

FINANCIAL REPORT

2010

KEY FIGURES OF THE KFW GROUP

Key income statement figures	2010	2009
	EUR in millions	EUR in millions
Net interest income	2,752	2,654
<i>Interest rate reductions</i>	- 558	- 571
Net commission income	273	286
Administrative expense	722	742
Operating result before valuation	2,302	2,198
Risk provisions for lending business	424	-972
Net gains/losses from hedge accounting and other financial instruments at fair value through profit or loss	- 13	55
Net gains/losses from securities and investments	- 1	- 120
Operating result after valuation	2,712	1,161
Net other operating income	- 27	23
Profit/loss from operating activities	2,685	1,184
Taxes on income	54	57
Consolidated profit	2,631	1,127
Consolidated profit before IFRS effects from hedging	3,061	1,432
Change in revaluation reserves recognised directly in equity	33	261
Cost/income ratio before interest rate reductions ¹⁾	20.2 %	21.1 %

Key balance sheet figures	2010	2009
	EUR in billions	EUR in billions
Total assets	441.8	400.1
Volume of lending	426.7	383.5
Contingent liabilities	7.0	7.5
Irrevocable loan commitments	65.3	50.4
Assets held in trust	16.6	16.9
Volume of business	530.6	474.8
Equity	15.8	13.1
Equity ratio	3.6 %	3.3 %

Key regulatory figures	2010	2009
	EUR in billions	EUR in billions
Risk position	124.1	129.4
Tier 1 capital	15.3	12.2
Total regulatory capital	18.3	15.2
Tier 1 ratio	12.4 %	9.4 %
Total capital ratio	14.7 %	11.7 %

Employees of KfW Bankengruppe	2010	2009
	4,531	4,265

¹⁾ Administrative expense in relation to adjusted income. Adjusted income is calculated by adding net interest and commission income and interest rate reductions.

Financial Report

The background of the page is composed of several diagonal stripes of varying widths and shades of blue, ranging from light to dark. In the bottom right corner, there are additional stripes in dark blue and orange, creating a dynamic, modern aesthetic.

CONTENTS

Key figures of the KfW Group

Executive Board, Directors and Managing Directors of KfW Bankengruppe 5

Letter from the Executive Board 6

Report of the Board of Supervisory Directors 12

Members of the Board of Supervisory Directors 14

Corporate Governance Report 16

GROUP MANAGEMENT REPORT 20

Economic report 22

Sustainability report 34

Risk report 36

Forecast report 57

Declaration of compliance 60

CONSOLIDATED FINANCIAL STATEMENTS 61

Statement of comprehensive income 64

Statement of financial position 66

Statement of changes in equity 67

Statement of cash flows 70

Notes 71

Auditor's report 149

*The figures in the tables were calculated accurately and added up.
 Figures may not add up to totals because of independent rounding.*

Executive Board

Dr Ulrich Schröder (Chief Executive Officer) | **Dr Günther Bräunig** | **Dr Norbert Kloppenburg** | **Bernd Loewen** | **Dr Axel Nawrath**

Directors

Dr Stefan Breuer	Dr Volker Groß	Klaus Neumann	Joachim Rastert
Dr Frank Czichowski	Klaus Klüber	Werner Oerter	Wolfgang Roßmeißl
Dr Lutz-Christian Funke	Doris Köhn	Uwe Ohls	Dr Jürgen Schneider
Helmut Gauges	Cherifa Larabi	Christiane Orłowski	Klaus Weirich
Werner Genter	Dr Matthias Leclerc	Dr Stefan Peiß	Dr Christian Zacherl

Management Board of KfW IPEX-Bank GmbH

Michael Ebert | **Christiane Laibach** | **Christian Murach** | **Markus Scheer** | **Harald Zenke** (Speaker from 1 January 2011)

KfW IPEX-Bank is responsible for the business areas of domestic project and corporate finance and international project and export finance. Since the beginning of 2008, it has been a legally independent subsidiary of KfW Bankengruppe which is subject to the German Banking Act (Kreditwesengesetz – KWG) and banking supervisory regulations.

Management Board of DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH

Dr Michael Bornmann | **Philipp Kreutz** | **Bruno Wenn** (Chairman)

DEG was founded in 1962 and has been a wholly-owned subsidiary of KfW Bankengruppe since 2001. DEG is one of the largest European development finance institutions for long-term project and corporate financing. It has been financing and structuring investments by private companies in developing and transition countries for nearly 50 years.

Dear Readers

Few people would have expected Germany's economy to recover so quickly. Just one year after the most severe economic and financial crisis since 1932, we are pleased to witness the strongest economic growth since unification. KfW's promotional business activities contributed significantly to mitigating the impact of the economic and financial crisis on enterprises. At the same time it helped to lay the foundation for Germany's economic recovery. The following milestones sum up the year 2010 for KfW:

- ▀ KfW financed investments and projects in Germany and abroad in a **total volume** of EUR 81.4 billion, an increase of 27% on the previous year thanks to the particularly positive economic situation.
- ▀ Never before was there such a high demand for KfW's financing programmes in **Germany**. In 2010 KfW provided EUR 66.6 billion to finance industry, the environment, housing and education in Germany. In the field of trade and industry alone, KfW extended loans in the sum of EUR 28.5 billion, predominantly helping small and medium-sized enterprises to stay afloat in the crisis. The KfW Special Programme played a very prominent role in this context. It helped to not only prevent a credit crunch but also to drive the recovery of the German economy.
- ▀ KfW's **international business** also increased strongly by 12% to EUR 15.0 billion. Strong demand for KfW IPEX-Bank's export and project financings continued from enterprises that were successful in quickly re-asserting themselves in global competition. The volume of commitments for operations in developing and transition countries also increased significantly.
- ▀ The current tasks to deal with the crisis had no impact on KfW's **environmental and climate protection** activities. One third of the entire promotional business volume - even more than the year before - went to domestic and international projects in energy-efficient technologies, renewable energies, forest protection and species conservation.
- ▀ In 2010 KfW and the Federal Government jointly prepared a new instrument aimed at improving **film financing** in Germany, which started in 2011. In this way we are responding swiftly and appropriately to the difficult financing conditions for film producers and are providing additional support for the economically relevant creative industries.

- In order to effectively address the emerging **eurozone debt crisis**, KfW granted a long-term loan of EUR 22.3 billion to Greece at the request of and with a guarantee from the Federal Government.
- Amid all its operational commitments, the **modernisation** of KfW remained on the agenda. Following the far-reaching modifications implemented over the last few years in the field of risk management and the restructuring of its domestic lending business, in 2010 the strategic reorientation of KfW's IT began under the motto entitled "IT Vision 2020", which is aimed at strengthening its performance capabilities in a sustainable manner. The strategic refocusing of KfW IPEX-Bank on German and European export and project financings was initiated as well. As this process evolved, Harald Zenke joined the Board of Management of KfW IPEX-Bank at the turn of the year 2010-2011. KfW also commenced its extensive "client orientation" initiative with a series of measures that include the relaunch of its internet presence and the strengthening of its marketing activities with the aim of catering to the educated consumer.
- As a promotional bank of the Federal Republic, KfW has committed itself to making responsible and transparent action comprehensible. The Board of Supervisory Directors and the Executive Board of KfW have decided to adopt the **Public Corporate Governance Code** (Public Corporate Governance Kodex – PCGK) of the Federal Republic. In order to implement the PCGK, in the course of the year 2010 KfW revised the By-Laws of KfW, modified the Rules of Procedure for the Executive Board and adopted new Rules of Procedure for the Board of Supervisory Directors. The new rules went into effect in 2011.
- The uniquely favourable framework conditions for KfW yielded an extraordinarily high **consolidated profit** of EUR 2.6 billion in 2010. KfW regards this as a special, exceptional result and considers it to be a good basis for the tasks ahead: it ensures the bank's long-term promotional capabilities and makes it easier for KfW to prepare for the tougher capital requirements under Basel III.

To support Germany, secure internationalisation and finance development – these were and continue to be KfW's great challenges. The bank has met them successfully, and it will continue to take responsibility for these challenges in the future as well.

■ "The record demand for KfW products in the year 2010 shows that we have offered the German economy the right solutions even during the crisis."

Results of the activities of the individual business areas

The **business area KfW Mittelstandsbank** made loan commitments in a volume of EUR 28.5 billion in 2010, a 20% increase on the previous year. Particularly in the focal area of environmental protection, commitments rose by 59% to EUR 11.1 billion due to the strong increase in demand for KfW's Renewable Energies Programme, among other factors. Increases were also recorded in the KfW Entrepreneur Loan and Innovation Finance programmes. Commitments rose to EUR 8.0 billion and EUR 2.1 billion, respectively.

One major focus was the **KfW Special Programme** which KfW successfully implemented in 2009 and 2010 as part of the economic stimulus packages of the Federal Government in order to avert a credit crunch, secure sufficient credit particularly for SMEs and assist in the recovery of the German economy following the deep slump in 2009. Nearly 5,000 applications for around EUR 13.3 billion were approved by the end of the year, mostly for small and medium-sized enterprises. The support had an immediate positive impact on employment: the investments carried out by these enterprises secured around 1.2 million jobs.

In the **business area KfW Privatkundenbank**, the overall volume of financing increased by 24% to EUR 20.0 billion. While demand for financing under the programmes for energy-efficient construction and refurbishment stabilised on a high level of EUR 8.7 billion, demand for loans under the KfW Home Ownership Programme increased much more strongly to reach a volume of EUR 6.5 billion. Education finance also increased greatly. Loans for education and professional development totalled EUR 2.1 billion in 2010, an increase of 22% on the previous year. The KfW Student Loan is also being well received. Currently around 53,000 young academics are financing their first course of study with a KfW loan.

Commitments in the **business area KfW Kommunalbank** increased strongly by 69% to EUR 15.8 billion. Promotion of infrastructure in particular was characterised by dynamic growth. Demand for the KfW Investment Loan was also strong, as was demand for the products offered for municipalities under the so-called "Investment Offensive" and the now discontinued Untied Municipal Loan. The global loan business with the special credit institutions of the federal states also developed very well, reaching EUR 9.2 billion by the end of 2010.



The **business area Export and Project Finance** also experienced strong demand. Commitments rose to EUR 9.3 billion. The financing products offered by KfW IPEX-Bank were particularly sought after in the sectors of transport and infrastructure as well as energy and environment. In what continued to be a difficult market environment, KfW's subsidiary supported German and European industry as a reliable partner. In line with internal changes, KfW IPEX-Bank again is directing its business more strongly to the financing of German and European projects and exports, and it now also accommodates the requests of small and medium-sized enterprises for support as they look to internationalise their business.

In the **business area Developing and Transition Countries**, the financing volume rose by 26% to EUR 5.7 billion. KfW Entwicklungsbank accounted for EUR 4.5 billion. It provided 50% of the financing from funds of its own to complement federal budget allocations. In this way, KfW was able to again increase its contribution to raising the commitment volume recognised as Official Development Aid (ODA). Three quarters of the commitments made in 2010 now count as ODA. With its commitment to environmentally and climate-relevant projects, which account for well over half of its overall commitments, KfW Entwicklungsbank significantly expanded its position as an international climate and environmental bank.



Commitments by the KfW subsidiary DEG increased significantly after weaker results in the previous year. It committed EUR 1.2 billion for private sector investments in developing countries.

The **securitisation market** contracted very strongly during the economic and financial crisis but was kick-started again in a sustainable manner. KfW's securitisation volume was EUR 2.1 billion. Owing to their solid structures and the quality label "German Securitisation Standard", which was introduced by TSI in the summer, German securitisations again have a very good reputation. KfW was instrumental in developing these standards.

In its **funding operations** KfW Bankengruppe raised a total of EUR 76.4 billion in the international capital markets in 2010. Although the European sovereign debt crisis continues to keep the markets in suspense, KfW was able to assert itself as a leading issuer with its first-class credit quality and its equally transparent and reliable issuing strategy. The International Financing Review therefore voted KfW as best issuer of the year in its segment for its performance in the capital market.

Operating result in the financial year 2010

The extraordinarily good overall conditions in 2010 had an extremely positive impact on KfW's results for the year. The group benefited from the significantly improved economic outlook, a relaxed risk situation and continued attractive funding conditions for KfW amid a low interest rate level.

The operating result before valuation was EUR 2.3 billion, a similarly high level as in the previous year. Thanks to its good funding opportunities, KfW was able to generate high net interest income despite interest rate reductions of EUR 558 million. It was able to significantly reduce risk provisions for lending business overall as a result of the surprisingly fast recovery of the world economy, in continuation of the bank's conservative risk policy. The securities portfolio also yielded positive effects on the result in spite of the eurozone sovereign debt crisis.


At EUR 2.6 billion, KfW achieved record net interest income in the 2010 financial year - certainly a one-time result, but one that provides a good basis for meeting future challenges. The loss carried forward from IKB rescue was fully reversed and additional reserves were formed. This secures the bank's long-term promotional capabilities and makes it easier for it to prepare for the tougher capital requirements under Basel III.

Outlook

As the economic recovery progresses, we expect demand for promotional loans from KfW to normalise in the course of the year 2011. Programmes that were indispensable for many enterprises which had struggled under the crisis have fulfilled their purpose and were discontinued as planned at the end of 2010. In other fields of activity KfW continues to be called upon to act as a financier. As a "bank behind the banks" KfW always operates on a subsidiary basis. It closes financing gaps in areas of particular economic importance - and specifically where the market has weaknesses.

Both industry and society face the same challenges after the crisis as they did before the crisis. They must commit to securing the sustainability of enterprises, embracing globalisation as an opportunity, managing the consequences of climate change, responding to dwindling energy supplies and natural resources, and adapting to demographic change.

For over 60 years KfW has been providing orientation and impetus to find the right approach between meeting short-term economic needs and the more long-term goal of establishing the economic, social and ecological bases for the future. Sustainability and responsible action will in future be reflected even more strongly as the guiding principle of KfW's product range.

 "We will push ahead with the modernisation of KfW so that we will be able to work successfully as a promotional bank in future as well. Besides orientating our promotional offers more consistently to the principle of sustainability, in the coming years we will also be focusing on improving our client orientation."

In order to reach our clients better, we want to expand our client orientation at all levels. In particular, we will streamline our promotional products and make them more transparent, and we will simplify the application and processing procedure – not least through the consistent use of our internet presence as our interface with banks and clients. The first steps towards creating the necessary technical conditions were taken last year, and step-by-step implementation is to follow in the coming years. However, our systematic modernisation strategy is intended to satisfy not only the evolving demands of clients but also the demands which the German Banking Act places on a professional bank.

A modern promotional bank must continually adapt to new challenges. The past years have illustrated that it is indispensable even in a modern, globalised economic world. We have been successful in our work to enable enterprises in Germany again to feel the wind at their back and to join in the recovery with renewed strength. We will persevere in our efforts to ensure that Germany as a business location is prepared for the challenges of the future. For this we take responsibility.



Dr Ulrich Schröder
(Chief Executive Officer)



Dr Günther Bräunig



Dr Norbert Kloppenburg



Bernd Loewen



Dr Axel Nawrath

REPORT OF THE BOARD OF SUPERVISORY DIRECTORS

*Dr Wolfgang Schäuble
Federal Minister of Finance*



Meetings of the Board of Supervisory Directors

The Board of Supervisory Directors with its Committees has continually supervised the conduct of KfW's business and the administration of its assets, and it has taken the necessary decisions on the provision of financing and the conduct of other business in accordance with the conditions set forth in the Law concerning KfW and the By-Laws. For this purpose the Board of Supervisory Directors and the Executive Committee each held three meetings while the Loan Approval Committee and the Audit Committee held two meetings in 2010.

At the meetings the Executive Board informed the Board of Supervisory Directors of:

- the business activities and current developments in KfW's individual fields of activity,
- the Group's net assets, earnings position and risk situation,
- particularly sensitive areas such as the development of the remaining risk positions from the risk protection afforded to, and the sale of, the equity interest in IKB, the ship portfolio and the exposure to European banks,
- KfW's new risk-bearing capacity concept and
- KfW's risk and business strategy for the year 2011.

The Board of Supervisory Directors and the Executive Board have also expressed the intention that KfW will essentially apply the regulations of the second section of the German Banking Act accordingly and that this will exclude business in which the Federal Republic of Germany has an interest (allocation business).

In the reports on the activities of the individual fields of business, the primary focus was on the following developments:

- In regard to the domestic promotion activities, the Executive Board reported on the state of implementation and the impacts of the KfW Special Programme and the other measures with which KfW has been supporting the Federal Government in the implementation of the agreed economic stimulus measures. In addition, the Executive Board presented new products for small and medium-sized enterprises and

in the area of housing and municipal finance which were introduced in the year under review and being planned for the following year.

- With a view to KfW Entwicklungsbank, the Executive Board reported on KfW's proposals for increasing Germany's ODA commitments through the expansion of development finance based on the bank's own funds, emerging markets funds and the German Climate Technology Initiative.
- In relation to KfW IPEX-Bank GmbH and the business area of Export and project finance, the reporting was primarily centred on the financing operations performed in the interest of the German and European economy against the backdrop of the financial and economic crisis.
- The Board of Supervisory Directors was also informed of the various measures adopted to further reinforce the commitment of KfW Bankengruppe to sustainability, among them the energy efficiency of the "West Arcade" building at the Frankfurt location, which KfW occupied in the summer of 2010, and the continued growth in importance of KfW's products and financings in this segment.

The Board of Supervisory Directors was informed quarterly about the Group's net assets, earnings position and risk situation, and the development of its promotional business. In this connection, the Board of Supervisory Directors and the Audit Committee concerned themselves especially with the risks of the industries and regions affected by the financial market crisis.

The Executive Board also discussed KfW's strategic orientation with the Board of Supervisory Directors. Potential new promotional activities and conceivable modifications in the definition of priorities were discussed. The continued positive development of the Group's profitability and the associated improvement of its risk-bearing capacity were also highlighted as fundamental objectives. The Board of Supervisory Directors approved the budgets associated with the planning for the year 2011.

In 2010 the Board of Supervisory Directors reviewed the compensation scheme for the Executive Board members.

Legal disputes

The Board of Supervisory Directors was informed of the current state of the lawsuits filed by the Executive Board members removed and dismissed in 2008 as a consequence of the Lehman incident and agreed to a settlement with one of the former Executive Board members and the D&O insurance company. The Executive Board also informed the Board of Supervisory Directors of lawsuits in connection with the "Rhineland" conduit taken over by IKB.

Corporate Governance

The Board of Supervisory Directors and the Executive Board of KfW in late 2009 decided to adopt the Federal Public Corporate Governance Code (Public Corporate Governance Kodex – PCGK). In implementing this decision, the Board of Supervisory Directors on 1 January 2011 approved an amendment to KfW's By-Laws, adopted Rules of Procedure of its own which comprise the regulations governing the work of the Board of Supervisory Directors, and approved the revised Rules of Procedure for the Executive Board. In addition, the submission and reporting obligations of the Executive Board to the Board of Supervisory Directors and its Committees were rewritten. The primary aim of these measures was to further enhance the transparency of KfW's By-Laws.

Committees of the Board of Supervisory Directors

In addition to the affairs of the Executive Board and the real estate matters of KfW, the Executive Committee also concerned itself with the amendments to the regulations of KfW in the course of implementation of the Corporate Governance Code.

The Loan Approval Committee reviewed the commitments that have to be presented to it under the Law concerning KfW (KfW Law) and By-Laws and was informed of the credit risks. KfW's new risk-bearing capacity concept was presented in the Loan Approval Committee and in the Audit Committee. The new concept more strongly integrates economic and regulatory targets in the management of KfW's risk-bearing capacity, incorporates stress scenarios and establishes processes for the assessment of the future risk-bearing capacity. Moreover, against the background of the financial market crisis both committees concerned themselves in particular detail with the development and risk management of KfW's securities portfolio, the ship portfolio, the exposures to European banks and the remaining risks in connection with the risk protection afforded to, and the sale of, the equity interest in IKB.

The Audit Committee concerned itself with the quarterly and risk reports as well as the annual statements of KfW Bankengruppe, and it was informed of the impacts that the German Accounting Principles Modernisation Act (Bilanzmodernisierungsgesetz) and the planned new capital regulations for banks (Basel III) will have for KfW. It made corresponding recommendations to the Board of Supervisory Directors for the preparation of the annual financial statements and the appointment of the auditor.

The committee chairpersons reported to the Board of Supervisory Directors regularly on the work of the committees.

Changes on the boards

At the proposal of the Executive Committee, the Board of Supervisory Directors in its meeting of 8 December 2010 again appointed Dr Günther Bräunig as a regular Executive Board member for the term from 1 October 2011 to 30 September 2016.

As was agreed, in my capacity as Federal Minister of Finance I assumed the position of Chairman of the Board of Supervisory Directors for 2011 from my colleague Rainer Brüderle, Federal Minister of Economics and Technology.

During the reporting period, Christian Brand, Prof. Dr Kurt Faltlhauser, Axel Gedaschko, Roland Koch, Dr Helmut Linssen, Hartmut Möllring, Alexander Rychter and Christine Scheel resigned from the Board of Supervisory Directors. The Board of Supervisory Directors would like to thank these former members for their work on the board. In the year 2010 Dr Norbert Walter-Borjans and on 1 January 2011 Norbert Barthle, Jan Bettink, Volker Bouffier, Ingeborg Esser, Georg Fahrenschohn and Stefan Mappus joined the Board of Supervisory Directors.

Annual financial statements

KPMG, who were appointed auditors for the 2010 financial year, have audited the annual financial statements and the management report of KfW as well as the consolidated financial statements and the group management report of the KfW Group, all of which were prepared as at 31 December 2010 by the Executive Board, and issued an unqualified auditor's report thereon. The financial statements and the management report were prepared in accordance with the provisions of the German Commercial Code (*Handelsgesetzbuch – HGB*) and the consolidated financial statements and the group management report were prepared in accordance with International Financial Reporting Standards (IFRS), as applicable in the European Union.

At its meeting on 6 April 2011 the Board of Supervisory Directors approved the financial statements and the consolidated financial statements, both of which were prepared by the Executive Board, as stipulated in Article 9 (2) of the Law Concerning KfW following a recommendation by the Audit Committee.

Frankfurt am Main, 6 April 2011

THE BOARD OF SUPERVISORY DIRECTORS



Chairman

MEMBERS AND TASKS OF THE BOARD OF SUPERVISORY DIRECTORS

The Board of Supervisory Directors supervises the conduct of KfW's business activities and the management of its assets. It approves, among others, the annual financial statements. The Board of Supervisory Directors consists of 37 members. In the year under review, the Chairman was the Federal Minister of Economics and Technology, and the Deputy Chairman was the Federal Minister of Finance.

Dr Wolfgang Schäuble

Federal Minister of Finance
Chairman
(from 1 January 2011)
Deputy Chairman
(from 1 January 2010 until 31 December 2010)

Rainer Brüderle

Federal Minister of Economics and Technology
Deputy Chairman
(from 1 January 2011)
Chairman
(from 1 January 2010 until 31 December 2010)

Ilse Aigner

Federal Minister of Food,
Agriculture and Consumer Protection

Norbert Barthle

Member of the German Bundestag
Member appointed by the German Bundestag
(from 1 January 2011)

Jan Bettink

President of the Verband
Deutscher Pfandbriefbanken
Representative of the mortgage banks
(from 1 January 2011)

Anton F. Börner

President of the Federation
of German Wholesale and Foreign Trade
Representative of trade

Volker Bouffier

Minister President of the State of Hesse
Member appointed by the German Bundesrat
(from 1 January 2011)

Christian Brand

Chairman of the Board of Managing Directors
L-Bank, Landeskreditbank Baden-Württemberg
Representative of the mortgage banks
(until 31 December 2010)

Frank Bsirske

Chairman of ver.di – Vereinigte
Dienstleistungsgewerkschaft
Representative of the trade unions

Prof. Dr Hans Heinrich Driftmann

President of the Association of German
Chambers of Industry and Commerce (DIHK)
Representative of industry

Ingeborg Esser

Managing Director
Federal Association of German Housing and
Real Estate Enterprises (GdW)
Representative of the housing industry
(from 1 January 2011)

Georg Fahrenschon

Minister of Finance of the Free State of Bavaria
Member appointed by the German Bundesrat
(from 1 January 2011)

Prof. Dr Kurt Faltlhauser

Former Minister of Finance of the
Free State of Bavaria
Member appointed by the German Bundesrat
(until 31 December 2010)

Axel Gedaschko

Former Senator
Office of Economic Affairs and Employment
Member appointed by the German Bundesrat
(until 31 October 2010)

Heinrich Haasis

President of the Deutscher Sparkassen-
und Giroverband
Representative of the savings banks

Hubertus Heil

Member of the German Bundestag
Member appointed by the German Bundestag

Gerhard P. Hofmann

Member of the Board of Managing Directors of the
Bundesverband der Deutschen
Volksbanken und Raiffeisenbanken e.V. (BVR)
Representative of the cooperative banks

Bartholomäus Kalb

Member of the German Bundestag
Member appointed by the German Bundestag

Roland Koch

Former Minister President of the State of Hesse
Member appointed by the German Bundesrat
(until 31 December 2010)

Dr h. c. Jürgen Koppelin

Member of the German Bundestag
Member appointed by the German Bundestag

Monika Kuban

Permanent deputy of the Managing Director
of the Deutscher Städtetag
Representative of the municipalities

Karoline Linnert

Mayor
Senator for Finance
of the Free Hanseatic City of Bremen
Member appointed by the German Bundesrat

Dr Helmut Linnssen

Former Minister of Finance
of the State of North Rhine-Westphalia
Member appointed by the German Bundesrat
(until 24 August 2010)

Dr Gesine Lötzsch

Member of the German Bundestag
Member appointed by the German Bundestag

Stefan Mappus

Minister President
of the State of Baden-Württemberg
Member appointed by the German Bundesrat
(from 1 January 2011)

Claus Matecki

Member of the Executive Board of the
Confederation of German Trade Unions (DGB)
Representative of the trade unions

Dr Michael Meister

Member of the German Bundestag
Member appointed by the German Bundestag

Franz-Josef Möllenberg

Chairman of the Trade Union
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
(until 31 December 2010)

Dirk Niebel

Federal Minister for Economic Cooperation and
Development

Dr Peter Ramsauer

Federal Minister for Transport, Building and Urban
Affairs

Dr Norbert Röttgen

Federal Minister for the Environment,
Nature Conservation and Nuclear Safety

Alexander Rychter

Director of the Verband der Wohnungs- und
Immobilienwirtschaft Rheinland-Westfalen e.V.
Representative of the housing industry
(until 31 December 2010)

Christine Scheel

Member of the German Bundestag
Member appointed by the German Bundestag
(until 31 December 2010)

Hanns-Eberhard Schleyer

Former Secretary General of the
Zentralverband des Deutschen Handwerks
Representative of the skilled crafts

Andreas Schmitz

President of the Bundesverband
deutscher Banken e.V.
Chairman of the Management Board
of HSBC Trinkaus & Burkhardt AG
Representative of the commercial banks

Dr Werner Schnappauf

Director General of the Executive Board of the
Bundesverband der Deutschen Industrie e.V. (BDI)
Representative of industry

Carsten Schneider

Member of the German Bundestag
Member appointed by the German Bundestag

Michael Sommer

Chairman of the Confederation
of German Trade Unions
Representative of the trade unions

Gerd Sonnleitner

President of the Deutscher Bauernverband e.V.
Representative of agriculture

Marion Walsmann

Minister for Federal and European Affairs and
Head of the State Chancellery
of the Free State of Thuringia
Member appointed by the German Bundesrat

Dr Norbert Walter-Borjans

Minister of Finance
of the State of North Rhine-Westphalia
Member appointed by the German Bundesrat
(from 15 October 2010)

Dr Guido Westerwelle

Federal Minister for Foreign Affairs

CORPORATE GOVERNANCE REPORT

As the promotional bank of the Federal Government, KfW has committed itself to making responsible and transparent actions understandable. The Executive Board and Board of Supervisory Directors of KfW have resolved to recognise the principles of the Federal Public Corporate Governance Code (Public Corporate Governance Kodex des Bundes – PCGK) and apply them at KfW. A declaration of compliance with the recommendations of the PCGK is being submitted for the first time for financial year 2010. Any potential deviations are disclosed and explained.

KfW is a public law institution under the KfW Law. The Law sets out KfW's main structural features. For example, KfW does not have a shareholders' general meeting. The shareholders are represented on the Board of Supervisory Directors of KfW and exercise control and shareholder functions (e. g. approval of the annual financial statements and adopting resolutions concerning the KfW by-laws). The number of members, membership structure and duties of the Board of Supervisory Directors are set out in the KfW Law. It also provides that the Board of Supervisory Directors is subject to supervision by the Federal Ministry of Finance in consultation with the Federal Ministry of Economics and Technology as well as direct control of the Bundesrechnungshof (Federal Audit Office).

To implement the PCGC, KfW amended its by-laws during the course of 2010, adapting the rules of procedure for the Executive Board, and including the procedural requirements in a new version of rules of procedure for the Board of Supervisory Directors. This process also included adapting proposals and legal requirements for joint stock companies where KfW saw the application to be feasible and appropriate. The new rules and regulations became effective on 1 January 2011.

Declaration of compliance

The Executive Board and Board of Supervisory Directors of KfW hereby declare: "The recommendations of the Public Corporate Governance Code of the Federal Government, as adopted by the Federal Government on 1 July 2009, the extent they are applicable for KfW as a public-law institution with the exception of the following recommendations."

D&O insurance deductible:

The existing D&O insurance contract of KfW for the Executive Board and Board of Supervisory Directors of KfW does not include a deductible, contrary to clause 3.3.2 of the Code. The future form of the insurance is currently under consideration. The members of the Federal Government who are members of the Board of Supervisory Directors have not received compensation since financial year 2010. The other members of the Board of Supervisory Directors receive relatively low compensation.

Thus the insurance deductible of "zero" for members of the Board of Supervisory Directors is thus considered appropriate.

Delegation to committees:

The KfW Law sets out the size of the Board of Supervisory Directors at 37 members and its structure. The actions of the Board of Supervisory Directors are ratified via committees, which have the advantage of being specialised in the subject matter and flexible in terms of time. In some cases, the committees not only prepare the decisions of the Board of Supervisory Directors but also – in derogation of clause 5.1.8 of the Code – make final decisions. This is done for reasons of practicality and efficiency.

- ▀ The **Executive Committee** makes final decisions in the following cases: It resolves measures dealing with important administrative matters and can make urgent decisions in pressing matters. The Executive Committee also accepts reports on Executive Board member conflicts of interest, in lieu of the Board of Supervisory Directors, in derogation of clause 4.4.3 of the Code. The Chairman of the Executive Committee approves secondary employment of Executive Board members instead of the Chairman of the Board of Supervisory Directors, in derogation of clause 4.4.4 of the Code.
- ▀ The **Credit Committee** gave final approval in 2010 to financings of up to and including EUR 100 million. It is standard procedure at banks for the final decision to be made by a credit committee. It serves to accelerate and bundle committee expertise.

Distribution of responsibilities:

The Executive Board has established rules of procedure for itself with the approval of the Board of Supervisory Directors, which govern cooperation at the management level. These rules stipulate, in derogation of clause 4.2.2 of the Code, that the Executive Board itself determine departmental responsibilities outside the rules of procedure. This ensures the required flexibility for making essential changes and thus efficient division of labour.

Loans to members of the bodies:

No personal loans were granted to members of the bodies in financial year 2010, in accordance with the recommendations in clause 3.4 of the Code. The amended by-laws stipulate that KfW may no longer grant individual loans to members of the Executive Board and Board of Supervisory Directors. For reasons of equal treatment, this does not apply to utilisation of promotional loans made available under the KfW programmes. Due to standardisation of lending and the principle of on-lending through applicants' own banks there is no danger of conflicts of interests concerning programme loans.

Cooperation between the Executive Board and Board of Supervisory Directors

The Executive Board and Board of Supervisory Directors work closely together for the benefit of KfW. The Executive Board maintains regular contact with the Chairman and Deputy Chairman of the Board of Supervisory Directors and discusses important issues concerning the management of the bank and strategy with them. The Chairman of the Board of Supervisory Directors informs the Board of Supervisory Directors of issues of major significance, and, if necessary, convenes an extraordinary meeting.

During the reporting year, the Executive Board informed the Board of Supervisory Directors about all relevant matters regarding the bank's planning, results of operations, risk assessment, risk management and financial position.

Executive Board

The Executive Board is responsible for managing the activities of KfW pursuant to the KfW Law, its by-laws and the procedural rules for the Executive Board.

The members of the KfW Executive Board assumed the following responsibilities during the year under review:

- ▀ Dr Ulrich Schröder – Chief Executive Officer, Distribution, Operational Management, Internal Auditing, Legal/Compliance and Sustainability
- ▀ Dr Günther Bräunig – Capital Market, Asset Securitisation, HR, Organisation and Internal Consulting
- ▀ Dr Norbert Kloppenburg – International Financing, Central Services
- ▀ Bernd Loewen – Risk, Finance, Restructuring, Transaction and Collateral Management
- ▀ Dr Axel Nawrath – Domestic Promotion, Environment, Information Technology

Executive Board members are obliged to act in the best interests of KfW, may not consider private interests in their decisions, and are subject to a comprehensive non-competition clause during their employment with KfW. Members of the Executive Board must disclose any conflicts of interest to the Executive Committee and their colleagues on the Executive Board without delay. No such situation occurred during the reporting year.

Board of Supervisory Directors

The Board of Supervisory Directors supervises and advises the Executive Board in the management of the bank.

In accordance with the KfW Law, the Board of Supervisory Directors consists of 37 members. In accordance with the law, seven Federal Ministers are members of the Board of Supervisory Directors. The Federal Minister of Finance and the Federal Minister of Economics and Technology alternate on a yearly basis as Chairman of the Board of Supervisory Directors. The Chairman of the Board of Supervisory Directors in the reporting year was Federal Minister Rainer Brüderle. There were six female members of the Board of Supervisory Directors during the reporting year.

No member of the Board of Supervisory Directors may have a business or personal relationship with KfW or its Executive Board which could be grounds for a significant non-temporary conflict of interest. Every member of the Board of Supervisory Directors is obliged to disclose conflicts of interest to the Board of Supervisory Directors. No such situation occurred during the reporting year.

Seven members of the Board of Supervisory Directors attended fewer than half of the board meetings in the reporting year.

Committees of the Board of Supervisory Directors

The Board of Supervisory Directors has established three committees to fulfil its monitoring responsibilities in a more efficient manner.

The **Executive Committee** is responsible for all legal and administrative matters, as well as the bank's business and corporate policy matters; it also makes urgent decisions in pressing matters.

The **Credit Committee** is responsible for all credit related issues.

The **Audit Committee** is responsible for accounting and risk management issues. In particular it monitors the accounting process, the effectiveness of the internal control, internal auditing and risk management systems, the auditing of the consolidated and annual financial statements and the required auditor independence, as well as establishing audit priorities.

The chairs of the committees report to the Board of Supervisory Directors on a regular basis. The Board of Supervisory Directors has the right to take responsibility for tasks delegated to the committees at any time.

The Board of Supervisory Directors provides information about its work and that of its committees during the reporting year in its report. An overview of the members of the Board of Supervisory Directors and its committees is available on the KfW website.

Shareholders

The Federal Government owns 80% of KfW's share capital; the German Federal States 20%. In accordance with section 1a of the KfW Law, the Federal Republic of Germany is liable for specific KfW liabilities. There is no profit distribution. The KfW Law does not require a shareholders' general meeting; the Board of Supervisory Directors performs the function of a shareholders' general meeting.

Supervision

KfW is subject to legal supervision by the Federal Ministry of Finance in consultation with the Federal Ministry of Economics and Technology. The supervisory authority is authorised to adopt all measures necessary to ensure that KfW operates its business activities in accordance with the by-laws and other rules and regulations.

KfW is not subject to banking supervision regulations although it does apply the relevant norms of the German Banking Act, particularly the minimum requirements for risk management and the German Solvency Regulation (Solvabilitätsverordnung - SolvV). The Group company KfW IPEX-Bank GmbH, however, is fully subject to the provisions of the German Banking Act.

Transparency

KfW provides all important information about the bank's consolidated and annual financial statements, the semi-annual report and the financial calendar on its website. Investor relations activities and corporate communications also involve regular announcements on the latest company developments. The annual Corporate Governance Report and Declaration of Compliance with the PCGC are always available on the KfW website.

Risk Management

Risk management and risk control are primary responsibilities of overall bank management at KfW. Using the risk strategy, the Executive Board defines the framework for the bank's business activities regarding risk tolerance and risk-bearing capacity. This ensures that KfW fulfils its unique responsibilities with an appropriate risk profile effectively and for the long term. The bank's total risk situation is subject to comprehensive analysis using monthly risk reports to the Executive Board, and corrective action is taken if necessary. The Board of Supervisory Directors regularly receives detailed information on the bank's risk situation.

Compliance

Compliance with regulatory requirements and voluntary performance standards is part of the corporate culture of KfW. The compliance organisation of KfW includes, in particular, systems for data protection as well as for the prevention of conflicts of interest, money laundering, terrorism financing and other criminal activities. There are therefore binding rules and procedures that influence the day-to-day implementation of values and the corporate culture; these are continually updated to reflect the latest legal and regulatory conditions as well as market requirements. Regular training sessions on compliance are held for KfW employees. E-learning programmes are also available in addition to the classroom seminars.

Accounting and auditing

As the supervisory authority, the Federal Ministry of Finance in consultation with the Bundesrechnungshof (Federal Audit Office) appointed KPMG AG Wirtschaftsprüfungsgesellschaft as auditor for financial year 2010 on 19 April 2010. The appointment was based on the proposal made by the Board of Supervisory Directors on 25 March 2010. The Audit Committee prepared this recommendation and determined the priorities of the audit with KPMG. The bank and the auditor agreed that the Chairman of the Audit Committee would be informed without delay of any potential grounds for bias or disqualification discovered during the audit that were not immediately rectified. It was furthermore agreed that the auditor would immediately inform the Audit Committee Chairman about any qualifying remarks or potential misstatements in the Declaration of Compliance with the PCGC. A declaration of auditor independence was obtained.

Frankfurt am Main, 6 April 2011

Efficiency audit of the Board of Supervisory Directors

The Board of Supervisory Directors reviews the efficiency of its activities on a regular basis. A self-assessment of the Board of Supervisory Directors was conducted for 2010 using a structured questionnaire. More than two thirds of the members participated in the efficiency audit. The results of the survey showed that the members of the Board of Supervisory Directors rated the work and efficiency of their body on average between satisfactory and good, while the average rating of the work and efficiency of the committees was good. The Board of Supervisory Directors discussed the results of the self-assessment in its meeting on 6 April 2011.

Compensation report

The compensation report describes the basic structure of the remuneration plan for members of the Executive Board and Board of Supervisory Directors; it also discloses the remuneration of the individual members. The compensation report is an integral part of the notes to the consolidated financial statements – Note (78) Compensation report.

The Executive Board

The Board of Supervisory Directors

GROUP MANAGEMENT REPORT



ECONOMIC REPORT

Overview of the KfW Group

The KfW Group consists of KfW and six consolidated subsidiaries. KfW is the promotional bank of the Federal Republic of Germany and supports the sustainable improvement of economic, social and ecological conditions, particularly with regard to SMEs, start-ups, environmental protection, the housing sector, infrastructure, education, project and export finance and development cooperation. In addition to KfW, the Group's main operating subsidiaries are KfW IPEX-Bank, which provides project and export financing, and DEG, which is active in promoting the private sector in developing and emerging countries.

In accordance with the requirements of SIC 12, two special funds (previous year: three) responsible for the Group's strategic asset management were included in the consolidated financial statements. The total volume of special funds was further reduced in 2010 following the realignment of the investment strategy in the previous year. The special fund established in connection with the IKB sale in 2008 is no longer included in the consolidated financial statements as the realisation of the portfolio investments has been completed.

The development of the Group's operating result is largely dependent on the financial performance of the KfW Group.

Composition of the KfW Group – Total assets (before consolidation)

	2010	2009
	EUR in millions	EUR in millions
KfW	440,280	400,305
Subsidiaries		
KfW IPEX-Bank GmbH, Frankfurt am Main (KfW IPEX-Bank)	24,140	25,787
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne (DEG)	4,215	3,710
KfW IPEX-Beteiligungsholding GmbH, Frankfurt am Main	1,871	1,873
KfW Beteiligungsholding GmbH, Bonn	1,093	1,043
tbg Technologie-Beteiligungs-Gesellschaft mbH, Bonn (tbg)	330	397
Finanzierungs- und Beratungsgesellschaft mbH, Berlin (FuB)	27	44
Special purpose entities required to be consolidated		
Special funds	2,237	3,323
Investments accounted for using the equity method		
Railpool Holding GmbH & Co. KG, Munich (50%)	303	283
Railpool GmbH, Munich (50%)	8	4
Microfinance Enhancement Facility S.A., Luxembourg (16.7%)	100	86
Green for Growth Fund, Southeast Europe S.A., Luxembourg (17.3%)	58	-
AF Eigenkapitalfonds für deutschen Mittelstand GmbH & Co. KG, Munich (49%)	4	-

General economic environment

The global economic recovery continued in 2010, leading to strong economic growth, particularly in the first half of the year. This recovery was mainly due to continuing highly-expansive monetary policy and fiscal stimuli in many countries. Positive growth effects also resulted from ongoing inventory build-up. In the second half of the year, the global economy adopted a more moderate pace but remained on an expansionary course.

All in all, global gross domestic product increased by around 5% in 2010 in real terms, following a decline in 2009. The growth drivers proved to be, above all, the Asian emerging markets. Aggregate output in these markets reached or exceeded the pre-crisis level in many cases. Development was particularly dynamic in China and India, where, in real terms, gross domestic product grew by over 10% and just under 10%, respectively. In most industrialised countries, meanwhile, the structural repercussions of the global financial crisis remained noticeable. The growth lost through the crisis could be only partially offset in 2010. Within the euro area, too, the growth disparities between regions widened further. Germany functioned as Europe's economic motor, in contrast to countries such as Greece and Ireland where the recession deepened.

Development on the financial markets in 2010 was hampered by growing concerns about rising government budget deficits resulting from the crisis. Credit default expectations rose considerably for some euro area member states and, during spring, reached a level for Greece at which support measures became necessary. However, the aid measures in response, which were agreed at the beginning of May, and the newly-established euro rescue package were unable to calm the financial markets for long. Ireland, another euro area member state, had to be supported in November. In view of the difficult financial market environment, the European Central Bank held tightly to its policy of generous liquidity provision for the banking sector and maintained key interest rates at a very low level. US monetary policy also maintained a highly expansive stance. In autumn the Federal Reserve Bank announced a considerable increase in the volume of its security purchases. The central banks' highly expansive monetary policy measures have been reflected in extremely low money market rates and relatively steep yield curves on average.

The problems in the European sovereign debt sector caused high volatility on the currency markets. While at the beginning of 2010 the euro was still reaching levels of over 1.45 against the dollar, it temporarily fell below 1.20 at the start of June as the Greek crisis worsened. On average, the EUR/USD exchange rate stood at 1.33 in 2010, making it around 5% lower than in the previous year.

The German real economy recovered considerably more quickly and strongly from the economic crisis than had been expected at the beginning of the year. In 2010, gross domestic product grew by 3.6% in real terms. This represented the highest annual average increase since German reunification. The recovery is particularly impressive in international comparison. Germany entered the crisis with an economy in relatively good structural health and – because it is highly export-oriented – had to contend only with a steep, but relatively short-lived drop in global demand. For the same reason, the country has benefited from global economic momentum in the upturn. Alongside export demand, domestic demand, i.e. consumption and investment, grew notably in 2010. Household consumption benefited from the declining unemployment rate which, uniquely among large industrialised countries, fell to below the pre-crisis level as early as summer 2010. The short-time working programme (Kurzarbeit), with which the state eased the cost burden on companies and helped them to maintain staff despite the sometimes severe loss of sales during the crisis, played a significant part in this positive labour market development. The improved sales prospects in the domestic market, together with increasing exports, had a positive impact on companies' willingness to invest. With perceptible increases in capacity utilisation, gross fixed capital formation contributed considerably to economic growth. Due to the strong upswing, public finances performed significantly less badly than had been feared at the start of 2010, although at 3.5%, the German government deficit, as with the deficits of almost all European Union countries, exceeded the Maastricht criterion in 2010 due to the after-effects of the stimulus measures.

Development of the KfW Group

The overall environment for the KfW Group was uniquely favourable in 2010. The Group benefited from considerably improved growth and a low level of risk, as well as from continuing attractive refinancing conditions with low interest rates. Business activity therefore generated record earnings of EUR 2.6 billion, compared to EUR 1.1 billion in the previous year. With this result, the remaining losses carried forward from the rescue of IKB have been fully recovered. In addition, the Group's capital base was strengthened to secure its promotional capacities for the long term and in preparation for stricter capital requirements in accordance with the new Basel III requirements. This included the allocation of EUR 0.6 billion to the fund for general banking risks. A normalisation is expected in 2011. In its current earnings projections for the Group, KfW expects to achieve total earnings of about EUR 1.0 billion.

Business performance in 2010 was largely characterised by the following developments:

- A. Record demand for KfW products – the renewed increase in promotional business volume, particularly in domestic business including the KfW Special Programme successfully completed at the end of 2010, played a large role in overcoming the economic crisis.
- B. A stable operating result at a consistently high level due to KfW's continuing highly favourable funding situation.
- C. The global economic recovery – which was faster than expected at the beginning of the year – and the resulting improved risk situation in important business areas of the KfW Group, which enabled net releases

of risk provisions for the lending business. This also had a positive impact on the earnings contributions of the equity investment portfolio.

- D. The continuing uncertainties on the financial markets, particularly as a result of the problems in the European sovereign debt sector, led to considerable fluctuations of the parameters relevant for valuation. These fluctuations resulted in volatility in the fair value of the securities portfolio, and a large, purely IFRS-related negative effect on earnings arising from hedging.

A. Record demand for KfW products

The Group committed a total financing volume of EUR 81.4 billion in Germany and abroad in 2010 (previous year: EUR 63.9 billion). The focus of commitments was again on the promotion of the economy, the environment, housing and education in Germany in the amount of EUR 66.6 billion (+31%), of which EUR 28.5 billion was granted to commercial enterprises alone. KfW thus played a significant role in alleviating the impact of the economic and financial crisis on German companies and in laying the foundations for economic recovery. At EUR 15.0 billion, commitments in international business in 2010 were also above the level of the previous year (+12%). This increase resulted both from export and project finance, and from the promotion for developing and transition countries. One of KfW's promotional priorities remains climate and environmental protection, for which EUR 25.3 billion, almost a third of the total promotional volume, was employed in 2010.

	2010	2009
	EUR in billions	EUR in billions
KfW Mittelstandsbank	28.5	23.8
KfW Privatkundenbank	20.0	16.1
KfW Kommunalbank	15.8	9.4
Advisory support	0.1	0.1
Asset securitisation and capital market-related products	2.1	1.5
Export and project finance	9.3	8.9
Promotion for developing and transition countries	5.7	4.5
Total promotional volume in core business ¹⁾	81.4	63.9
Total commitment volume ²⁾	103.7	63.9

¹⁾ Adjusted for export and project financing refinanced through KfW programme loans

²⁾ Including special business from the loan granted to Greece in 2010

Another important contribution to SME lending was made by the KfW Special Programme introduced at the start of 2009, guaranteed by the Federal Republic of Germany, which expired successfully on 31 December 2010. Commitments under the programme totalled EUR 13.3 billion (of which in 2010: EUR 6.2 billion).

KfW was also mandated by the Federal Government, in accordance with Section 2 (4) of the KfW Law, to participate, without assuming any risk, in the European Union measures to refinance Greece and granted a loan of EUR 22.3 billion in this context. The total commitment volume for financial year 2010 was therefore EUR 103.7 billion.

B. Stable operating result at a consistently high level

The operating result before valuation proved stable at a consistently high level with a slight increase of EUR 105 million to EUR 2,302 million.

The Group's major source of income remained net interest income, which improved on the previous year by EUR 98 million to reach EUR 2,752 million. The Group benefited from the very good financing opportunities available to KfW. These were a result of KfW's first-class credit rating combined with the general favourable interest rate environment with very low short-term rates. At EUR 558 million, the interest rate reductions as a component of KfW's promotional business remained at a high level.

A slight decrease in general administrative expenses also helped to further improve the Group's cost/income ratio before interest rate reductions from 21.1% to 20.2%.

C. Earnings benefit from global economic recovery

The significant increase in consolidated net income in 2010 was primarily a result of the Group's risk situation, which has improved considerably thanks to the economic recovery during 2010 proceeding more quickly than had been expected at the beginning of the year. While maintaining the same conservative risk policy, risk provisions could be reduced by a total of EUR 424 million through profit or loss, after the increased need for risk provisioning had a considerable negative effect on earnings in the previous year of EUR 972 million.

In particular, collective impairments for latent risks in the loan portfolio of EUR 405 million (previous year: allocations of EUR 163 million) were reversed. These impairments were recognised to account primarily for those sectors and countries that were particularly hard-hit by the recession. The provision for immediate lending risks, which predominantly involves start-up and

innovation financing for SMEs, was more than offset by recoveries on loans already written off.

The situation in the equity investment portfolio was similar. After the negative impact on earnings of poor economic performance in the previous year (EUR 73 million), the portfolio recovered with a very positive earnings contribution of EUR 163 million in financial year 2010.

D. Continuing uncertainty on the financial markets

After improvements on the financial markets in 2009 due to stabilising measures taken by governments and central banks, the situation worsened again considerably due to problems in the European sovereign debt sector, and continued to be characterised by continuing high levels of uncertainty at the end of 2010, despite European Union measures to support certain countries in the euro area.

As in the previous year, however, the KfW Group's securities portfolio yielded both net gains recognised on the income statement (EUR 107 million; previous year: EUR 296 million) and net gains recognised directly in equity (EUR 22 million; previous year: EUR 285 million). The latter are directly connected to the reclassification of securities held as liquidity reserves in 2009.

As a result of the support measures introduced, the major part of price losses for securities and investments not carried at fair value was not considered to be permanent and therefore had no effect on profit or loss.

The valuation of derivatives resulted in charges of EUR 431 million (previous year: EUR 305 million). As a non-trading book institution, KfW uses derivatives exclusively to hedge risks that arise in connection with refinancing. Accordingly, the resulting effects on earnings were not economically meaningful, as they will offset each other again in the future.

The following key figures provide an overview of the developments in 2010:

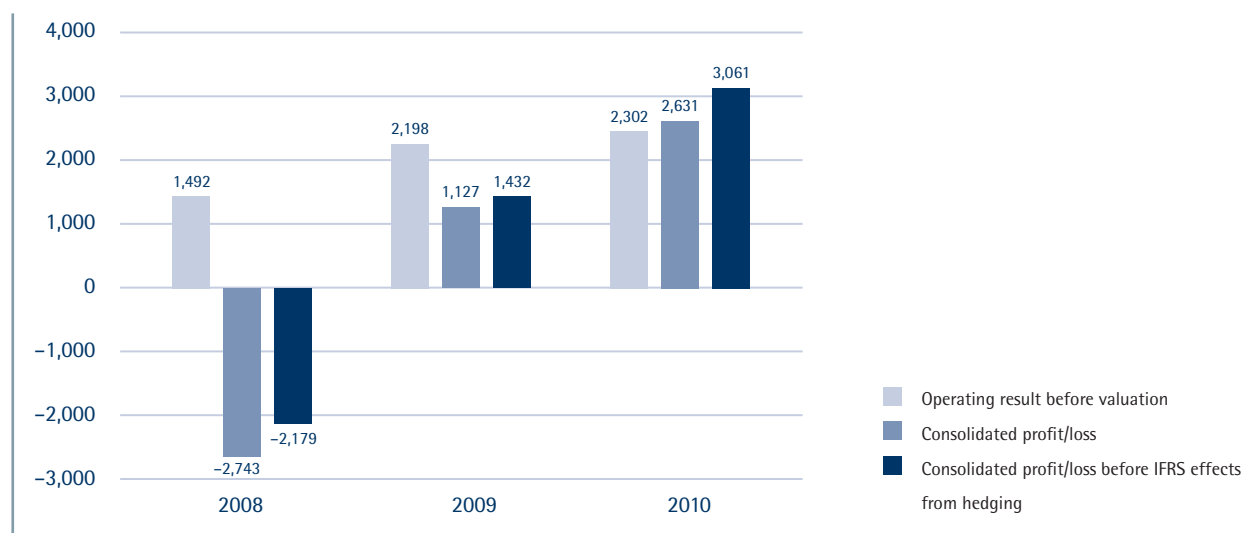
Key financial figures for the KfW Group

	2010	2009
Statement of financial position	EUR in billions	EUR in billions
Total assets	441.8	400.1
Volume of lending	426.7	383.5
Contingent liabilities	7.0	7.5
Irrevocable loan commitments	65.3	50.4
Assets held in trust	16.6	16.9
Volume of business	530.6	474.8
Equity	15.8	13.1
Equity ratio	3.6%	3.3%
Income statement	EUR in millions	EUR in millions
Operating result before valuation	2,302	2,198
Operating result after valuation	2,712	1,161
Consolidated profit	2,631	1,127
Cost/income ratio before interest rate reductions ¹⁾	20.2%	21.1%
Economic key figures	EUR in millions	EUR in millions
Consolidated profit before IFRS effects from hedging	3,061	1,432
Change in revaluation reserves recognized directly in equity	33	261

¹⁾ Administrative expense in relation to adjusted income, which is calculated by adding net interest and commission income and interest rate reductions.

The **consolidated total assets** of the KfW Group increased by EUR 41.7 billion to EUR 441.8 billion in 2010. This growth is attributable primarily to new lending business in Germany, with an increase of EUR 27.7 billion in total loans and advances to EUR 345.4 billion. In addition, particularly the conversion of funding

in USD in connection with currency derivatives used for hedging purposes, had a positive effect on total assets. The growth in total assets resulted from increased issuing activities. At EUR 358.0 billion, the volume of own issues reported under certificated liabilities was EUR 36.6 billion higher than in the previous year.

Operating result before valuation, consolidated profit/loss, consolidated profit/loss before IFRS effects from hedging (EUR in millions)


At EUR 2,302 million, the operating result before valuation improved again and remained at a high level, mainly due to stable high net interest income.

The operating result was also strengthened by a very positive valuation result – particularly due to the release of risk provisions. The combination of these two effects in financial year 2010, i.e. favourable refinancing conditions on the one hand and the low level of risk on the other, was historically unique and led to a **record consolidated profit** of EUR 2,631 million (previous year: EUR 1,127 million).

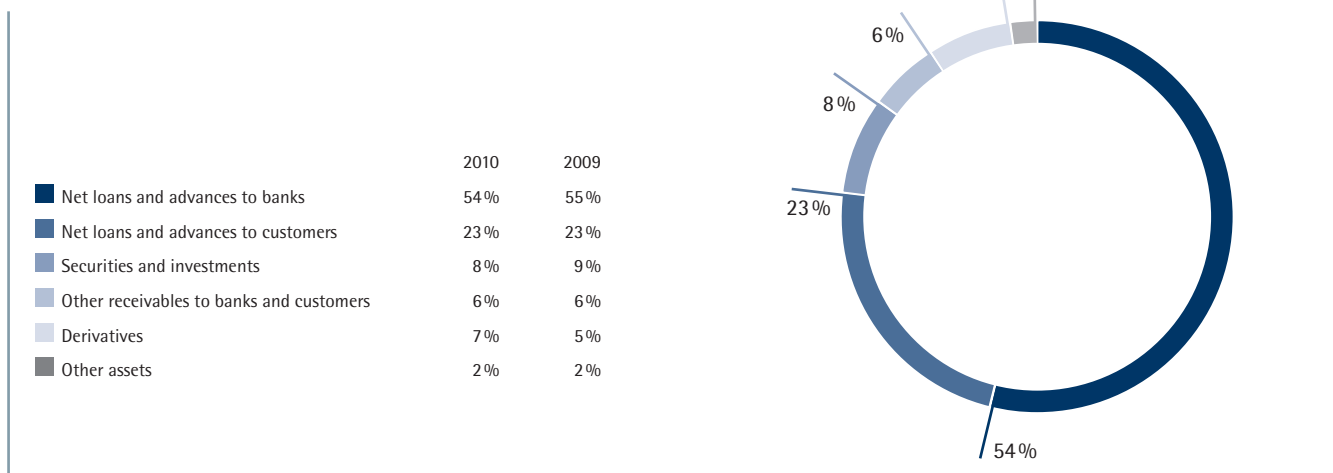
The consolidated profit including transactions recognised directly in group equity totalling EUR 33 million – mainly from securities valuations – amounted to EUR 2,663 million (previous year: EUR 1,388 million).

The consolidated profit includes purely IFRS-related charges in the amount of EUR 431 million (previous year: EUR 305 million). To aid transparency, KfW reported a consolidated profit adjusted for these effects of EUR 3,061 million (previous year EUR 1,432 million).

Development of net assets

The Group's core business remains lending to banks and customers. 77% of the Group's assets in 2010 was attributable to its lending business.

Net Assets 2010



The **volume of lending** increased by EUR 43.2 billion, or 11 %, to EUR 426.7 billion.

Volume of lending

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances	345,402	317,696	27,705
Risk provisions for lending business	-5,422	-6,904	1,482
Net loans and advances	339,980	310,793	29,187
Contingent liabilities from financial guarantees	4,950	5,637	-688
Irrevocable loan commitments	65,276	50,360	14,916
Loans and advances held in trust	16,496	16,757	-261
Total	426,701	383,546	43,155

Loans and advances increased by EUR 27.7 billion to EUR 345.4 billion in 2010, mainly due to strong new lending business in Germany. Risk provisions for lending business decreased mainly as a result of defaults on liquidity lines related to the IKB rescue measures, which were already impaired in 2008, and to the reversal of risk provisions through profit or loss resulting from improved economic growth. Net loans and advances totalled EUR 340.0 billion at year-end 2010, representing 80% of the volume of lending.

Contingent liabilities from financial guarantees stood at EUR 5.0 billion, slightly below the previous year's level. Irrevocable loan commitments increased by EUR 14.9 billion to EUR 65.3 billion in 2010, particularly due to the portion of the loan granted to Greece that has not yet been paid out. Within assets held in trust, the volume of loans and advances held in trust,

which primarily comprise loans to support developing countries that are financed by federal budget funds provided by the Federal Republic of Germany, declined only slightly on the previous year to EUR 16.5 billion.

At EUR 26.1 billion, other loans and advances to banks and customers increased by EUR 2.9 billion on the previous year's amount of EUR 23.2 billion. This item primarily comprises short-term investments, which were made due to loan commitments that had already been refinanced as well as for overall liquidity maintenance.

The total amount of securities and investments was EUR 35.2 billion, 4% below the previous year's level.

Securities and investments

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Bonds and other fixed-income securities	33,599	35,292	-1,694
Shares and other non-fixed income securities	16	67	-51
Equity investments	1,591	1,333	258
Shares in affiliated entities not included in the consolidated financial statements	2	2	0
Total	35,207	36,694	-1,487

The securities portfolio was further reduced by EUR 1.7 billion to EUR 33.6 billion as a result of the further implementation of the Group's new investment strategy, launched in the previous year, which focuses on low-risk business and maintaining liquidity. Bonds and other fixed-income securities decreased by EUR 1.8 billion to EUR 33.2 billion and the volume of money market securities remained more or less constant at EUR 0.4 billion. The volume of securities held in the special funds for strategic investment purposes was also further reduced. As at 31 December 2010, the portfolio still totalled EUR 2.2 billion (previous year: EUR 3.0 billion).

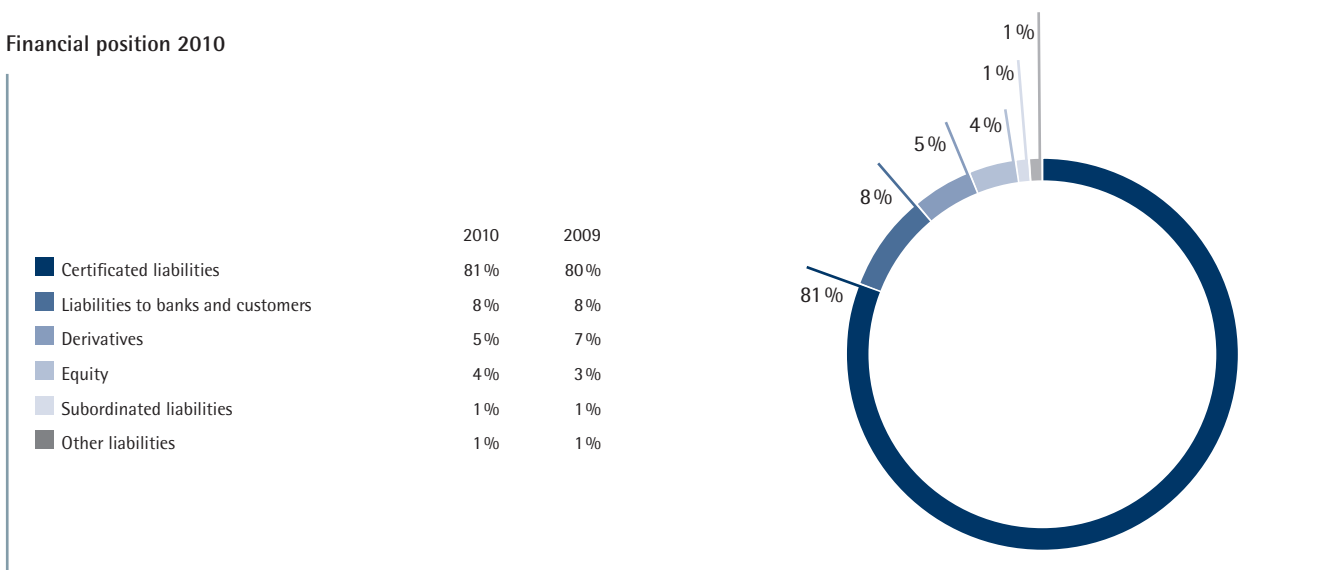
The fair values of derivatives primarily used to hedge refinancing transactions increased by EUR 10.2 billion to EUR 29.9 billion due to the development of market parameters, including exchange rates. Netting agreements reached with counterparties that also include derivatives with negative fair values and collateral agreements (largely cash collateral received) reduced the counterparty risk substantially. Value adjustments from macro hedging for underlying asset portfolios increased by EUR 0.7 billion to EUR 7.5 billion. There were only minor changes to the other items on the statement of financial position.

Development of financial position

The Group's crisis-resistant refinancing strategy in the international capital markets rests on the three pillars of "benchmark bonds in euros and US dollars," "other public bonds" and "private placements." Funds raised in

the form of certificated liabilities continued to play a key role, accounting for an increased share of 81 % of total assets in 2010.

Financial position 2010



Borrowings increased by EUR 42.4 billion, or 12%, to EUR 398.0 billion at year-end 2010.

Borrowings

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Short-term funds	26,422	33,121	-6,699
Bonds and notes	331,712	288,950	42,762
Other borrowings	36,588	30,273	6,315
Subordinated liabilities	3,247	3,247	0
Total	397,969	355,591	42,378

The Group's principal sources of funding were medium- and long-term bonds and other fixed-income securities of KfW. In 2010, funds from these sources amounted to EUR 331.7 billion and accounted for 83 % of borrowings. The increase of EUR 42.8 billion is a result of both new business and changes in exchange rates over the course of 2010 (especially with regard to the USD). Short-term issues of commercial paper decreased by EUR 6.2 billion to EUR 26.3 billion. Total short-term funds, including call and term money, amounted to EUR 26.4 billion. Other borrowings by KfW, in addition to promissory note loans by banks and customers, which declined by

EUR 3.0 billion compared with the previous year to EUR 11.4 billion, consisted mainly of liabilities to the Federal Republic of Germany and cash collateral received to reduce counterparty risk from the derivatives business.

Subordinated liabilities continue to include a subordinated loan totalling EUR 3.25 billion granted by the ERP Special Fund as part of the restructuring of the ERP economic promotion programme in 2007.

The volume of derivatives with negative fair values decreased by EUR 3.5 billion, amounting to EUR 22.8 billion at year-end.

There were only minor changes to the other items on the statement of financial position.

Equity increased by EUR 2.7 billion compared with the previous year due to the excellent consolidated comprehensive income result. As a result, the equity ratio has increased to 3.6% (previous year: 3.3%) despite the strong growth in total assets.

Equity

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Paid-in subscribed capital	3,300	3,300	0
Capital reserve	5,947	5,947	0
<i>promotional reserves from the ERP Special Fund</i>	<i>4,650</i>	<i>4,650</i>	<i>0</i>
Reserve from the ERP Special Fund	977	893	84
Retained earnings	5,218	4,725	493
Fund for general banking risks	600	46	554
Revaluation reserves	-257	-290	33
Balance sheet loss	0	-1,499	1,499
Total	15,784	13,121	2,663

The balance sheet loss from the previous year caused by the IKB rescue measures was fully recovered. The remaining profit was used to increase retained earnings and strengthen the fund for general banking risks. With the addition of EUR 0.6 billion to the fund for general banking risks, the strategy of maintaining separate risk provisions has been resumed. The risk

provisions of EUR 5.3 billion at year-end 2006 were fully used in the IKB rescue in 2007. There was a sustained improvement in the Group's capital base in 2010, which will help to secure KfW's promotional capacities for the long-term and to prepare it for the stricter capital requirements in accordance with Basel III.

Development of earnings position

The Group's operating result has been characterised by consistently high net interest income. Together with the positive valuation result driven by net income from the release of risk provisions, this has led to record earnings.

Earnings position

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Net interest income	2,752	2,654	98
<i>Including interest rate reductions</i>	- 558	- 571	13
Net commission income	273	286	- 13
Administrative expense	722	742	- 20
Operating result before valuation	2,302	2,198	105
Risk provisions for lending business	424	- 972	1,396
Net gains/losses from hedge accounting and other financial instruments at fair value through profit or loss	- 13	55	- 68
Net gains/losses from securities and investments and from investments accounted for using the equity method	- 1	- 120	119
Operating result after valuation	2,712	1,161	1,551
Net other operating income	- 27	23	- 50
Profit/loss from operating activities	2,685	1,184	1,501
Taxes on income	54	57	- 3
Consolidated profit	2,631	1,127	1,504
Consolidated profit before IFRS effects from hedging	3,061	1,432	1,630

At EUR 2,302 million in 2010, the **operating result before valuation** was EUR 105 million higher than the previous year's figure of EUR 2,198 million.

Net interest income was the Group's most important source of income and, at EUR 2,752 million in 2010, was up EUR 98 million on the previous year's level. The main driver of the continuing positive development was the extremely favourable refinancing opportunities for KfW. These opportunities were a result of both the generally favourable interest rate environment, with very low short-term rates, and KfW's first-class credit rating. Earnings from the lending business were stable and higher distribution income from the equity investment portfolio was recorded. At EUR 558 million in 2010, the interest rate reductions granted in the promotional lending business remained at an elevated level.

Net commission income decreased slightly to EUR 273 million in 2010 (previous year: EUR 286 million). In particular, the reduction of EUR 9 million in loan processing fees (EUR 112 million) and falling net income from the PROMISE and PROVIDE securitisation platforms (EUR 24 million compared to EUR 34 million in the previous year) had a negative effect on net commission income. Due to the continuing difficult market situation for securitisation products, existing business cannot be replaced with new transactions. Nominal volume decreased by EUR 12.2 billion in 2010 to

EUR 15.4 billion. Income generated by managing German Financial Cooperation in the business area Promotion for developing and transition countries business area, which was offset by corresponding administrative expenses, remained constant at EUR 107 million.

At EUR 722 million, **administrative expenses** were below expectations, decreasing from their value in the previous year of EUR 742 million, which was characterised by one-off charges from properties and internally-generated intangible assets.

Personnel expense rose by EUR 44 million to EUR 448 million as a result of salary increases due to collective pay agreements and improved performance, as well as an increase in employee headcount (by an annual average of + 6%) and in pension expenses.

The decrease in non-personnel expenses by EUR 64 million to EUR 274 million was largely due to one-off charges in the previous year.

The cost/income ratio before interest rate reductions further improved to 20.2% (previous year: 21.1%) due to the increase in operating income and the simultaneous fall in administrative expenses.

The Group's positive net result from **risk provisions for lending business** was due to a significant reduction in credit risk over the course of the year. This reflected the significant global economic recovery, which proceeded faster than had been expected at the beginning of the year, and the resulting improved risk assessments in important business areas of the KfW Group. Portfolio impairments, in particular, could therefore be reversed in financial year 2010. Taking into account recoveries of amounts previously written off, net income from risk provisions for lending business was EUR 424 million, after a large increase in provisions of EUR 972 million was necessary in the previous year.

At EUR 203 million, impairment charges for immediate lending risks, including direct write-offs, were significantly lower than their high level in the previous year (EUR 877 million). These charges predominantly resulted from start-up and innovation financing for SMEs. The Export and project financing business area also continued to record net expenditure. However, this decreased considerably on the previous year and largely related to ship financing, where no defaults have yet occurred. In contrast, promotion for developing and transition countries recorded significant net reversals which were also attributable to the business activities of DEG.

In light of the positive economic developments, a substantial net reduction of EUR 405 million in risk provisions for not yet specifically identifiable risks in the loan portfolio was achieved. In the previous year these risk provisions had to be increased by EUR 163 million. The risk provisions as at year-end 2010 thus amounted to EUR 0.9 billion (previous year: EUR 1.3 billion). Net income was mainly attributable to the reversal of risk provisions for the sectors and countries that were particularly hard-hit by the recession in the business area of Export and project financing. In the previous year the need for increased individual impairment charges was estimated to be much greater.

The provisions for losses on loans and advances cover all immediate and latent risks, reflecting consistent implementation of the KfW Group's conservative risk policy.

One-off charges resulting from the valuation of all measures implemented in 2007 and 2008 to rescue IKB remained nearly unchanged compared to the previous year and continue to total EUR 8.4 billion. After impairments, the remaining portfolio resulting from the various rescue measures was significantly reduced again in financial year 2010 to EUR 0.4 billion.

In financial year 2010 the **net gains/losses from hedge accounting and other financial instruments at fair value through profit or loss** were shaped in particular by the pleasing performance of the securities and equity investment portfolios. Due to the continuing large negative earnings effects of economic hedges under IFRS, the net result was EUR -13 million.

Despite the great uncertainties on the financial markets at the end of the year due to the problems in the European sovereign debt sector, net gains of EUR 80 million were recognised from securities recorded at fair value

through profit or loss, including fair value accounting for gains and losses on special funds for strategic asset management (previous year: EUR 368 million). These net gains primarily resulted from the reversal of impairment losses on structured securities.

The equity investment portfolio measured at fair value through profit or loss generated a pleasing high income of EUR 200 million, thanks in large part to the significant economic recovery. In the previous year, by contrast, a charge of EUR 42 million was recorded. This development is primarily attributable to the business activities of DEG in promoting developing and transition countries.

The purely IFRS-induced net negative earnings effects resulting from hedge accounting and borrowing recorded at fair value, including derivatives used for hedging purposes, remained significant at EUR 431 million (previous year: EUR 305 million). The marked-to-market derivatives are each components of economically hedged positions. However, situations in which the other part of the relevant hedged positions cannot be carried at fair value or in which different methods have to be used in the valuation inevitably result in temporary fluctuations in earnings that fully offset each other by maturity of the transaction. Due to considerable changes in the relevant market factors, these effects continue to be significant.

The improvement in **net gains/losses from securities and investments and from investment accounted for using the equity method** at EUR -1 million (previous year: EUR -120 million) was the result of opposing developments in the securities and equity investment portfolios.

Net gains/losses from securities not carried at fair value through profit or loss were EUR +27 million, an improvement on the previous year (net charges of EUR 74 million). At EUR 38 million, net charges from the equity investment portfolio were at the previous year's level.

The reversals of impairment losses from securities and investments not recognised directly in equity under revaluation reserves, amounted to EUR 30 million and also included scheduled write-ups due to the reclassifications that took place in 2008 (structured securities) and 2009 (securities held as a liquidity reserve) (EUR 113 million in 2010 and EUR 125 million in previous year). Nevertheless, these write-ups have decreased significantly in comparison to the previous year (EUR 285 million) due to the uncertainty on the financial markets and resulting temporary effects on the measurement of the securities and investments that remain carried at fair value with changes recognised directly in equity.

The total volume of securities and investments not carried at fair value was EUR 20.1 billion. Price losses were primarily observable in countries that were particularly affected by the problems in the European sovereign debt sector, while the market situation for structured securities has further improved. As a result, the difference between the carrying amount and the fair value has widened by EUR 453 million to EUR -895 million. In view of the continuing high ratings of the relevant debtors, the good collateral structure and the

support measures introduced, these changes in value were not considered to be permanent and therefore had no effect on profit or loss.

Accounting for both net other operating income and taxes on income, a **record consolidated profit** of EUR 2,631 million was recorded in 2010, following the profit of EUR 1,127 million in the previous year.

The **consolidated profit before IFRS effects from hedging** is a further key financial figure based on the consolidated profit in accordance with IFRS. Derivative financial instruments are entered into for hedging purposes. Under IFRS, the requirements for recognition and valuation of derivatives and hedges nevertheless give rise to temporary net gains or losses. In KfW's opinion, such net gains or losses do not sufficiently reflect economically effective hedges.

As a result, the following reconciliations were performed by eliminating temporary contributions to income in the amount of EUR 431 million for 2010 as follows:

- Valuation results from micro and macro hedge accounting; all of the Group's hedges are economically effective and do not give rise to any net gain or loss over the entire period to maturity.
- Valuation results from the use of the *fair value option* to avoid an accounting mismatch in the case of borrowings, including related hedging derivatives. The economically effective hedges do not give rise to any net gain or loss over the entire period to maturity.
- Valuation results from the fair value accounting of hedges with high economic effectiveness but not qualifying for hedge accounting; these hedges do not give rise to any net gain or loss over the entire period to maturity.

The reconciled earnings position stood at a net gain of EUR 3,061 million (previous year: EUR 1,432 million).

Overall, the KfW Group closed financial year 2010 with a record profit. This was principally due to the excellent overall environment and very favourable refinancing opportunities, together with a considerably improved risk situation.

Supplementary report (as of 8 March 2011)

No matters of particular importance have occurred since the end of the financial year.

SUSTAINABILITY REPORT

The sustainable improvement of economic, social and ecological conditions is the key value of KfW's mission statement. The KfW Law includes measures to protect the environment, measures with purely social objectives and to promote education, and also development policy cooperation, as independent promotional activities.

As the bank of the German Federal Government and federal states, KfW uses the Federal Government's sustainability strategy as the basis for its decisions. The comprehensive financing and promotional offering of KfW Bankengruppe in Germany and worldwide follows a set of objectives that largely correspond with those of the national sustainability strategy. This is clear from our promotional track record: Environmental and climate protection alone regularly constitutes around one third of the overall financing volume.

Dialogue with our stakeholders

The regular dialogue with our stakeholders on current developments and issues serves as a foundation for our actions. One clear example of this culture of dialogue was last year's conference "Climate protection and energy future: Setting the course for a climate-friendly economy in Germany" that KfW organised. One day after the cabinet decision on the Federal Government's Energy Concept, politicians, economists, scientists and representatives of associations met under the patronage of Federal Environment

KfW restructured its sustainability management system in 2010, thus addressing the ever increasing importance of sustainability for KfW's business performance. The Chief Executive Officer now bears direct responsibility for strategy and communication in sustainability issues. A group-level environmental and climate protection steering committee chaired by the KfW Executive Board member in charge of environmental issues was created to manage group-wide coordination and development of KfW business activities in the area of environmental and climate protection. The committee assumes a central role not only in ensuring and developing the offering of sustainable financing in environmental and climate protection but also in coordinating and developing the sustainability policy of our business areas.

Minister Dr Norbert Röttgen at our branch office in Berlin for discussions on the challenges of climate change and potential strategies for dealing with them.

Moreover, via its website KfW provides target-group specific information on all the bank's activities that now fall under the term "sustainable action".

The men and women on our staff

The employees are the cornerstone of the current and future success of the entire KfW Bankengruppe. Important components of personnel policy include fair wages, part-time work, equal opportunities and a large number of professional and health benefits. The relevant key figures remained high in 2010. Severely disabled employees constitute 6% of staff. The proportion of part-time employees rose slightly over the previous year from 18% to 19%, while the share of women in managerial positions remained constant at 26%.

In 2010, as part of certification for career and family related solutions under the "berufundfamilie" scheme, KfW performed the re-audit for the third time in a row. It was supplemented by an employee survey on current measures as well as on other potential needs in combining career and family and/or personal life. With a high participation rate and an overall positive result, the auditors confirmed that KfW maintains a family-friendly stance and culture that is above average compared to other companies.

Sustainable products

Environmental and climate protection as a promotional focus

In addition to financing for start-ups and SMEs, environmental and climate protection now constitutes KfW's most important promotional focus. The KfW Group provided a total commitment volume of EUR 25.3 billion to finance environmental and climate protection measures in Germany and

abroad in 2010 (+28% year-on-year). Thus, 31% of the total commitment volume of KfW's core business was dedicated to financing environmental and climate protection projects.

KfW's promotional programmes make a key contribution towards achievement of the Federal Government's climate protection targets. According to

preliminary estimates, the investments promoted in Germany in the area of energy-saving building rehabilitation and the expansion of renewable energies in 2010 alone will result in a permanent CO₂ reduction of around 6.6 million tonnes per year.

Evaluating environmental and social risks in core business

An environmental and social impact analysis is a major component of the assessment of every project we help finance in developing and transition countries as well as for export and project financing, above all in countries outside the EU or the OECD. The assessment systematically monitors the projects to be financed for any potential negative impacts. The environmental and social impact assessment defines protection and offsetting measures, which are overseen by a monitoring programme. KfW has over 40 of its own experts from various scientific disciplines who are not only employed to examine projects but may also be involved as needed to support projects through all stages of development.

Binding sustainability guidelines setting out the requirements for the environmental and social impact assessments specific to each business area and the procedures for implementing them have been developed for all business areas. All guidelines have been revised since 2007. A revised sustainability guideline goes into effect from 1 January 2011 for Financial Cooperation with developing countries, in which the environmental and social impact assessment is combined with a climate change assessment. This assessment ensures in a two-step process that any climate risks to the project's success are detected early and minimised, and that any potential to reduce emissions is understood and utilised where it is possible and makes sense.

Sustainable business operations

Principles for Responsible Investment (PRI)

In 2006, as one of the first German companies to join the United Nations "Principles for Responsible Investment" initiative, KfW undertook to invest its own funds in fixed and variable-rate securities, also in terms of socially responsible actions. A good 85% of the securities business in the stricter sense met these criteria as at the end of 2010. This refers to KfW's liquidity reserve, which amounted to just under EUR 20.0 billion as at 31 December 2010.

In-house environmental protection

We also aim to address the high expectations of our owners as well as our employees with our in-house environmental protection. For instance, our newly constructed and rehabilitated administrative buildings are to serve as an example of energy-efficient construction and rehabilitation. The „West-Arkade" building, a 14-storey state-of-the-art office building for up to 700 employees at our Frankfurt location, which was inaugurated in the summer, has one of the world's lowest energy requirements for an office tower, with primary energy consumption of 98 kWh per square metre.

KfW's remaining greenhouse gas emissions, particularly from business travel and heating, have been offset using emission reduction credits, resulting in a carbon footprint of zero for the bank since 2006. The primary focus of KfW's in-house environmental protection however has always been on

preventing environmental damage. This is evident in the amount of energy-related emissions, which shows that the need for offsetting has continually fallen over the years, from around 29,000 t CO₂ in 2006 to just under half that amount in 2009 (15,800 t CO₂).

KfW bonds as an investment in sustainability

Independent rating agencies specialised in the sustainable investment sector analyse and rate the corporate social responsibility of equity and bond issuers for institutional investors. Such CSR ratings assess a large number of other aspects in addition to environmental management and the products and services companies offer. Other aspects include, for example, flexible working models for employees, organisational measures to combat corruption and security investment strategies implemented. For many years, KfW has been rated by the two CSR rating agencies "Oekom Research" and "Sustainalytics", and has been assigned a top ranking by each in their international sector comparisons. Thus all KfW bonds offer attractive investment opportunities to those investors who consider a company's sustainability performance in their investment decisions. Sustainalytics (Frankfurt) assigned KfW its top rating in the "Development Agencies" segment in 2010. KfW was ranked third out of 75 non-exchange listed banks. Oekom Research (Munich) ranked KfW fourth in the "Development Banks" segment in 2010. This means it is rated a "prime investment".

RISK REPORT

Current developments

In financial year 2010, the global economy gained considerable momentum over 2009, although it slowed towards the end of the year. As expected, government rescue measures to limit the effects of the financial market crisis were reflected in the high budget deficits of the industrialised nations. This, combined with structural deficiencies in some EU countries led to a loss of confidence among capital market investors. As a result, refinancing via the capital market became too costly for some countries. International support measures of immense proportions were necessary to avoid a payment default by Greece. Ireland was the first country to have to resort to the newly established European stabilisation fund. Support measures for other euro-zone countries cannot be ruled out for 2011 unless the steps taken by the relevant countries to reduce their budget deficits and debt can restore investor confidence for the long term.

The European financial sector was heavily impacted by the negative effects of the sovereign debt crisis in Europe on the earnings and funding situation in 2010. The governmental support measures to safeguard the liquidity of euro-zone countries have had – and continue to have – a risk-mitigating effect, as do the refinancing instruments provided by the ECB. The very expansive monetary policy has been reflected in extremely low money market rates and the relatively steep yield curves on average. In addition, in some countries (e.g. Portugal, Spain, Ireland and Greece), the quality of loan portfolios deteriorated further. All in all, the risks in the banking sectors of some European countries remain substantially heightened in 2011. Furthermore, the higher capital and liquidity requirements under Basel III will pose a great challenge to the majority of banks over the next few years.

The overall positive economic development worldwide was also a positive factor for the different corporate segments in Germany. Sectors which were particularly hard hit by the crisis, such as the aviation and automotive industries, showed significant recovery and in some cases were back close to pre-crisis levels. The clear trend towards recovery has enough potential for continued positive development in 2011. However, the latent danger due to the strong export focus should not be completely ignored.

Basic principles and objectives of risk management

The Group has a statutory promotional mandate, which provides the foundations for its special position and its institutional structure. Sustained promotion is the Group's overarching purpose. Measuring and controlling the risks assumed is a key factor in order to optimally employ the available resources to carry out this promotional mandate. As part of its risk manage-

ment, the Group aims to enter into risks only to the extent that they appear acceptable with regard to the current and anticipated earnings and the probable course of the risks. Group risk/return management takes into account the special characteristics of a promotional bank. Banking supervisory law requirements, such as the minimum requirements for risk

The problems in the European sovereign debt sector caused high volatility on the currency markets in 2010. The euro temporarily suffered extreme depreciation when the Greek crisis worsened, falling below 1.20 against the US dollar at the beginning of June, for example. The annual average EUR/USD exchange rate for 2010 was 5% below the previous year.

KfW Bankengruppe has also been affected by the aforementioned developments due to its international promotional mandate. However, the effects on the group portfolio were manageable overall, and KfW was able to reduce risk provisions in the Group during the course of the year. All recognisable risks are measured using conservative standards and are taken into account in the new business management through systematic establishment of risk guidelines. The regular calculations of risk-bearing capacity show that the KfW Group can bear the risks assumed in the context of its mandate.

As in the previous years, KfW systematically further developed its processes and instruments in risk management and control in financial year 2010, also taking heed of experience gained in the financial market crisis. The key issues were revising the risk-bearing capacity concept and developing a systematic and intensive sector monitoring process. KfW IPEX-Bank and DEG were also further integrated into group risk management. The ongoing development of processes and instruments in risk management and control in 2011 will be strongly affected by the developments in the banking supervision environment. The current focus in this regard is on the third amendment to the MaRisk requirements for risk-bearing capacity, strategy and stress tests, the implementation of the amendments to the German Banking Act (*Kreditwesengesetz – KWG*), particularly relating to securitisation, and the foreseeable changes under Basel III meaning increased liquidity and capital requirements.

management (German Minimum Requirements for Risk Management – MaRisk), constitute important secondary requirements for KfW's risk management structures and procedures.

modular programme on risk topics. This training programme enables employees and management staff throughout the KfW Group to acquire orientation knowledge or to deepen their specialised knowledge.

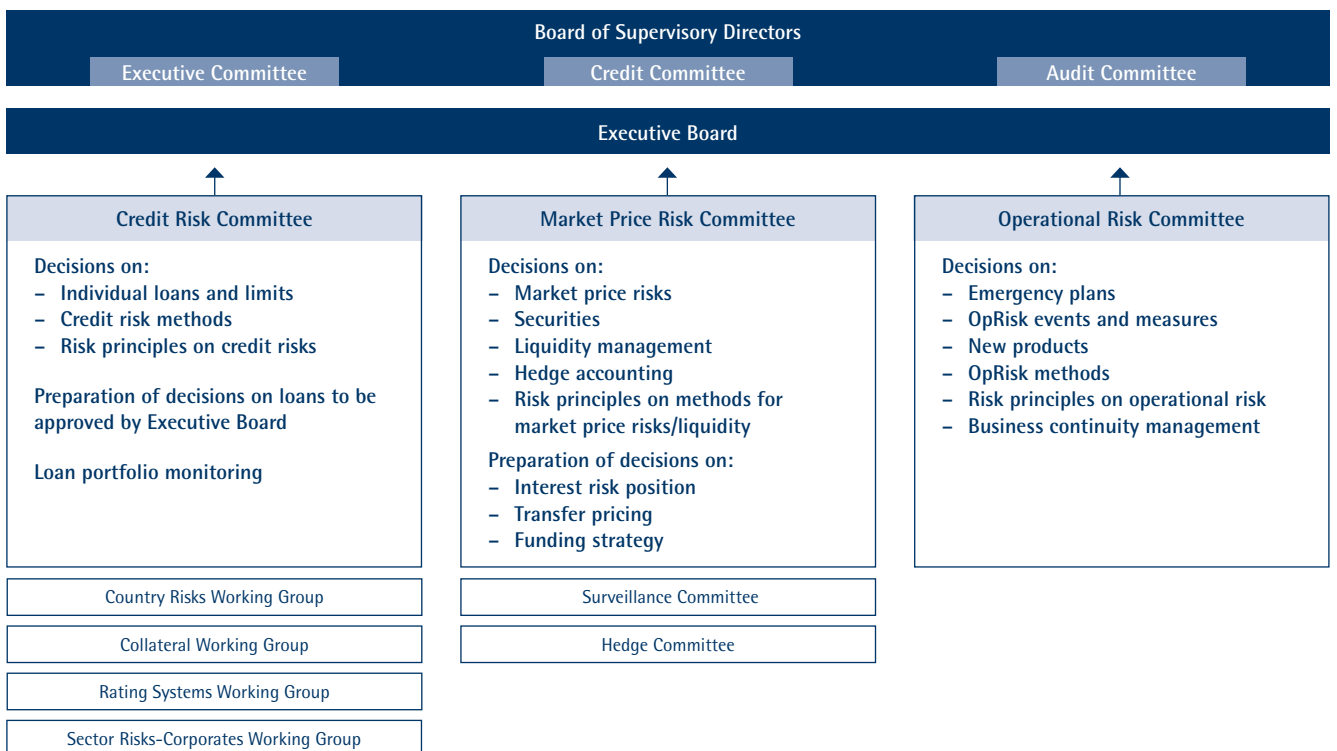
In order to establish risk management and control competence within the organisation of the bank, KfW offers training courses which include a

Organisation of risk management and monitoring

Risk management bodies and functional aspects of risk management

As part of its overall responsibility, KfW's Executive Board determines the bank's risk principles and guidelines. KfW's supervisory bodies – the Board of Supervisory Directors and the Federal Ministries of Finance and of Economics and Technology, which alternate in providing the chairman and deputy chairman of the Board of Supervisory Directors – are informed at least once per quarter of the Group's risk situation. The Executive Committee of the Board of Supervisory Directors is responsible for particularly urgent decisions. The Chairman of the Board of Supervisory Directors decides whether an issue is urgent. Risk management within the KfW Group is exercised by closely intertwined decision-making bodies. The Executive Board is at the helm of

the system; it makes the key decisions on risk policy. There is also a quarterly Executive Board meeting which includes the directors and focuses on risk management and accounting issues. These include in particular the reports prepared at the end of each quarter, but also major changes to the Group's risk manual. There are three risk committees below the level of the Executive Board (Credit Risk Committee, Market Price Risk Committee and Operational Risk Committee) which prepare decisions for the Executive Board and also make their own decisions within defined ranges of competency. Further working groups support these committees. The Chief Risk Officer of KfW generally has the right of veto in the committees. If no unanimous decision has been reached, an issue may be escalated to Executive Board level.



Credit Risk Committee

The Credit Risk Committee is chaired by the chief risk officer, and meets once a week. Its other members are the director of Risk Management and Controlling and two members of the Executive Board with front-office responsibilities. The Credit Risk Committee is supported by the Country Risks, Collateral, Rating Systems and Sector Risks–Corporates Working Groups. The weekly meetings involve in particular decisions on loans and limits. Further meetings, held on a quarterly basis, are also attended by representatives of the business areas, some central staff departments and subsidiaries of the KfW Group. Internal Auditing has guest status. The development of supervisory requirements and the effects of their implementation for KfW, as well as for KfW IPEX-Bank and DEG are discussed in these quarterly meetings and major changes to existing risk principles and credit risk methods, and drafts of new principles and methods are adopted. The committee also monitors the Group's loan portfolio.

Market Price Risk Committee

The Market Price Risk Committee is chaired by the chief risk officer, and meets once a month. Other members include the Executive Board member responsible for capital market activities, and the directors of Treasury and Capital Markets, Asset Securitisation, Risk Management and Controlling and Accounting. The Market Price Risk Committee makes decisions regarding entering into market price risks, valuation of securities, changes in market price risk methods, liquidity management issues and risk principles on market price and liquidity risk management. It also makes preparations for Executive Board resolutions on interest risk positions, transfer pricing and the funding strategy. The Market Price Risk Committee is supported by the Surveillance Committee, which deals with valuation of securities and equity investments, and the Hedge Committee, which deals primarily with the earnings effects of IFRS hedge accounting and the further development thereof.

Operational Risk Committee

The Operational Risk Committee comprises directors and meets once a quarter. It is chaired by the director of Risk Management and Controlling. The central staff departments and subsidiaries of KfW are also represented on this committee. It is responsible for dealing with issues relating to operational risk. These issues include in particular measuring and evaluating operational risks including legal risks and the relevant provisions in the risk manual, in addition to business continuity management. Resolutions and recommendations by the Operational Risk Committee are presented to the Executive Board.

There are six working groups or committees below the level of these bodies, which report to the Credit Risk Committee or Market Price Risk Committee and prepare decisions. These are:

Country Risks Working Group

The Country Risks Working Group is the central unit for assessing country risks. It is composed of economists from the regional departments of KfW Entwicklungsbank and representatives of KfW IPEX-Bank, DEG and KfW's Transaction Management. It is chaired by Risk Management. The working

group currently meets once a month due to the crisis situation (in particular the Euro crisis, Middle East crisis). If necessary, country ratings can be adjusted between the regular meetings. The role of the Country Risks Working Group is to identify, analyse and assess political and economic risks (and rewards) in the global economy and particularly in the countries in which the KfW Group does or plans to do business. Proposals for risk ratings assigned to developing, transition and emerging countries are made by the economists, while proposals for ratings assigned to industrial countries are submitted by Risk Management. Countries are ultimately assigned to risk categories on the basis of discussions conducted within the Country Risks Working Group. If no consensus is reached, Risk Management casts the deciding vote. Risk Management reports on the conclusions of meetings to the Credit Risk Committee.

Collateral Working Group

The Collateral Working Group is a central body serving KfW and its subsidiaries which ensures sufficient understanding of and uniform procedures throughout the Group for all essential aspects of collateral acceptance and valuation, and collateral management processes for lending and trading activities and structured products. It also makes recommendations for development and enhancement measures for approval/decision by the management and, when the matter falls within its defined range of competency, takes these decisions independently. The Collateral Working Group is composed of representatives from various business areas and departments. Its central functions include development, enhancement and review of collateral valuation procedures, review and expansion of accepted and acceptable collateral and the related acceptance criteria, definition and review of minimum requirements of collateral management processes and collateral acceptance and establishment of conditions for meeting guidelines under regulatory law regarding risk mitigation techniques.

Rating Systems Working Group

The Rating Systems Working Group is a central body serving KfW and its subsidiaries, which ensures sufficient understanding of all essential aspects of credit risk measurement instruments. These include in particular rating systems, loan portfolio models, risk indicators and limit management systems. The working group's tasks include evaluating and approving reports on validation and further development as well as deriving recommendations for measures to develop and enhance credit risk measurement instruments.

Sector Risks–Corporates Working Group

The new Sector Risks–Corporates Working Group, which was formed in 2010, is a central body of experts serving KfW and its subsidiaries which analyses sector-based credit risks in the corporate segment and bundles analyses which have been conducted decentrally. It provides relevant information based on the analyses to the areas of the Group concerned and if appropriate, makes proposals to minimise risk.

Surveillance Committee

The Surveillance Committee is an integral component of the surveillance and impairment process for securities and structured credit products, and reports to the Market Price Risk Committee. One of the Surveillance Committee's

central functions is to recommend valuation figures for the securities and structured products which are not to be recognised at fair value through profit or loss, i.e. for positions in the IFRS categories "loans and receivables", "held-to-maturity investments" and "available for sale", and fixed assets under the German Commercial Code (*Handelsgesetzbuch – HGB*). These recommendations are presented to the Market Price Risk Committee for decision-making.

In 2010, the valuation processes for the equity investment portfolio were integrated into the Surveillance Committee, which reports on them to the Credit Risk Committee.

Members of the Surveillance Committee include representatives of the middle and back-office departments (Risk Management and Controlling, Accounting as well as Transaction and Collateral Management) and of the responsible front-office departments.

Hedge Committee

The economic management of market price risks at KfW is the responsibility of the Market Price Risk Committee. Management measures of this kind can lead to fluctuations in valuation/results in purely accounting terms, when instruments that are to be recognised at fair value under IFRSs are used. At KfW, this applies in particular to the use of derivatives. The role of the Hedge Committee is to analyse the treatment of these instruments recognised at fair value under IFRS in line with the economic objective of the use of derivatives at KfW, and to further develop their use in compliance with IFRS provisions.

Risk Management

The primary task of the Risk Management Department is to ensure that the Group is able to bear the risks falling within its defined risk tolerance. For this purpose, it formulates and regularly reviews the Group's risk strategy, including the risk management of the major subsidiaries. The risk strategy builds on the basic business policy and establishes general risk principles and concrete risk policy measures in line with business strategy. A variety of instruments to control credit, market price and operational risks are used to implement the risk strategy. These instruments include risk management instruments for individual counterparties and portfolios: capital allocation, second vote for loan approvals, limit management systems, portfolio guidelines, risk guidelines for countries and sectors, and early warning systems. Concentration limits apply at various sub-portfolio levels (including borrower units, countries and sectors) to prevent major individual losses and to restrict

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

Responsibility for developing and assuring the quality of the risk management and control lies outside the credit departments, with Risk Management and Controlling. There is a comprehensive risk manual for this purpose and is continually updated. The rules and regulations laid out in the risk manual are binding for the entire Group and are accessible to all employees. Risk principles (i.e. normative rules for loan and risk management procedures) and portfolio guidelines (e.g. business restrictions, collateral requirements, etc.) make up the core of the risk manual. A new set of guidelines on the internal capital adequacy process was prepared in 2010. In addition, the risk strategy requirements were comprehensively revised, and substantial changes were made to the risk principles for operational risk and to various portfolio guidelines. The risk principles and portfolio guidelines serve as the framework for the operating activities of all business areas. The risk manual ensures that uniform procedures are applied throughout the Group to identify, measure, control and monitor risks. In addition, group-wide regulations are supplemented in individual business areas by specific rules. Risk Management and Controlling reviews these for conformity with group-wide regulations.

risk concentration in the loan portfolio. If necessary, a selective risk transfer can also be made to the capital market (e.g. through credit derivatives), depending on the market situation.

At KfW, Group Risk Management has the second vote in terms of credit risk assessment on a single exposure level. KfW IPEX-Bank and DEG have their own second vote independent of the front office. The relevant business decision-making processes are structured with a view to risk. The need for a second vote is determined by the type, scope (material risk content and effect on the overall risk position) and complexity of a transaction.

Risk Management Loan Support

The Risk Management Loan Support department is responsible for non-performing loans and for providing intensive support for banks and corporates in the KfW portfolio. It becomes involved and assumes full responsibility and further functions as soon as initial signs of crisis are in evidence. The objective is to achieve recovery of a loan through restructuring, reorganisation and workout arrangements. If the business partner is deemed incapable or unworthy of restructuring, the priority becomes optimum realisation of the asset and the related collateral. Internal interface regulations are in place with the relevant business areas to ensure clear control of

competences and allocation; Risk Management Loan Support also cooperates closely with the credit departments and legal department.

In the event of crisis in the banking sector, the department has to be able to act immediately both in-house and externally. The financial institution crisis plan has been further developed for this purpose. It primarily provides for the establishment of a working group headed by Risk Management, immediate loss analysis and implementation of the next steps necessary.

Risk Controlling

Risk Controlling is in charge of measuring and reporting all risks and risk groups of the KfW Group and analysing the Group's risk-bearing capacity. In this regard uniform methods and models are implemented throughout the Group on an operating level. Stress tests and scenario calculations are also used with the goal of quantifying the capital requirements needed to ensure the Group's risk-bearing capacity, including in situations characterised by considerably worsening economic conditions.

The department is involved in the quality management process for the risk indicators used in risk management and control, and also provides profes-

sional support for the information systems used in reporting. In operational risk and business continuity management, the department is responsible for the group frameworks and guidelines and supports the business areas in implementing these standards.

Risk reporting is in line with regulatory requirements (MaRisk). The Executive Board is informed on a monthly basis about the Group's risk situation. A risk report is issued quarterly to the Group's supervisory bodies. The respective bodies will be informed on an ad-hoc basis as the case may be.

Risk Methods, Instruments and Process Management

The Risk Methods, Instruments and Process Management Department is responsible for providing suitable methods and instruments for group-wide risk analysis and management. The development of a long-term, sustainable, consistent method and instrument strategy for risk management and risk control is rounded off with regular validations and developments and enhancements of models and methods. The focus is on models to measure, control and price credit and market price risks. In addition, the department

is also responsible for the coordination and project management of the professional implementation of the requirements placed on instruments and IT systems used in risk management and control. In addition, it coordinates the formulation and development of group-wide risk principles as well as the procedure manual for risk management and control.

Internal Auditing

The Internal Auditing Department supports the Executive Board, is not bound by directives and works independently of group procedures. It generally audits all of KfW's processes and activities to identify the risks involved and reports directly to the Executive Board.

The audit cycles for individual audit areas are determined by Internal Auditing based on an annual risk assessment of the audit areas. In so doing the

department takes into account the economic capital requirements of the operations to be audited.

In addition to promotional business (including the KfW Special Programme), auditing activities focused on risk management procedures and methods and the accounting department in 2010. The risk management audits focused on the further development of risk management processes and methods.

While maintaining its independence, Internal Auditing monitored important projects, particularly the implementation and development of IT systems. In 2010 Internal Auditing monitored, as in previous years, the further development of risk measurement procedures by participating (with guest status) in meetings of decision-making bodies.

Internal control system

KfW's internal control system (ICS) objectives are to ensure

- ▀ the effectiveness and profitability of business activities
- ▀ the correctness and reliability of external and internal accounting
- ▀ compliance with legal provisions applicable to KfW
- ▀ and the protection of its assets.

This is based on the organisational structure and the principles, procedures and measures introduced with a view to the organisational implementation of management decisions.

The internal control system (ICS) comprises the regulations introduced on the management of corporate activities and measures that ensure functionality of and compliance with these regulations. Accordingly, the ICS includes monitoring measures that are integrated into processes, such as internal controls, and measures that accompany processes such as those relating to

KfW's Internal Auditing is also the group auditing department for the KfW Group. It incorporates the internal auditing departments of the subsidiaries in group-wide audit reporting.

compliance. KfW's internal control system is supplemented by monitoring measures independent of processes via Internal Auditing, which also include an assessment of the adequacy and effectiveness of the ICS.

The ICS at KfW is based on the relevant standards, in particular those set forth in the KWG and MaRisk, and the market standard COSO model¹⁾. KfW's subsidiaries base their own internal control systems on the ICS at KfW and implement them in a similar way.

The Executive Board of KfW bears the overall responsibility for the internal control system. The design and implementation at the different corporate levels is the responsibility of the relevant managers according to the organisational structure. Regular reports are submitted to the supervisory bodies; at KfW to the Audit Committee of the Board of Supervisory Directors.

Accounting-related internal control system

KfW has implemented an accounting-related ICS to minimise the risk of error in single-entity and consolidated financial statements and ensure the correctness and reliability of internal and external accounting.

The accounting-related ICS has five dimensions at KfW:

1. Control environment

The control environment defines the framework for the adoption and application of regulations. The accounting-related ICS covers all systems and processes from recording business transactions to further processing and booking, and defines the relevant key controls for the responsible organisational units.

2. Risk assessment

Risk assessment includes the identification, analysis and evaluation of risks. In the accounting-related ICS, all processes between the accounting department and the relevant departments are subjected to a risk evaluation, with profitability aspects taken into account, with a view to their influence on the completeness, accuracy, recognition and measurement in the financial state-

ments. The preparation and structuring of each control item in the front-office, settlement and accounting department processes are focused on strictly defined subject areas, which comprise a complete chain of accounting-related steps from the recording of transactions to external reporting. Workshops are held on a regular basis for accounting staff and staff from KfW's business areas to rectify discrepancies and agree on procedural adjustments based on practical experience.

3. Control activities

Control activities are aimed at achieving corporate objectives effectively and reducing or detecting risks. All defined control functions are clearly assigned and are exercised by the managers of the respective departments. Each control is documented for auditing purposes and monitored centrally. The accounting department is responsible for the coordination and central monitoring of these processes.

The IT systems used at KfW are protected against unauthorised access and are integrated in the ICS. Data in the feeding systems (sub-ledgers) and the general ledger are matched on a monthly basis to ensure the completeness

¹⁾ COSO = Committee of Sponsoring Organizations of the Treadway Commission, www.coso.org

and accuracy of the data for further processing in the financial statements. External data sources (e.g. Bloomberg, Reuters) are used to value financial instruments, and are continuously monitored. Model-based valuations are in line with the market standard.

4. Information and communication

Information and communication ensures that all parties involved receive the necessary information in order to meet their control-related responsibilities. The applicable principles, organisational structure and workflow and the central processes relevant for accounting and risk management are recorded in process descriptions, working instructions and generally accessible manuals. The relevant accounting requirements are documented in full detail in a group accounting policy (IFRS) and an accounting manual (HGB). These are updated on a regular basis according to amendments by the standard setters or legislation and provided to the relevant group units. In addition, the members of group staff involved with accounting receive regular and comprehensive training.

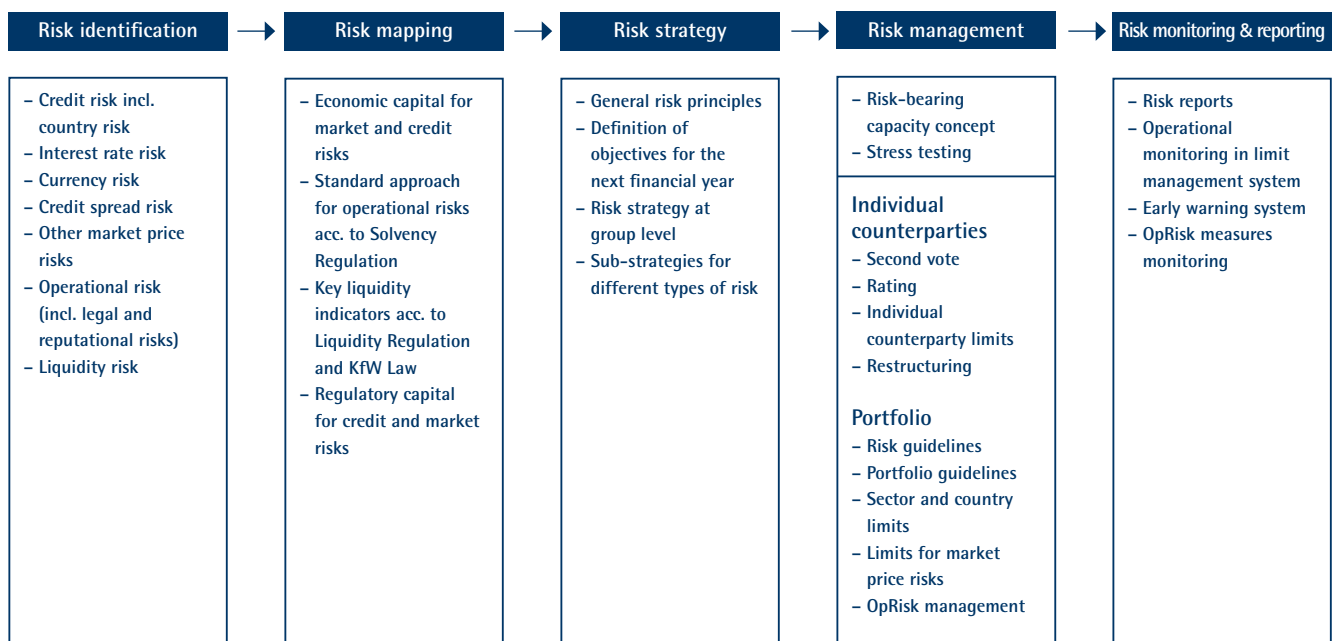
The entire control process is automated within the ICS, from carrying out the control through issuing confirmation to ongoing tracking. During the preparation of the annual financial statements, reports are submitted to the decision makers in a prompt and decision-oriented manner.

The Executive Board and Audit Committee are regularly updated on the effectiveness of the accounting-related internal control system and compliance with legal requirements.

5. Monitoring

The monitoring of the ICS ensures its functionality and effectiveness. The accounting-related ICS is subject to an ongoing monitoring and escalation process. Updates and expansions are also accounted for on an ongoing basis. The established processes provide enough scope to accommodate both accounting changes and new (technical) procedures, thereby ensuring the annual financial statements' consistent high quality level.

Risk management approach of the KfW Group



The chart above shows the KfW Group's risk management process. Risk management within the KfW Group serves one central purpose: ensuring the Group's risk-bearing capacity.

Risk-bearing capacity

Risk management was improved during the reporting year by creating stronger links between regulatory and economic risk-bearing capacity. This integration is to be further developed in 2011.

A key component of the new concept is stronger integration of economic and regulatory objectives in the management of risk-bearing capacity. Compliance with economic and regulatory requirements are treated as equal

higher-level objectives. Accordingly, all risk monitoring and management measures must ensure that an economic solvency target and a tier 1 and total capital ratio target are met. The economic and regulatory risk coverage potential have been harmonised for this purpose. KfW uses the modified available capital in accordance with Sections 10 and 10a KWG as economic resources available for risk coverage (available financial resources).

A further core issue is a stronger proactive focus of the risk-bearing capacity concept resulting from an additional forward-looking component. This evaluates the absorption potential of KfW's reserves – and thus also its ability to act – in the event of certain (stress) scenarios. A traffic light system has

been established in this context with thresholds set by the Executive Board for the strategic and operational management of economic and regulatory risk-bearing capacity.

Regulatory risk-bearing capacity

Indicators under supervisory law	2010	2009
	EUR in millions	EUR in millions
Risk position	124,077	129,386
Tier 1 capital	15,347	12,223
Regulatory capital (available financial resources)	18,259	15,195
Tier 1 ratio	12.4 %	9.4 %
Total capital ratio	14.7 %	11.7 %

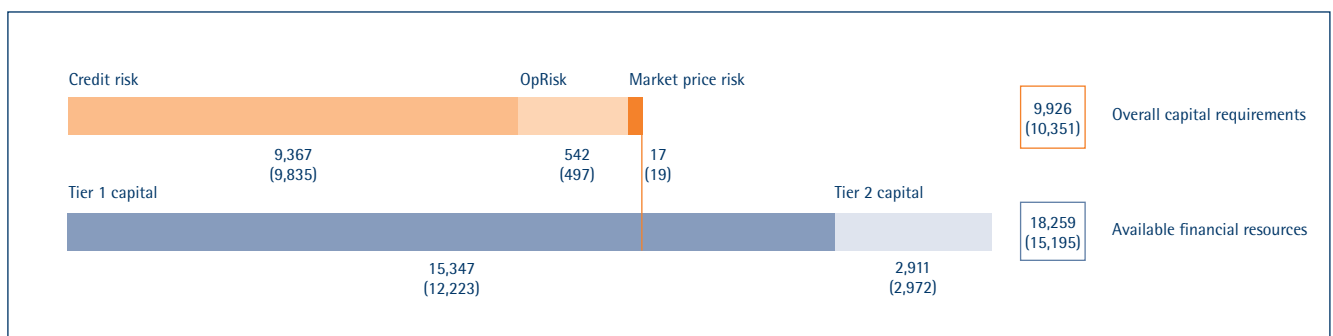
The "Risk position" indicator is the product of the total amounts of capital charges for counterparty risks, market risks and operational risks multiplied by 12.5.

KfW is not subject to the requirements of Sections 10 and/or 10a of the German Banking Act (*Kreditwesengesetz – KWG*). For internal purposes, however, the regulatory capital ratios are voluntarily calculated based on the key legal requirements. In-house rating methods are used for large sections of the loan portfolio to calculate the risk exposure (advanced IRB approach).

account the consolidated comprehensive income was 14.7% (previous year: 11.7%), and the tier 1 ratio was 12.4% (previous year: 9.4%). The positive development is largely due to the increase in regulatory capital due to the consolidated comprehensive income. In addition, the selective reduction of risk positions and methodical further development of risk assessment contributed to the decline in capital requirements for credit risks.

KfW Bankengruppe's regulatory capital ratios improved greatly on the previous year. As at 31 December 2010, the total capital ratio taking into

Regulatory risk-bearing capacity as of 31 December 2010 (EUR in millions)



In brackets: figures as of 31 December 2009

The capital requirement for credit risk was calculated to be 8%.

Economic risk-bearing capacity

To determine economic risk-bearing capacity, potential financial losses are measured with the aid of two central risk-measuring indicators: expected loss and economic capital required to cover unexpected losses.

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

- the probability of a borrower's default (probability of default, PD),
- the expected amount of receivables at the time of the potential default (exposure at default, EAD) and
- the (anticipated) loss rate upon default (loss given default, LGD).

The probability of default is estimated for each borrower with the aid of rating methods. The result of the rating measures is an estimate of the probability that a counterparty will be unable to fulfil its obligations within the next twelve months. In particular, collateral has to be evaluated to estimate the magnitude of the likely loss.

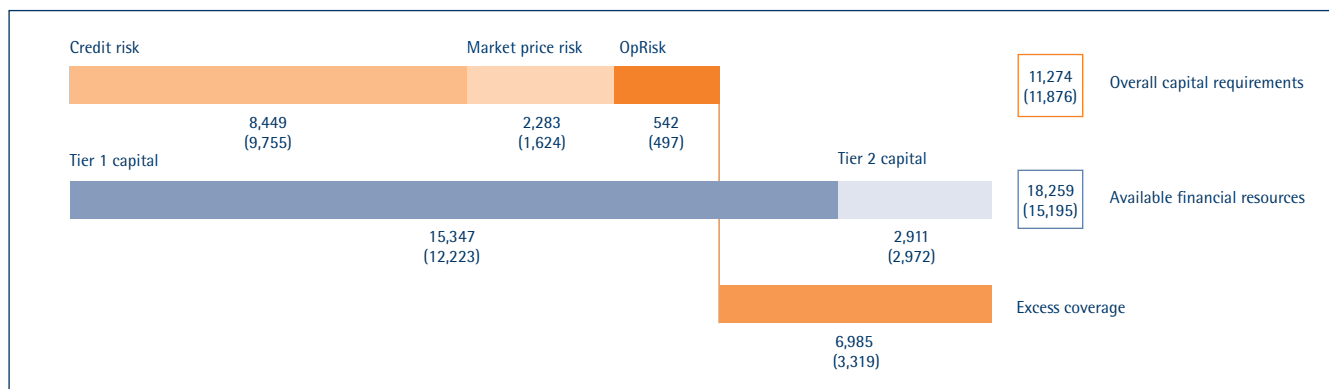
The risk potential to be backed by capital is quantified by Risk Controlling with the aid of statistical models. For credit risks, the loss potential is computed using a loan portfolio model and using the risk measure "credit value-at-risk". The difference between credit value-at-risk and expected loss is referred to as the economic capital requirement.

The Group takes a similar approach with regard to market price risks. Value-at-risk is also calculated using statistical models. For market price risks, the value-at-risk is also the economic capital requirement.

The forecast period for both risk categories is one year. The capital requirement for credit and market price risks is aggregated, taking diversification effects into account. The capital requirement for operational risks is calculated using the regulatory standard approach according to the German Solvency Regulation (*Solvabilitätsverordnung – SolV*).

To assess the risk-bearing capacity, the capital requirement (economic capital requirement) is matched against the risk-covering potential. Using this method, the economic risk-bearing capacity as at 31 December 2010 satisfied a solvency level of 99.99%. This means that overall capital requirements are covered by the risk-covering potential. The excess coverage of the risk-covering potential over the total capital requirement as at 31 December 2010 (EUR 6,985 million) was an improvement on the previous year's figure (EUR 3,319 million) calculated on the basis of the new definition of risk-covering potential and a solvency level of 99.99%.²⁾ The significant increase is partly due to the rise the risk-covering potential and the selective reduction in risk positions. In addition, the adjustments to the methods, such as the new calculation of loss given default (LGD) in the on-lending business and the revised risk assessment for equity investment fund business, led to a decline in the economic capital requirement.

Economic risk-bearing capacity as of 31 December 2010 (EUR in millions)



In brackets: figures as of 31 December 2009³⁾

²⁾ A solvency level of 99.96% was used in the previous year.

³⁾ Capital requirement determined at a 99.99% solvency level for purposes of comparison; risk coverage potential adjusted in accordance with the new definition (modified available capital in accordance with sections 10 and 10a KWG)

Hidden burdens and reserves are treated separately: the balance of hidden reserves and burdens existing as at the balance sheet date on the basis of IFRS is offset against the available economic capital buffer (excess coverage) in a memo item. Excess coverage after hidden reserves and burdens (on the basis of IFRS) amounted to EUR 6,090 million as at 31 December 2010.

KfW addresses liquidity and other risks by monitoring appropriate key figures and by regularly controlling the processes of the banking operations.

KfW's risk measurement is based on state-of-the-art models used in banking practice. However, each model represents a simplification of a complex reality and builds on the assumption that risk parameters observed in the past can be considered representative of the future. Not all possible influential factors

and their complex interactions can be identified and modelled for the risk development of a portfolio. This is one reason why KfW carries out stress tests both in the credit risk models and in the market risk models. The Group works continually to refine its risk models and processes. In 2011 KfW plans, among other things, to factor the increased correlations arising from the financial and economic crisis into risk measurement and to adapt the internal methodology for estimating exposure at default (EAD) to the regulatory approach. These changes will lead to an increase in the economic capital requirement for credit risks. In addition, the current environment of rising capital market interest rates is likely to increase in the economic capital requirement. In 2011 a fundamental review of the model for measuring interest rate risks is planned. This is likely to also lead to a change in capital requirement.

Stress and scenario calculations

When assessing risk-bearing capacity, KfW takes into account potential additional capital requirements for stress scenarios calculated in accordance with conservative standards. To ensure a stronger proactive focus in its risk-bearing capacity concept, KfW monitors, on a quarterly basis, a forecast scenario (baseline scenario), a downturn scenario (slight economic slow-down) and a stress scenario (deep recession), and their effects on economic and regulatory risk-bearing capacity. This forward-looking component shows KfW's resilience and ability to act in the event of these scenarios and therefore delivers direct management stimuli.

The forecast scenario provides a preview of risk-bearing capacity at year-end. The impact of the expected economic development on credit risks and interest rates is also included. The current forecast for year-end 2011 shows a slight decrease in the excess coverage of the risk-covering potential over the economic capital requirement compared to 31 December 2010.

In the downturn and stress scenario, effects on earnings and changes in the capital requirement are simulated for a 12 month period presuming negative

economic development. In the stress scenario, the effects of a severe recession are depicted. In both scenarios the bank assumes increasing credit risks (of differing severities). These scenarios anticipate modest falls in EUR and USD interest rates. Due to the difficult market environment to be expected in this case the stress scenario also assumes an increased capital requirement for interest risks. Potential losses from operational risks also reduce the risk-covering potential.

On the basis of the analyses carried out, KfW assumes a reduction in excess coverage of EUR 7.0 billion to EUR 2.9 billion in the stress scenario. Risk-bearing capacity is therefore assured at a solvency level of 99.99% even under unfavourable economic conditions.

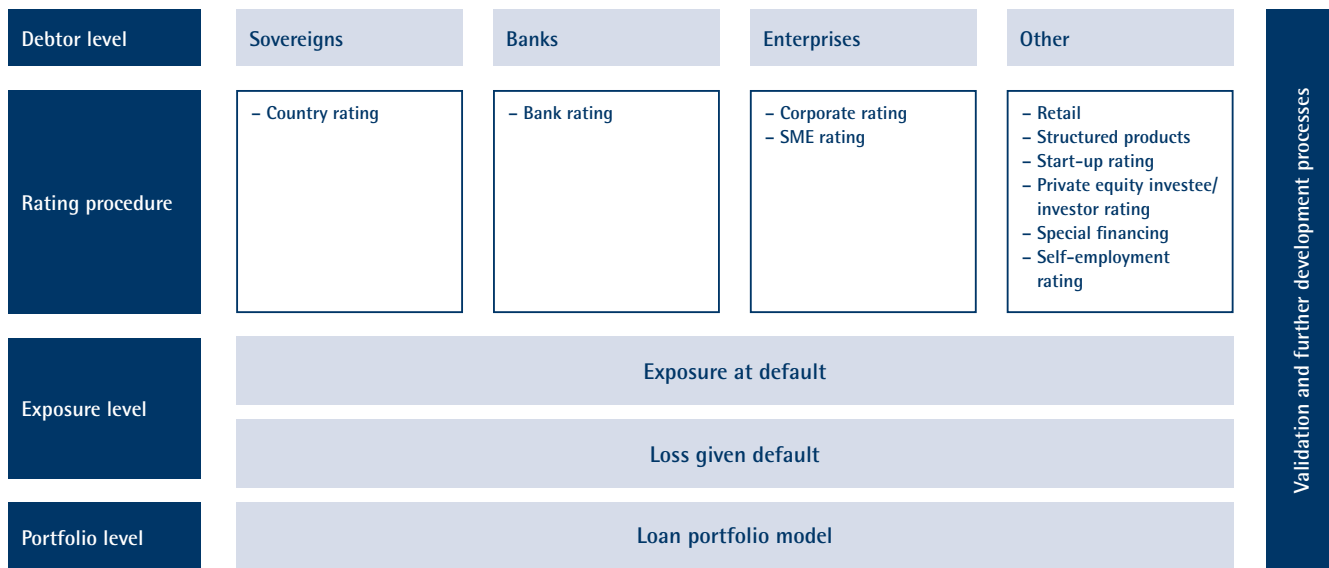
In addition to the tests based on economic scenarios, scenario stress tests are carried out. To this end, current potential macroeconomic dangers are regularly identified, on the basis of which the resilience of KfW's risk-bearing capacity is examined.

Types of risks

COUNTERPARTY DEFAULT RISK

The KfW Group assumes counterparty risks⁴⁾ in the context of its promotional mandate. The main risks in the domestic promotional lending business are in the areas of start-up finance for small- and medium-sized enterprises and

equity investments. In addition, KfW assumes risks in the context of export and project finance as well as in the context of promotion for developing and transition countries.



Counterparty default risk is **measured** by estimating the probability of default (PD), the exposure at default (EAD) and the (anticipated) loss given default (LGD).

In identifying the probability of default, the Group uses internal rating procedures for banks, corporates, small- and medium-sized enterprises, private equity investors, private equity investees, the self-employed, start-up businesses, and countries. These procedures are based on scorecards and follow a uniform and consistent model architecture. For specialised financing, a simulation-based rating method is often used. For structured products, cash flow-based rating methods are applied. For securitisation transactions, tranche ratings are determined stochastically on the basis of the default pattern of the asset pool and the waterfall structure of the transactions. The rating procedures aim at forecasting one-year default probability. As a rule, middle and back-office departments are responsible for preparing ratings for risk-bearing business. Ratings are updated at least once annually, with the exception of business partners with whom only retail business is conducted.

Mapping the default probability to a master scale which is uniform for the entire KfW Group ensures comparability of ratings issued using different rating procedures and for various business areas. The master scale consists of 20 different classes which can be divided into four groups: investment grade, non-investment grade, watch list and default. The range of default probabilities and the average default probability are defined for each master scale class.

Specific organisation regulations, which mainly specify the responsibilities, competencies and control mechanisms associated with a particular rating, apply to each rating procedure. External ratings are mapped to the KfW master scale to ensure the comparability of internal ratings within the KfW Group with ratings of external rating agencies. Periodic validation and further development of the rating procedures ensure that KfW is able to rapidly respond to changes in overall conditions. The aim is to continuously optimise the discriminative power for all rating procedures. Rating instruments and procedures largely meet the minimum requirements of the prevailing regulatory standards (MaRisk/Basel II).

⁴⁾ Counterparty default risk is defined as the risk of financial loss that can occur if the borrower or counterparty fails to meet contractual payment obligations. Counterparty default risk also includes country risk, comprising transfer, conversion and political risks.

Exposure at default (EAD) and valuation of collateral are heavily weighted when determining the severity of loss. Collateral has a risk-mitigating effect in calculating loss given default (LGD). In valuing acceptable collateral the expected net revenue from collateral realisation in case of loss is estimated over the entire loan term. This estimate takes into account haircuts based, in the case of personal surety, on the probability of default and the magnitude of loss incurred by the collateral provider. For tangible collateral the haircuts are chiefly attributable to fluctuations in market prices and devaluation resulting from depreciation. The determined value is an important element in estimating loss given default within the KfW Group. Depending on the availability of data, the various valuation procedures for individual types of collateral are based on internal and external historical data and expert estimates. The valuation parameters are reviewed on a regular basis. This guarantees the reliable valuation of individual collateral. A risk principle for loan collateral regulates uniform management, valuation and recognition of collateral across the Group.

The KfW Group has various portfolio guidelines to limit risks from **new business**. These guidelines form the basis for the second vote on lending

RISK PROVISIONING

The KfW Group takes appropriate measures to address all identifiable default risks in its lending business by making risk provisions for loans. These risks also include political risks resulting from financing transactions outside Germany. For loans with an immediate risk of default (i.e. non-performing loans) KfW recognises individual impairment charges or provisions for undisbursed portions. These events are identified on the basis of criteria that meet both Basel II and IFRS requirements. Criteria include the identification of considerable financial difficulties on the part of the debtor, payment arrears, concessions made to the debtor owing to its financial situation (for example, in the context of restructuring measures), conspicuous measures undertaken by the debtor to increase its liquidity, and a substantial deterioration in the value of collateral received. These criteria are further specified in KfW's risk manual. Individual impairment charges are determined by means of an impairment procedure. The calculation of individual impairment charges is also based on an individual assessment of the borrower's ability to make payments in the future. The calculation takes into account the scope

MAXIMUM RISK OF DEFAULT

According to IFRS 7.36, the maximum exposure to credit risk for the KfW Group arising from financial instruments is the total loss of the respective risk positions. Contingent liabilities and irrevocable loan commitments are also taken into account. Carrying amounts have been reduced by the risk provisions made.

⁵⁾ These guidelines take into account the special nature of KfW's promotional business.

transactions and serve as an orientation guide for loan approvals. They are also designed to ensure adequate quality and risk structure of KfW's portfolio⁵⁾. These guidelines distinguish between types of counterparties and product variants and define conditions under which business transactions may generally be conducted.

Existing higher-risk exposures are divided into a watch list and a list for non-performing **loans**. The watch list serves to identify potential problem loans early and, if necessary, to make preparations for handling these loans. KfW closely monitors the economic and financial environment of the respective borrower in the case of a potential problem loan. It regularly reviews and documents the economic situation and the collateral provided and formulates proposals for remedial action. In the case of non-performing loans, the units in charge of restructuring are responsible for this process. This enables the involvement of specialists from an early stage to ensure professional management of problem loans.

and value of the collateral as well as the political risk. A simplified impairment procedure is performed for small and standardised loans on the basis of homogeneous sub-portfolios.

Risk provisions for latent risks (i.e. portfolio impairment) are derived from the valuation of loan receivables in the context of annual rating procedures and collateral valuations. Portfolio impairment charges are recorded for both economic and political risks. The basis for this is the expected loss model described above, which is adjusted for IFRS purposes. Risk provisions for irrevocable loan commitments and financial guarantees are set up using the same method of calculation.

Further portfolio impairment charges taken for the sectors and countries particularly affected by the economic crisis were significantly reduced as a result of the economic recovery.

Payment arrears on the balance sheet date were reported only in Loans and advances to banks and customers, and Securities and investments. Individual impairment charges were also reported under Contingent liabilities and Irrevocable loan commitments.

Maximum risk of default (EUR in millions)

	Loans and advances to banks		Loans and advances to customers		Value adjustments from macro fair value hedge accounting		Derivatives used for hedge accounting; other derivatives		Securities and investments; investments accounted for using the equity method		Contingent liabilities; irrevocable loan commitments	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Carrying amount as equivalent for maximum risk of default	263,222	241,139	102,878	92,892	7,478	6,751	29,891	19,645	35,236	36,709	72,257	57,889
Risk provisions	200	420	5,221	6,484	0	0	0	0	20	4	484	355
Carrying amount neither past due nor impaired	262,969	240,832	100,984	90,551	7,478	6,751	29,891	19,645	34,993	36,469	72,256	57,848
<i>With conditions renegotiated (in the reporting year)¹⁾</i>	0	0	886	2,165	0	0	0	0	11	2	0	0
<i>Collateral</i>	170,154	151,885	23,627	19,948	0	0	9,353	1,535	94	9	2,828	2,458

¹⁾ Includes financial instruments that would be past due or impaired without renegotiation of conditions.

Financial instruments past due and not individually impaired (EUR in millions)

	Loans and advances to banks		Loans and advances to customers		Securities and investments; investments accounted for using the equity method	
	2010	2009	2010	2009	2010	2009
Carrying amount less than 90 days past due	86	115	268	439	1	1
Carrying amount 90 days and more past due	16	21	215	318	0	0
Collateral	56	132	257	351	0	0

Individually impaired financial instruments (EUR in millions)

	Loans and advances to banks		Loans and advances to customers		Securities and investments; investments accounted for using the equity method		Contingent liabilities; irrevocable loan commitments	
	2010	2009	2010	2009	2010	2009	2010	2009
Carrying amount	151	172	1,411	1,584	242	239	1	41
Individual impairments, provisions	88	282	4,483	5,421	0	0	429	278
Collateral	26	14	428	265	7	5	0	0

At year-end 2010 EUR 1.8 billion (net after deduction of risk provisions; previous year: EUR 2.0 billion) were classified as individually impaired out of EUR 511.0 billion (previous year: EUR 455.0 billion) in financial instruments outstanding. Potential losses are conservatively estimated, and individual impairment charges have been recognised in the amount of EUR 5.0 billion (previous year: EUR 6.0 billion). This includes provision for risks from the various IKB rescue measures in the amount of EUR 3.7 billion (previous year: EUR 4.2 billion).

In addition to provisions for immediate risks of default, the KfW Group makes provisions for latent risks of default (economic and political risks). As at 31 December 2010, risk provisions for transactions not individually impaired totalled EUR 0.9 billion (previous year: EUR 1.3 billion). The collateralisation of loans in the Group portfolio primarily relates to on-lending business and promotional business guaranteed by the Federal Republic of Germany or individual federal states⁶⁾. By far the largest portion of collateral is attributable to assigned end-borrower receivables from on-lending business. Tangible collateral, e.g. ships and aeroplanes, plays only a minor role with regard to the total amount of collateral.

PORTFOLIO STRUCTURE

The contribution of individual positions to the risk associated with the KfW Group's loan portfolio is assessed based on an internal portfolio model. Concentrations of individual borrowers or groups of borrowers give rise to the risk of major losses that could jeopardise KfW's existence. On the basis of the economic capital concept, Risk Controlling measures the risk concentrations by individual borrower, sector and country. The risk concentrations are primarily reflected in the economic capital requirement. This ensures that not only high risk volumes but also unfavourable probabilities of default and undesirable risk correlations are taken into account. The results form a central basis for the management of the loan portfolio.

The high exposure as regards derivatives with positive fair values has to be put into the context of the netting agreements with counterparties. These also include derivatives with negative fair values and considerably reduce the counterparty risk.

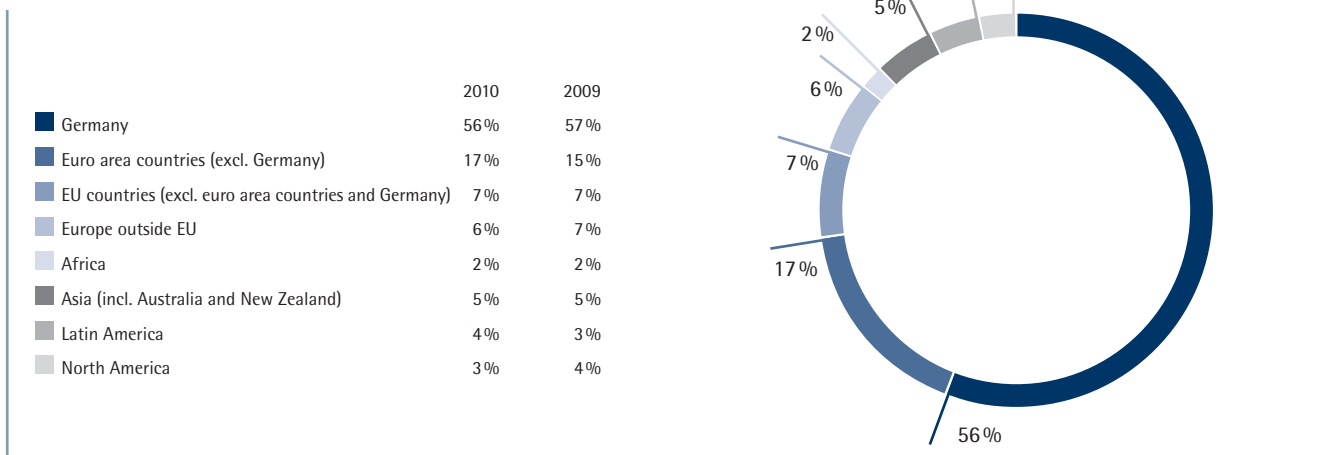
There was an increase in irrevocable loan commitments of EUR 14.9 billion in the reporting year. This is primarily a result of the support loan for Greece, which has not yet been called in full.

As part of the restructuring of a syndicated loan, the Group took possession in the reporting year of assets that had previously been held as tangible collateral, with a pro rata value of USD 108.7 million, by means of a rescue acquisition. These assets are to be sold within 5 years in an orderly sale. The equity position with a pro rata value of USD 703,000 under the new structure adopted was written down to a memo value of USD 1, while a risk provision of USD 20 million exists for pro rata debt financing as at 31 December 2010. As at the reporting date the Group carries the assets at a pro rata value of around USD 72 million.

Regions

As at 31 December 2010, 73% of the Group's loan portfolio⁷⁾ in terms of economic capital requirements was attributable to the euro area (previous year: 72%). There were slight shifts within the euro area: while capital requirements for loans fell in Germany, they increased mainly in crisis-hit countries of the euro area due to higher probability of default.

Economic capital requirements by region, 2010



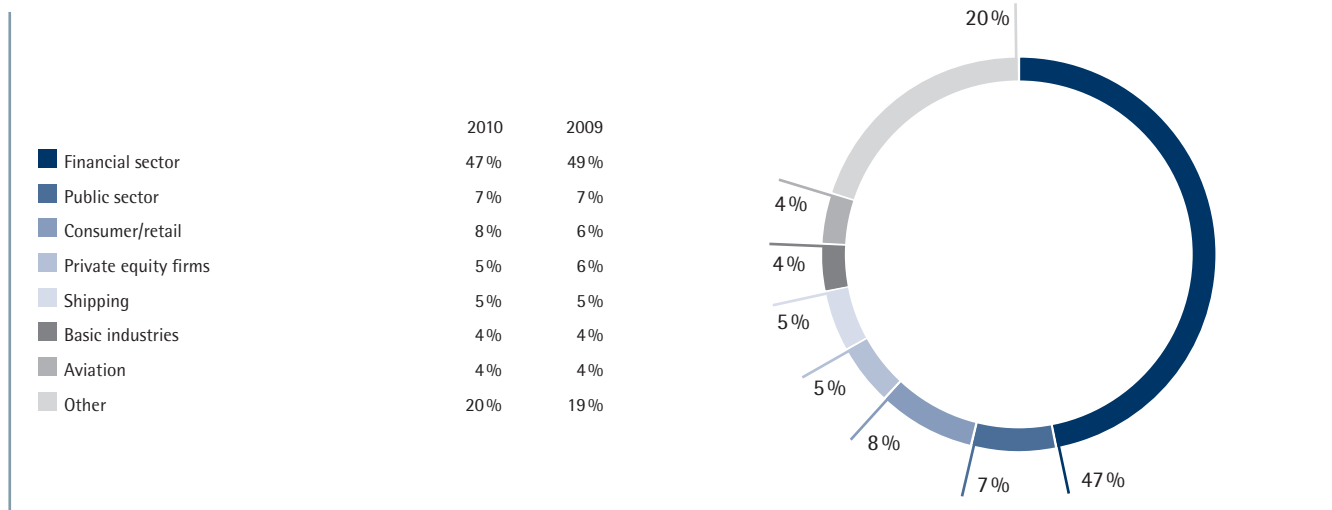
⁶⁾ The collateral is presented as recognised for purposes of internal management of economic risks. Participation effects are taken into account in order to avoid reporting double collateralisation.
⁷⁾ The loan portfolio includes loans as well as securities and investments in performing business.

Sectors

The significant share of overall capital required for credit risks attributable to the financial sector is due to the KfW Group's promotional mandate. By far the greatest portion of the Group's domestic promotional lending

business consists of loans that are on-lent through banks. The distribution of capital requirements among all sectors has proved stable on the previous year.

Economic capital requirements by sector, 2010

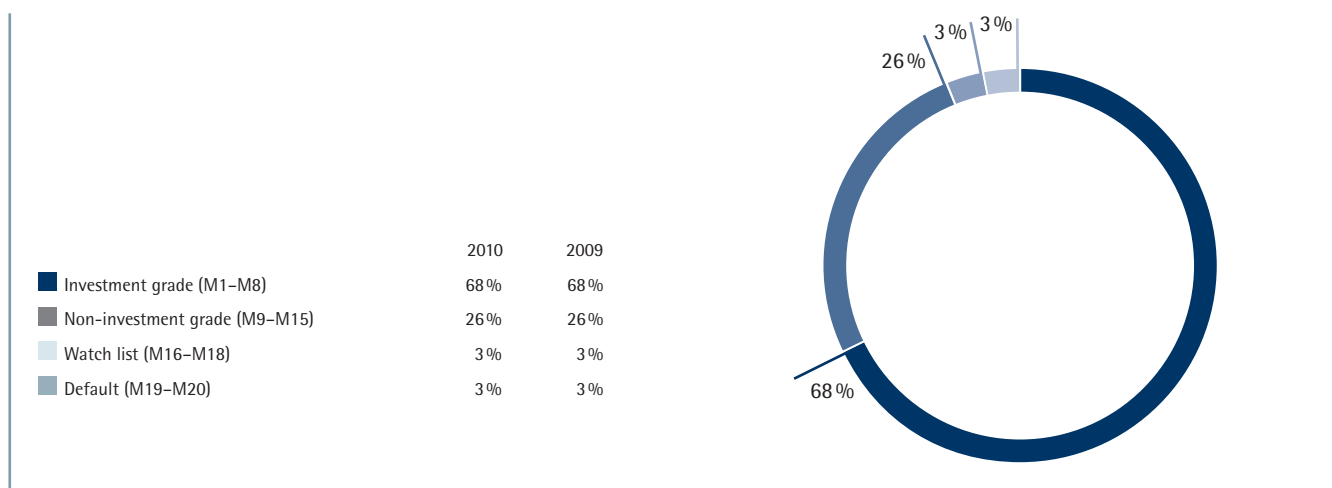


Credit quality

As credit quality is a major factor influencing the economic capital requirement, it is appropriate in analysing the credit quality structure to examine the distribution of net exposures by credit quality category. The credit quality is unchanged on the previous year with regard to the four categories

presented. This is due to two interrelated effects in 2010. While the situation for financial institutions stabilised in the reporting year, the economic crisis triggered numerous rating downgrades in corporate financing. The Group's loan portfolio therefore continues to show a good credit quality structure.

Credit quality by net exposure, 2010



Structured products in the group portfolio

In this section, the Group's portfolio of structured products, divided into asset-backed securities (ABS) and platform securitisations (PROMISE, PROVIDE), is presented separately.

Asset-backed securities

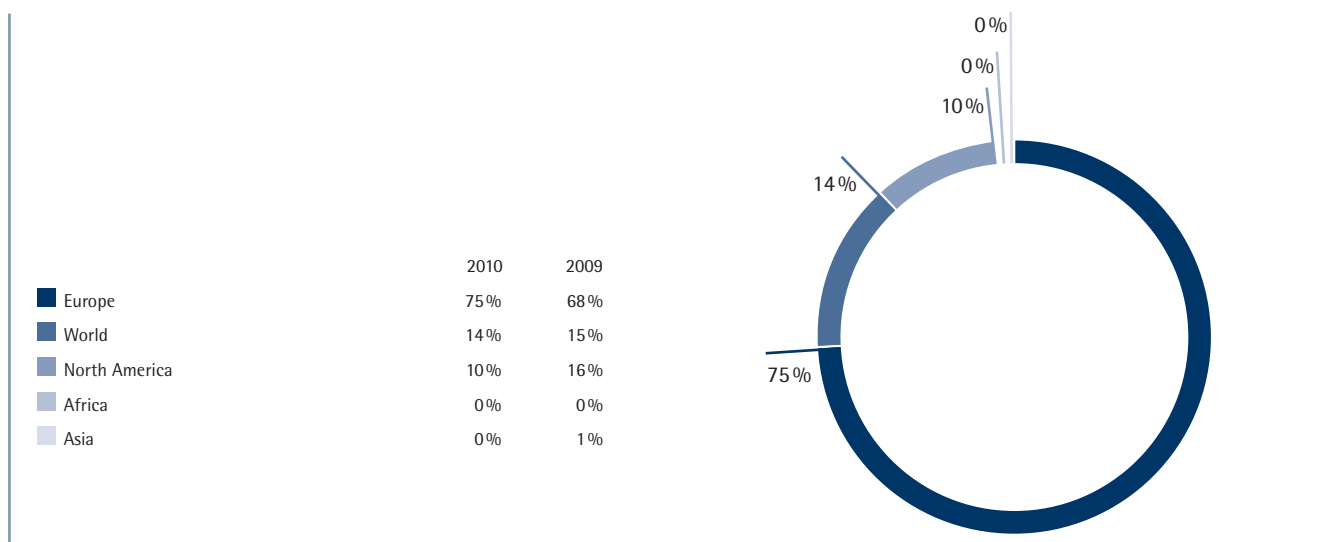
In addition to its own holdings of ABSs, the Group's ABS portfolio includes ABS investments in special funds. These investments were again reduced over the last year.

The ABSs had a par value of around EUR 5.0 billion as at the balance sheet date, 31 December 2010. Accounting for the mark-to-market valuation of the securities reported at fair value and impairments, the portfolio had a total value (including pro-rata interest) of EUR 4.6 billion. The following tables show the composition of the ABS portfolio by asset class, rating and geographic distribution of the underlying assets in the securitisation portfolios.

Exposure based on par values, 2010

	CLO	RMBS	CMBS	CDO	ABS & other	Total 2010	Total 2009
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Investment grade	1,709	1,172	387	1	854	4,123	4,515
Non-investment grade	309	7	2	2	1	322	560
Watch list	15	62	4	-	-	80	439
Default	219	10	49	192	-	471	382
	2,252	1,251	442	195	855	4,995	5,896

Geographic breakdown of the underlying asset pool (based on nominal) 2010



The portfolio volume was lower than the previous year's figure due to sales and repayments (nominal value EUR – 0.9 billion). A comparison of the rating structure of the portfolio shows a considerable reduction in watch-list holdings, which is also largely attributable to sales and repayments. At the same time, the proportion of securities with default status has increased due to declines in credit quality, particularly for CLO securities. The regional focus of the ABS portfolio remains on Europe.

Overall, European securitisations showed a solid performance, including German securitisations. Even three years after the outbreak of the crisis, cumulative default rates for European securitisations are very low.

The Group has indirect exposure to additional risks, associated with structured securities, via the risk protection measures for IKB. For example, KfW assumed all of IKB's rights and obligations under IKB's liquidity lines to refinance the special purpose entities of the Rhineland Funding Capital Corporation conduit. Taking into account redemptions and loss realisation, receivables in the amount of EUR 3.8 billion from the purchasing companies remained outstanding as at 31 December 2010. Impairment charges of EUR 3.4 billion have been taken on these receivables.

Market price risk

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

- ▀ the interest structure (interest rate risks),
- ▀ exchange rates (currency risks),
- ▀ issuer-related premiums on the interest rate of securities (credit spread risks) and
- ▀ other market prices (e.g. share prices, commodity prices).

KfW and its subsidiaries are non-trading book institutions as per the German Commercial Code; consequently, their market price risks are limited to the banking book.

Interest rate risks

The main market risk component in the KfW Group is interest rate risk. The Group assumes limited interest rate risks in order to take advantage of opportunities for returns. Additionally, interest rate risks arise from the special design of the domestic lending business with its prepayment options. KfW takes this into account in its risk management by including the estimated future volume of exercised prepayment options in its funding strategy.

To record interest rate risks in its banking book, the KfW Group uses standard software that integrates all data relevant for risk assessment. This standard software is used to determine current balances of interest rate maturities

Platform securitisations

Banks can transfer credit risks synthetically from SME loan portfolios to the capital market using the securitisation platform PROMISE. KfW complements its promotional offering with its securitisation programme PROVIDE, which aims to securitise private housing loans. The securitisation of housing loans and of corporate loans each accounted for around half of the underlying asset volume as at the reporting date 31 December 2010. As of the same date, the volume securitised via the platforms totalled EUR 15.4 billion. Of this total, EUR 14.7 billion was securitised through credit default swaps or credit-linked notes. The Group has retained risks from senior tranches with respect to the remaining EUR 0.6 billion. The decline in the securitisation volume of EUR 12.2 billion against the previous year was primarily a result of the use of the originator banks' call options. In addition, no new business was entered into in 2010.

Risk in the platform business is primarily defined by the quality of the securitised portfolios. There are currently no immediate loss expectations for KfW.

(euro, US dollar and British pound). On this basis, the KfW Group regularly performs value-at-risk calculations to assess its interest risk position. The applied simulation-based method – which was subject to major revision as at 31 December 2009 – is based on a two-factor Cox-Ingersoll-Ross model, which is used to estimate the distribution of risk positions in the Group given possible changes in market interest rates. In accordance with MaRisk requirements, the separation of the aggregate banking book business into one bank-ing book for equity and one for debt instruments, as previously practised by KfW in determining the present value of interest risk, is no longer permitted as of 2010. Therefore these two books were combined into an aggregate banking book for risk assessment and management purposes.

Key optional components of business (e.g. terminable loans) are accounted for in the Group's cash flow. The economic capital requirements are identified – as are credit risks – for a period of one year. Periodic stress tests supplement this calculation to estimate possible losses under extreme market conditions. Apart from a parallel shift in the yield curve prescribed by supervisory law, these tests include scenarios such as a twist in the yield curve and an extension of the holding period.

Currency risks

Foreign currency loans are largely refinanced in the same currency or secured by appropriate foreign currency hedging instruments. This also applies to individual impairments for which the corresponding replacement assets are provided. Foreign currency equity investments of DEG and to a small extent promotional instruments of KfW Entwicklungsbank, in contrast, are at present not funded in the same currency. Open currency positions resulting from accrued margins or impairment losses are generally closed as soon as possible.

Risks from open currency positions remaining at the balance sheet date are measured by a variance/covariance approach in the form of a value-at-risk with a holding period of three months. The required parameters (exchange rate volatility and the expected value of changes in exchange rates) are estimated on the basis of historical data.

As at 31 December 2010, DEG has now been included in currency risk measurement for the first time, analogous to the inclusion thus far of KfW IPEX-Bank. Measurement and control approaches for currency risk at the different KfW Bankengruppe companies are currently being revised as part of a project aimed at standardising the Group's currency management. Going live is scheduled for 2011.

Credit spread risks

Credit spread risks were integrated into the calculation of the risk-bearing capacity for the first time during the reporting year. For the Group, risks arising from credit spread changes are estimated for positions in the categories "available-for-sale financial assets" and "financial assets at fair value through profit or loss". The economic capital requirement is determined for a one-year period based on historical simulation to satisfy the 99.99% solvency level.

Other market price risks

Other market price risks include share price risks from equity investments. They also include commodity price risks from CO₂ certificates which the Group keeps in its own books. Risks from CO₂ certificates arise as a result of the Group's decision to act as an intermediary between the buyers and sellers of CO₂ certificates. As a result, KfW also keeps certificates in its own books.

Other market price risks are measured using variance/covariance approaches. The required parameters (price volatility and the expected value of changes in prices) are calculated using historical data. The historical data used for estimating the model parameters for CO₂ certificates is daily prices since the beginning of 2005 and for share price risks monthly prices since 2001.

The Market Price Risk Committee manages market price risks based on the valuation and analysis of interest and currency positions, other market price risks and stress tests for interest rate risks. The objective of this is long-term management of a reasonable market risk position for the bank. The strategy pursued is defined annually as part of the Group's business area planning. This strategy is monitored using a limit system for all market price risks.

In accordance with MaRisk, framework conditions imposed by the Executive Board which are in line with market standards apply for the transaction, processing and settlement of trades.

In total, market price risks within the Group required a total of EUR 2,283 million in economic capital as at 31 December 2010. This position is composed of the following individual risks:

Total economic capital for market price risks

	31 Dec. 2010	31 Dec. 2009 ¹⁾
	EUR in millions	EUR in millions
Interest rate risks	1,623	1,444
Currency risks	114	46
Credit spread risks	425	-
Other market price risks	121	134
Market price risk	2,283	1,624

¹⁾ Figures for the previous year were adjusted to satisfy the 99.99% solvency level.

The capital requirement for interest rate risks rose slightly as at 31 December 2010 due to a rise in volatilities in the interest rate environment while interest risk positions remained structurally unchanged.

The rise in currency risk as at 31 December 2010 is largely based on the inclusion of DEG in the currency risk measurement.

Credit spread risks were integrated into the risk assessment for the first time in the current financial year.

With respect to the remaining market price risks, required economic capital was virtually unchanged as against the previous year, at EUR 121 million.

Liquidity risk

Liquidity risk is the risk of a lack of liquidity. KfW differentiates between institutional liquidity risk (the risk of not being able to meet payment obligations) and market liquidity risk (the risk that the required funds are only available at costs higher than the risk-commensurate interest rate).

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

the liquidity requirements of the subsidiaries are included both in KfW's funding schedule and in the liquidity maintenance strategy.

Liquidity risk is measured on the basis of the liquidity risk indicator under regulatory law, the utilisation threshold in accordance with the KfW Law and economic scenario analyses.

A significant component for liquidity risk assessment is the contractual payment obligations (principal and interest) of the KfW Group arising from financial instruments, which are shown in the table below by maturity range:

Payment obligations arising from financial instruments by maturity range, 31 December 2010¹⁾

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	5 years and more	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks and customers	13,355	2,848	1,831	13,366	18,979	50,380
Certificated liabilities	9,855	15,183	34,179	199,748	143,622	402,587
Net liabilities under derivative financial instruments	-674	-327	-3,201	-6,453	-14,208	-24,862
<i>Liabilities under derivative financial instruments</i>	<i>23,508</i>	<i>44,442</i>	<i>62,208</i>	<i>375,690</i>	<i>309,201</i>	<i>815,049</i>
Subordinated liabilities	0	0	146	404	3,359	3,909
Liabilities under on-balance sheet financial instruments	22,536	17,705	32,956	207,065	151,752	432,014
Contingent liabilities	6,982	0	0	0	0	6,982
Irrevocable loan commitments	65,276	0	0	0	0	65,276
Liabilities under off-balance sheet financial instruments	72,257	0	0	0	0	72,257
Liabilities under financial instruments	94,793	17,705	32,956	207,065	151,752	504,271

Payment obligations arising from financial instruments by maturity range, 31 December 2009¹⁾

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	5 years and more	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks and customers	7,893	2,924	2,006	15,672	21,026	49,521
Certificated liabilities	8,559	7,605	40,138	178,190	132,984	367,476
Net liabilities under derivative financial instruments	-225	-519	942	-9	-12,051	-11,863
<i>Liabilities under derivative financial instruments</i>	<i>25,409</i>	<i>26,881</i>	<i>69,370</i>	<i>347,303</i>	<i>282,940</i>	<i>751,903</i>
Subordinated liabilities	0	0	146	494	3,415	4,055
Liabilities under on-balance sheet financial instruments	16,227	10,009	43,231	194,347	145,374	409,190
Contingent liabilities	7,529	0	0	0	0	7,529
Irrevocable loan commitments	50,360	0	0	0	0	50,360
Liabilities under off-balance sheet financial instruments	57,889	0	0	0	0	57,889
Liabilities under financial instruments	74,116	10,009	43,231	194,347	145,374	467,079

¹⁾ The net liabilities under derivative financial instruments comprise payment obligations which are offset against the corresponding payment claims from derivative contracts; the gross liabilities are reported as liabilities under derivative financial instruments. Irrevocable loan commitments and contingent liabilities are generally allocated to the first maturity range.

Liquidity risk management is based on scenario calculations. This approach first analyses the expected inflow and total outflow of funds for the next twelve months based on business already concluded. This basis cash flow is then supplemented by uncertain payments (e.g. borrowings from the capital market, expected loan defaults or planned new business). The result provides an overview of the liquidity required by KfW in the next twelve months. The required liquidity is calculated for the three scenarios of normal case, stress case and worst case, the main difference being variation among the uncertain payments.

The available liquidity potential is calculated parallel to this. It largely consists of KfW's ECB collateral account, repo assets, liquidity portfolios and the volume of commercial paper that is regularly placeable on the market. The available liquidity potential is subjected to stress in the same way as the other cash flow components in the stress case and worst case scenario tests.

The ratio of cumulative required liquidity to the cumulative available liquidity potential is calculated for each scenario. This figure may not exceed the value of 1 in any scenario for any period. The prescribed horizon in the

normal case scenario is twelve months, in the stress case six months, and in the worst case, three months.

The key figures are calculated and reported to the Market Price Risk Committee on a monthly basis. The following table shows the key risk indicators for the scenarios as at 31 December 2010:

KfW liquidity risk indicators as at 31 December 2010

	Indicator
Normal case	0.36
Stress case	0.65
Worst case	0.66

Since the indicators for all three scenarios including the extremely conservative "worst case" are significantly below 1, KfW can be said to have a comfortable liquidity position at present.

Current refinancing environment

International financial markets continued to feel the impacts of the financial crisis in financial year 2010. This was topped by the debt situation of some countries – particularly in the euro area, which was increasingly regarded as critical. Against this backdrop, the general market environment was characterised overall by a high degree of nervousness and volatility. KfW's strengths – top-notch credit rating combined with a transparent emission strategy – were highly regarded on the international capital markets in this environment. In order to fund its promotional business, KfW issued 371 bonds in a total of 17 different currencies in the year under review,

thus raising long-term funding with a value of EUR 76.4 billion. In terms of short-term refinancing on the money market, KfW profited from the persistent low risk tolerance of many investors. This kept demand for KfW commercial paper at a comparatively high level. During the reporting year, the bank issued a total of 1,624 individual securities under two commercial paper programmes. Average outstanding volume for the year totalled EUR 18.9 billion and USD 7.4 billion. For financial year 2011 KfW expects a stable long-term funding requirement of around EUR 75.0 billion at the previous years' level.

Operational and other risks and business continuity management

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

The organisational structure provides for a two-tier system comprising decentralised OpRisk Management and central OpRisk Controlling units liaising with the Operational Risk Committee.

Operational risks are managed decentrally within the business areas and subsidiaries, by the respective directors and/or managing directors and the coordinator of the operational risks and business continuity management function.

The responsibility of the business areas and subsidiaries in the decentralised OpRisk Management unit involves controlling operational risks within the respective areas of responsibility. This includes identifying and assessing operational risks, analysing and reporting risk events, as well as determining, evaluating and implementing risk-mitigation measures. In using OpRisk instruments, directors and managing directors are supported by the respective coordinator of the operational risks and business continuity management function as well as a central operational risk management team.

The operational risk management team performs central control of operational risks and business continuity management in the area of risk management and control. This unit develops the methods for identifying and assessing risks and monitors their uniform application. The operational risk management team is mapped to the business areas so that each business area has one central contact.

The central OpRisk Controlling unit provides OpRisk instruments within its authority to select methods, and further develops them. The methods and instruments for identification, assessment and management of operational risks are the events database, assessment, controlling of measures, determination of regulatory capital, and reporting regulations. Business continuity management includes the provision of the business impact analysis, methods and IT tools to use for exercises and tests as well as for planning business continuity. Central responsibility also includes the critical plausibility check of risk identification and assessment performed at a decentral level. The operational risk management team trains the decentralised function coordinators and informs them of new developments.

In accordance with the definition laid out in the German Solvency Regulation, operational risks in the KfW Group are integrated into its economic capital management as part of a comprehensive management approach covering all risk types. Quantification as well as determining capital requirements is performed in accordance with the regulatory standard approach. This resulted in OpRisk backing for 2010 in the amount of EUR 542 million (EUR 497 million for 2009).

OpRisk assessments are performed regularly at business area and process level for purposes of risk management and control. The risk assessment process was completely revised in 2010 and given a quantitative focus. A pilot project was successfully concluded. The rollout was started in the decentralised business areas in the second half of 2010 and will be completed by mid-2011.

The monthly risk report to the KfW Executive Board, which also contains OpRisk event data, constitutes the core of management reporting. Moreover, material events are reported to the Executive on an ad hoc basis.

The Group addresses legal risks by involving its in-house legal department early in the process and by cooperating closely with external legal advisers in Germany and abroad.

As reputational risks are also based on operational risks, they are taken into account in KfW Bankengruppe in the risk management process for operational risks, in the assessment, in gathering event data and in outsourcing risk analysis.

As part of business continuity management, KfW has implemented a proactive (emergency provision) and a reactive emergency organisation (emergency management). These comprise the emergency team and the crisis team. Business continuity management is a management process to continue key business processes, for which time is critical, in cases of emergency and crisis.

Business continuity plans have been developed and are to be updated for all relevant processes and support resources. Emergency plans exist for the following scenarios: damage to buildings, IT failure, unavailability of staff or service providers.

Fully equipped emergency workspaces have been created at an alternative location sufficiently far away from KfW premises for processes in which time plays a particularly critical role.

The business continuity plans are tested in accordance with the annual planning by the departments. Additionally, in 2010 crisis teams held drills at an alternative location of KfW.

A readily available external alarm system was implemented for use in emergency and crisis situations.

FORECAST REPORT

Global economic development will remain mixed in 2011. The Asian emerging markets are likely to record high growth rates again. Meanwhile, the economic environment in industrialised economies will remain difficult, and not only with regard to government finances. Structural adjustments in many countries are still in their infancy. In view of the problematic state of government budgets, many countries will follow a path of fiscal consolidation that will dampen growth. Monetary policy, in contrast, will continue to be highly expansive for a long time yet in most industrialised nations, in order to cushion the impact of the crisis and ease the refinancing of the banking sector.

In some emerging markets, however, particularly India and China, pressure is increasing to keep a stronger rein on monetary policy and to scale back fiscal stimuli in order to counteract increasing inflation. Overall, the upward trend in the economy is likely to continue in 2011, although momentum may slow somewhat in comparison with the previous year.

In the **euro area**, economic activity is likely to slacken slightly in 2011. However, there are differences between the countries in the euro area. Sentiment has deteriorated especially in the countries directly affected by the debt crisis, and falls in production must be expected. These countries are likely to remain under pressure with regard to their credit ratings. This particularly applies to the peripheral countries in the euro area whose economies are struggling. Economic activity in Greece, Ireland and Portugal may even shrink. Northern European countries, on the other hand, are showing more momentum.

The German economy could grow by significantly more than 2% and a real growth rate above the long-term trend also looks possible for 2012 from the current standpoint. Compared to the very high real growth of 2010, this is a slowdown in momentum of a growth rate that remains high; this slowdown is attributable in particular to the somewhat weaker global economic environment. The fundamental conditions for a stable upturn in Germany are more favourable than they have been for a long time, since in addition to the traditionally strong export economy – as “world supplier” its products have long met the needs of the emerging economies – the domestic economic situation has also improved. Higher wages and falling unemployment should further revive private consumption in 2011, giving positive momentum to domestic sales prospects and providing a key investment incentive, particularly in capacity expansion. But it is not only on the demand-side that investment is becoming more attractive. On the supply side too, there has been a turn-around in two important factors that have hindered domestic investment in the past ten years. In setting key interest rates for Europe, the ECB must take into account the persistent structural problems in the peripheral countries of the euro area. For Germany, this means that rates are likely to be low given the conditions in its domestic economy. In addition, exporting capital to the euro-zone periphery – and also to the US – is likely to have become considerably less attractive than before the crisis, meaning that in future, excess savings will increasingly be mobilised for investment in Germany again.

There are significant risk factors in this forecast due to the simultaneous exit from stimulating fiscal policy by numerous trading partner countries, the continuing current account imbalances in the European and global benchmark – despite the expected recovery of German domestic demand – and the financial crisis persisting in the euro-area periphery, which could also negatively affect economically strong countries like Germany due to the close financial and real-economic ties.

In terms of risk, a range of different developments are anticipated in the individual segments of the KfW credit portfolio in 2011, but these are expected to have a positive overall impact.

The risk profile in the **corporate sector** is expected to benefit in particular from the continuing, though less dynamic economic upturn. Sectors particularly affected by the crisis, such as mechanical engineering, automotive, aviation and shipping, look set to catch up, albeit at different rates. In small and medium-sized enterprises (SMEs) in particular, the signs of economic recovery are likely to be delayed due to trailing ratings and structural disadvantages in financing. Special attention should be paid, however, to growth in China and other Asian markets. These represent a large part of the export demand that benefits German companies to a greater extent than average. Fiscal or regulatory measures to curb excessive growth in these countries could harm the sales prospects of German companies. The after-effects of the financial and economic crisis are also evident at some companies in reduced equity buffers and liquidity reserves that have yet to be fully replenished. This makes them more vulnerable to an unexpectedly rapid fall in demand.

The development of the **European financial sector** will be influenced by two main issues – the debt crisis in several European countries and the new regulatory requirements of Basel III.

A considerable burden is expected for banks with strong regional ties to European problem countries in 2011 too. In addition to higher costs of refinancing and difficulties in raising funds, the cost of credit risk will continue to exert a negative influence on the profitability of these financial institutions, especially in countries with real estate market problems (Spain, Ireland).

Although the Basel III regulations, which have now been finalised but not yet transferred into national law, in some cases include long transitional periods, many banks will be working under extreme pressure as early as next year to implement the new requirements. Efficient use of capital resources will gain further importance. The higher capital requirements and new requirements regarding short-term liquidity will lead in the medium term to falling returns (RoE) at the banks. Basel III presents the banking world as a whole with major challenges. Increased competition will be evident among institutions and further market concentration in the banking sector cannot be ruled out.

In addition to the Basel III requirements, the discussion regarding the Landesbanks will continue in the **German banking sector**. The strict restructuring requirements imposed by the European Commission have led to an extensive process of adjustment at many Landesbanks. It remains to be seen to what extent merger activity will take shape in this sector in the coming year. The effects of the financial market and economic crises on the **US financial sector** also remain clearly visible in 2011. Particularly among small and medium-sized banks, the risk of insolvency remains heightened. The fragile state of the real estate market will continue to perceptibly influence credit quality, although the efforts made to restructure in recent years will have a positive effect on profitability, at least at the large universal banks. The slow-down in global economic growth in 2011 is expected to cause a stagnation of credit defaults. Improvements in profitability will slow down and remain subject to considerable volatility in the individual quarters.

A slower recovery is expected in the **private equity market** compared to the corporate sector in 2011. With initially moderate risk appetite on the part of investors, potential transactions will record only low volumes. The moderate recovery is set to continue in the European **securitisation market** in 2011. This assumes the sustained return to confidence in this asset class and the widening of the investor base. Issue volumes will remain considerably below the pre-crisis level; however growing trust on the part of investors will allow the public marketing of ABS transactions to gradually increase again.

The exceptional growth in KfW's promotional volume recently was a result of the crisis. The normalisation of the economic situation is also bringing normalisation to the promotional volume.

KfW is concentrating on supporting SMEs, ensuring the future viability of companies, protecting the climate and the environment, promoting housing and education, and improving municipal infrastructure. Other key areas are strengthening cooperation with developing, transition and industrialising countries and expanding the support for the export sector.

Domestically, KfW supports the German **economy with the promotional programmes of KfW Mittelstandsbank, KfW Privatkundenbank and KfW Kommunalbank**.

An important element of the promotional work that will be carried out by **KfW Mittelstandsbank** in 2011 is securing financing for the upturn. KfW Mittelstandsbank is making a contribution here by providing start-ups and SMEs with financing that meets their needs. KfW Mittelstandsbank is to strengthen and bundle its support for start-ups in 2011 through a realignment of its programmes. The promotion of innovation is also a particularly important funding priority for the future viability of enterprises. In terms of industrial environmental protection, increasing energy efficiency and the use of renewable energies remain important objectives. In addition to traditional promotional loans, KfW Mittelstandsbank also offers mezzanine funding and private equity.

At **KfW Privatkundenbank**, the promotion of energy rehabilitation and energy-efficient housing construction in the interests of climate protection remains an important focus. Support for measures to improve accessibility in residential accommodation is also to be expanded in preparation for the ageing of Germany's population. In addition, home ownership is promoted. Financing education will become increasingly important in the next few years, with a view to the Federal Government's goal of making Germany a country with a strong focus on education ("Bildungsrepublik Deutschland"). The KfW Student Loan already enables students to finance their first course of studies, regardless of financial standing, and lifelong learning is supported by the loan programme for further training to achieve master craftsman level in skilled manual trades.

Promotion of infrastructure by **KfW Kommunalbank** will be continued at a comparable level despite the expiry of special programmes connected to the infrastructure investment offensive. There will be a new focus on funding energy efficiency in municipalities. The special credit institutions of the federal states remain the main focus of the global loan business. Given the multitude of influencing factors, only a rough estimate can be given for promotional business volume. New business volume totalling around EUR 48.0 billion is expected for domestic business in 2011.

Securitisation activities are and will remain an important component in providing the economy with sufficient lending, since the regulatory challenges of the future (including Basel III) and high medium to long-term refinancing requirements on the part of banks mean that the entire spectrum of refinancing opportunities must be exploited.

With its high-quality securitisation products and its activities – also as part of TSI (True Sale International), KfW is making a valuable contribution to reviving the securitisation market and is therefore supporting lending to SMEs and the housing sector. For 2011, KfW anticipates a new business volume of around EUR 3.5 billion for its securitisation platforms PROMISE and PROVIDE, and for its involvement in securitisation transactions of SME, lease and mortgage loans.

Other measures in addition to securitisation activities are planned to support the economy in 2011. For example, KfW will continue the successful programme for "refinancing export loans covered by federal guarantees" with changed conditions. The aim of the programme is to improve the financing situation of German exporters.

In the course of the global recovery of financial markets and the real economy, KfW IPEX-Bank saw a renewed increase in export projects and larger infrastructure projects in 2010 in the business area **Export and project financing** for which it is responsible. As a result of the financial crisis, and the increased capital requirements expected from Basel III, there continues to be strong competition in the banking sector for low-risk and well-collateralised financing structures. The bank does not anticipate an immediate increase in its business activities for 2011, but expects demand for medium and long-term financing, KfW IPEX-Bank's core product, to

increase slightly year-on-year. It sees good opportunities in energy and environment financing, as well as infrastructure and transport projects. The regional focus is primarily on markets that play a special role for the German export industry. Besides European countries, this includes in particular the emerging markets in Asia and Latin America.

On the basis of the economic conditions described above, KfW IPEX-Bank anticipates a new business volume in the business area Export and project financing of around EUR 9.0 billion.

The **Promotion for developing and transition countries** business area comprises the business activities of KfW Entwicklungsbank, the KfW Carbon Fund and DEG.

As the international promotional bank of the Federal Government for development, environment and climate, **KfW Entwicklungsbank** will continue to concentrate its efforts in particular on the further mobilisation of funding for partner countries and to the benefit of international climate financing in 2011. Emphasis is placed here on developing innovative financing instruments (together with the Federal Government) and increasing the use of KfW's own funds in the more advanced developing and emerging market countries. Despite the budget consolidation, KfW Entwicklungsbank is increasing its commitment to developing and expanding the financial sector, promoting the water and energy sectors, and protecting the environment and climate. KfW Entwicklungsbank is supporting the Federal Government in forming global development partnerships for sustainability. In consultation with the Federal Government, KfW Entwicklungsbank is taking an active role in achieving EU objectives in development policy and climate protection, such as the design and implementation of common European financing platforms. In 2011 new commitments are expected of slightly over EUR 4.0 billion, similar to the previous year.

The environment in which the **KfW Carbon Fund** operates in 2011 will continue to be characterised by the lack of a binding international climate treaty for the period after the expiry of the Kyoto Protocol. Continuing uncertainties and increased market complexity have provided the KfW Carbon Fund with good marketing opportunities for the innovative "EIB-KfW CO₂ Programme II", developed in partnership with the EIB, which began to generate interest among numerous companies in the previous year. In 2011, given the economic environment, certificate purchases are planned primarily from projects with innovative programmatic approaches and projects in the poorest developing countries.

DEG expects markets to continue to recover in its partner countries in 2011 and thus aims to pursue a growth course using its own resources with a gradual increase in new business volume – while maintaining high developmental quality – to EUR 1.5 billion by 2015. DEG's promotional objectives include promoting the private sector in DEG partner countries, particularly by increasing promotion of SMEs and climate protection, intensifying cooperation with German companies, extending promotion in Africa, expanding venture capital financing and positioning DEG as a promoter of business sustainability.

In the course of the **privatisation transactions with the Federal Republic**, KfW will continue to hold stakes in Deutsche Telekom AG, Bonn, and Deutsche

Post AG, Bonn. Further privatisation transactions will take place in line with the prevailing market conditions and the strategic requirements of the Federal Government.

KfW expects high **refinancing volumes** for the next two years. At around EUR 75.0 billion, KfW expects funding requirements for financial year 2011 to be stable in comparison to previous years. A key parameter in determining the amount of the planned funding requirement is the promotional volume which remains consistently high, although a slight decrease is expected in 2011. The capital market environment should continue to normalise in the forecast period as it emerges from the financial and economic crisis. Nevertheless, the debt situation of some countries may still mean distortions or market disturbances – at least of a temporary nature. Due to the continuing high volatility on the international capital markets and a noticeable increase in supply from supranational and non-state issuers, competition is expected to remain challenging in 2011.

In order to refinance its funding requirements, KfW will rely on its tried-and-tested combination of high-volume benchmark bonds, other public bonds and private placements. EUR and USD will continue to be the main funding currencies. It is further to be expected that, alongside the British pound and Japanese yen, currencies such as the Australian dollar and Norwegian krone will play an important part in total funding.

First-class credit quality together with the diversified and reliable KfW refinancing strategy will remain the most important guarantees for KfW's access to primary markets in the future. Offers throughout the maturity range and flexibility in format and currency will be the key factors for successful, needs-based issuing activity.

In its current **earnings projections** for the Group, KfW expects to achieve total earnings of approximately EUR 1.0 billion in 2011. The key assumption for this forecast is a continuing economic recovery from the economic and financial crisis with a slight slowdown in the rate of growth. This is expected to be accompanied by moderate rises in interest rates and a slight flattening of the yield curve. All in all, KfW predicts economic conditions that will lead to decreases in net interest income, although this key component of the Group's operating result is expected to remain at a high level in 2011. In 2010, KfW benefited from the fact that a large proportion of the risk provisions created in 2009 were reversed. A normalisation is expected for 2011, and therefore a rise in risk provisions for lending business in comparison to 2010. The development in net interest income and risk provisions for lending business is expected to be offset by improvements in the valuation result. Administrative expense in 2011 is expected to increase slightly over 2010.

In a scenario in which the economy falls back into recession, contrary to expectations, KfW expects stable, low interest rates. The increase in risk provisions for the lending business in the event of a recession would thus likely be compensated by higher net interest income. On the other hand, a scenario of unexpected dynamic recovery in the economy and increasing interest rates with a flattening yield curve would mean lower net interest income.

However, in this case, a major reduction in loan defaults would also be likely, with a stabilising effect on the earnings situation.

Given the after-effects of the financial market and economic crisis, however, the forecast remains subject to a large degree of uncertainty. This primarily relates to the development of interest and exchange rates which have a considerable influence on the contribution of net interest income and valuation results to the overall result. There may also be fluctuations in earnings from IFRS-compliant hedging in the future, although from an economic point of view these are unfounded.

After the expiry of the stimulus package, KfW will use natural fluctuation to adjust the size of its **workforce** in 2011 to current requirements. This is likely to be repeated in the following year. No significant impact is expected on the personnel structure at KfW.

KfW will continue to offer the same number of trainee positions as in the past, in order to fulfil its responsibility with respect to the younger generation.

DECLARATION OF COMPLIANCE

The Executive Board and Board of Supervisory Directors of KfW have resolved to recognise the principles of the Federal Public Corporate Governance Code (Public Corporate Governance Kodex des Bundes – PCGK). The Corporate Governance report contains the declaration of compliance with the PCGK.

CONSOLIDATED FINANCIAL STATEMENTS

The bottom right corner of the page features a decorative graphic consisting of several parallel diagonal lines in a light blue-grey color, extending from the bottom edge towards the right edge.

CONTENTS

Consolidated financial statements

Statement of comprehensive income	64
Statement of financial position	66
Statement of changes in equity	67
Statement of cash flow	70
Notes	71

Notes Accounting policies **72**

(1) Basis of presentation	72
(2) Assessment of the impact of IFRS/IFRIC standards to be applied in the future	73
(3) Consolidated Group	74
(4) Basis of consolidation	74
(5) Financial instruments: recognition and measurement	75
(6) Financial instruments: valuation techniques	77
(7) Hedging relationships	79
(8) Treatment of embedded derivatives	80
(9) Credit derivatives	81
(10) Risk protection, capital measures and sale of IKB	82
(11) Foreign currency translation	83
(12) Loans and advances to banks and customers	83
(13) Risk provisions for lending business	83
(14) Securities and investments	84
(15) Repurchase agreements	85
(16) Property, plant and equipment	86
(17) Intangible assets	86
(18) Taxes on income	86
(19) Liabilities to banks and customers and certificated liabilities	87
(20) Provisions	87
(21) Subordinated liabilities	88
(22) Equity	88
(23) Contingent liabilities and irrevocable loan commitments	89
(24) Trust activities	89
(25) Leasing transactions	89

Notes to the statement of comprehensive income **90**

(26) Net interest income	90
(27) Risk provisions for lending business	91
(28) Net commission income	91
(29) Net gains/losses from hedge accounting	92
(30) Net gains/losses from other financial instruments at fair value through profit or loss	93
(31) Net gains/losses from securities and investments	95
(32) Net gains/losses from investments accounted for using the equity method	96
(33) Administrative expense	96
(34) Net other operating income	96
(35) Taxes on income	97
(36) Notes to other comprehensive income	98

Segment reporting **99**

(37) Segment reporting by business area	99
(38) Segment reporting by region	103

Notes to the statement of financial position	104
(39) Cash reserves	104
(40) Loans and advances to banks	104
(41) Loans and advances to customers	105
(42) Risk provisions for lending business	105
(43) Value adjustments from macro fair value hedge accounting	106
(44) Derivatives used for hedge accounting	107
(45) Other derivatives	107
(46) Securities and investments	108
(47) Investments accounted for using the equity method	108
(48) Property, plant and equipment	108
(49) Intangible assets	109
(50) Income tax assets	110
(51) Other assets	111
(52) Liabilities to banks	111
(53) Liabilities to customers	112
(54) Certificated liabilities	112
(55) Value adjustments from macro fair value hedge accounting	112
(56) Derivatives used for hedge accounting	112
(57) Other derivatives	113
(58) Provisions	113
(59) Income tax liabilities	116
(60) Other liabilities	116
(61) Subordinated liabilities	117
(62) Equity	117
Notes on financial instruments	118
(63) Gains and losses from financial instruments by valuation category	118
(64) Balance sheet for financial instruments by valuation category	120
(65) Disclosures on the reclassification of financial assets	122
(66) Disclosures on the valuation methods used for financial instruments carried at fair value	123
(67) Fair values of financial instruments	131
(68) Additional disclosures on liabilities to banks	132
(69) Additional disclosures on liabilities to customers	133
(70) Additional disclosures on certificated liabilities	133
(71) Additional disclosures on derivatives	133
(72) Additional disclosures on the PROMISE/PROVIDE securitisation platforms	134
(73) Disclosures on repurchase agreements	135
Other notes	136
(74) Contingent liabilities and irrevocable loan commitments	136
(75) Trust activities and administered loans	136
(76) Leasing transactions as lessee	137
(77) Average number of employees during the financial year	137
(78) Compensation report	138
(79) Related party disclosures	142
(80) Auditor's fees	142
(81) Disclosures on shareholdings	143
Statement by the Executive Board	148
Auditor's report	149

STATEMENT OF COMPREHENSIVE INCOME

Income statement

	Note(s)	2010	2009	Change
		EUR in millions	EUR in millions	EUR in millions
Interest income	(26)	14,454	18,017	-3,563
Interest expense	(26)	11,702	15,363	-3,661
Net interest income		2,752	2,654	98
Risk provisions for lending business	(10), (13), (27)	424	-972	1,396
Net interest income after risk provisions		3,176	1,682	1,494
Commission income	(28)	375	430	-55
Commission expense	(28)	102	144	-41
Net commission income		273	286	-13
Net gains/losses from hedge accounting	(7), (29)	-219	-313	94
Net gains/losses from other financial instruments at fair value through profit or loss	(7), (9), (30)	206	368	-162
Net gains/losses from securities and investments	(14), (31)	1	-117	119
Net gains/losses from investments accounted for using the equity method	(4), (32)	-3	-3	0
Administrative expense	(33)	722	742	-20
Net other operating income	(34)	-27	23	-50
Profit/loss from operating activities		2,685	1,184	1,501
Taxes on income	(18), (35)	54	57	-3
Consolidated profit		2,631	1,127	1,504

Statement of comprehensive income

	Note(s)	2010	2009	Change
		EUR in millions	EUR in millions	EUR in millions
Consolidated profit		2,631	1,127	1,504
Other comprehensive income from financial instruments	(14), (36)	30	285	-254
Other comprehensive income from deferred taxes on financial instruments	(18), (36)	8	-17	25
Other comprehensive income from investments accounted for using the equity method	(4), (36)	-6	-7	1
Other comprehensive income, total		33	261	-228
Consolidated comprehensive income		2,663	1,388	1,275

Other comprehensive income comprises income and expenses recorded under Revaluation reserves.

Presentation of reclassification amounts included in the income statement

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Reclassification amounts relating to financial instruments	57	135	-79
Reclassification amounts relating to deferred taxes on financial instruments	0	-1	1
Total	56	134	-78

The reclassification amounts are the result of income and expenses which were accounted for through profit or loss during the reporting period and which were previously recognised directly in equity in the revaluation reserves. They also include amortisation of revaluation reserves from the reclassification of securities and investments from the valuation category "available-for-sale financial assets" to the "loans and advances" category. Income recognised in the income statement is reported with a negative sign preceding the amount and expenses with a positive sign.

STATEMENT OF FINANCIAL POSITION

ASSETS

	Note(s)	31 Dec. 2010	31 Dec. 2009	Change
		EUR in millions	EUR in millions	EUR in millions
Cash reserves	(39)	604	337	267
Loans and advances to banks	(9), (12), (40)	263,422	241,559	21,863
Loans and advances to customers	(9), (10), (12), (41)	108,099	99,376	8,723
Risk provisions for lending business	(10), (13), (42)	-5,422	-6,904	1,482
Value adjustments from macro fair value hedge accounting	(7), (43)	7,478	6,751	727
Derivatives used for hedge accounting	(7), (44)	23,323	14,622	8,701
Other derivatives	(7), (8), (9), (45)	6,568	5,023	1,545
Securities and investments	(14), (15), (46)	35,207	36,694	-1,487
Investments accounted for using the equity method	(4), (47)	29	15	14
Property, plant and equipment	(16), (48)	912	876	36
Intangible assets	(17), (49)	44	44	-1
Income tax assets	(18), (50)	198	189	9
Other assets	(51)	1,296	1,502	-206
Total		441,757	400,084	41,673

LIABILITIES AND EQUITY

	Note(s)	31 Dec. 2010	31 Dec. 2009	Change
		EUR in millions	EUR in millions	EUR in millions
Liabilities to banks	(9), (19), (52)	15,461	8,095	7,365
Liabilities to customers	(9), (19), (53)	22,011	23,734	-1,724
Certificated liabilities	(19), (54)	357,984	321,429	36,556
Value adjustments from macro fair value hedge accounting	(7), (55)	141	27	114
Derivatives used for hedge accounting	(7), (56)	18,191	19,476	-1,285
Other derivatives	(7), (8), (9), (57)	4,623	6,838	-2,215
Provisions	(13), (20), (58)	2,290	2,065	225
Income tax liabilities	(18), (59)	118	68	50
Other liabilities	(21), (60)	1,906	1,984	-78
Subordinated liabilities	(21), (61)	3,247	3,247	0
Equity	(22), (62)	15,784	13,121	2,663
Paid-in subscribed capital		3,300	3,300	0
Capital reserve		5,947	5,947	0
Reserve from the ERP Special Fund		977	893	84
Retained earnings		5,218	4,725	493
Fund for general banking risks		600	46	554
Revaluation reserves	(4), (14)	-257	-290	33
Balance sheet loss		0	-1,499	1,499
Total		441,757	400,084	41,673

STATEMENT OF CHANGES IN EQUITY

Statement of changes in equity in financial year 2010

	As at 1 Jan. 2010	Owner-related changes in equity	Appropriation of comprehensive income 2010	As at 31 Dec. 2010
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Subscribed capital	3,750	0	0	3,750
less uncalled outstanding contributions	- 450	0	0	- 450
Capital reserve	5,947	0	0	5,947
<i>Promotional reserves from the ERP Special Fund</i>	4,650	0	0	4,650
Reserve from the ERP Special Fund	893	0	84	977
Retained earnings	4,725	0	493	5,218
<i>Statutory reserve under Section 10 (2) KfW Law</i>	1,574	0	264	1,838
<i>Special reserve under Section 10 (3) KfW Law</i>	1,928	0	250	2,178
<i>Special reserve less the special loss account from provisioning pursuant to Section 17 (4) of the D-Mark Balance Sheet Law</i>	21	0	0	21
<i>Other retained earnings</i>	1,202	0	- 21	1,181
Fund for general banking risks	46	0	554	600
Revaluation reserves	- 290	0	33	- 257
Balance sheet loss	- 1,499	0	1,499	0
Equity	13,121	0	2,663	15,784

KfW's reserves from the ERP Special Fund are increased on the basis of contractual agreements. The balance sheet loss carried forward from the previous year in the amount of EUR 1,499 million was fully offset by KfW's net income for the period in the amount of EUR 2,013 million. Moreover, the fund for general banking risks was increased by EUR 554 million. The statutory reserve under Section 10 (2) KfW Law was increased by EUR 264 million, and the special reserve under Section 10 (3) of the KfW Law by EUR 250 million.

The difference from the comprehensive income is allocated to Other retained earnings or – if recognised directly in equity – to Revaluation reserves.

Statement of changes in revaluation reserves in financial year 2010

	Bonds and other fixed-income securities	Shares and other non-fixed income securities	Equity investments	Effects of deferred taxes	Investments accounted for using the equity method	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2010	- 291	21	0	- 13	- 7	- 290
A. Changes recognised in the income statement						
Decrease due to disposals	0	- 60	0	0	0	- 60
Increase due to disposals	4	0	0	0	0	4
Decrease due to impairments	0	0	0	0	0	0
Amortisation after reclassification	113	0	0	0	0	113
Total changes recognised in the income statement	117	- 60	0	0	0	56
B. Changes recognised directly in equity						
Changes in revaluation reserves due to impairment reversal only for equity instruments	0	0	8	0	0	8
Changes in revaluation reserves due to fair value changes	- 73	38	0	9	- 6	- 32
Total changes recognised directly in equity	- 73	38	8	9	- 6	- 24
Effects of exchange rate changes	- 2	2	0	0	0	0
As at 31 Dec. 2010	- 249	1	8	- 4	- 13	- 257

Statement of changes in equity in financial year 2009

	As at 1 Jan. 2009	Owner-related changes in equity	Appropriation of comprehensive income 2009	As at 31 Dec. 2009
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Subscribed capital	3,750	0	0	3,750
less uncalled outstanding contributions	- 450	0	0	- 450
Capital reserve	6,254	- 307	0	5,947
<i>Promotional reserves from the ERP Special Fund</i>	4,650	0	0	4,650
Reserve from the ERP Special Fund	848	0	45	893
Retained earnings	5,269	34	- 578	4,725
<i>Statutory reserve under Section 10 (2) KfW Law</i>	1,574	0	0	1,574
<i>Special reserve under Section 10 (3) KfW Law</i>	1,893	34	0	1,928
<i>Special reserve less the special loss account from provisioning pursuant to Section 17 (4) of the D-Mark Balance Sheet Law</i>	21	0	0	21
<i>Other retained earnings</i>	1,780	0	- 578	1,202
Fund for general banking risks	50	0	- 4	46
Revaluation reserves	- 551	0	261	- 290
Balance sheet loss	- 3,436	272	1,664	- 1,499
Equity	11,733	0	1,388	13,121

Statement of changes in revaluation reserves in financial year 2009

	Bonds and other fixed-income securities	Shares and other non-fixed income securities	Equity investments	Effects of deferred taxes	Investments accounted for using the equity method	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2009	- 557	2	0	4	0	- 551
A. Changes recognised in the income statement						
Decrease due to disposals	0	0	0	0	0	0
Increase due to disposals	10	0	0	- 1	0	9
Decrease due to impairments	0	0	0	0	0	0
Amortisation after reclassification	125	0	0	0	0	125
Total changes recognised in the income statement	136	0	0	- 1	0	134
B. Changes recognised directly in equity						
Changes in revaluation reserves due to impairment reversal only for equity instruments	0	20	0	0	0	20
Changes in revaluation reserves due to fair value changes	129	0	0	- 15	- 7	107
Total changes recognised directly in equity	129	19	0	- 15	- 7	126
Effects of exchange rate changes	1	0	0	0	0	1
As at 31 Dec. 2009	- 291	21	0	- 13	- 7	- 290

STATEMENT OF CASH FLOW

Statement of cash flow

	2010	2009
	EUR in millions	EUR in millions
Consolidated profit	2,631	1,127
Non-cash items included in consolidated profit/loss and reconciliation to cash flow from operating activities:		
Depreciation, amortisation, impairment and reversal of impairment losses (receivables, property, plant and equipment, securities and investments) and changes in risk provisions for lending business	- 134	1,169
Changes in other provisions	174	305
Profit/loss from the disposal of securities and investments and property, plant and equipment	1	- 3
Other adjustments	- 2,532	- 3,374
Subtotal	139	- 775
Changes in assets and liabilities from operating activities after adjustment for non-cash items:		
Loans and advances to banks	- 21,862	- 18,098
Loans and advances to customers	- 10,211	3,654
Securities and investments (securities)	1,732	7,854
Other assets relating to operating activities	- 10,646	1,775
Liabilities to banks	7,365	- 3,693
Liabilities to customers	- 1,724	- 7,572
Certificated liabilities	36,556	18,870
Other liabilities relating to operating activities	- 3,546	- 4,152
Interest and dividends received	14,454	18,017
Interest paid	- 11,702	- 15,363
Income tax paid	- 33	- 10
Cash flow from operating activities	523	507
Cash proceeds from the disposal of:		
Property, plant and equipment	10	24
Cash payments for investment in:		
Securities and investments (equity investments)	- 173	- 197
Property, plant and equipment	- 93	- 96
Cash flow from investing activities	- 256	- 269
Cash proceeds from/(cash payments for) capital increases/(decreases)	0	0
Cash flow from financing activities	0	0
Cash and cash equivalents as at the end of the previous period	337	99
Cash flow from operating activities	523	507
Cash flow from investing activities	- 256	- 269
Cash flow from financing activities	0	0
Cash and cash equivalents as at the end of the period	604	337

The IAS 7 item Cash and cash equivalents reported in the statement of cash flow is identical to the balance sheet item Cash reserves and thus comprises cash on hand and balances with central banks.

The statement of cash flow shows the changes in cash and cash equivalents in the financial year through the cash flows from operating activities, investing activities and financing activities.

The item Other adjustments largely comprises the adjustment for net interest income in the amount of EUR - 2,752 million as well as for valuation results (EUR - 120 million) and effects of exchange rate changes (EUR 265 million).

Please refer to the comments on liquidity risk in the group management report for information on the KfW Group's liquidity risk management.

NOTES



NOTES

ACCOUNTING POLICIES

(1) Basis of presentation

KfW is the promotional bank of the Federal Republic of Germany and was founded in 1948 as a public law institution based in Frankfurt am Main.

The Executive Board of KfW is responsible for the presentation of the consolidated financial statements and the group management report. After they have been recommended by the Audit Committee, they are submitted to the KfW Board of Supervisory Directors for approval. No incidents of particular importance have occurred since the end of the financial year (as at 8 March 2011).

As at the reporting date, the KfW Group includes six subsidiaries and two special funds (securities funds – *Wertpapiersondervermögen*) that are fully consolidated. Two jointly controlled entities and three associated companies are accounted for at equity.

The consolidated financial statements as at 31 December 2010 have been prepared, pursuant to Section 315 a (1) of the German Commercial Code (*Handelsgesetzbuch – HGB*), in accordance with the International Financial Reporting Standards (IFRS), as applicable in the European Union (EU), and with the interpretations set out by the International Financial Reporting Interpretations Committee (IFRIC), as mandatory consolidated accounts in accordance with Article 4 of Regulation (EC) No. 1606/2002 (IAS Regulation) of the European Parliament and of the Council of 19 July 2002, as well as further regulations on the adoption of certain international accounting standards. The standards and interpretations that apply are those that had been published and endorsed by the EU on the reporting date.

The supplementary provisions of the German Commercial Code that also apply to IFRS consolidated financial statements have been taken into account. The group management report prepared in accordance with Section 315 of the German Commercial Code includes the risk report with the risk-oriented information on financial instruments as set out in IFRS 7, material events after the balance sheet date according to IAS 10 as well as information on capital and capital management as set out in IAS 1.124.

The consolidated financial statements were prepared in accordance with accounting policies that are uniform within the KfW Group and are based on the going concern principle. The companies accounted for prepared their annual financial statements as at 31 December 2010, except where financial statements as at 30 September 2010 were used for companies accounted for at equity.

The accounting policies were used consistently.

The reporting currency and the functional currency of all consolidated entities is the euro. Unless otherwise specified, all amounts are stated in millions of euros (EUR in millions).

As a general rule, assets are carried at (amortised) cost, with the exception of the following financial instruments:

- ▀ derivative financial instruments carried at fair value through profit or loss;
- ▀ designated financial instruments carried at fair value through profit or loss; and
- ▀ available-for-sale financial assets carried at fair value recognised directly in equity.

The consolidated financial statements include values which are determined on the basis of judgements and/or estimates and assumptions which are determined to the best possible knowledge and in accordance with the applicable standard. The amounts actually realised in the future can deviate from these estimates. Estimates and assumptions are required, in particular, for calculating risk provisions, recognising and measuring provisions (primarily for pension liabilities and legal risks), performing the fair value accounting for financial instruments based on valuation models, assessing and measuring impairment of assets, and assessing the realizability of deferred tax assets. The estimates and assumptions underlying these estimates are reviewed on an ongoing basis and are based, among other things, on historical experience or expected future events that appear likely given the particular circumstances. Insofar as estimates and their underlying assumptions were required, the assumptions made are explained in the notes to the relevant items.

KfW does not expect any deviations from its assumptions or any uncertainties with respect to estimates that could result in a substantial adjustment to the related assets and liabilities within the next financial year. Given the strong dependency on the development of the economic situation and financial markets, however, this cannot be fully excluded. These risks are nevertheless low because valuation models for measuring the fair value of financial instruments – especially those involving the use of inputs not based on observable market data – are only employed for part of the portfolio.

(2) Assessment of the impact of IFRS/IFRIC standards to be applied in the future

The new rules of the amended standards IFRS 1 "First-time Adoption of International Financial Reporting Standards" (November 2008, July 2009, January 2010), IFRS 2 "Share-Based Payment" (June 2009), IFRS 3 "Business Combinations" (January 2008), IAS 27 "Consolidated and Separate Financial Statements" (January 2008), IAS 39 "Financial Instruments: Recognition and Measurement" (July 2008) and the "Improvement to IFRSs 2007 – 2009" (April 2009), to be applied for the first time in financial year 2010, result in no material impacts on the bank's net assets, financial position and results of operations.

The new rules of the amended standard IAS 24 "Related Party Disclosures" (November 2009), the application of which is mandatory with effect from financial year 2011, were voluntarily applied early. This has not had any material impact on the Group's net assets, financial position and results of operations.

The amendments of IAS 32 "Financial Instruments: Presentation" (October 2009), which the EU has already adopted and the application of which is mandatory with effect from financial year 2011, were not voluntarily applied early. These amendments are not expected to have any material impacts on the Group's net assets, financial position and results of operations nor are they of relevance to the Group.

The amendments to IFRIC 14 "Prepayments of a Minimum Funding Requirement" and IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments", which have already been passed by the EU and the application of which is mandatory with effect from financial year 2011, are of no relevance to the Group.

(3) Consolidated Group

All significant subsidiaries, jointly controlled entities and associated companies have been included in the consolidated financial statements.

Affiliated entities are consolidated in accordance with IAS 27 if KfW can exercise control over the company directly or indirectly. They are consolidated for the first time as soon as they can be controlled. Affiliated entities are deconsolidated when control can no longer be exercised.

Associated companies and jointly controlled entities are included in accordance with IAS 28/IAS 31 insofar as significant influence or joint control is exercised.

Special purpose entities (SPEs) are companies formed to accomplish a narrow, well-defined objective. In accordance with IAS 27/SIC-12, a special purpose entity is consolidated when the substance of the relationship between the reporting enterprise and the SPE indicates that the SPE is controlled by that enterprise. This is indicated if

- A. the SPE conducts its activities to meet the enterprise's needs and the enterprise derives benefit from this, or
- B. the enterprise has the decision-making powers to obtain the majority of the benefits of the SPE's activities, or
- C. the enterprise has rights to obtain the majority of the benefits of the SPE's activities, or
- D. the enterprise holds the majority of the risks and rewards.

The structure of the consolidated group is set out in the Notes under "Disclosures on shareholdings".

(4) Basis of consolidation

Consolidation involves revaluing the total assets and liabilities of the subsidiaries at the acquisition date, irrespective of the percentage of equity instruments acquired, and incorporating them into the consolidated statement of financial position. Revealed hidden reserves and burdens are treated in accordance with the applicable standards. If the revaluation procedure results in an excess of acquisition cost, this amount is capitalised as goodwill. At present, no goodwill is recognised.

Any intragroup assets and liabilities as well as expenses and revenues from transactions between companies included in the consolidated financial statements are eliminated in the process of the intragroup consolidation of debt, expenses and earnings. Intragroup profits between consolidated companies are also eliminated.

Associated and jointly controlled entities are accounted for using the equity method. These are presented separately in the consolidated statement of financial position. Changes in value are shown depending on their underlying cause as a separate item in the income statement or in the revaluation reserves.

KfW holds no minority interests.

(5) Financial instruments: recognition and measurement

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. The following explanations provide an overview of how the requirements of IAS 39 are implemented.

Initial recognition is as at the settlement date for non-derivative financial instruments and as at the trade date for derivatives.

Upon initial recognition, financial instruments must be assigned to one of the following categories. The subsequent valuation depends on this categorisation:

- A. *Loans and receivables*
- B. *Held-to-maturity investments,*
- C. *Financial assets and liabilities at fair value through profit or loss,*
 - a. *Financial assets and liabilities designated at fair value through profit or loss, fair value option,*
 - b. *Financial assets and liabilities held for trading,*
- D. *Available-for-sale financial assets, or*
- E. *Other liabilities.*

The category "*loans and receivables*" includes non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are measured at amortised cost using the effective interest method. For the KfW Group, this primarily relates to the lending business reported under Loans and advances to banks and Loans and advances to customers. In its lending business the KfW Group uses the Basel definition for its selection of default criteria and applies a uniform definition of default group-wide. Default criteria are, in particular, payments overdue for more than 90 days (taking a marginality limit into account) and anticipated non-fulfilment of payment obligations in the face of indicators such as filing for bankruptcy, material adverse change, distressed loan indication, cases of conversion and transfer, debt to equity swaps, deferment/restructuring and disposal of loans or advances at significant loss.

"*Held-to-maturity investments*" are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the intention and ability to hold to maturity. This valuation category is used for acquisitions in the Group's securities portfolio on a case-by-case basis. These are carried under Securities and investments, any impairments and reversals of impairment losses are to be recognised in Net gains/losses from securities and investments. Premiums and discounts amortised according to the effective interest method are accounted for through profit or loss under Interest income.

For financial assets and liabilities, the *fair value option* can be used irrevocably if

- ▀ the categorisation can resolve or substantially reduce an accounting mismatch resulting from the valuation of financial assets or financial liabilities or the recognition of a loss or a gain as a result of differing accounting policies;
- ▀ a group of financial assets and/or financial liabilities is managed in accordance with the documented risk management or investment strategy and its performance is assessed on the basis of the fair value and the information is passed on to key personnel; or
- ▀ a contract contains one or several embedded derivatives which significantly modify the cash flows required by the contract or an analysis is required to determine that the embedded derivative(s) may not be separated.

“Designated financial assets and liabilities” are measured at fair value through profit or loss. The KfW Group uses the *fair value option* for hedging relationships, structured products, securitisation transactions, equity finance business, and for financial instruments of special funds. These financial instruments are reported under Securities and investments, Liabilities to banks and customers and Certificated liabilities. Changes to the fair value are stated under Net gains/losses from other financial instruments at fair value through profit or loss, while interest income/expense is reported under Net interest income.

Financial instruments that belong to the category “financial assets and liabilities held for trading” are measured at fair value through profit or loss. This category includes both derivative and non-derivative financial instruments purchased with the intention of generating a short-term profit. The KfW Group does not enter into any transactions with the intention of generating a short-term profit. Derivative transactions concluded exclusively for hedging purposes are allocated to this category if they are not used in hedge accounting according to IAS 39. They are reported under Other derivatives. Changes to the fair value are reported under Net gains/losses from other financial instruments at fair value through profit or loss. Derivatives used for hedge accounting are carried under the item of the same name. Changes to the fair value are reported under Net gains/losses from hedge accounting. Interest income/expense from derivatives is reported under Net interest income.

All other financial assets fall under the category “available-for-sale financial assets”. The difference between the fair value and the (amortised) cost is recognised directly in a separate equity item until the asset is sold or an impairment loss has to be recognised in profit or loss. This is the case for debt instruments if there is objective evidence (“trigger”) of impairment with an impact on the expected future cash flows. Specific trigger events are defined depending on the type of financial instrument. Events such as payments overdue for 30 days or more, a deterioration in the internal rating to the non-performing loans category, and a decline in the market price can be considered objective evidence of a possible impairment. Furthermore, an impairment has to be recognised in profit or loss in the case of a significant or prolonged decline below the acquisition cost of equity instruments. The impairment of a debt instrument assigned to this category is reversed through profit or loss if there is no longer any objective evidence for an impairment. Impairments of equity instruments assigned to this category may only be reversed directly in equity. Equity instruments that cannot be reliably measured at fair value are accounted for at cost. Impairments are recognised in profit or loss, while reversals of impairment losses are not considered. Within the KfW Group, the *available-for-sale financial assets* are reported under Securities and investments. Gains and losses from disposals, impairments to be recognised in profit or loss and the reversal of impairments from debt instruments are reported under Net gains/losses from securities and investments. Premiums and discounts are amortised through profit or loss using the effective interest method and recognised under Interest income.

All non-derivative financial liabilities for which the *fair value option* is not applied are categorised as “other liabilities”. These are measured at amortised cost using the effective interest method. For the KfW Group, this category covers borrowings that are reported under Liabilities to banks and customers, Certificated liabilities and Subordinated liabilities.

Financial assets are derecognised as at the settlement date, with the exception of derivatives. Derecognition is performed when the contractual rights relating to the asset have expired, the power of disposal/control has been transferred, or a substantial portion of the risks and rewards has been transferred to a third party unrelated to the KfW Group.

Financial liabilities are derecognised if the obligations set out in the agreement have been discharged or cancelled or have expired.

For operations assigned to KfW by the Federal Government in accordance with section 2 (4) of the KfW Law, for which KfW may or may not assume the risk, the Group's general recognition procedures for the relevant financial instruments will be applied. Measurement is based on the relevant individual contractual regulations concerning risk allocation.

The amendment to IAS 39 in the version dated 13 October 2008 expanded the possibilities to reclassify financial assets. Accordingly, until 31 October 2008, it was possible to reclassify assets carried as *"available-for-sale financial assets"* as *"loans and receivables"* with retroactive effect as at 1 July 2008 and afterwards prospectively as at the date of the resolution if there was the intention and ability to hold the respective financial instruments for the foreseeable future or until maturity and if the general categorisation criteria for *"loans and receivables"* were fulfilled at the date of reclassification.

On 31 October 2008, the KfW Group decided to use this approach with retroactive effect as of 1 July 2008 for its asset-backed securities for which, as part of the general crisis of confidence in the financial markets, there was no longer an active market when the decision was passed (i. e., no current, regularly occurring market transactions on an arm's length basis could be observed) and which were to be held through to maturity.

In addition, some of the securities that serve to maintain group liquidity – through their use in repo transactions or open market transactions of the European Central Bank – were reclassified with prospective effect taking advantage of the resolution dated 17 February 2009. An active market for these securities that were to be held for the foreseeable future no longer existed at the date of the resolution, as a result of the general crisis of confidence in the financial markets.

The fair value on the date of reclassification is the new acquisition cost of the reclassified financial assets. Amortisation is accounted for through profit or loss under Interest income according to the effective interest method. The difference between the fair value and (amortised) cost which had been recognised directly in equity until the reclassification continues to be carried under equity as a separate item. Amortisation using the effective interest method is accounted for through profit or loss under Interest income.

Classification for the Notes was performed in agreement with the Group's business model focussed primarily on the lending business – valued at (amortised) cost – on the basis of products or the balance sheet items which encompass them.

(6) Financial instruments: valuation techniques

At the KfW Group, initial recognition of financial instruments is at fair value.

Subsequent valuation at amortised cost is based, within the KfW Group, on the fair value upon initial recognition, taking into account any principal repayments and any impairments. The amortisation of premiums and discounts, transaction costs and fees is performed in accordance with the effective interest method on the basis of the contractual cash flows. In its promotional business, only discounts are amortised; this is carried out until the end of the first fixed interest rate period (generally five or ten years).

At the KfW Group, subsequent valuation at fair value is based on the following hierarchy:

1. Active market

The best objective evidence of fair value is provided by published price quotations in an active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available and those prices represent current – i.e., traded on the date of conclusion or shortly before – and regularly occurring market transactions on an arm's length basis. Apart from the traded nominal volumes, the contract sizes and the number of contracts, this assessment takes into account in particular the bid-ask spreads observed, which in the event of a significant expansion point towards an inactive market.

2. No active market – valuation techniques

If the financial instrument is not quoted in an active market, valuation techniques are used. The valuation techniques used include, in particular, the discounted cash flow (DCF) method and option pricing models, as well as a comparison with the fair value of a financial instrument with almost identical characteristics (e.g., multiplier-based models). The valuation techniques take account of all of the parameters that the market participants would include in the pricing process, e.g., market rates, risk-free interest rates, credit spreads or swap curves. As these data can generally be observed on the market and are also usually the only relevant parameters in measuring financial instruments to be valued using valuation techniques, the disclosures on valuation methods used for financial instruments carried at fair value normally state "Valuation method based on observable market data (model)". If, however, relevant data are used in valuation that are not observable on the market, the instrument is allocated to the category "Valuation method based in part on unobservable market data".

If differences between the transaction price and model value arise from the use of a valuation technique that makes significant use of unobservable inputs, the differential amounts are amortised through profit or loss over the life of the financial instruments. This only applied to a small part of the derivative portfolio.

3. No active market – equity instruments

If in exceptional cases it is not possible to reliably determine the fair value of equity instruments that are not quoted in an active market using valuation models, they are measured at cost. The fair value cannot be calculated reliably if the range of reasonable fair value estimates for this instrument is significant and the probabilities of the various estimates cannot be reasonably assessed.

For its securities, the Group examines whether a financial instrument is quoted on an active market on the basis of homogeneous portfolios. In examining the criteria of an active market, particular account also need be taken of whether the market transactions and pricing are characterised by very high illiquidity discounts, as the criteria for regularly occurring market transactions on an arm's length basis can thus no longer be regarded as fulfilled.

As a result, in these cases, according to the valuation hierarchy of IAS 39, valuation methods to determine the fair value are used, which take into account the parameters which can be observed on the market. The valuation methods used thus include, in particular, changes in creditworthiness and risk-free interest rates, however they also take into account the general and the financial instrument-specific tightening of the market due to lower liquidity.

This was not the case for the Group's securities as at the reporting date, so that the prices of liquid markets could continue to be used to determine fair value.

Fair values are determined on the basis of the valuation category for recognition on the balance sheet and for information on financial instruments in the Notes. Fair values from active markets are applied,

in particular, for bonds and other fixed-income securities – unless there are inactive markets and thus valuation techniques are used – as well as shares and other non-fixed income securities. However, valuation techniques for non-derivative financial instruments are applied in particular to the products reported under Loans and advances to banks and customers, Liabilities to banks and customers, and Certificated liabilities. Furthermore, in the case of OTC derivatives, valuation techniques are used that pay special attention to the counterparty-specific default risks, taking into account available collateral. Equity investments and shares which cannot be reliably measured at fair value are measured at cost.

The fair value for loans to banks and customers is calculated using the discounted cash flow (DCF) method based on the discounting of the risk-adjusted cash flows with the swap curve. The expected loss calculated for the respective reporting date is used to correct the contractual cash flows. The fair value at initial recognition is equivalent to the cost upon acquisition. The customer fee includes operating expenses, the margin, the equity and debt risk premium, and any subsidies. The customer fee remains unchanged for subsequent valuation (constant spread).

The fair value of financial instruments due on demand, such as cash reserves or receivables and liabilities due on demand, is the carrying amount.

In cases in which no prices from liquid markets are available, recognised valuation models and methods are applied. The DCF method is used for securities, swaps, and currency and money market transactions with no embedded options and no complex coupons. Independent options, as well as derivatives with embedded options, triggers, guaranteed interest rates and/or complex coupon agreements, are measured using recognised models (e.g. Hull & White) unless they are listed on a stock exchange. The same applies for credit default swaps.

The aforementioned models are calibrated, if possible, on the basis of observable market data for instruments that are similar in terms of the type of transaction, maturity, and credit quality.

(7) Hedging relationships

Derivatives are used within the KfW Group for the hedging of interest rate and currency risks. Economic hedging relationships are recognised through hedge accounting and by using the *fair value option*. Economic hedging relationships also impact the accounts in the form of embedded derivatives requiring separation which are accounted for through profit or loss. However, as not all derivatives are subject to hedge accounting or the *fair value option*, some economic hedging derivatives are reflected in the accounts, although their risk-mitigating impact is not reflected in the accounts because the hedged risk associated with the underlying transactions is not recognised in profit or loss under IFRS.

Hedge accounting, i.e. the accounting for hedging instruments (derivatives) and hedged transactions in accordance with special rules, is subject to strict requirements.

Within the KfW Group, hedge accounting is used solely in the form of fair value hedges to recognise hedging relationships between derivatives and the respective assets/liabilities. The hedging relationship is reported at the individual transaction level in the form of micro fair value hedge accounting, and at portfolio level in the form of macro fair value hedge accounting. The effectiveness of the hedging relationships is verified using the dollar offset method and a regression analysis.

In micro fair value hedge accounting, interest rate and currency risks from bonds allocated to securities and investments ("*loans and receivables*" and "*available-for-sale financial assets*" categories) and borrowings ("*other liabilities*" category) are hedged. The fair values attributable to the hedged risks are

reported as an adjustment of the carrying amount of the hedged items with the corresponding gain or loss reported under Net gains/losses from hedge accounting. The hedging instruments are recognised at fair value under Derivatives used for hedge accounting. Changes in the value of these instruments are also reported under Net gains/losses from hedge accounting, leading to a substantial compensation of the earnings effects resulting from the valuation of the hedged items. The fair value of the hedged risks from hedging relationships which no longer fulfil the strict hedge accounting requirements is amortised over the residual term of the original hedging relationship under Net gains/losses from hedge accounting.

In macro fair value hedge accounting, interest rate risks from loan receivables ("*loans and receivables*" category) and borrowings ("*other liabilities*" category) are hedged. The fair values attributable to the hedged risks in the hedged portfolios in the "*loans and receivables*" category are reported under Value adjustments from macro fair value hedge accounting on the assets side. The fair values attributable to the hedged risks in the hedged portfolios in the "*other liabilities*" category are reported under Value adjustments from macro fair value hedge accounting on the liabilities side. Changes in the fair values of the hedged risks from the hedged portfolios are reported under Net gains/losses from hedge accounting. The hedging instruments are reported at fair value under Derivatives used for hedge accounting. Changes in the value of these instruments are also reported under Net gains/losses from hedge accounting, with the consequence that they almost fully offset the earnings effects from the valuation of the hedged portfolios. The portfolio of underlying transactions is determined each month in the context of a dynamic hedge designation and reversal process. The resultant value adjustment items are amortised over the residual term of the maturity period in Net gains/losses from hedge accounting. Disposals from the hedged portfolios result in a partial reversal of the related value adjustments in Net gains/losses from hedge accounting.

If the strict hedge accounting requirements for the designation of hedging relationships between derivatives and financial assets/liabilities are not fulfilled within the KfW Group, the *fair value option* is used for the non-derivative financial instruments in certain circumstances, in particular for structured products. Based on the product, in the case of some structured financial liabilities the embedded derivatives requiring separation are accounted for independently instead of using the *fair value option*.

Further derivative financial instruments are also used to hedge risks, but their resultant hedge effect is not reflected in the accounts.

The fair values of all derivatives not subject to hedge accounting are reported under Other derivatives. Changes in the fair values are recognised in the income statement under Net gains/losses from other financial instruments at fair value through profit or loss.

(8) Treatment of embedded derivatives

Derivative financial instruments can be part of a hybrid (combined) financial instrument as embedded derivatives. Under certain conditions, they are reported separately from the host contract, similar to stand-alone derivatives. They must be reported separately if the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract. The host contract will be accounted for depending on its categorisation.

The KfW Group enters into contracts with embedded derivatives requiring separation particularly with respect to borrowings. As it makes use of the *fair value option*, KfW reports these hybrid (combined)

financial instruments at fair value. In the case of certain products, the embedded derivatives requiring separation are spun-off and accounted for separately. Changes in fair value are recorded in Net gains/losses from other financial instruments at fair value through profit or loss under the item Derivatives not qualifying for hedge accounting, where they have a compensatory effect on the valuation of the hedging derivatives.

Supplementary agreements made in the KfW Group's equity finance business are treated as separate embedded derivatives which are measured at fair value through profit or loss and reported under Other derivatives. The loan receivables are reported under Loans and advances to customers. Changes in fair value are recorded in Net gains/losses from other financial instruments at fair value through profit or loss under the item Derivatives not qualifying for hedge accounting.

Unscheduled termination rights that are granted regularly in promotional loan transactions are not recorded as embedded derivatives requiring separation since the economic characteristics and risks associated with the termination rights are closely related to the economic characteristics and risks of the loans and a premature repayment is made at approximately amortised cost.

(9) Credit derivatives

The KfW Group enters into credit derivatives as protection seller and protection buyer.

As part of active portfolio management, single name CDSs (credit default swaps) are used to hedge the risks of individual counterparties. These are recognised at fair value under Other derivatives. The changes in value are reported in the income statement under Net gains/losses from other financial instruments at fair value through profit or loss. The current risk premiums are reported under Commission expense.

As part of risk diversification, single name CDSs are also used to acquire the risks of individual counterparties. These are recognised at fair value under Other derivatives. The changes in value are reported in the income statement under Net gains/losses from other financial instruments at fair value through profit or loss. The current risk premiums are reported under Commission income.

As part of its promotional loan business, the KfW Group gives commercial banks the opportunity to place their credit risks in the capital market as part of a synthetic securitisation via the two standardised platforms PROMISE (programme for the securitisation of SME loans) and PROVIDE (programme for the securitisation of housing loans). In a first step, the KfW Group assumes the default risks of the reference portfolio via portfolio CDSs, while the risks are simultaneously passed on to third parties via portfolio CDSs/credit-linked notes. These transactions are reported using the *fair value option*. The fair values are reported as receivables or liabilities. Changes to the fair values are recognised under Net gains/losses from other financial instruments at fair value through profit or loss. The current risk premiums are reported under Net commission income.

In the case of transactions for which, in line with individual contractual regulations, the *fair value option* is not used in order to avoid an accounting mismatch, portfolio CDSs are recognised in the balance sheet as financial guarantees issued or received in accordance with the generally applicable procedure for these financial instruments. Credit-linked notes with embedded financial guarantees not requiring separation are classified as "*other liabilities*" and recognised in accordance with the principles for reporting borrowings.

(10) Risk protection, capital measures and sale of IKB

Until its sale in financial year 2008, IKB was an affiliated entity of KfW, supported in 2007 and 2008 by the German banking sector and the Federal Republic of Germany with measures protecting it against risks related to the US subprime mortgage crisis, various capital measures and additional agreements made as part of its sale.

As part of the risk protection measures agreed in 2007, KfW assumed all of IKB's rights and obligations under IKB's liquidity lines to refinance the special purpose entities of the "Rhineland Funding Capital Corporation, New York, USA" conduit. The other financial instruments used for risk protection were settled during financial year 2008.

The "Rhineland Funding Capital Corporation, New York/USA" conduit was not consolidated by the KfW Group during the reporting year. The provision of the liquidity lines did not trigger an obligation for KfW to consolidate the special purpose entities because KfW did not control the SPEs within the meaning of SIC -12. KfW did not obtain any power of disposal over the SPEs or over their assets by providing the liquidity lines. KfW served solely as provider of debt capital for the conduit and did not possess any decision-making powers over the assets of the SPEs or over the SPEs themselves. The fully drawn liquidity lines are reported under Loans and advances to customers.

The valuation of receivables resulting from the assumption of the liquidity lines was based on an analysis of the underlying assets. The valuation techniques took into account the hierarchy set out in IAS 39.48A. To the extent available, market values were used for the instruments covered by the risk protection. In all other cases valuation was carried out on the basis of models that took into consideration directly or indirectly observed market prices for similar or substantially identical financial instruments. Valuation was carried out using models only insofar as no prices or market parameters were available for the instruments covered by the risk protection or for similar or substantially identical financial instruments. In such cases the capital losses resulting from the protected financial instruments were calculated using a cash flow-based loss estimate. The financial instruments were differentiated by asset category, rating and, in some cases, year of issue. The values were verified through comparison with quotations by arrangers and/or independent estimates by specialists.

Using this as a basis, KfW recorded individual impairments for the receivables resulting from the assumption of the liquidity lines or adjusted the allowance account in subsequent valuations recognising the change in profit or loss. If the receivables are deemed partially or fully uncollectible they are written-down or written-off against the allowance account. Recoveries on loans already written off are recognised as income from risk provisions.

In addition to various capital measures carried out for the benefit of IKB in financial year 2008, KfW granted IKB liquidity facilities on market terms, which were terminated early by IKB in financial year 2010.

The portfolio of financial instruments carrying risks acquired by KfW through the sale of IKB was reduced as far as possible in financial year 2010. The agreement in this context on involvement by KfW in refinancing a portfolio of further IKB structured securities expired in financial year 2010.

In addition, KfW agreed to indemnify IKB for certain legal risks in a certain amount as part of the sale of IKB. As at the end of the reporting period, several proceedings against IKB which are relevant in this context were pending. There were no major claims made against KfW in 2010 under the indemnification agreement as a result of the legal action.

(11) Foreign currency translation

The functional currency of KfW and its consolidated subsidiaries and special funds is the euro.

Monetary assets and liabilities denominated in foreign currency are converted at the spot rate. Translation is made as at the balance sheet date using the European Central Bank reference rates. Income and expenses are translated strictly at the average monthly rate.

The results from foreign currency translation are recognised in profit or loss under Net gains/losses from other financial instruments at fair value through profit or loss.

(12) Loans and advances to banks and customers

The KfW Group's lending business carried at amortised cost is reported under Loans and advances to banks and customers. This item consists primarily of the promotional loan business, in which loans are typically granted to the final borrowers through accredited commercial banks. These assets are reported under Loans and advances to banks insofar as the commercial banks underwrite part of the liability. Promotional on-lending without underwriting of liability by commercial banks is reported under Loans and advances to customers.

Current interest and similar income are recorded under Interest income. Premiums, discounts, processing fees and charges are amortised in Interest income using the effective interest method. Processing fees that do not need to be amortised using the effective interest method are recognised under Commission income.

Loans and advances to banks and customers also include loans with a subsidy element (interest rate reductions) granted by KfW as part of the ERP economic promotion programme. The promotional subsidies granted annually to KfW through the ERP Special Fund based on the ERP-Wirtschaftsplan-gesetz for the purpose of executing ERP funding are reported as deferred income under Other liabilities; their deferral is not recognized in profit or loss under Interest income until the underlying promotional expenses are incurred during the loan maturity.

(13) Risk provisions for lending business

The overall risk provisions for lending business include the provisions for losses on loans and advances and receivables from money market investments, including reverse repos, as a separate asset item, as well as the provisions for contingent liabilities and irrevocable loan commitments reported under Provisions.

The risks resulting from on balance sheet lending business are accounted for by individual and portfolio impairments recognised in profit or loss.

Individual impairments are recorded for counterparty risks identified in an impairment test of individual loans. The amount of the impairment loss corresponds to the difference between the carrying amount of the loan and the discounted expected future cash flows from interest and redemption payments and from collateral-based cash flows. The recognition of interest income in accordance with the original contractual terms is terminated as at the date on which the first individual impairment is set up. In the subsequent valuation, the effect of compounding the present value of anticipated cash flows using the original effective interest rate is determined and carried as interest income (unwinding).

The risk provisions are reduced by this amount. Any reversals of individual impairment losses are accounted for through profit or loss.

Smaller and standardised loans are grouped into homogenous subportfolios for portfolio impairment on the basis of the default risks identified. Any reversals of portfolio impairment losses are accounted for through profit or loss.

For performing loans not subject to individual impairment, the risk of impairment losses that have already occurred but have not yet been individually identified is addressed by portfolio impairment. Economic risk and transfer risk are taken into account for the calculation. The key parameters are the outstanding loan volume (based on the carrying amount) as at the reporting date, the expected loss given default and one-year probabilities of default (given an LIP [loss identification period] factor of 1). The probabilities of default are provided by credit risk control, as is the loss given default, whereby the latter is adjusted for imputed cost. The underlying assumptions of expected losses are backtested on a regular basis against the actual loss experience.

In addition, portfolio impairments are recorded for impairment losses from the loan portfolio that have already occurred but have not yet been individually identified, and which occur particularly in periods of strong economic downturn. Identification is based on empirical values from comparable past economic scenarios, for example at sector or regional level.

Any reversal of impairment losses that have not yet been individually identified (e.g. due to economic recovery after a downturn) are accounted for through profit or loss.

For contingent liabilities and irrevocable loan commitments the individual risks detected are addressed in the form of provisions, with a corresponding effect on the income statement. For irrevocable loan commitments, impairments not yet identified individually are addressed by forming provisions, which are determined based on portfolio models.

If the loans are deemed partially or fully uncollectible they are written-down or written-off against the allowance account. Uncollectible loans, for which no individual impairments have been recorded, are written off directly. Recoveries on loans already written off are recognised as income from risk provisions.

(14) Securities and investments

Securities and investments include, in particular, securities portfolios. These mainly serve to support KfW's liquidity status or are used to optimise and stabilise the ability of the KfW Group to fulfil its promotional mandate in the long term.

The Securities and investments item on the balance sheet comprises bonds and other fixed-income securities, shares and other non-fixed income securities, equity investments, and shares in affiliated entities not included in the consolidated financial statements which are held by KfW, its subsidiaries and consolidated special funds.

To ensure uniform accounting treatment for equity investments with and without significant influence, individual group business divisions that provide equity financing as part of their promotional mandate are categorised as venture capital organisations for accounting purposes provided they meet the

respective requirements. These equity investments, like all other equity investments, are reported under Securities and investments.

Securities and investments are initially recognised at fair value and subsequently measured depending on their classification either as *“financial assets at fair value through profit or loss”* or as *“available-for-sale financial assets”*. Financial instruments with fixed or determinable payments which are not quoted in an active market are categorised as *“loans and receivables”*. Classification as *“held-to-maturity investments”* occurs on a case-by-case basis provided that the relevant criteria were fulfilled at the time of acquisition.

When non-listed equity investments are measured at fair value, appropriate allowances are made for illiquidity. For example, when discounted cash flow (DCF) models are used, a discount rate adjusted for a fungibility factor is applied. In cases where the fair value of non-listed equity investments cannot be reliably measured, such assets are carried at cost allowing for impairment losses.

Any changes in the value of *“financial assets at fair value through profit or loss”* are reported under Net gains/losses from other financial instruments at fair value through profit or loss. Realised gains and losses and impairments relating to the *“available-for-sale financial assets”*, *“loans and receivables”* and *“held-to-maturity investments”* categories are recognised under Net gains/losses from securities and investments; amounts reported for *“loans and receivables”* and *“held-to-maturity investments”* include allowances for impairment losses that have already occurred but have not yet been individually identified, based on the expected loss for one year. Unrealised gains from *“available-for-sale financial assets”* are recognised directly in equity as revaluation reserves. Current interest payments and dividends are reported under Interest income.

(15) Repurchase agreements

The KfW Group enters into repurchase agreements as standardised repos or reverse repos. These are combinations of simultaneous spot and forward transactions on securities with the same counterparty. The terms and modalities of collateralisation and for the use of collateral follow common market practice. Credit claims are also an eligible type of collateral for open-market transactions.

The securities sold under repo transactions (spot sale) continue to be recognised and measured as securities. The repayment obligation is carried as a liability to banks or customers in the amount of the cash inflow. Interest is recorded under Interest expense in accordance with the respective conditions of the repurchase agreements.

A repayment claim is recognised and measured as a loan or advance to banks or customers in the amount of the cash outflow generated by reverse repos. The securities received (spot purchase) are not recognised or measured. Interest is recorded in Interest income in accordance with the respective conditions of the reverse repurchase agreements.

(16) Property, plant and equipment

The land and buildings and the plant and equipment reported by the KfW Group are carried at cost less depreciation on a straight-line basis and impairment, both recognised under Administrative expense. An impairment is recognised if the carrying amount of the asset exceeds the recoverable amount, which is the higher of the fair value less the disposal cost or the value in use. The useful life is determined based on expected wear and tear. The KfW Group assumes an estimated useful life of 40 to 50 years for premises, four years for workstation computer equipment and five years for other property, plant and equipment. Gains and losses from the sale of property, plant and equipment are reported under Net other operating income.

The KfW Group's land and buildings are almost entirely owner-occupied. There is only a small volume of rental activity to third parties.

Payments in advance and assets under construction are reported under Other property, plant and equipment and are not subject to depreciation.

(17) Intangible assets

Under intangible assets, the KfW Group reports purchased and internally generated software at cost, less scheduled straight-line amortisation and impairments, both recognised under Administrative expense. The useful life is determined based on expected wear and tear. The KfW Group assumes a useful life of five years.

Assets are impaired when the carrying amount of an asset exceeds the recoverable amount. An impairment is recorded when no future economic benefits can be identified.

In-house software under development is reported under Other intangible assets and is not subject to amortisation.

(18) Taxes on income

KfW is a non-taxable entity. Taxes on income for non-exempt subsidiaries and their taxed permanent establishments are determined using tax laws in the country of residence. Current taxes on income as well as expenses and income from the change in deferred taxes are recognised in profit or loss as Taxes on income or directly in equity under Revaluation reserves depending on the underlying transaction. Current and deferred tax assets and liabilities are reported as separate items. Deferred income tax assets and liabilities are offset insofar as the requirements are met.

Current taxes on income are calculated using currently applicable tax rates.

Deferred tax assets and liabilities arise as a result of differences between carrying values according to IFRS of an asset or a liability and the respective tax bases if these are likely to result in taxable or tax deductible amounts in the future (temporary differences). Deferred tax assets relating to loss carryforwards not yet used are recognised only if there is a sufficient degree of certainty that the respective taxable entity will earn sufficient taxable income in subsequent periods to use the loss carryforward.

(19) Liabilities to banks and customers and certificated liabilities

The item Liabilities to banks and customers primarily includes non-current borrowings carried at amortised cost and the KfW Group's money-market transactions. The item Certificated liabilities contains bonds, notes and money-market instruments issued. Own issues repurchased for market-making purposes are deducted from the liabilities as at the repurchase date.

The *fair value option* is used for structured liabilities. There are no changes in the fair value due to changes in credit risk as KfW is classified in the highest rating classes with stable outlook by the leading international rating agencies. The valuation effects from market-related changes in purchase prices (including liquidity spreads) generated by the development of demand for the different KfW refinancing instruments are recognised under Net gains/losses from other financial instruments at fair value through profit or loss. In the case of certain products, the embedded derivatives requiring separation are accounted for separately. Presentation of the different types of borrowed funds is not based on their categorisation or their designation as hedged items. Valuation of the items is based on their respective categorisation.

Current interest is recorded in Interest expense; premiums and discounts are amortised using the effective interest method over the expected life in Interest expense. Changes in the value of liabilities designated at fair value are recorded in profit or loss under Net gains/losses from other financial instruments at fair value through profit or loss. Results from the repurchase of own issues categorised as "*other liabilities*" are recognised as at the repurchase date under Net other operating income.

(20) Provisions

The item Provisions includes provisions for pensions and similar commitments, credit risks as well as other obligations of uncertain amount and timing involving a probable outflow of funds.

The employees of the KfW Group participate in a company pension plan that pays retirement, long-term disability and survivor benefits. The KfW Group's pension plans are exclusively defined-benefit plans. The benefits depend on the length of service and salary. Apart from employer-financed pension plans there are also plans in place involving contributions by employees.

The pension commitments are calculated by an independent qualified expert in accordance with the projected unit credit method on the basis of group-wide uniform parameters such as age, length of service and salary. The commitments are recognised at present value of the defined-benefit obligations as at the reporting date, taking into consideration actuarial gains and losses to be amortised. The discount factor is based on current market conditions for corporate bonds with a maturity matching that of the obligations. Additional demographic factors (including the Heubeck actuarial tables for 2005 G) and actuarial assumptions (rate of salary increases, rate of pension increases, rate of staff turnover, etc.) are accounted for. No plan assets were defined for the pension obligations of the KfW Group, so the related special regulations do not apply.

The KfW Group recognises net cumulative actuarial gains and losses that exceed 10% of the present value of the defined-benefit obligations (corridor approach). Amounts in excess of the 10% mark are amortised in profit or loss on a straight-line basis over the expected average remaining working life under Administrative expense and recognised under Provisions for pensions and similar commitments.

All pension obligations are financed from the recognised pension provisions. There are no fund-financed pension obligations. Allocations to pension provisions distinguish between current service cost, interest expense and other allocations (including past service cost). The interest expense for pension obligations is reported under Other interest expense and other allocations are included in the item Administrative expense.

Pension-like obligations include commitments for deferred compensation, early retirement and partial retirement. Actuarial reports are prepared and a provision is set up accordingly for these types of commitments as well. There are no actuarial gains and losses, so that the recognised provision matches the present value of the obligations.

Other provisions are set up, including those for obligations to employees and for audit and consultancy services at the estimated expenditure. Long-term provisions are discounted where the interest effect is material. Added to this are obligations arising from the assumption of the tasks of the State Insurance Company of the GDR in liquidation (*Staatliche Versicherung der Deutschen Demokratischen Republik in Abwicklung – SinA* (institution under public law)), which are offset by receivables in the same amount from the Federal Agency for Special Tasks arising from Unification (*Bundesanstalt für vereinigungsbedingte Sonderaufgaben – BvS*) reported under Other assets.

(21) Subordinated liabilities

This item is used to carry subordinated liabilities to the ERP Special Fund.

Subordinated liabilities are classified as “*other liabilities*” and carried at amortised cost.

Deferred interest as well as value adjustments from micro fair value hedge accounting are recognised under Other liabilities.

Current interest expenses are recorded under Interest expense.

(22) Equity

The equity structure is determined by the KfW Law and IFRSs.

Pursuant to Section 10 (2) and (3) of the KfW Law, KfW's net income for the period determined in accordance with the German Commercial Code is transferred to reserves and is included in equity under IFRSs. In accordance with IFRSs, the KfW Group must report the contractually agreed “strengthening” of the reserve from the ERP Special Fund under equity as appropriation of consolidated profit/loss.

The KfW Group maintains a fund for general banking risks. Additions to or reductions of the fund are shown under IFRSs as appropriation of consolidated profit/loss.

Under IFRSs any remaining consolidated net income is allocated to Other retained earnings in the same period.

The revaluation reserves include the valuation results from the category “*available-for-sale financial assets*” and also deferred taxes recognised directly in equity, depending on the underlying transaction.

(23) Contingent liabilities and irrevocable loan commitments

The KfW Group's contingent liabilities result mainly from guarantees (financial guarantee contracts). All contingent liabilities are listed in the Notes at their nominal amounts less provisions.

Irrevocable loan commitments are firm commitments by the KfW Group to grant a loan under contractually agreed terms. These are listed in the Notes at their nominal amounts less provisions.

(24) Trust activities

Assets and liabilities held by the KfW Group in its own name but for third-party accounts are not recognised. This applies in particular to loans granted under German Financial Cooperation to support developing countries; the federal budget both grants the funds and underwrites these loans. The remuneration associated with these transactions is recognised under Commission income.

(25) Leasing transactions

Leases are classified as operating leases or as finance leases depending on the risks and rewards relating to ownership of an asset. This classification determines their accounting treatment.

The KfW Group enters into both types of leases as a lessee. Real estate leases are classified as operating leases; the corresponding rental payments are included under Administrative expense.

Finance leases are entered into only to a limited extent. The leased assets are capitalised and depreciated over the useful life or lease term, whichever is shorter, in Administrative expense. Liabilities arising from future leasing payments are reported under Other liabilities.

The small number of contracts in which the KfW Group acts as the lessor are classified as operating leases. The corresponding rental income is reported under Other operating income.

NOTES TO THE STATEMENT OF COMPREHENSIVE INCOME

(26) Net interest income

Analysis of net interest income by class

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Interest and similar income from loans and advances to banks and customers	11,152	11,613	- 460
Similar income from financial guarantees	41	44	- 3
Interest income from securities and investments	1,057	1,305	- 248
Interest income from derivatives	2,187	5,011	- 2,824
Other interest income	16	45	- 28
Interest income	14,454	18,017	- 3,563
Interest and similar expense for liabilities to banks and customers	767	1,041	- 275
Interest expense for certificated liabilities	11,358	11,524	- 166
Interest expense for subordinated liabilities	146	146	0
Interest expense for derivatives	- 746	2,433	- 3,179
Other interest expense	177	219	- 42
Interest expense	11,702	15,363	- 3,661
Total	2,752	2,654	98

Income from unwinding in the amount of EUR 41 million (previous year: EUR 55 million) is reported under Interest and similar income from loans and advances to banks and customers.

Interest income from derivatives includes the net interest income from derivatives irrespective of whether they are designated for hedge accounting. Interest income and expenses from derivatives which are directly related to individual financial instruments either on the assets or liabilities side and are not included in macro fair value hedge accounting are reported in interest income from derivatives (for financial instruments on the assets side) or in interest expenses from derivatives (for financial instruments on the liabilities side), depending on the hedged item. Taking account of interest income or expenses from the related hedged items, presentation is thus based on the economic nature of the hedged financial assets (variable-rate financial assets) or hedged financial liabilities (variable-rate financial liabilities).

Analysis of interest income from securities and investments

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Interest income from bonds and other fixed-income securities	989	1,271	- 282
Income from shares and other non-fixed income securities	1	3	- 2
Income from equity investments	67	31	36
Total	1,057	1,305	- 248

(27) Risk provisions for lending business

Analysis of risk provisions by transaction

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Impairment charges	680	1,352	- 673
Direct write-offs	109	123	- 14
Expense for risk provisions	789	1,475	- 686
Income from the reversal of impairment losses	990	443	547
Income from recoveries of amounts previously written off	223	60	163
Income from risk provisions	1,213	503	710
Total	424	-972	1,396

(28) Net commission income

Analysis of net commission income by class

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Commission income from lending business	234	286	- 52
Commission income from credit derivatives	2	6	- 5
Other commission income	139	136	3
Income from trust activities	1	1	- 1
Commission income	375	430	- 55
Commission expense for lending business	93	129	- 36
Commission expense for credit derivatives	1	3	- 2
Other commission expense	8	12	- 4
Commission expense	102	144	- 41
Total	273	286	- 13

Commission income from lending business also includes current premiums and fees from the securitisation platforms PROMISE and PROVIDE.

Other commission income includes fees for handling German Financial Cooperation with developing countries in the amount of EUR 107 million (previous year: EUR 107 million).

(29) Net gains/losses from hedge accounting

Analysis of net gains/losses from hedge accounting by type of hedging relationship

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Micro fair value hedge accounting	48	389	- 341
Macro fair value hedge accounting	- 267	- 702	435
Total	- 219	- 313	94

Net gains/losses from macro fair value hedge accounting comprise the valuation of hedging instruments in the amount of EUR - 1,763 million (previous year: EUR - 1,746 million) and the valuation of hedged risks from the hedged portfolios. It also includes the amortisation of the value adjustments from the dynamic hedge designation and reversal process and the pro-rata reversal of value adjustments in the event of disposals from the underlying portfolios as well as the residual term effect of the hedging derivatives.

Analysis of net results from micro fair value hedge accounting by hedged item

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Hedging of securities and investments	0	- 17	17
Hedging of liabilities to banks and customers	0	7	- 7
Hedging of certificated liabilities	41	314	- 273
Hedging of subordinated liabilities	0	4	- 4
Subtotal: Effectiveness of hedges	41	308	- 267
Amortisation of value adjustments	7	81	- 74
Total	48	389	- 341

Gross analysis of valuation results from micro fair value hedge accounting:

Comparison of hedged items and hedging instruments in financial year 2010

	Hedged items	Hedging instruments	Effectiveness of hedges
	EUR in millions	EUR in millions	EUR in millions
Hedging of securities and investments	121	- 121	0
Hedging of liabilities to banks and customers	- 25	25	0
Hedging of certificated liabilities	- 961	1,001	41
Hedging of subordinated liabilities	- 26	26	0
Total	- 891	932	41

Gross analysis of valuation results from micro fair value hedge accounting: Comparison of hedged items and hedging instruments in financial year 2009

	Hedged items	Hedging instruments	Effectiveness of hedges
	EUR in millions	EUR in millions	EUR in millions
Hedging of securities and investments	- 1	- 16	- 17
Hedging of liabilities to banks and customers	27	- 20	7
Hedging of certificated liabilities	2,864	- 2,550	314
Hedging of subordinated liabilities	- 49	53	4
Total	2,841	- 2,533	308

(30) Net gains/losses from other financial instruments at fair value through profit or loss

Analysis of net gains/losses from other financial instruments at fair value through profit or loss by class

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Securities and investments	312	582	- 271
Assets	312	582	- 271
Liabilities to banks and customers	- 52	- 592	540
Certificated liabilities	- 269	1,596	- 1,865
Liabilities	- 321	1,004	- 1,325
Financial derivatives not qualifying for hedge accounting	100	- 1,553	1,653
Credit derivatives	27	386	- 359
Derivative financial instruments	127	- 1,167	1,294
Foreign currency translation	88	- 51	139
Total	206	368	- 162

The net gains/losses from liabilities to banks and customers include the result of the credit-linked notes issued under the PROMISE and PROVIDE securitisation platforms. The net gains/losses from credit derivatives include the result from the portfolio CDSs concluded under this item.

The net gains/losses from derivatives not qualifying for hedge accounting are attributable mainly to derivatives in economic hedges which are recognised by using the *fair value option* for classifying the hedged items. The hedged items include, in particular, borrowings in the form of certificated liabilities and liabilities to banks and customers as well as securities and investments.

In addition, the net gains/losses from financial derivatives that do not qualify for hedge accounting include changes in the value of embedded derivatives from equity finance business which have to be separated. In addition, this item is used to carry results from embedded derivatives that are accounted for separately and which are connected to financial liabilities; the net gains/losses from the valuation of the associated hedging derivatives are thus compensated for.

Analysis of net gains/losses from securities and investments at fair value through profit or loss by product type

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Bonds and other fixed-income securities	160	601	- 441
Shares and other non-fixed income securities	1	1	0
Equity investments	151	- 20	171
Total	312	582	- 271

Analysis of net gains/losses from credit derivatives and credit-linked notes from the securitisation platforms PROMISE and PROVIDE at fair value through profit or loss

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Single Name CDSs	1	98	- 97
Portfolio CDSs	0	- 286	286
PROMISE/PROVIDE	13	- 27	40
CDSs	26	574	- 548
<i>Issued credit-linked notes</i>	- 13	- 601	588
Total	14	- 215	229

Gross analysis of results from economically hedged borrowing:
Comparison of hedged items and hedging instruments

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Borrowings	- 307	1,605	- 1,912
Hedging instruments	694	- 1,686	2,380
Total (Effectiveness of economic hedges)	387	- 81	468

(31) Net gains/losses from securities and investments

Analysis of net gains/losses from securities and investments by class

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Bonds and other fixed-income securities	- 17	- 83	66
Shares and other non-fixed income securities	58	1	57
Equity investments	- 39	- 35	- 4
Total	1	- 117	119

The net gains/losses from financial instruments include gains and losses realised from the sale and impairment of securities and investments classified as "available-for-sale financial assets", "loans and receivables" or "held-to-maturity investments".

In the reporting year, equity instruments at a carrying amount of EUR 37 million (previous year: EUR 15 million) for which the fair value could not be reliably determined, were disposed of. This generated a realised net result of EUR -12 million (previous year: + EUR 8 million), which is contained in the net gains/losses from shares and other non-fixed income securities and the net gains/losses from equity investments.

Disclosures on impairment of securities and investments

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Securities and investments	84	142	- 57
<i>Bonds and other fixed-income securities</i>	43	100	- 57
<i>Shares and other non-fixed income securities</i>	2	0	2
<i>Equity investments</i>	39	41	- 2

Disclosures on the reversal of impairment losses from securities and investments

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Securities and investments	23	34	- 11
<i>Bonds and other fixed-income securities</i>	23	34	- 11

(32) Net gains/losses from investments accounted for using the equity method

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Net gains/losses from investments accounted for using the equity method	-3	-3	0

(33) Administrative expense

Analysis of administrative expense

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Wages and salaries	360	333	27
Social security contributions	49	44	5
Expense for pension provision and other employee benefits	39	27	12
Personnel expense	448	404	44
Other administrative expense	227	256	-28
Depreciation, amortisation and impairment of property, plant and equipment and intangible assets	47	83	-36
Non-personnel expense	274	339	-64
Total	722	742	-20

The non-personnel expense includes EUR 5 million for depreciation, amortisation and impairment relating to finance leases (previous year: EUR 5 million).

Other administrative expense includes rental expense arising from operating leases in the amount of EUR 7 million (previous year: EUR 16 million).

(34) Net other operating income

Analysis of net other operating income

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Other operating income	68	51	16
Other operating expense	95	29	66
Total	-27	23	-50

Other operating income contains income from repurchasing own issues, rental income of EUR 2 million (previous year: EUR 3 million) and income from the reversal of other provisions.

(35) Taxes on income

Analysis of taxes on income by component

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Current taxes on income	42	35	6
Deferred taxes	12	22	-9
Total	54	57	-3

In the reporting year deferred tax liabilities resulted in expenses of EUR 12 million (previous year: EUR 22 million). These were largely a result of the change in recognition of temporary differences. The reconciliation presents the relationship between the calculated income tax expense for the financial year and reported taxes on income.

Tax reconciliation

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Profit/loss from operating activities (before taxes)	2,685	1,184	1,501
Group income tax rate	0%	0%	0%
Calculated income tax expense	0	0	0
Effects of tax rate differentials within the Group	134	-116	250
Effect of tax rate changes	0	0	0
Effects of previous year taxes recorded in the reporting year	-14	9	-23
Effects of non-deductible taxes on income	2	14	-12
Effects of non-deductible business expenses	2	6	-4
Effects of tax-free income	-6	-2	-4
Trade tax add-ons	3	2	1
Permanent accounting differences	-4	0	-4
Effects of changes in recognised deferred tax assets	-63	144	-207
Other effects	0	0	0
Reported taxes on income	54	57	-3

The KfW Group's applicable income tax rate of zero per cent, on which the reconciliation is based, takes into account the tax status of KfW as a non-taxable public-law institution and the major effect of this status on profit/loss from operating activities.

The effects of tax rate differentials result from individual group companies being taxable and the related different tax rates. The tax rates range from 0% to 33%.

The effects of changes in recognised deferred tax assets include, in particular, the non-consideration of tax loss carryforwards and of the surplus assets for deductible temporary differences. This reflects KfW's conservative approach to the valuation of deferred tax assets.

(36) Notes to other comprehensive income

Analysis of other comprehensive income by class

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Financial instruments	30	285	-254
<i>Bonds and other fixed-income securities</i>	42	266	-223
<i>Shares and other non-fixed income securities</i>	-20	19	-40
<i>Equity investments</i>	8	0	8
Deferred taxes on financial instruments	8	-17	25
Investments accounted for using the equity method	-6	-7	1
Other comprehensive income, total	33	261	-228

Other comprehensive income comprises income and expenses recognised directly in equity under Revaluation reserves.

Analysis of reclassification amounts included in the income statement by class

	2010	2009	Change
	EUR in millions	EUR in millions	EUR in millions
Reclassification amounts relating to financial instruments	57	135	-79
<i>Bonds and other fixed-income securities</i>	117	136	-19
<i>Shares and other non-fixed income securities</i>	-60	0	-60
Reclassification amounts relating to deferred taxes on financial instruments	0	-1	1
Total	56	134	-78

The reclassification amounts are the result of income and expenses which were accounted for through profit or loss during the reporting period and which were previously recognised directly in equity in the revaluation reserves. They also include amortisation of revaluation reserves from the reclassification of securities and investments from the valuation category "available-for-sale financial assets" to the "loans and advances" category. Income recognised in the income statement is reported with a negative sign preceding the amount and expenses without a negative sign.

SEGMENT REPORTING

(37) Segment reporting by business area

In accordance with the provisions of IFRS 8, segment reporting follows the internal management reporting system, which is used by the Group's main decision makers to assess each segment's performance and to allocate resources to segments.

In accordance with the business area structure for the KfW Group, the segments and their products and services are broken down as follows:

KfW Mittelstandsbank	<ul style="list-style-type: none"> – Financing of corporate investments and industrial pollution control – Equity financing
KfW Privatkundenbank	<ul style="list-style-type: none"> – Financing for housing construction and modernisation – Education finance
KfW Kommunalbank	<ul style="list-style-type: none"> – Infrastructure and social finance – Global loans – Transactions on behalf of the Federal Government
Export and project finance	<ul style="list-style-type: none"> – Financing for German and European export activities – Financing for projects and investments in the German and European interest
Promotion for developing and transition countries	<ul style="list-style-type: none"> – Promotion for developing and transition countries on behalf of the Federal Government (budget funds) with complementary market funds raised by KfW – Financing provided by DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH (private enterprise financing)
Capital Markets	<ul style="list-style-type: none"> – Securities and money market investments – Asset securitisation and capital market-related products – Holding arrangements for the Federal Republic of Germany – Refinancing
Group centre	<ul style="list-style-type: none"> – Central interest rate and currency management – Strategic equity investments – Advisory services

In terms of content, the business area structure remains unchanged since the last reporting. The Financial Markets business area was renamed "Capital Markets". It continues to comprise the following product groups: securities and money market investments, asset securitisation, holding arrangements for the Federal Republic of Germany and refinancing. Moreover, capital market-related transactions are assigned to this business area; such transactions include the loan granted to Greece in 2010 as mandated by the Federal Government in accordance with the KfW Law.

The business areas are measured on the basis of their contribution to consolidated profit. The individual line items are based on the following methods:

- Net interest income (before interest rate reductions) comprises interest margins from asset operations calculated on the basis of the market interest rate method¹⁾. The item also includes the imputed return on equity with an analysis based on economic capital usage. Group centre also includes the interest rate management result, which largely comprises the income/loss from maturity matching. Deviating from previous reporting, the treasury result reflecting the profit contribution from KfW refinancing²⁾ is allocated to the Capital Markets business area. In the past, this profit contribution could only be indicatively separated. In the 2009 figures, the profit contribution from refinancing thus remains included in the interest rate management result of the group centre. For this reason, net interest income of the two segments Capital Markets and group centre is only comparable to a limited extent with the previous year's figures.
- The interest rate reductions included in Net interest income in the income statement are reported separately in line with the internal management report due to their special relevance as a management variable. Interest rate reductions are components of promotional business of the KfW Mittelstandsbank, KfW Privatkundenbank and KfW Kommunalbank business areas. Promotional loans with a KfW interest receivable which is below the KfW refinancing rate are deemed reduced-interest loans.
- The allocation of administrative expense is based on the results from activity-based accounting by cost centres³⁾. Administrative expense includes depreciation on property, plant and equipment.
- In the Risk provisions for lending business item, net impairment charges, direct write-offs and recoveries on loans written off are distributed among the business areas according to the attributable risk provision amounts.
- The valuation result comprises the net gains/losses from hedge accounting, the net gains/losses from other financial instruments at fair value, the net gains/losses from securities and investments, the net gains/losses from investments accounted for using the equity method and net other operating income.
- When taxes on income are allocated to the business areas (excluding the group centre), only the current taxes on income are taken in account. Deferred taxes are allocated to the group centre.
- Deviating from previous reporting, the reported economic capital requirement to cover potential credit, market price and operating risks is quantified for a solvency level of 99.99%⁴⁾. The corresponding figures for 2009 were adjusted to reflect the changed solvency level.
- Segment assets are not reported since, as per the internal management reporting system, they are used neither to assess each segment's performance nor to allocate resources to segments.
- The presentation of segment income and expenses is based on consolidated figures. Internal administrative and commission expense as well as commission income and other operating income resulting from service relationships within the group is adjusted in segment reporting. Negligible consolidation effects remaining are reported under Reconciliation/consolidation.

¹⁾ Refinancing at matching maturities using KfW's internal refinancing curve is assumed for the calculation of interest margins in this method.

²⁾ The difference between the realised refinancing rates and the maturity-matched refinancing rates calculated in-house.

³⁾ The costs incurred in the organisational units are allocated to the products by means of core services.

⁴⁾ The statistical models and methods used are explained in the risk report section of the group management report. A solvency level of 99.96% was used in the previous year's report.

Segment reporting by business area for financial year 2010

	KfW Mittel- stands- bank ¹⁾	KfW Privat- kunden- bank	KfW Kommun- albank	Export and project finance ¹⁾	Promotion for devel- oping and transition countries ¹⁾	Capital markets ²⁾	Group centre	Recon- ciliation/ consoli- dation	KfW Group
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Volume of new commitments	28,504	20,025	15,787	9,336	5,679	2,125	126	- 231	81,351
Net interest income before interest rate reductions	332	174	51	746	239	603	1,163	0	3,309
Net commission income	19	28	6	63	132	24	1	0	273
Administrative expense	122	116	28	136	219	59	43	0	722
Operating result before valuation (before interest rate reductions)	230	87	30	673	152	568	1,121	0	2,860
Risk provisions for lending business	- 28	- 17	29	191	139	232	- 121	0	424
Valuation result	13	0	1	60	208	- 31	- 292	0	- 42
Profit/loss from operating activities (before interest rate reductions)	215	70	59	923	498	769	708	0	3,242
Interest rate reductions	- 286	- 211	- 61	-	-	-	-	-	- 558
Taxes on income	-	-	0	34	4	0	16	-	54
Consolidated profit	- 71	- 141	- 2	889	494	769	692	0	2,631
Economic capital requirement	2,356	1,378	446	2,325	1,190	1,654	1,924	-	11,274

¹⁾ The valuation result of the business areas contains the following net gains/losses from investments accounted for using the equity method: KfW Mittelstandsbank EUR - 0.5 million, Export and project finance EUR - 3.1 million and Promotion for developing and transition countries EUR 1.0 million.

²⁾ The amount reported in the Volume of new commitments line comprises new commitments in the core business of the Capital Markets segment. In addition, a volume of EUR 22,336 million was committed as part of a loan granted to Greece, resulting in a total commitment volume for financial year 2010 of EUR 103.7 billion.

Segment reporting by business area for financial year 2009

	KfW Mittel- stands- bank	KfW Privat- kunden- bank	KfW Kommun- albank	Export and project finance ¹⁾	Promotion for developing and transition countries	Capital markets	Group centre	Recon- ciliation/ consoli- dation	KfW Group
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Volume of new commitments	23,766	16,094	9,358	8,910	4,497	1,537	98	- 394	63,867
Net interest income before interest rate reductions	264	155	55	627	201	287	1,633	2	3,224
Net commission income	25	8	5	84	131	37	- 4	0	286
Administrative expense	115	99	27	136	191	64	110	0	742
Operating result before valuation (before interest rate reductions)	174	64	34	575	141	261	1,519	2	2,769
Risk provisions for lending business	- 248	- 2	14	- 499	- 232	- 27	21	0	- 972
Valuation result	- 43	0	2	- 53	- 10	363	- 300	- 2	- 42
Profit/loss from operating activities (before interest rate reductions)	- 117	62	50	23	- 101	597	1,241	0	1,755
Interest rate reductions	- 262	- 234	- 75	-	-	-	-	-	- 571
Taxes on income	- 1	-	0	22	3	0	33	-	57
Consolidated profit	- 379	- 172	- 25	1	- 104	597	1,208	0	1,127
Economic capital requirement	2,577	1,430	531	2,340	1,094	2,241	1,662	-	11,876

¹⁾ In the Export and project finance business area, the valuation result includes the result attributable to investments accounted for using the equity method totalling EUR - 3 million.

The reconciliation/consolidation column includes all adjustments that were necessary to reconcile segment information with the aggregated information for the KfW Group. The consolidation effects reported for "Volume of new commitments" relate to commitments for programme loans made by KfW Mittelstandsbank for which KfW IPEX-Bank acts as on-lending bank. The other amounts in this column result from minimal consolidation effects.

(38) Segment reporting by region

Net interest and commission income are allocated on the basis of the clients' geographical location. The imputed return on equity included in net interest income, the treasury result and the interest rate management result are allocated to Germany. KfW receives commission income from the Federal Government for supporting developing countries using budget funds of the Federal Government. This is allocated according to the region of the country receiving the investment. The commission expense paid to special purpose entities resulting from the asset securitisation platform is distributed according to the geographical location of the originator bank.

Property, plant and equipment and intangible assets are not reported according to region because, apart from immaterial amounts, these assets relate to Germany.

Segment reporting by region for financial year 2010

	Germany	Europe (excl. Germany)	Rest of the world	Reconciliation/ consolidation	KfW Group
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Net interest income	1,873	422	456	0	2,752
Net commission income	107	38	128	0	273
Segment income	1,979	461	584	0	3,025

Segment reporting by region for financial year 2009

	Germany	Europe (excl. Germany)	Rest of the world	Reconciliation/ consolidation	KfW Group
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Net interest income	1,829	402	422	2	2,654
Net commission income	105	40	142	0	286
Segment income	1,934	441	564	2	2,940

The reconciliation/consolidation column includes all adjustments that were necessary to reconcile segment information with the aggregated information for the KfW Group. The amounts in this column result solely from minimal consolidation effects.

NOTES TO THE STATEMENT OF FINANCIAL POSITION

(39) Cash reserves

Analysis of cash reserves by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Balances with central banks	604	337	267

(40) Loans and advances to banks

Analysis of loans and advances to banks by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market transactions	6,423	4,004	2,419
Loans and advances	237,897	218,870	19,027
Other receivables	19,101	18,685	417
Total	263,422	241,559	21,863

The receivables from reverse repos and the PROMISE and PROVIDE securitisation platforms are included in Other receivables.

Analysis of loans and advances to banks by liability type

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Direct loans to banks	87,721	82,084	5,637
On-lent customer loans with full underwriting borne by the on-lending bank	143,024	132,422	10,602
On-lent customer loans with partial underwriting borne by the on-lending bank	6,758	4,011	2,747
Direct and on-lent subordinated loans	394	353	41
Total	237,897	218,870	19,027

(41) Loans and advances to customers

Analysis of loans and advances to customers by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances	107,505	98,826	8,678
Promissory note loans	0	3	- 3
Other receivables	595	546	48
Total	108,099	99,376	8,723

The receivables from reverse repos and the PROMISE and PROVIDE securitisation platforms are included in Other receivables.

Analysis of loans and advances to customers by liability type

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Direct loans to customers	100,579	91,507	9,072
On-lent customer loans without underwriting borne by the on-lending bank	629	679	- 50
Direct and on-lent subordinated loans	6,297	6,641	- 344
Total	107,505	98,826	8,678

(42) Risk provisions for lending business

Analysis of risk provisions for lending business by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks	200	420	- 220
Loans and advances to customers	5,221	6,484	- 1,262
Provisions for losses on loans and advances	5,422	6,904	- 1,482
Provisions for contingent liabilities and irrevocable loan commitments	484	355	130
Total	5,906	7,258	- 1,352

Provisions for losses on loans and advances also includes money market investments and reverse repos.

Development of risk provisions for lending business in financial year 2010 by risk assessment type

	Individually assessed risks	Risks assessed on a portfolio basis	Provisions for losses on loans and advances	Provisions (individual risks)	Provisions (portfolio risks)	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2010	5,702	1,201	6,904	278	76	7,258
Additions	519	13	532	250	7	789
Write-offs	-1,487	0	-1,487	-1	0	-1,488
Reversals	-452	-396	-847	-114	-29	-990
Unwinding	-41	0	-41	0	0	-41
Exchange rate changes	334	27	362	14	2	378
Transfers	-5	5	0	0	0	0
As at 31 Dec. 2010	4,571	851	5,422	429	56	5,906

Provisions for risks assessed on a portfolio basis comprise both provisions for credit rating risks and provisions for country risks.

In 2010, EUR 129 million (previous year: EUR 175 million) in interest income was not collected for impaired loans.

Development of risk provisions for lending business in financial year 2009 by risk assessment type

	Individually assessed risks	Risks assessed on a portfolio basis	Provisions for losses on loans and advances	Provisions (individual risks)	Provisions (portfolio risks)	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2009	6,544	1,059	7,604	180	75	7,859
Additions	865	322	1,187	260	29	1,475
Write-offs	-1,410	0	-1,410	0	0	-1,410
Reversals	-107	-160	-267	-149	-28	-443
Unwinding	-55	0	-55	0	0	-55
Exchange rate changes	-146	-7	-153	-11	1	-163
Transfers	11	-13	-2	-2	0	-4
As at 31 Dec. 2010	5,702	1,201	6,904	278	76	7,258

(43) Value adjustments from macro fair value hedge accounting

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Value adjustments to assets designated for macro fair value hedge accounting	7,478	6,751	727

The fair values attributable to the hedged risks in the hedged portfolios under the category "loans and receivables" are included in this item.

(44) Derivatives used for hedge accounting

Analysis of derivatives with positive fair values designated for hedge accounting by type of hedging relationship

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Micro fair value hedge accounting	22,282	13,979	8,303
Macro fair value hedge accounting	1,041	643	398
Total	23,323	14,622	8,701

Analysis of derivatives with positive fair values designated for hedge accounting by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Interest-related derivatives	12,296	10,747	1,549
Currency-related derivatives	11,026	3,875	7,151
Total	23,323	14,622	8,701

Only interest-related derivatives are designated for macro fair value hedge accounting.
Cross-currency swaps are presented under Currency-related derivatives.

(45) Other derivatives

Analysis of other derivatives with positive fair values by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Interest-related derivatives	3,246	2,636	611
Currency-related derivatives	3,276	2,320	957
Equity/index-related derivatives	0	27	-27
Credit derivatives	2	10	-8
Other derivatives	44	31	12
Total	6,568	5,023	1,545

Cross-currency swaps are presented under Currency-related derivatives.

(46) Securities and investments

Analysis of securities and investments by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Bonds and other fixed-income securities	33,599	35,292	- 1,694
Shares and other non-fixed income securities	16	67	- 51
Equity investments	1,591	1,333	258
Shares in affiliated entities not included in the consolidated financial statements	2	2	0
Total	35,207	36,694	- 1,487

Bonds and other fixed-income securities are recognised less impairments for the risk of decreases in value that have already occurred but have not yet been individually identified.

(47) Investments accounted for using the equity method

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Investments accounted for using the equity method	29	15	14

Note (81) Disclosures on shareholdings contains a list of investments accounted for using the equity method.

(48) Property, plant and equipment

Analysis of property, plant and equipment by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Land and buildings	780	585	195
Plant and equipment	45	42	4
Other property, plant and equipment	85	231	- 146
Property, plant and equipment for own use	911	857	53
Investment property	1	18	- 17
Total	912	876	36

Plant and equipment includes leased assets from finance leases that are required to be capitalised. Payments in advance and assets under construction are presented under Other property, plant and equipment.

Development in property, plant and equipment in financial year 2010

	Purchase/production cost	Accumulated depreciation, impairment and reversal of impairment losses	Net carrying amount
	EUR in millions	EUR in millions	EUR in millions
Carrying amount as at 1 Jan. 2010	1,086	-210	876
Additions/reversals of impairment losses	76	0	76
Disposals	-12	3	-9
Depreciation	-	-30	-30
Non-scheduled impairment losses	-	0	0
Carrying amount as at 31 Dec. 2010	1,150	-238	912

Development in property, plant and equipment in financial year 2009

	Purchase/production cost	Accumulated depreciation, impairment and reversal of impairment losses	Net carrying amount
	EUR in millions	EUR in millions	EUR in millions
Carrying amount as at 1 Jan. 2009	1,098	-226	871
Additions/reversals of impairment losses	80	0	80
Disposals	-92	68	-24
Depreciation	-	-30	-30
Non-scheduled impairment losses	-	-23	-23
Carrying amount as at 31 Dec. 2009	1,086	-210	876

(49) Intangible assets

Analysis of intangible assets by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Software	29	36	-6
<i>Acquired software</i>	13	12	1
<i>Internally generated software</i>	16	23	-7
Other intangible assets	14	9	6
Total	44	44	-1

Other intangible assets include, in particular, software under development.

Development in intangible assets in financial year 2010

	Purchase/production cost	Accumulated amortisation, impairment and reversal of impairment losses	Net carrying amount
	EUR in millions	EUR in millions	EUR in millions
Carrying amount as at 1 Jan. 2010	103	- 59	44
Additions/reversals of impairment losses	17	0	17
Disposals	- 5	5	0
Amortisation	-	- 17	- 17
Non-scheduled impairment losses	-	0	0
Carrying amount as at 31 Dec. 2010	114	- 71	44

Development in intangible assets in financial year 2009

	Purchase/production cost	Accumulated amortisation, impairment and reversal of impairment losses	Net carrying amount
	EUR in millions	EUR in millions	EUR in millions
Carrying amount as at 1 Jan. 2009	126	- 64	62
Additions/reversals of impairment losses	16	0	16
Disposals	- 39	38	0
Amortisation	-	- 18	- 18
Non-scheduled impairment losses	-	- 15	- 15
Carrying amount as at 31 Dec. 2009	103	- 59	44

(50) Income tax assets

Analysis of income tax assets by type

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Current income tax assets	25	33	- 8
Deferred income tax assets	173	156	17
Total	198	189	9

The current income tax assets derive from deductible taxes (investment income tax/solidarity surcharge) and tax receivables from advance tax payments during the reporting year.

Deferred income tax assets mostly result from valuation differences relating to the balance sheet items listed below.

Analysis of deferred tax assets by balance sheet item

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks and customers (incl. risk provisions)	56	58	-2
Securities and investments	5	4	1
Intangible assets	23	23	0
Liabilities to banks and customers	0	5	-5
Other derivatives (liabilities)	45	27	18
Provisions	15	13	2
Other balance sheet items	28	16	12
Tax loss carryforwards	1	10	-9
Subtotal	173	156	17
Offset against deferred tax liabilities	0	0	0
Total	173	156	17

The use of existing tax loss carryforwards for the taxable group companies is not sufficiently probable, with the result that it was only possible to carry deferred tax assets to a limited extent.

(51) Other assets

Analysis of other assets by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Other assets and receivables	827	826	1
Prepaid expenses and deferred charges	468	676	-207
Total	1,296	1,502	-206

(52) Liabilities to banks

Analysis of liabilities to banks by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market transactions	0	5	-4
Promissory note loans	1,665	3,144	-1,479
Other liabilities	13,796	4,947	8,849
Total	15,461	8,095	7,365

Liabilities from repos, cash collateral received and the PROMISE and PROVIDE securitisation platforms are included in Other liabilities.

(53) Liabilities to customers

Analysis of liabilities to customers by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market transactions	150	638	- 488
Promissory note loans	9,783	11,259	- 1,477
Other liabilities	12,078	11,837	241
Total	22,011	23,734	- 1,724

Liabilities from repos, cash collateral received and the PROMISE and PROVIDE securitisation platforms are included in Other liabilities. Credit-linked notes issued on these platforms are included under Promissory note loans.

(54) Certificated liabilities

Analysis of certificated liabilities by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market issues	26,272	32,479	- 6,206
Bonds and notes	331,712	288,950	42,762
Total	357,984	321,429	36,556

(55) Value adjustments from macro fair value hedge accounting

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Value adjustments to liabilities under macro fair value hedge accounting	141	27	114

The fair values attributable to hedged risks in the hedged portfolios in the category "other liabilities" are included in this item.

(56) Derivatives used for hedge accounting

Analysis of derivatives with negative fair values designated for hedge accounting by type of hedging relationship

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Micro fair value hedge accounting	6,017	9,016	- 2,999
Macro fair value hedge accounting	12,174	10,461	1,714
Total	18,191	19,476	- 1,285

Analysis of derivatives with negative fair values designated for hedge accounting by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Interest-related derivatives	14,063	11,664	2,399
Currency-related derivatives	4,128	7,812	-3,684
Total	18,191	19,476	-1,285

Only interest-related derivatives are designated for macro fair value hedge accounting. Cross-currency swaps are presented under Currency-related derivatives.

(57) Other derivatives

Analysis of other derivatives with negative fair values by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Interest-related derivatives	1,270	1,203	67
Currency-related derivatives	3,351	5,584	-2,233
Credit derivatives	0	17	-17
Other derivatives	2	35	-33
Total	4,623	6,838	-2,215

Cross-currency swaps are presented under Currency-related derivatives.

(58) Provisions

Analysis of provisions by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Provisions for pensions and similar commitments	1,042	993	49
Provisions for credit risks	484	355	130
Other provisions	764	717	47
Total	2,290	2,065	225

Development in provisions for pensions and similar commitments in financial year 2010

	Pension obligations	Early retirement	Partial retirement	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2010	984	3	6	993
Pension benefits paid	-34	-1	-1	-36
Additions	70	11	4	85
<i>Service cost</i>	23	11	3	38
<i>Interest cost</i>	44	0	0	44
<i>Contributions by plan participants</i>	4	0	0	4
Reversals	0	0	0	0
As at 31 Dec. 2010	1,020	13	9	1,042

The calculation of the pension entitlements which were vested as at the valuation reference date results in actuarial gains to be amortised of EUR 42 million (previous year: EUR 101 million).

	31 Dec. 2010	31 Dec. 2009	31 Dec. 2008	31 Dec. 2007	31 Dec. 2006
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Projected benefit obligation under the pension commitments	980	884	771	769	854

Development in provisions for pensions and similar commitments in financial year 2009

	Pension obligations	Early retirement	Partial retirement	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2009	951	5	9	965
Pension benefits paid	-34	-1	-1	-36
Additions	67	0	0	67
<i>Service cost</i>	13	0	0	14
<i>Interest cost</i>	51	0	0	51
<i>Contributions by plan participants</i>	2	0	0	2
Reversals	0	-1	-2	-3
As at 31 Dec. 2009	984	3	6	993

The provisions for pensions and similar commitments are calculated on the basis of the 2005 G Heubeck actuarial tables and based on the following actuarial assumptions:

Actuarial assumptions in % p. a.

	31 Dec. 2010	31 Dec. 2009
Technical discount rate	4.40	4.90
Rate of salary increases	3.00	2.90
Rate of pension increases	2.30	2.30
Rate of staff turnover	0.80	2.00

Development in risk provisions for lending business

For the development in risk provisions for lending business see note (42) Risk provisions for lending business.

Development in other provisions in financial year 2010

	Obligations to employees	Other provisions	Total
	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2010	28	689	717
Additions	2	98	100
Used amounts	-5	-37	-42
Reversals	-4	-7	-11
Transfers	0	0	0
As at 31 Dec. 2010	22	742	764

The obligations to employees show other long-term employee benefits including provisions for service anniversaries. Corresponding actuarial reports have been prepared for these obligations. Other provisions comprise obligations arising from the assumption of the tasks of the State Insurance Company of the GDR in liquidation (*Staatliche Versicherung der Deutschen Demokratischen Republik in Abwicklung – SinA* (institution under public law)), which are offset by receivables in the same amount from the Federal Agency for Special Tasks arising from Unification (*Bundesanstalt für vereinigungsbedingte Sonderaufgaben – BvS*) reported under Other assets.

Development in other provisions in financial year 2009

	Obligations to employees	Other provisions	Total
	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2009	24	484	508
Additions	10	231	241
Used amounts	-4	-28	-33
Reversals	-1	0	-1
Transfers	0	2	2
As at 31 Dec. 2009	28	689	717

(59) Income tax liabilities

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Current income tax liabilities	38	9	29
Deferred income tax liabilities	80	59	21
Total	118	68	50

The current income tax liabilities in the reporting year are the result of additions to tax provisions at the level of taxable companies included in the consolidated financial statements.

Deferred income tax liabilities mostly result from valuation differences relating to the balance sheet items listed below.

Development in tax provisions

	2010	2009
	EUR in millions	EUR in millions
As at 1 Jan.	9	3
Additions	36	6
Used amounts	-4	0
Reversals	-2	0
As at 31 Dec.	38	9

Analysis of deferred tax liabilities by balance sheet item

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Other derivatives (assets)	45	27	18
Securities and investments	7	15	-8
Other balance sheet items	28	17	11
Subtotal	80	59	21
Offset against deferred tax assets	0	0	0
Total	80	59	21

(60) Other liabilities

Analysis of other liabilities by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Other liabilities	1,486	1,668	-182
Deferred income	420	316	104
Total	1,906	1,984	-78

The promotional subsidies granted to KfW through the ERP Special Fund based on the German Law to define the economic plan of the ERP Special Fund (*ERP-Wirtschaftsplangesetz*) in the amount of EUR 104 million (previous year: EUR 178 million) were reported as deferred income.

(61) Subordinated liabilities

Analysis of subordinated liabilities by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Subordinated liabilities	3,247	3,247	0

As part of the new legislation governing ERP economic promotion as at 1 July 2007, the ERP Special Fund provided a subordinated loan to KfW in the amount of EUR 3,247 million. The loan consists of three tranches with different fixed-interest periods. The period during which capital is tied up ends for all tranches as at 31 December 2017. Interest is charged on the tranches at an initial rate of 4.5% p.a.

(62) Equity

Analysis of equity

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Subscribed capital	3,750	3,750	0
less uncalled outstanding contributions	- 450	- 450	0
Paid-in subscribed capital	3,300	3,300	0
Capital reserve	5,947	5,947	0
<i>Promotional reserves from the ERP Special Fund</i>	4,650	4,650	0
Reserve from the ERP Special Fund	977	893	84
Retained earnings	5,218	4,725	493
<i>Statutory reserve under Section 10 (2) KfW Law</i>	1,838	1,574	264
<i>Special reserve under Section 10 (3) KfW Law</i>	2,178	1,928	250
<i>Special reserve less the special loss account from provisioning pursuant to Section 17 (4) of the D-Mark Balance Sheet Law</i>	21	21	0
<i>Other retained earnings</i>	1,181	1,202	- 21
Fund for general banking risks	600	46	554
Revaluation reserves	- 257	- 290	33
Balance sheet loss	0	- 1,499	1,499
Total	15,784	13,121	2,663

Equity forms the basis for the economic resources available for risk coverage which are matched against the capital requirements derived from internal steering.

For details, please refer to the risk report of the group management report.

NOTES ON FINANCIAL INSTRUMENTS

(63) Gains and losses from financial instruments by valuation category

The following tables show an analysis of the results from financial instruments included in the various income statement items organised by valuation category. In addition to interest and similar income and expenses reported in Net interest and commission income and loan processing fees included in Net commission income, contributions to income included in particular the risk provisions for lending business. Depending on measurement and designation for hedge accounting, the effects of fair value measurement, impairment losses and reversals of impairment losses and gains and losses from disposals are also included. The result from foreign currency translation is not included.

Gains and losses from financial instruments by valuation category in financial year 2010

	Net interest income	Risk provisions for lending business	Net commission income	Net gains/losses from hedge accounting	Net gains/losses from other financial instruments at fair value through profit or loss	Net gains/losses from securities and investments	Net other operating income	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Loans and receivables	11,774	424	131	794	-	-22	0	13,101
Held-to-maturity investments	16	-	-	-	-	0	-	16
Other liabilities	-11,289	-	-12	-1,099	-	-	14	-12,387
Available-for-sale financial assets	286	-	0	40	-	23	-	349
Financial assets at fair value through profit or loss	188	-	101	-	338	-	-	627
Financial liabilities at fair value through profit or loss	-1,114	-	-81	-	-321	-	-	-1,516
Derivatives used for hedge accounting	2,021	-	-	47	-	-	-	2,068
Other derivatives	912	-	2	-	101	-	-	1,015
Total	2,794	424	141	-219	118	1	14	3,273

Gains and losses from financial instruments by valuation category in financial year 2009

	Net interest income	Risk provisions for lending business	Net commission income	Net gains/ losses from hedge accounting	Net gains/ losses from other financial instruments at fair value through profit or loss	Net gains/ losses from securities and investments	Net other operating income	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Loans and receivables	12,347	-972	134	1,243	-	-96	-	12,657
Held-to-maturity investments	21	-	-	-	-	-1	-	20
Other liabilities	-11,447	-	-10	2,916	-	-	13	-8,527
Available-for-sale financial assets	335	-	0	43	-	-21	-	357
Financial assets at fair value through profit or loss	303	-	151	-	1,156	-	-	1,610
Financial liabilities at fair value through profit or loss	-1,432	-	-119	-	1,004	-	-	-547
Derivatives used for hedge accounting	2,322	-	-	-4,515	-	-	-	-2,193
Other derivatives	256	-	4	-	-1,741	-	-	-1,481
Total	2,705	-972	160	-313	419	-117	13	1,896

(64) Balance sheet for financial instruments by valuation category

The following tables show the assets and liabilities from financial instruments included in the different balance sheet items organised by valuation category.

Financial assets by valuation category as at 31 December 2010

	Loans and advances to banks	Loans and advances to customers	Risk provisions for lending business	Value adjustments from macro fair value hedge accounting	Derivatives used for hedge accounting	Other derivatives	Securities and investments	Assets (financial instruments)	
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	%
Loans and receivables	263,020	108,076	- 5,422	7,478	-	-	19,023	392,175	89.4
Held-to-maturity investments	-	-	-	-	-	-	1,089	1,089	0.2
Available-for-sale financial assets	0	0	-	-	-	-	10,766	10,766	2.5
Financial assets at fair value through profit or loss	402	23	-	-	-	-	4,329	4,754	1.1
Derivatives used for hedge accounting	-	-	-	-	23,323	-	-	23,323	5.3
Other derivatives	-	-	-	-	-	6,568	-	6,568	1.5
Total	263,422	108,099	- 5,422	7,478	23,323	6,568	35,207	438,675	100.0

Financial liabilities by valuation category as at 31 December 2010

	Liabilities to banks	Liabilities to customers	Certificated liabilities	Value adjustments from macro fair value hedge accounting	Derivatives used for hedge accounting	Other derivatives	Other liabilities	Subordinated liabilities	Liabilities (financial instruments)	
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	%
Other financial liabilities	14,522	16,926	333,128	141	-	-	289	3,247	368,252	87.3
Financial liabilities at fair value through profit or loss	939	5,085	24,856	-	-	-	-	0	30,880	7.3
Derivatives used for hedge accounting	-	-	-	-	18,191	-	-	-	18,191	4.3
Other derivatives	-	-	-	-	-	4,623	-	-	4,623	1.1
Total	15,461	22,011	357,984	141	18,191	4,623	289	3,247	421,947	100.0

Financial assets by valuation category as at 31 December 2009

	Loans and advances to banks	Loans and advances to customers	Risk provisions for lending business	Value adjustments from macro fair value hedge accounting	Derivatives used for hedge accounting	Other derivatives	Securities and investments	Assets (financial instruments)	
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	%
Loans and receivables	241,017	99,362	-6,904	6,751	-	-	22,821	363,046	91.4
Held-to-maturity investments	-	-	-	-	-	-	996	996	0.3
Available-for-sale financial assets	0	0	-	-	-	-	7,295	7,295	1.8
Financial assets at fair value through profit or loss	542	15	-	-	-	-	5,582	6,139	1.5
Derivatives used for hedge accounting	-	-	-	-	14,622	-	-	14,622	3.7
Other derivatives	-	-	-	-	-	5,023	-	5,023	1.3
Total	241,559	99,376	-6,904	6,751	14,622	5,023	36,694	397,121	100.0

Financial liabilities by valuation category as at 31 December 2009

	Liabilities to banks	Liabilities to customers	Certificated liabilities	Value adjustments from macro fair value hedge accounting	Derivatives used for hedge accounting	Other derivatives	Other liabilities	Subordinated liabilities	Liabilities (financial instruments)	
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	%
Other financial liabilities	7,005	17,738	295,955	27	-	-	263	3,247	324,234	84.6
Financial liabilities at fair value through profit or loss	1,090	5,997	25,473	-	-	-	-	0	32,560	8.5
Derivatives used for hedge accounting	-	-	-	-	19,476	-	-	-	19,476	5.1
Other derivatives	-	-	-	-	-	6,838	-	-	6,838	1.8
Total	8,095	23,734	321,429	27	19,476	6,838	263	3,247	383,109	100.0

(65) Disclosures on the reclassification of financial assets

In financial year 2008 and with retroactive effect from 1 July 2008, the KfW Group reclassified bonds and other fixed-income securities reported under Securities and investments (variable-interest asset-backed securities) with a volume of EUR 2,750 million (fair value as at the date of reclassification) from the valuation category "available-for-sale financial assets" to the valuation category "loans and receivables".

The following table shows the carrying amounts of these reclassified financial assets and their fair values.

	31 Dec. 2010	31 Dec. 2009
	EUR in millions	EUR in millions
Carrying amount (balance sheet)	1,369	2,135
Fair value	1,313	2,028

For the reclassified financial assets a change of EUR 41 million (previous year: EUR 107 million) in fair value would have been recorded directly in equity under Revaluation reserves, and net gains/losses from securities and investments of EUR 5 million (previous year: EUR 11 million) would have been recorded as well. Net gains/losses from securities and investments include reversals of impairment losses and impairments on reclassified financial assets totalling EUR 4 million (previous year: EUR 11 million); as in the previous year, no realised gains and losses were recorded. Interest income from the reclassified securities is still received unchanged.

In financial year 2009, in accordance with a resolution with prospective effect dated 17 February 2009, bonds and other fixed-income securities reported under Securities and investments (which serve to maintain liquidity through the use of repo transactions (repos) or open market transactions of the European Central Bank) with a volume of EUR 18,170 million (fair value as at the date of reclassification) were reclassified from the valuation category "available-for-sale financial assets" to the valuation category "loans and receivables".

The following table shows the carrying amounts of the reclassified financial assets and their fair values.

	31 Dec. 2010	31 Dec. 2009
	EUR in millions	EUR in millions
Carrying amount (balance sheet)	14,437	18,270
Fair value	13,838	18,208

For the reclassified financial assets a change of EUR – 547 million (previous year: EUR 43 million) in fair value would have been recorded directly in equity under Revaluation reserves, and net gains/losses from securities and investments of EUR – 4 million (previous year: EUR – 7 million).

Net gains/losses from securities and investments includes realised gains and losses of EUR – 4 million (previous year: EUR – 6 million) as well as reversals of impairment losses and impairments on reclassified financial assets of EUR – 11 million (previous year: EUR – 1 million). Interest income from the reclassified securities is still received unchanged.

(66) Disclosures on the valuation methods used for financial instruments carried at fair value

The following tables show the financial instruments carried at fair value according to the valuation methods used.

Financial instruments allocated to the "quoted market prices" class are primarily bonds and other fixed-income securities reported under Securities and investments, for which prices from an active market are available.

Fair value measurement of OTC derivatives as well as borrowings accounted for under the *fair value option* is largely performed using valuation models with inputs that are observable on the market and are also usually the only relevant inputs, resulting in allocation to the "Valuation method based on observable market data (model)" class.

The "Valuation method based in part on unobservable market data" class largely comprises low-risk tranches of portfolio CDSs (with KfW as both protection seller and protection buyer) accounted for using the *fair value option* and reported under loans and advances or liabilities as well as securities and investments from equity finance business recorded at fair value through profit or loss, which are not listed or for which prices cannot be derived from similar financial instruments listed on an exchange.

Equity instruments included in – available-for-sale – securities and investments, for which the fair value could not be reliably determined, are also allocated to this class.

Financial assets carried at fair value as at 31 December 2010

	Quoted market price	Valuation method based on observable market data (model)	Valuation method based in part on unobservable market data	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks – recorded at fair value through profit or loss	42	308	52	402
Loans and advances to customers – recorded at fair value through profit or loss	0	13	10	23
Derivatives used for hedge accounting	0	23,323	0	23,323
Other derivatives	7	6,498	63	6,568
Securities and investments – available for sale	10,013	0	753	10,766
Securities and investments – recorded at fair value through profit or loss	2,398	1,511	420	4,329
Total	12,461	31,653	1,298	45,411

Financial liabilities carried at fair value as at 31 December 2010

	Quoted market price	Valuation method based on observable market data (model)	Valuation method based in part on unobservable market data	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks – recorded at fair value through profit or loss	0	874	65	939
Liabilities to customers – recorded at fair value through profit or loss	0	5,083	2	5,085
Certificated liabilities – recorded at fair value through profit or loss	137	24,719	0	24,856
Derivatives used for hedge accounting	0	18,188	3	18,191
Other derivatives	2	4,601	20	4,623
Total	140	53,465	90	53,694

Financial assets carried at fair value as at 31 December 2009

	Quoted market price	Valuation method based on observable market data (model)	Valuation method based in part on unobservable market data	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks – recorded at fair value through profit or loss	43	175	324	542
Loans and advances to customers – recorded at fair value through profit or loss	0	11	3	15
Derivatives used for hedge accounting	0	14,622	0	14,622
Other derivatives	7	4,990	26	5,023
Securities and investments – available for sale	6,606	45	645	7,295
Securities and investments – recorded at fair value through profit or loss	4,919	349	314	5,582
Total	11,575	20,192	1,313	33,079

Financial liabilities carried at fair value as at 31 December 2009

	Quoted market price	Valuation method based on observable market data (model)	Valuation method based in part on unobservable market data	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks – recorded at fair value through profit or loss	1	732	357	1,090
Liabilities to customers – recorded at fair value through profit or loss	0	5,995	2	5,997
Certificated liabilities – recorded at fair value through profit or loss	249	25,224	0	25,473
Derivatives used for hedge accounting	0	19,362	114	19,476
Other derivatives	13	6,826	0	6,838
Total	263	58,138	473	58,875

Development of financial assets carried at fair value in financial year 2010, using valuation methods based in part on unobservable market data

	Loans and advances to banks – recorded at fair value through profit or loss	Loans and advances to customers – recorded at fair value through profit or loss	Other derivatives	Securities and investments – available for sale	Securities and investments – recorded at fair value through profit or loss	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2010	324	3	26	645	314	1,313
A. Changes recognised in the income statement						
Net interest and commission income	1	0	1	0	0	2
<i>Contracts still valid at year-end</i>	0	0	1	0	0	1
Net gains/losses from other financial instruments at fair value through profit or loss	-5	7	45	0	-38	8
<i>Contracts still valid at year-end</i>	-5	7	45	0	-45	2
Net gains/losses from securities and investments	0	0	0	-36	0	-36
<i>Contracts still valid at year-end</i>	0	0	0	-18	0	-18
Change in revaluation reserves	0	0	0	8	0	8
<i>Contracts still valid at year-end</i>	0	0	0	8	0	8
Total changes recognised in the income statement	-4	7	46	-27	-38	-17
B. Changes recognised directly in equity						
Change of valuation method used	-268	0	0	32	120	-116
Additions	0	0	0	124	34	158
Disposals	0	0	-8	-29	-49	-86
Total changes recognised directly in equity	-268	0	-8	127	105	-44
Changes in the consolidated group	0	0	0	0	0	0
Exchange rate changes	0	0	-1	8	29	36
Other changes	0	0	0	0	10	10
As at 31 Dec. 2010	52	10	63	753	420	1,298

Development of financial liabilities carried at fair value in financial year 2010, using valuation methods based in part on unobservable market data

	Liabilities to banks – recorded at fair value through profit or loss	Liabilities to customers – recorded at fair value through profit or loss	Derivatives used for hedge accounting	Other derivatives	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2010	357	2	114	0	473
A. Changes recognised in the income statement					
Net interest and commission income	-1	0	3	0	2
<i>Contracts still valid at year-end</i>	0	0	0	0	-1
Net gains/losses from hedge accounting	0	0	3	0	3
<i>Contracts still valid at year-end</i>	0	0	0	0	0
Net gains/losses from other financial instruments at fair value through profit or loss	6	0	0	19	24
<i>Contracts still valid at year-end</i>	6	0	0	20	25
Total changes recognised in the income statement	5	0	5	19	29
B. Changes recognised directly in equity					
Change of valuation method used	-297	0	0	0	-297
Additions	0	0	0	-1	-1
Disposals	0	0	-116	1	-115
Total changes recognised directly in equity	-297	0	-116	0	-412
Changes in the consolidated group	0	0	0	0	0
Exchange rate changes	0	0	0	1	1
Other changes	0	0	0	0	0
As at 31 Dec. 2010	65	2	3	20	90

Development of financial assets carried at fair value in financial year 2009, using valuation methods based in part on unobservable market data

	Loans and advances to banks – recorded at fair value through profit or loss	Loans and advances to customers – recorded at fair value through profit or loss	Other derivatives	Securities and investments – available for sale	Securities and investments – recorded at fair value through profit or loss	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2009	150	46	142	497	320	1,155
A. Changes recognised in the income statement						
Net interest and commission income	1	0	0	0	0	0
<i>Contracts still valid at year-end</i>	1	0	0	0	0	1
Net gains/losses from other financial instruments at fair value through profit or loss	155	-42	-28	0	-19	67
<i>Contracts still valid at year-end</i>	155	-42	-28	0	-18	67
Net gains/losses from securities and investments	0	0	0	-11	0	-11
<i>Contracts still valid at year-end</i>	0	0	0	-31	0	-31
Total changes recognised in the income statement	156	-42	-28	-12	-18	55
B. Changes recognised directly in equity						
Change of valuation method used	19	0	-85	98	5	37
Additions	0	0	0	114	27	141
Disposals	0	0	-3	-50	-9	-61
Total changes recognised directly in equity	19	0	-88	162	23	116
Changes in the consolidated group	0	0	0	1	0	1
Exchange rate changes	0	0	0	-3	-11	-14
As at 31 Dec. 2009	324	3	26	645	314	1,313

Development of financial liabilities carried at fair value in financial year 2009, using valuation methods based in part on unobservable market data

	Liabilities to banks – recorded at fair value through profit or loss	Liabilities to customers – recorded at fair value through profit or loss	Derivatives used for hedge accounting	Other derivatives	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2009	152	2	0	20	174
A. Changes recognised in the income statement					
Net interest and commission income	1	0	0	0	1
<i>Contracts still valid at year-end</i>	1	0	0	0	1
Net gains/losses from other financial instruments at fair value through profit or loss	205	0	0	0	205
<i>Contracts still valid at year-end</i>	162	0	0	0	162
Total changes recognised in the income statement	205	0	0	0	205
B. Changes recognised directly in equity					
Change of valuation method used	0	0	114	-20	94
Additions	0	0	0	0	0
Disposals	0	0	0	0	0
Total changes recognised directly in equity	0	0	114	-20	94
Changes in consolidated group	0	0	0	0	0
Effects of exchange rate changes	0	0	0	0	0
As at 31 Dec. 2009	357	2	114	0	473

In accordance with the valuation method defined for the KfW Group, the fair value reported in the statement of financial position is the best evidence of the fair value for those financial instruments allocated to the "Valuation method based in part on unobservable market data" class.

The following tables show how an alternative determination of relevant unobservable market data (liquidity discounts above all), i. e. values in best and worst case scenarios, would impact fair values for significant products allocated to this class, such as the portfolio CDSs (with KfW as protection seller and protection buyer) accounted for using the *fair value option* and the securities and investments from equity finance business recorded at fair value through profit or loss.

Sensitivity analysis for the financial assets carried at fair value, using valuation methods based in part on unobservable market data as at 31 December 2010

	Best case scenario	Reported value	Worst case scenario
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks – recorded at fair value through profit or loss	57	52	51
Loans and advances to customers – recorded at fair value through profit or loss	11	10	9
Securities and investments – recorded at fair value through profit or loss	492	420	348
Total	560	482	408

Sensitivity analysis for the financial liabilities carried at fair value, using valuation methods based in part on unobservable market data as at 31 December 2010

	Best case scenario	Reported value	Worst case scenario
	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks – recorded at fair value through profit or loss	63	65	72
Liabilities to customers – recorded at fair value through profit or loss	2	2	2
Total	65	67	73

Sensitivity analysis for the financial assets carried at fair value, using valuation methods based in part on unobservable market data as at 31 December 2009

	Best case scenario	Reported value	Worst case scenario
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks – recorded at fair value through profit or loss	356	324	314
Loans and advances to customers – recorded at fair value through profit or loss	5	3	3
Securities and investments – recorded at fair value through profit or loss	386	314	242
Total	747	641	559

Sensitivity analysis for the financial liabilities carried at fair value, using valuation methods based in part on unobservable market data as at 31 December 2009

	Best case scenario	Reported value	Worst case scenario
	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks – recorded at fair value through profit or loss	345	357	397
Liabilities to customers – recorded at fair value through profit or loss	2	2	2
Total	347	359	399

(67) Fair values of financial instruments

In the following tables, the fair values of financial instruments are compared to their carrying amounts. Existing provisions for losses on loans and advances are deducted from the carrying amounts of loans and advances to banks and customers. The carrying amount of the subordinated liabilities comprises pro-rata interest and value adjustments from micro fair value hedge accounting reported in the item Other liabilities.

Fair values of financial instruments as at 31 December 2010

	Fair value	Carrying amount (statement of financial position)	Difference
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks	270,522	263,222	7,300
Loans and advances to customers	105,496	102,878	2,618
Value adjustments from macro fair value hedge accounting	-	7,478	-7,478
Derivatives used for hedge accounting	23,323	23,323	0
Other derivatives	6,568	6,568	0
Securities and investments	34,312	35,207	-895
Assets	440,221	438,675	1,546
Liabilities to banks	15,508	15,461	47
Liabilities to customers	23,076	22,011	1,066
Certificated liabilities	360,085	357,984	2,100
Value adjustments from macro fair value hedge accounting	-	141	-141
Derivatives used for hedge accounting	18,191	18,191	0
Other derivatives	4,623	4,623	0
Subordinated liabilities	3,530	3,536	-6
Liabilities	425,013	421,947	3,067

Interest-related changes in value are also included in calculating the fair value of the financial instruments. Accordingly, when the comparison is made with the carrying amount, it is necessary to take account of the (interest-related) changes in value resulting from the recognition of loans and advances and borrowings in macro fair value hedge accounting.

Equity instruments included in Securities and investments, for which the fair value could not be reliably determined, are carried at cost allowing for impairment losses in the amount of EUR 627 million (previous year: EUR 548 million); disposal in the subsequent year is possible on a case-by-case basis.

Fair values of financial instruments as at 31 December 2009

	Fair value	Carrying amount (statement of financial position)	Difference
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks	245,877	241,139	4,739
Loans and advances to customers	95,860	92,892	2,967
Value adjustments from macro fair value hedge accounting	-	6,751	-6,751
Derivatives used for hedge accounting	14,622	14,622	0
Other derivatives	5,023	5,023	0
Securities and investments	36,252	36,694	-442
Assets	397,635	397,121	513
Liabilities to banks	8,168	8,095	73
Liabilities to customers	24,784	23,734	1,050
Certificated liabilities	323,873	321,429	2,445
Value adjustments from macro fair value hedge accounting	-	27	-27
Derivatives used for hedge accounting	19,476	19,476	0
Other derivatives	6,838	6,838	0
Subordinated liabilities	3,486	3,509	-24
Liabilities	386,625	383,109	3,516

(68) Additional disclosures on liabilities to banks

Disclosures on liabilities to banks designated at fair value through profit or loss
(fair value option)

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Carrying amount	229	182	47
Repayment at maturity	740	360	380
Difference	511	178	333

Of the difference between the repayment amount at maturity and the carrying amount, EUR 392 million (previous year: EUR 45 million) is attributable to borrowings for which the repayment amount builds up as a result of the capitalisation over time of interest due.

(69) Additional disclosures on liabilities to customers

Disclosures on liabilities to customers designated at fair value through profit or loss
(fair value option)

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Carrying amount	5,064	5,992	- 929
Repayment at maturity	8,809	9,509	- 700
Difference	3,745	3,517	229

Of the difference between the repayment amount at maturity and the carrying amount, EUR 3,422 million (previous year: EUR 3,172 million) is attributable to borrowings for which the repayment amount builds up as a result of the capitalisation over time of interest due.

(70) Additional disclosures on certificated liabilities

Disclosures on certificated liabilities designated at fair value through profit or loss
(fair value option)

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Carrying amount	24,856	25,473	- 617
Repayment at maturity	38,232	42,514	- 4,282
Difference	13,376	17,041	- 3,665

Of the difference between the repayment amount at maturity and the carrying amount, EUR 9,536 million (previous year: EUR 14,171 million) is attributable to borrowings for which the repayment amount builds up as a result of the capitalisation over time of interest due.

(71) Additional disclosures on derivatives

Analysis of derivatives by counterparty

	Par value		Fair value 31 Dec. 2010		Fair value 31 Dec. 2009	
	31 Dec. 2010	31 Dec. 2009	positive	negative	positive	negative
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
OECD banks	641,633	564,383	28,113	21,142	18,068	24,910
Non-OECD banks	37	39	0	4	0	3
Other counterparties	35,675	30,053	1,613	1,653	1,480	1,394
Public sector	1,888	531	62	0	27	0
Total	679,233	595,006	29,788	22,799	19,575	26,308

The analysis includes stand-alone financial and credit derivatives which are presented in the items Derivatives used for hedge accounting and Other derivatives.

The volume of differences between the transaction price and model value arising from the use of a valuation technique that makes significant use of unobservable market data which have yet to be amortised over the life of the financial instrument amounts to EUR 20 million. The net gains/losses from derivatives not qualifying for hedge accounting includes amortisation effects in the amount of EUR 1 million.

The economic hedge effect of financial derivatives with a nominal volume of EUR 598.0 billion (2009: EUR 503.0 billion) is presented in accordance with IAS 39; the risk-mitigating impact of the remaining financial derivatives is not reflected in the accounts.

In the previous year, the KfW Group had received collateral (in the form of securities) under derivative transactions, which could be resold or repledged at any time, even if the party furnishing collateral had not defaulted. The fair value of this collateral totalled EUR 166 million. The collateral has been neither resold nor repledged. No such collateral was accepted in 2010.

However, provision of liquid collateral totalling EUR 10,973 million (previous year: EUR 1,523 million) was accepted, which was reported under Liabilities to banks and customers.

(72) Additional disclosures on the PROMISE/PROVIDE securitisation platforms

In the previous year, the KfW Group had received collateral (in the form of securities) under platform transactions, which could be resold or repledged at any time, without the party furnishing collateral having defaulted. The fair value of this collateral totalled EUR 97 million. The collateral has been neither resold nor repledged. No such collateral was accepted in 2010.

However, provision of liquid collateral totalling EUR 106 million (previous year: EUR 225 million) was accepted, which was reported under Liabilities to banks and customers.

(73) Disclosures on repurchase agreements

Disclosures on repo transactions

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Carrying amount of securities sold under repo transactions that continue to be recognised in securities and investments	804	620	184
Liabilities to banks (countervalue)	796	624	172

The KfW Group has pledged collateral (in the form of securities) under repo transactions which can be resold or repledged at any time, without the party furnishing collateral having defaulted. The carrying amount of this collateral totalled EUR 1 million (previous year: EUR 1 million).

As in 2009, the KfW Group did not receive any collateral under repo transactions, which can be resold or repledged at any time, without the party furnishing collateral having defaulted.

As in 2009, no liquid collateral has been provided.

Disclosures on reverse repo transactions

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks (countervalue)	18,664	18,116	548

Securities purchased under reverse repos are not recognised.

As in 2009, the KfW Group has not pledged any collateral under reverse repo transactions which can be resold or repledged at any time, without the party furnishing collateral having defaulted.

As in the previous year, the KfW Group did not receive any collateral under reverse repo transactions, which can be resold or repledged at any time, without the party furnishing collateral having defaulted.

As in 2009, no liquid collateral has been provided.

OTHER NOTES

(74) Contingent liabilities and irrevocable loan commitments

Analysis of contingent liabilities by class

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Contingent liabilities from financial guarantees	4,950	5,637	- 688
Contingent liabilities from PROMISE/PROVIDE securitisation platforms	1,142	1,369	- 227
Performance guarantees	53	43	10
Other contingent liabilities	837	480	357
Total	6,982	7,529	- 548

Other contingent liabilities include payment obligations attributable to investments which are not fully paid up and do not have to be consolidated.

Volume of irrevocable loan commitments

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Irrevocable loan commitments	65,276	50,360	14,916

The irrevocable loan commitments are mainly attributable to domestic promotional lending business as well as the portion of the loan to Greece that has not yet been paid out.

(75) Trust activities and administered loans

Analysis of trust activities by class (transactions in the bank's own name but for third party accounts)

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks	2,008	2,038	- 29
Loans and advances to customers	14,488	14,719	- 231
Securities and investments	109	108	2
Assets held in trust	16,605	16,864	- 259
Liabilities to banks	10	78	- 68
Liabilities to customers	16,596	16,786	- 191
Liabilities held in trust	16,605	16,864	- 259

EUR 14,800 million (previous year: EUR 14,988 million) of the assets held in trust are attributable to the business area Promotion for developing and transition countries.

Volume of administered loans granted (loans in the name and for the account of third parties)

	31 Dec. 2010	31 Dec. 2009	Change
	EUR in millions	EUR in millions	EUR in millions
Administered loans	6,793	5,643	1,150

(76) Leasing transactions as lessee
Disclosures on lessee agreements as at 31 December 2010

	Due within one year	Due in between one and five years	Due in more than five years	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Finance leases				
Future minimum leasing payments	4	6	0	10
Unearned finance income after remaining maturities	0	1	0	1
Present value of future minimum leasing payments	4	5	0	9
Operating leases				
Future minimum leasing payments	6	14	0	20

Disclosures on lessee agreements as at 31 December 2009

	Due within one year	Due in between one and five years	Due in more than five years	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Finance leases				
Future minimum leasing payments	5	4	0	9
Unearned finance income after remaining maturities	0	0	0	1
Present value of future minimum leasing payments	5	4	0	9
Operating leases				
Future minimum leasing payments	11	5	0	16

(77) Average number of employees during the financial year

	2010	2009	Change
Employees (female)	2,227	2,086	141
Employees (male)	2,304	2,179	125
Total	4,531	4,265	266
<i>Staff not covered by collective agreements</i>	<i>3,193</i>	<i>3,017</i>	<i>176</i>
<i>Staff covered by collective agreements</i>	<i>1,338</i>	<i>1,248</i>	<i>90</i>

The average number of employees including temporary staff but without members of the Executive Board and trainees was calculated based on the levels at the end of each quarter.

(78) Compensation report

Overview of total compensation to members of the Executive Board and Board of Supervisory Directors

	2010	2009	Change
	EUR in thousands	EUR in thousands	EUR in thousands
Members of the Executive Board	3,346	2,658	688
Former members of the Executive Board and their surviving dependants	4,026	3,619	407
Members of the Board of Supervisory Directors	176	160	16
Total	7,548	6,437	1,111

Compensation to the Executive Board

The compensation system for the KfW Executive Board is aimed at appropriately compensating members of the Executive Board for their duties and responsibilities. Executive Board contracts are drawn up based on the 1992 version of the policy for hiring executive board members at credit institutions of the Federal Government. The individual contracts contain adjustments.

Executive Board members that were appointed to the Executive Board prior to June 2009 currently receive annual salaries paid in twelve equal payments. They also receive a fixed end-of-year bonus paid annually upon approval of the annual financial statements by the Board of Supervisory Directors. Executive Board members who have been appointed or reappointed since June 2009 receive the fixed end-of-year bonus paid out as part of their monthly salaries.

Compensation of the Chief Executive Officer is an exception. He receives a variable end-of-year bonus of at least EUR 160,000 in addition to his fixed annual salary. This minimum bonus payment does not apply if KfW net income for a financial year is insufficient to ensure allocation to the statutory reserves.

The Executive Committee discusses the Executive Board compensation system including contract components in detail and regularly reviews it. The Board of Supervisory Directors resolves upon the basic structure of the Executive Board compensation system as proposed by the Executive Committee. Appropriateness of compensation was most recently reviewed in December 2010.

The following table shows total compensation, broken down into fixed and, where applicable, variable components and other forms of compensation, as well as allocations to pension provisions for the individual Executive Board members.

Annual compensation to the Executive Board and allocations to pension provisions in 2010

	Salary	Variable compensation	Other compensation	Total	Allocation to pension provisions
	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands
Dr Ulrich Schröder (Chief Executive Officer)	660.0	160.0	177.2	997.2	516.4
Dr Günther Bräunig	466.6	0.0	26.0	492.6	269.2
Dr Norbert Kloppenburg	466.6	0.0	52.0	518.7	270.2
Bernd Loewen	480.0	0.0	283.6	763.6	181.4
Dr Axel Nawrath	466.0	0.0	107.6	573.6	412.9
Total	2,539.2	160.0	646.5	3,345.8	1,650.1

Other compensation largely comprises contractually agreed fringe benefits. Executive Board members are entitled to a company car with driver services for business and personal use. Executive Board members reimburse KfW for using a company car with a driver for private purposes in accordance with applicable tax regulations. They are reimbursed for the costs of maintaining a secondary residence for business reasons under tax regulations. Based on a personal security scheme, costs for security measures at Executive Board members' residences are covered to an appropriate extent and were therefore first reported in 2010 under other compensation.

Executive Board members are insured under a group accident insurance policy. Supplements are paid on health and long-term care insurance premiums. Executive Board members are covered by a directors and officers liability insurance policy, which insures them against the risks of financial loss associated with their actions in their capacity as Executive Board members and by a supplemental legal expenses insurance policy. These two policies are group insurance policies. The D&O policy protects against financial loss, which could arise from performance of duties as KfW Executive Board members. At present, there is no deductible. KfW Executive Board members acting in their management capacity are also protected by a special legal expenses group policy for employees covering criminal action brought against Board members.

Other compensation also includes compensation for exercising group mandates.

As all other executives, Executive Board members may also opt to participate in the deferred compensation program – a supplemental company pension scheme financed via tax-free salary conversion.

Benefits in kind that cannot be granted tax-free are subject to taxation as non-cash benefits for Executive Board members.

As at the end of the year, there was one loan to a member of the Executive Board with an outstanding amount of EUR 81.4 thousand (previous year: EUR 87.5 thousand). The interest rate is between 3% p. a. and 4% p. a. No new loans were granted to Executive Board members in financial year 2010 nor will any more be granted in future.

Executive Board members are entitled to pension payments after retiring from KfW. Pension commitments for Executive Board members as well as their surviving dependants are based on the 1992 version of the policy for hiring executive board members at credit institutions of the Federal Government.

Pension payments to former Executive Board members or their surviving dependants were as follows in 2010:

Pension payments to former Executive Board members or their surviving dependants

	Number	EUR in thousands
Former members of the Executive Board	20	3,318
Surviving dependants	10	708
Total	30	4,026

Provisions in the amount of EUR 48,515 thousand had been set up at the end of the financial year for pension obligations to former members of the Executive Board and their surviving dependants (previous year: EUR 47,515 thousand). No loans were granted to former Executive Board members and their surviving dependants in financial year 2010.

Compensation to members of the Board of Supervisory Directors

The amount of compensation to members of the Board of Supervisory Directors is determined by the Supervisory Authority in accordance with Section 4 (5) of the KfW By-Laws. Prior to the amendment to the By-Laws effective 1 January 2011, the term *"Aufwandsentschädigung"* (*expense allowance*) was used. With the last revision in May 2010, compensation to members of the Federal Government who are members of the Board of Supervisory Directors pursuant to section 7 (1) no. 2 KfW Law was set at EUR 0.00 for the first time for financial year 2010. Moreover, compensation for the Chairman of the Board of KfW Supervisory Directors and his deputy was also set at EUR 0.00.

For the reporting year, compensation for other members of the Board of Supervisory Directors pursuant to section 7 (1) no. 3–6 KfW Law amounted to EUR 5.1 thousand p. a.; compensation for membership on the Executive, Credit or Audit Committees, was a standard amount of EUR 0.6 thousand p. a. for each member. Committee chairs received no special compensation.

Members who join during the year receive their compensation on a pro-rata basis.

A daily allowance (EUR 0.2 thousand per meeting day) is paid and travel expenses and applicable VAT are reimbursed upon request.

The following table provides details on the compensation paid to the Board of Supervisory Directors in financial year 2010; stated amounts are net amounts in EUR thousands.

Compensation to members of the Board of Supervisory Directors for financial year 2010

No.	Name	Dates of membership in 2010	Board of Supervisory Directors membership	Committee membership	Daily allowance ¹⁾	Total
			EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands
1.	Rainer Brüderle	1 Jan.–31 Dec.	0.0	0.0	0.0	0.0
2.	Dr Wolfgang Schäuble	1 Jan.–31 Dec.	0.0	0.0	0.0	0.0
3.	Ilse Aigner	1 Jan.–31 Dec.	0.0	0.0	0.0	0.0
4.	Anton F. Börner ³⁾	1 Jan.–31 Dec.	5.1	0.6	0.2	5.9
5.	Christian Brand ³⁾	1 Jan.–31 Dec.	5.1	1.2	0.0	6.3
6.	Frank Bsirske ³⁾	1 Jan.–31 Dec.	5.1	0.0	0.0	5.1
7.	Prof. Dr Hans Heinrich Driftmann ³⁾	1 Jan.–31 Dec.	5.1	0.0	0.0	5.1
8.	Prof. Dr Kurt Faltlhauser ^{2), 3)}	1 Jan.–31 Dec.	5.1	0.6	0.8	6.5
9.	Axel Gedaschko ^{2), 3)}	1 Jan.–31 Oct.	4.2	0.4	0.0	4.7
10.	Heinrich Haasis ³⁾	1 Jan.–31 Dec.	5.1	1.8	0.6	7.6
11.	Hubertus Heil ³⁾	1 Jan.–31 Dec.	5.1	0.5	0.2	5.8
12.	Gerhard P. Hofmann ³⁾	1 Jan.–31 Dec.	5.1	1.2	0.8	7.1
13.	Bartholomäus Kalb ³⁾	1 Jan.–31 Dec.	5.1	1.2	0.4	6.7
14.	Roland Koch ^{2), 3)}	1 Jan.–31 Dec.	5.1	0.6	0.0	5.7
15.	Dr h. c. Jürgen Koppelin ³⁾	1 Jan.–31 Dec.	5.1	0.6	0.8	6.5
16.	Monika Kuban ³⁾	1 Jan.–31 Dec.	5.1	0.0	0.2	5.3
17.	Karoline Linnert ^{2), 3)}	1 Jan.–31 Dec.	5.1	0.5	0.4	6.1
18.	Dr Helmut Linszen ^{2), 3)}	1 Jan.–24 Aug.	3.4	0.7	0.0	4.1
19.	Dr Gesine Löttsch ³⁾	1 Jan.–31 Dec.	5.1	0.5	0.8	6.4
20.	Claus Matecki ³⁾	1 Jan.–31 Dec.	5.1	0.0	0.2	5.3
21.	Dr Michael Meister ³⁾	1 Jan.–31 Dec.	5.1	0.6	0.6	6.3
22.	Franz-Josef Möllenberg ³⁾	1 Jan.–31 Dec.	5.1	1.2	0.6	6.9
23.	Hartmut Möllring ^{2), 3)}	1 Jan.–31 Dec.	5.1	0.0	0.6	5.7
24.	Dirk Niebel	1 Jan.–31 Dec.	0.0	0.0	0.0	0.0
25.	Dr Peter Ramsauer	1 Jan.–31 Dec.	0.0	0.0	0.0	0.0
26.	Dr Norbert Röttgen	1 Jan.–31 Dec.	0.0	0.0	0.0	0.0
27.	Alexander Rychter ³⁾	1 Jan.–31 Dec.	5.1	0.6	0.6	6.3
28.	Christine Scheel ³⁾	1 Jan.–31 Dec.	5.1	0.6	0.6	6.3
29.	Hanns-Eberhard Schleyer ³⁾	1 Jan.–31 Dec.	5.1	1.2	0.6	6.9
30.	Andreas Schmitz ³⁾	1 Jan.–31 Dec.	5.1	1.8	0.2	7.2
31.	Dr Werner Schnappauf ³⁾	1 Jan.–31 Dec.	5.1	0.6	0.0	5.7
32.	Carsten Schneider ³⁾	1 Jan.–31 Dec.	5.1	0.5	0.8	6.4
33.	Michael Sommer ³⁾	1 Jan.–31 Dec.	5.1	0.6	0.0	5.7
34.	Gerd Sonnleitner ³⁾	1 Jan.–31 Dec.	5.1	0.6	0.0	5.7
35.	Marion Walsmann ^{2), 3)}	1 Jan.–31 Dec.	5.1	0.0	0.0	5.1
36.	Dr Norbert Walter-Borjans ^{2), 3)}	15 Oct.–31 Dec.	1.3	0.0	0.0	1.3
37.	Dr Guido Westerwelle	1 Jan.–31 Dec.	0.0	0.0	0.0	0.0
Total			147.0⁴⁾	19.1⁴⁾	10.0	176.1⁴⁾

¹⁾ Reported for the first time in 2010 under Compensation paid to the Board of Supervisory Directors

³⁾ Amount not called as at 31 December 2010

²⁾ Amount determined by state law

⁴⁾ Including amounts not yet called

There are no pension obligations for members of the Board of Supervisory Directors. In the reporting year, members of the Board of Supervisory Directors received no compensation for personal services provided.

No loans were granted to members of the Board of Supervisory Directors in the reporting year.

Members of the Board of Supervisory Directors are covered by a directors and officers liability insurance policy, which insures them against the risks

of financial loss associated with their actions in their capacity as Supervisory Directors, and by a supplemental legal expenses insurance policy. These two policies are group insurance policies. The D&O policy protects against financial loss, which could arise from performance of duties as KfW Supervisory Directors. There is no deductible. KfW Supervisory Directors acting in that capacity are also protected by a special legal expenses group policy for employees covering criminal action brought against Supervisory Directors and by a group accident insurance policy.

(79) Related party disclosures

The KfW Group's related parties, in accordance with IAS 24, include as legal entities the consolidated subsidiaries, the non-consolidated affiliated entities, jointly controlled entities, associated entities and the shareholdings for the Federal Government.

Natural persons considered related parties in accordance with IAS 24 include the members of the Executive Board and the Directors of KfW, the managing directors of all subsidiaries included in the financial statements and the members of the supervisory boards of certain consolidated subsidiaries.

KfW is a public law institution in which the Federal Republic of Germany (Federal Government) holds an 80% and the federal states a 20% stake. Any transactions with the Federal Government and the federal states in the reporting year are covered by the rules and regulations set forth in the KfW Law. This also includes operations in which the Federal Republic of Germany has a state interest and which the Federal Government has assigned to KfW (mandated transactions in accordance with Section 2 (4) of the KfW Law).

The business relationships between KfW and its affiliates and other natural persons considered related parties are primarily determined by the rules set out in the KfW Law, the KfW By-Laws and by applying the principles of the Federal Public Corporate Governance Code (*Public Corporate Governance Kodex des Bundes*). The conditions and prices are in line with standard market conditions and are concluded in accordance with KfW's general conditions for its loan programmes open to the general public.

(80) Auditor's fees

	2010	2009	Change
	EUR in thousands	EUR in thousands	EUR in thousands
Audit	1,635	1,834	- 198
Other audit-related services	237	40	197
Tax advisory services	156	329	- 173
Other services	677	278	399
Total	2,706	2,481	225

(81) Disclosures on shareholdings**Subsidiaries included in the consolidated financial statements**

Name/registered office	Capital share	Equity (IFRS) as at 31 Dec. 2010
	%	EUR in millions
KfW IPEX-Bank GmbH, Frankfurt am Main (www.kfw-ipex-bank.de)	100.0	2,601
KfW IPEX-Beteiligungsholding GmbH, Frankfurt am Main	100.0	1,858
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne (www.deginvest.de)	100.0	1,877
tbg Technologie-Beteiligungs-Gesellschaft mbH, Bonn	100.0	286
KfW Beteiligungsholding GmbH, Bonn	100.0	277
Finanzierungs- und Beratungsgesellschaft mbH, Berlin	100.0	19

Investments included in the consolidated financial statements using the equity method

Name/registered office	Capital share	Equity (IFRS) as at 31 Dec. 2010
	%	EUR in millions
Railpool Holding GmbH & Co. KG, Munich	50.0	12
Railpool GmbH, Munich	50.0	1
Microfinance Enhancement Facility S.A., Luxembourg	16.7	98
Green for Growth Fund, Southeast Europe S.A., Luxembourg	17.3	58
AF Eigenkapitalfonds für deutschen Mittelstand GmbH & Co. KG, Munich	49.0	4

The leasing company Railpool GmbH was formed in 2008 as an asset manager for rail vehicles, and has been included in the consolidated financial statements as a jointly controlled entity accounted for using the equity method (with the equity share increased by the pro-rata net income share) since 2009. KfW IPEX-Bank holds a 50% share in Railpool GmbH and actively supports building up this company. Railpool Holding GmbH & Co. KG was already accounted for using the equity method in the consolidated financial statements in 2008. Railpool Holding GmbH & Co. KG covers all of the key elements in providing leasing for locomotives and other railway vehicles via various operating companies. Details of the areas of operation as well as a summary of financial information can be found on the respective companies' websites (<http://www.railpool.eu>).

Microfinance Enhancement Facility S.A. (MEF), an associated entity, is also accounted for using the equity method. The business area Promotion for developing and transition countries is responsible for MEF, a KfW investment in a refinancing facility for microfinance institutions.

Green for Growth Fund, Southeast Europe (GGF, formerly Southeast Europe Energy Efficiency Fund) and AF Eigenkapitalfonds für deutschen Mittelstand GmbH & Co. KG have newly been included in the consolidated financial statements as associated entities accounted for using the equity method. GGF is a fund to promote SME and private household investment in energy efficiency and renewable energy in the Western Balkans and in Turkey (business area: Promotion for developing and transition countries). The Eigenkapitalfonds für deutschen Mittelstand initiated by KW Bankengruppe and Commerzbank serves to provide equity for the sustainable development of higher turnover SMEs (business area: KfW Mittelstandsbank).

Special funds included in the consolidated financial statements

Name	Capital share	Fund volume (IFRS) as at 31 Dec. 2010
	%	EUR in millions
Frankfurt I	100.0	1,052
Atlantik	100.0	1,088

The investments held in the special security funds are mostly part of the KfW Group's strategic asset management. The special funds Frankfurt I, München I and Atlantik existed at the beginning of financial year 2010. The special fund München I was merged with the special fund Frankfurt I after fund assets were transferred within the KfW Group in the third quarter of 2010. The special fund Cologne established in connection with the IKB sale in 2008 is no longer included in the consolidated financial statements as realisation of the portfolio investments has been completed.

Affiliated entities not included in the consolidated financial statements

Five affiliated entities, nine associated entities, four jointly controlled entities and four special purpose vehicles of minor significance to the presentation of the financial position and performance of the KfW Group have not been consolidated; instead they are shown in the statement of financial position under Securities and investments. These companies account for 0.1 % of KfW Group's total assets.

List of KfW Group shareholdings as at 31 December 2010

No.	Name	Place	Capital share in %	CC ¹⁾	Exchange rate EUR 1.00 = _CU ²⁾ as at 31 Dec. 2010	Equity in TCU ³⁾	Net income in TCU ³⁾
KfW shareholdings							
A. Fully consolidated affiliated entities included in the consolidated financial statements							
1	DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH	Cologne	100.0	EUR	1	1,604,535	268,230
2	KfW Beteiligungsholding GmbH	Bonn	100.0	EUR	1	275,972	95,744
3	KfW IPEX-Beteiligungsholding GmbH	Frankfurt am Main	100.0	EUR	1	1,625,985	351
B. Affiliated entities not included in the consolidated financial statements							
4	Astra Grundstücksgesellschaft mbH & Co. Bauträger KG	Frankfurt am Main	100.0	EUR	1	1,500	33
5	KfW International Finance Inc. i. L.	Delaware, USA	100.0	USD	1.3362	0	0
C. Jointly controlled entities not included in the consolidated financial statements							
6	Berliner Energieagentur GmbH	Berlin	25.0	EUR	1	3,285	405
7	DENA-Deutsche Energie-Agentur GmbH	Berlin	26.0	EUR	1	4,861	1,113
D. Other shareholdings							
8	AF Eigenkapitalfonds für deutschen Mittelstand GmbH & Co. KG ⁴⁾	Munich	49.0	EUR	1	n.a.	n.a.
9	Deutsche Post AG	Bonn	30.5	EUR	1	8,273,000	693,000
10	eCapital Technologies Fonds II GmbH & Co. KG	Münster	24.8	EUR	1	14,125	- 1,445
11	Mittelstandsfonds Hamburg MHH GmbH & Co. KG	Hamburg	24.9	EUR	1	6,601	639
12	Post 2012 Carbon Credit Fund CV	Amsterdam, Netherlands	20.0	EUR	1	82	- 101
13	Galaxy S.à.r.l.	Luxembourg, Luxembourg	20.0	EUR	1	67,702	- 34,967

Shareholdings of KfW IPEX-Bank GmbH

A. Affiliated entities not included in the consolidated financial statements							
1	Sperber Rail Holdings Inc. ⁴⁾	Wilmington, USA	100.0	USD	1.3362	n.a.	n.a.
B. Jointly controlled entities included in the consolidated financial statements							
2	Railpool GmbH	Munich	50.0	EUR	1	942	- 1,969
3	Railpool Holding GmbH & Co. KG	Munich	50.0	EUR	1	- 246	- 2,201
C. Jointly controlled entities not included in the consolidated financial statements							
4	Movesta Development Capital Beteiligungsgesellschaft mbH	Düsseldorf	50.0	EUR	1	2,625	- 1,433
5	Canas Leasing Ltd.	Dublin, Ireland	50.0	USD	1.3362	0	0
D. Other shareholdings							
6	Freighter Leasing S.A.	Luxembourg, Luxembourg	22.2	USD	1.3362	15,268	1,633

¹⁾ ISO currency code

²⁾ CU-Currency units in local currency

³⁾ Financial statements prepared in accordance with local financial reporting framework

⁴⁾ The company is in the start-up phase. No financial statements have been prepared yet.

No.	Name	Place	Capital share in %	CC ¹⁾	Exchange rate EUR 1.00 = _CU ²⁾ as at 31 Dec. 2010	Equity in TCU ³⁾	Net income in TCU ³⁾
Shareholdings of tbg Technologie-Beteiligungs-Gesellschaft mbH							
A. Affiliated entities not included in the consolidated financial statements							
1	Strategic European Technologies N.V.	's-Hertogenbosch, Netherlands	52.0	EUR	1	20,372	11,551
B. Other shareholdings							
2	ASMEC Advanced Surface Mechanics GmbH	Rosendorf	20.8	EUR	1	65	- 118
3	AURELIA Technologie-Fonds I GmbH & Co. Beteiligungen KG	Frankfurt am Main	24.6	EUR	1	7,717	-2,837
4	BioM VC GmbH & Co. Fonds KG	Munich	19.4	EUR	1	2,177	-8
5	Business-Angel-Beteiligungsgesellschaft mbH & Co. KG	Hannover	23.8	EUR	1	3,870	1,882
6	cv cryptovision GmbH	Gelsenkirchen	24.8	EUR	1	565	-288
7	eCapital New Technologies Fonds AG & Co. Unternehmensbeteiligungsgesellschaft KG	Münster	24.8	EUR	1	3,076	133
8	FAMA Fassaden GmbH	Apolda-Zottelstedt	24.7	EUR	1	92	74
9	FIB Fonds für Innovation und Beschäftigung Rheinland Pfalz UBG mbH	Mainz	24.0	EUR	1	2,844	-67
10	Heidelberg Innovation GmbH & Co. BioScience Venture KG	Heidelberg	25.0	EUR	1	2,230	-1,735
11	IMH Venture Capital Berlin GmbH	Berlin	25.0	EUR	1	422	-287
12	infoRoad GmbH	Heroldsberg	22.5	EUR	1	-24	1,138
13	i42 Informationsmanagement GmbH	Mannheim	20.9	EUR	1	66	-97
14	KTB Technologie Beteiligungsgesellschaft mbH & Co. KG	Hemmingen	36.7	EUR	1	3,896	-4,501
15	Medizin Forum AG	Bad Nauheim	24.9	EUR	1	72	-9
16	MicroVenture GmbH & Co. KGaA Beteiligungsgesellschaft	Düsseldorf	23.3	EUR	1	6,349	-187
17	Premium Bodywear AG	Wittgensdorf	24.0	EUR	1	394	78
18	RS Reengineering Softwaredesign AG	Berlin	23.3	EUR	1	-122	52
19	Saarländische Wagnisfinanzierungsgesellschaft mbH	Saarbrücken	20.4	EUR	1	6,384	150
20	Sachsen LB V.C. GmbH & Co. KG	Leipzig	24.8	EUR	1	9,387	-450
21	Sepiatec GmbH	Berlin	21.9	EUR	1	51	-220
22	SHS Gesellschaft für Beteiligungen mbH & Co. Mittelstand KG	Tübingen	24.8	EUR	1	5,642	-457
23	S-ReFIT AG	Regensburg	21.5	EUR	1	28,741	258
24	Technologie Beteiligungsfonds Bayern GmbH & Co. KG	Munich	25.0	EUR	1	4,752	371
25	Technologie Beteiligungsfonds Bayern Verwaltungs GmbH	Munich	25.0	EUR	1	32	2
26	Tübinger Seed Fonds KG	Tübingen	21.9	EUR	1	638	-3
27	TVM Medical Ventures GmbH & Co. KG	Munich	23.3	EUR	1	6,789	-387
28	Venture Capital Thüringen GmbH & Co. KG	Erfurt	25.0	EUR	1	2,050	-2,780

¹⁾ ISO currency code

²⁾ CU-Currency units in local currency

³⁾ Financial statements prepared in accordance with local financial reporting framework

No.	Name	Place	Capital share in %	CC ¹⁾	Exchange rate EUR 1.00 = _CU ²⁾ as at 31 Dec. 2010	Equity in TCU ³⁾	Net income in TCU ³⁾
Shareholdings of KfW IPEX-Beteiligungsholding GmbH							
A. Fully consolidated affiliated entities included in the consolidated financial statements							
1	KfW IPEX-Bank GmbH	Frankfurt am Main	100.0	EUR	1	2,559,402	144,694

Shareholdings of KfW Beteiligungsholding GmbH							
A. Fully consolidated affiliated entities included in the consolidated financial statements							
1	Finanzierungs- und Beratungsgesellschaft mbH	Berlin	100.0	EUR	1	13,291	1,299
2	tbg Technologie-Beteiligungs-Gesellschaft mbH	Bonn	100.0	EUR	1	316,300	0
B. Affiliated entities not included in the consolidated financial statements							
1	Astra Grundstücksgesellschaft mbH	Frankfurt am Main	100.0	EUR	1	58	0

Shareholdings of DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH							
A. Other shareholdings							
1.	PCC-DEG Renewables GmbH	Duisburg	40.0	EUR	1	7,438	- 115
2.	Banque Nationale de Développement Agricole	Bamako, Mali	21.4	XOF	655.957	14,673,751	2,019,012
3.	Corporate Leasing Company Egypt	Cairo, Egypt	22.2	EGP	7.75839	109,156	23,208
4.	Tourism Promotion Services Ltd.	Kigali, Ruanda	29.1	RWF	791.21	6,299,016	- 41,315
5.	Banyan Tree Growth Capital	Port Louis, Mauritius	27.0	USD	1.3362	16,828	- 91
6.	The SEAF Central and Eastern Europe Growth Fund	Washington, USA	25.0	USD	1.3362	10,467	- 158
7.	Kendall Court Mezzanine (Asia) Bristol Merit Fund L.P.	Cayman Islands	24.4	USD	1.3362	14,203	1,567
8.	Tolstoi Investimentos S.A.	Sao Paulo, Brazil	38.0	BRL	2.218	69,129	- 13,086
9.	Acon Latin American Opportunities Fund-A, L.P.	Washington, USA	40.0	USD	1.3362	303	- 1,444
10.	H&Q Philippine Holdings, Inc.	Manila, Philippines	50.0	PHP	58.3360	42,042	5,025
11.	Benetex Industries Ltd.	Dhaka, Bangladesh	28.3	BDT	94.3236	278,214	8,763
12.	Langfang Hess Building Materials Machinery, Co. Ltd.	Langfang, China	40.0	CNY	8.8220	37,290	4,874
13.	Jade Cargo International Co. Ltd.	Shenzhen, China	24.0	CNY	8.8220	- 671,444	13,209
14.	The New Baghlan Sugar Company Ltd.	Baghlan-e Sonhati, Afghanistan	30.3	AFN	45.7600	880,160	- 12,673
15.	HaPe International Ningbo Ltd.	Ningbo, China	37.5	CNY	8.8220	77,857	8,523
16.	Wanfeng MotorcycleWheel Co. Ltd.	Xinchang, China	34.8	CNY	8.8220	519,976	119,684
17.	Ace Power Pvt. Ltd.	Colombo, Sri Lanka	26.0	LKR	148.2780	4,283,276	1,125,226
18.	OJSC Tourism Promotion Services	Dushanbe, Tajikistan	21.0	TJS	5.8832	- 59	- 90
19.	PT Avrist Assurance	Jakarta, Indonesia	23.0	IDR	12,041.8700	905,092,000	147,073,000
20.	TOO Knauf Gips Kaptschagaij GmbH	Kapshagaij, Kazakhstan	40.0	KZT	197.24	5,957,699	1,797,831
21.	PII TOW Ukrspoon LLC	Kiev, Ukraine	22.6	EUR	1	1,104	315
22.	Tirana Airport Partners SHPK	Rinas, Albania	31.7	EUR	1	33,313	3,246
23.	Center-Invest Bank	Rostov-on-Don, Russ. Föderation	22.5	RUB	40.82	5,442,300	66,614
24.	TOO Isi Gips Inder	Inderborskij, Kazakhstan	40.0	KZT	197.24	1,392,651	23,121
25.	Emerging Europe Leasing and Finance (EELF) B.V.	Amsterdam, Netherlands	25.0	EUR	1	13,401	- 79

¹⁾ ISO currency code

²⁾ CU-Currency units in local currency

³⁾ Financial statements prepared in accordance with local financial reporting framework

STATEMENT BY THE EXECUTIVE BOARD

To the best of our knowledge, and in accordance with the applicable accounting principles, the consolidated financial statements give a true and fair view of the financial position and performance of the KfW Group, and the group management report includes a fair review of the development and performance of the business and the position of the KfW Group, together with a description of the principal risks and rewards associated with the expected developments of the KfW Group.

Frankfurt am Main, 31 January 2011
KfW



Dr Ulrich Schröder
(Chief Executive Officer)



Dr Günther Bräunig



Dr Norbert Kloppenburg



Bernd Loewen



Dr Axel Nawrath

AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by KfW, Frankfurt am Main, comprising the statement of comprehensive income, statement of financial position, statement of changes in equity, statement of cash flows and the notes to the consolidated financial statements, together with the group management report for the business year from 1 January to 31 December 2010. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § (Article) 315 a Abs. (paragraph) 1 HGB [*Handelsgesetzbuch* "German Commercial Code"] and supplementary provisions of the Law concerning KfW (KfW Law) are the responsibility of KfW's Executive Board. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with §317 HGB [*Handelsgesetzbuch* "German Commercial Code"] and German generally accepted standards for the audit of financial statements promulgated by the *Institut der Wirtschaftsprüfer* [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 consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of 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 consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the Executive Board, as well as evaluating the overall presentation of the consolidated financial statements and the group 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 findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU and the additional requirements of German commercial law pursuant to § 315 a Abs. 1 HGB and supplementary provisions of the KfW Law and give a true and fair view of the net assets, financial position and results of operations of the KfW Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Frankfurt am Main, 8 March 2011

KPMG AG
Wirtschaftsprüfungsgesellschaft



Mock
Wirtschaftsprüfer
(German Public Auditor)



Schweitzer
Wirtschaftsprüfer
(German Public Auditor)

Imprint

Published by:

KfW Bankengruppe
Communication Department
Palmengartenstrasse 5–9, 60325 Frankfurt am Main
Phone +49 69 7431 0, Fax +49 69 7431 2944
infocenter@kfw.de, www.kfw.de

Design and realisation:

MEHR Werbe- und Projektagentur, Düsseldorf

Photography:

Rüdiger Nehmzow, Düsseldorf | pages 8–9
Laurence Chaperon, Berlin | page 12

Lithography: Laser-Litho4, Düsseldorf

Printed by: Mareis Druck, Weißenhorn

Printed on
Heaven 42, Igempa group
PlanoPlus, Papyrus



KfW Bankengruppe

Palmengartenstrasse 5-9

60325 Frankfurt am Main

Phone +49 69 7431 0

Fax +49 69 7431 2944

infocenter@kfw.de

www.kfw.de

