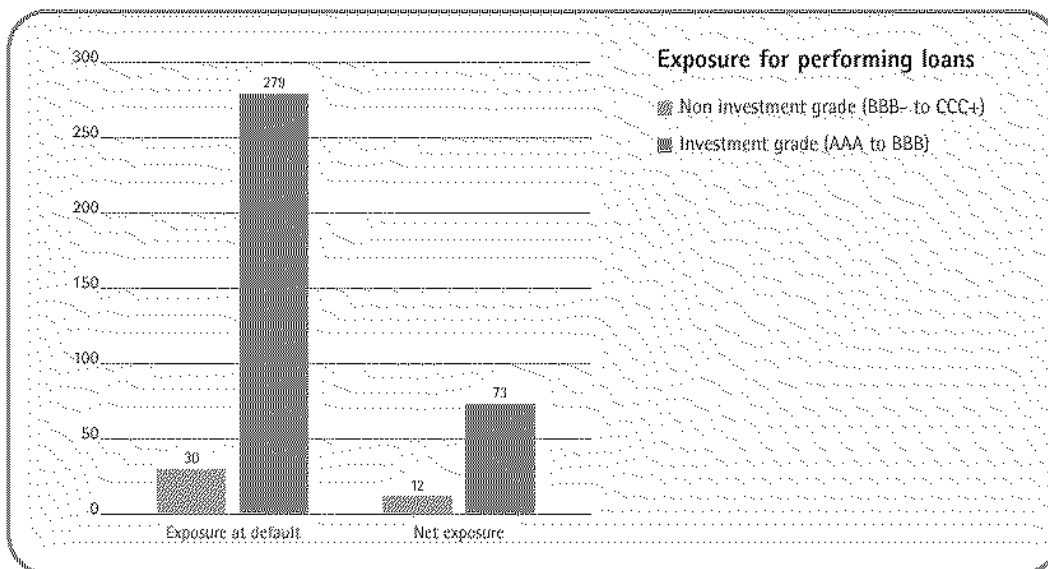
Of EUR 312 billion loans and advances (EAD) of the Group, EUR 3.0 billion were classified as non-performing loans during the 2006 business year. The potential defaults on these non-performing loans extended in the lending and private equity business have been conservatively assessed and specific provisions of a total of EUR 1.4 billion have been made.

In addition to the provision for acute default risks, KfW Bankengruppe also makes provisions for latent default risks (economic and political risks). In the future, provisions for latent risks will be calculated according to IFRS on the basis of the concept of expected losses. This figure deviates from the expected loss as calculated in our internal risk control department by the adjustments made according to the provisions of IAS/IFRS. The expected loss calculated in the internal risk control department for the performing loans as at 31 December 2006 was EUR 366 million, EUR 53 million of which covered political risks. On average, more than 70% of the loans in the KfW portfolio are collateralised while just under 30% are uncollateralised. Looking at this uncollateralised portion of KfW's loan portfolio (net exposure), 86% of the counterparties have a rating in the investment grade range. This corresponds to a rating range of external rating agencies (e.g. S&P) between AAA and BBB.

In terms of net exposure, approximately 77% of the loans in the portfolio of KfW Bankengruppe are extended to countries in the euro zone (chart 2). Thus, with regard to the regional structure the risks in the loan portfolio are moderate.

<sup>21</sup> Here, account is taken of the special features of KfW's promotional lending business.

<sup>22</sup> This is done on the basis of default criteria that satisfy both Basel II and IAS/IFRS requirements.



#### MARKET PRICE RISKS.

Market price risks arise mainly from potential losses caused by changes in

- the interest rate structure (risk of changes in interest rates),
- exchange rates (currency risks) and
- other market prices (e.g. equity prices, raw material prices).

KfW and its subsidiaries are not commercial banks under the Commercial Code; consequently their market price risks are limited to the banking book.

#### INTEREST RATE RISKS.

The interest rate risk is the main component of the market price risk. KfW Bankengruppe engages in maturity transformation mainly in the Euro interest rate book. With regard to the overall risk of KfW this allows the Bank to diversify its credit risks. In addition, the interest rate risk is influenced by the special nature of the domestic promotional loan business, which offers the possibility of loan repayment ahead of schedule. KfW takes this into account in the Group's risk management by including the estimated volume of off-schedule repayments in its funding strategy.

As regards the identification of interest rate risks on the banking book KfW uses standard software, which is connected to all data relevant for risk assessment. On this basis KfW carries out regular value-at-risk calculations for the Group's risk position using an interest structure model and manages its funding decisions accordingly. This is complemented by regular stress tests, which help to estimate possible losses under extreme market conditions.

#### CURRENCY RISKS.

Foreign currency loans are funded in the same currency or secured by appropriate foreign currency hedging instruments. This also applies to specific loan loss provisions, for which the corresponding "ersatz" assets are provided. Exchange rate risks mainly occur on margins achieved in the lending business and commissions earned in US dollar. In general no major impacts are to be expected for other currencies.

The risks from open currency positions are measured by means of a variance-covariance approach in the form of a value-at-risk calculation.

#### OTHER MARKET PRICE RISKS.

Besides listed shares held in asset allocation and shares in IKB, the other market price risks of KfW Bankengruppe comprise CO<sub>2</sub> certificates held by KfW. Risks from CO<sub>2</sub> certificates are incurred because KfW has decided to act as an intermediary between CO<sub>2</sub> sellers and buyers and holds the certificates in its portfolio.

The other market price risks – with the exception of CO<sub>2</sub> certificates – are measured by means of a variance-covariance approach in the form of a value-at-risk calculation. The risks from CO<sub>2</sub> certificates are quantified using a maximum loss approach (biggest decline in value observed in the past).

The risk controlling department assesses and analyses the interest rate and currency positions

and makes stress tests for interest rate risks. On this basis the Risk Management Committee controls and manages the market risks for KfW Bankengruppe. The objective is the long-term management of the Bank's overall market risk position and the investment of own funds. For this purpose a global limit system was developed, which serves to monitor and manage all market risks.

For the transaction, handling and settlement of trading activities in the sense of the minimum requirements for risk management (MaRisk) the Board of Managing Directors has issued general conditions that are largely in line with market standards.

#### LIQUIDITY RISK<sup>41</sup>.

The liquidity risk at KfW Bankengruppe is controlled by the individual subsidiaries with KfW being available as a partner. KfW uses different instruments and criteria to monitor and control its liquidity position and its funding need. This is based on a computerised liquidity control system, which analyses all known current and future payment flows. Any payment flows expected in addition, such as new lending transactions, off-schedule repayments, exercise of termination rights, etc, are estimated and added to the known payment flows. On the basis of these data a liquidity plan is established at daily, monthly and annual intervals. If required, ad hoc analyses may also be made at any time.

KfW also supervises its liquidity position following the instructions in the KfW Law, and, at monthly intervals, calculates the key liquidity

figures in accordance with Principle II of the German Banking Law (KW-Grundsatz II). In the year under review the relevant liquidity figures were above the minimum requirement.

To maintain its liquidity KfW holds an adequate stock of money market paper and liquid securities that are Category I securities eligible as collateral with the European Central Bank, both for residual funding and for regular open market transactions. KfW also holds liquid US dollar securities as a liquid reserve for its US dollar business. The required liquidity cushion is assessed regularly and calculated in order to make sure that also in the event of an assumed extraordinary market disruption KfW's operations in terms of refinancing can be continued as planned. The Risk Management Committee monitors the liquidity management activities.

<sup>41</sup> The liquidity risk is the risk that current or future payment obligations cannot be met in time, in full or only at very high cost.

#### OPERATIONAL AND OTHER RISKS.

Besides the typical banking risks the management of operational risks plays an increasingly important role in banking practice and in the context of developing banking supervisory instruments (Basel II). Besides general operating risks this category chiefly consists of risks that can arise from single events (fraud, computer failures, natural catastrophes, etc) and legal risks.

The operating risks within the Group are limited by an internal control system. The IT system is under permanent development and the business processes are constantly being analysed and optimised. For risks that can arise from unforeseeable events appropriate emergency concepts have been evolved (for computer disruptions) and sufficient insurance cover has been obtained (for fire and water damage, etc)

In 2006 the "Operational Risk (OpRisk)" framework was adjusted to the regulatory requirements. The recording of loss events was improved further. In September 2006 OpRisk assessments were introduced throughout the Bank. Both

OpRisk instruments are supported by DP systems specifically tailored to the needs of KfW Bankengruppe.

The concept for the management of OpRisk measures, which will become a central part of the entire OpRisk management, was designed in 2006. The IT project to implement an IT system that supports this process was started.

A comprehensive management reporting and the development of early warning indicators are part of the project map for 2007.

Moreover, the systematic revision of contingency plans for crisis management and the action plans to maintain and restart business operations was started and will be continued in 2007.

The Group counters the legal risk by involving its own legal department in good time and by cooperating closely with external legal advisers in Germany and abroad. Contracts may only be signed on the basis of clear and correctly documented agreements. For the usual business standard contracts (e.g. ISDA contracts) are in use.

#### SUMMARY AND OUTLOOK.

In the future, too, KfW will attach great importance to the further development of its risk measurement and control instruments. In the 2007 business year the focus will be especially on further developing and validating rating procedures and stress testing instruments. The development of rating procedures will focus on instruments for business start-ups and small and medium-sized enterprises. High importance is also attached to the continuous improvement and acceleration of risk management and control-

ling processes. For this purpose the Bank has launched projects to establish processes aimed at maintaining and improving data quality and at integrating KfW's risk models more strongly into the IT systems.

KfW plans to further expand the active management of its loan portfolio. Especially with a view to larger risk concentrations in specific industries KfW is examining the use of further innovative portfolio management concepts.

#### FORECAST REPORT.

KfW Bankengruppe expects its earnings and risk situation to remain stable in 2007 and 2008, allowing the implementation of its planned financing activities and an appropriate increase in its capital base. Certain components of the Group result will also be affected by the changeover on 31 December 2007 to IFRS group accounting methods, which are more strongly geared to fair value. Compared with accounting procedures based on the German Commercial Code (HGB), KfW's results can therefore be expected to be far more volatile, partly because the hedge accounting rules established by the international standard setters in the IASB take no account of economic relationships. On the one hand, KfW Bankengruppe has sufficient capital to cushion the effect of fluctuations in the results and, in particular, to take account of equity burdens in possible periods of weakness. This ensures that KfW is in a position to provide sustainable promotional financing even in possible stress scenarios. On the other hand, it has paid greater attention to continuously developed risk reduction and risk management instruments in recent years. Coupled with the consistent application of a limit management system, these active controlling measures will also contribute to reducing concentration risks and to making the overall portfolio less susceptible to changes in the economic conditions.

With regard to the economy as a whole, KfW Bankengruppe expects global growth to slow

moderately in 2007 and to hold steady at that level in 2008. In the coming years no more than a slight worsening of KfW Bankengruppe's loan portfolio is expected. This is indicated, for example, by the further stabilisation of the earnings situation of the German banking industry, which is a major component in KfW Bankengruppe's loan portfolio, and the economic recovery in Germany, which is likely to continue in 2007. However, real growth in Germany may well slow compared with the recent six-year high, given, most of all, the increase in VAT with its adverse effect on domestic demand. Generally speaking, this will have a more marked impact on the SME sector, which is relatively strongly geared to the domestic market, than on the large, internationally oriented companies. Investment will probably bolster growth again, although the momentum is expected to be slightly weaker than in 2005. In 2008, too, there will probably be a further increase in German real gross domestic product. Private consumption is expected to pick up speed and to constitute a decisive propeller of growth. In our macroeconomic assessment, we consider the main risks to lie in a more marked decline in global economic growth than expected, a further strong rise in energy prices, a marked appreciation of the euro or the ongoing risk of a global pandemic.

Over the next two years the promotional programmes of KfW Mittelstandsbank and KfW Förderbank will continue to provide substantial

support for the German economy. The focus will be on promoting business start-ups and SMEs, innovation and growth, climate protection and education. Through KfW Mittelstandsbank, we will provide a wide range of financial support for start-ups as well as small and medium-sized enterprises. Depending on their financing needs, this target group can make use of loans, mezzanine capital or private equity. Following the thorough up-dating of the innovation-financing instruments, further additions will be made in the field of private equity in 2007. Furthermore, a distinct improvement will be made to the financing conditions for micro-businesses. The intention is also to make better use of the risk-adjusted interest rate system introduced in 2005. Through KfW Förderbank, our promotional programmes will provide support in the fields of environmental and climate protection, housing, municipal and social infrastructure and education. Further improvements will be made primarily to the promotional instruments available for environmental and climate protection. We expect this to have a tangible impact on the environment and to boost growth, from which SMEs will also benefit. In addition, ongoing adjustments are being made to the loan programmes to bring them into line with the need for financial support and market requirements. In particular, the structural change in the banking industry means that the further development of our products and processes must be geared to the future. A particular focus in 2007

will be the up-dating of our range of promotional financing with a view to achieving leaner, more efficient and better quality products and processes. Given the wide range of influential factors, only a rough estimate can be made of the financing volume. Overall, we expect the commitment volume for our promotional loans to be around EUR 40 billion. A particular focus at KfW Förderbank is climate protection. We intend to expand our involvement in the purchase of emission credits from international climate protection projects in accordance with the provisions of the Kyoto Protocol. It will then be easier for enterprises subject to the European Emissions Trading Scheme – and particularly for enterprises without direct access to projects abroad – to use the project-related mechanisms of the Kyoto Protocol. At the same time, the purchase of certificates will promote climate protection projects.

Securitisation is another pillar of our promotional activities which will remain important in the future, too. In addition to our "classic" promotional instruments, the goal of this dual strategy is to influence the financial system as a whole in such a way as to increase efficiency, adaptability and the range of loans available – in particular, for small and medium-sized enterprises. The securitisation market is growing from one year to the next and, in terms of this key component of SME financing, Germany is now leading the international capital market in Europe. One of our tasks in the coming years is to

ensure that the entire breadth of the SME sector benefits directly or indirectly from the new forms of financing. We are therefore planning to make our two securitisation platforms PROMISE and PROVIDE more flexible and to open them up to new asset classes. In 2007 we expect the securitisation volume to be between EUR 10 billion and EUR 15 billion. In addition, we are still pursuing new developments in the highly innovative securitisation markets. The overarching aim in 2007 will again be to react flexibly to changes in the market and to provide support, in particular, in those areas where market inefficiencies still exist and can be eliminated.

To establish KfW IPEX-Bank – with the legal form of a private limited company (GmbH) – as a legally independent bank responsible, within KfW Bankengruppe, for competitive business on 1 January 2008, we are preparing to transfer an initial stock of loan receivables from KfW to the new company. The planned annual volume of new business for KfW IPEX-Bank is EUR 10 billion for the next two years. In addition to the previous business strategy of diversifying the product range, we will offer short-term financing and guarantee instruments. The core business will, however, still be medium and long-term loans for international project and export finance and for general corporate finance, particularly for larger SMEs. Given the new organisational structure, the expansion of the product range, a further representative office in the Gulf region and its extensive experience of countries

and markets, KfW IPEX-Bank considers itself in a good position to achieve long-term business success.

For business year 2007, KfW Entwicklungsbank expects more than EUR 2 billion in loan commitments. The provision of additional budget funds by the federal government leads us to expect growth to accelerate in the coming years. Moreover, we are planning a further increase in promotional financing from KfW funds, both in combination with budget funds to provide FC development loans as well as through FC promotional loans granted entirely at our own risk. KfW Entwicklungsbank will also push ahead with its joint commitment with bilateral, regional and multilateral development banks in programme-based finance, the aim being to enhance implementation efficiency and to achieve major structure building effects in the partner countries.

DEG's target for 2007 and 2008 is EUR 0.9 billion in new business in order to permit an annual portfolio growth rate of 10%. The maintenance of this ongoing high volume of finance is a reflection of the continued lively demand for promotional support for long-term investment finance and, in particular, for venture capital. Owing to the current positive underlying economic conditions in most of the DEG-related markets in developing and emerging countries, the opportunities to develop the private sector in these regions are still good.

The privatisation of Deutsche Telekom and Deutsche Post is proceeding. As previously, KfW will gear the volume of transactions to the market situation and thus aim to optimise earnings. In the course of the privatisation, KfW is willing to accept further share packages from the German government.

For the next two years, KfW expects a funding volume of approximately EUR 55 billion. By far the large share of the bonds will continue to be issued in EUR, USD and GBP. In addition, KfW is planning to expand its issuing activity in the emerging markets. However, these markets will still play a minor role. We assess the underlying conditions in the capital markets as stable and the demand for blue chip investments is likely to remain high.

With regard to staff policy, the aim will again be to strike a balance between the three principal objectives of safeguarding existing jobs, increasing staff as appropriate to further business growth and keeping staff costs in check. A moderate staff increase is planned for the next two years, mainly in connection with the spin-off of KfW IPEX-Bank. In view of the obligation arising from the training pact between the German government and leading business associations, the Bank will keep to its high training ratio and will continue to train more people than it actually needs.

# FINANCIAL STATEMENTS 2006.

Balance Sheet of KfW as at 31 December 2006.

## Assets

	2006				2005		
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR million	EUR million	EUR million
<b>1. Cash reserves</b>							
a) Cash in hand			191			0	
b) Balances with central banks			25,806			26	
of which: with the Deutsche Bundesbank	25,806				26		
c) Balances with postal giro centres			0	25,997		0	26
<b>2. Loans and advances to banks</b>							
a) At call			883,842			2,750	
b) Other loans and advances			197,773,848	198,657,888	177,611	180,361	
<b>3. Loans and advances to customers</b>				90,343,916			95,032
of which: secured with mortgages							
of which: municipal loans	33,763,491						
<b>4. Bonds and other fixed-income securities</b>							
a) Money market paper							
aa) Of public issuers		0				0	
of which: eligible as collateral with the Deutsche Bundesbank	0				0		
ab) Of other issuers		1,471,915	1,471,915			915	
of which: eligible as collateral with the Deutsche Bundesbank	0						
b) Bonds and debentures							
ba) Of public issuers		2,321,071				2,745	
of which: eligible as collateral with the Deutsche Bundesbank	2,203,772						
bb) Of other issuers		29,602,544	31,923,615			22,680	
of which: eligible as collateral with the Deutsche Bundesbank	28,294,417						
c) KfW's own bond issues			4,844,319	38,239,849	3,673	3,881	30,221
Par value	4,621,909						
<b>5. Shares and other non-fixed income securities</b>				19,141,057			21,319
<b>6. Investments</b>				144,220			61
of which: in banks	11,550				12		
of which: in financial services institutions	0				0		
<b>7. Shares in affiliated enterprises</b>				1,184,312			1,136
of which: in banks	306,852				307		
of which: in financial services institutions	0				0		
<b>8. Assets on a trust basis</b>				7,302,362			8,199
of which: loans on a trust basis	7,250,996				8,177		
<b>9. Intangible assets</b>				7,193			7
<b>10. Tangible assets</b>				747,032			693
<b>11. Other assets</b>				17,397			64
<b>12. Deferred income</b>				2,936,429			3,170
<b>13. Special loss account consisting of provisions under § 17 (4) of the D-Mark Balance Sheet Law</b>				26,737			27
<b>Total assets</b>				<b>358,774,189</b>			<b>340,316</b>

## Liabilities and Shareholders' Equity

	2006				2005		
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR million	EUR million	EUR million
<b>1. Funds borrowed from banks</b>							
a) At call			1,662,311			1,316	
b) With agreed term or period of notice			20,281,669	21,943,980	21,728	23,044	
<b>2. Funds borrowed from customers</b>							
a) Savings deposits			0			0	
b) Other funds							
ba) At call		453,831				427	
bb) With agreed term or period of notice		58,392,067	58,845,898	58,845,898	70,616	71,043	
<b>3. Securitised liabilities</b>							
a) Bond issues			243,017,322		216,235		
b) Other securitised liabilities			0	243,017,322	0	216,235	
<b>4. Liabilities on a trust basis</b>				7,302,362		8,199	
of which: loans on a trust basis	7,250,996				8,177		
<b>5. Other liabilities</b>				6,171,339		1,625	
<b>6. Deferred income</b>				5,699,280		5,971	
<b>7. Accrued estimated liabilities</b>							
a) Accrued pension liabilities and similar obligations			621,797			584	
b) Others			193,659	815,456	213	797	
<b>8. Obligatory charges under the D-Mark Balance Sheet Law</b>				1,367		2	
<b>9. Subordinated liabilities</b>				500,000		500	
<b>10. Fund for general bank risks</b>				5,300,000		4,600	
<b>11. Equity Capital</b>							
a) Subscribed capital		3,750,000				3,750	
Outstanding contributions, not requested		(450,000)				(450)	
Paid-in subscribed capital			3,300,000				
of which: requested	0						
b) Capital reserves			1,603,764			1,604	
Allocation	0						
c) Reserve from the ERP Special Fund			757,453			703	
Contractual appropriation of interest	54,872				49		
d) Retained earnings							
da) Statutory reserve under § 10 (2) of the KW Law		1,574,347				1,087	
db) Special reserve under § 10 (3) of the KW Law		1,893,414				1,559	
dc) Special reserve under § 17 (4) of the D-Mark Balance Sheet Law		47,607	3,515,368	9,176,585		47	8,300
<b>Total liabilities</b>				<b>353,774,189</b>		<b>340,316</b>	
<b>1. Contingent liabilities</b>							
a) On bills discounted and charged			0			0	
b) On guarantees			79,210,808			74,236	
c) Liability under collateral provided for third party liabilities			0	79,210,808	0	74,236	
<b>2. Other obligations</b>							
a) Repurchase obligations on non-genuine repurchase transactions			0			0	
b) Placing and underwriting obligations			0			0	
c) Irrevocable loan commitments			46,123,915	46,123,915	38,476	38,476	

Statement of Income of KfW for the period from 1 January to 31 December 2006.

## Expenses

	2006				2005		
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR million	EUR million	EUR million
1. Interest expenses				11,646,591			10,658
2. Contractual appropriation of interest to reserve from the ERP Special Fund				54,872			49
3. Commissions and similar charges payable				215,418			205
4. Net expenditure on financial transactions				186			-
5. General administrative expenses							
a) Expenditure on personnel							
aa) Salaries and wages		239,112				230	
ab) Social security contributions, expenditure on pensions and support		76,007	315,119			74	
of which: for pensions	40,718				40		
b) Other administrative expenses			176,339	491,468		172	476
6. Depreciation and value adjustments on intangible assets and fixed assets				31,693			35
7. Other operating expenses				4,488			3
8. Write-downs of and value adjustments on loans and certain securities and increase of allowances for possible loan losses				394,014			657
of which: allocation to the Fund for general bank risks	700,000				1,300		
9. Write-downs on the special loss account under § 17 (4) of the D-Mark Balance Sheet Law				40			0
10. Net income for the year				821,932			475
<b>Total expenses</b>				<b>13,660,752</b>			<b>12,558</b>

## Income

	2006				2005		
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR million	EUR million	EUR million
<b>1. Interest income from</b>							
a) Lending and money market transactions			12,072,015		11,325		
b) Fixed-income securities and debt register claims			1,069,090	13,141,105	683	12,008	
<b>2. Current income from</b>							
a) Shares and other non-fixed income securities			15,924		107		
b) Investments			1,392		6		
c) Shares in affiliated enterprises			0	17,317	0	113	
<b>3. Commissions and similar service charges earned</b>				425,534		403	
<b>4. Net earnings on financial transactions</b>				-		2	
<b>5. Earnings on allocations to investments, shares in affiliated enterprises and securities treated as fixed assets</b>				48,663		19	
<b>6. Other operating income</b>				28,133		13	

**Total income**

**13,660,752**

**12,558**

Balance Sheet of KfW Bankengruppe as at 31 December 2006.

Assets

	2006				2005		
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR million	EUR million	EUR million
<b>1. Cash reserves</b>							
a) Cash in hand			193			0	
b) Balances with central banks			25,806			26	
of which: with the Deutsche Bundesbank	25,806				26		
c) Balances with postal giro centres			0	25,999		0	26
<b>2. Loans and advances to banks</b>							
a) At call			888,313			2,791	
b) Other loans and advances			197,168,010	198,056,323	177,402	180,193	
<b>3. Loans and advances to customers</b>				90,959,185			95,384
of which: secured with mortgages	0				0		
of which: municipal loans	33,763,491				29,306		
<b>4. Bonds and other fixed-income securities</b>							
a) Money market paper							
aa) Of public issuers		0				0	
of which: eligible as collateral with the Deutsche Bundesbank	0				0		
ab) Of other issuers		1,471,914	1,471,914			915	
of which: eligible as collateral with the Deutsche Bundesbank	0				40		
b) Bonds and debentures							
ba) Of public issuers		2,328,625				2,757	
of which: eligible as collateral with the Deutsche Bundesbank	2,211,326				2,530		
bb) Of other issuers		29,634,649	31,963,274			21,496	
of which: eligible as collateral with the Deutsche Bundesbank	28,309,223				17,518		
c) The group's own bond issues			4,844,319	38,279,507		5,076	30,243
Par value	4,621,909				4,821		
<b>5. Shares and other non-fixed income securities</b>				19,510,624			21,511
<b>6. Investments</b>				810,438			750
of which: in banks	81,978				72		
of which: in financial services institutions	1,524						
<b>7. Investments in associated enterprises</b>				652,852			620
of which: in banks	652,852				620		
of which: in financial services institutions	0				0		
<b>8. Shares in affiliated enterprises</b>				14,206			12
of which: in banks	0				0		
of which: in financial services institutions	0				0		
<b>9. Assets on a trust basis</b>				7,454,258			8,372
of which: loans on a trust basis	7,364,851				8,304		
<b>10. Intangible assets</b>				8,752			9
<b>11. Tangible assets</b>				769,060			711
<b>12. Other assets</b>				102,003			113
<b>13. Deferred income</b>				2,936,496			3,171
<b>14. Special loss account consisting of provisions under § 17 (4) of the D-Mark Balance Sheet Law</b>				26,737			27
<b>Total assets</b>				<b>359,606,436</b>			<b>341,143</b>

## Liabilities and Shareholders' Equity

	2006				2005		
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR million	EUR million	EUR million
<b>1. Funds borrowed from banks</b>							
a) At call			1,628,816			1,296	
b) With agreed term or period of notice			20,304,372	21,933,188	21,729		23,025
<b>2. Funds borrowed from customers</b>							
a) Savings deposits			0			0	
b) Other funds							
ba) At call		140,908				159	
bb) With agreed term or period of notice		55,394,582	55,535,490	55,535,490	47,977		48,136
<b>3. Securitised liabilities</b>							
a) Bond issues			246,024,584		238,928		
b) Other securitised liabilities			0	246,024,584		0	238,928
<b>4. Liabilities on a trust basis</b>				7,454,258			8,372
of which: loans on a trust basis	7,364,851				8,304		
<b>5. Other liabilities</b>				8,179,094			1,671
<b>6. Deferred income</b>				5,700,707			5,973
<b>7. Accrued estimated liabilities</b>							
a) Accrued pension liabilities and similar obligations			686,571			642	
b) Accrued tax liabilities			10,232			5	
c) Others			252,578	949,381	290		937
<b>8. Obligatory charges under the D-Mark Balance Sheet Law</b>				1,967			2
<b>9. Subordinated liabilities</b>				500,000			500
<b>10. Fund for general bank risks</b>				3,300,000			4,600
<b>11. Equity Capital</b>							
a) Subscribed capital		3,750,000				3,750	
Outstanding contributions, not requested		(450,000)				(450)	
Paid-in subscribed capital			3,300,000				
of which: requested	0				0		
b) Capital reserves			1,603,795			1,604	
Allocation	0				0		
c) Reserve from the ERP Special Fund			757,453			703	
Contractual appropriation of interest	54,872				49		
d) Retained earnings							
da) Statutory reserve under § 10 (2) of the KfW Law		1,574,347				1,087	
db) Special reserve under § 10 (3) of the KfW Law		1,893,414				1,559	
dc) Special reserve under § 17 (4) of the D-Mark Balance Sheet Law		47,607				47	
dd) Other retained earnings		851,183	4,366,551	10,027,769	699		8,998
<b>Total liabilities</b>				<b>359,606,436</b>			<b>341,143</b>
<b>1. Contingent liabilities</b>							
a) On bills discounted and charged			0			0	
b) On guarantors		79,185,211				74,170	
c) Liability under collateral provided for third party liabilities			0	79,185,211	79,185,211	0	74,170
<b>2. Other obligations</b>							
a) Repurchase obligations on non-genuine repurchase transactions			0			0	
b) Placing and underwriting obligations			0			0	
c) Irrevocable loan commitments		46,525,255	46,525,255	46,525,255	38,888		38,888

Statement of Income of KfW Bankengruppe for the period from 1 January to 31 December 2006.

Expenses

	2006				2005		
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR million	EUR million	EUR million
1. Interest expenses				11,668,951			10,661
2. Contractual appropriation of interest to reserve from the ERP Special Fund				54,872			49
3. Commissions and similar charges payable				216,727			209
4. Net expenditure on financial transactions				1,585			-
5. General administrative expenses							
a) Expenditure on personnel							
aa) Salaries and wages		270,275				260	
ab) Social security contributions, expenditure on pensions and support		92,087	362,362			91	
of which: for pensions	51,746				52		
b) Other administrative expenses			198,155	560,517		194	545
6. Depreciation and value adjustments on intangible assets and fixed assets				33,186			36
7. Other operating expenses				7,553			6
8. Write-downs of and value adjustments on loans and certain securities and increase of allowances for possible loan losses				331,638			585
of which: allocation to the Fund for general bank risks	700,000				1,300		
9. Write-downs of and value adjustments on investments, shares in affiliated enterprises and securities treated as fixed assets				-			18
10. Write-downs on the special loss account under § 17 (4) of the D-Mark Balance Sheet Law				40			0
11. Taxes on income and profits				17,608			4
12. Net income for the year				873,541			625
<b>Total expenses</b>				<b>13,866,218</b>			<b>12,738</b>

## Income

	2006				2005		
	EUR thousand	EUR thousand	EUR thousand	EUR thousand	EUR million	EUR million	EUR million
<b>1. Interest income from</b>							
a) Lending and money market transactions			12,167,011		11,406		
b) Fixed-income securities and debt register claims			1,070,189	13,237,200	683	12,089	
<b>2. Current income from</b>							
a) Shares and other non-fixed income securities			16,706		107		
b) Investments			48,822		52		
c) Shares in affiliated enterprises			0		0		
d) Investments in associated enterprises			60,904	126,432	51	210	
<b>3. Commissions and similar service charges earned</b>				443,246		411	
<b>4. Net earnings on financial transactions</b>				-		2	
<b>5. Earnings on allocations to investments, shares in affiliated enterprises and securities treated as fixed assets</b>				25,345		-	
<b>6. Other operating income</b>				33,998		26	

**Total income**

**13,866,218**

**12,738**

## Cash Flow Statement of KfW Bankengruppe as at 31 December 2006.

EUR million

	31 Dec 2006	31 Dec 2005
<b>Net income before tax</b>	<b>991</b>	<b>629</b>
Non-cash positions in net income and adjustments to reconcile net income to net cash used in operating activities:		
- Write-downs, risk provisions, depreciation and adjustments on loans and advances, investments and fixed assets	339	640
- Change in accrued estimated liabilities	99	147
- Change in other non-cash provisions	-28	-27
- Gain on sale of investments and fixed assets	30	-33
- Other adjustments (net)	2,975	-10,031
<b>Sub-total</b>	<b>4,405</b>	<b>-8,675</b>
Change in assets and liabilities from operating activities:		
- Loans and advances to banks	-17,904	-3,747
- Loans and advances to customers	4,854	860
- Securities (not including investments)	-4,974	-7,693
- Funds borrowed from banks	-1,091	-2,269
- Funds borrowed from customers	7,399	-7,172
- Securitised liabilities	7,097	28,122
- Other assets	10	3
- Other liabilities	-114	-104
- Interest earned	13,237	12,089
- Interest paid	-11,669	-10,661
- Income tax paid	-18	-4
<b>Net cash used in operating activities</b>	<b>1,232</b>	<b>749</b>
Proceeds from sale of:		
- Investments	902	1,030
- Fixed assets	11	74
Payments for purchase of:		
- Investments	-2,128	-1,819
- Fixed assets	-98	-116
Change from other investment activities	28	27
<b>Net cash provided by investment activities</b>	<b>-1,285</b>	<b>-804</b>
Proceeds from equity capital contributions	55	49
Change from other financing activities	0	0
<b>Net cash used in financing activities</b>	<b>55</b>	<b>49</b>
<b>Cash and cash equivalents at the end of the previous period</b>	<b>26</b>	<b>27</b>
Net cash used in operating activities	1,232	749
Net cash provided by investment activities	-1,285	-804
Net cash used in financing activities	55	49
Effect of exchange rate changes and consolidation	-2	5
<b>Cash and cash equivalents at the end of the period</b>	<b>26</b>	<b>26</b>

The cash flow statement of KfW Bankengruppe is drawn up in accordance with the recommendations of GAS 2-10. The total cash shown includes cash in hand and balances with central banks.

# ANNEX AND GROUP ANNEX.

## THE CONSOLIDATED ENTERPRISES AND THE PRINCIPLES OF CONSOLIDATION.

The consolidated financial statements include, besides KfW, DEG-Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne, KfW Beteiligungsholding GmbH, Bonn, KfW IPEX-Beteiligungsholding GmbH, Frankfurt am Main, tbg Technologie-Beteiligungs-Gesellschaft mbH, Bonn, KfW International Finance Inc., Delaware, USA, and Finanzierungs- und Beratungsgesellschaft mbH, Berlin.

§ 296 (1) No. 3 of the German Commercial Code (HGB) has been utilised with regard to one subsidiary, whose shares were held exclusively for the purpose of resale. In accordance with § 296 (2) HGB four affiliated enterprises are not included in the consolidated financial statements, because their results are of only minor significance for the presentation of the assets, financial situation and earnings of the Group. Equally in accordance with § 311 (2) HGB two enterprises were not included in the at-equity consolidation.

The annual financial statements for the individual enterprises in the Group were drawn up in accordance with the accounting and valuation methods applying to KfW. Loans and advances and liabilities, and income and expenditure between the consolidated enterprises were netted. The first consolidation was made by the book value method with the values stated on the Group's balance sheet date.

The capital was consolidated on the basis of the values stated on the date the enterprises were first included in the Group's accounts. The differences in the liabilities resulting from the capital consolidation total EUR 446 million and are included in the Group's retained earnings.

The annual financial statements for KfW International Finance Inc. are drawn up in foreign currency and the amounts were converted at the ECB reference rates quoted on 31 December 2006.

## ACCOUNTING AND VALUATION METHODS.

The Financial Statements for 2006 for KfW and for KfW Bankengruppe have been drawn up in accordance with the requirements of the German Commercial Code (HGB), the Ordinance Regarding the Accounting System for Banks (RechKredV) and the Law Concerning KfW. The special provisions of the D-Mark Balance Sheet Law (DM-BilG) have also been observed. In the Financial Statements the reserves from the ERP Special Fund and the contractual allocation of interest earnings to these are shown separately, as is the allocation to the capital reserves, which are

shown as a memo item. Statements on individual items in the Balance Sheet, which may be made either in the Balance Sheet or an Annex, are given in the Annex.

The cash in hand, loans and advances to banks and customers, investments, investments in associated enterprises and shares in affiliated enterprises and the other assets have been shown at cost, par or a lower value. Differences between notional amounts and lower disbursement amounts of loans or advances have been included in the deferred income.

The securities held as a liquidity reserve are valued strictly at the lower of cost or market, where they are not covered by off-balance sheet business. Securities held as fixed assets are shown on a modified application of this principle. In part, securities are aggregated with the derivatives contracts (interest swap contracts) concluded for price hedging to form separately documented valuation units. No allocations of securities to the trading stock have been made. The statutorily required write-ups were made.

Fixed assets are shown at acquisition or production cost, reduced by straight line depreciation in accordance with the expected useful life of the items. Minor items were fully written off in the year of acquisition.

Liabilities are shown at repayment value; differences between agreed higher repayment amounts and issue amounts have been included in the item "Prepaid expenses and deferred charges".

Accrued pension liabilities and similar obligations were valued in accordance with actuarial

principles on the basis of "Richttafeln für die Pensionsversicherung" (Mortality and Disability Tables) of 2005 by Dr Klaus Heubeck. For KfW the part-value method was used, with interest rates for accounting purposes of 3% and 6%, respectively. The other accrued estimated liabilities are shown at their expected recourse value.

Sufficient allowance has been made for risks, most of which are on loans as a result of the structure of KfW's business, through provisions and allocations to the Fund for general bank risks in accordance with § 340 g of the German Commercial Code. The allocations are shown in the item "Write-downs of and value adjustments on loans and certain securities and increase of allowances for possible loan losses". The possibility for netting in the Statement of Income in accordance with § 340 f (3) and § 340 c (2) of the German Commercial Code has been utilised. In the event of non-performing loans interest income is generally calculated on the basis of expected income.

NOTES ON THE ASSETS.

**Loans and advances to banks**

EUR million

	At call	Remaining term				Pro rata interest	Total
		Up to 3 months	More than 3 months to 1 year	More than 1 year to 5 years	More than 5 years		
31 Dec 2006 KfW	884	21,874	11,173	46,103	113,469	5,155	198,658
31 Dec 2006 Group	888	21,840	11,240	46,148	112,772	5,168	198,056
31 Dec 2005 KfW	2,750	17,667	12,283	40,465	103,597	3,599	180,361
31 Dec 2005 Group	2,791	17,681	12,339	40,635	103,129	3,618	180,193
						<b>KfW</b>	<b>Group</b>
<i>of which to:</i>							
<i>affiliated enterprises</i>						1,255	0
<i>enterprises, in which KfW holds a stake</i>						4	5,403
<i>without on-lending banks' liability</i>						1,771	1,771
<i>minor assets</i>						10	10

**Loans and advances to customers**

EUR million

	With no fixed maturity	Remaining term				Pro rata interest	Total
		Up to 3 months	More than 3 months to 1 year	More than 1 year to 5 years	More than 5 years		
31 Dec 2006 KfW	0	3,684	6,699	30,472	47,500	1,989	90,344
31 Dec 2006 Group	0	3,736	6,721	30,870	47,624	2,008	90,959
31 Dec 2005 KfW	0	4,118	6,874	31,730	50,401	1,909	95,032
31 Dec 2005 Group	0	4,172	6,899	32,111	50,279	1,924	95,384
						<b>KfW</b>	<b>Group</b>
<i>of which to:</i>							
<i>affiliated enterprises</i>						576	0
<i>enterprises, in which KfW holds a stake</i>						52	101
<i>minor assets</i>						7,058	7,058

## BONDS AND OTHER FIXED-INCOME SECURITIES.

Amounts shown under "Bonds and other fixed-income securities" due in the year following the balance sheet date:

Due the following year  
EUR million

Balance sheet date	31 Dec 2006 KfW	31 Dec 2005 KfW	31 Dec 2006 Group	31 Dec 2005 Group
Money market paper, bonds and notes	9,353	6,521	9,353	6,330
<i>Par value</i>	9,231	6,460	9,231	6,269
Own bond issues	726	272	726	463
<i>Par value</i>	719	266	719	457
<b>Total</b>	<b>10,079</b>	<b>6,793</b>	<b>10,079</b>	<b>6,793</b>
<i>Par value</i>	9,950	6,726	9,950	6,726

The item "Bonds and other fixed-income securities" includes:

EUR million

	KfW	Group
Listed enterprises	35,594	35,616
Unlisted securities	1,112	1,112
<b>Marketable securities</b>	<b>36,706</b>	<b>36,728</b>

SECURITIES TRANSACTIONS UNDER REPURCHASE AGREEMENTS.

In the context of genuine repurchase transactions (sell & buy back transactions, repos) securities to the book value of EUR 1,260 million were repurchased.

FIXED ASSETS.

Fixed assets as at 31 December 2006 KfW  
EUR thousand

						Changes <sup>1)</sup> 2006 (7)	Residual book value as at 31 Dec 2006 (8)	Residual book value as at 31 Dec 2005 (9)
Investments						82,920	144,220	61,300
Shares in affiliated enterprises						48,076	1,184,312	1,136,236
Securities treated as fixed assets						1,205,130	5,031,093	3,825,963
<b>Total</b>						<b>1,336,126</b>	<b>6,359,625</b>	<b>5,023,499</b>

	Acquisition/ production costs <sup>2)</sup> (1)	Inflows (2)	Outflows (3)	Transfers (4)	Allocations (5)	Total (6)	Write-downs/ adjustments (7)	Residual book value as at 31 Dec 2006 (8)	Residual book value as at 31 Dec 2005 (9)
Intangible assets	34,282	3,171	1,397	0	0	28,863	3,074	7,193	7,431
Tangible assets <sup>3)</sup>	850,740	89,675	9,057	0	0	184,326	28,619	747,032	692,664
<b>Total</b>	<b>885,022</b>	<b>92,846</b>	<b>10,454</b>	<b>0</b>	<b>0</b>	<b>213,189</b>	<b>31,693</b>	<b>754,225</b>	<b>700,095</b>
<b>Sum</b>								<b>7,113,850</b>	<b>5,723,594</b>

<sup>1)</sup> Including price changes.

<sup>2)</sup> The Relief Facility under § 31 (6) of the EC Commercial Code has been utilised.

<sup>3)</sup> Of which as at 31 December 2006: - total value of land and buildings used for the Bank's activities EUR 710,291,000  
- total value of office furniture and equipment EUR 36,741,000

**Fixed assets as at 31 December 2006 Group**  
 EUR thousand

	Changes <sup>1)</sup> 2006 (7)	Residual book value as at 31 Dec 2006 (8)	Residual book value as at 31 Dec 2005 (9)
Investments	92,899	1,483,288	1,370,389
Shares in affiliated enterprises	2,362	14,206	11,844
Securities treated as fixed assets <sup>2)</sup>	1,222,428	5,048,391	3,825,963
<b>Total</b>	<b>1,317,689</b>	<b>6,525,885</b>	<b>5,208,196</b>

	Acquisition/ production costs <sup>3)</sup> (1)	Inflows (2)	Outflows (3)	Transfers (4)	Allocations (5)	Write-downs/ adjustments		Residual book value as at 31 Dec 2006 (8)	Residual book value as at 31 Dec 2005 (9)
						Total (6)	2006 (7)		
Intangible assets	39,331	3,747	1,397	0	0	32,929	3,727	6,752	9,068
Tangible assets <sup>4)</sup>	882,628	94,649	9,284	0	0	198,933	29,458	769,060	710,654
<b>Total</b>	<b>321,959</b>	<b>98,396</b>	<b>10,681</b>	<b>0</b>	<b>0</b>	<b>231,862</b>	<b>33,185</b>	<b>777,812</b>	<b>719,722</b>
<b>Sum</b>								<b>7,303,697</b>	<b>5,927,918</b>

<sup>1)</sup> Including price changes.

<sup>2)</sup> The Relief Facility under § 31 (6) of the EC Commercial Code has been utilised.

<sup>3)</sup> Of which as at 31 December 2006: – total value of land and buildings used for the Bank's activities EUR 716,261,000

– total value of office furniture and equipment EUR 38,212,000

Bonds and other fixed-income securities, as well as shares and other non-fixed income securities, intended as a permanent part of operations and so usually held until maturity, have been included with the securities treated as fixed assets. They are shown separately in the accounts and valued following the lower of cost or market principle (modified).

The book value of the marketable bonds not valued at the lower of cost or market and included in the item "Bonds and other fixed-income securities" is EUR 5,048 million. This includes investments in securities, whose book value of EUR 718 million was EUR 1 million higher than the present value of EUR 717 million. Since these securities are to be held until maturity they were not written down. Overall, the securities treated as fixed assets contain hidden reserves of EUR 4 million.

The item "Shares and other non-fixed income securities" includes:

EUR million		
	KfW	Group
Listed securities	12,791	12,859
Unlisted securities	6,350	6,349
<b>Marketable securities</b>	<b>19,141</b>	<b>19,209</b>

The total holding is recorded as current assets.

Information on equity investments			
EUR thousand and %			
The enterprises listed below are included in the consolidated financial statements as subsidiaries.			
Name and domicile of company	Share held in %	Equity capital <sup>1)</sup> EUR thousand	Net income for the year <sup>1)</sup> EUR thousand
1. DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne	100.0	1,129,247	114,950
2. Finanzierungs- und Beratungsgesellschaft mbH (FuB), Berlin	100.0	16,812	3,270
3. KfW International Finance Inc., Delaware, USA	100.0	8 <sup>2)</sup>	0 <sup>2)</sup>
4. KfW Beteiligungsholding AG, Bonn	100.0	847,970	48,077
5. tbg Technologie-Beteiligungs-Gesellschaft mbH, Bonn	100.0	479,800	0
6. KfW IPEX-Beteiligungsholding GmbH, Frankfurt	100.0	32,601	57

<sup>1)</sup> As at 31 Dec 2006.  
<sup>2)</sup> Converted at the rate quoted on 31 Dec 2006 (EUR 1 = USD 1.317).

The full list of shareholdings in accordance with § 285 No 11 and § 313 (2) of the German Commercial Code (HGB) is disclosed as part of the Annual Financial Statements in the electronic corporate register and made available as part of the Annual Financial Statements in the Electronic Federal Gazette.

The item "Investments" includes:

EUR thousand		
	KfW	Group
Listed securities	0	680,574
Unlisted securities	108,805	108,805
<b>Marketable securities</b>	<b>108,805</b>	<b>789,379</b>

Assets on a trust basis				
EUR million				
	KfW		Group	
Loans and advances to banks				
a) At call	212		213	
b) Other loans and advances	762	974	860	1,073
Loans and advances to customers		6,277		6,292
Securities		1		1
Investments		50		88
<b>Total</b>		<b>7,302</b>		<b>7,454</b>

PREPAID EXPENSES AND DEFERRED CHARGES.

The difference contained in the item "Prepaid expenses and deferred charges" between the repayment amount and the lower issue amount of liabilities is EUR 646 million.

NOTES ON LIABILITIES.

**Maturities structure of borrowed funds**  
EUR million

	At call	Remaining term				Pro rata interest	Total
		Up to 3 months	More than 3 months to 1 year	More than 1 year to 5 years	More than 5 years		
<b>Funds borrowed from banks with agreed term or period of notice</b>							
KfW	1,663	2,471	2,053	7,897	3,002	4,858	21,944
Group	1,629	2,471	2,053	7,898	3,017	4,865	21,933
<i>as at 31 Dec 2005 KfW</i>	1,316	1,795	1,637	11,774	2,876	3,646	23,044
<i>as at 31 Dec 2005 Group</i>	1,296	1,753	1,637	11,801	2,891	3,647	23,025
<b>Funds borrowed from customers</b>							
<b>Other borrowed funds with agreed term or period of notice</b>							
KfW	454	9,015	3,837	15,326	28,986	1,228	58,846
Group	141	6,757	3,088	15,326	28,995	1,228	55,535
<i>as at 31 Dec 2005 KfW</i>	427	12,128	5,517	30,094	21,522	1,355	71,043
<i>as at 31 Dec 2005 Group</i>	159	7,466	2,856	17,985	18,756	914	48,136
<b>KfW</b>	<b>2,117</b>	<b>11,486</b>	<b>5,890</b>	<b>23,223</b>	<b>31,988</b>	<b>6,086</b>	<b>80,790</b>
<b>Group</b>	<b>1,770</b>	<b>9,228</b>	<b>5,141</b>	<b>23,224</b>	<b>32,012</b>	<b>6,093</b>	<b>77,468</b>
<b>in %</b>							
<b>KfW</b>	<b>3</b>	<b>14</b>	<b>7</b>	<b>29</b>	<b>40</b>	<b>7</b>	<b>100</b>
<b>Group</b>	<b>2</b>	<b>12</b>	<b>6</b>	<b>30</b>	<b>42</b>	<b>8</b>	<b>100</b>
<b>Due the following year</b>							
			<b>KfW</b>	<b>Group</b>			
Securitised liabilities							
- bonds issued			61,178	61,178			
<i>as at 31 December 2005</i>			50,175	57,497			

**Liabilities to affiliated enterprises and enterprises in which KfW/KfW Bankengruppe holds a stake**  
 EUR million

	Securitized and non-securitized liabilities			
	To affiliated enterprises		To enterprises in which KfW/ KfW Bankengruppe holds a stake	
	KfW	Group	KfW	Group
Funds borrowed from banks	49	0	0	0
Funds borrowed from customers	3,338	0	0	0
Securitized liabilities	0	0	0	0 <sup>1)</sup>
<b>Total</b>	<b>3,387</b>	<b>0</b>	<b>0</b>	<b>0</b>

<sup>1)</sup> As far as can be ascertained.

**Liabilities on a trust basis**  
 EUR million

	KfW		Group	
Funds borrowed from banks				
a) At call	0		0	
b) With agreed term or period of notice	59	59	59	59
Funds borrowed from customers				
a) Savings deposits				
b) Other liabilities				
ba) At call	595		596	
bb) With agreed term or period of notice	6,648	7,243	6,769	7,365
<b>Total</b>		<b>7,302</b>		<b>7,454</b>

**OTHER LIABILITIES.**

The "Other liabilities" are mainly the difference on the currency conversion of derivatives used in the context of the management of foreign currency positions.

#### DEFERRED INCOME.

The item "Deferred income" includes discounts on loans and advances totalling EUR 1,180 million.

#### SUBORDINATED LIABILITIES.

In connection with the acquisition of shares of Deutsche Telekom AG and Deutsche Post AG for the further privatisation of these corporations the German government granted KfW a subordinated loan of EUR 500 million. The loan bears an agreed interest rate of 3.9475% and is due for repayment on 11 November 2008. Notice of cancellation was given in due time. KfW is not obligated to repay the subordinate loan ahead of schedule. The terms of subordination of this loan are in line with the requirements of the German Banking Act (KWG).

Interest expenses for the subordinate loan amounted to EUR 19.7 million. This interest accrued but not yet due in the amount of EUR 2.7 million is reported under the item "Other liabilities".

#### EQUITY CAPITAL.

##### Group equity according to GAS No 7 EUR million

	31 Dec 2005	Group's net income	Other changes	31 Dec 2006
KfW's subscribed capital	3,750.0	0.0	0.0	3,750.0
Outstanding contributions, not requested	- 450.0	0.0	0.0	- 450.0
Capital reserves	1,603.8	0.0	0.0	1,603.8
Reserve from the ERP Special fund	702.6	0.0	54.9	757.5
<b>Retained Group earnings</b>				
a) Statutory reserve under § 10 (2) of the KfW Law	1,087.0	487.3	0.0	1,574.3
b) Special reserve under § 10 (3) of the KfW Law	1,558.7	334.7	0.0	1,893.4
c) Special reserve under § 17 (4) D-Mark Balance Sheet Law	47.6	0.0	0.0	47.6
d) Other retained earnings	699.7	151.5	0.0	851.2
<b>Group equity</b>	<b>8,999.4</b>	<b>973.5</b>	<b>54.9</b>	<b>10,027.8</b>

Of the Group's net income for the year of EUR 974 million, an amount corresponding to KfW's net income for the year of EUR 822 million was allocated to the statutory reserve (EUR 487 million) and to the special reserve (EUR 335 million) in accordance with § 10 (2) and (3) of the KfW Law. The net income for the year of EUR 152 million achieved by the consolidated subsidiaries was allocated to the other retained earnings. KfW's equity capital is EUR 9,177 million.

## OTHER REQUIRED NOTES ON THE LIABILITIES.

### CONTINGENT LIABILITIES.

The Group's liabilities under guarantees total EUR 79,185 million. Of the total amount as at 31 December 2006 EUR 72,403 million was credit default swaps, EUR 6,782 million was credit guarantees (of which guarantees for special loans totalled EUR 1,541 million, guarantees for aircraft finance EUR 793 million, guarantees for energy loans EUR 599 million, guarantees for ship and shipyard financing EUR 510 million and guarantees for housing construction EUR 282 million).

The new guarantees for third party risks given in 2006 amounted to EUR 19,184 million; they result mainly from the assumption of third party risks of credit default in connection with securitisation transactions of a total of EUR 17,121 million. Altogether EUR 14,138 million was redeemed.

### OTHER OBLIGATIONS.

The Group's irrevocable loan commitments total EUR 46,525 million, of which EUR 14,029 million is export and project finance, EUR 21,055 million is investment finance, EUR 4,313 million is loans to promote the developing countries, EUR 2,835 million is guarantees and EUR 4,293 million is asset securitisation.

## NOTES ON THE STATEMENT OF INCOME.

### SEGMENT REPORTING.

The segment reporting in accordance with DRS 3-10 follows the structure of the internal control of the business units of KfW Bankengruppe.

The composition of the segments is shown in the following overview:

Segment reporting
<b>Investment Finance Germany/Europe</b>
■ Equity finance (incl. tbG – Technologie-Beteiligungs-Gesellschaft mbH)
■ Corporate finance/industrial pollution control finance
■ Education and social finance
■ Infrastructure and housing finance
■ Global loans
■ Asset securitisation
<b>Export and Project Finance</b>
■ Promotion of German and European exports
■ Financing of direct and other corporate investment
<b>Promotion of the Developing Countries</b>
■ Promotion of the developing and transition countries on behalf of the German federal government (budget funds) and with complementary market funds raised by KfW
■ DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH (promotion of the private sector)
<b>Shareholdings, Treasury and Services</b>
■ Holding arrangements for the federal government
■ Shareholdings
■ Securities investments
■ Other services

A detailed description of the products and services offered by the individual business units is contained in the statements presented under "KfW's Business Units" of this annual report.

The operative business units are measured on the basis of the net operating result and the allocated equity capital. The individual positions are based on the following methods:

- Net interest income was itemised according to the principle of the market interest rate method<sup>1)</sup>. The position also includes internally calculated return on equity. The itemisation was for the first time based entirely on risk-weighted assets. For reasons of commensurability we refrained from adjusting the previous year's figures accordingly.
- The allocation of administrative expenses by cost centres to the individual segments is based on the results of activity-based costing<sup>2)</sup>.
- Risk provisioning was determined on the basis of the concept of expected losses (standard risk costs) and charged to the individual segments.
- The segment assets contain the total asset positions. The allocation of the own funds<sup>3)</sup> to the segments is effected on the basis of the corresponding risk-weighted position (pursuant to Principle I of the German Banking Act).
- The risk-weighted position was determined as a representative average for 2006 on the basis of the figures as at 30 September 2006.

Contributions to income that accrue outside the segments are allocated to the central segment.

The transference/consolidation column contains all adjustment measures necessary for transferring the internal accounting measures into the corresponding data in the external financial reporting.

### Segment reporting by business unit

EUR million

Primary segments	Investment Finance Germany/Europe	Project/Export Finance	Promotion of the Developing Countries	Shareholdings/Treasury and Services	Central segment	Transference/consolidation	KfW Bankengruppe
<b>+ Interest received, net</b>							
2006	331	500	192	169	414	88	1.695
2005	316	447	188	219	411	58	1.638
<b>+ Commissions received, net</b>							
2006	129	119	100	15	0	-136	227
2005	102	104	101	28	0	-132	203
<b>- Administrative expenses</b>							
2006	240	121	158	71	0	4	594
2005	260	116	169	33	0	4	582

<sup>1)</sup> Under this method the calculation of interest margins is based on the assumption of a refinancing at matching maturities.

<sup>2)</sup> The costs incurred in the organisational units are allocated to the individual products by means of business processes.

<sup>3)</sup> The own funds include the paid-in subscribed capital, reserves and the Fund for general bank risks pursuant to § 340 g of the German Commercial Code.

(cont)

Primary segments	Investment Finance Germany/ Europe	Project/ Export Finance	Promotion of the Developing Countries	Share- holdings/ Treasury and Services	Central segment	Trans- ference/ consoli- dation	KfW Banken- gruppe
+ Net result from financial transactions/other operating result							
2006	3	0	7	1	29	-15	25
2005	5	0	4	1	42	-30	22
- Risk provisions/ valuations, net							
2006	107	156	71	23	16	-67	306
2005	100	163	70	18	361	-108	603
= Income from current operations							
2006	116	342	69	91	428	0	1,046
2005	63	272	53	197	93	0	678
Assets							
2006	203,338	42,648	20,281	80,725	12,614	0	359,606
2005	187,628	46,421	21,173	72,943	12,978	0	341,143
Liabilities							
2006	197,227	38,924	18,868	75,095	12,391	1,773	344,279
2005	181,892	42,312	20,015	68,881	12,746	1,698	327,544
Risk-weighted positions							
2006	59,705	39,479	3,007	48,926	2,366	0	153,483
2005	50,899	39,702	2,900	40,845	2,249	0	136,595
Own funds							
2006	6,111	3,724	1,413	5,630	223	-1,773	15,328
2005	5,736	4,109	1,157	4,062	233	-1,698	13,599
In %							
Return on average allocated own funds <sup>1)</sup>							
2006	2.0	8.7	5.4	1.9			7.2
2005	1.2	7.2	4.9	5.3			5.4
Cost/income ratio <sup>2)</sup>							
2006	51.8	19.6	53.0	38.2			30.5
2005	61.4	21.0	57.7	13.3			31.2

<sup>1)</sup> Ratio of income from current operations to average allocated own funds.<sup>2)</sup> Ratio of administrative expenses to net income (net interest received, net commissions received, other operating income).

## SEGMENT REPORTING BY REGION.

As KfW Bankengruppe maintains no foreign branch offices the geographic segmentation of the volume of lending is made on the basis of the customers' country of domicile. The remaining asset positions are allocated to the domestic activities.

## Segment reporting by region

EUR million

Secondary segments	Germany	Euroland (without Germany)	Other Europe	North America	Latin America including Caribbean	Asia/ Australia	Africa	Trans- ference/ consoli- dation	KfW Banken- gruppe
<b>+ Interest received, net</b>									
2006	1,224	16	193	- 38	73	108	31	88	1,695
2005	1,064	49	172	16	82	132	65	58	1,638
<b>+ Commissions received, net</b>									
2006	156	29	52	10	23	54	39	- 136	227
2005	165	18	30	8	16	59	38	- 132	203
<b>- Administrative expenses</b>									
2006	310	57	89	18	30	62	23	4	594
2005	293	64	64	21	30	69	36	4	582
<b>+ Net result from financial transactions/other operating result</b>									
2006	33	0	0	0	4	2	0	- 15	25
2005	48	0	1	0	1	1	1	- 30	22
<b>- Risk provisions/valuations, net</b>									
2006	157	33	68	19	35	52	8	- 67	306
2005	491	34	76	23	30	58	0	- 108	603
<b>= Income from current operations</b>									
2006	945	- 46	87	- 66	36	49	40	0	1,046
2005	493	- 30	63	- 20	39	64	68	0	678
<b>Assets</b>									
2006	250,830	28,344	35,464	8,885	6,891	23,185	6,007	0	359,606
2005	245,111	30,506	22,673	9,399	6,771	20,871	5,812	0	341,143
<b>Liabilities</b>									
2006	240,504	26,726	32,707	8,361	6,301	22,198	5,708	1,773	344,279
2005	235,738	28,681	20,834	8,818	6,235	20,015	5,526	1,698	327,544

(cont)

Secondary segments	Germany	Euroland (without Germany)	Other Europe	North America	Latin America including Caribbean	Asia/ Australia	Africa	Trans- ference/ consoli- dation	KfW Banken- gruppe
<b>Risk-weighted positions</b>									
2006	93,623	17,157	25,321	5,568	3,902	6,469	1,453	0	153,483
2005	87,339	17,628	15,454	5,613	3,660	5,559	1,342	0	136,595
<b>Own funds</b>									
2006	10,326	1,618	2,758	524	589	987	299	-1,773	15,328
2005	9,373	1,824	1,840	581	536	857	286	-1,698	13,599
<b>In %</b>									
<b>Return on average allocated own funds<sup>a)</sup></b>									
2006	9.6	-2.7	3.8	-11.9	6.4	5.4	13.5		7.2
2005	5.6	-1.9	3.8	-3.6	7.5	8.3	24.8		5.4
<b>Cost/income ratio<sup>b)</sup></b>									
2006	22.0	128.6	36.5	n.e.	29.5	37.9	32.9		30.5
2005	22.9	94.2	31.7	87.9	30.5	36.0	34.8		31.2

<sup>a)</sup> Ratio of income from current operations to average allocated own funds.

<sup>b)</sup> Ratio of administrative expenses to net income (net interest received, net commissions received, other operating income).

## OTHER NOTES REQUIRED.

### ASSETS AND DEBTS IN FOREIGN CURRENCIES.

The assets and debts in foreign currencies and the cash transactions not completed on the balance sheet date have been converted into euros at the official middle exchange rates quoted on the balance sheet date. Irrevocable loan commitments, for which forward transactions were concluded, were converted at the hedging rate.

Expenditure and earnings on currency conversion have been included in the "Net earnings on financial transactions"; the imparity principle has been observed.

Revaluations of provisions for loan losses in foreign currencies were included in the item "Net expenditure on financial transactions".

Forward transactions in connection with on-balance sheet business were converted with due observance of the regulations on special cover or cover in the same currency.

As at 31 December 2006 total assets in foreign currencies were EUR 45.2 billion, converted in accordance with § 340 h (1) of the German Commercial Code.

Total debts in foreign currencies were EUR 143.4 billion.

#### DERIVATIVES REPORTING.

KfW Bankengruppe uses the following forward transactions/derivative products, mainly to hedge against the risk of changes in interest rates and exchange rates, and other price and credit risks:

1. Interest-rate related forward transactions/derivative products
  - Interest rate swaps
  - Interest rate options
  - Caps and floors
  - Spreadlocks
2. Currency-related forward transactions/derivative products
  - Cross-currency swaps
  - FX swaps
  - Spot exchange deals
  - Forward exchange deals
3. Share price-related and other price risk-related forward transactions/derivative products
  - Share options
  - KfW Carbon Fund forward sales
4. Credit derivatives
  - Single name credit default swaps

The following presentation of the derivatives business is in accordance with the requirements of § 285 No. 18 of the German Commercial Code. It discloses the positive and negative market values of the derivatives positions as at 31 December 2006.

As derivatives instruments are used to hedge market risks of on-balance sheet business, these instruments are treated as off-balance sheet items.

All types of contracts are valued according to the mark-to-market method. In cases where market prices were not available for derivatives instruments, fair values were established by means of market parameters based on generally acknowledged option price models and present value estimates.

Purchased and written options are classified as other assets or other liabilities in the amounts paid as premiums.

**KfW 2006**  
EUR million

	Nominal values		Fair values	
	31 Dec 2006	31 Dec 2005	positive	negative
Volumes	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2006
<b>Contracts with interest rate risks</b>				
Interest swaps	313,105	278,615	6,584	7,484
Interest options				
of which: Purchases	0	0	0	0
Sales	1,245	1,230	0	14
Caps and floors <sup>1)</sup>	573	604	1	1
Spreadlocks	0	169	0	0
<b>Total</b>	<b>314,923</b>	<b>280,618</b>	<b>6,585</b>	<b>7,499</b>
<b>Contracts with currency risks</b>				
Cross-currency swaps	119,598	103,624	1,523	7,181
FX swaps	11,350	18,434	50	449
Forward exchange swaps	71	140	3	0
Spot exchange deals	0	17	0	0
<b>Total</b>	<b>131,019</b>	<b>122,215</b>	<b>1,576</b>	<b>7,630</b>
<b>Share and other price risks<sup>1)</sup></b>				
	93	342	1	3
<b>Credit derivatives<sup>2)</sup></b>				
of which: Purchases	1,885	850	0	4
Sales	0	0	0	0
<b>Total</b>	<b>1,885</b>	<b>850</b>	<b>0</b>	<b>4</b>

<sup>1)</sup> Derivative financing instruments are shown without embedded derivatives.  
<sup>2)</sup> here: Single name credit default swaps

Nominal values	Interest risks		Currency risks		Other price risks <sup>1)</sup>		Credit derivatives <sup>2)</sup>	
	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2005
<b>Maturity</b>								
<b>Remaining term of</b>								
■ up to 3 months	17,868	6,987	17,052	18,827	8	342	0	0
■ > 3 months to 1 year	34,224	38,364	22,480	16,988	0	0	0	0
■ > 1 to 5 years	145,843	135,723	65,110	65,002	85	0	1,685	850
■ > 5 years	116,988	99,544	26,377	21,398	0	0	200	0
<b>Total</b>	<b>314,923</b>	<b>280,618</b>	<b>131,019</b>	<b>122,215</b>	<b>93</b>	<b>342</b>	<b>1,885</b>	<b>850</b>

<sup>1)</sup> Derivative financing instruments are shown without embedded derivatives.  
<sup>2)</sup> here: Single name credit default swaps

EUR million

	Nominal values	Nominal values	Fair values positive	Fair values negative
	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2006
<b>Counterparties</b>				
OECD Banks	372,856	329,417	6,585	12,612
Banks outside the OECD	0	0	0	0
Other counterparties	74,459	74,420	1,555	2,514
Public authorities	605	188	22	10
<b>Total</b>	<b>447,920</b>	<b>404,025</b>	<b>8,162</b>	<b>15,136</b>

KfW Group 2006

EUR million

	Nominal values	Nominal values	Fair values positive	Fair values negative
	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2006
<b>Volumes</b>				
<b>Contracts with interest rate risks</b>				
Interest swaps	313,664	279,732	6,596	7,487
Forward rate agreements	0	13	0	0
Interest options				
of which: Purchases	0	0	0	0
Sales	1,245	1,230	0	14
Caps and floors <sup>1)</sup>	580	613	1	1
Spreadlocks	0	169	0	0
<b>Total</b>	<b>315,489</b>	<b>281,757</b>	<b>6,597</b>	<b>7,502</b>
<b>Contracts with currency risks</b>				
Cross-currency swaps	120,006	104,269	1,565	7,174
FX swaps	11,350	18,434	50	449
Forward exchange swaps	78	140	3	0
Spot exchange deals	0	17	0	0
<b>Total</b>	<b>131,434</b>	<b>122,860</b>	<b>1,618</b>	<b>7,623</b>
<b>Share and other price risks<sup>1)</sup></b>	<b>93</b>	<b>342</b>	<b>1</b>	<b>3</b>
<b>Credit derivatives<sup>2)</sup></b>				
of which: Purchases	1,885	850	0	4
Sales	0	0	0	0
<b>Total</b>	<b>1,885</b>	<b>850</b>	<b>0</b>	<b>4</b>

<sup>1)</sup> Derivative financing instruments are shown without embedded derivatives.<sup>2)</sup> here: Single name credit default swaps

Nominal values EUR million	Interest risks <sup>1)</sup>		Currency risks		Other price risks <sup>2)</sup>		Credit derivatives <sup>3)</sup>	
	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2005
<b>Maturity</b>								
Remaining term of								
▬ up to 3 months	17,895	7,103	17,059	18,851	8	342	0	0
▬ > 3 months to 1 year	34,527	38,291	22,524	17,064	0	0	0	0
▬ > 1 to 5 years	145,964	136,396	65,330	65,398	85	0	1,685	850
▬ > 5 years	117,103	99,967	26,521	21,547	0	0	200	0
<b>Total</b>	<b>315,489</b>	<b>281,757</b>	<b>131,434</b>	<b>122,860</b>	<b>93</b>	<b>342</b>	<b>1,885</b>	<b>850</b>

<sup>1)</sup> Derivative financing instruments are shown without embedded derivatives.

<sup>2)</sup> here: Single name credit default swaps

EUR million

	Nominal values		Fair values	
	31 Dec 2006	31 Dec 2005	positive 31 Dec 2006	negative 31 Dec 2006
<b>Counterparties</b>				
OECD Banks	373,836	331,200	6,639	12,608
Banks outside the OECD	1	2	0	0
Other counterparties	74,469	74,420	1,555	2,514
Public authorities	605	187	22	10
<b>Total</b>	<b>448,901</b>	<b>405,809</b>	<b>8,216</b>	<b>15,132</b>

In addition, KfW has taken on the default risks on SME and housing loans and transferred them to the capital market. These risks assumed through credit derivatives in the total amount of EUR 72.4 billion (2005: EUR 68.4 billion) are shown under the item "Contingent liabilities". The transfer of the risk in the amount of EUR 71.4 to the capital market was made through credit default swaps (EUR 61.8 billion) or credit linked notes (EUR 9.6 billion).

#### LOANS IN THE NAME OF THIRD PARTIES FOR THIRD PARTY ACCOUNT.

The loans outstanding in the name of third parties and for third party account totalled EUR 3,085 million as at 31 December 2006.

## PERSONNEL.

The average number of staff, not including the Board of Managing Directors and trainees, but including temporary staff, is calculated from the figures at quarter endings during the year under review.

	2006 KfW	2005 KfW	2006 Group	2005 Group
Female employees	1,835	1,592	1,868	1,828
Male employees	1,763	1,711	1,963	1,869
Staff not covered by collective agreements	2,241	2,140	2,506	2,141
Staff covered by collective agreements	1,157	1,163	1,325	1,556
<b>Total</b>	<b>3,398</b>	<b>3,303</b>	<b>3,831</b>	<b>3,697</b>

REMUNERATIONS AND LOANS TO MEMBERS OF THE BOARD OF  
MANAGING DIRECTORS AND THE BOARD OF SUPERVISORY DIRECTORS.

The total remuneration paid to members of the Board of Managing Directors for 2006 in the Group was EUR 2,589 thousand. This includes EUR 84 thousand for non-cash benefits and other remuneration. The current salary components were uniformly fixed at EUR 418 thousand for all members of the Board of Managing Directors.

The remuneration paid to members of the Board of Supervisory Directors of KfW was EUR 209 thousand. It is composed as follows:

The remuneration for the Chairman of the Board of Supervisory Directors is EUR 13 thousand annually, for the Deputy Chairman of the Board of Supervisory Directors it is EUR 10 thousand annually, for the members of the Board of Supervisory Directors it is EUR 5 thousand annually, for the members of the Loan Approvals Committee it is EUR 1 thousand annually and for the members of the Legal and Administrative Committee it is EUR 0,3 thousand annually. Remuneration is paid on a pro-rata basis if member join or leave the Board of Supervisory Directors during the current year.

A liability of EUR 39,106 thousand had been accrued at 31 December 2006 for obligations under pension arrangements for retired members of the Board of Managing Directors and their surviving dependants. Current payments amounted to EUR 3,336 thousand.

Loans to members of the Board of Managing Directors amounted to EUR 15 thousand on 31 December 2006. The interest rates range from 2% to 5%.

## RELATED PARTY DISCLOSURES.

Related parties or companies in the sense of GAS 11 are natural and legal persons and companies over which the reporting company may exercise an influence or which may exercise an influence over the reporting company. KfW is a public law institution owned 80% by the Federal Republic of Germany and 20% by the federal states. Transactions concluded in the year under review with the German government and individual companies in which the German government holds stakes

and which are shown in the annual report on state shareholdings (Beteiligungsbericht des Bundes) were conducted within the framework set by the KfW Law. The objective of the holdings of the German government is to fulfil the promotional mission laid down in the KfW Law.

In addition to the members of the Board of Managing Directors and the Board of Supervisory Directors, other management staff may also be related parties in accordance with GAS 11. Related parties, defined in this sense, are shown in the list of mandates and the organisation chart of KfW. Transactions with any of these persons or their close relatives may be entered into at the usual terms and conditions of KfW in the framework of its loan programmes open to the general public. Internal transactions (advances and loans) entered into with Directors of KfW are not reported here for reasons of materiality.

#### REMUNERATION OF THE AUDITOR OF THE ANNUAL FINANCIAL STATEMENTS.

The expenses contain the following remuneration of the auditor of the financial statements:

In EUR thousand				
	2006 KfW	2005 KfW	2006 Group	2005 Group
Audit	1,043	1,006	1,516	1,548
Other certifications and valuations	1,779	1,751	1,821	1,770
Tax consultancy services	0	70	2	84
Other services	632	416	632	420
<b>Total</b>	<b>3,454</b>	<b>3,243</b>	<b>3,971</b>	<b>3,822</b>

#### MANDATES HELD BY STATUTORY REPRESENTATIVES OR OTHER REPRESENTATIVES ON SUPERVISORY BOARDS OF MAJOR JOINT STOCK COMPANIES IN ACCORDANCE WITH SECTION 267 (3) OF THE GERMAN COMMERCIAL CODE (HGB)

##### Ingrid Matthäus-Maier

Deutsche Post AG, Bonn  
Deutsche Telekom AG, Bonn  
RAG AG, Essen  
RAG Beteiligungs-AG, Essen  
Salzgitter Mannesmann Handel GmbH, Düsseldorf

##### Dr Peter Fleischer

DEG - Deutsche Investitions- und  
Entwicklungsgesellschaft mbH, Cologne

##### Dr Peter Klaus

Georgsmarienhütte Holding GmbH, Georgsmarienhütte  
STEAG AG, Essen  
ThyssenKrupp Technologies AG, Essen  
Lufthansa Technik AG, Hamburg

##### Wolfgang Kroh

DEG - Deutsche Investitions- und  
Entwicklungsgesellschaft mbH, Cologne

##### Detlef Leinberger

IKB Deutsche Industriebank AG, Düsseldorf

##### Heinrich Heims

Arcelor Eisenhüttenstadt GmbH, Eisenhüttenstadt

As at 31 December 2006

BOARD OF SUPERVISORY DIRECTORS.

**Michael Glos**  
Federal Minister of Economics  
and Technology  
Chairman  
(Until 31 December 2006)  
Deputy Chairman  
(From 1 January 2007)

**Peer Steinbrück**  
Federal Minister of Finance  
Deputy Chairman  
(Until 31 December 2006)  
Chairman  
(From 1 January 2007)

**Dietrich Austermann**  
Minister of Science,  
Economics and Transport of the  
State of Schleswig-Holstein  
Member appointed by the  
German Bundesrat  
(Until 31 December 2006)

**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  
(BGW)  
Representative of Trade

**Dr Uwe Brandl**  
President of the Bayerischer  
Gemeindefrat  
Representative of the Municipalities  
(From 1 January 2007)

**Dr Ulrich Brixner**  
Chairman of the Board of Managing  
Directors of DZ BANK AG (retired)  
Representative of the Cooperative  
Banks  
(Until 31 December 2006)

**Frank Bsirske**  
Chairman of ver.di – Vereinigte  
Dienstleistungsgewerkschaft  
Representative of the Trade Unions  
(From 1 October 2006)

**Prof Dr Ingolf Deubel**  
Minister of Finance of the  
State of Rhineland-Palatinate  
Member appointed by the  
German Bundesrat  
(From 1 January 2007)

**Rüdiger Dorn**  
President  
Haus & Grund Deutschland  
Representative of the Housing  
Industry

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

**Dr Thomas R Fischer**  
Chairman of the Board of Managing  
Directors of WestLB  
Representative of the Mortgage Banks

**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  
(From 1 July 2006)

**Prof Dr Hans-Günter Henneke**  
Managing Director of the  
Deutscher Landkreistag  
Representative of the Municipalities  
(Until 31 December 2006)

**Dr Dietrich H Hoppenstedt**  
President of the Deutscher  
Sparkassen- und Giroverband e.V.  
(retired)  
Representative of the Savings Banks  
(Until 30 June 2006)

**Peter Jacoby**  
Minister of Finance  
of the State of Saarland  
Member appointed by the  
German Bundesrat  
(From 1 January 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 Bundestag

**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

**Claus Matecki**  
Member of the Federal Executive  
Board of the Confederation of  
German Trade Unions (DGB)  
Representative of the Trade Unions  
(From 1 January 2007)

**Dr Michael Meister**  
Member of the German Bundestag  
Member appointed by the  
German Bundestag  
(From 1 January 2007)

**Prof Dr Wolfgang Methling**  
Minister of the Environment of the  
State of Mecklenburg-West Pomerania  
Member appointed by the  
German Bundesrat  
(Until 31 December 2006)

**Dr Horst Metz**  
Minister of Finance of the Free State  
of Saxony  
Member appointed by the  
German Bundesrat  
(Until 31 December 2006)

**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

**Margret Mönig-Raane**  
Deputy Chairperson of ver.di e.V.  
Representative of the Trade Unions  
(Until 30 September 2006)

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

**Stefan Ortseifen**  
CEO, Board of Managing Directors of  
IKB  
Deutsche Industriebank AG  
Representative of the Industrial Loan  
Banks

**Matthias Platzeck**  
Minister President of the State of  
Brandenburg  
Member appointed by the  
German Bundesrat  
(From 1 January 2007)

**Dr Christopher Pleister**  
President of the Bundesverband  
der Deutschen Volks- und  
Raiffeisenbanken e.V. (BVR)  
Representative of the Cooperative  
Banks  
(From 1 January 2007)

**Ronald Pofalla**  
Member of the German Bundestag  
Member appointed by the  
German Bundestag  
(Until 31 December 2006)

**Heinz Putzhammer**  
Member of the Federal Executive  
Board of the Confederation of  
German Trade Unions (DGB)  
(Until 27 June 2006, deceased)

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

**Hanns-Eberhard Schleyer**  
Secretary-General of the German  
Confederation of Skilled Crafts (ZdH)  
Representative of the Skilled Crafts

**Horst Seehofer**  
Federal Minister of Food, Agriculture  
and Consumer Protection

**Michael Sommer**  
Chairman of the Confederation of  
German Trade Unions (DGB)  
Representative of the Trade Unions

**Gerhard Sonnleitner**  
President of the Deutscher  
Bauernverband e.V.  
Representative of Agriculture

**Jörg-Otto Spiffler**  
Member of the German Bundestag  
Member appointed by the  
German Bundestag

**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

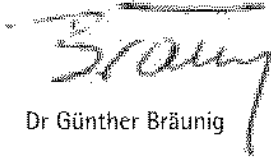
**Jürgen R Thumann**  
President of the Bundesverband  
der Deutschen Industrie e.V. (BDI)  
Representative of Industry

**Wolfgang Tiefensee**  
Federal Minister of Transport,  
Building and Urban Affairs

**Heidmarie Wieczorek-Zeul**  
Federal Minister for Economic  
Cooperation and Development

THE BOARD OF MANAGING DIRECTORS.

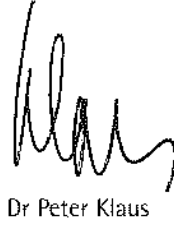
Dr Günther Bräunig      Dr Peter Fleischer      Dr Peter Klaus      Dr Norbert Kloppenburg  
Wolfgang Kroh      Detlef Leinberger      Ingrid Matthäus-Maier (Spokeswoman)



Dr Günther Bräunig



Dr Peter Fleischer



Dr Peter Klaus



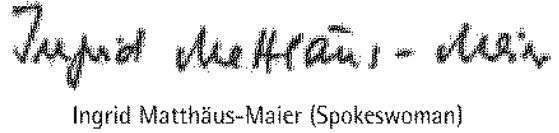
Dr Norbert Kloppenburg



Wolfgang Kroh



Detlef Leinberger



Ingrid Matthäus-Maier (Spokeswoman)

Frankfurt am Main, 23 January 2007

KfW

AUDITOR'S REPORT REPRINT.

After concluding our audit we gave the following unqualified report:

AUDITOR'S REPORT.

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, which are combined with the notes to the consolidated financial statements, together with the bookkeeping system of KfW, Frankfurt am Main, and the consolidated financial statements, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement, the segment report and the notes to the consolidated financial statements, which are combined with the notes to the financial statements as well as the combined management report of KfW and the Group for the business year from 1 January to 31 December 2006. The bookkeeping system and the preparation of these documents in accordance with German commercial law and the regulations in the Law on the KfW and its By-Laws are the responsibility of the Board of Managing Directors of KfW. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, as well as on the consolidated financial statements and the combined management report of KfW and the Group based on our audit.

We conducted our audit of the annual and consolidated financial statements in accordance with § (Article) 317 HGB ("Handelsgesetzbuch": "German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Deutschland (Institute of Public Auditors in Germany) (IDW). Those

standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual and consolidated financial statements in accordance with (German) principles of proper accounting and in the combined management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of KfW and the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual and consolidated financial statements and the combined management report are examined primarily on a test basis within the framework of the audit. The audit includes for the annual financial statements assessing the accounting principles used and for the consolidated financial statements assessing the annual financial statements of the companies included in consolidation, the determination of the companies to be included in consolidation, the accounting and consolidation principles used as well as for both statements the evaluation of significant estimates made by the Board of Managing Directors of KfW, and evaluating the overall presentation of the annual and consolidated financial statements and the combined management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

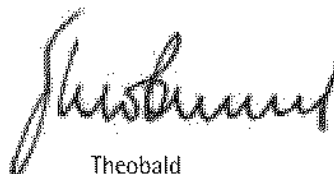
In our opinion based on the results of our audit, the annual financial statements and the consolidated financial statements comply with the legal requirements and the regulations in the Law on the KfW and its By-Laws and give a true and fair view of the net assets, financial position and results of operations of KfW and

the Group, respectively, in accordance with (German) principles of proper accounting. The combined management report is consistent with the annual financial statements and the consolidated financial statements and as a whole provides a suitable view of KfW's and the Group's position and suitably presents the opportunities and risks of future development.

Frankfurt am Main, 8 March 2007  
PricewaterhouseCoopers  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

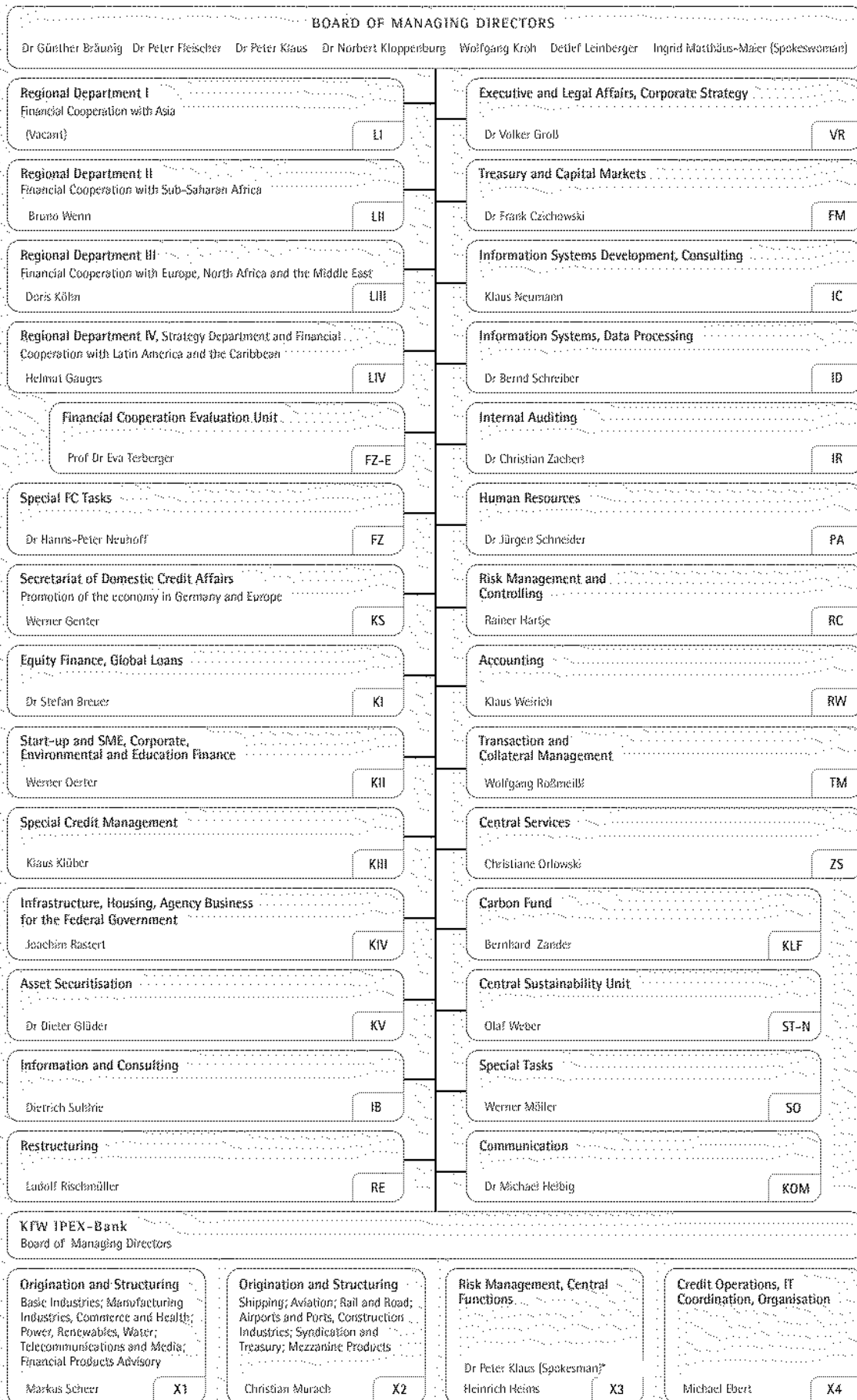


Struwe  
Wirtschaftsprüfer



Theobald  
Wirtschaftsprüfer

# KFW ORGANISATION CHART.



1 April 2007

\* Until 30 April 2007. From 1 May 2007 Mr H Heims will take over as Spokesman and retain the same areas of responsibility.

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Communication Department

Palmengartenstrasse 5-9, 60325 Frankfurt am Main

Tel +49 69 7431-0, Fax +49 69 7431-2944

infocenter@kfw.de, www.kfw.de

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Architecture: k\_m architektur, DI Daniel Sauter, [www.k\\_m-architektur.com](http://www.k_m-architektur.com)

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KfW Bankengruppe, Palmengartenstrasse 5 - 9, 60325 Frankfurt am Main  
Tel: +49 69 7431-0, Fax: +49 69 7431-2944, [infocenter@kfw.de](mailto:infocenter@kfw.de), [www.kfw.de](http://www.kfw.de)