MANAGEMENT REPORT AND FINANCIAL STATEMENTS
2011

Bank aus Verantwortung

KEY FIGURES OF KFW

	2009	2010	2011
	EUR in millions	EUR in millions	EUR in millions
Financial statements			
Business volume	482,470	524,629	555,564
Balance sheet total	407,237	445,514	493,008
Bonds issued	324,323	360,145	399,160
Subordinated liabilities	3,247	3,247	3,247
Own funds	12,236	14,888	16,614
Net interest income	2,141	2,389	1,941
Interest rate reductions	571	558	557
Net commission income	199	205	153
Administrative expense	552	555	581
Net income for the year	1,664	2,013	547
Cost-income ratio before interest rate reductions	19.0	17.6	21.9
Tier 1 ratio	11.6	14.7	18.3
Total capital ratio[1)]	14.6	17.7	21.6
Employees	3,321	3,543	3,890

[1)] *The regulatory total capital ratio and the tier 1 ratio are calculated for internal purposes.*

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

Management Report and Financial Statements 2011

CONTENTS

MANAGEMENT REPORT

ECONOMIC REPORT

General economic environment

The world economy continued its recovery in 2011. Global gross domestic product grew by around 4 % in real terms. Although the upturn lost momentum compared to 2010, growth still measured above the average of the last twenty years. This occurred despite the fact that economic policy measures had a dampening effect. Fiscal and monetary policies were restrictive in developing and industrialising market countries in order to counteract the signs of overheating particularly evident in the rising rates of inflation. Consolidation requirements also forced the industrialised nations to curb spending.

While the beginning of the year was still characterised by strong upward movement, the global economy cooled off considerably over the course of the year. A number of factors contributed to this. Firstly, the massive earthquake in Japan in March took its toll. The global economy was further slowed in the summer with the culmination of the euro area debt crisis.

Asian industrialising markets drove global growth even more strongly than in 2010. Aggregate output in these markets expanded at more or less the same pace as the previous year. China's strength remains constant; GDP there continued to increase at a rate of over 9 %. In contrast, below-average growth in industrialised countries was disappointing. The US economy regained some momentum at the end of the year; however with the overall real growth rate of 1.7 % for 2011 it remained below the pre-crisis level. Germany continued to demonstrate strength in the euro area; however, strict consolidation programmes and the extreme uncertainty about the progress of the crisis still visibly burdened those countries with high levels of government debt and low competitive ability. Overall, the euro area recorded an increase in real gross domestic product of 1.4 %.

Financial market events remained characterised by the European sovereign debt crisis in 2011. In April 2011, another euro area country, Portugal, followed Greece and Ireland in making use of the euro rescue package aid. Moreover, Greece's continued financial problems necessitated an additional rescue package and also fuelled market participant concerns about other euro countries' capacity to bear their levels of public debt. Against this backdrop, starting in the summer there was a significant increase in risk premiums on Spanish and Italian government bonds. This caused mounting pressure on those European banks heavily engaged in trading government bonds, resulting in demand again increasing for the European Central Bank to perform its role in fighting the crisis. The decisions to increase key rates made until summer were reversed by the end of the year. Moreover, the unconventional monetary policy measures were again significantly expanded to address the banks' increasing mutual mistrust and the resulting increasing need for funding among financial institutions, primarily banks in the euro periphery countries. The US also continued to steer its monetary policy in a very expansionary direction. Consequentially, money market rates in both currency zones remained at extraordinarily low levels in 2011. The average slope of the yield curves declined in 2011 as compared to 2010. This was not least due to the significant decline in long-term yields over the course of the year, since investors increasingly demanded both US and German government bonds as the severity of the euro crisis deepened.

The EUR/USD exchange rate experienced marked fluctuation during 2011. Thanks to positive economic conditions of the euro zone in the first quarter of 2011 and the prospect of key rate hikes by the central bank, the euro appreciated at the beginning of the year, peaking for the year at 1.49 to the US dollar at the beginning of May. As the government debt crisis worsened, the euro depreciated considerably in the second half of the year. At the end of 2011, the EUR/USD exchange rate stood at 1.29, thus clearly below its annual average of 1.39.

The German real economy demonstrated its strength in 2011 despite the persisting sovereign debt crisis, primarily in the first half of the year. It grew by 3.0 % in 2011 as a whole, and thus very strongly for the second year in a row – in fact twice as fast as the country's long-term average rate since reunification. It has meanwhile more than made up for the historic drop in 2009 when GDP fell by more than 5 % due to the crisis. Aggregate output for 2011 was once again higher in absolute terms and also per capita than before the crisis began in 2008. The German upturn after 2009 is thus not only impressive in European terms, but also compared to other major advanced countries like the US and Japan, whose economies at least per capita have not yet returned to their pre-crisis levels. This was possible because Germany entered into the crisis without major upheavals such as asset price bubbles or over-indebtedness by private households and, for the most part, its exporters only had to face a very strong but relatively short global drop in demand. At the same time new domestic economic momentum has developed, decoupling the German economy somewhat from the cyclical fluctuations in the global economy. In 2011 domestic demand accounted for nearly three-fourths of total growth. Private consumption in particular recovered considerably, growing by 1.5 % in 2011; the last time it grew more than this was eleven years ago. It benefited from a significant rise in disposable income and the very favourable development on the labour market, which experienced two excellent indicators in 2011: the number of people in work exceeded the 41-million mark for the first time, thus setting a new record for Germany, and unemployment fell to an overall German low. The good sales prospects in the domestic market together with increasing exports had, as in 2010, a positive impact on companies' willingness to invest. Corporate investment grew by 7.2 % in 2011, after increasing the previous year at a similar rate. Public finances developed extremely positively as a result of the strong upswing. The German federal budget deficit declined by 3.3 percentage points year-on-year to 1.0% of GDP. This makes Germany one of the very few countries in 2011 that was able to push its deficit back below the reference value contained in the Maastricht criteria.

Development of KfW

KfW continued to benefit from a very favourable environment in financial year 2011. Earnings were favoured in particular by KfW's good refinancing opportunities at continued low interest rates and a steep yield curve that is however becoming flatter than the previous year, in conjunction with a robust German economy. Consequently, interest income as a main source of earnings as well as risk provisions for lending business remained well above long-term expectations, however below the exceptional year 2010. After considerable additions to the fund for general banking risks of EUR 1.1 billion (previous year: EUR 0.6 billion), business activities therefore remained at a sustained high level, generating net income for the year of EUR 0.5 billion (previous year: EUR 2.0 billion). Given the stricter regulatory capital requirements and the uncertainties about future economic development, the resulting improved capital base safeguards KfW's promotional capacity in the long term. KfW expects earnings to continue their return to a normal level in 2012.

Business performance in 2011 was largely characterised by the following developments:

A) Strong demand for KfW products while focussing on a long-term strategy of qualitative growth applied to the product portfolio. KfW's particular priorities in 2011 were financing climate and environmental protection – an area of continued expansion – and ensuring long-term credit availability, in addition to financing SMEs.

B) A high operating result due to KfW's very favourable refinancing conditions.

C) KfW's risk situation has continued to improve overall particularly due to Germany's robust economy. Risk provisions for lending business were thus further reduced.

D) The securities portfolio was burdened primarily by developments in those countries particularly affected by the European sovereign debt crisis - above all Greece.

A) High demand for KfW products

KfW made new commitments to the volume of EUR 62.9 billion in 2011 (previous year: EUR 74.7 billion). The marked decline year-on-year is due to the end of the promotional measures KfW significantly expanded in 2010 in connection with economic stimulus measures, thus highlighting its subsidiary role. Overall, KfW has returned to a moderate and long-term qualitative growth path. This is also reflected in the increase in KfW's total assets in financial year 2011 of EUR 47.5 billion or 11% to EUR 493.0 billion.

KfW Mittelstandbank's promotional business volume was EUR 22.4 billion in 2011 (previous year: EUR 28.5 billion). This decline is primarily attributable to the phase-out of the KfW Special Programme at the end of 2010. At the same time, the commitment volume was greater than the planned volume (EUR 18.8 billion), mainly reflecting economic growth in 2011 and the resultant investment activity by companies.

The promotional business volume of KfW Privatkundenbank decreased from EUR 20.0 billion to EUR 16.7 billion in 2011. This development was partly attributable to pull-forward effects from 2010. In addition, demand also receded as a result of the decline in federal budget funds available for interest rate reductions.

The business area KfW Kommunalbank achieved a promotional business volume of EUR 11.8 billion compared to EUR 15.4 billion[1)] in the previous year. The primary reason behind this decline was the expiry of the "Infrastructure Investment Offensive" and the reduction, as planned, in the non-programme-related refinancing of the special credit institutions of the federal states.

A strong impetus was also experienced in international business. The promotional business in export and project finance saw a particular increase, growing by EUR 2.4 billion to reach EUR 6.4 billion at year-end 2011. At EUR 4.5 billion, the volume of new commitments at KfW Entwicklungsbank is on the prior-year level. Alongside funds from the federal budget, KfW Entwicklungsbank used EUR 2.6 billion in own funds for projects in developing and transition countries.

1) Adjustment of corresponding figures for the previous year due to changes in product responsibility.

B) High operating result posted

The operating result before valuation remained at a very high level of EUR 1,589 million despite its expected decline, however it was considerably lower than that seen in the exceptional year of 2010 (EUR 2,049 million).

The decline was due in particular to the reduction in net interest income, which remains KfW's most important source of earnings, by EUR 448 million to EUR 1,941 million. KfW's excellent financing opportunities, which were a result of its first-class credit rating along with the current sustained low short-term interest rate environment – with a steep yield curve that is nevertheless becoming flatter than the previous year – are responsible for continued above-average earnings. At EUR 557 million, the interest rate reductions as a component of promotional business remained at the same high level as in the previous year.

In addition to this there was a decrease in net commission income as well as a moderate increase in administrative expenses due in particular to the continuation of KfW's modernisation measures. Given this background, the cost-income ratio[2)] before interest rate reductions rose from 18 % to 22 %.

C) Continued improvement in risk situation

The risk situation continued to develop positively in 2011 after the major improvement seen in the previous year. This is particularly due to the robust economic situation prevailing in Germany. Risk provisions were successfully reduced by a total of EUR 140 million (previous year: EUR 336 million), maintaining a cautious risk position.

Collective impairments for latent risks in the loan portfolio, which were recognised in the previous years to account primarily for those sectors and countries particularly hard hit by the recession, were further reversed by EUR 156 million (previous year: EUR 303 million). The moderate need for provision for immediate lending risks to the amount of EUR 106 million, which predominantly involve export and project finance as well as financing for SMEs, was largely offset by recoveries on loans already written off amounting to EUR 90 million.

KfW continued its conservative risk provisioning policy in financial year 2011 and further strengthened its capital base by substantially increasing the fund for general banking risks by EUR 1,100 million to EUR 1,700 million.

D) Difficult financial market environment

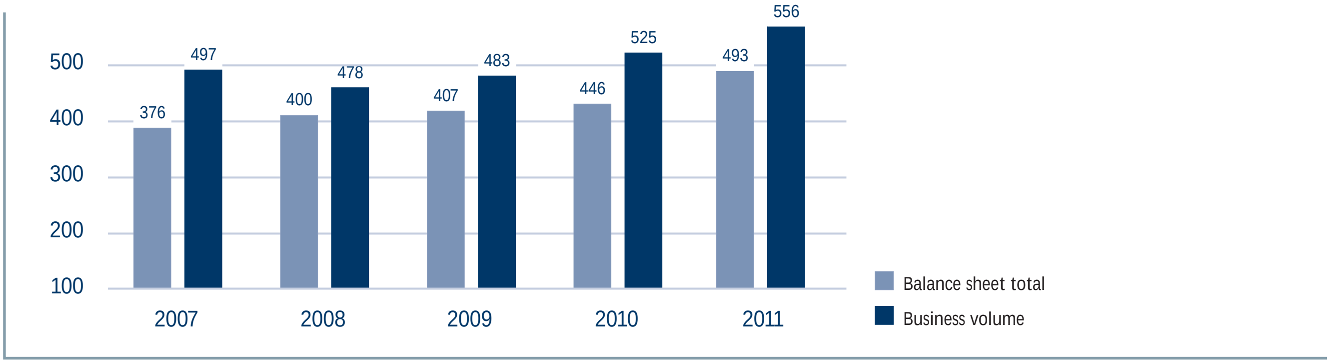
The financial markets are characterised by persisting high levels of uncertainty, particularly as a result of the European sovereign debt crisis which escalated further in the course of the year. The valuation result decreased year-on-year from EUR 341 million to EUR 3 million. The impairment of Greek government bonds had a particular impact as bonds with the nominal value of EUR 229 million were written down to their market value. The resulting negative effect on the income statement amounted to EUR 166 million.

[2)] Administrative expense in relation to adjusted income, which is calculated from the net interest and commission income plus interest rate reductions.

Overview of the net assets, financial position and results of operations

KfW's volume of business was EUR 555.6 billion (previous year: EUR 524.6 billion). The increase is primarily attributable to greater liquidity maintenance at year-end as well as increased loans and advances to customers as a result of loan draw-downs by Greece (EUR 9.2 billion). Irrevocable loan commitments decreased due to the loan draw-downs by Greece. Contingent liabilities also decreased considerably due to the difficult market situation for securitisation products and the resultant effects on new business.

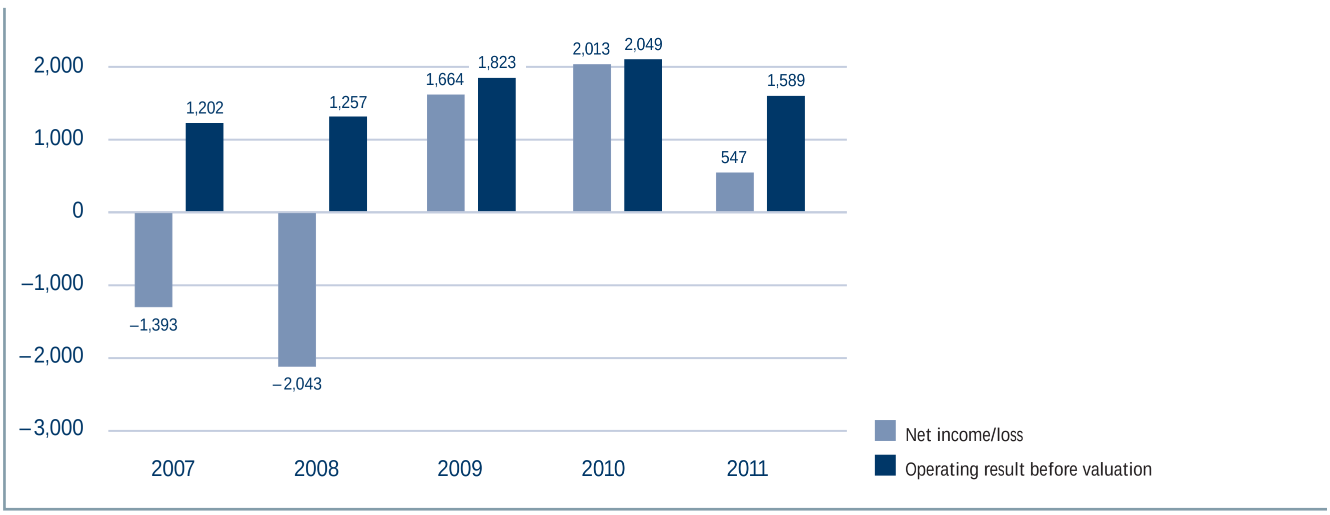
Balance sheet total and business volume (EUR in billions)



At EUR 1,589 million, the operating result before valuation was EUR 460 million lower than the previous year's outstanding figure of EUR 2,049 million.

The fund for general banking risks was increased by EUR 1,100 million to EUR 1,700 million. The entire net income of EUR 547 million (previous year: EUR 2,013 million) was allocated to retained earnings.

Operating result before valuation and net income/loss (EUR in millions)



Volume of lending

The volume of lending (loans and advances, including loans on a trust basis and guarantees, and irrevocable loan commitments) increased to EUR 425.4 billion (previous year: EUR 419.6 billion).

The volume of lending in domestic promotion increased from EUR 308.5 billion to EUR 314.4 billion. The increase is attributable particularly to growth in the priority areas of environmental protection and housing. The volume of lending in domestic promotion in relation to KfW's total lending volume remains practically unchanged at 74 %.

International lending business increased to EUR 100.0 billion (previous year: EUR 92.3 billion) and accounts for 24 % of the total lending volume, including the loans to Greece (EUR 22.3 billion).

Guarantees, which are mainly related to KfW's securitisation activities, declined by EUR 7.8 billion to EUR 11.0 billion, thus accounting for just 3 % of the lending volume.

Assets held in trust totalled EUR 16.2 billion, remaining at the prior-year level.

Refinancing

Last year too, KfW funded its business predominantly by issuing bonds and notes in the capital market. KfW raised funds in the amount of EUR 79.7 billion in 2011 (previous year: EUR 76.4 billion).

Bonds issued increased by EUR 39.0 billion year-on-year and totalled EUR 399.2 billion as at 31 December 2011.

Bonds issued accounted for 88 % of borrowed funds, unchanged from the previous year. They therefore remain KfW's most important source of funding.

The share of funds borrowed from banks and customers (excluding federal budget funds) increased slightly from 8 % to 9 %. This includes cash collateral received to reduce counterparty risk from the derivatives business in the amount of EUR 20.0 billion. Federal budget funds accounted for 2 % of borrowed funds, almost unchanged from the previous year.

There were also subordinated liabilities in the amount of EUR 3.2 billion.

Borrowed funds

	31 Dec. 2011	31 Dec. 2010	Change	Change
	EUR in millions	EUR in millions	EUR in millions	in %
Federal Republic of Germany				
■ ERP Special Fund	399	259	140	54
■ Federal budget	10,050	11,303	–1,253	–11
	10,449	11,562	–1,113	–10
Other lenders	11,286	11,164	122	1
Liabilities to customers	21,735	22,726	–991	–4
Liabilities to banks	27,082	19,515	7,567	39
Bonds issued	139,923	128,340	11,583	9
Bearer securities (incl. Commercial Paper)	253,957	226,667	27,290	12
Accrued interest	5,280	5,138	142	3
Bonds and notes	399,160	360,145	39,015	11
Subordinated liabilities	3,247	3,247	0	0
Total	451,224	405,633	45,591	11

Own funds

The fund for general banking risks was increased by EUR 1.1 billion and stood at EUR 1.7 billion as at 31 December 2011. The net income of EUR 547 million remaining after the increase was allocated in full to retained earnings.

KfW's own funds thus amounted to EUR 16.6 billion as at 31 December 2011, 12 % up on the previous year.

Own funds

	31 Dec. 2011	31 Dec. 2010	Change
	EUR in millions	EUR in millions	EUR in millions
Subscribed capital	3,750	3,750	0
Uncalled outstanding contributions	–450	–450	0
Capital reserves	5,947	5,947	0
Promotional reserves from the ERP Special Fund	*4,650*	*4,650*	*0*
Reserves from the ERP Special Fund	1,056	977	79
Retained earnings			
a) Statutory reserve under Section 10 (2) KfW Law	1,875	1,838	37
b) Special reserve under Section 10 (3) KfW Law	2,689	2,178	510
c) Statutory reserve under Section 17 (4) of the D-Mark Balance Sheet Law[1)]	48	48	0
Net loss/net income for the year	0	0	0
Fund for general banking risks under Section 340 g HGB	1,700	600	1,100
Total	16,614	14,888	1,727

[1)] *To be adjusted by the special loss account shown on the assets side in accordance with Section 17 (4) of the D-Mark Balance Sheet Law (EUR 27 million)*

The regulatory total capital ratio was 21.6 % (previous year: 17.7 %).

Changes in other major balance sheet items

Total bonds and other fixed-income securities increased slightly by EUR 2.8 billion to EUR 40.8 billion. Holdings of securities of other issuers, which make up 65% of the total holdings of all bonds and other fixed-income securities, declined in 2011 by 7% to EUR 26.7 billion.

These securities, held for the purpose of maintaining KfW's liquidity, are maintained in euros and to a small extent in US dollars. Of the securities from other issuers, 77% is eligible as collateral for funding operations with the European Central Bank (ECB). In addition to the Treasury securities portfolios, KfW holds asset backed securities (ABS) with a book value of EUR 3.6 billion in connection with its securitisation and SME finance activities. Potential risks are sufficiently addressed by appropriate risk provisioning.

For price management purposes, KfW held own bonds with a nominal value of EUR 14.7 billion as at the end of the year (previous year: EUR 9.9 billion). This was equivalent to 4% of bonds issued.

The shares and other non-fixed income securities held as at 31 December 2011 amounted to EUR 12.4 billion (previous year: EUR 14.2 billion). The primary reason for the decline was the redemption of shares in special funds, as planned, resulting from implementation of the securities strategy already applied in the previous years.

The value of shares in affiliated companies increased slightly year-on-year from EUR 2.5 billion to EUR 2.6 billion.

Other assets include in particular the currency adjustment item from foreign currency derivatives in the amount of EUR 14.9 billion used in the context of management of the foreign currency exposure. It also includes the claim of EUR 0.6 billion against the Federal Agency for Special Tasks resulting from Unification *(Bundesanstalt für vereinigungsbedingte Sonderaufgaben - BvS)*, due to the transfer of the rights and obligations of the State Insurance Company of the GDR in liquidation (SinA) to KfW as at 1 January 2008. However, the obligations of SinA continue to be borne in economic terms by the BvS. This claim is offset by technical provisions in the same amount.

The primary component of prepaid expenses and deferred charges is deferred interest expenditure mainly for derivative financial instruments and leasing obligations in project finance attributable to the following period. The item also includes differences between the repayment amount and lower issue amount in the context of borrowed funds (discounts and placing commissions). The item deferred income shows in particular the discounts from lending operations deferred over the loan terms.

Provisions decreased year-on-year by EUR 0.1 billion to EUR 2.1 billion. The total amount included provisions for pensions and similar commitments (EUR 0.8 billion) and other provisions (EUR 1.3 billion). Other provisions included in particular the technical provisions relating to SinA, the provision for covering future interest charges from the transfer of the ERP Special Fund as well as provisions created for losses on receivables.

Earnings position

KfW's operating result before risk provisioning and valuation was EUR 1,589 million and remains at a sustained high level despite its expected decline compared to the exceptional year 2010 (EUR 2,049 million).

Net interest income – KfW's most important source of income – was EUR 1,941 million in 2011, down EUR 448 million on the previous year's level. It remains high despite this decline and continues to benefit from the favourable refinancing conditions for KfW. Net interest income includes interest rate reductions of EUR 557 million (previous year: EUR 558 million).

Net commission income decreased to EUR 153 million from EUR 205 million in the previous year. The decline was primarily caused by falling net income from the securitisation platforms PROMISE and PROVIDE, and by lower guarantee and loan processing fees. The performance of the securitisation platforms reflects the ongoing difficult market situation for securitisation products and the resultant effects on new business.

Administrative expense increased moderately by EUR 26 million to EUR 581 million. While personnel expense remained at the previous year's level, non-personnel expense increased significantly, particularly as a result of investments to modernise IT facilities, including the use of external service providers.

The risk provisioning and valuation result made a positive earnings contribution of EUR 143 million, which was considerably below the previous year's EUR 678 million.

The valuation result decreased year-on-year from EUR 341 million to EUR 3 million. This considerable reduction was caused by the very good valuation result in the previous year, which was the product of price gains realised from the redemption of shares in special funds and disposals of securities, and major positive earnings contributions from the affiliated companies. Write-downs on Greek government bonds had a negative effect on the valuation result in 2011.

The positive risk provisioning result of EUR 140 million (previous year: EUR 336 million) was the result of a further improvement in the risk situation. Expenses relating to specific value adjustments for immediate risks were offset by the high amount of reversed portfolio value adjustments and proceeds from the realisation of collateral. Specific value adjustments and allowances for possible loan losses fell primarily due to net draw-downs in the amount of EUR 3.9 billion (previous year: EUR 4.4 billion). At EUR 3.2 billion, the largest proportion of this remained provisions for risks from the liquidity lines provided to refinance the special purpose entities of the "Rhineland Funding Capital Corporation, New York, USA" conduit, which KfW assumed in 2007 as part of the rescue of IKB Deutsche Industriebank AG, Düsseldorf.

Non-performing loans in the amount of EUR 681 million were written off in financial year 2011 (previous year: EUR 1,337 million), the majority of which was attributable to receivables under the IKB rescue measures. Recoveries on loans written off totalled EUR 90 million in 2011 (previous year: EUR 187 million). Expected losses were addressed in the form of specific and general value adjustments.

The fund for general banking risks was increased by EUR 1.1 billion in financial year 2011 and now totals EUR 1.7 billion.

Financial year 2011 closed with a profit of EUR 547 million.

Events after the end of the financial year

No events of particular significance for the assessment of the financial position and performance of KfW occurred after the end of financial year 2011.

SUSTAINABILITY REPORT

As one of the world's leading promotional banks, KfW firmly believes in sustainable development. For us, entrepreneurial action and social responsibility are inextricably linked. Contributing to a sustainable improvement in economic, social and ecological living conditions at all levels is thus a central component of KfW's guiding principles (the KfW Kompass).

We support the sustainability objectives of the Federal Republic of Germany, the European Union and the international community. We are guided in particular by the sustainability strategy of the Federal Government and the KfW Law.

2011 was marked by the Federal Government's decisions regarding the energy turnaround and the phasing out of nuclear power. To achieve the ambitious aims, the proportion of renewable energies in Germany must be greatly expanded in the next few years and decades and energy consumption considerably reduced. KfW's financing and promotional offerings are already in high demand for the investments required. With a view to the requirements of the energy turnaround, KfW has expanded existing funding programmes for private persons, companies and municipalities and launched suitable new promotional offerings, including the new KfW "Offshore Wind Energy" programme. KfW promotion aims to enable the urgent investments necessary for the energy turnaround, and create incentives to rehabilitate buildings, for example, or to make energy-efficient investments in SMEs and municipalities.

On the international stage too, KfW continues to meet its responsibility as a major promotional bank and the "safest bank in the world". As well as providing financing for international environmental protection and conservation projects, KfW also initiated the worldwide network for development banks (International Development Finance Club – IDFC). This network pools international expertise in development financing, improving the response to global challenges such as climate change and the continuing decline in biodiversity.

Internally, KfW's sustainability management system, which was newly launched in 2010, was further expanded by appointing new sustainability officers in all relevant organisational units. These officers coordinate the implementation of and compliance with the sustainability principles that their units have committed themselves to, as well as further developing those principles. Sustainability was therefore not only strengthened in KfW products in 2011, but in internal processes too.

Dialogue with our stakeholders

An elementary component of our activity is regular discussion with our stakeholders, including KfW shareholders, sales partners and customers, capital market participants and employees, on the latest events and issues. A visible example of this culture of dialogue in the reporting year was a series of events and publications organised by KfW on the energy turnaround. This will be continued in 2012. At the opening event in Berlin, well-known representatives from politics, academia and the energy field itself discussed how to structure a successful transition to a sustainable energy supply, and the framework and incentives that policymakers must put in place. The results of this series of events are also fed back into product development at KfW Bankengruppe.

All stakeholders can find targeted information on KfW's wide range of sustainability activities on the new website (www.nachhaltigkeit.kfw.de) and get in touch with the relevant contacts. For example, KfW's procurement management has developed an extensive purchase portal for its suppliers. Special guidelines on systematically considering environmental and social concerns in the procurement process will be published in 2012.

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 number of professional and health benefits. The relevant key figures in this regard remained high in 2011. Severely disabled employees constitute almost 6 % of staff. The proportion of part-time employees rose slightly over the previous year from 19 % to 20 %, while the share of women in managerial positions remained constant at 26 %. Even in difficult times, the KfW Group continued to provide a large number of apprentice, student and graduate trainee positions, with a training rate of almost 6 % (based on the number of staff).

KfW adopted its third Gender Equalisation Plan in 2011, the main objective of which is to further increase the proportion of women in executive and senior staff positions to one third by mid-2015. KfW firmly believes that this is only possible with an everyday culture of gender balance, and has committed itself to a gender-sensitive approach to management and teamwork. KfW aims to further raise its high status in terms of balancing work and family life using numerous supporting measures and a broad framework for flexibility of working hours and locations.

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 22.8 billion to finance environmental and climate protection measures in Germany and abroad in 2011. Thus, 32 % of the total commitment volume of KfW's core business was dedicated to financing environmental and climate protection projects.

Implementing the energy turnaround and transforming the energy system is a long-term and cost-intensive process. Therefore, in the next five years KfW will make more than EUR 100 billion available for this energy transition. The target for 2012 is for environmental and climate protection financing to comprise at least a third of total commitment volume.

Offshore wind energy is a flagship of the funding activity associated with the energy turnaround. KfW launched the “Offshore Wind Energy” programme in June 2011 on behalf of the Federal Government. Project financing was completed for the offshore wind farms “Meerwind” and “Global Tech 1” in 2011, to which KfW contributed a total of EUR 543 million as part of bank syndicates. The wind farms each consist of 80 wind turbines in the North Sea and will generate a total output of 688 MW.

On behalf of the German Federal Government KfW is currently investing around EUR 1.1 billion worldwide in protecting tropical rainforests and preserving biological diversity. It promotes and preserves among others 270 nature conservation areas in 34 countries around the globe covering a total area of 676,000 km^2 (almost double the surface area of Germany), including 19 areas designated as World Heritage Sites by UNESCO. These also provide long-term protection for the last refuges of the Sumatran tiger, lowland gorilla and golden-headed lion tamarin. The new commitments from 2011 alone will reach over 1.5 million people and reduce greenhouse gas emissions by more than 3 million tonnes of CO_2. KfW is working closely with German and international environmental organisations such as the Worldwide Fund for Nature (WWF), the Nature and Biodiversity Conservation Union (NABU) and the Frankfurt Zoological Society (ZGF).

Evaluating environmental and social risks in core business

An environmental and social impact analysis (ESIA) is a major component of the assessment of projects 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 co-financed for any potential negative impacts. The ESIA defines protection and mitigation measures which are overseen by a monitoring programme.

To reduce social risks and enable successful sustainable development, KfW revised its gender strategy for Financial Cooperation in 2011. This builds on what has already been achieved and aims to further augment the conceptual and operational work at KfW Entwicklungsbank on gender equality.

Social engagement

KfW's social engagement is bundled in a corporate social responsibility (CSR) strategy. All our activities are focussed on the objective of taking responsibility – whether regarding the environment, social and business life, or culture. Through sponsoring, donations and other measures, the bank supports initiatives which realise, promote or enable responsible behaviour. We also develop our own flagship projects using our reputation and experience in selected "responsibility partnerships". In terms of content, KfW strategically focuses its social engagement on preserving biodiversity, promoting socially engaged staff, cultural sponsorship work at KfW locations and knowledge transfer for start-up entrepreneurs.

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. Over 90 % of the securities business in the stricter sense met these criteria as at the end of 2011. This refers to KfW's liquidity reserve, which amounted to EUR 20 billion as at 31 December 2011.

The PRI in KfW's portfolio management are implemented in three steps: in addition to creditworthiness analysis, ESG criteria (Environmental, Social and Governance) are included in investment decisions. There are also exclusion criteria for non-government issuers. Finally, KfW communicates its methodology and the outcomes to its portfolio issuers. 2011 saw KfW recognised for its approach as "best sustainable investor" by the specialist magazine *portfolio institutionell*. KfW was awarded a top PRI rating on the basis of the annual member survey.

In KfW's view, investors who trade sustainably on the capital market play an important role in overcoming global challenges. A further important step for us in 2011 was thus the establishment of a German PRI network in order to anchor sustainable thinking on the capital market too.

KfW bonds as an investment in sustainability

All KfW bonds offer attractive investment opportunities to those investors who consider a company's sustainability performance in their investment decisions. The leading sustainability ratings, which consider numerous other factors along with environmental management and the products and services offered, continue to place KfW Bankengruppe in the top class.

In-house environmental protection

KfW Bankengruppe's in-house environmental protection also sets high standards. Energy consumption and business travel have been carbon-neutral since 2006 thanks to offsetting using emission reduction credits. We are pursuing the main objective of reducing unavoidable emissions as much as possible with great success. Emissions were cut again significantly from 15,800 tonnes of CO_2 (2009) to around 13,400 tonnes in 2010. This has brought with it a reduction in compensation costs. The largest contributor to this was the move by KfW subsidiary KfW IPEX-Bank from a rented building with conventional electricity supply to KfW's Westarkade building which, like all KfW buildings, is supplied exclusively with certified green electricity. The Westarkade was recognised in 2011 by the Council on Tall Buildings and Urban Habitat in Chicago and named the "Best Tall Building in the World".

The Senckenberganlage building, which KfW moved into in 2011, will also make its contribution to reducing emissions with an annual primary energy consumption of around 125 kWh/m^2. Its energy consumption is considerably lower than a comparable standard office building thanks to a comprehensive energy concept including an optimised facade and wood pellet heating system.

To help further reduce KfW's overall carbon footprint, all publications printed externally are climate neutral. KfW has worked exclusively with certified printing companies since the beginning of 2011.

RISK REPORT

This risk report corresponds in structure, scope and content to the group risk report published in the group management report. As risk management and risk controlling are focused on the KfW Group, a risk report at single institution level is not prepared.

Current developments

After the global economy initially continued on the road to recovery in 2011, the climate became much bleaker in the second half of the year. Government packages of measures for overcoming the financial market crisis were reflected in high budget deficits and rising debt ratios in 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. Portugal was the second country after Ireland to have to resort to the newly established European stabilisation fund. Despite international support measures of immense proportions, Greece still needed a haircut. The European countries agreed on stronger economic integration and stricter budget discipline in order to solve the debt crisis. However, support measures for further euro-zone countries cannot be ruled out in the coming year.

The situation for banks, especially European ones, also noticeably worsened in 2011. In addition to the challenges of the European sovereign debt crisis, capital requirements, which were increased at short notice and are to be implemented by mid 2012, are also having a negative impact on the economic situation for banks and restricting business opportunities. The situation on the interbank market has recently deteriorated and exhibits parallels with the state of affairs after Lehman Brothers' collapse in autumn 2008. The European Central Bank's major measures to support liquidity are impeding serious upheavals in the banking sector. Overall, enormous risks mean that the European banking sector in particular will also face major challenges in 2012. The difficulties remain diverse – the European government debt crisis, economic cooldown, increasing problems in Eastern Europe and implementing the increased capital requirements.

Despite the euro crisis and in contrast to most other European countries, Germany's economic recovery continued across all sectors in 2011. Many companies returned to their pre-crisis level, built reserves and emerged strengthened from the crisis. In international merchant shipping, the new tonnage coming into the market meant that excess supply increased again in 2011, pushing down freight and charter rates considerably. No recovery is in sight in the short term. A continuation of the European government debt crisis and the weakening global economy will have a dampening effect on the German economy in 2012, meaning that companies will probably invest less or delay investment.

The problems in the European sovereign debt sector caused continued high volatility on the currency markets in 2011 too. Although on average, the euro recovered considerably compared to the previous year, at year end the exchange rate fell again against the US dollar to a level of below EUR/USD 1.30. Credit spreads also experienced increased volatility as a consequence of the sovereign debt crisis.

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 – even based on conservative stress scenarios.

As in previous years, KfW systematically further developed its processes and instruments in risk management and control in financial year 2011, taking account of current banking supervisory requirements. With a few exceptions, KfW is exempt from the application of the German Banking Act *(Kreditwesengesetz – KWG)* pursuant to Section 2 (1) no. 2 of the Act, but it does apply the core components of the KWG voluntarily, particularly the minimum requirements for risk management (MaRisk) and the German Solvency Regulation *(Solvabilitätsverordnung – SolvV)*. In order to continue and develop the application of the German Banking Act in accordance with KfW's business model and its particular situation as a public sector entity, KfW set up a separate project in 2011. Furthermore, the stress testing concept was further developed and supplemented by inverse stress tests and concentration stress tests covering all types of risk in order to implement the third amendment of the minimum requirements for risk management (MaRisk). A comprehensive risk inventory was also designed and implemented, in which all KfW Bankengruppe's risks were reviewed for their materiality using a structured process. Another topical focus was on the methodical development and group-wide standardisation of the measurement and management of market price and liquidity risk.

The ongoing development of processes and instruments in risk management and control in 2012 will again be strongly influenced by the developments in the banking supervision environment. The focus in this regard is on the foreseeable changes under Basel III, meaning increased liquidity and capital requirements. In addition, developments are planned with a view to the identification and management of reputational and earnings risks and also risks from embedded derivatives. The risk model is also to be benchmarked and the development of counterparty risk measurement investigated.

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 management, the Group assumes 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 management, constitute important secondary requirements for KfW's risk management structures and procedures.

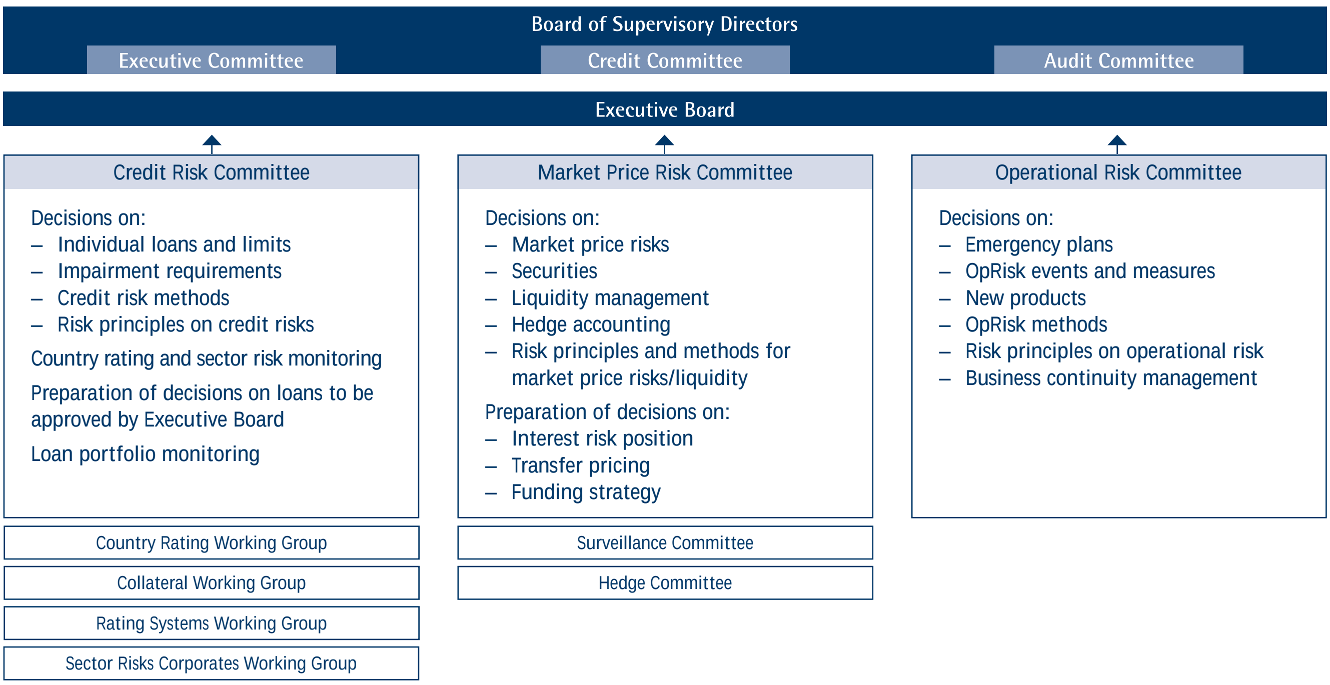
In order to establish risk management and control competence within the organisation of the bank, the Group trains its employees, using courses including a modular programme on risk topics. This enables employees and management staff throughout the KfW Bankengruppe to acquire basic knowledge or to deepen their specialised knowledge.

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. The Credit Committee is responsible, in particular, for the authorisation of loan applications, while the Audit Committee handles accounting and risk management issues, including auditing the consolidated and annual financial statements.

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 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. The committees were given a stronger focus on Group strategy and planning functions in 2011, with the result that representatives from KfW IPEX-Bank and DEG were included. Further working groups support these committees. The middle and back office departments generally have 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, all three members of the Executive Board with front-office responsibilities, and the CRO of KfW IPEX-Bank. The Credit Risk Committee is supported by the Country Rating, Collateral, Rating Systems and Sector Risks Corporates Working Groups. The weekly meetings involve in particular decisions on loans and limits. KfW IPEX-Bank and DEG's large volume commitments have also been presented in the Credit Risk Committee since 2011. Further meetings, held on a quarterly basis, are also attended by representatives of the business areas and of DEG. Internal Auditing has guest status. Reports about the development of supervisory requirements, e. g. MaRisk/Basel III, their impact and the progress of implementation projects for KfW, KfW IPEX-Bank and DEG, are made at this quarterly meeting. The meeting also approves major changes to existing risk principles and credit risk methods, and drafts of new principles and methods. 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. Representatives of KfW IPEX-Bank and DEG also take part in the meeting on a quarterly basis and as necessary. 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 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. This committee also handles operational risk issues (operational risks and business continuity management). As part of the risk report, the Operational Risk Committee is informed on a monthly or quarterly basis about current OpRisk damages and risk potentials as well as any measures taken as a result. Reports about planned or implemented emergency and crisis team tests and significant disruptions to business are made to the Operational Risk Committee at quarterly meetings. 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 Rating Working Group

The Country Rating 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 in the euro area and North Africa/the Middle East). If necessary, country ratings can be adjusted between the regular meetings. The role of the Country Rating 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 Bankengruppe does or plans to do business. Proposals for risk ratings assigned to developing, transition and emerging countries are made by the economists for the country section, 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 Rating 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 Sector Risks Corporates Working Group is a central group-wide body of experts serving KfW and its subsidiaries. It analyses sector-based credit risks in the corporate segment. It provides relevant information based on the analyses to the areas of the Group concerned and if appropriate, makes proposals to minimise risk. Sector and product-related risk guidelines and recommendations for the relevant business areas and subsidiaries are developed, updated and checked for consistency on an annual basis, with the objective of uniformly and transparently managing corporate risks in the group as a whole. This process was carried out for the first time in 2011.

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 key functions is to evaluate market developments with regard to their implication for KfW's securities portfolio. In this context, representatives of the responsible front-office departments and of Risk Management submit an assessment of the long-term value of selected securities. The Surveillance Committee also discusses any write-downs on individual securities which Risk Management has planned or made.

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 IFRS 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.

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 co-ordinated approach, for example in the rollout of rating instruments to subsidiaries or the management and valuation of collateral.

Responsibility for developing and shaping risk management and control lies outside the credit departments with Risk Management and Controlling and, for specific tasks, with Transaction and Collateral Management (operating collateral management processes in the lending business as well as collateral, limit and rating control and evaluation methodology for trading activities). There is a comprehensive risk manual for this purpose which 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) make up the core of the risk manual. It also clearly develops rules for sector, product and risk guidelines and also 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

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 include risk management instruments for individual counterparties and portfolios: capital allocation, second vote for loan approvals, a limit management system, 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 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 each have their own second vote independent of the front office. The relevant business decision-making processes are structured with a view to risk. Lending transactions currently require a second vote depending on the type, scope (material risk content and effect on the overall risk position) and complexity of a transaction. The rules for the second vote requirement will be adapted in 2012 in view of the application of the German Banking Act (KWG). Major and risky commitments will be presented at least to the Credit Risk Committee, and if necessary also to the Executive Board, the Credit Committee or the Board of Supervisory Directors.

Risk Management and Controlling – Restructuring

The Risk Management and Controlling – Restructuring department is responsible for non-performing loans and for providing intensive support for banks and corporates in the KfW portfolio. A separate restructuring area is responsible for looking after retail business. KfW IPEX-Bank and DEG's non-performing commitments and commitments requiring intensive support are managed by each subsidiary for themselves. If more than one group company is involved, Risk Management and Controlling – Restructuring will coordinate centrally.

Risk Management and Controlling – Restructuring 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 and Controlling-Restructuring 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 necessary next steps.

Risk Controlling

Risk Controlling is in charge of centrally 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 to assess the Group's risk bearing capacity, quantifying on the one hand the increase of capital requirements and on the other hand the impact on the Group's available financial resources.

The department is involved in the quality management process for the risk indicators used in risk management and control, and also provides professional 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 required.

Risk Methods and Instruments

The Risk Methods and Instruments 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.

Risk Controlling – Export & Project Finance and Supervisory Law

The Risk Controlling – Export & Project Finance and Supervisory Law department was established in 2011. It is a central point of contact throughout the KfW Group for all supervisory law issues within the department's responsibility. As part of this activity, it monitors, provides the initial evaluation of and reports regularly on amendments to supervisory law. Implementation measures are initiated as and when required. The department also defines group-wide standards for the structure and formulation of framework conditions.

The department is also responsible for KfW IPEX-Bank's risk reporting. It also functions as a competence centre for KfW IPEX-Bank's management with regard to planning and management information relating to credit risk assumed, optimisation approaches relating to portfolio management and KfW IPEX-Bank's risk-bearing capacity.

Internal Auditing

Internal Auditing is an instrument of the Executive Board. As an entity which works independently of group procedures, it audits and assesses all of KfW's processes and activities to identify the risks involved and reports directly to the Executive Board.

With a view to risk management processes, Internal Auditing audited the decentralised risk management processes and central aspects of risk management which are relevant bank-wide, in the past financial year. One focus was on risk assessment processes in lending and loan support in various business areas. Internal Auditing also focused on the central procedures and methods of risk management and on further developing these.

As in previous years, Internal Auditing also monitored the further development of risk measurement procedures by participating (with guest status) in meetings of decision-making bodies in 2011.

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

Risk management approach of the KfW Group

Risk identification →	Risk mapping →	Risk strategy →	Risk management →	Risk monitoring & reporting
Risk inventory: – Credit risk incl. country risk – Interest rate risk – Currency risk – Credit spread risk – Other market price risks – Operational risk (incl. legal risks) – Liquidity risk - Reputational risk	– Economic capital for market and credit risks – Standard approach for operational risks acc. to Solvency Regulation – Key liquidity indicators acc. to Liquidity Regulation and KfW Law – Regulatory capital for credit and market risks	– General risk principles – Definition of objectives for the next financial year – Risk strategy at group level – Sub-strategies for material types of risk	– Risk-bearing capacity concept – Stress testing - Capital allocation **Individual counterparties** – Second vote – Rating – Individual counterparty limits – Restructuring - Pricing **Portfolio** – Risk guidelines – Portfolio guidelines - Borrower unit, sector and country limits – Budgets for risk types – OpRisk management	– Risk reports – Operational monitoring in limit management system – Early warning system – OpRisk measures monitoring

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.

Internal capital adequacy process

MaRisk requires banks to set up an internal capital adequacy process which ensures risk-bearing capacity on an ongoing basis. KfW Bankengruppe's internal capital adequacy process is characterised by the fact that economic and regulatory requirements regarding risk-bearing capacity are equally high level objectives for the Group. Accordingly, all risk monitoring and management measures must ensure compliance with both an economic solvency target and minimum requirements for tier 1 and total capital ratios. This couples economically reasonable capital management with the obligation to ensure regulatory minimum capital requirements. KfW takes a uniform definition of the resources available for risk coverage as the basis for the close integration of the two perspectives: the modified equity available pursuant to Sections 10 and 10 a KWG is used as risk-covering potential for both views.

A further core feature of the capital adequacy process is the proactive focus resulting from an additional forward-looking perspective. This evaluates the absorption potential of KfW's reserves – and thus also its ability to act – in the event of certain economic (stress) scenarios. A traffic light system with thresholds established in this context signals the required action in the event of critical developments as part of operational and strategic management.

KfW Bankengruppe's risk-bearing capacity concept adopts a liquidation perspective in its basic form. However, the addition of a forward-looking perspective, which also guarantees compliance with regulatory minimum capital requirements, expands the concept to include a "going-concern view" and thus includes elements of both basic types of risk-bearing capacity concepts.

By means of capital allocation, the targets for risk-bearing capacity are transferred in the form of economic capital budgets to individual business areas/departments. The allocated risk-covering potential is available to the business areas/departments for backing old and new business for the various types of risk. Capital allocation is conducted annually as part of the Group's business area planning. In addition to requirement planning for the business areas/departments, this takes risk objectives and risk appetite into account (e.g. traffic light limits). At the same time, the Executive Board establishes a centrally held capital buffer for stress cases, which serves anti-cyclical risk management. Compliance is checked quarterly and any necessary action taken. In addition, the corresponding target figures for regulatory capital employed is determined at group level for the business areas/departments, the utilisation of which is also monitored quarterly.

KfW's capital adequacy process was further improved in the year under review, particularly in technical and organisational aspects. Selective further developments which primarily result from the new supervisory requirements for risk-bearing capacity concepts are to be made in 2012.

Regulatory risk-bearing capacity

Indicators under supervisory law

	2011	2010
	EUR in millions	EUR in millions
Risk position	113,283	124,077
Tier 1 capital	17,414	15,347
Regulatory capital (available financial resources)	20,216	18,259
Tier 1 ratio	15.4 %	12.4 %
Total capital ratio	17.8 %	14.7 %

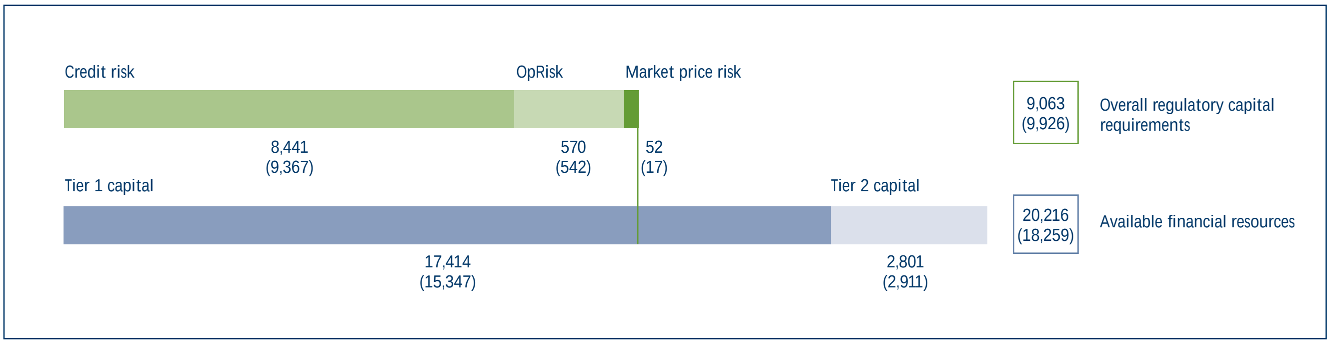
The "risk position" indicator is the product of the total amounts of capital charges for counterparty risks, market risks and operational risks multiplied by 12.5.

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

As with the application of the KWG requirements, KfW is also excluded from the scope of the EU capital requirements directive (CRD). However, it will implement the amendments which come into force incrementally from 2013 on a voluntary basis, similarly to its previous approach. As part of internal reporting, the regulatory risk-bearing capacity is already being calculated indicatively, taking account of the current status of the Basel III drafts. As a result, KfW already fulfils the minimum ratios which will apply from 2019. However, in view of the still open discussions and the pending finalisation of key aspects, KfW is not yet publishing any specific figures.

KfW Bankengruppe's regulatory capital ratios improved greatly on the previous year. As at 31 December 2011, the total capital ratio taking into account the consolidated comprehensive income was 17.8 % (previous year: 14.7 %), and the core capital ratio was 15.4 % (previous year: 12.4 %). The positive development is largely due to the increase in regulatory capital due to the consolidated comprehensive income in 2011. 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. The low capital requirement for market price risks is due to the fact that KfW uses the rules for non-trading-book institutions. The regulatory capital requirements for market price risks result solely from the requirement to back the open foreign exchange positions *(Unterlegungspflicht)*.

Regulatory risk-bearing capacity as of 31 December 2011 (EUR in millions)



In brackets: figures as of 31 December 2010
The capital requirement for credit risk was calculated to be 8 %.

Economic risk-bearing capacity

To assess its economic risk-bearing capacity, KfW compares its economic capital requirement for potential losses from material risks against its available financial resources. KfW uses an economic solvency target of 99.99 % as the basis for this.

KfW undertakes a risk inventory at least once a year in order to determine its material risks. The risk inventory identifies and defines types of risk relevant for KfW in a structured process, and then subjects these to an evaluation of materiality. The materiality of a risk type depends primarily on the risk potential for KfW's net assets, earnings and liquidity. The key outcome of the risk inventory is the overall risk profile, which provides an overview of the Group's material and immaterial risk types.

The dominant risk type at KfW is **credit risk**. It means the risk of losses if business partners do not meet their payment obligations to KfW at all, in due time or in full (default), or their credit ratings worsen (migration). Credit risk thus comprises counterparty default and migration risk. Risk measurement is based primarily on the following three variables:

- the (expected) amount of receivables at the time of a potential default (exposure at default – EAD)
- the probability of a business partner's default (probability of default – PD)
- the (expected) loss rate upon default (loss given default – LGD)

The probability of default is estimated for each business partner 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. The estimated loss given default takes account of the existence of collateral.

The product of the three aforementioned variables is the expected loss – the statistical average loss predicted to arise over a number of years. The expected loss is taken into account when determining risk-bearing capacity by deducting from the available financial resources in accordance with the supervisory requirements of Sections 104 et seq of the German Solvency Regulation *(Solvabilitätsverordnung – SolvV)*.

The economic capital requirement for credit risks is quantified by Risk Controlling with the aid of statistical models. For counterparty risks, the loss potential is computed using a loan portfolio model and 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. Migration risks are taken into account in the forward-looking component of the calculation of the risk-bearing capacity, on the basis of scenarios.

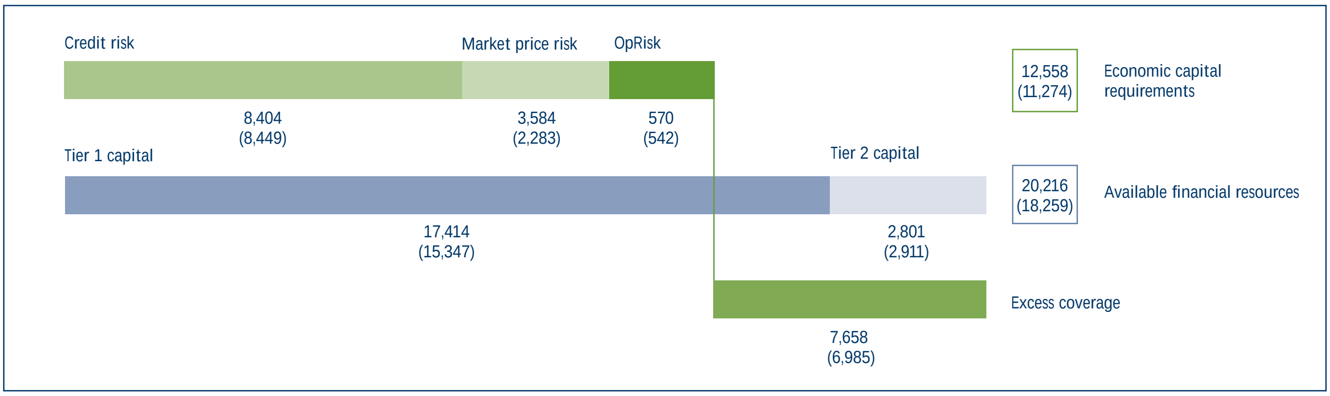
The Group takes a similar approach with regard to market price risks. Here, the possible loss of present value in a worst case scenario (defined by the solvency level) is determined for each type of risk using statistical models. The economic capital requirement is equal to this loss of present value.

The capital requirement for operational risks is calculated using the regulatory standard approach according to the SolvV.

The forecast period for all risk categories is one year. The capital requirement for credit and market price risks is aggregated conservatively, i.e. without taking diversification effects into account.

Using this method, the economic risk-bearing capacity as at 31 December 2011 satisfied a solvency level of 99.99 %. The excess coverage of the available financial resources beyond the total capital requirement as at 31 December 2011 (EUR 7,658 million) was an improvement on the previous year's figure (EUR 6,985 million). The increase is partly due to the higher available financial resources – caused by the consolidated comprehensive income in 2011. The rise in overall capital requirements compared to the prior year is primarily due to market price risks. In contrast to the regulatory requirements of pillar I on non-trading-book institutions, pillar II's economic analysis also takes account of interest-rate risk, credit-spread risk and other market price risks. In addition, in contrast to the pillar I approach, it uses an internal model for currency risk. The increase in capital requirement for market price risks compared to the previous year largely results from adjustments to the methods used (see market price risks section).

Economic risk-bearing capacity as of 31 December 2011 (EUR in millions)



In brackets: figures as of 31 December 2010

Hidden reserves and obligations from the securities portfolio are treated separately: the balance of hidden reserves and obligations existing as at the balance 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 7,058 million as at 31 December 2011.

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 the market risk models. The Group works continually to refine its risk models and processes. Thus, the parameters of the loan portfolio model were changed in 2011 and the aggregation of types of risk revised – prompted by the third MaRisk amendment. In 2012, the foreseeable changes under Basel III, meaning increased liquidity and capital requirements, will be one of the focuses for further development.

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 slowdown) 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 2012 shows a decrease in the excess coverage of the available financial resources over the economic capital requirement compared to 31 December 2011. The main reason for the decrease is the planned conversion to a more sophisticated model for measuring interest rate risks. This will raise the economic capital requirement for market price risks.

In the downturn and stress scenario, effects on earnings and changes in the capital requirement are simulated for a 12 month period presuming (different degrees of) negative economic development. In the stress scenario, the effects of a severe recession are depicted. In both scenarios the bank assumes an overall increase in credit risks (counterparty and migration risks). These scenarios anticipate falls in EUR and USD interest rates. At the same time, it is assumed that increasing market uncertainties will lead to increased volatility in interest rates, currencies and credit spreads, as a result of which the economic capital requirement for the corresponding types of risk will rise. Potential losses from operational risks also reduce the available financial resources in the stress scenario.

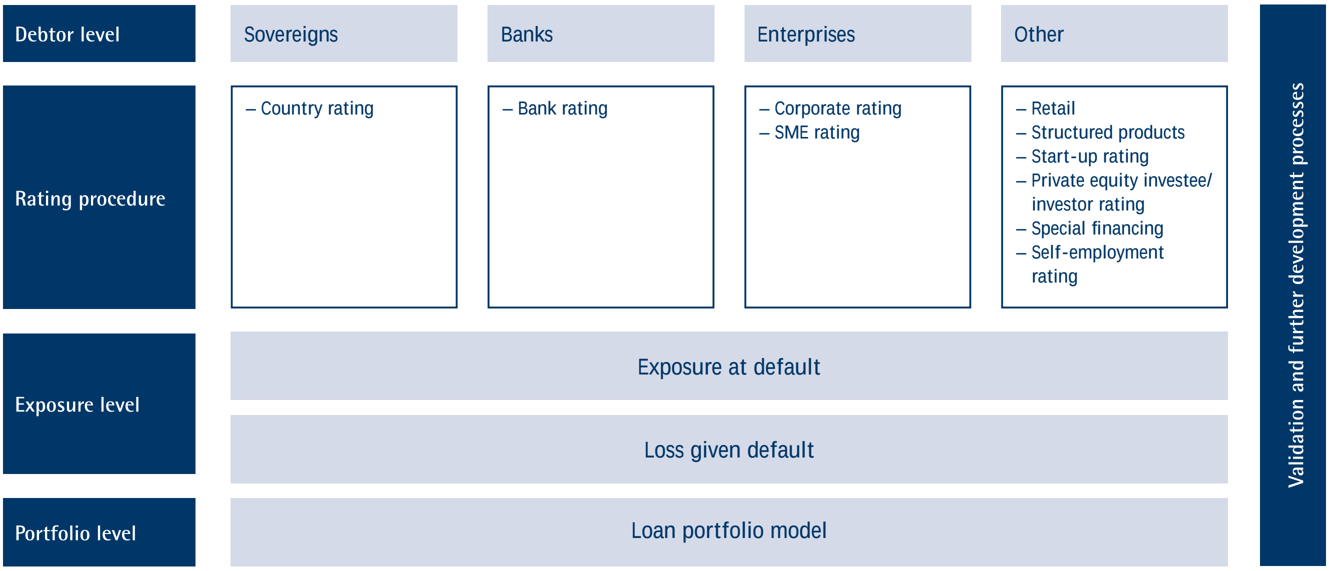
On the basis of the analyses carried out, KfW assumes a reduction in excess coverage of EUR 7.7 billion to EUR 2.2 billion in the stress scenario. Risk-bearing capacity therefore remains assured at a solvency level of 99.99 %, even under unfavourable economic conditions.

Further stress tests are carried out in addition to the economic scenarios, to examine the resilience of KfW's risk-bearing capacity. Current potential macroeconomic dangers form the basis for the changing scenario stress tests. The concentration and inverse stress test introduced in the year under review – in accordance with the new requirements of the third MaRisk amendment – show how concentration risks materialising in unfavourable constellations could bring KfW's risk-bearing capacity to its limits.

Types of risks

COUNTERPARTY DEFAULT RISK

The KfW Group assumes counterparty risks[1] in the context of its promotional mandate. The main risks in domestic promotional lending business are in the areas of start-up finance for small- and medium-sized enterprises and equity investments, as KfW, particularly in these segments of domestic promotion, also bears end borrower risks (for a large proportion of domestic promotion, the on-lending banks bear the end borrower's default risks as part of the principle of disbursement through the end-borrower's own bank *(Hausbankprinzip)*). 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[2] and follow a uniform and consistent model architecture. A simulation-based rating method is often used for specialised financing, and cash flow-based rating methods are applied for structured products. 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, the transaction management departments are responsible for preparing ratings for risk-bearing business[3]. 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. Rating instruments and procedures largely meet the minimum requirements of the prevailing regulatory standards (MaRisk/Basel II).

[1] *Counterparty default risk is defined as the risk of financial loss that can occur if the borrower or counterparty fails to meet contractual payment obligations. Counterparty default risk also includes country risk, comprising transfer, conversion and political risks.*
[2] *Scorecards are a mathematical and statistical model and/or an expert-knowledge-based model. The individual risk factors considered relevant for credit rating are converted into a score depending on their value and weighted for aggregation.*
[3] *There are exceptions to this in the on-lending business.*

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 valuating 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 limit management systems, risk guidelines and various portfolio guidelines to limit risks from new business. These guidelines form the basis for the second vote on lending transactions and serve as an orientation guide for loan approvals. They are also designed to ensure adequate quality and risk structure of KfW's portfolio[4)]. The portfolio guidelines distinguish between types of counterparties and product variants and define conditions under which business transactions may generally be conducted. In addition, risk guidelines for countries, sectors and products are defined in order to react to existing or potential negative developments at short notice with specific requirements for lending. The limit management systems ultimately track both risk concentrations (concentration limits) and credit rating-dependent individual counterparty risks (counterparty limits). Concentration limits serve to restrict risk concentration in the loan portfolio and thus to prevent major individual losses. Counterparty limits serve the counterparty-specific management of credit default risks in terms of fine tuning.

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. It regularly reviews and documents the economic situation, the particular borrower's market environment and the collateral provided, and formulates proposals for remedial action – particularly for risk-limiting measures. In the case of non-performing loans and also to a great extent for watch-list commitments[5)], 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.

RISK PROVISIONS FOR LENDING BUSINESS

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 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 further reduced in 2011 as a result of the economic recovery.

[4)] These guidelines take into account the special nature of KfW's promotional business.
[5)] The assumption of responsibility for watch-list cases at KfW IPEX-Bank is decided on a case-by-case basis by Risk Management in consultation with the unit responsible for restructuring.

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.

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	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
Carrying amount as equivalent for maximum risk of default	290,810	263,222	113,528	102,878	13,468	7,478	41,494	29,891	31,904	35,236	62,007	72,257
Risk provisions	162	200	4,778	5,221	0	0	0	0	15	20	256	484
Carrying amount neither past due nor impaired	290,308	262,969	110,392	100,984	13,468	7,478	41,494	29,891	31,625	34,993	62,003	72,256
Collateral	*191,053*	*170,154*	*27,690*	*23,627*	*0*	*0*	*11,520*	*9,353*	*1,677*	*94*	*1,659*	*2,828*

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	
	2011	2010	2011	2010	2011	2010
Carrying amount less than 90 days past due	323	86	882	268	2	1
Carrying amount 90 days and more past due	24	16	985	215	0	0
Total	347	102	1,867	483	2	1
Collateral	*310*	*56*	*461*	*257*	*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	
	2011	2010	2011	2010	2011	2010	2011	2010
Carrying amount	154	151	1,268	1,411	277	242	4	1
Individual impairments, provisions	*66*	*88*	*4,232*	*4,483*	*0*	*0*	*210*	*429*
Collateral	*35*	*26*	*540*	*428*	*6*	*7*	*0*	*0*

At year-end 2011 EUR 1.7 billion (net after deduction of risk provisions; previous year: EUR 1.8 billion) were classified as individually impaired out of EUR 553 billion (previous year: EUR 511 billion) in financial instruments outstanding. Potential losses are conservatively estimated, and individual impairments have been formed in the amount of EUR 4.5 billion (previous year: EUR 5.0 billion). This includes provision for risks from the various IKB rescue measures in the amount of EUR 3.2 billion (previous year: EUR 3.7 billion)[6].

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 2011, risk provisions for transactions not individually impaired totalled EUR 0.7 billion (previous year: EUR 0.9 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 states[7]. 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.

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 loans and advances which were past due and not individually impaired in the year under review. The loans and advances less than 90 days past due were largely arrears of one day and have since been settled. The loans and advances to customers which were in arrears for 90 days or longer include defaulted loans from the KfW Special Programme. No individual risk provisions were made due to the full federal guarantee for this business.

In the year under review, the KfW Group did not take possession of any significant assets previously held as tangible collateral.

PORTFOLIO STRUCTURE

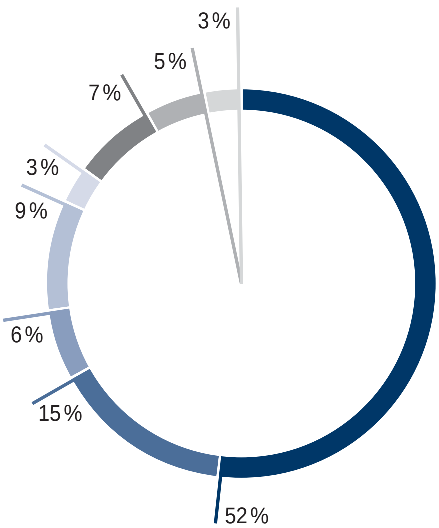
The contribution of individual positions to the risk associated with the KfW Group's loan portfolio is assessed based on an internal portfolio model. Concentrations of individual borrowers or groups of borrowers give rise to the risk of major losses that could jeopardise KfW's existence. On the basis 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 high risk volumes and unfavourable probabilities of default are taken into account, along with undesirable risk correlations. The results form a central basis for the management of the loan portfolio.

Regions

As at 31 December 2011, 67 % of the Group's loan portfolio[8] in terms of economic capital requirements was attributable to the euro area (previous year: 73 %). In Germany, the alignment of the economic capital requirement for domestic government-guaranteed lending business – including the lending business with special credit institutions of the federal states – to the supervisory approach (zero weighting), will largely mean a noticeable decrease in capital employed. Repayments of global loans and covered bonds *(Pfandbriefe)* in Portugal and fixed-term deposits in France and Austria will mean lower capital employed in the euro area (excluding Germany).

Economic capital requirements by region, 2011

	2011	2010
Germany	52 %	56 %
Euro area countries (excl. Germany)	15 %	17 %
EU countries (excl. euro area countries and Germany)	6 %	7 %
Europe outside EU	9 %	6 %
Africa	3 %	2 %
Asia (incl. Australia and New Zealand)	7 %	5 %
Latin America	5 %	4 %
North America	3 %	3 %



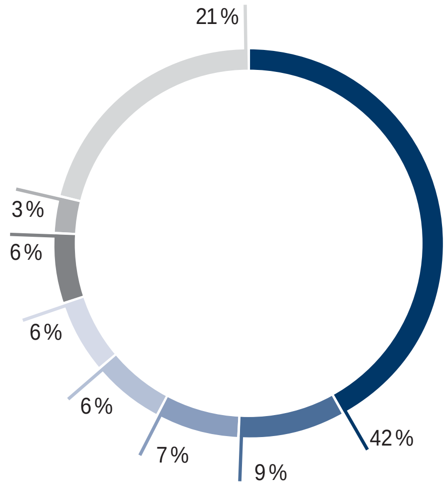
[6] *The EUR 22.3 billion transaction mandated by the Federal Government as part of the support measures for Greece is completely hedged by a federal guarantee and is therefore not shown in the portfolio of individually impaired financial instruments.*
[7] *The collateral is presented as recognised for purposes of internal management of economic risks. Participation effects are taken into account in order to avoid reporting double collateralisation.*
[8] *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 decrease in capital employed in the financial sector is largely due to the aforementioned zero weighting of the lending business with domestic government-guaranteed special credit institutions of the federal states. In the commodities sector, new business in renewable energies in particular, will mean an increase in capital employed.

Economic capital requirements by sector, 2011

	2011	2010
Financial sector	42 %	47 %
Consumer/retail	9 %	8 %
Basic industries	7 %	4 %
Shipping	6 %	5 %
Private equity firms	6 %	5 %
Public sector	6 %	7 %
Transport	3 %	2 %
Other	21 %	22 %

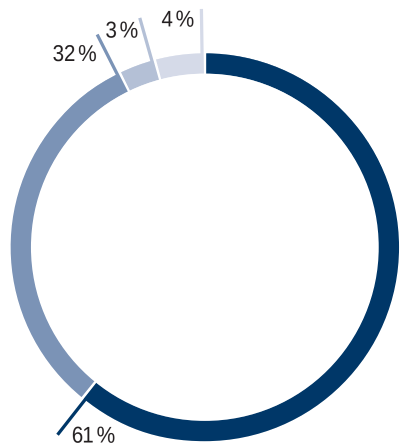


Credit quality

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 zero weighting of the domestic government-guaranteed lending business will mean a stronger decrease in net exposure in the investment-grade area. This will cause an increase in the other credit quality categories' relative share of the overall portfolio's net exposure. However, the average probability of default of the Group's loan portfolio remains almost unchanged compared to the previous year. The Group's loan portfolio therefore continues to show a good credit quality structure.

Credit quality by net exposure, 2011

	2011	2010
Investment grade (M1–M8)	61 %	68 %
Non-investment grade (M9–M15)	32 %	26 %
Watch list (M16–M18)	3 %	3 %
Default (M19–M20)	4 %	3 %



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.

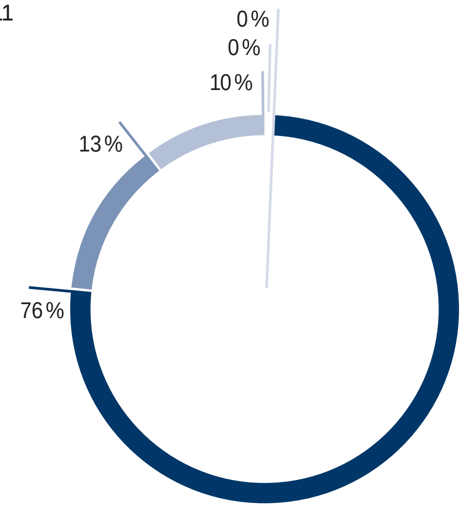
The ABSs had a par value of around EUR 4.4 billion as at the balance sheet date, 31 December 2011. Accounting for the mark-to-market valuation of the securities reported at fair value and impairments, the portfolio had a total value (including pro-rata interest) of EUR 4.1 billion. The following tables 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, 31 December 2011

	CLO	RMBS	CMBS	CDO	ABS & other	Total 2011	Total 2010
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Investment grade	1,573	862	323	14	849	3,621	4,123
Non-investment grade	276	22	–	2	1	301	322
Watchlist	35	65	6	–	–	107	80
Default	202	13	47	142	–	404	471
	2,086	962	377	158	850	4,433	4,995

Geographic breakdown of the underlying asset pool (based on nominal value), 2011

	2011	2010
Europe	76 %	75 %
World	13 %	14 %
North America	10 %	10 %
Africa	0 %	0 %
Asia	0 %	0 %



The portfolio volume was lower than in the previous year due to repayments and sales of some holdings (nominal value EUR -0.6 billion). Comparison of the portfolio's rating structure shows a reduction in default holdings, which is attributable to repayments and improvements in credit quality. The asset pool's geographical distribution has changed little compared to the previous year; the regional focus of the ABS portfolio remains on Europe.

Overall, European securitisations showed a solid performance, including German securitisations. The cumulative default rates for European securitisations remain very low.

The Group also 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 3.4 billion from the purchasing companies remained outstanding as at 31 December 2011. Impairment charges of EUR 3.1 billion have been taken on these receivables.

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 corporate loans each accounted for around half of the underlying asset volume in platform securitisations as at the reporting date 31 December 2011. As of the same date, the volume securitised via the platforms totalled EUR 8.4 billion. Of this total, EUR 8.3 billion was securitised through portfolio CDSs or credit-linked notes. The Group has retained risks from senior tranches with respect to the remaining approximately EUR 0.05 billion. The decline in the securitisation volume of EUR 7.0 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 2011.

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

Commitments in European crisis countries

Net carrying amount (including irrevocable loan commitments)

Country	31 December 2011		31 December 2010	
		of which collateralised		of which collateralised
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Greece	22,398	22,320	22,657	22,341
Public-sector debtors	*22,380*	*22,307*	*22,611*	*22,324*
Financial institutions	*18*	*13*	*46*	*17*
Spain	3,211	2,510	3,644	2,904
Public-sector debtors	*399*	–	*121*	–
Financial institutions	*2,812*	*2,510*	*3,523*	*2,904*
Italy	1,746	652	3,110	717
Public-sector debtors	*387*	–	*464*	–
Financial institutions	*1,359*	*652*	*2,646*	*717*
Ireland	1,486	1,211	1,832	1,156
Public-sector debtors	*2*	–	*2*	–
Financial institutions	*1,484*	*1,211*	*1,830*	*1,156*
Portugal	560	236	2,689	1,603
Public-sector debtors	*115*	–	*118*	–
Financial institutions	*445*	*236*	*2,571*	*1,603*
Total	29,401	26,928	33,932	28,722

The table shows the net carrying amounts[9)] of the liabilities to public-sector borrowers (including municipalities and local authorities) in the countries particularly affected by the euro sovereign debt crisis and to financial institutions in these countries.

Of the commitments shown, a total of EUR 27,248 million (previous year: EUR 31,652 million) was attributable to the *"loans and receivables"* measurement category, EUR 55 million (previous year: EUR 55 million) to *"held-to-maturity investments"*, EUR 763 million (previous year: EUR 985 million) to *"available-for-sale financial assets"* and EUR 1,335 million (previous year: EUR 1,240 million) to *"financial assets at fair value through profit or loss"* as at 31 December 2011.

The largest item was the special mandate by the Federal Government to commit loans in an amount of EUR 22.3 billion to Greece in 2010 (which is hedged by a federal guarantee). The other items relating to public-sector borrowers largely consist of bonds held in the liquidity portfolio. Commitments to financial institutions for the most part comprise covered bonds *(Pfandbriefe)*. In addition, they primarily include global loans, financial derivatives and bank bonds. Apart from the federal guarantee for the special mandate with Greece, collateral primarily consists of cash collateral of EUR 0.9 billion (previous year: EUR 0.9 billion) from the derivatives business. In addition, the EUR 3.4 billion (previous year: EUR 5.2 billion) in covered bonds *(Pfandbriefe)* included in the portfolio is also presented as a collateralised commitment.

9) The net carrying amounts were determined depending on their IAS 39 measurement category, taking into account any impairments or fair value measurements, and also include pro-rata interest. With respect to derivatives, transactions with the same counterparty are offset against one another on the basis of contractual provisions for offsetting, regardless of provisions for offsetting for reporting purposes. Irrevocable loan commitments and other contingent liabilities are also included.

In internal controlling, these commitments are subject to strict and regular monitoring. In the process of steering new business activities, business with or in these countries is subject to higher collateral requirements. In some cases a basic freeze on new business has been imposed. In addition, during the course of the year, the internal ratings for these countries and the banks based there were downgraded, limiting, among other things, the scope for new business generally across all sectors. Because KfW's risk management is based on its own internal ratings, changes to the external ratings of countries and banks based there by independent rating agencies have no immediate impact on KfW's risk assessment.

Risk positions in existing business were selectively reduced. In particular, KfW significantly reduced its exposure to financial institutions, especially in Italy, Portugal and Spain, through repayments of global loans and covered bonds *(Pfandbriefe)*, and the reallocation of money market transactions.

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. The largest concentration within market price risks is interest-rate risk, with an average of 75% of the economic capital requirement over the course of the year.

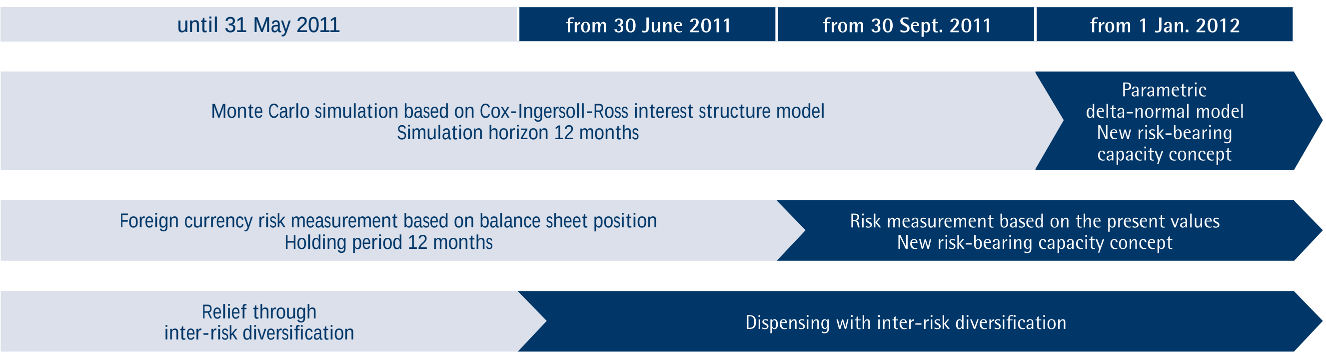
In 2011, the model for measuring interest rate and currency risks was substantially revised with the aim of standardising and methodically further developing it across the KfW Group.

- The method for calculating the economic capital requirement for interest-rate risks was revised in 2011. The Monte Carlo simulation on the basis of a Cox-Ingersoll-Ross interest structure model previously used, will be replaced by a parametric delta-normal model in future. The new method will be used from 1 January 2012. Therefore, the effects of the shift will not be in evidence until 2012. The additional economic capital that will be required as a result of these adjustments amounts to around EUR 800 million.

- The economic (present value) approach was established in addition to the accounting approach as the primary management instrument for measuring the economic capital requirement for currency risks. The definition of the economic capital requirement was also revised (see currency risks section).

- When determining the economic capital requirement, no account has been taken of the diversification effects between market and credit risks since 30 June 2011; instead a conservative representation even in extreme market situations has been used since then.

The following diagram shows an overview of the key developments in methods in 2011 and their implementation:



In total, market price risks within the Group required a total of EUR 3,584 million in economic capital as at 31 December 2011. This position is composed of the following individual risks:

Total economic capital for market price risks (EUR in millions)

	31 Dec. 2011	31 Dec. 2010
	EUR in millions	EUR in millions
Interest rate risks	2,430	1,623
Currency risks	480	114
Credit spread risks	511	425
Other market price risks	163	121
Market price risk	3,584	2,283

Interest rate risks

The main market price risk component in the KfW Group is interest rate risk. The Group assumes limited interest rate risks in order to take advantage of long-term 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.

When recording interest-rate risks in its banking book, all data relevant for risk assessment is taken into account when preparing balances of interest rate maturities (euro, US dollar and British pound). On this basis, the KfW Group regularly performs value-at-risk calculations to assess its interest risk position.

Key optional components of business 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. These have been adapted to current supervisory requirements[10]. Apart from the prescribed parallel shift in the yield curve, these tests included scenarios such as a twist in the yield curve and an extension of the holding period.

The capital requirement for interest-rate risks rose as at 31 December 2011. The key drivers of the rise were a change in correlation assumptions and a slightly increased risk position, which includes both internal and debt financing.

Currency risks

Foreign currency loans are largely refinanced in the same currency or secured by appropriate foreign currency hedging instruments. Open currency positions on the statement of financial position resulting from accrued margins or impairment losses are generally closed as soon as possible. DEG's foreign currency equity investments and to a small extent KfW Entwicklungsbank's promotional instruments are only funded in the same currency if this is possible and practical.

The method for measuring and managing currency risk was substantially revised in 2010 and 2011. The main change affected the shift in the management of risk from a German Commercial Code *(Handelsgesetzbuch – HGB)* accounting approach to an economic (present value) approach. This allows the Group's currency risk to be reflected consistently, irrespective of accounting standards.

The new management concept for currency risks focuses more strongly on operational circumstances. With currency risk, it is possible to close the risk positions at short notice both in market terms and in terms of operating processes if the operating loss of value in the calendar year exceeds a predefined stop loss buffer. The economic capital requirement will therefore be re-determined as the sum of this buffer and a “position risk” (possible loss during closure). The VaR risk measure is used to determine the position risk; the holding period is based on the time needed to close the position (two months). The aim of avoiding exchange rate effects on the income statement was maintained within the management concept.

The increase in the capital requirement for currency risks as at 31 December 2011 is largely due to this change of method.

Credit spread risks

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 by means of a historical simulation on the basis of a time series comprising the previous year (250 trading days). The VaR is initially ascertained from credit spread changes for a holding period of one day at a confidence level of 95 %, and then scaled to a period of one year and a solvency level of 99.99 %.

[10] *Statutory parallel upward (or downward) shift in the yield curve by 200 bp. The less favourable result in each case is reported. Up to and including October 2011, the bp shift was +130 bp (or -190 bp).*

The increased economic capital required to back credit spread risks is largely due to the spread volatility caused by the euro debt crisis.

Other market price risks

Other market price risks include risks from certain investments and commodity price risks from CO_2 certificates. The risks from CO_2 certificates arise as a result of the Group's decision to act as an intermediary between the buyers and sellers of CO_2 certificates. As a result, KfW also keeps certificates in its own books.

Other market price risks are measured for each risk type using an independent variance/covariance approach. 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 CO_2 certificates is daily prices since June 2005, and for share price risks, monthly prices since the beginning of 2005.

The economic capital requirement for other market price risks rose primarily due to the higher value of KfW's investments.

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 2011[1)]

	Up to 1 month	More than 1 month up to 3 months	More than 3 months up to 1 year	More than 1 year up to 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	20,880	4,634	6,906	11,852	15,296	59,568
Certificated liabilities	25,411	21,708	50,035	203,733	147,594	448,482
Net liabilities under derivative financial instruments	–983	–611	–1,698	–9,673	–21,818	–34,785
Liabilities under derivative financial instruments	*16,391*	*18,853*	*36,274*	*147,495*	*91,276*	*310,288*
Subordinated liabilities	0	0	146	314	3,303	3,763
Liabilities under on-balance sheet financial instruments	45,308	25,731	55,389	206,226	144,374	477,028
Contingent liabilities	6,287	0	0	0	0	6,287
Irrevocable loan commitments	55,720	0	0	0	0	55,720
Liabilities under off-balance sheet financial instruments	62,008	0	0	0	0	62,008
Liabilities under financial instruments	107,315	25,731	55,389	206,226	144,374	539,036

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.*

Payment obligations arising from financial instruments by maturity range, 31 December 2010[1)]

	Up to 1 month	More than 1 month up to 3 months	More than 3 months up to 1 year	More than 1 year up 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
Liabilities under derivative financial instruments[2)]	*13,612*	*29,820*	*26,783*	*151,925*	*103,174*	*325,315*
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

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.
2) Adjustment of corresponding figures for the previous year due to refinement of the method. Non-cash liabilities from nominal values of interest-related derivatives are no longer taken into account.

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 liquidity required is calculated for a total of four scenarios. Stress is placed on market-wide and institution-specific risk factors and an evaluation is made of the impact on KfW Bankengruppe's liquidity.

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 analysis in the same way as the other cash flow components in the (market-wide) stress case, (institution-specific) worst case scenario 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 (market-wide) stress case six months, and in the two worst case scenarios, 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 2011:

KfW liquidity risk indicators as at 31 December 2011

	Indicator
Normal case	0.29
(Market-wide) stress case	0.47
(Institution-specific) worst case	0.41
Worst case	0.51

Since the indicators for all four 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

The international financial markets were shaped by the escalation of the European debt crisis in 2011. The general market environment was characterised by a high degree of nervousness, volatility and uncertainty. As investment opportunities deemed safe, KfW bonds were therefore particularly in demand. The bank profited from this, making 2011 a very successful year for refinancing with a record issue volume. In the 2011 financial year, in order to fund its promotional business in the long term, KfW issued 362 bonds on the international capital markets in a total of eleven currencies, thus raising funding with a value of EUR 79.7 billion. Also 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 both KfW's commercial paper programmes at a comparatively high level. KfW expects a stable long-term funding requirement for financial year 2012, at the prior-year level of around EUR 80 billion.

Operational risks and business continuity management (operating risks) and other risks

KfW Bankengruppe uses operating risks as the umbrella term for operational risks and risks arising from business interruption (business continuity management).

The organisational structure provides for a two-tier system comprising decentralised management units and central control units liaising with the Operational Risk Committee. Operating 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 operating risk management team performs central control of operating risks in the area of risk management and control. It develops the methods and instruments for identifying and assessing operating risks and monitors their uniform application.

The aim of management and control of operational risks and business continuity management is to identify and avert potential losses for KfW ahead of time, in other words to make emergencies and crises manageable and secure the bank's structural ability to remain in operation despite the loss of key resources.

In compliance with Section 269 of the German Solvency Regulation (SolvV), KfW 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. It does not include reputational or strategic risks. Losses which have occurred are recorded in an OpRisk events database.

In addition, operational risks are systematically recorded in the risk assessments which are carried out in all departments and across selected process chains. Operational risks are measured within the risk assessments on the basis of data-supported expert estimates which are backed by a distribution assumption for loss frequency and amount. The increased risk potential in the risk assessments carried out is reported to the respective senior vice president and first vice president. The respective business areas are to check the implementation of risk indicators decentrally for the purpose of monitoring throughout the year the risk potentials which were established in the risk assessment and are above a fixed threshold value. After each quarter, a detailed report is made of the loss events recorded and any measures introduced in the relevant departments as a result. The Executive Board, the Board of Supervisory Directors and the Operational Risk Committee are briefed monthly or quarterly as part of the risk report. Above a fixed level of loss, ad hoc reports are also made.

Capital charges for operational risks are calculated in accordance with the standardised approach pursuant to Section 272 SolvV. As at 31 December 2011, there was OpRisk backing in the amount of EUR 570 million (EUR 542 million for 2010). As part of economic management, the regulatory capital requirement calculated in accordance with the standardised approach is assigned to defined business areas. This is compared to the loss which has actually occurred.

Business continuity management is implemented if an unavoidable business interruption occurs due to internal or external events. This is an integrated management process which covers all the aspects of the four key outage and loss scenarios: site outage (building or infrastructure), IT system outages (including facilities), staff outage and service provider outage. Business continuity management incorporates preventative components (emergency provisions) and reactive components (emergency and crisis management) in equal measure.

For the purpose of business continuity management, business processes are analysed and categorised according to how critical they are, and the supporting resources for each case examined. Identifying critical business processes and their dependency on supporting resources forms the basis for effective business continuity management. Individual measures are developed for these business processes and their supporting resources, which ensure that the required availability is guaranteed and business risks are reduced. These include emergency workspaces, emergency plans, communication tools and alerts/alarms. KfW's crisis team takes responsibility for crisis management as a whole when unplanned events occur and practises emergency and crisis organisation teamwork in regular crisis team tests.

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

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.

Equity investment risks

In managing equity investment risks, KfW Group differentiates between risks from operating investments and strategic equity investments.

Operating investments

Operating investments are used to carry out KfW's promotional mandate or to fulfil its subsidiaries' business objectives. The group-wide basic rules for operating investments are specified via a business model. Specific rules tailored to certain segments of equity investments are also set out in subportfolio guidelines.

Risk measurement is performed at individual commitment level for operating investments in the same way as for credit risks. With regard to reporting, the equity investment portfolio risks are additionally presented in their own report.

Strategic equity investments

A specialised unit is responsible for strategic equity investments based on an equity investment manual which describes legal bases, strategies, principles, procedures and responsibilities of equity investment management. Acquisitions and disposals of, and changes to strategic equity investments are subject to defined due diligence processes as well as authorisation by the KfW Executive Board and Board of Supervisory Directors. In addition, entry into an equity investment of >25 % requires authorisation by the Federal Ministry of Finance in accordance with the Federal Budget Code *(Bundeshaushaltsordnung – BHO)*. Individual equity investment strategies and specific risks are constantly monitored and are presented to the Executive Board as part of an annual equity investment report – as well as in ad hoc reports as necessary. In addition, KfW is as a rule represented at executive board level in the supervisory bodies of companies in which it has a significant holding.

Due to the high risk relevance for the Group and for reasons of uniform group management, KfW IPEX-Bank and DEG's risks are managed as part of group risk management. For example, the subsidiaries' business activities are included in the group-wide limits under the look-through principle; economic capital budgets are assigned to their business areas and representatives of the subsidiaries are included in the group risk committees. Risk monitoring for these two subsidiaries is also performed at a stand-alone level. This monitoring includes regular reporting to the Executive Board as part of the group risk report.

Management of compliance risks

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 insider trading, 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 statutory and regulatory conditions as well as market requirements. Compliance executes independent control procedures in this respect for the purpose of compliance and continual improvement. Regular training sessions on compliance are held for KfW employees. E-learning programmes are also available in addition to the classroom seminars.

Internal control system

The aim of KfW Bankengruppe's internal control system (KfW ICS) is to use suitable principles, measures and procedures to ensure the effectiveness and profitability of business activities, compliance with the legal provisions applicable to KfW and protection of assets.

The ICS at KfW Bankengruppe is based on the relevant legal requirements[11)] (under banking regulation), in particular those set forth in the German Accounting Law Reform Act *(Bilanzrechtsmodernisierungsgesetz – BilMoG)*, KWG and MaRisk, and the market standard COSO model[12)].

Like the COSO model, the KfW ICS consists of the five interrelated components of control environment, risk assessment, control activities, information/communication and monitoring. These extend to all KfW Bankengruppe business units, functions and processes. The control environment is the environment within which KfW introduces and applies rules. Risk assessment includes the identification, analysis and evaluation of risks which result from implementing corporate strategy. Control activities are aimed at achieving corporate objectives effectively and preventing or detecting risks. Adequate information and communication procedures in KfW Bankengruppe enable all stakeholders to be provided with the information they need in the necessary detail. Appropriate monitoring mechanisms determine the functionality and effectiveness of the KfW ICS.

The written framework forms the basis of the KfW ICS. It lays out the conditions for proper business organisation at KfW Bankengruppe and formulates binding rules and requirements for process documentation and controls and for an organisational manual. Organisational measures and controls in the workflows ensure monitoring is integrated into processes. Monitoring measures that are integrated into processes serve to avoid, reduce, detect and/or correct processing errors or financial loss.

The system is supplemented by Compliance, which, on the basis of statutory and supervisory requirements/conditions, defines and monitors compliance with measures in relation to personal data protection (data protection), money-laundering prevention, fraud prevention and securities trading, and in relation to compliance with financial sanctions and protection against the financing of terrorism.

The effectiveness and adequacy of the KfW ICS is also assessed by Internal Auditing on the basis of audits carried out independently of group procedures. The details of the implementation of ICS at KfW and its legally independent subsidiaries DEG and KfW IPEX-Bank are determined by their respective risk strategies and business areas and the prevailing circumstances.

The Executive Board holds overall responsibility for the internal control system at KfW. At DEG and KfW IPEX-Bank, KfW's legally independent subsidiaries, overall responsibility is held by the management. The design and implementation at the different corporate levels is the responsibility of the

[11)] See section 25a (1) no.1 KWG, MaRisk AT 4.3, and sections 289 (5), 315 (2) no.5, 324, and 264 d HGB
[12)] COSO = Committee of Sponsoring Organizations of the Treadway Commission, www.coso.org

relevant managers according to the organisational structure. A report is made annually to KfW Bankengruppe's supervisory bodies.

To ensure the effectiveness of the ICS, KfW regularly examines and continually develops the standards and conventions set and assures that they are permanently anchored in KfW's business areas.

KfW Bankengruppe has an accounting-related ICS in order to fulfil statutory requirements in connection with the accounting process. The accounting-related ICS is part of the group-wide ICS.

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 statements. 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 preventing 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 Bankengruppe are protected against unauthorised access and are integrated in the ICS. Data in the feeding systems (subledgers) and the general ledger are matched on a monthly basis to ensure the completeness and accuracy of the data for further processing in the financial statements. External data sources (e. g. Bloomberg, Reuters) are used to valuate 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 monitoring. 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.

FORECAST REPORT

This forecast report largely corresponds in scope and content to the group forecast report published in the group management report. As business area planning and earnings projections are focused on the KfW Group, a forecast report at single institution level is not prepared. The following projected figures therefore relate to the KfW Group.

The world economy is in an extremely fragile state. The industrialised nations are suffering the consequences of the government debt crisis. Developments in the European Monetary Union (EMU) have escalated into a major crisis of confidence, which has not only infected the financial system but is also beginning to impact upon the real economy. Whether policymakers can stem the debt crisis for the long term will be decisive for the performance of the world economy in 2012.

Even if they are successful, growth in advanced economies will remain subdued. Major fiscal consolidation measures and uncertainty with regard to future developments present considerable impediments to growth. The scope for monetary policy has been largely exhausted in most advanced economies, meaning that little impetus can be expected from this sphere.

The emerging market countries will show weaker growth in 2012 as they are not wholly immune to a slowdown in demand from the industrialised countries. However, domestic demand and regional trade have gained importance for emerging markets and there is comparatively ample room for economic manoeuvre, so the negative effects on growth are likely to be limited. Overall, the world economy should see moderate growth in 2012 and avoid a recession. However, considerable downside risks remain.

The growth prospects for the euro area in 2012 are considerably overshadowed by the ongoing sovereign debt crisis. The consequences for the real economy will still be felt even if the crisis is successfully contained and there is a lasting improvement in the situation on the financial markets. Growth in the euro area will be severely impeded above all by the fiscal consolidation being pursued in many EMU member states which has been tightened again in some cases as a result of the financial crisis. Given this background, recessionary development is to be expected in almost all EMU crisis countries. The core countries will not be able to escape the downturn either and will see much less momentum than in the previous year. After price-adjusted growth in gross domestic product of 1.4 % in 2011, a stagnation in macroeconomic performance is to be expected for the euro area in 2012. There are considerable downside risks associated with this outlook. After the strong upswing that started as early as mid-2009, Germany saw a downturn in the last quarter of 2011. According to estimates by KfW at the beginning of the year, calendar-adjusted average annual real growth in 2012 will fall to around 1 % and thus a third of the level seen in 2011. Domestic consumption is likely to be the key driver here. The ongoing euro crisis creates an extremely high degree of uncertainty for all economic actors, however, and thus also for growth forecasts. In this situation it is especially important to point out the assumptions made by forecasts and to develop an alternative risk scenario. The forecast assumes that a credible approach to solving the euro crisis will be found within a reasonable timeframe, allowing confidence in the future to return to companies, consumers and financial markets. These conditions would allow Germany's continuing strengths – competitive companies and products with global appeal, high-value capital goods, robust labour market and comparatively sound government finances – to take greater effect and overcome the downturn in the course of 2012. If there are no convincing prospects of stemming the crisis, however, the slump will deepen and continue for a longer period. The vicious circle of declining trust, increasing caution and falling demand would likely intensify and be difficult to break, making a recession probable in Germany.

In terms of risk, negative year-on-year performance is expected in the individual segments of the KfW loan portfolio.

The risk outlook for countries continues to be mixed: industrialised nations, particularly those with high or growing government debt, are likely to remain under pressure regarding credit ratings. Economic activity in the emerging markets, which has remained dynamic until recently, will weaken as a result of the close real economic ties to the industrialised nations. This means that the risk assessment for the emerging market economies also shows a negative trend.

The banking sector will remain highly dependent on the development of the European debt crisis (and vice versa) in 2012. The focus here is primarily on the European banks, which face the challenge of stabilising themselves in a difficult environment and improving their liquidity and equity situation. In addition, the expected worldwide economic slowdown will have a detrimental effect on banks' credit risks. All in all, 2012 will be a very challenging year for the banks as they are under heavy pressure from both regulators and the real economy.

The corporate sector in Germany will likewise be marked by the ongoing debt crisis in Europe, as well as by slowing world growth and the associated deterioration in sentiment. Given these conditions, companies will tend to remain in wait-and-see mode in 2012. German companies will invest more cautiously and postpone some investments, which in turn will have negative impacts primarily on the engineering/supplier sector. However, as German companies overcame the last recession relatively quickly and were able to establish reserves, they are not thought to be under major threat in 2012. Provided that credit availability and demand decline at approximately the same rate, no symptoms of a credit crunch are expected, however there are risks in this area.

No particularly positive impetus for Germany is expected from the US corporate sector either. Provided that the US and European debt crises do not lead to a global conflagration, companies will likely continue their expansion into emerging markets at the current level or scale back only slightly.

The German equity investment market in 2012 will continue to be characterised by caution on the part of banks when it comes to co-financing equity investments, for example through acquisition finance. Company valuations in particular, which are based on the good figures for 2010 and 2011, may be too high for investors and banks against the possible backdrop of a slowing economy. However, the uncertainty could also create opportunities for acquiring equity investments in some areas. In terms of exits, companies that have generated good earnings in the last two years are likely to act increasingly as strategic investors, causing the exit channel to open again slightly.

The European securitisation market in 2012 is likely to be close to the prior-year level. This means that activities on the primary and secondary market will remain well below the pre-crisis level. Spreads on the European ABS market remained largely constant in the previous year, albeit with slight widening in the peripheral countries of the euro area. Risk premiums for ABS bonds are likely to be close to the previous year's level in 2012 provided that there is no further escalation of the European government debt crisis or a major global economic downturn.

At EUR 73 billion, the planned new business volume of the KfW Group for 2012 is similar to that of the previous year. The focus in promotional business will continue to be on SME financing and ensuring the future viability of companies. KfW will concentrate in the future even more strongly on the quality of promotion and will place less emphasis on unrestricted activities, for example global loans not tied to promotional areas. Strengthening cooperation with developing, transition and emerging market countries, and expanding support for the export industry remain core tasks for KfW. One of the challenges for promotional business will be to accompany and support the energy turnaround. KfW plans the strongest growth in the group-wide priority issue of environmental and climate protection.

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

Financing investment to support the energy transition will be the focus for KfW Mittelstandsbank in 2012, but without any reduction in promotional activity for start-ups, SMEs and innovations. The existing programmes focussed on energy efficiency and renewable energies are to be adapted and expanded, particularly by increasing the maximum promotional amounts and extending the financing offering, for larger companies too. Financing for further projects is also planned under the KfW "Offshore Wind Energy" programme successfully introduced in 2011. The programme provides start-up funds which help to realise the first offshore wind farm projects despite the scale of the plans and the major technical risks associated with installation on the open sea. Equity finance will be expanded from 2012 to include an offering for social enterprises. As developers of innovative ideas to solve social problems, social enterprises may receive equity to finance their growth. With a planned promotional volume of EUR 24.5 billion in 2012, KfW Mittelstandsbank is expanding its promotion in comparison to the previous year. The financing offering covers the promotional areas of general corporate financing, start-ups, innovation and environmental protection.

KfW Privatkundenbank will focus its housing promotion activities in 2012 even more on the key future challenges of the energy turnaround and demographic change. The Federal Government's "Energy-Efficient Construction" and "Energy-Efficient Refurbishment" programmes will undergo targeted expansion and development in 2012, and the application process will be simplified. KfW's own "Housing Modernisation" programme is to be closed in order to avoid overlap with the priority promotional programmes and to raise the high promotional standards of the Federal Government programme. The loan option of the Federal Government's existing "Age-Appropriate Conversion" programme will be continued in 2012 as one of KfW's own programmes, and is expected to have a higher commitment volume. KfW will continue to promote home ownership with the "KfW Home Ownership Programme", but with a reduced maximum promotional amount. In the area of education, KfW is addressing the demands of "lifelong learning", for example by expanding the "KfW Student Loan". KfW's funding for family care leave is a further major step towards reconciling family and career. KfW Privatkundenbank is planning a new business volume of EUR 16.1 billion for 2012 in the promotional areas of housing, education and social concerns.

KfW Kommunalbank will continue to serve as a reliable partner for municipalities, semi-municipal enterprises and social organisations in 2012. It will thus ensure a high promotional volume and further improve the financing on offer. KfW Kommunalbank will continue to focus its financing activities over the coming year on environmental and climate protection, and will also set a new focus on the issue of demographic change. General non-project-related refinancing of the credit institutions of the federal states will be reduced, while KfW will improve its refinancing offering for these institutions for promotional products relating to key areas. Municipalities and municipal enterprises receive particularly effective support for their investments which serve to implement the energy transition. Among other measures, the "Urban Energy-Efficient Rehabilitation" programme family launched in 2011, which is subsidised by the Federal Government and is in line with its energy concept, is to be expanded in 2012. One of KfW Kommunalbank's plans within this programme family is the new financing window "Energy-Efficient Supply for Neighbourhoods". The planned "Accessible City" programme will also put the issue of demographics into the focus of promotion. KfW Kommunalbank is planning a promotional volume of EUR 9.9 billion for 2012.

Conditions on the European securitisation markets will continue to be mainly characterised by the government debt crisis and the major long-term financing and recapitalisation needs of the banks in 2012. In this environment, securitisations will remain in demand as a form of collateralised financing. Established asset classes from euro area core countries and the UK (e.g. securitisations from private housing financing in the UK and the Netherlands, and German car financing) will continue to be particularly marketable. With its securitisation products, KfW is supporting the long-term financing of commercial enterprises and SMEs in Germany. This includes provision of the KfW securitisation platform PROMISE, and participation in securitisation transactions as an investor, particularly in commercial leasing and loans. KfW will continue to play an active part in initiatives to improve the quality and transparency of the securitisation market in 2012. In addition, the promotional spectrum will be complemented through greater use of capital market-related products. While long-term liquidity in various currencies will continue to be provided to the export economy in 2012 via the programme for refinancing export loans covered by federal guarantees, high-volume promotional loans will be used for German leasing finance and European environmental projects. Using its various instruments, KfW plans a commitment volume of EUR 3.6 billion for 2012.

In the demanding economic environment, the aim of the Export and Project Finance business area, which is managed by KfW IPEX-Bank GmbH, Frankfurt am Main, is to strengthen its market position as a leading specialist financier. The bank plans continued high-level commitment to projects involving energy and the environment. In order to secure the supply of raw materials in Germany, commitments in basic materials and trade and commodity finance will be expanded slightly. The bank is continuing new business in the asset finance area (ships, trains, aircraft) selectively at the previous level and with good collateral. The regional focus is on important markets for the German-European export industry, with support for clients being extended in countries outside Europe, especially emerging markets. The Export and Project Finance business area plans non-derivative new business of EUR 11.4 billion for 2012. A bank refinancing under the shipping CIRR (Commercial Interest Reference Rate) of EUR 1.2 billion is also expected. KfW's promotional business involves a total of EUR 5.3 billion.

The Promotion for Developing and Transition Countries business area comprises the business activities of KfW Entwicklungsbank and DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne.

In response to the consistently high demand for promotional financing, KfW Entwicklungsbank is planning to further expand its commitment volume in developing and transition countries to EUR 5.0 billion in 2012. In this way it is providing large-scale support to the Federal Government in meeting its development and climate targets. Two development policy initiatives will form the centrepiece in 2012 and will be implemented on behalf of the Federal Government by KfW Entwicklungsbank. To encourage sustainable growth in developing countries and combat poverty effectively, the "Impact initiative" will further increase the deployment of own funds for German development financing. The German Climate Technology Initiative *(Deutsche Klima-Technologie Initiative - DKTI)* aims to help middle-income countries drive climate protection forward with modern technologies. This initiative serves to further expand KfW's commitment to global climate and environmental protection. And both initiatives help to increase the Federal Government's international aid commitments (ODA quota). At international and EU level too, KfW will actively employ its expertise to help shape international climate financing. To this end it will step up the exchange of climate expertise and the cooperation with national and sub-regional promotional banks as part of the International Development Finance Club (IDFC), which KfW helped to initiate in 2011.

In the course of the privatisation transactions by the Federal Government, 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 may be asked in 2012 to serve as an investor for a 7.5 % stake in EADS N.V., Netherlands, as part of a mandate by the Federal Government in accordance with the KfW Law.

KfW expects high refinancing volumes to continue for the next two years. For financial year 2011 KfW expects its funding requirements to amount to approximately EUR 80 billion. A key parameter in determining the amount of the planned funding requirement, which is at a comparable level to 2011, is the promotional volume. This should remain high according to KfW's plans. KfW is cautiously optimistic for 2012, however renewed setbacks are possible. With the explicit, direct guarantee by the Federal Government, it sees itself well equipped. KfW's first-class credit quality, combined with a diverse and reliable refinancing strategy, mean that the bank stands on solid foundations. Offers throughout the maturity range and high flexibility in format and currency will remain key factors in the future for successful issuing activity tailored to investors' needs. 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. The euro and US dollar will continue to be the main funding currencies. Along with the British pound and Japanese yen, currencies such as the Australian dollar, the Norwegian krone and Swedish krona can once again be expected to play an important role. KfW expects to benefit from the increasing currency diversification of central banks and major investors.

In its current earnings projections for the Group, KfW expects to achieve total earnings of about EUR 1.2 billion in 2012. The key assumption for this forecast is moderate economic growth. This is expected to be accompanied by slight rises in interest rates and a flattening of the yield curve. Although such development has a negative effect on net interest income, this is still expected to be at a high level in 2012. As in 2010, KfW benefited again in 2011 from the fact that a large proportion of the risk provisions created in 2009 could be reversed. A normalisation is expected for 2012, and therefore a rise in the need for risk provisions for lending business in comparison to 2011. Administrative expense will increase over the 2011 level in 2012. This is primarily a result of initiatives and major projects to modernise KfW (including greater customer focus, conversion/restructuring of the IT architecture in the finance area, and IT restructuring and reorientation).

In a scenario in which the economy falls into recession, KfW assumes a slight fall in interest rates, in contrast to the expected scenario, which would mean higher net interest income. However, this would be counteracted by a higher value adjustment requirement in the lending business. On the other hand, a scenario of unexpectedly strong growth in the economy and an associated rise in 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.

KfW's earnings projections remain characterised by a high degree of uncertainty in view of the current developments in the euro area. 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.

After the extensive efforts in 2011 to find sufficient personnel for the critical areas – especially accounting and IT – a high level of recruitment activity will continue in 2012. This is primarily due to the initiatives and major projects surrounding the comprehensive modernisation of the bank. The bank expects to further increase its personnel before the end of 2012. 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 KfW Corporate Governance report contains the declaration of compliance with the recommendations of the PCGK.

FINANCIAL STATEMENTS

FINANCIAL STATEMENTS

BALANCE SHEET OF KFW AS AT 31 DECEMBER 2011

Assets

				31 Dec. 2011			31 Dec. 2010
	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in millions	EUR in millions	EUR in millions
1. Cash reserves							
a) Cash in hand			235			0	
b) Balances with central banks			996,733			604	
of which: with the Deutsche Bundesbank	996,733			996,968	604		604
2. Receivables from banks							
a) At call			4,417,641			149	
b) Other loans and receivables			316,435,008	320,852,649		292,240	292,389
3. Receivables from customers				79,642,098			68,620
of which: secured with mortgages							
of which: municipal loans	52,946,808				40,440		
4. Bonds and other fixed-income securities							
a) Money market paper							
aa) Of public issuers		0				0	
of which: eligible as collateral with the Deutsche Bundesbank	0				0		
ab) Of other issuers		299,883	299,883			360	
of which: eligible as collateral with the Deutsche Bundesbank	0				91		
b) Bonds and debentures							
ba) Of public issuers		4,142,575				3,578	
of which: eligible as collateral with the Deutschen Bundesbank	3,978,041				3,445		
bb) Of other issuers		22,218,152	26,360,727			24,784	
of which: eligible as collateral with the Deutschen Bundesbank	16,459,032				18,963		
c) KfW's own bond issues			14,096,801	40,757,411		9,196	37,918
Par value	14,719,832				9,870		
5. Shares and other non-fixed income securities				12,364,910			14,187
6. Investments				604,925			514
of which: in banks	40,193				36		
of which: in financial services institutions	0				0		
7. Shares in affiliated entities				2,553,986			2,486
of which: in banks	306,852				307		
of which: in financial services institutions	0				0		
8. Assets held in trust				16,426,033			16,282
of which: loans held in trust	16,165,732				16,191		
9. Intangible assets							
a) Concessions, industrial property rights and similar rights and values, as well as licenses to such rights and values			12,526	12,526			12
10. Tangible assets				861,928			853
11. Other assets				15,622,242			9,230
12. Deferred income				2,286,252			2,392
13. Special loss account consisting of provisions under Section 17 (4) of the D-Mark Balance Sheet Law				26,519			27
Total assets				493,008,447			445,514

Liabilities and shareholders' equity

	31 Dec. 2011				31 Dec. 2010		
	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in millions	EUR in millions	EUR in millions
1. Liabilities to banks							
a) At call			17,336,675			11,223	
b) With agreed terms or periods of notice			9,745,363	27,082,038		8,292	19,515
2. Liabilities to customers							
a) Other funds							
aa) At call		862,074				557	
ab) With agreed terms or periods of notice		20,873,213	21,735,287	21,735,287		22,168	22,725
3. Certificated liabilities							
a) Bond issues			399,160,345	399,160,345		360,145	360,145
4. Liabilities held in trust				16,426,033			16,282
of which: loans held in trust	16,165,732				16,191		
5. Other liabilities				141,024			72
6. Deferred income				6,529,423			6,427
7. Provisions							
a) Provisions for pensions and similar commitments			765,077			747	
b) Other provisions			1,308,532	2,073,609		1,466	2,213
8. Obligatory charges under the D-Mark Balance Sheet Law				280			0
9. Subordinated liabilities				3,246,589			3,247
10. Fund for general banking risks				1,700,000			600
11. Equity							
a) Called in capital		0				0	
Subscribed capital		3,750,000				3,750	
excluding uncalled outstanding contributions		(450,000)	3,300,000			(450)	
b) Capital reserves			5,946,989			5,947	
of which: promotional reserves from the ERP Special Fund	4,650,000				4,650		
Allocation	0				0		
c) Reserves from the ERP Special Fund			1,055,663			977	
Contractual appropriation of interest	78,629				84		
d) Retained earnings							
da) Statutory reserve under Section 10 (2) of KfW Law		1,875,000				1,838	
db) Special reserve under Section 10 (3) of KfW Law		2,688,560				2,178	
dc) Special reserve under Section 17 (4) of the D-Mark Balance Sheet Law		47,607	4,611,167	14,913,819		48	14,288
Total liabilities				493,008,447			445,514
1. Contingent liabilities							
a) On guarantees			10,645,259	10,645,259		18,348	18,348
2. Other obligations							
a) Irrevocable loan commitments			51,910,610	51,910,610		60,766	60,766

INCOME STATEMENT OF KFW FOR THE PERIOD FROM 1 JANUARY – 31 DECEMBER 2011

Expenses

				2011			2010
	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in millions	EUR in millions	EUR in millions
1. Interest expenses				10,419,364			9,207
2. Contractual appropriation of interest to reserves from the ERP Special Fund				78,629			84
3. Commissions and similar charges payable				202,672			209
4. General administrative expenses							
a) Expenditure on personnel							
aa) Salaries and wages		285,681			274		
ab) Social security contributions, expenditure on pensions and support		48,878	334,559		61	335	
of which: for pensions	11,099				24		
b) Other administrative expenses			215,928	550,487		193	528
5. Depreciation and value adjustments on intangible assets and fixed assets				30,148			27
6. Other operating expenses				30,834			118
7. Allocation to fund for general banking risks				1,100,000			554
8. Write-offs of and value adjustments on investments, shares in affiliated entities and securities treated as fixed assets				101,295			0
9. Extraordinary expenses				0			75
10. Taxes on income				5,624			0
11. Write-offs on the special loss acount under Section 17 (4) of the D-Mark Balance Sheet Law				38			0
12. Profit				547,565			2,013
Total expenses				13,066,656			12,815
1. Profit				547,565			2,013
2. Loss carried forward from previous year				0			–1,499
3. Withdrawal from capital reserves				0			0
4. Allocation to retained earnings							
a) to the statutory reserve under Section 10 (2) of the KfW Law			–37,101			–264	
b) to the special reserve under Section 10 (3) of the KfW Law			–510,464	–547,565		–250	–514
5. Distributable profit/loss				0			0

Income

				2011			2010
	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in millions	EUR in millions	EUR in millions
1. Interest income from							
a) Lending and money market transactions			11,665,097			11,028	
b) Fixed-income securities and debt register claims			682,024	12,347,121		543	11,571
2. Current income from							
a) Shares and other non-fixed income securities			99			0	
b) Investments			13,521			26	
c) Shares in affiliated entities			0	13,620		0	26
3. Commissions and similar service charges earned				355,640			413
4. Write-ups on loans and certain securities and release of allowances for possible loan losses				244,142			527
5. Write-ups on investments, shares in affiliated entities and securities treated as fixed assests				0			150
6. Other operating income				106,133			128
Total income				13,066,656			12,815

NOTES

The financial statements for 2011 for KfW have been drawn up in accordance with the requirements of the German Commercial Code *(Handelsgesetzbuch - HGB)*, the Ordinance Regarding the Accounting System for Banks and Financial Services Institutions *(Kreditinstituts-Rechnungslegungsverordnung - RechKredV)* and the Law Concerning KfW. The special provisions of the D-Mark Balance Sheet Law *(D-Mark-Bilanz-Gesetz – DMBilG)* have also been observed.

In the financial statements the reserves from the ERP Special Fund and the contractual allocation of interest income to these are shown separately, as is the allocation to the capital reserves, which is shown as a memo item. Information on individual items in the balance sheet, which may be provided either in the balance sheet or in the notes, is provided in the Notes.

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

The securities held as a liquidity reserve are valued strictly at the lower of cost or market *(strenges Niederstwertprinzip)*, where they are not hedged. For securities held as fixed assets the modified lower of cost or market principle *(gemildertes Niederstwertprinzip)* has consistently been applied. In some cases, hedging relationships are recognised for securities and their interest hedges (primarily interest rate swaps). No securities have been allocated to the trading stock. The statutorily required write-ups were made. Structured securities with embedded derivatives are accounted for as a unit and are valued strictly at the lower of cost or market.

Fixed assets are shown at acquisition or production cost, reduced by straight line depreciation in accordance with the expected useful life of the items. Non-scheduled value adjustments are recognised as required. Minor items are combined to form a collective item and are depreciated over a period of five years using the straight-line method.

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

Provisions for pensions and similar commitments were valued in accordance with actuarial principles on the basis of the 2005 G mortality tables *(Richttafeln 2005 G)*, by Dr Klaus Heubeck. The projected unit credit method was applied for KfW's calculations, with a discount rate of 5.14 % in accordance with Section 253 (2) HGB, a rate of salary increases between 1 % and 3 % depending on collective wage agreement grades, a rate of pension increases between 1 % and 2.5 % depending on the pension scheme, and a fluctuation rate of 1.5 % for all active staff members. Other provisions are recorded in the amount of the estimated expenditure required to settle the obligation, taking future price/cost increases into account. Provisions with a remaining term of more than one year are to be discounted at the market interest rate published by the Deutsche Bundesbank.

Sufficient allowance has been made for risks, most of which are on loans as a result of the structure of KfW's business, through value adjustments. Allocations and reversals are shown net in the item Write-ups on loans and certain securities and release of allowances for possible loan losses. The possibility for netting in the income statement in accordance with Section 340 c (2) and Section 340 f (3) HGB has been utilised. For non-performing loans, interest income is generally accrued based on the probability of collection.

NOTES TO THE ASSETS

Receivables from banks

	At call	Remaining maturity				Pro rata interest	Total
		Up to 3 months	More than 3 months to 1 year	More than 1 year to 5 years	More than 5 years		
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
31 Dec. 2011	4,418	52,008	25,542	126,405	106,213	6,267	320,853
31 Dec. 2010	*149*	*36,696*	*22,864*	*123,026*	*103,987*	*5,667*	*292,389*
of which (previous year):							
to affiliated entities						*20,167*	*(17,828)*
to entities in which KfW holds a share						*16*	*(24)*
without on-lending banks' liability						*3,898*	*(4,247)*
subordinated assets						*2,404*	*(2,326)*

Receivables from customers

	With no fixed maturity	Remaining maturity				Pro rata interest	Total
		Up to 3 months	More than 3 months to 1 year	More than 1 year to 5 years	More than 5 years		
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
31 Dec. 2011	0	7,245	5,549	37,848	28,156	844	79,642
31 Dec. 2010	*0*	*6,570*	*5,955*	*32,814*	*22,408*	*873*	*68,620*
of which (previous year):							
to affiliated entities						*678*	*(814)*
to entities in which KfW holds a share						*33*	*(30)*
subordinated assets						*5,964*	*(6,337)*

Bonds and other fixed-income securities

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

Due the following year

Balance sheet date	31 Dec. 2011	31 Dec. 2010
	EUR in millions	EUR in millions
Money market paper, bonds and notes	3,589	3,835
Par value	*3,609*	*3,825*
Own bond issues	376	96
Par value	*369*	*94*
Total	3,965	3,931
Par value	*3,978*	*3,919*

The item Bonds and other fixed-income securities includes:

	EUR in millions
Listed securities	38,479
Unlisted securities	2,278
Marketable securities	40,757

The item Bonds and other fixed-income securities contained subordinated securities with a book value of EUR 24 million as at the reporting date (previous year: EUR 1 million).

Repurchase agreements

Securities to the book value of EUR 1,489 million were sold under genuine repurchase (repo) agreements.

Fixed assets

Fixed assets as at 31 December 2011

	Purchase/ production costs[2]	Inflows	Outflows	Transfers	Alloca-tions	Write offs/ adjustments		Changes[1]	Residual book value	Residual book value
						Total	2011	2011	31 Dec. 2011	31 Dec. 2010
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(7)	(8)	(9)
	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands
Intangible assets[3]	22,410	4,666	1,028	0	0	13,522	4,637		12,526	12,522
Tangible assets[4]	1,073,497	35,934	3,122	0	0	244,381	25,511		861,928	852,600
Total	1,095,907	40,600	4,150	0	0	257,903	30,148		874,454	865,122
Investments								90,847	604,925	514,078
Shares in affiliated entities								67,465	2,553,986	2,486,521
Securities treated as fixed assets								−2,313,966	24,305,676	26,619,642
Total								−2,155,654	27,464,587	29,620,241
Total									28,339,041	30,485,363

1) Including price changes
2) The Relief Facility under Section 31 (6) of the EC Commercial Code has been utilised
3) Non-scheduled amortisation of intangible assets of EUR 662 thousand
4) Of which as at 31 December 2011: - Total value of land and buildings used for the bank's activities EUR 820,514 thousand
- total value of office furniture and equipment EUR 41,413 thousand

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

The book value of the marketable securities in fixed assets not valued at the lower of cost or market was EUR 23,913 million as at 31 December 2011. This includes investments in securities, whose book value of EUR 8,634 million was higher than the market value of EUR 8,106 million. Since these securities are to be held until maturity they were not written off.

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

	EUR in millions
Listed securities	11,239
Unlisted securities	1,126
Marketable securities	12,365

Securities are fully included in current assets.

This item includes transactions with a total volume of EUR 11,239 million, which the Federal Government mandated KfW to conclude pursuant to Section 2 (4) of the KfW Law.

Disclosures on shareholdings

Name and domicile of company	Share held	Equity	Net income for the year
	in %	EUR in thousands	EUR in thousands
1. DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne[1)]	100.0	1,700,287	217,900
2. KfW Beteiligungsholding GmbH, Bonn[1)]	100.0	343,445	67,473
3. KfW IPEX-Beteiligungsholding GmbH, Frankfurt am Main[1)]	100.0	1,626,490	527
4. Astra Grundstücksgesellschaft mbH & Co. Bauträger KG, Frankfurt am Main[2)]	100.0	1,500	0
5. KfW International Finance Inc. in liq., Delaware, USA	100.0	0	0
6. AF Eigenkapitalfonds für deutschen Mittelstand GmbH & Co. KG, Munich[2)]	47.7	2,695	–285
7. Deutsche Post AG, Bonn[2)]	30.5	10,696,000	2,630,000
8. Deutsche Energie-Agentur GmbH (dena), Berlin[2)]	26.0	5,223	351
9. Berliner Energieagentur GmbH, Berlin[2)]	25.0	3,647	304
10. Mittelstandsfonds Hamburg MHH GmbH & Co. KG, Hamburg[2)]	24.9	10,219	–643
11. eCapital Technologies Fonds II GmbH & Co. KG, Münster[2)]	24.8	23,541	116
12. Post 2012 Carbon Credit Fund CV, Amsterdam, Netherlands[2)]	20.0	21	–192
13. Galaxy S. à r. l., Luxembourg, Luxembourg[2)]	20.0	125,569	38,961

[1)] *Most recent available financial statements 2011*
[2)] *Most recent available financial statements 2010*

The item Investments includes:

	EUR in millions
Listed securities	2
Unlisted securities	18
Marketable securities	20

Shares in investment funds

	Share in total assets	Book values	Dividend payments	Redeemable daily
	%	EUR in thousands	EUR in thousands	
Fonds Frankfurt I	100.0	617,693	0	Yes
Fonds Atlantik	100.0	506,804	0	Yes
European Fund for Southeast Europe S.A., SICAV-SIF	18.8	120,000	3,646	No
Global Climate Partnership Fund SA, SICAV-SIF	19.1	11,979	56	No
Green for Growth Fund, Southeast Europe S.A., SICAV-SIF	10.5	10,025	0	No
Fondo PPP Italia c/o Fondaco SGR S. p. A.	14.6	8,483	58	No
2020 European Fund Galaxy for Energy, Climate Change and Infrastructure SICAV	14.1	7,100	0	No
Galaxy S. à r. l. SICAR	20.0	6,986	4,351	No
Rural Impulse Fund II S. A., SICAF-SF	16.5	3,500	0	No
Post 2012 Carbon Credit Fund CV	20.0	0	95	No

The market values of the Frankfurt I and Atlantik funds which were in the portfolio as at 31 December 2011 are both EUR 0.6 billion. Both are special funds which are consolidated in the IFRS consolidated financial statements. Shares in special funds were reduced as planned in 2011 as part of the new investment strategy applied in the previous years.

The other shares in investment funds serve primarily to strengthen and support projects relating to climate protection, renewable energies and infrastructure expansion. The limitations imposed on daily redemptions are due to the funds' long-term orientation and the specific investors involved. These funds are an essentially illiquid investment vehicle.

Due to the considerable falls in market prices, the value of the Post 2012 Carbon Credit Fund CV value was written down to EUR 0 thousand. None of the other investments have been impaired. The investments are subject to a regular valuation process.

Other assets

Other assets mainly comprise the adjustment item from the currency conversion of derivatives (EUR 14,928 million) used in the context of management of the foreign currency positions. They also include the claim of EUR 602 million against the Federal Agency for Special Tasks associated with Unification *(Bundesanstalt für vereinigungsbedingte Sonderaufgaben - BvS)*, due to the transfer to KfW of the insurance business of the former State Insurance Company of the GDR in liquidation *(Staatliche Versicherung der DDR in Abwicklung - SinA)*. The claim is offset by technical insurance provisions in the same amount.

Prepaid expenses and deferred charges

The differences contained in the item Prepaid expenses and deferred charges between the repayment amount and the lower issue amount of liabilities amount to EUR 851 million (previous year: EUR 829 million).

NOTES TO THE LIABILITIES

Maturities structure of borrowed funds

	At call	Remaining maturity				Pro rata interest	Total
		Up to 3 months	More than 3 months to 1 year	More than 1 year to 5 years	More than 5 years		
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks							
As at 31 Dec. 2011	17,337	1,687	123	1,211	1,761	4,963	27,082
As at 31 Dec. 2010	*11,224*	*1,431*	*74*	*1,263*	*1,074*	*4,449*	*19,515*
Liabilities to customers							
As at 31 Dec. 2011	862	5,392	4,393	6,550	4,083	455	21,735
As at 31 Dec. 2010	*557*	*4,145*	*4,005*	*10,907*	*2,763*	*349*	*22,726*
As at 31 Dec. 2011	18,199	7,079	4,516	7,761	5,844	5,418	48,817
in %	37	15	9	16	12	11	100
							Due the following year
Certificated liabilities - Bonds issued							
As at 31 Dec. 2011							87,344
As at 31 Dec. 2010							*89,158*

Liabilities to affiliated entities and entities in which KfW holds a share

	Certificated and non-certificated liabilities			
	To affiliated entities		To entities in which KfW holds a share	
	2011	2010	2011	2010
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks	50	63	*0*	*0*
Liabilities to customers	142	165	*0*	*0*
Certificated liabilities	840	50	*0*	*0*
Total	1,032	278	*0*	*0*

Deferred income

Deferred income includes discounts on receivables totalling EUR 2,305 million (previous year: EUR 2,460 million).

Provisions

Apart from the provisions for pensions and similar commitments amounting to a total of EUR 765 million, as at 31 December 2011, other provisions of EUR 1,309 million are reported which mainly relate to the technical provisions in connection with the transfer to KfW of the insurance business of SinA, provisions for covering future interest charges resulting from the transfer of the ERP Special Fund as well as risk provisions for lending business of KfW.

In the case of provisions with a remaining term of more than one year and a recognition value as at 31 December 2011 of EUR 191 million, KfW exercised the option in accordance with Article 67 (1) Sentence 4 of the Introductory Act to the German Commercial Code *(Einführungsgesetz zum Handelsgesetzbuch – EGHGB)*. The value after discounting at the applicable Bundesbank interest rate totals EUR 178 million.

Expenses of EUR 37 million resulting from interest accrued on provisions for pensions and similar commitments are recorded under Interest expense.

Subordinated liabilities

As part of the new legislation of the ERP economic promotion programme 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.

KfW is not obligated to repay the subordinated loan ahead of schedule. The terms of subordination of this loan are in line with the requirements of the German Banking Act *(Kreditwesengesetz - KWG)*.

Interest expenses for the subordinated loan amounted to EUR 146 million.

Equity

	31 Dec. 2010	Net income for the year	Other changes	31 Dec. 2011
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Subscribed capital	3,750	0	0	3,750
Uncalled outstanding contributions	–450	0	0	–450
Capital reserves	5,947	0	0	5,947
Promotional reserves from the ERP Special Fund	4,650	0	0	4,650
Reserves from the ERP Special Fund	977	0	79	1,056
Retained earnings				
a) Statutory reserve under Section 10 (2) KfW Law	1,838	37	0	1,875
b) Special reserve under Section 10 (3) KfW Law	2,178	510	0	2,689
c) Special reserve under Section 17 (4) of the D-Mark Balance Sheet Law	48	0	0	48
Equity	14,288	547	79	14,914

The promotional reserves from the ERP Special Fund relate to the amount transferred into the capital reserve by the ERP Special Fund in financial year 2007 as part of the reorganisation of the ERP economic promotion programme.

All of the net income for 2011 was allocated to retained earnings. As at year-end 2011, KfW's equity amounted to EUR 14,914 million.

OTHER REQUIRED NOTES TO THE LIABILITIES

Contingent liabilities

The liabilities under guarantees and warranties total EUR 10,645 million. Of the total amount as at 31 December 2011, EUR 8,368 million was attributable to platform securitisations, predominantly PROMISE/PROVIDE transactions.

Banks can transfer credit risks synthetically from SME loan portfolios or private housing loans to the capital market using the securitisation platforms PROMISE/PROVIDE. As at the balance sheet date the volume securitised via the platforms totalled EUR 8,368 million, of which EUR 8,322 million was collateralised by credit default swaps or credit-linked notes. KfW has retained risks from senior tranches with respect to the remaining EUR 46 million.

Risk in this platform business is primarily defined by the quality of the securitised portfolios. In this business KfW transfers tranches with higher probability of default to the capital market and retains only senior tranches with the best credit quality. The default risk faced by KfW is therefore considered to be very low.

Liabilities under guarantees and warranties also included guarantees for special loans of EUR 785 million, guarantees for aircraft finance of EUR 418 million, guarantees for housing construction of EUR 148 million and guarantees for ship and shipyard financing of EUR 72 million.

The risks from these transactions are addressed by making portfolio and individual provisions.

Other obligations

Irrevocable loan commitments total EUR 51,911 million, of which EUR 28,726 million is attributable to investment finance, with the majority relating to KfW Privatkundenbank (EUR 11,155 million) and KfW Mittelstandsbank (EUR 7,820 million), EUR 9,454 million to export and project finance, EUR 6,192 million to loans to promote developing countries, EUR 283 million to guarantees and EUR 84 million to forward forward deposits.

In addition, irrevocable loan commitments of EUR 7,171 million are attributable to Germany's share of the credit facility established for Greece by the EU member states, provided by KfW.

The risks from these transactions are addressed by making portfolio and individual provisions.

Assets and liabilities held in trust

The trust items reported mainly concern receivables from and liabilities to customers. KfW's assets held in trust include loans on a trust basis of EUR 16,166 million.

NOTES TO THE INCOME STATEMENT

Additions to the fund for general banking risks

The fund for general banking risks was increased by EUR 1,100 million in financial year 2011 to EUR 1,700 million. This is reported in a special item on the income statement. In 2011 the increase in the fund for general banking risks aimed to protect the bank against general business-specific risks.

Geographical markets

As KfW has no foreign branch offices the total amounts reported under certain income items in accordance with Section 34 (2) No 1 RechKredV were not broken down by region.

OTHER REQUIRED NOTES

Assets and debts in foreign currencies

The assets and debts in foreign currencies and the cash transactions not completed on the balance sheet date have been converted into euros at the exchange rates quoted on the balance sheet date.

The bank applies the principle of special cover within the meaning of Section 340 h HGB in conjunction with Section 256 a HGB.

In accordance with Sections 277 (5) Sentence 2 and 340 h of the HGB, expenditure on and income from currency conversion have been reported as gross figures under Other operating expenses (EUR 9 million, previous year: EUR 33 million) and Other operating income (EUR 12 million, previous year: EUR 40 million).

Exchange rate-related changes in the amount of specific value adjustments denominated in foreign currencies have also been included in Other operating expenses or Other operating income.

As at 31 December 2011, total assets in foreign currencies were EUR 42 billion, converted in accordance with Section 340 h HGB. Total liabilities in foreign currencies were EUR 238 billion.

Other financial commitments and free facilities

The bank has remaining payment obligations totalling EUR 567 million in connection with equity finance operations.

Liquidity facilities in the context of monetary policy transactions with the Deutsche Bundesbank which have not yet been exhausted are available to KfW.

Derivatives reporting

KfW uses the following forward transactions/derivative products, mainly to hedge against the risk of changes in interest and exchange rates, and other price and credit risks:

1. Interest rate forward transactions/derivative products
   - Interest rate swaps
   - Interest rate options, swaptions
   - Caps and floors

2. Currency-related forward transactions/derivative products
   - Cross-currency swaps
   - FX swaps
   - Spot exchange deals
   - Forward exchange swaps

3. Share-price related and other price risk-related forward transactions/derivative products
   - Share options
   - Carbon Fund forward purchases and sales

4. Credit derivatives
   - Single name credit default swaps

The following presentation of derivatives transactions is in accordance with the requirements of Section 285 No 19 HGB and Section 36 RechKredV. It discloses the positive and negative fair values of the derivatives positions as at 31 December 2011.

All types of contracts are marked to market. In cases where market prices were not available for derivatives instruments, substitute values were determined by means of market parameters based on generally acknowledged option price models and present value estimates.

Purchased and written options are recorded as Other assets or Other liabilities in the amounts paid as premiums.

Volumes	Par values 31 Dec. 2011 EUR in millions	Par values 31 Dec. 2010 EUR in millions	Market values positive 31 Dec. 2011 EUR in millions	Market values negative 31 Dec. 2011 EUR in millions
Contracts with interest rate risks				
Interest swaps	479,555	456,050	22,525	20,579
Interest options				
Purchases	0	44	0	0
Sales	0	44	0	0
Caps and floors[1]	226	376	0	0
Total	479,781	456,514	22,525	20,579
Contracts with currency risks				
Cross-currency swaps	213,448	199,993	18,129	5,557
FX swaps	23,421	24,946	744	46
Forward exchange deals	198	600	3	3
Spot exchange deals	3	0	0	0
Total	237,070	225,539	18,876	5,606
Share and other price risks[2]	768	906	62	63
Credit derivatives[3]				
Purchases	150	290	1	0
Sales	0	0	0	0
Total	150	290	1	0

1) Shown are separately traded caps and floors
2) Shown without embedded derivatives
3) Here: Single name credit default swaps

Par values	Interest rate risks[1]		Currency risks		Other price risks[1]		Credit derivatives[2]	
	31 Dec. 2011	31 Dec. 2010	31 Dec. 2011	31 Dec. 2010	31 Dec. 2011	31 Dec. 2010	31 Dec. 2011	31 Dec. 2010
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Remaining term of								
up to 3 months	21,807	23,900	32,414	40,452	4	4	50	90
more than 3 months to 1 year	41,758	33,990	26,337	18,222	2	3	100	0
more than 1 year to 5 years	226,033	216,328	113,839	105,091	752	888	0	200
more than 5 years	190,183	182,296	64,480	61,774	10	11	0	0
Total	479,781	456,514	237,070	225,539	768	906	150	290

1) Derivative financial instruments are shown without embedded derivatives.
2) Here: Single name credit default swaps

Counterparties	Par values	Par values	Market values positive	Market values negative
	31 Dec. 2011	31 Dec. 2010	31 Dec. 2011	31 Dec. 2011
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
OECD banks	678,417	639,756	39,548	23,568
Banks outside the OECD	64	37	1	6
Other counterparties	30,553	33,111	1,733	2,422
Public authorities	8,735	10,345	182	252
Total	717,769	683,249	41,464	26,248

The following section describes hedging relationships within the meaning of Sections 254 and 285 No 23 HGB.

The table lists the volume of securities held as fixed assets and as a liquidity reserve, which are hedged against interest rate and equity risks as at the reporting date.

	Book values	Par values	Market values
	EUR in millions	EUR in millions	EUR in millions
Securities held as fixed assets			
Bonds and other fixed-income securities	17,692	17,109	17,667
Securities held as liquidity reserves			
Bonds and other fixed-income securities	7,533	8,180	7,944
Shares and other non-fixed-income securities	11,239	–	10,897
Total	36,464	25,289	36,508

KfW uses derivatives only to hedge open positions.

The option to perform hedge accounting for economic hedges is exercised with KfW's own holdings of securities and forward purchases with CO_2 certificates as designated hedged items. The net hedge presentation method is applied to the effective portion of the hedge.

A portion of the securities treated as fixed assets is hedged against interest rate changes using micro hedges (primarily interest rate swaps) for fixed-income securities. In economic terms, this results in variable-rate bonds.

Due to identical parameters of hedged item and hedging instrument, the offsetting effect is evidenced both prospectively and retrospectively using the critical term match method.

The use of the modified lower of cost or market principle for the fixed assets shows only permanent losses in value in the income statement.

The fixed-income securities held as a liquidity reserve are also hedged against interest rate changes using micro hedges (primarily interest rate swaps). Any ineffective portion of the hedge is reported in earnings immediately. In addition, hedging relationships are recognised as part of the repurchase of own issues, with matching certificated liabilities as hedging instruments. Shares held under holding arrangements reached with the Federal Republic (Deutsche Telekom AG and Deutsche Post AG) were hedged against exchange rate changes through contractual arrangements with the Federal Government.

The forward purchases of CO_2 certificates (nominal value EUR 98 million) are hedged against the risk of changes in market price using corresponding forward sales (nominal value EUR 98 million) as part of a portfolio. Measuring this exposure using market data as at the balance sheet date yields a net hidden reserve of EUR 0.8 million.

Due to the negative correlation between changes in value and the hedged risks, changes in value and cash flows of hedged items and hedging instruments largely offset one another as at the reporting date. With regard to the long-term effectiveness of the hedging relationships, the hedges can be expected to continue to almost fully offset the hedged risks until their designated maturities.

Alongside the hedging relationships within the meaning of Section 254 HGB, derivative financial instruments used to hedge interest rate risks in the banking book, and the interest-bearing hedged items are included in asset liability management. KfW manages the interest margin or market value of all interest-bearing transactions in the banking book as a whole. A positive present value was calculated as at 31 December 2011.

Loans in the name of third parties for third party account

Loans in the name of third parties and for third party account totalled EUR 4,317 million as at 31 December 2011.

Personnel

The average number of employees including temporary staff and students on our degree programme, but excluding the Executive Board and trainees is calculated based on the levels at the end of each quarter of the reporting year.

	2011	2010
Employees (female)	1,868	1,745
Employees (male)	1,896	1,798
Staff not covered by collective agreements	*2,564*	*2,441*
Staff covered by collective agreements	*1,200*	*1,102*
Total	3,764	3,543

COMPENSATION AND LOANS TO MEMBERS OF THE EXECUTIVE BOARD AND THE BOARD OF SUPERVISORY DIRECTORS

Annual compensation 2011

	Salary	Variable compensation	Other compensation[1)]	Total
	EUR in thousands	EUR in thousands	EUR in thousands	EUR in thousands
Dr Ulrich Schröder (Chief Executive Officer)	673.1	240.0	117.9	1,031.0
Dr Günther Bräunig	515.8	0.0	27.2	543.0
Dr Norbert Kloppenburg	474.0	0.0	69.7	543.7
Dr Edeltraud Leibrock	124.5	0.0	11.4	135.9
Bernd Loewen	487.7	0.0	45.4	533.1
Dr Axel Nawrath	473.5	0.0	104.7	578.2
Gesamt	2,748.6	240.0	376.3	3,364.9

[1)] *Other compensation mostly comprises the use of company cars, insurance premiums and the taxes and social security payments of these amounts. Remuneration for supervisory board mandates in subsidiaries is also included.*

Compensation to members of the Board of Supervisory Directors totalled EUR 175 thousand. This amount is broken down as follows:

Compensation for the members of the Board of Supervisory Directors is EUR 5 thousand p.a. Members of the Credit, Executive and Audit Committees receive EUR 0.6 thousand p.a. Members who join during the year receive their compensation on a pro-rata basis. 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 financial year 2011. Moreover, compensation for the Chairman of the Board of KfW Supervisory Directors and his deputy was also set at EUR 0.00.

Provisions in the amount of EUR 46,039 thousand had been set up as at 31 December 2011 for obligations under pension arrangements for retired members of the Executive Board and their surviving dependents. The regular compensation totalled EUR 3,827 thousand.

In the reporting year, one-off payments of EUR 660 thousand were made to former Executive Board members on the basis of a settlement.

The total amount of loans granted to members of the Executive Board was EUR 75 thousand as at 31 December 2011. Interest rates were between 3 % p.a. and 4 % p.a. The residual term of the loans was 9.9 years as at the reporting date.

Auditor's fees

KfW has utilised the option under Section 285 No 17 HGB and refers to the breakdown of auditor fees in the consolidated financial statements of KfW Bankengruppe.

Group affiliation

KfW is included in the consolidated financial statements of KfW Bankengruppe, Frankfurt am Main, as at 31 December 2011. The consolidated financial statements are prepared in accordance with International Financial Reporting Statements (IFRS) and published in German in the electronic Federal Gazette *(Bundesanzeiger)*.

Mandates held by statutory representatives or other employees in supervisory boards of major joint stock companies in accordance with Section 267 (3) HGB

Dr Ulrich Schröder (Chief Executive Officer)

DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne

Deutsche Post AG, Bonn

Deutsche Telekom AG, Bonn

Dr Günther Bräunig

Deutsche Pfandbriefbank AG, Munich

Hypo Real Estate Holding AG, Munich

Dr Norbert Kloppenburg

DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne

DFS Deutsche Flugsicherung GmbH, Langen

KfW IPEX-Bank GmbH, Frankfurt am Main

Bernd Loewen

KfW IPEX-Bank GmbH, Frankfurt am Main

Dr Axel Nawrath

Saarstahl AG, Völklingen

SHS – Stahl-Holding-Saar GmbH & Co. KGaA, Dillingen

Dr Lutz-Christian Funke

IKB – Deutsche Industriebank AG, Düsseldorf

Doris Köhn

ProCredit Holding AG & Co. KGaA, Frankfurt am Main

BOARD OF SUPERVISORY DIRECTORS

Dr Philipp Rösler
Federal Minister of Economics
and Technology
Chairman (from 1 January 2012)
Deputy Chairman (from 12 May 2011
until 31 December 2011)

Dr Wolfgang Schäuble
Federal Minister of Finance
Deputy Chairman
(from 1 January 2012)
Chairman
(from 1 January 2011 until 31 December 2011)

Rainer Brüderle
Former Federal Minister of Economics
and Technology
Deputy Chairman
(from 1 January 2011 until 12 May 2011)

Ilse Aigner
Federal Minister of Food,
Agriculture and Consumer Protection

Norbert Barthle
Member of the German Bundestag
Member appointed by the German Bundestag

Jan Bettink
President of the Verband
Deutscher Pfandbriefbanken
Representative of the mortgage banks

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

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

Helmut Dedy
Permanent Deputy of the Managing Director
of the Deutscher Städtetag
Representative of the municipalities
(from 1 January 2012)

Prof. Dr Hans Heinrich Driftmann
President of the Association of German Chambers
of Industry and Commerce (DIHK)
Representative of industry

Ingeborg Esser
Member of the Executive Board
Federal Association of German Housing
and Real Estate Enterprises (GdW)
Representative of the housing industry

Georg Fahrenschon
Former Minister of Finance
of the Free State of Bavaria
Member appointed by the German Bundesrat
(until 3 November 2011)

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

Frank Horch
Senator of the Free Hanseatic City of Hamburg
Ministry of Economy, Transport and Innovation
Member appointed by the German Bundesrat
(from 17 June 2011)

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

Dr Markus Kerber
Director General of the Executive Board of the
Bundesverband der Deutschen Industrie e.V. (BDI)
Representative of industry
(from 1 January 2012)

Dr h.c. Jürgen Koppelin
Member of the German Bundestag
Member appointed by the German Bundestag

Monika Kuban
Former permanent deputy of the Managing Director
of the Deutscher Städtetag
Representative of the municipalities
(until 31 December 2011)

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

Dr Gesine Lötzsch
Member of the German Bundestag
Member appointed by the German Bundestag

Stefan Mappus
Former Minister President
of the State of Baden-Württemberg
Member appointed by the German Bundesrat
(until 31 August 2011)

Claus Matecki
Member of the Executive Board
of the Confederation of German Trade Unions
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

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

Hanns-Eberhard Schleyer
Former Secretary General of the
Zentralverband des Deutschen Handwerks
Representative of the skilled crafts

Dr Nils Schmid
Minister of Finance of the State
of Baden-Württemberg
Member appointed by the German Bundesrat
(from 4 November 2011)

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
Former Director General of the
Executive Board of the Bundesverband
der Deutschen Industrie e. V.
Representative of industry
(until 31 December 2011)

Carsten Schneider
Member of the German Bundestag
Member appointed by the German Bundestag

Dr Markus Söder
Minister of Finance of the Free State of Bavaria
Member appointed by the German Bundesrat
(from 16 December 2011)

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

Dr Guido Westerwelle
Federal Minister for Foreign Affairs

EXECUTIVE BOARD

Dr Ulrich Schröder
Chief Executive Officer

Dr Günther Bräunig

Dr Norbert Kloppenburg

Dr Edeltraud Leibrock (from 01 October 2011)

Bernd Loewen

Dr Axel Nawrath

Dr Ulrich Schröder
(Chief Executive Officer)

Dr Günther Bräunig

Dr Norbert Kloppenburg

Dr Edeltraud Leibrock

Bernd Loewen

Dr Axel Nawrath

Frankfurt am Main, 31 January 2012

AUDITOR'S REPORT

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of the KfW, Frankfurt am Main, for the financial year from 1 January to 31 December 2011. The maintenance of the books and records and the preparation of the annual financial statements and the management report in accordance with German commercial law and the regulation and supplementary provisions of the law concerning KfW (KfW Law) are the responsibility of the Company's Managing Board. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual 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 annual financial statements in accordance with (German) principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Company's Managing Board, as well as evaluating the overall presentation of the annual financial statements and 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 annual financial statements comply with the legal requirements and the 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 Company in accordance with (German) principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Frankfurt am Main, 28 February 2012

KPMG AG
Wirtschaftsprüfungsgesellschaft

Mock	Schweitzer
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(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

KfW Bankengruppe

Palmengartenstrasse 5–9

60325 Frankfurt am Main

Germany

Telefon +49 69 7431 0

Telefax +49 69 7431 2944

infocenter@kfw.de

www.kfw.de