Management Report and Financial Statements 2017

KFW

Key figures of KfW

Overall activities of KfW

	2017	2016	2015
	EUR in millions	EUR in millions	EUR in millions
Financial statements			
Volume of business	553,100	577,887	551,333
Total assets	477,947	500,684	493,205
Bonds issued	408,606	422,268	412,308
Subordinated liabilities	0	200	300
Own funds	24,668	23,772	22,482
Net interest income before promotional expense	1,964	1,983	2,356
Net commission income before promotional expense	193	196	190
Administrative expense before promotional expense	1,027	931	971
Promotional expense	213	230	345
Profit for the year	895	1,290	1,331
Cost-income ratio before promotional expense	48	43	38
Tier 1 capital ratio[1]	20.6	22.3	18.3
Total capital ratio[1]	20.6	22.3	18.4
Employees	4,990	4,872	4,698

[1] The regulatory total capital ratio and the tier 1 ratio are calculated for internal purposes.
The figures relate to the whole KfW Group, data are based on the IAS/IFRS consolidated financial statements.

The figures in tables were calculated exactly and added up. Figures may not add up to totals because of rounding.
Actual zero amounts and amounts rounded to zero are presented as EUR 0 million.

Responsible Banking

Contents

Management report

Economic report

General economic environment

The **global economy** accelerated considerably in 2017, ending the downward growth trend that had persisted since 2011. The industrialised nations, developing countries and emerging economies all contributed to this. Preliminary figures show that more than half of all countries worldwide increased their growth rate year-on-year. After a weak start, the US economy performed very robustly, and the Japanese economy also grew more strongly than had been expected at the start of the year. The Chinese economy put in a strong performance, benefiting from policies implemented in the previous year. Inflationary pressure was only modest. Along with favourable financing conditions worldwide, this helped to underpin global growth. Over the course of the year, there was an easing of the uncertainty surrounding the political stability of the European Union, the direct consequences of the Brexit decision and the political stance of the new US administration especially on trade-related issues. As a result, world trade grew more strongly than in recent years, supported by a continuing recovery of investment activity in industrialised countries and emerging economies.

Economic performance in the member states of the **European Economic and Monetary Union (EMU)** surprisingly improved with the strongest growth since 2007. Overall, economic output in EMU member states rose by 2.5% year-on-year in 2017. The growth rate was thus also higher than KfW expected a year ago. Growth now has a broad foundation, both in terms of regions and the sources of demand. Consumer spending reaffirmed its role as a dependable pillar of growth, driven by the continuing improvement on labour markets and the associated rise in incomes. An additional boost was provided especially by the upturn in global trade, from which the European economy was also able to benefit despite the appreciation of the euro over the course of the year. With political risks subsiding as the year progressed and supported by a tailwind from foreign trade, corporate sentiment significantly improved, causing companies to overcome their reluctance to invest and make greater use of the favourable financing conditions.

Germany grew strongly by 2.2% in 2017 according to preliminary estimates by the German Federal Statistical Office, thus outpacing the growth recorded in 2016 (1.9%). A year ago, KfW predicted that economic growth would slow to 1.3% in 2017. Like almost all forecasters, it thus underestimated the actual development of gross domestic product. The 2017 publicly available economic growth forecasts at the end of 2016 ranged from 0.9% to 1.7%. The main reason for what later proved to be overly cautious growth expectations for 2017 was the view taken on the prevailing political uncertainty. Given Germany's export focus, KfW expected that the uncertain consequences of the Brexit vote and the risk of a less open system of world trade following US policy would permit only a moderate increase in corporate investment. This despite generally favourable conditions for investment, such as the already very high utilisation of industrial capacity. In fact, however, the impact of these risks on corporate investment was far less than feared. Private sector investments in equipment actually accelerated in 2017. Residential construction and consumer spending remained on their clear upward trajectory and made a substantial contribution to the year's strong growth. With growth in both exports and imports increasing, net exports provided only a slight stimulus to economic growth.

The **financial markets** presented a favourable picture overall in 2017 and were spared from turbulence. The strong stock market performance on both sides of the Atlantic was notable. There was little price fluctuation and volatility indices were at historically low levels. Optimism among equity investors was fed by surprisingly strong global economic growth combined with a continuation of a highly expansionary monetary policy by the major central banks. This policy kept interest rates especially in Europe and Japan at extremely low levels. International investors also showed growing interest in euro zone investments again in 2017. One significant trigger for this was the victory by the pro-European candidate Emmanuel Macron in the French presidential elections. Investor sentiment was boosted once again at the end of the year by the passing of the US tax reform bill. The crude oil price also rose substantially in 2017, which is likely to have fuelled higher growth in oil-exporting countries and thus bolstered the world economy as a whole.

In 2017, the European Central Bank began a gradual withdrawal from its unconventional monetary policy by reducing the volume of its monthly bond purchases from EUR 80 to EUR 60 billion from April onwards. Amid steadier inflation and strong growth, it decided in the autumn to halve its bond purchases from January 2018 onwards and to maintain this level until at least September 2018. At the same time, it repeatedly indicated in 2017 that it will not raise interest rates until well after the bond purchasing programme has ended. Against this backdrop, money market rates in the euro zone remained at historically low levels (and in negative territory), while the capital market experienced slight rate increases. Yields on ten-year German government bonds in 2017 were up by an average of approximately 24 basis points year-on-year and stood at 0.43% at year-end. Averaged over the year, the yield curve steepened considerably, which noticeably benefited bank stocks. From early 2017, the ECB began for the first time to buy bonds with yields below the ECB deposit rate of –0.40%, which partly explains the steeper yield curve. Initially, the ECB's move put further downward pressure on yields for short-term bonds that were already close to the deposit rate.

With the US Federal Reserve continuing its rate-hike cycle, money market rates in the US continued to increase throughout 2017. The Federal Reserve raised rates three times in 2017 to a range of 1.25% to 1.50% for its benchmark rate by the end of the year. It also began to gradually reduce its balance sheet. Beginning in the autumn, maturing bonds from the Fed's portfolio were no longer replaced by new purchases. On the US sovereign bond market, yields increased mainly for short-term bonds. Market participants believed that, although the Fed would conduct several rate hikes in the near term, it would struggle to raise key rates beyond the region of 2% in the medium term given the advanced stage of the business cycle. This resulted in a noticeable flattening of the yield curve. In early 2017, the yield spread between ten-year and two-year US government bonds was above 120 basis points. This narrowed to just over 50 basis points by the end of the year. The yield on ten-year bonds rose by just under ten basis points to around 2.40% over this period.

The EUR/USD exchange rate rose noticeably in 2017 – from around USD 1.05 per EUR at the start of the year to EUR 1.20 at year-end. The strength of the euro against the US dollar was not explained by a smaller interest rate differential, but by the rediscovery of the euro zone by international investors following the positive outcome of the French presidential elections. From this point in time, the EUR/USD rate rose significantly before consolidating in the autumn. The average for the year of 1.13 in 2017 was slightly up on the previous year's rate of 1.11.

Strategic objectives

KfW Group has a set of strategic objectives in place that define KfW's targeted medium-term positioning. This framework encompasses selected top-level objectives at the overall bank level and serves as a central, binding reference for the strategic orientation of all business sectors, with a five-year horizon.

The **primary objective of all of KfW's market areas is promotion** – the heart of KfW's business activities – abiding by the fundamental principles of subsidiarity and sustainability. KfW addresses the primary objective of promotion largely by focusing its promotional activities on the socially and economically important megatrends of "climate change and the environment", "globalisation", "digitalisation and innovation", and "social change".

In relation to the "climate change and the environment" megatrend, KfW finances measures to support renewable energies, improve energy efficiency, safeguard biodiversity and prevent and/or reduce environmental pollution. To address the particular importance of this megatrend, KfW has set an environmental commitment ratio of around 35% of total promotional business volume. In the context of the "globalisation" megatrend, KfW contributes to strengthening the international competitiveness of German companies by granting loans for projects to secure Germany's supply of raw materials and in areas such as infrastructure and transport. The "digitalisation and innovation" megatrend reflects the importance of the increasing digitalisation that is critical to the German economy's success. Establishing the megatrend sets the standard for advancing and expanding targeted promotion in this area through suitable product approaches. Measures such as the planned expansion of domestic equity financing are a direct response to this megatrend. KfW's objective with respect to the "social change" megatrend is focused on the issues of demographic change in the stricter sense (e.g. age-appropriate infrastructure, follow-on financing) and vocational and further training. KfW's domestic commitment to meeting the challenges presented by the influx of refugees is also reflected in this megatrend. KfW also focuses on "non-trend-based promotional issues" that play an important role for KfW but that are not related to any of the four megatrends, such as combating poverty in developing countries. In addition to focusing on the issues described above, the primary objective in the bank's strategic framework also extends to covering KfW's most important customer groups and regions as well as to ensuring promotional quality. For KfW, this means a commitment to maintain the high level of quality of its promotional products that it has achieved in recent years and sufficient coverage of KfW's key regions and customer groups. Given the special importance of SMEs, KfW aims to have around 45% of its domestic promotional business volume utilised for this target group.

The stated priorities set for the primary objective are complemented by a set of secondary objectives or strict ancillary conditions that reflect profitability and efficiency, risk-bearing capacity, as well as liquidity and regulatory aspects. KfW acts in accordance with the principle of subsidiarity and plans nominal growth of 2% to 3% p.a. as measured by the group's total new commitment volume. Moreover, KfW's success depends upon a high level of customer and employee satisfaction as well as continuing to pursue the path of professionalism in the modernisation process upon which it has embarked.

Internal management system

KfW has a closely interlinked strategy and planning process. Conceived as a group-wide strategy process, group business sector planning is KfW Group's central planning and management tool. Group business sector planning consists of two consecutive sub-processes performed every year: strategic planning and operational planning. The overall strategy and planning process includes close communication between the employees responsible for planning in all areas including the Risk Controlling department.

The group-wide strategic objectives set by the Executive Board form the basis for the strategic planning. In particular, the system of objectives serves KfW Group as a clear roadmap, indicating the direction in which KfW would like to develop over the next five years. The system defines KfW Group's medium-term targeted positioning and sets top-level objectives at overall bank level. The strategic objectives are reviewed annually for topicality, completeness and aspiration level and adjusted where necessary – for example, due to changed parameters or newly determined focal areas. Efforts are made, however, to maintain a high degree of consistency to ensure that there are no fundamental changes made to strategic impetus in the course of the annual review. Strategic medium-term courses of action are developed by the business sectors in a base case within this strategic framework. Assumptions regarding to the future development of determining factors are made on the basis of assessments of risks and opportunities. This analysis takes into account both external factors (including market development, regulatory requirements, the competitive situation and customer behaviour) and internal factors and resources (including human, technical and organisational resources, promotional expense, primary cost planning and tied-up capital) as well as targeted earnings levels. It involves regular evaluation of the key business and revenue drivers for the business sectors and the group. The central departments (e.g. information technology, human resources and central services) play important roles in achieving the strategic objectives. By involving these departments, their own strategies are aligned with the strategic objectives. The first regular capital budgeting in the base and stress case will be undertaken on a multi-year horizon on the basis of the strategic business sector planning. This enables early identification of any capital bottlenecks arising from strategic assessment or changed parameters and counteraction to be taken by resolution of relevant measures. Cost planning and full-time equivalent (staff) planning are conducted in parallel to strategic planning for all business sectors for the entire planning period. The underlying assumptions are reviewed annually via a rolling planning process. The Executive Board defines business sector objectives for all sectors in the form of guidelines (with regard to operations, risk and budget) for the entire planning period on the basis of the group-wide strategic assessment.
Strategic group-level planning was expanded this year to include business strategy scenario analysis. Scenario analysis is a "what if" analysis of a specific but plausible scenario, looking at the interaction of external influencing factors. The results of this analysis are then translated into management-relevant parameters in the new business, earnings and risk/capital dimensions. Such scenarios assist the process of identifying potential risks and opportunities for promotional targets and KfW's profitability and risk-bearing capacity, thus facilitating the inclusion of these factors in the further planning process.

In operations planning, the business sectors plan their new business, risks and earnings, and all departments of the bank plan their budgets based on the guidelines issued by the Executive Board, taking into account any changes in external or internal factors. These plans are checked for consistency with the group's and business sectors' strategic planning. The forecast interest rate development is a key factor in KfW's earnings position. Thus, a high and a low interest rate scenario are also examined in addition to the anticipated base case. The plans are also assessed for future risk-bearing capacity in a second round of regular capital budgeting over a multi-year horizon. The Executive Board either approves the resultant operating budget or has plans fine-tuned in a revision round. The external assumptions underlying the plans are also checked at this stage. The operational planning process ends when the Executive Board has adopted a final budget for the entire planning period, including the future capital requirement.

The key conclusions from the planning process are incorporated into the business and risk strategies. The management has overall responsibility for formulating and adopting both strategies. The business strategy comprises the group's strategic objectives for its main business activities as well as important internal and external factors, which are included in the strategy process. It also contains the business sectors' contribution to the strategic objectives and the measures for achieving each objective. Moreover, the business strategy combines the operating budget at the group and business sector levels. The Executive Board sets KfW Group's risk policies in its risk strategy, which is consistent with the business strategy. KfW Group has defined strategic risk objectives for factors including risk-bearing capacity and liquidity. The main risk management approaches and risk tolerance are also incorporated into the risk strategy as a basis for operational risk management. Any changes to the business strategy are subject to consultation with the Risk Controlling department in order to ensure consistency between the business and risk strategy.

The Executive Board draws up the operating budget for the entire planning period, including any future capital requirement as well as the business and risk strategy. The budget is then presented to the supervisory body (Board of Supervisory Directors) for approval, along with the business and risk strategy for discussion. After the Board of Supervisory Directors decided on the business and risk strategy, it is appropriately communicated to the staff.

When the group business sector planning is approved, this establishes the group's qualitative and quantitative objectives. The Executive Board reviews achievement of these objectives as part of controlling on both a regular and an ad hoc basis during the current financial year. The assumptions concerning external and internal factors made when determining the business strategy are also subject to regular checks. The development of relevant control variables, their attainment, and the cause of any failure in this respect are analysed as part of strategic controlling. Strategic assumptions are reviewed and a systematic planned vs actual comparison of early objectives and forecasts is performed at the beginning of every year. Experience gained from this comparison is incorporated into the next planning process. This is accompanied by an annual structured peer group comparison of key indicators, which yields important contributions to systematic assessment and indicates any need for action. The integrated forecasting process serves at mid-year as a comprehensive basis for interim quantitative management input on group variables of strategic importance (new business, risks and earnings, taking funding opportunities into account), while functioning as a well-founded guide to achieving planned objectives. Promised benefits (e.g. project efficiencies) are pooled and monitored as part of strategic controlling to enable appropriate consideration in business sector planning. Ad hoc issues of strategic relevance are also addressed in consultation with the group's departments. Recommendations for action concerning potential strategy adjustments or optimising the use of resources are made to the Executive Board by means of the strategic performance report. The results of the analysis are included in further strategy discussions and strategic planning processes. The achievement of objectives is regularly monitored by the Board of Supervisory Directors based on reports submitted under KfW Bylaws. The commentary in these reports outlines analyses of causes and any potential plans for action. Comprehensive and detailed reports are prepared on a monthly or quarterly basis as part of operational controlling. These comprehensive detailed analyses at group, business sector and/or product group level comprise earnings, cost and full-time equivalent (staff) developments and are reported to specific departments. Additionally, complete analyses of significant relevance to overall group performance are also presented directly to the Executive Board. The risk controlling function has been implemented alongside strategic and operational controlling. Early warning systems have been established and mitigation measures defined for all material risk types in line with the risk management requirements set out in the risk strategy. All controlling and monitoring approaches are integrated into regular and comprehensive risk reporting.

Alternative key financial figures used

KfW uses key financial figures in its strategic objectives that treat promotion as the core business activity. It also uses key figures which summarise the results reported on the income statement prepared in accordance with commercial law on the basis of their economic substance.

KfW has defined the following main alternative key financial figures calculated at group level in accordance with IFRS:

Promotional business volume

Promotional business volume refers to the commitments of each business sector during the reporting period. In addition to the lending commitments shown in the statement of financial position, promotional business volume comprises loans from Federal Government funds for promotion of developing countries and emerging economies – which are accounted for as trust activities – financial guarantees, equity financing and securities purchases in certain asset classes (green bonds, SME loan securitisation). Promotional business volume also includes grants committed as part of development aid and in domestic promotional programmes. Allocation to Promotional business volume for the current financial year is generally based on the commitment date of each loan, financial guarantee and grant, and the transaction date of the equity finance and securities transactions. In departure from this, allocation of global loans to the promotional institutions of the federal states *(Landesförderinstitute – "LFI")* and BAföG government loans is based on individual drawdown volume and date, instead of the total volume of the contract at the time of commitment. Financing amounts denominated in foreign currency are translated into euros in the lending business at the exchange rate on the commitment date, and in the securities and equity finance business generally at the rate on the transaction date.

Promotional expense

The term "promotional activity" is to be replaced in internal and external communication from 2018 by the term "promotional expense" with the definition fundamentally unchanged. **Promotional expense** is understood to mean certain expenses of the two business sectors Mittelstandsbank (SME Bank) and Kommunal- und Privatkundenbank/Kreditinstitute (Municipal and Private Client Bank/Credit Institutions) with a positive impact on the achievement of KfW's promotional objectives.

The key component of KfW's promotional expenses comprise interest rate reductions accounted for at present value. KfW grants these reductions for certain domestic promotional loans for new business during the first fixed interest rate period in addition to passing on KfW's favourable funding conditions. The difference between the fair value of these promotional loans and the transaction value during the first fixed interest rate period, due to the interest rate being below the market rate, is recognised in profit or loss as an interest expense and accounted for as an adjustment to the carrying amount under the items Loans and advances to banks or Loans and advances to customers. In addition, the amount by which interest rate reductions are compounded over the fixed interest rate period is recognised in Net interest income through profit or loss (see the relevant Notes on "Accounting policies").

As of financial year 2017, promotional components in Commission expense exclusively comprise upfront fees paid to sales partners for processing microloans. Promotional expenses from KfW's one-time financing share in the advisory programme newly launched by the Federal Office of Economics and Export Control *(Bundesamt für Wirtschaft und Ausfuhrkontrolle – "BAFA")* to promote entrepreneurial knowledge and skills were also included in the comparative figures for the previous year.
Promotional expense also contains disposable and product-related marketing and sales expenses (Administrative expense).

Cost-income ratio (before promotional expense)
The cost-income ratio (before promotional expense) comprises Administrative expense (excluding promotional expense) in relation to Net interest income and Net commission income before promotional expense.
The cost-income ratio (CIR) shows costs in relation to income and is thus a measure of efficiency. By incorporating the CIR as a long-term measure of efficiency into its strategic objectives, KfW aims to strengthen its leading position in Germany's promotional banking landscape. The reason for this way of calculating the cost-income ratio is that promotional expense is a promotional bank-specific expense (and, as an interest rate reduction accounted for at present value, gives a multi-period view). To enable comparison of the CIR with other (non-promotional) institutions and to determine a correct standardised amount, it is necessary to eliminate promotional expenses from the numerator (Administrative expenses) and denominator (Net interest income and Net commission income). Promotional expense is managed separately and independently via own budgets.

Development of KfW

In 2017, KfW slightly reduced its promotional business as planned, recording a total volume of EUR 67.0 billion after EUR 71.1 billion the previous year. Given the strong economic performance and the sustained positive financing environment for commercial and private investors, KfW decreased its promotional business in Germany to EUR 51.8 billion in 2017 from EUR 55.1 billion in 2016. Promotional activities focused on innovation, start-ups and business energy efficiency, all of which recorded significant growth. KfW posted a volume of EUR 13.7 billion in international business activities (2016: EUR 14.8 billion), largely due to a considerable increase in financial cooperation commitments in developing countries and emerging economies, whose volume rose to EUR 8.2 billion (2016: EUR 7.3 billion). Export and project finance achieved a business volume of EUR 5.5 billion (2016: EUR 7.5 billion) in a highly competitive environment. As in the preceding years, KfW focused its promotional activities on qualitative targets such as supporting climate and environmental protection in 2017.

KfW's **earnings position** continued its stable development despite the volatile market environment in financial year 2017, although it closed below the prior-year level. Net interest income before promotional expense was slightly below the previous year's figure. Increased Administrative expense and risk provisions for lending business above the level of the prior year but still below plan put pressure on the profit for the year. The cost-income ratio (before promotional expense) increased to 47.6% (2016: 42.7%) due to the rise in Administrative expense and decline in net interest income. KfW sustainably strengthened its capital base due to its good earnings position, with a profit for the year of EUR 895 million.

Total assets fell from EUR 500.7 billion to EUR 477.9 billion, with business volume decreasing from EUR 577.9 billion to EUR 553.1 billion.

Business performance in 2017 was largely characterised by the following developments:

A. Promotional business volume

KfW slightly decreased its promotional business in financial year 2017 for economic reasons. Promotional commitment volume decreased as planned by EUR 4.1 billion from the previous year's EUR 71.1 billion to EUR 67.0 billion in 2017. Demand in Germany decreased by EUR 3.3 billion from EUR 55.1 billion to EUR 51.8 billion. This enabled new business volume in the business sector Mittelstandsbank (SME Bank) to be further increased to EUR 21.9 billion (2016: EUR 21.4 billion). This development mainly reflects the high demand for investment loans for business energy efficiency, digitalisation and innovation. Commitments of EUR 6.0 billion in the **general corporate finance** priority area were slightly below the prior-year level of EUR 6.4 billion. **Start-up finance** recorded positive performance and at EUR 3.8 billion again exceeded the pleasing result of the previous year (2016: EUR 3.6 billion) despite a general decline in start-up activities. A very strong result was posted for **innovation financing,** which was considerably above the prior-year level with commitments of EUR 2.0 billion (2016: EUR 0.6 billion), driven primarily by the new ERP innovation and digitalisation programme.
The **environment** priority area achieved an excellent result in 2017, with a promotional business volume of EUR 10.2 billion (2016: EUR 10.7 billion). At EUR 5.7 billion, the promotional programmes aimed at energy-efficiency projects in commercial enterprises exceeded the already very strong prior-year level of EUR 5.2 billion. The commitments in the KfW Renewable energy programme on the other hand fell short of the previous year's record of EUR 4.7 billion, but posted a positive result of EUR 3.9 billion.

The business sector Kommunal- und Privatkundenbank/Kreditinstitute (Municipal and Private Client Bank/Credit Institutions) had a successful financial year with new business volume of EUR 29.9 billion, compared to EUR 33.7 billion in 2016. The key factor was sustained high demand in the key promotional area **housing** at EUR 18.9 billion (2016: EUR 20.8 billion), particularly the Energy-efficient Construction and Refurbishment grant programme at EUR 14.2 billion (2016: EUR 15.5 billion). Commitments with a volume of EUR 3.9 billion were issued in the **infrastructure finance** segment (2016: EUR 4.1 billion). The **education and social development** promotional area recorded a total business volume of EUR 2.2 billion, only just short of the previous year's EUR 2.3 billion, but still stable.

Commitments in **international financing** of EUR 13.7 billion were below the prior-year level of EUR 14.8 billion. The greatest demand in the Export and project finance business sector came from Shipping CIRR bank refinancing of EUR 1.7 billion (2016: EUR 1.7 billion), Maritime Industries of EUR 0.9 billion (2016: EUR 1.6 billion) and Power, Renewables and Water of EUR 0.8 billion (2016: EUR 1.3 billion). The business area KfW Development Bank further increased new commitments. Around EUR 8.2 billion in financing was provided to developing countries and emerging economies over the past year on behalf of the German Federal Government (2016: EUR 7.3 billion), 55% of which was destined for climate and environmental protection projects. Projects in Africa and the Middle East will be financed by almost 40% of all new commitments.

Promotional business volume

	31. Dec. 2017 EUR in millions	31. Dec. 2016 EUR in millions	Change EUR in millions	Change in %
Domestic business	**51,812**	**55,086**	**–3,274**	**–6**
Mittelstandsbank (SME Bank)	21,899	21,388	511	2
Kommunal- und Privatkundenbank/Kreditinstitute (Municipal and Private Client Bank/Credit Institutions)	29,913	33,698	–3,785	–11
Financial markets	**1,541**	**1,274**	**267**	**21**
International business	**13,673**	**14,774**	**–1,101**	**–7**
Export and project finance	5,476	7,484	–2,008	–27
Promotion of developing countries and emerging economies	8,197	7,290	907	12
Volume of new commitments	**67,026**	**71,134**	**–4,108**	**–6**

B. Operating result below prior-year level

The operating result before valuation and before promotional expense for financial year 2017 stood at EUR 1,226 million and thus below the previous year's level of EUR 1,450 million. Net interest income was only slightly down from the previous financial year. Commission income remained at the 2016 level. Increased Administrative expense as a result of higher pension expenses and expenses from measures to modernise the group as well as regulatory measures (mandatory application of the KWG) negatively affected the result.

C. Risk provisions burden valuation result

Risk provisions for lending business were at a low level of EUR 122 million (2016: EUR 89 million net income), and had a negative impact on the result. This was due in particular to net additions to the individual risk provisions in the business areas Mittelstandsbank (SME Bank) and Privatkundenbank (Private Client Bank), primarily from education financing. These effects were partially offset by recoveries on loans written off.

A low net income of EUR 5 million was recorded from the valuation of equity investments (2016: net loss of EUR 28 million). The securities portfolio continued to make a positive, although lower, contribution of EUR 6 million (2016: EUR 14 million).

Overall, the result continued to benefit from low risk provisions compared to the bank's total loan portfolio.

D. Limited scope for reductions in the low interest rate environment

KfW's domestic promotional expense, which had a negative impact on KfW Group's earnings position in the financial year, fell slightly again to EUR 213 million in 2017 (2016: EUR 230 million), which was lower than expected.

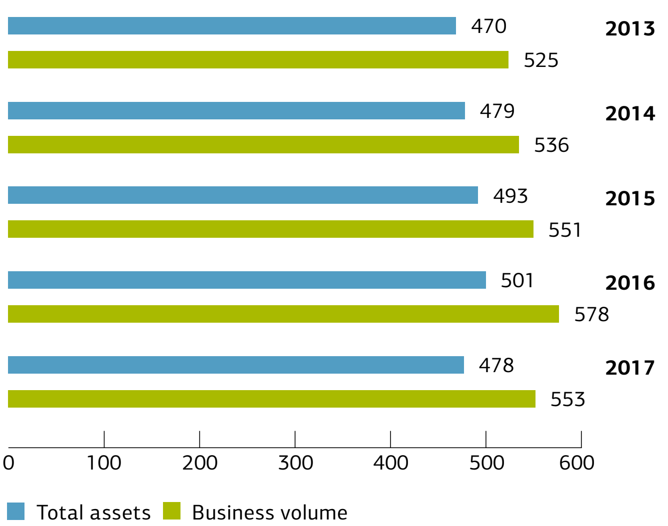
The key components of promotional expense are reductions of interest rates, which reached a volume of EUR 186 million (2016: EUR 193 million). The decline resulted primarily from the lower volume of commitments subsidised with KfW funds of EUR 11.7 billion (2016: EUR 11.9 billion) due to the sustained low interest rate environment.

Development of net assets, financial position and results of operations

KfW saw both its total assets and its volume of business decrease in financial year 2017.

Total assets and volume of business

EUR in billions



Volume of receivables

The volume of receivables (loans and advances to banks and customers, including irrevocable loan commitments, loans held in trust and guarantees) decreased from EUR 502.0 billion to EUR 491.6 billion.

The decline is primarily due to a decline in money-market transactions for both loans and advances to banks (–EUR 4.2 billion) and loans and advances to customers (–EUR 4.5 billion). In loans and advances to banks, lower receivables from term deposits of EUR 12.9 billion (2016: EUR 24.6 billion) were offset by increased Credit Support Annex (CSA) cash collateral receivables of EUR 9.5 billion (2016: EUR 2.4 billion).

The volume of loans held in trust, which primarily comprised loans to promote developing countries financed by budget funds provided by the Federal Republic of Germany, remained almost unchanged at EUR 12.7 billion (2016: EUR 12.1 billion).

Guarantees fell by EUR 0.3 billion to EUR 0.8 billion, while irrevocable loan commitments declined more strongly by EUR 1.7 billion to EUR 74.4 billion, largely due to a decrease in export financing.

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions	Change EUR in millions	Change in %
Loans and advances to banks	302,028	304,674	–2,646	–1
Loans and advances to customers	102,255	107,416	–5,160	–5
Loans held in trust	12,124	12,727	–603	–5
Contingent liabilities from financial guarantees	755	1,114	–359	–32
Irrevocable loan commitments	74,398	76,089	–1,691	–2
Total	**491,560**	**502,019**	**–10,459**	**–2**

Funding

In the year under review, KfW funded its business predominantly by issuing bonds in the capital market. It raised funds totalling EUR 78.2 billion in 2017 (2016: EUR 72.8 billion) and issued 145 bonds in ten currencies.

Bonds and notes decreased by EUR 13.7 billion year on year and totalled EUR 408.6 billion as of 31 December 2017. Fluctuations in foreign exchange rates, particularly in that of the US dollar, had an impact on portfolio development, as did new issues and maturities.

Bonds and notes accounted for 96.0% of borrowed funds, which was slightly more than the previous year (92.8%). They therefore remain KfW's most important source of funding. The euro market share registered a multi-year high of 53% (2016: 36%), in contrast to the US dollar market share, which decreased to 34% (2016: 47%). Excellent results were achieved on the pound sterling market despite the Brexit-induced uncertainties. KfW is in fact the largest issuer in the segment with the equivalent of EUR 5.4 billion.

The green bond market remained dynamic in 2017. The outstanding volume of "Green Bonds – Made by KfW" now amounts to EUR 12.9 billion and corresponds to a global market share of just under 6%. KfW issued seven transactions in four currencies this year – including two private placements in US dollar for the first time – with a total volume of EUR 3.7 billion.

The share of funds from banks and customers (excluding federal budget funds), at 3% of borrowed funds, is below the previous year's level (7%). This includes cash collateral received primarily to reduce counterparty risk from the derivatives business in the amount of EUR 4.1 billion (2016: EUR 17.6 billion). The subordinated loan in the amount of EUR 0.2 billion reported in 2016 was granted through the ERP Special Fund as part of the restructuring of the 2007 ERP economic promotion programme. KfW repaid this loan early in financial year 2017.

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions	Change EUR in millions	Change in %
Federal Republic of Germany				
– ERP Special Fund	633	480	153	32
– Federal budget	3,233	2,500	733	29
	3,866	**2,980**	**886**	**30**
Other lenders	5,268	7,787	–2,519	–32
Liabilities to customers	**9,134**	**10,767**	**–1,633**	**–15**
Liabilities to banks	**7,991**	**22,002**	**–14,011**	**–64**
Bonds issued	52,693	63,336	–10,643	–17
Bearer securities (incl. Commercial Papers)	352,793	355,460	–2,667	–1
Accrued interest	3,120	3,472	–352	–10
Bonds and notes	**408,606**	**422,268**	**–13,662**	**–3**
Subordinated liabilities	**0**	**200**	**–200**	**–100**
Total	**425,731**	**455,237**	**–29,506**	**–6**

Own funds

The fund for general banking risks remained unchanged from the previous year at EUR 0.6 billion. The entire profit of EUR 895 million was allocated to retained earnings.

KfW's own funds thus amounted to EUR 24.7 billion as of 31 December 2017, 3.8% up on the previous year. This increase was due exclusively to the net profit allocated to retained earnings.

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions	Change EUR in millions
KfW's subscribed capital	3,750	3,750	0
Uncalled outstanding contributions	–450	–450	0
Capital reserves	8,447	8,447	0
Promotional reserves of the ERP Special Fund	*7,150*	*7,150*	*0*
Reserves from the ERP Special Fund	1,191	1,191	0
Retained earnings			
a) Statutory reserve under Article 10 (2) KfW Law	1,875	1,875	0
b) Special reserve under Article 10 (3) KfW Law	9,207	8,312	895
c) Special reserve under Section 17 (4) D-Mark Balance Sheet Act[1)]	48	48	0
Fund for general bank risks under Section 340g HGB	600	600	0
Total	**24,668**	**23,772**	**895**

[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 Act (EUR 26 million)

Both the regulatory total capital ratio and the tier 1 capital ratio were 20.6% (2016: both 22.3%). Ratios are determined based on IAS figures for the group.

Changes in other significant items in the statement of financial position

Total bonds and other fixed-income securities increased slightly by EUR 0.7 billion to EUR 39.2 billion (2016: EUR 38.5 billion). By contrast, holdings of repurchased own issues dropped from EUR 9.1 billion the previous year to EUR 8.7 billion. This was equivalent to 2% of bonds and notes.
At a total amount of EUR 30.5 billion, holdings of securities from other issuers, which make up 78% of the total holdings of all bonds and other fixed-income securities, slightly exceeded the previous year's level of EUR 29.4 billion by EUR 1.1 billion. Of the securities from other issuers, 80% 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 carrying amount of EUR 4.8 billion (previous year: EUR 4.9 billion), related to its securitisation and SME finance activities. Potential risks are sufficiently addressed by appropriate risk provisioning.
KfW supported climate protection through its green bond portfolio in 2017, buying green bonds with a volume of around EUR 350 million.

The value of shares in affiliated companies amounted to EUR 3.3 billion and rose slightly year on year by EUR 0.2 billion.

Other assets fell this year by EUR 15 billion to EUR 0.6 billion. This is primarily due to the decrease in the currency adjustment item from foreign currency derivatives induced by currency fluctuations. This assets-side item primarily comprises the receivable of EUR 0.6 billion from the Federal Agency for Special Tasks associated with 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 of 1 January 2008. However, BvS remains the beneficial owner of the SinA obligations. This receivable is offset by actuarial provisions in the same amount.

The primary component of deferred charges are the differences between the repayment amount and the lower issuing amount in the context of borrowed funds (discounts and placing commissions) and accrued upfront payments for derivative financial instruments. Deferred income includes in particular premiums from certificated liabilities and accrued upfront payments for derivative financial instruments deferred over the loan life.

Provisions remain unchanged from the previous year's total of EUR 2.2 billion. The total amount includes provisions for pensions and similar obligations (EUR 1.2 billion) and other provisions (EUR 1.0 billion). Other provisions include in particular the actuarial provisions relating to SinA, the provision for variable compensation components, the provisions for credit risks and provisions relating to the present value approach applied to interest rate reductions.

Earnings position

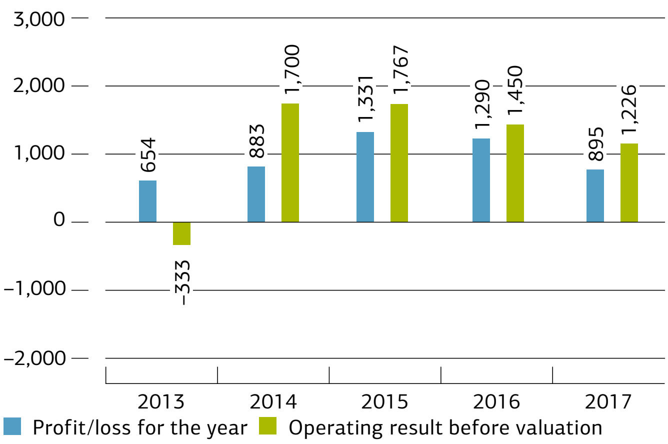
KfW's operating result before valuation and promotional expense was EUR 1,226 million, which was lower (by EUR 224 million) than the previous year's figure of EUR 1,450 million.
At EUR 1,964 million, Net interest income (before promotional expense) was slightly lower than the previous year (EUR 1,983 million). This was partly because of the discontinuation of a grant provided in previous years for ERP economic promotion (2016: EUR 98 million) that was no longer awarded in 2017. In addition, lower income from early repayment penalties and changes to the contractual terms of the Energy-efficient Construction and Refurbishment promotional programmes as of 1 July 2017, which meant that the remuneration was recognised in Net commission income, led to a decline in interest income. Thanks to the favourable funding conditions for KfW on the money and capital markets and the stable interest margins in the lending business, net interest income remained the main source of income despite having declined.

Net commission income (before promotional expense) of EUR 193 million was marginally below (by EUR 3 million) the previous year's level of EUR 196 million. This decline was primarily due to higher expenses arising from KfW IPEX-Bank GmbH's agency agreement to manage the Export and project finance trust activities (2017: EUR 108 million; 2016: EUR 85 million), and decreasing processing fees from Export and project finance amounting to EUR 12 million. This was offset by remuneration for the Energy-efficient Construction and Refurbishment programmes of EUR 74 million (2016: EUR 35 million).

Administrative expense (before promotional expense) increased by EUR 96 million to EUR 1,027 million, due to higher personnel expense resulting from the changes in legislation on discounting pension obligations in 2016. The average discount rates of the past ten years were effective in 2017, in contrast to the previous year, in which no additions to pension obligations with a negative impact on Administrative expenses were necessary due to the increased discount rate resulting from the new statutory requirement, which increased the average market rate to be applied from the past seven to the past ten years. Expenses for wages and salaries rose as well, due to wage increases and a larger number of employees. Non-personnel expense increased moderately in financial year 2017, largely due to higher costs for external service provision required to meet regulatory requirements and for the modernisation of KfW's information technology architecture. This extensive project portfolio is also expected to entail a rise in Administrative expenses in the future.
Lower depreciation and amortisation of property, plant and equipment and intangible assets have an offsetting effect on the result.

Net other operating income primarily comprised income from KfW IPEX-Bank GmbH's agency agreement.

Operating result before valuation and before promotional expense[1)] and profit/loss for the year
EUR in millions



[1)] From financial year 2013

The income of EUR 11 million (2016: loss of EUR 14 million) on the valuation of equity investments is largely due to sale proceeds, partially offset by impairments of equity investments. The reversal of impairment losses on securities made a positive contribution. There are negative differences to market values of EUR 5 million (2016: EUR 53 million) for securities in fixed assets not valued at the lower of cost or fair value.

In contrast to the previous year, risk provisioning resulted in a negative contribution to earnings of EUR 122 million (2016: EUR 89 million net income). Net additions to specific valuation allowances, particularly from education financing, and in Export and project finance, in the Transport and Social Infrastructure segment, were offset by income from successful recovery of loans written off. There was an increase in specific valuation allowances and specific provisions for the lending business from EUR 460 million to EUR 498 million. Non-performing loans in the amount of EUR 125 million were written off in financial year 2017 (2016: EUR 247 million). Expected losses were sufficiently covered by specific and general valuation allowances.

KfW's domestic promotional expense, which has a negative impact on the group's earnings position, amounted to EUR 213 million in 2017, following EUR 230 million in 2016, and was below the prior-year level and projections. The key component of KfW's promotional expense is interest rate reductions of EUR 186 million, granted during the first fixed interest rate period in addition to passing on its favourable refinancing conditions. Moreover, promotional expenses, as reported in Net commission income and Administrative expenses, were incurred in the amount of EUR 27 million (2016: EUR 37 million). This activity was aimed among other things at better and more targeted sales for KfW's promotional products.

Net other operating income declined considerably year on year, with a continued positive impact on the earnings position. The decline was largely due to the waiver of the repayment of a partial amount of the subordinated loan from the ERP Special Fund in 2016.

Financial year 2017 closed with profit for the period of EUR 895 million (2016: EUR 1,290 million), which was fully allocated to retained earnings.

Reconciliation of earnings position before promotional expense to the income statement prepared in accordance with commercial law for financial year 2017

Earnings position		Promotional expense	Cross compensation		German Commercial Code income statement form
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	
Net interest income (before promotional expense)	1,964	–186		1,777	Net interest income incl. current income
Net commission income (before promotional expense)	193	–14		179	Net commission income
General Administrative expense (before promotional expense)	1,027	13		1,040	General administrative expenses incl. depreciation, amortisation and impairments on property, plant and equipment and intangible assets
Other operating income and expenses	96			96	Other operating income and expenses
Operating result (before risk provisions/ valuation/promotional expense)	**1,226**	**–213**		**1,013**	**Operating result (before risk provisions/valuation)**
Valuation result	11		–4	7	Income from reversals of write-downs of equity investments, shares in affiliated companies and securities held as fixed assets
Risk provisions for lending business	–122		4	–118	Impairment of receivables and certain securities and additions to provisions for loan losses
Profit/loss from operating activities (before promotional expense)	**1,115**	**–213**		**902**	**Profit/loss from operating activities**
Promotional expense	213	–213		0	–
Taxes on income	5			5	Taxes on income
Other taxes	1			1	Other taxes
Profit for the year	**895**			**895**	**Profit for the year**

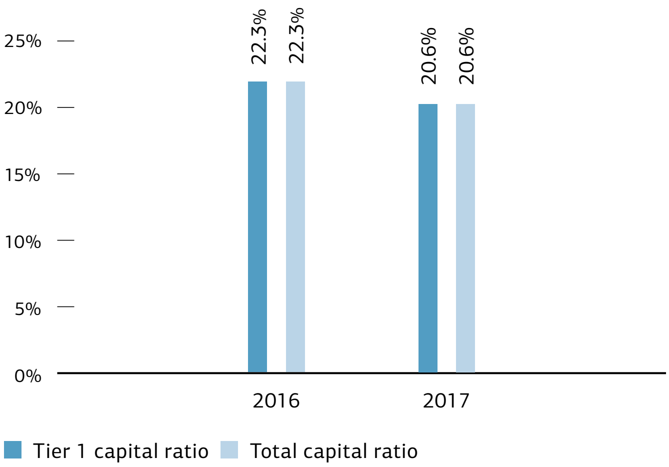
Risk report

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 KfW Group, a risk report is not prepared at single institution level.

Overview of key indicators

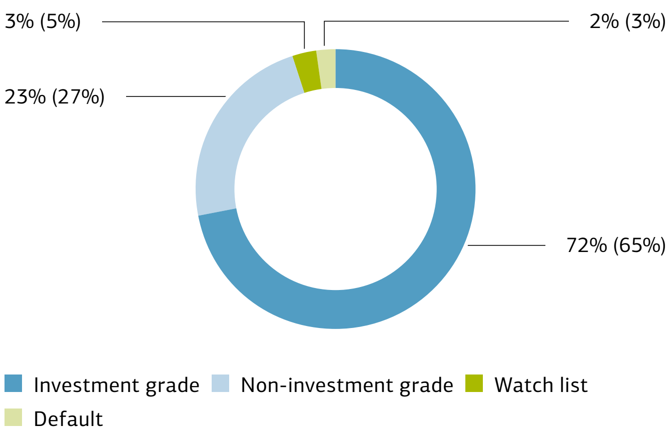
Risks are reported in accordance with KfW Group's internal risk management. The key risk indicators are presented below:

Regulatory capital ratios remain at a good level



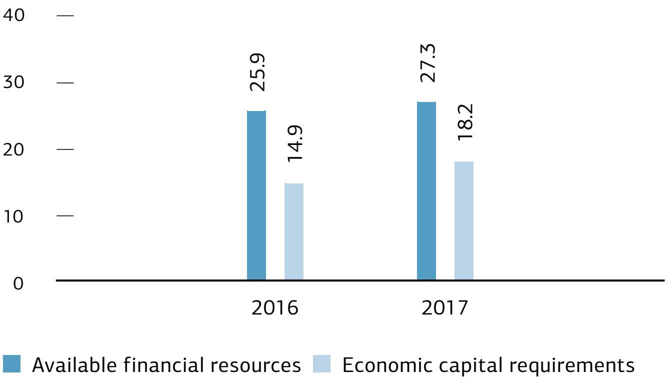
KfW obtained regulatory approval from BaFin to measure material portfolio segments using the advanced internal ratings-based (IRB) approach, with effect from 30 June 2017. The decline in the capital ratio is primarily due to transition effects resulting from the previous use by analogy of the IRB approach for internal purposes.

Credit risk: Good credit quality structure maintained
2017 (2016) Net exposure breakdown



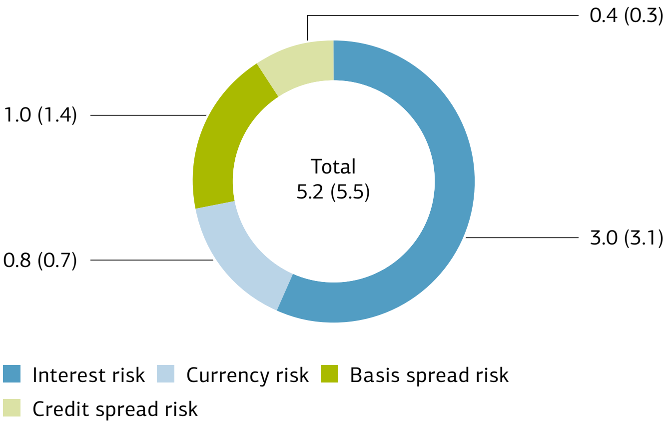
In 2017, the share of investment grade net exposure comprised 72% of the total net exposure. Risk provisions (specific and portfolio valuation allowances, loan loss provisions) declined slightly to EUR 1.5 billion (31 Dec. 2016: EUR 1.7 billion).

Economic risk-bearing capacity: Clearly secured
EUR in billions



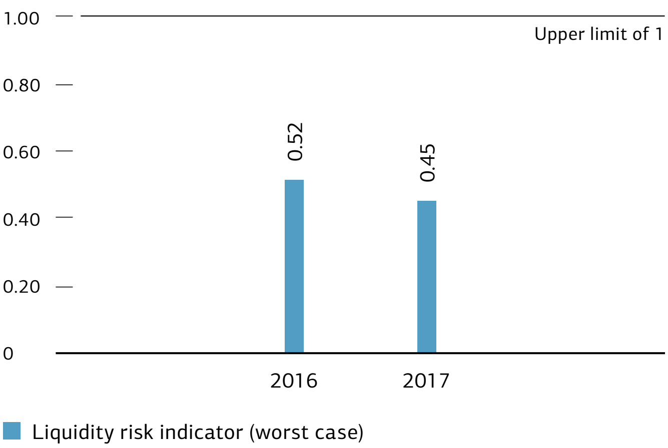
The excess coverage was reduced due to a higher total capital requirement. Overall, risk-bearing capacity is clearly secured at a solvency level of 99.99%.

Market price risks: Slight decrease in capital requirement
2017 (2016), ECAP EUR in billions



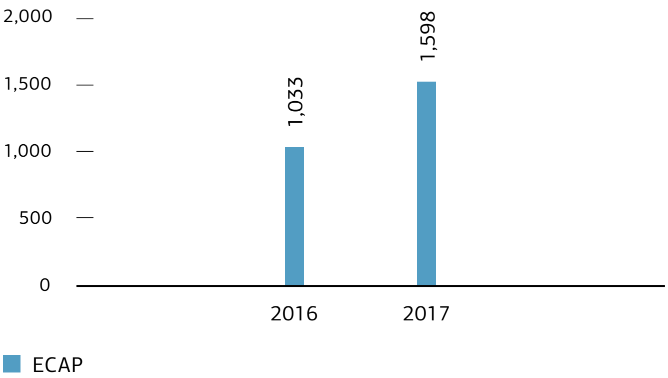
The capital requirement for market price risks declined slightly year on year. This was primarily due to a reduced ECAP requirement for basis spread risk, which was offset by the increased capital requirement for currency and credit spread risk.

Liquidity risk: Situation remains comfortable



The liquidity risk indicators remained considerably below the internal limit throughout 2017.

Operational risk: Significant increase in capital requirement
EUR in millions



Individual losses and updated risk scenarios led to a higher economic capital requirement in 2017.

Current developments

The global economy recorded real growth of over three percent for the fifth consecutive year in 2017, and momentum actually increased year on year. This relatively healthy development was a result of the broadly stable economic trend overall in many industrialised countries and emerging economies. While industrialised nations such as the USA, Canada, the Euro area and Japan posted significant increases in growth, the UK suffered a slowdown in growth – as was expected following the Brexit vote – although the country is still far from the recession forecast by many economists. Moreover, the current situation is not solely a result of the Brexit vote or the uncertainties caused thereby, but is also due to familiar problems such as the traditional twin deficit (concurrent budget and current account deficit) and the comparatively weak international competitiveness in the industrial sector. The key factor for the economic future of the UK, aside from the new relationship between the country and the EU, will be the necessary reorientation of the British economy. As for the large emerging economies, China and India more or less maintained their high level of growth of the previous year and Brazil and Russia came out of their recessions, while South Africa remained close to economic stagnation. Positive sentiment among consumers and businesses generated and buoyed by impetus from economic policy along with increased industrial production and a recovery in trade served to secure growth on a broad base in many countries. Growth expectations in the base scenario remain positive for 2018, as current sentiment indicators and new orders suggest that economic performance in many industrialised countries and emerging economies will remain stable and broadbased.

However, the improved growth momentum in 2017 should not disguise the fact that economic performance was restrained compared to previous upswing periods. Despite the evident improvements, the after-effects of the financial crisis are still noticeable in 2017 in the areas of productivity, investment, wage development and trade. The higher economic momentum in the industrialised nations was largely supported by the continuing expansionary monetary policy and increasingly also by an easing of fiscal policy. The downside to this economic policy is the steady rise in risks to be seen in the financial markets, because the long period of low interest rates has both increased risk tolerance and caused asset prices to climb, particularly in the residential property markets. Growth development, and thus the recovery process in the emerging economies and developing countries as well, where growth is still weaker than in the past, is being inhibited by reduced or delayed reform efforts and increasing financial risks as result of a rising debt load (primarily in China).

KfW Group observes and assesses these trends on a continuous basis. The downward adjustments to the country risk assessment in 2017 again mainly concerned countries that are highly vulnerable to external shocks (exporters of commodities, above all) and those with significantly increased political risks.

The development of the European banking sector remained unstable in 2017, but showed positive signs overall, due to, among other reasons, further capital increases by systemically important banks. The large number of non-performing loans (NPLs) and the resulting restrictions to business activity were a key issue last year. Ideas about forming a European "bad bank" or much more conservative risk provisions for NPLs from 2018 have not yet taken hold. More progress was made in sales of these to private investors in the second half of the year, particularly in Italy, where the majority of NPLs is concentrated, although most were sold well under book value. Despite this, the situation for Italian banks remained difficult. Several large banks had to be bailed out because of the oppressive problem loans. The government intervened directly to prevent losses for senior unsecured creditors, despite the Banking Recovery and Resolution Directive (BRRD). The fear of an excessive shock to the financial markets relating to senior unsecured losses remained significant as a considerable proportion of bank loan holders in Italy are private clients, among other reasons.

The weaknesses of the German banking sector, high administrative costs and low returns, force the banks to continue working on their business models. Problems affecting regional state banks *(Landesbanken),* some of which were still suffering greatly due to shipping loans and some of which were under privatisation pressure, could not be adequately solved. Moreover, the Bundesbank warned of the high interest-change risk in the savings and cooperative bank sector, which is particularly heavily dependent on net interest income. Uncertainties regarding future business opportunities in Europe for banks with registered offices in the UK prompted primarily Japanese banks to relocate their European headquarters to Frankfurt or Amsterdam. A feared deterioration of credit quality in the Turkish banking sector due to considerable depreciation of the Turkish lira combined with a high share of refinancing in foreign currencies has not yet materialised; credit growth and consequently the economy too were further sustained for the time being through the KGF – Credit Guarantee Fund. Different countries showed excessive valuation levels in the real estate markets (Sweden, Norway, Australia and Canada, above all) and high levels of consumer and automobile loans (US and UK above all), some of which were reminiscent of pre-crisis levels and could put pressure on the banking sector in the future. However, the banks in those countries currently appear robust and adequately prepared. Changes in the banking markets are under constant observation and assessment to enable undertaking risk-mitigating measures early on.

In light of stable domestic demand, positive overall performance continues to be expected for the German and European business sector in 2018. Given the high capacity utilisation, investment activity could moreover increase in Germany as well as in Europe, which would provide further positive economic impetus. Expectations for the US market are also favourable. The group continues to expect difficult performance only in the offshore oil sector. On the assumption that there will be no escalations in any of the different hotspots around the world, the group expects stable overall development in portfolio credit quality. The sub-portfolios concerned will be closely monitored on a continuous basis.

The group's portfolio recorded stable performance overall. All recognisable risks are measured using conservative standards and are taken into account in KfW Group's new business management through the systematic implementation of risk guidelines. The regularly performed calculations of risk-bearing capacity show that KfW Group can bear the risks assumed in the context of its mandate – even based on conservative stress scenarios. In financial year 2017, as in previous years, KfW Group systematically refined the processes and instruments in its risk management and controlling, taking into account current banking regulations. This particularly affected the further development of the measurement process for credit spread and settlement risks, the separation of continued development and validation of credit risk models at departmental level as well as revision of OpRisk management in terms of reporting and governance processes. After finalisation of the fifth amendment to the German Minimum Requirements for Risk Management *(Mindestanforderungen an das Risikomanagement* – "MaRisk"), KfW commenced the related implementation measures.

As a result of an amendment to the KfW Law in 2013 and the issuance of the "Regulation concerning key banking supervision standards under the German Banking Act to be declared applicable by analogy to KfW and supervision of compliance to these standards to be assigned to the German Federal Financial Supervisory Authority" (the "KfW Regulation"), the German legislature enacted an expanded application of the KWG to KfW. KfW has since been obliged to apply key bank regulatory standards (KWG and Capital Requirements Regulation, "CRR") by analogy. The German Federal Financial Supervisory Authority and the German Central Bank (Bundesbank) are responsible for supervising compliance with the relevant applicable bank regulatory standards. Since autumn 2015 KfW has been undergoing the approval process for application of the advanced IRB approach ("IRBA"). The initial IRBA (partial) approval was granted with effect as of 30 June 2017. Having obtained regulatory approval for the advanced IRBA, KfW applied the advanced IRB approach to capital market communication, internal management and reporting. The IRBA approval process is currently scheduled to be fully completed as of 30 June 2022 at the latest.

Basic principles and objectives of risk management

KfW Group has a statutory promotional mandate, which provides the basis for its special position and institutional structure. Sustainable promotion is KfW Group's overarching purpose. In order to utilise available resources to best carry out KfW Group's promotional mandate, it is vital to measure and control incurred risks. As part of its risk management, KfW Group takes risks only to the extent that they appear manageable in the context of its current and anticipated earnings position and the development of the risks. KfW Group's risk/return management takes into account the special characteristics of a promotional bank, with adherence to supervisory requirements constituting a fundamental prerequisite to the group's business activities.

KfW Group's risk culture forms the basis for efficient risk management; this culture is largely characterised by the promotional bank business model with no primary intention of generating profit and no trading book. In addition to the code of conduct, the risk culture is also marked by open communication, clear responsibilities and an appropriate incentive structure. In order to solidify risk management and controlling know-how within its organisation, KfW Group offers its employees training that includes a modular programme on risk topics. The training programme enables management and non-management staff throughout KfW Group to acquire basic knowledge or to deepen their specialised knowledge.

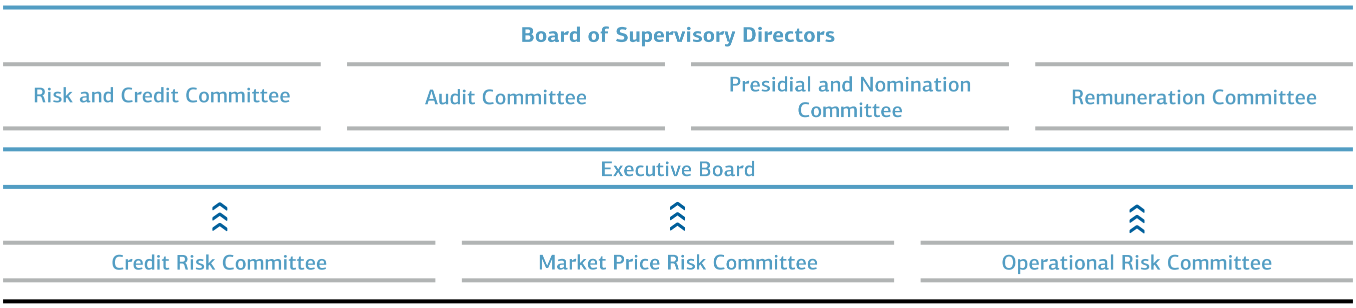
Organisation of risk management and monitoring

Risk management bodies and responsibilities

As part of its overall responsibility, KfW's Executive Board determines the group's risk policies. The Board of Supervisory Directors is informed at least quarterly of KfW Group's risk situation. The Presidial and Nomination Committee is responsible for dealing with legal and administrative matters as well as fundamental business and corporate policy issues. Moreover, in certain urgent cases, the committee has the authority to adopt resolutions in lieu of the Board of Supervisory Directors. The Chair of the Board of Supervisory Directors decides whether an issue is urgent. The Risk and Credit Committee is primarily responsible for advising the Board of Supervisory Directors on the group's current and future overall risk tolerance and strategy and supports it in monitoring implementation of the latter. It decides on loan approvals (including loans to members of management), operational level equity investments, funding and swap transactions, for which committee authorisation is required by the KfW Bylaws. The Audit Committee monitors, above all, the accounting process and the effectiveness of the risk management system and internal monitoring procedures and offers recommendations to the Board of Supervisory Directors concerning its approval of the consolidated financial statements. The Remuneration Committee monitors whether the structure of the remuneration system for the Executive Board and employees is appropriate.

In accordance with applicable bank regulatory provisions, the Remuneration Committee is also responsible for monitoring whether the structure of the remuneration systems for the heads of the Risk Controlling and Compliance functions and for any employees who have a significant impact on the group's overall risk profile is appropriate.

Risk management within KfW Group is exercised by closely interlinked decision-making bodies. At the top of the system is the Executive Board, which takes the key decisions on risk policy and receives relevant information for this purpose. 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 take their own decisions within their remits. The committees also perform KfW Group management functions; thus, representatives from the subsidiaries KfW IPEX-Bank and DEG are also included. Additional working groups do the preliminary work for these committees. Committee resolutions are adopted by simple majority with middle and back office departments (*Marktfolge*) or Risk Controlling being generally entitled to veto. An issue may be escalated to the Executive Board level in the Credit Risk Committee and the Operational Risk Committee.

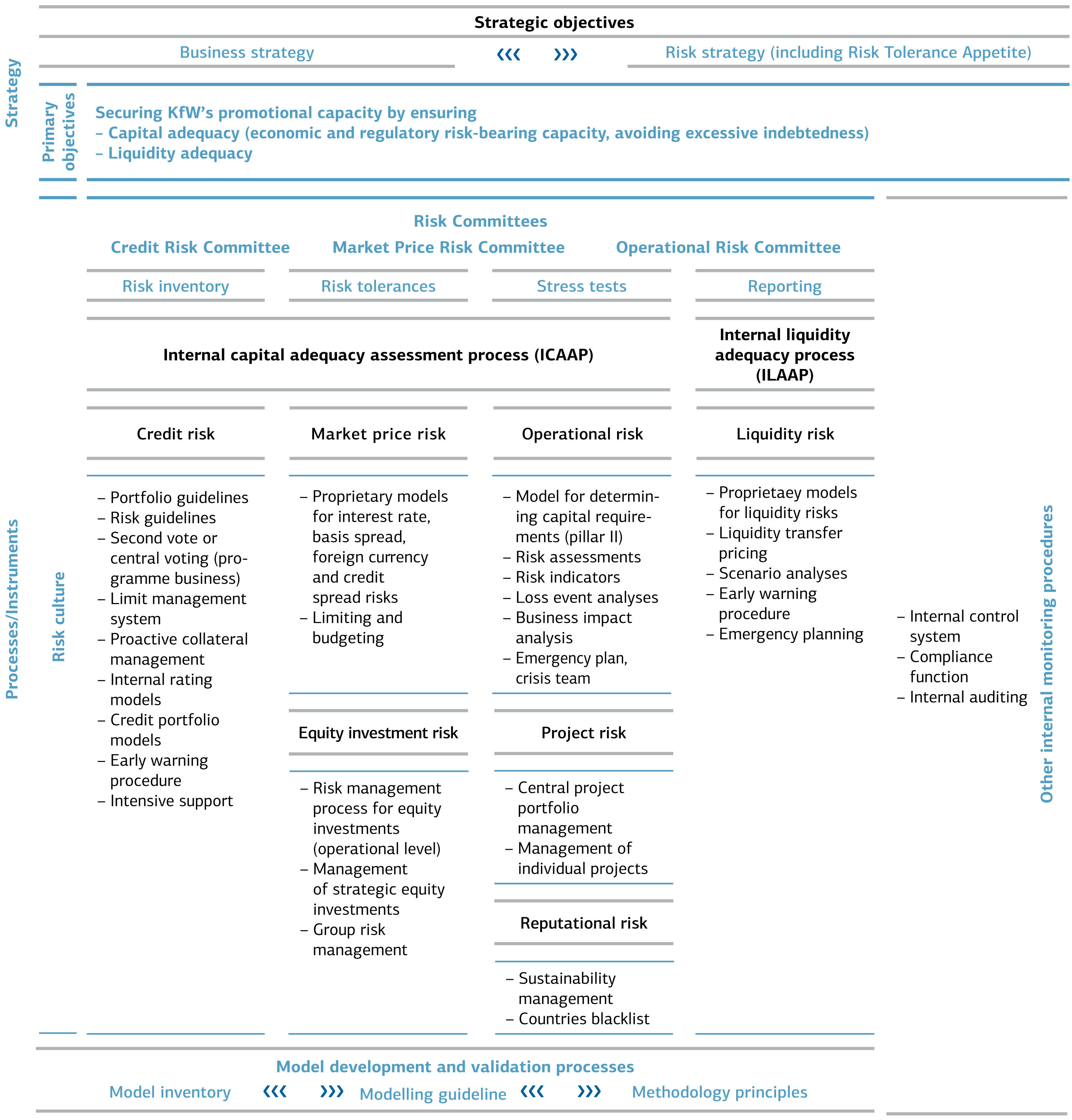


Credit Risk Committee
The Credit Risk Committee is chaired by the Chief Risk Officer and meets once a week. The committee's other voting members are the Director of Credit Risk Management, members of the Executive Board with front-office responsibilities and KfW IPEX-Bank's Chief Risk Officer ("CRO"). The Credit Risk Committee is supported by various working groups. The Country Rating Working Group serves as the central unit for assessing country risk. The Collateral Working Group is responsible for handling fundamental aspects of collateral acceptance and valuation, particularly in terms of the methods used and their validation as well as the collateral management processes. The Rating Systems Working Group is responsible for credit risk measurement instruments and rating procedures. The Corporate Sector Risk Working Group analyses sector and product-related credit risks in the corporate segment. The weekly Credit Risk Committee meetings involve decisions on loans and credit lines and discussions on current loan portfolio developments. KfW IPEX-Bank's and DEG's commitments are also presented to the Credit Risk Committee. An additional meeting, held on a quarterly basis, also includes the Director of Risk Controlling and those of the business sectors as well as the DEG CRO. Internal Auditing, Compliance and Legal staff are granted guest status. Reports about the development of regulatory requirements, their impact and the progress of implementation projects in KfW Group are given at this quarterly meeting. The committee also approves major changes to existing risk principles and credit risk methods as well as new principles and methods and procedural rules for the working groups performing the groundwork. The committee also monitors KfW Group's loan portfolio, including country and sector risks.

Market Price Risk Committee
The Market Price Risk Committee is chaired by the Chief Risk Officer and meets once a month. The committee's other members include the Executive Board members responsible for capital markets business and finance as well as the directors of Financial Markets, Risk Controlling, Accounting, Transaction Management, Group Development and Economics. Internal Auditing and Compliance have guest status. The Chief Risk Officers of KfW IPEX-Bank and DEG attend the meetings on a quarterly basis and as necessary. The Market Price Risk Committee discusses KfW Group's market price risk position and assesses the market price risk strategy on a monthly basis. The committee also monitors KfW Group's liquidity risk position and decides on all questions relating to the principles and methods for the management of market price and liquidity risks, and funding as well as transfer pricing and the valuation model for commercial transactions. The committee prepares the final decision of the Executive Board regarding the interest risk strategy. Furthermore, the Market Price Risk Committee is supported by the Hedge Committee, which deals primarily with the earnings effects of IFRS hedge accounting and the further development thereof, and the Market Price Risk Working Group. In addition to accepting validation reports and changes to models, this working group also works and decides – or prepares decisions by the Market Price Risk Committee – on other methodological issues relating to market price and liquidity risks as well as measurement issues.

Operational Risk Committee
The Operational Risk Committee meets once a quarter and provides support to the Executive Board in cross-functional management and the necessary decisions and acknowledgements in respect of operational and reputational risk, and group security including business continuity management. The Operational Risk Committee is comprised of the Chief Risk Officer, who is responsible for chairing the meetings, a further Executive Board member (deputy chair of meetings) and all KfW directors, who can be represented in exceptional cases by the heads of the departments appointed. KfW IPEX-Bank and DEG are also represented in the committee. Internal Auditing participates in the meetings but is not entitled to vote. The committee's task is to resolve on risk principles anchored in guidelines and on methods and instruments that are applied by the first line of defence in the risk management cycle. It also takes decisions on group-wide management measures. Moreover, the committee discusses the risk status on the basis of the findings obtained through different methods and instruments and evaluates any group-wide need for action, with the aim of adequate risk management. In the area of business continuity management the committee establishes crisis-prevention and emergency-planning measures using the results of the annual business impact analysis. Monitoring is based on reports about planned or implemented emergency and crisis team tests and significant disruptions to business. All resolutions and recommendations by the Operational Risk Committee are presented to the Executive Board. The Operational Risk Committee may form sub-committees for certain focal areas to facilitate its work. It formed the Group Security Board for matters relating to group security and business continuity management and the OpRisk Working Group for exchange with the decentralised department coordinators for operational risk and business continuity management.

Additionally, the subsidiaries and organisational entities of KfW Group exercise their own control functions within the group-wide risk management system. In these entities, group-wide projects and working groups ensure a coordinated approach, for example, in the rollout of rating instruments to subsidiaries or in the management and valuation of collateral. The responsibility for developing and structuring risk management and risk control activities is located outside the market areas and lies in particular with the Risk Controlling department.



To ensure capital and liquidity adequacy in line with defined risk tolerance, Risk Controlling supports the Executive Board in developing and implementing the group's **risk strategy,** including significant subsidiaries.

The orientation of KfW Group's risk strategy is in line with its business strategy and takes into account the regulatory requirements relating to KfW Group's business model. The risk strategy translates the group's long-term and strategic risk objectives into operational risk management requirements. This involves defining risk management objectives for core business activities and measures for achieving targets, as well as setting risk tolerance limits on KfW Group's material risks.

In order to determine its material risks, KfW Group conducts a **risk inventory** at least once a year. The risk inventory identifies and defines types of risks relevant to KfW Group in a structured process and then subjects these risks to an evaluation of materiality. The materiality of a risk type depends primarily on the potential danger for KfW Group's net assets, earnings and liquidity. The key outcome of the risk inventory is an overall risk profile, which provides an overview of KfW Group's material and immaterial risk types. The 2017 inventory identified that KfW Group faces the following material risks: credit, market price, liquidity, operational, equity investment, project and reputational risks. **Risk concentrations** within a risk type or across various risk types are taken into account in the risk inventory.

Risk reporting is in line with regulatory requirements (MaRisk). The Executive Board is informed about KfW Group's risk situation on a monthly basis. A risk report is issued quarterly to KfW Group's supervisory bodies. The respective bodies are informed on an ad hoc basis as required. The risk indicators and information systems used by the Risk Management and Controlling department are reviewed on an ongoing basis.

The methods and instruments for KfW group-wide risk measurement and controls are regularly validated and adjusted through further development, if necessary. The focus is particularly on models to measure, control and price credit, market price, liquidity and operational risks. Validation and further development activities take account of regulatory requirements.

The risk management approach is set out in KfW Group's risk manual. The risk manual stipulates the framework for the application of uniform procedures and rules and regulations to identify, measure, control and monitor risk. The rules and regulations laid out in the risk manual are binding for the entire KfW Group, accessible to all employees and continually updated. KfW group-wide regulations are supplemented by rules specific to each business sector. See the following sections for details on other elements of KfW Group's risk management approach.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

KfW Group's internal capital adequacy assessment process is characterised by the fact that compliance with regulatory and economic requirements regarding risk-bearing capacity are equally important overarching objectives for KfW Group. Accordingly, all risk monitoring and management measures must ensure compliance with both an economic solvency target and minimum requirements for the regulatory capital ratios. This approach combines economically practicable capital management with the obligation to comply with regulatory capital requirements. KfW Group takes a uniform definition of capital as the basis for the close integration of these two perspectives: regulatory capital in line with Articles 25-91 of Regulation (EU) No. 575/2013 (CRR) is used as available risk coverage resources for both views.

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

KfW Group's risk-bearing capacity concept serves first and foremost to protect senior debt capital providers from losses and therefore adopts a liquidation approach in its basic form. However, the addition of a forward-looking component, which also guarantees compliance with regulatory capital requirements, expands the concept to include a going-concern view. KfW Group's risk-bearing concept thus includes elements of both basic types of risk-bearing capacity approaches.

Budgets based on risk-weighted assets (RWA) at the level of each business sector/department are taken into account to ensure risk-bearing capacity. The allocated budgets are available to the business sectors/departments for backing old and new business for the various types of risk. Capital allocation is conducted as part of KfW Group's annual business sector planning. In addition to the requirements induced by business sector planning, this process also takes into account the risk objectives and the bank's risk tolerance. Budget compliance is checked on a monthly basis and action is taken, if necessary. Moreover, economic capital budgets are set for different types of risk as their central control and limit variable, and monitored monthly.

To avoid excessive debt, the leverage ratio is integrated into the capital adequacy assessment process as a further control variable. The leverage ratio is taken into account in additional forward-looking projections, and compliance with defined traffic light limits checked on a quarterly basis.

In addition to KfW Group's risk-bearing capacity concept, the capital planning process monitors the medium-term development of capital adequacy. Reliance on scenario-based extrapolations of regulatory and economic risk-bearing capacity as well as the leverage ratio over a multi-year observation horizon enables the capital planning process to identify potential capital bottlenecks early on in order to derive recommendations for action that strengthen capital or reduce risk, as necessary. The process takes into account changes in strategic objectives, business activity and the economic environment. In addition to a base case, regulatory and economic risk-bearing capacity and the leverage ratio are also taken into account in a stress case. Capital planning is performed as part of the overall KfW group-wide planning and strategy process.

The risk-bearing capacity concept is subject to annual review of its limits and restrictions. The results are taken into account accordingly in the assessment of risk-bearing capacity.

Regulatory risk-bearing capacity

Key regulatory figures (pursuant to advanced IRBA)

	31 Dec. 2017 EUR in millions	31 Dec. 2016[1)] EUR in millions
Total risk exposure in accordance with Art. 92 CRR	133,072	116,108
– Credit risk	*126,180*	*108,723*
– Market price risk	*1,233*	*1,298*
– Operational risk	*5,660*	*6,087*
Regulatory capital (available risk coverage resources)	27,347	25,890
– Tier 1 capital	*27,347*	*25,890*
– Tier 2 capital	*0*	*0*
Tier 1 capital ratio	20.6%	22.3%
Total capital ratio	20.6%	22.3%

1) Analogous application of advanced IRBA for internal purposes

At the end of the second quarter 2017 KfW, as expected, received an initial partial approval to calculate the regulatory capital ratios in accordance with the advanced IRBA. The aim is to obtain additional approval for other portfolio segments by 2022. Meanwhile, portfolio segments not yet approved are valued by applying the generally more capital-intensive credit risk standardised approach ("CRSA"). These portfolio segments were previously valued in accordance with the advanced IRBA under voluntary, analogous application of the advanced IRBA based on the main legal requirements. The decline in capital ratios over the course of the year was largely due to the transition from the previous analogous IRBA application to the regulator-approved IRBA application from mid-year on. Adjustments made to the methods of collateral valuation for final-borrower assignments in the domestic promotional business were necessary as part of the IRBA approval process, which resulted not only in increasing RWA but also a higher economic capital requirement (see also the following section). At 20.6%, the total capital ratio at year-end 2017 far exceeded the overall capital requirement:

Minimum capital requirements[1)]

	31 Dec. 2017
Total SREP Capital Requirements (TSCR)	**13.0%**
Capital conservation buffer	*1.250%*
Countercyclical capital buffer	*0.054%*
Overall Capital Requirement (OCR)	**14.3%**

1) As of 31 December 2016, KfW reported its capital ratio according to the CRSA; therefore, no year-on-year comparison is made.

Economic risk-bearing capacity

To assess its economic risk-bearing capacity, KfW Group compares its economic capital requirement for potential losses from material quantifiable risks to its available risk coverage resources. KfW Group bases its calculation of the economic capital requirement on a solvency target of 99.99% and a time frame of one year. The aggregation of the economic capital requirement across various types of risks is made through addition without taking account of diversification effects.

The most significant risk type for KfW Group is **credit risk.** Credit risk is the risk of losses if business partners fail to meet their payment obligations to KfW Group at all, in due time or in full ("default") or if their credit ratings deteriorate ("migration"). Credit risk includes settlement risk involved in settling derivative transactions. The economic capital requirement for credit risk is quantified by the Risk Controlling department, largely with the help of statistical models. For counterparty risk, the loss potential is computed using a loan portfolio model and the risk measure of "credit value-at-risk". The difference between credit value-at-risk and expected loss is referred to as the economic capital requirement. Migration risk is taken into account in the forward-looking component of the calculation of risk-bearing capacity on the basis of scenarios. For settlement risks, a buffer determined on the basis of different quantification approaches, which is validated annually, is applied in calculating economic risk-bearing capacity.

The economic capital requirement for **equity investments** at operational level is measured in the same way as for counterparty and migration risks.

The economic capital requirement for **market price risk** is calculated on the basis of the value-at-risk concept. Pillar II's economic analysis takes account of interest risk in the banking book, foreign currency risk, credit spread risk for securities, and basis spread risk. The possible loss of present value or price is determined for each type of market price risk using a value-at-risk based on statistical models. Moreover, a stop loss buffer is maintained for interest and foreign currency risks. Ultimately, the economic capital requirement is defined as the sum of value-at-risk and an additional stop loss buffer.

The capital requirement for **operational risk** is calculated using an internal statistical model, which was designed based on regulatory requirements for advanced measurement approaches. It takes a risk-sensitive approach to internal and external event data and risk scenarios. The capital requirement is calculated using diversification effects at the business sector level. Moreover, the measurement of the quality of operational risk management within the group generates premiums and discounts that are then applied to the capital requirement.

Project risks are also taken into account in the risk-bearing capacity concept. Both quantified individual risks from major projects and general assumptions about potential losses in the project portfolio are included in risk measurement.

KfW Group also includes **hidden burdens** *(stille Lasten)* for securities held as fixed assets, which are held directly as an economic capital requirement without including offsetting hidden reserves *(stille Reserven).*

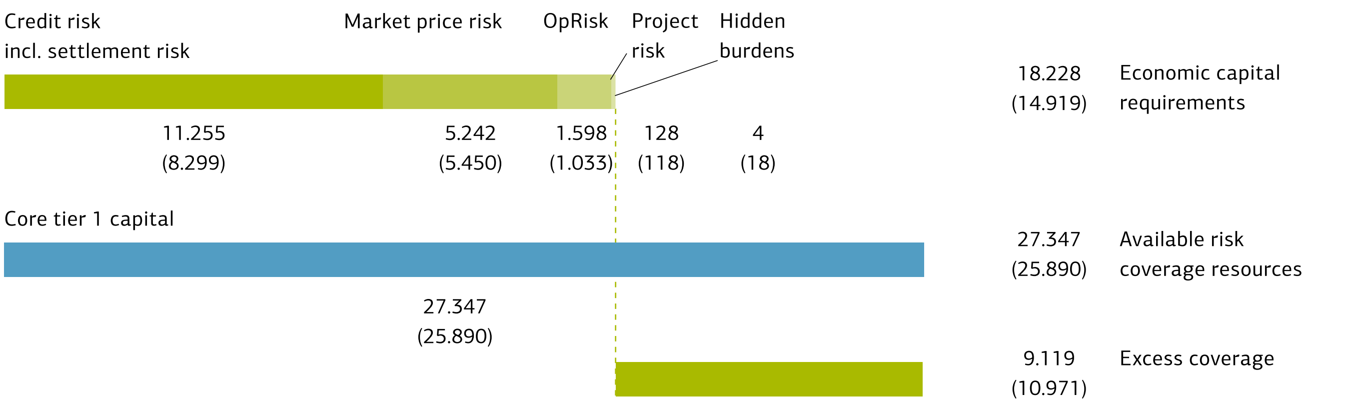
Using this method, the economic risk-bearing capacity as of 31 December 2017 satisfied a solvency level of 99.99%. The excess coverage of the available risk coverage resources beyond the total capital requirement as of 31 December 2017 of EUR 9,119 million decreased compared to 31 December 2016 (EUR 10,971 million). The decrease is largely due to the higher capital requirement for credit risk due to the aforementioned adjustments made to methods of collateral valuation for final-borrower assignments. The capital requirement for operational risks rose as well due to individual losses and updated risk scenarios. The capital requirement for market price risks declined mainly due to lower basis spread risks, while that for project risks rose slightly. Hidden burdens, on the other hand, declined. Intercompany profits of the first three quarters of 2017, in particular, raised available risk coverage resources, thus partially offsetting the risk-bearing capacity burden resulting from the higher capital requirement. The fourth quarter result will be taken into account on 31 March 2018 after the issuance of the auditor's opinion.

The group manages **liquidity risks** using appropriate internal key risk figures, maximum liquidity gap limits (outflows on a monthly and yearly basis) and minimum levels of available liquidity (liquidity potential) as well as the utilisation threshold in accordance with Article 4 of the KfW Law. Internal calculations relating to the liquidity situation are based on comparing liquidity need and liquidity potential as a ratio in stress scenarios of differing severity. No capital backing is provided as part of calculating risk-bearing capacity.

Reputational risks are evaluated and managed on a qualitative basis. Capital backing as part of calculating risk-bearing capacity is not currently provided, as the materiality of risk is primarily due to the fact that KfW is a government-owned institution with a high moral responsibility and as such subject to corresponding expectations of the public at large and other stakeholders. Materiality is thus based less on observed or potential decreases in KfW Group's net assets, earnings or liquidity. Moreover, reputational risks are to some extent implicitly included in other quantified types of risk.

KfW Group'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 inputs and their complex interactions can be identified and modelled for the risk development of a portfolio. This is one reason why KfW Group carries out stress tests with both the credit risk models and the market price risk models. KfW Group also continually works to refine its risk models and processes.

Economic risk-bearing capacity as of 31 December 2017
EUR in millions



In brackets: figures as of 31 December 2016

Stress and scenario calculations
To ensure a stronger early indicator function and proactive focus in its risk-bearing capacity concept, KfW Group monitors, on a quarterly basis, a forecast scenario (baseline scenario), a downturn scenario (slight economic slowdown) and a stress scenario (deep recession) as well as their respective effects on economic and regulatory risk-bearing capacity. This forward-looking perspective illustrates KfW Group's resilience and ability to act in the event of these scenarios and, accordingly, delivers direct input to management. A forecast and stress scenario are also calculated for the leverage ratio.

The forecast scenario provides a preview of risk-bearing capacity at the relevant year-end and includes the projected business performance, expected consolidated comprehensive income, and other effects influencing risk-bearing capacity, such as foreseeable changes in the capital structure and methodological developments. The current forecast for 31 December 2018 shows reduced excess coverage of available risk coverage resources over the economic capital requirement compared to 31 December 2017. At the same time, the forecast shows a slight drop in the total capital ratio compared to 31 December 2017. It should be noted in this respect that the overall capital requirements for the turn of the year 2017/2018 and 2018/2019 will increase in each case as a result of phasing in the buffer requirements and that these may change under the banking supervisory authorities' Supervisory Review and Evaluation Process (SREP). According to current planning, the forecast complies with overall capital requirements at all times.

In the downturn and stress scenarios, effects on earnings and changes in capital requirements are simulated for a twelve-month period assuming negative economic development scenarios of varying severity. The effects of a severe global recession emanating from the euro area are depicted in the stress scenario. In both scenarios, KfW Group currently assumes an overall increase in credit risk (counterparty and migration risks) and equity investment risk. In these scenarios, the EUR and USD interest rates as well as the EUR-USD exchange rate are forecast to develop in line with the economic situation. At the same time, it is assumed that increasing market uncertainties will lead to increased volatility in interest rates, credit spreads and basis spreads, as a result of which the economic capital requirement for the corresponding types of risk will rise. Losses from securities prices as well as from operational and project risk further reduce available risk coverage resources in the stress scenario.

Overall, risk-bearing capacity at a solvency level of 99.99% and the leverage ratio are at an adequate level.

Further stress tests are regularly carried out in addition to the economic scenarios to examine the resilience of KfW Group's economic and regulatory risk-bearing capacity. In addition to the standard stress tests, current potential macroeconomic dangers form the basis for varying scenario stress tests. In 2017, the scenarios focused on US protectionism, the Qatar crisis, the potential resolution of a major German bank and China's high debt level. The concentration and inverse stress tests show how concentration risks and other potential dangers materialising in unfavourable combinations could jeopardise KfW Group's business model. In 2017, they again simulated the potential impact of the planned regulatory changes associated with the finalisation of Basel III on the group's capital ratios.

Types of risk

COUNTERPARTY DEFAULT RISK

KfW Group faces counterparty risks[1)] in the context of its promotional mandate. In the domestic promotional lending business, the majority of final borrower default risks are borne by the on-lending institutions. Due to the business model, this results in a large proportion of bank risks in the portfolio. Other main risks result from promotional activities in the area of start-up finance for SMEs and equity investments. Particularly in these segments of domestic promotion, KfW Group bears the risk stemming from final borrowers. In addition, KfW Group faces risks in the business sectors Export and project finance as well as Promotion of developing countries and emerging economies

Debtor level	Sovereigns	Banks	Enterprises	Other
Major rating procedures (Probability of default)	– Country rating	– Bank rating	– Corporate rating – SME rating	– Retail – Structured products – Start-up rating – Investment fund rating – Special financing – Self-employment rating
Business level	Exposure at default			
	Loss given default			
Portfolio level	Loan portfolio model			

Validation and further development processes

Counterparty default risk is measured by estimating the probability of default ("PD"), the exposure at default ("EAD") and the loss given default ("LGD"). The product of the three aforementioned variables is the loss that can be expected, statistically, on average over many years. The expected loss is taken into account when determining risk-bearing capacity by deducting it from the available financial resources in accordance with the supervisory requirements of Article 158 of the CRR.

KfW Group uses internal rating procedures for the measurement of the probability of default for banks, countries, corporations, small and medium-sized enterprises, start-ups, the self-employed, investment funds and private equity investors. These procedures are based on scorecards[2)] and follow a consistent uniform model. Simulation and cash flow-based rating procedures are used for significant parts of special financing and structured products, some of which were licensed by an external provider. For structured products, tranche ratings are determined on the basis of the default pattern of the asset pool and the waterfall structure of the transactions. The rating procedures aim to predict the probability of default on a one-year basis. As a rule, the middle and back office departments are responsible for preparing ratings for risk-bearing business. Ratings are updated regularly, at least once per year.

The probability of default is mapped on a uniform master scale for the entire KfW Group, allowing comparison of ratings from different rating procedures and business sectors. The master scale consists of 20 distinct classes which are 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 class of the master scale. There are operating procedures specifying the responsibilities, competencies and control mechanisms associated with each rating procedure. External ratings are mapped to KfW Group's master scale to ensure the comparability of internal ratings with ratings of external rating agencies. Periodic validation and continued development of the internal rating procedures ensure a rapid response to changes in overall conditions.

Exposure at default and valuation of collateral have significant influence on the severity of loss. Collateral has a risk-mitigating effect in calculating loss given default. In valuing accept-

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) A scorecard is 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.

able collateral, the expected net revenue from collateral realisation in the case of loss, including haircuts, is determined. Haircuts to cover the credit risk of final borrowers are a major factor in the valuation of assignments made by financing partners in the on-lending business. For tangible collateral, haircuts are applied in particular for market price volatility, the costs of realisation and devaluation resulting from depreciation. Depending on the availability of data, the various valuation procedures for individual types of collateral are based on internal and external historical data and on expert estimates. A risk principle for loan collateral regulates uniform management, valuation and recognition of collateral across KfW Group. In addition to net revenue from collateral realisation, the recovery rate for uncollateralised exposure amounts is also an important component in determining loss given default (LGD). The collateral valuation procedure and the procedure for estimating EAD and LGD are also subject to regulation validation and further developed as needed.

KfW Group has limit management systems, risk guidelines and various portfolio guidelines to limit risks from new business. This set of risk management instruments forms the basis for the second vote on lending transactions, serves as an orientation guide for loan approvals and has the function of ensuring the appropriate quality and risk structure of KfW Group's portfolio. The special nature of KfW Group's promotional business is taken into account in the process. At KfW, Group Risk Management has the second vote 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 the transaction. The qualification levels for approval of new business depend on rating, collateralisation or net exposure and total commitments to the group of connected borrowers and product type. Approval is also required by the Board of Supervisory Directors' Risk and Credit Committee for pre-defined, individual transaction volumes (according to rating and product type).

The portfolio guidelines distinguish between different types of counterparties and product variants and define the 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 with specific requirements for lending. The limit management systems ultimately track both risk concentrations (concentration limits) and credit rating-dependent individual counterparty risk (counterparty limits). Concentration limits serve to restrict risk concentrations in the loan portfolio and thus to prevent major individual losses. Counterparty limits serve to fine-tune the counterparty-specific management of credit default risk.

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 proposals for risk-limiting measures. Non-performing loans and to a great extent watch-list loan exposures[3)] are handed over to restructuring units. This transfer of responsibility enables the involvement of specialists from an early stage to ensure professional management of problematic loans. The objective of this system 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. The Restructuring division is responsible for non-performing loans and for providing intensive support to banks and higher volume loans with a risk amount greater than EUR 1 million in the KfW portfolio. The portfolio credit management department is responsible for supporting retail business. KfW IPEX-Bank and DEG's non-performing loans and commitments requiring intensive support are managed directly by each subsidiary. Internal interface regulations are in place in the relevant business sectors to ensure clear control of responsibilities and allocation. Restructuring also cooperates closely with the market areas and the central Legal Affairs department.

In the event of a crisis in the banking sector, the Risk Management department has to be able to act immediately both in-house and externally. A financial institution crisis plan is also in place for this purpose. It primarily provides for the establishment of a working group under the direction of the Credit Risk Management department, immediate loss analysis and implementation of the necessary next steps.

Risk provisions for lending business

KfW Group takes appropriate measures to address all identifiable default risks in its lending business by making risk provisions for loans. These risks include the political risk resulting from financing transactions outside Germany. For loans with an imminent risk of default (i. e. non-performing loans), KfW Group recognises individual impairment charges or provisions for undisbursed portions. These events are identified on the basis of criteria that meet both CRR 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. Individual impairment charges are determined by means of an impairment procedure. The calculation of individual impairment charges in the non-retail business incorporates

[3)] 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.

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 (retail business) 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 based on 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.

Maximum risk of default

According to IFRS 7.36, the maximum exposure to credit risk for 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 are 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	
	31 Dec. 2017	**31 Dec. 2016**	**31 Dec. 2017**	**31 Dec. 2016**	**31 Dec. 2017**	**31 Dec. 2016**
Carrying amount as equivalent for maximum risk of default	274,119	275,752	126,671	135,265	9,648	13,917
Risk provisions for lending business	177	171	1,280	1,439	0	0
Carrying amount neither past due nor impaired	273,674	275,482	123,669	132,900	9,648	13,917
Collateral provided	*151,487*	*167,033*	*51,108*	*53,409*	*0*	*0*

	Derivatives designated for hedge accounting; other derivatives		Securities and investments; investments accounted for using the equity method		Contingent liabilities; irrevocable loan commitments	
	31 Dec. 2017	**31 Dec. 2016**	**31 Dec. 2017**	**31 Dec. 2016**	**31 Dec. 2017**	**31 Dec. 2016**
Carrying amount as equivalent for maximum risk of default	14,219	34,808	34,029	33,061	83,733	85,489
Risk provisions for lending business	0	0	2	4	61	44
Carrying amount neither past due nor impaired	14,219	34,808	33,879	32,883	83,718	85,438
Collateral provided	*3,797*	*17,355*	*182*	*294*	*0*	*0*

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	
	31 Dec. 2017	**31 Dec. 2016**	**31 Dec. 2017**	**31 Dec. 2016**	**31 Dec. 2017**	**31 Dec. 2016**
Carrying amount less than 90 days past due	341	207	1,854	1,143	0	0
Carrying amount 90 days and more past due	52	19	284	269	1	1
Total	**394**	**225**	**2,138**	**1,412**	**1**	**1**
Collateral provided	*245*	*149*	*452*	*716*	*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	
	31 Dec. 2017	31 Dec. 2016	31 Dec. 2017	31 Dec. 2016	31 Dec. 2017	31 Dec. 2016	31 Dec. 2017	31 Dec. 2016
Carrying amount	52	45	864	952	150	177	14	51
Individual impairments, provisions	*26*	*40*	*930*	*1,024*	*0*	*0*	*8*	*9*
Collateral provided	*1*	*1*	*446*	*438*	*0*	*2*	*0*	*0*

As of 31 December 2017, EUR 1.1 billion (net after deduction of risk provisions, year-end 2016: EUR 1.2 billion) was classified as individually impaired out of EUR 542 billion (year-end 2016: EUR 578 billion) in financial instruments outstanding. Potential losses are conservatively estimated, and individual impairment losses of EUR 1.0 billion (year-end 2016: EUR 1.1 billion) were recognised.[4)]

In addition to provisions for immediate risks of default, KfW Group made provisions for latent risks of default (economic and political risks). As of 31 December 2017, risk provisions for transactions not individually impaired totalled EUR 0.6 billion (year-end 2016: EUR 0.6 billion). The collateralisation of loans in KfW Group's portfolio primarily relates to the on-lending business and the promotional business guaranteed by the Federal Republic or individual federal states *(Länder)*.[5)] By far the largest portion of collateral is attributable to assigned final-borrower receivables from the on-lending business. Tangible collateral, e.g. ships and aeroplanes, plays only a minor role in relation to the total amount of collateral.

The decline in derivatives exposure is primarily due to exchange rate effects (USD depreciation). The derivatives exposure with positive fair values has to be seen in the context of the netting agreements with counterparties. These netting agreements also include derivatives with negative fair values and considerably reduce the counterparty risk.

There was an increase in loans and advances which were less than 90 days past due and not individually impaired in the year under review. These were largely arrears of one day. Most of these loans and advances were settled the following working day.

KfW Group did not take possession of any significant assets previously held as tangible collateral in 2017. Deferred payments in the performing portfolio in 2017 were primarily in the Export and project finance business sector. This deferred payment volume is not significant based on total lending volume.

Portfolio structure

The contribution of individual positions to the risk associated with KfW Group's loan portfolio[6)] is assessed based on an internal portfolio model. Concentrations of individual borrowers or groups of borrowers give rise to a risk of major losses that could jeopardise KfW Group's existence. On the basis of the economic capital concept, Risk Controlling department measures risk concentrations by individual borrower, sector and country. Risk concentrations are primarily reflected in the economic capital requirement, ensuring that high risk volumes and unfavourable probabilities of default are taken into account, along with undesirable risk correlations. The results form the main basis for managing the loan portfolio.

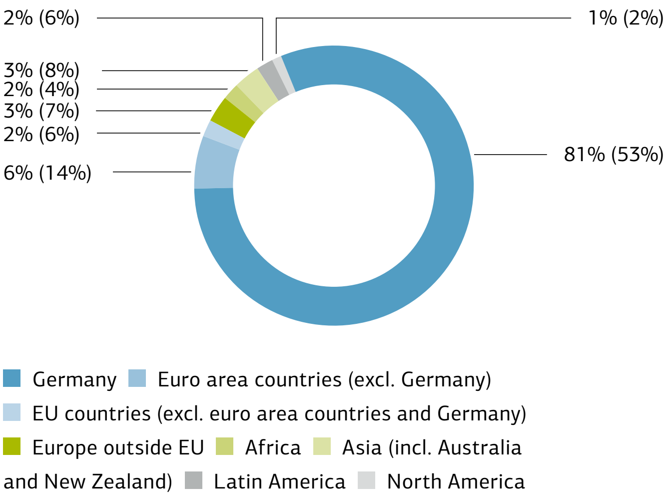
[4)] The transaction of approximately EUR 15 billion mandated by the Federal Government as part of the support measures for Greece is completely hedged by a federal guarantee and is therefore not presented in the portfolio of individually impaired financial instruments.
[5)] The collateral is presented as recognised for purposes of internal management of economic risks. Participation effects are taken into account in order to avoid reporting double collateralisation.
[6)] The loan portfolio includes loans as well as securities and investments in performing business. The non-performing portfolio is only included in the presentation of credit quality.

Regions

As of 31 December 2017, 87% of KfW Group's loan portfolio in terms of economic capital requirements was attributable to the euro area (year-end 2016: 67%). The key drivers for this development were adjustments made to methods of collateral valuation for final borrower assignments. This resulted in a significant increase in economic capital requirements, especially in Germany and primarily in the on-lending business (mainly in housing and environmental programmes). Outside of Germany, these adjustments resulted in lower economic capital requirements due to portfolio effects and a decrease in business, particularly in the Export and project finance business sector.

Economic capital requirements by region

31 Dec. 2017 (31 Dec. 2016)

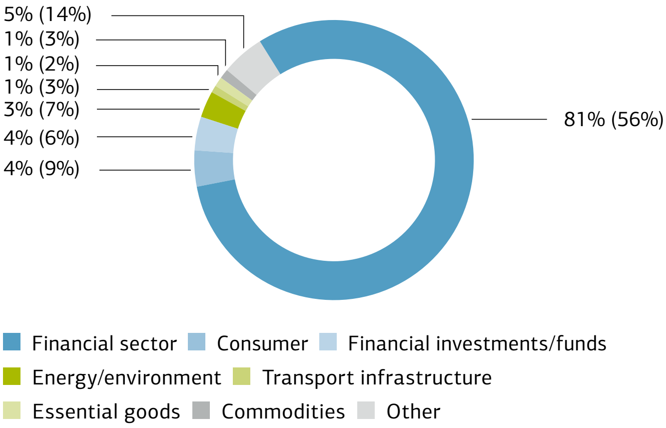


Sectors

The significant share of overall capital required for credit risks attributable to the financial sector is due to KfW Group's promotional mandate. By far the greatest portion of KfW Group's domestic promotional business consists of loans on-lent through commercial banks. The financial sector's economic capital requirement increased overall, primarily due to the adjustments to methods described above. This particularly affected banks with large volumes of on-lending business. For all other sector clusters, the adjustments to methods led to a reduction of the capital requirement.

Economic capital requirements by sector

31 Dec. 2017 (31 Dec. 2016)

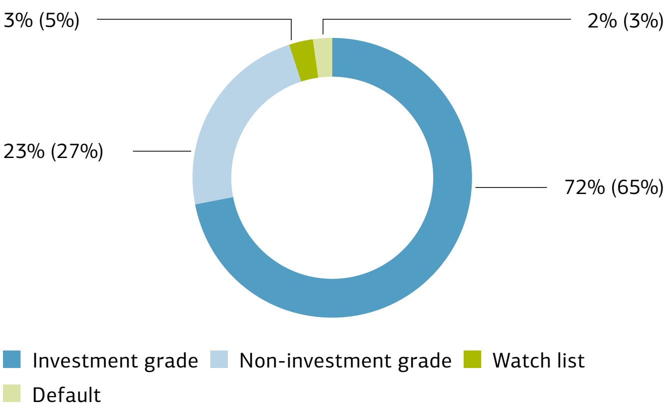


Credit quality

As credit quality is a major factor influencing economic capital requirements, it is appropriate to examine the distribution of net exposure[7)] by credit quality category when analysing the credit quality structure. Overall, net exposure at nearly stable volumes rose due to the aforementioned adjustments to collateral valuation methods, in particular in the on-lending business (mainly in housing and environmental programmes). This resulted in an increase in good rating classes or a higher investment grade exposure. The proportion of watch list and non-performing loan exposures decreased both in absolute as well as relative terms. KfW Group's loan portfolio continued to possess a good credit quality structure.

Credit quality by net exposure

31 Dec. 2017 (31 Dec. 2016)



[7)] Net exposure is the economic loss that potentially occurs in the event of an economic or political default event.

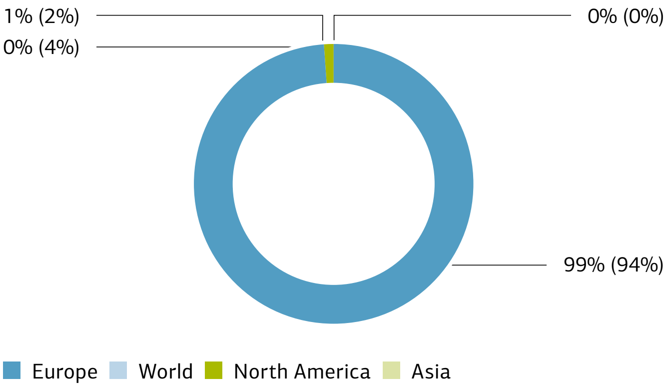
Structured products in KfW Group's portfolio

Asset-backed securities (ABS)

ABSs had a par value of around EUR 4.8 billion as of 31 December 2017. Accounting for the mark-to-market valuation of the securities reported at fair value and impairments, the portfolio also had a book value (including pro rata interest) of around EUR 4.8 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.

Geographic breakdown of the underlying asset pool (based on par value)

31 Dec. 2017 (31 Dec. 2016)



Exposure based on par values

	CLO	RMBS	CMBS	ABS & other	Total 31 Dec. 2017	Total 31 Dec. 2016
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Investment grade	0	975	5	3,792	4,773	4,792
Non-investment grade	0	7	1	42	50	56
Watch list	0	0	0	0	0	0
Default	21	0	0	0	21	58
	21	**982**	**6**	**3,834**	**4,844**	**4,906**

The portfolio volume as of 31 December 2017 decreased slightly year on year (nominal value EUR –0.1 billion). The decrease affected investment and non-investment grade as well as default holdings. The regional focus on Europe remains unchanged in the geographic breakdown of the underlying asset pool compared with 31 December 2016, with the largest share attributable to Germany. Overall, European securitisations, including German securitisations, performed well. The cumulative default rates for European securitisations remained low.

MARKET PRICE RISK

KfW Group measures and manages market price risk on a present-value basis. The key drivers of market price risk in this context are:
- the interest rate structure (interest risk) particularly for the EUR and USD currency areas,
- exchange rates (currency risk),
- basis spreads (basis spread risk) and
- issuer-related spreads for securities (credit spread risk).

In total, market price risk within the group required a total of EUR 5.2 billion in economic capital as of 31 December 2017. This is EUR 208 million less than compared to the previous year.
KfW Group market price risk is broken down as follows:

Total economic capital requirements for market price risk

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
Interest risk	2,975	3,066
Currency risk	833	744
Basis spread risk	969	1,350
Credit spread risk	464	290
Market price risk	**5,242**	**5,450**

Interest risk

KfW Group assumes limited interest rate risk in EUR and USD only, in order to take advantage of long-term opportunities for returns. All relevant data from the preparation of fixed interest statements are considered in the determination of interest risk in the banking book. On the basis of this data, KfW Group regularly performs value-at-risk calculations using a variance/covariance approach to assess its interest risk position. The management concept for interest risk is part of a long-term management philosophy. A substantial stop loss buffer is maintained in order to mitigate short-term fluctuations in present value caused by interest rates. In addition to this buffer, value at risk is computed at a solvency level of 99.99% and for a period of two months in order to calculate risk-bearing capacity. The choice of this period is based on a conservative estimate of the maximum timeframe to close the entire interest risk position. Continuous monitoring of the risk position and the available management options ensures that the allocated capital is also sufficient to cover the risk for a one-year period in accordance with the uniformly applied solvency level of 99.99%. Periodic stress tests supplement this calculation to examine possible losses under extreme market conditions. Apart from this shift required by regulatory law, the tests include scenarios such as tilts of the yield curve and an extension of the holding period. The capital requirement for interest risk decreased only slightly by EUR 90 million as of 31 December 2017; the USD exposure was slightly reduced.

Currency risk

Foreign currency loans are largely funded in the same currency or secured by appropriate foreign currency hedging instruments. DEG's foreign currency equity investments and to a small extent KfW Development Bank's promotional instruments are only funded in the same currency when possible and practical. Foreign currency earnings generated from the lending business throughout the year are sold promptly. As with interest risk, the economic capital requirement for liquid currency positions is calculated analogously to interest risk using a variance/covariance approach as the sum of a stop loss buffer and a two-month value-at-risk at a solvency level of 99.99%. A twelve-month value-at-risk is used for all currencies with limited trading and hedging opportunities. The Market Price Risk Committee classifies each currency as liquid or illiquid at least once a year. The currency portfolio predominantly comprises liquid positions. Stress tests are regularly conducted in order to estimate possible losses in the event of extreme market conditions. USD depreciation in the reporting year (EUR/USD as of 31 December 2017: 1.1993 and as of 31 December 2016: 1.0541) resulted in negative effects on net present value, which were offset by forward sales of margins. Moreover, the stop-loss buffer totalling EUR 230 million was increased to EUR 550 million. This resulted in an increase in the capital requirement for currency risks of EUR 89 million as of 31 December 2017 which was compensated by the aforementioned reduction in the USD interest risk position in 2017.

Basis spread risk

Basis spread risk largely comprises tenor and foreign exchange basis spread risk. The economic capital requirement for this risk is calculated with a variance/covariance approach at a solvency level of 99.99% and with a holding period of twelve months. The capital requirement for basis spread risk as of 31 December 2017 stood at EUR 969 million, representing a year-on-year decrease of EUR 380 million. The decline resulted in particular from a reduced liquidity maturity transformation and a cross-currency spread position in USD, in addition to risk-mitigating market data effects.

Credit spread risk

Risk measurement is carried out for the securities portfolio. The economic capital requirement is calculated using the historical simulation method on the basis of a credit spread time series comprising the previous three years (750 trading days). Value at risk 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%. The economic capital requirement for credit spread risk as of 31 December 2017 was EUR 464 million. Credit spread risk rose by EUR 174 million year on year. The rise resulted primarily from the use of sector curves rather than security-specific spreads as were used thus far.

LIQUIDITY RISK

Liquidity risk is the risk of not being able to make payments in a timely manner when due. A distinction is made between

– institutional liquidity risk (the risk of not being able to meet payment obligations),
– refinancing risk (the risk of lower income due to more expensive funding (liabilities) that cannot be passed on to borrowers) and
– market liquidity risk (the risk of being unable to unwind specific exposures without significantly lowering market prices because of inadequate market depth or market disruptions).

The primary objective of liquidity management is to ensure that KfW Group is capable of meeting its payment obligations at all times. KfW 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 Group's funding plans and in the liquidity maintenance strategy.

Liquidity risk is measured on the basis of economic scenario analyses and the utilisation threshold under the KfW Law. In addition, liquidity gaps are limited based on business already concluded and available liquidity potential.

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

Contractual payment obligations arising from financial instruments by maturity range
as of 31 December 2017[1)]

	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year	More than 1 and up to 5 years	More than 5 years	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks and customers	4,394	1,795	565	3,144	8,596	18,494
Certificated liabilities	25,916	18,311	69,123	209,530	103,246	426,126
Net liabilities arising from derivative financial instruments	–190	–251	–356	297	–6,842	–7,341
thereof Liabilities arising from derivative financial instruments	*16,465*	*15,086*	*44,213*	*129,157*	*43,442*	*248,363*
Subordinated liabilities	0	0	0	0	0	0
Liabilities arising from on-balance sheet financial instruments	**30,120**	**19,856**	**69,332**	**212,972**	**105,000**	**437,279**
Contingent liabilities	3,651	0	0	0	0	3,651
Irrevocable loan commitments	80,082	0	0	0	0	80,082
Liabilities arising from off-balance sheet financial instruments	**83,733**	**0**	**0**	**0**	**0**	**83,733**
Liabilities arising from financial instruments	**113,852**	**19,856**	**69,332**	**212,972**	**105,000**	**521,012**

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

Contractual payment obligations arising from financial instruments by maturity range
as of 31 December 2016[1)]

	Up to 1 month	More than 1 and up to 3 months	More than 3 months and up to 1 year	More than 1 and up to 5 years	More than 5 years	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks and customers	18,481	2,944	603	3,221	8,828	34,076
Certificated liabilities	30,398	36,185	50,879	235,095	91,766	444,323
Net liabilities arising from derivative financial instruments	−1,276	−2,503	−3,012	−13,632	−10,633	−31,057
thereof Liabilities arising from derivative financial instruments	*14,921*	*19,589*	*28,398*	*137,634*	*50,427*	*250,969*
Subordinated liabilities	0	0	4	23	235	262
Liabilities arising from on-balance sheet financial instruments	**47,603**	**36,626**	**48,473**	**224,707**	**90,195**	**447,604**
Contingent liabilities	3,955	0	0	0	0	3,955
Irrevocable loan commitments	81,534	0	0	0	0	81,534
Liabilities arising from off-balance sheet financial instruments	**85,489**	**0**	**0**	**0**	**0**	**85,489**
Liabilities arising from financial instruments	**133,092**	**36,626**	**48,473**	**224,707**	**90,195**	**533,093**

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

Internal measurement of liquidity risk is based on scenario calculations. This approach first analyses the expected inflow and total outflow of payments for the next twelve months based on business already concluded. This basis cash flow is then supplemented by planned and estimated payments (e.g. borrowings from the capital market, expected liquidity-related loan defaults or planned new business). The result provides an overview of the liquidity required by KfW Group over the next twelve months. The liquidity required is calculated for different scenarios. In this respect, market-wide and institution-specific risk factors are stressed and an evaluation is made of the impact on KfW Group's liquidity.

Parallel to the above approach, KfW Group also determines the available liquidity potential, which largely consists of KfW's collateral account with the Bundesbank, repurchase agreement assets, the liquidity portfolio 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. The ratio of cumulative required liquidity to the cumulative available liquidity potential is calculated for each scenario. This figure may not exceed the value of 1 in any scenario for any period. The prescribed horizon in the normal case scenario is twelve months, in the stress case six months, and in the two worst case scenarios, three months. The scenario assumptions are validated on an annual basis.

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 of 31 December 2017:

KfW liquidity risk indicators as of 31 December 2017

	Indicator
Normal case	0.13
Stress case	0.23
Worst case (institution-specific)	0.16
Worst case	0.45

The internal liquidity risk indicators remained below the maximum limit of 1 throughout 2017.

Current funding environment

Developments on the international capital markets in 2017 were characterised by major political events in France and Germany as well as the persistence of loose central bank policy in the euro area and interest rate hikes in the US. While the ECB's monetary policy continued its expansionary course in 2017 regardless of strong economic growth and subdued inflation expectations, the US Federal Reserve undertook three rate hikes over the course of the year and stayed its course of a more contractionary monetary policy. Despite high volatility at the beginning of 2017, the euro market saw a considerable increase in investor demand as the year progressed. In addition to the Eurosystem public sector purchase programme ("PSPP"), the growing positive perception of Europe underpinned by positive economic data at the end of the year was also a determining factor.

KfW Group's established funding strategy is characterised by high-volume bonds well placed to a global investor base. KfW successfully completed its funding activities thanks to its flexible attitude to currencies, instruments and structures. It raised a total volume of EUR 78.2 billion on the international capital markets (2016: EUR 72.8 billion) in 10 different currencies and 145 individual transactions in financial year 2017. Around 88% of its long-term funding was undertaken in the two main funding currencies: euro and US dollar. The share of bonds denominated in euros rose to a multi-year high of 53% in 2017 (2016: 36%); those denominated in US dollars amounted to 34% (2016: 47%).

The development of KfW's funding activities in the money market segment was equally positive in 2017. The programme volume of the Euro Commercial Paper ("ECP") programme designed for global investors amounted to EUR 60 billion. As planned, the volume issued in the Euro Commercial Paper programme was lower in 2017 than in the previous year. The outstanding volume here amounted to EUR 34.7 billion at the end of 2017 (year-end 2016: EUR 37.8 billion). The issue volume in the US Commercial Paper ("USCP") programme was also lower year on year in 2017. The USCP, with a programme volume of USD 10 billion, is specially designed for the US market. KfW Group uses this programme to cover a large portion of its need for short-term funds in US dollars. The outstanding volume amounted to USD 8.1 billion at the end of 2017 (year-end 2016: USD 8.7 billion).

OPERATIONAL RISK AND BUSINESS CONTINUITY MANAGEMENT (OPERATING RISK)

KfW Group's organisational structure provides for a two-tier system comprising decentralised and centralised units liaising with the Operational Risk Committee. Management of focal areas is decentralised within the business sectors and the subsidiaries, and is performed by the respective directors or managing directors, who are supported by the respective sector coordinators of Operational Risk and Business Continuity Management. Monitoring and communication of focal areas is performed by Risk Controlling (central OpRisk Controlling) and Compliance (central Business Continuity Management). These groups develop the relevant methods and instruments for identifying and assessing risks and monitor their group-wide uniform application.

The aim of management and control of operational risk and business continuity management is the proactive identification and prevention of potential losses for KfW Group, i.e. to make emergencies and crises manageable and to secure KfW Group's structural ability to remain in operation even in the event of loss of key resources.

In accordance with Article 4 (1) No. 52 of the CRR, KfW Group defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The following types of risk/sub-types of operational risk are also defined and generally monitored by specialised second line of defence units: compliance risk, information security risk, physical security risk, legal risk, conduct risk, service provider risk (including outsourcing risk), personnel risk, operational risk from adjustment processes, model risk and information technology risk unrelated to information security.

Losses are recorded in KfW Group in an OpRisk events database. After each quarter, a detailed report is made in the relevant departments of the loss events recorded and any measures introduced as a result. The Executive Board, the Board of Supervisory Directors and the Operational Risk Committee are briefed monthly or quarterly as part of internal risk reporting. Ad hoc reports are also made if a loss exceeds a certain level.

In addition, operational risk is systematically recorded in risk assessments that are carried out group-wide. Such assessments also examine new activities in the New Products Process ("NPP") as well as changes in operational processes for potential operational risks. Within the risk assessments, operational risk is measured on the basis of internal data or expert estimates which are backed by a distribution assumption for loss frequency and amount. The potential losses revealed in the risk assessments carried out are reported to the directors and heads of department and the Executive Board once the data have been collected. As part of the risk assessment, the business areas check the implementation of additional risk-mitigating measures (e.g. checks as part of the internal control system, or "ICS").

Where adequate monitoring of operational risks using metrics is possible, risk indicators are used. Compliance with centrally prescribed risk-sensitive methodology requirements (e. g. training course participation, deadlines, escalation procedures) is monitored using business area-specific OpRisk information dashboards that ensure escalation across all levels up to the Executive Board in the event of non-compliance.

In total, operational risk within the group required a total of EUR 1,598 million in economic capital as of 31 December 2017. This amount is EUR 565 million higher than as of 31 December 2016 as a result of several individual losses in particular due to creation of provisions and updated risk scenarios.

Business continuity management is implemented if a 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 outages (building or infrastructure), IT system outages, staff outages and service provider outages. Business continuity management incorporates preventative components (emergency preparedness) and reactive components (emergency and crisis management) in equal measure.

For the purpose of business continuity management, business processes are analysed and categorised based on how critical they are, and the supporting resources for each case examined accordingly. 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, ensuring that the required availability is guaranteed and business risks are reduced. These include emergency workstations, emergency plans, communication tools and alerts/alarms. KfW Group's crisis team takes responsibility for overall crisis management if necessary. It practises emergency and crisis organisation teamwork in regular crisis team tests.

OTHER RISKS

Equity investment risks

In managing equity investment risks, KfW Group differentiates between risks from equity investments at operational level and strategic equity investments.

Equity investments (operational level)

Undertaking equity investments at operational level is part of the group's promotional mandate. Accordingly, there are equity investments in connection with domestic and European investment financing and in the Promotion of developing countries and emerging economies and Export and project finance business areas. KfW group-wide basic rules for equity investments at operational level are set out in guidelines. Specific rules tailored to certain segments of equity investments are also set out in portfolio guidelines, working instructions or risk guidelines. Risk measurement is performed at an individual loan commitment level for operational level equity investments in the same way as for credit risk. In addition, equity investment portfolio risk is reported separately.

Strategic equity investments

Strategic equity investments support KfW's mandate of providing an efficient and sustainable promotional offering. In addition to reinforcing and expanding core competencies, the focus of this investment type is on complementing KfW's business sectors. Strategic equity investments normally have a long-term holding period. In addition, KfW also makes equity investments in accordance with Article 2 (4) of the KfW Law (mandated transactions). The Federal Government mandates these equity investments to KfW because the Federal Republic of Germany has a state interest in them.
A dedicated organisational unit is responsible for strategic equity investments based on an equity investment manual that 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 Executive Board and Board of Supervisory Directors in accordance with the KfW Bylaws. Moreover, the acquisition of an equity investment in excess of 25%, the increase of such an equity investment or their partial or full disposal requires authorisation by the Federal Ministry of Finance in accordance with Section 65 (3) of the Federal Budget Code (*Bundeshaushaltsordnung* – "BHO"). Strategic equity investments and their individual 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. The individually defined strategies for the equity investments are updated annually. Moreover, the group is normally represented in the supervisory bodies of its strategic equity investments.

Due to the high risk relevance for KfW Group and for reasons of uniform group management, KfW IPEX-Bank and DEG's risks are managed as part of KfW Group's risk management. For example, the subsidiaries' business activities are included under the look-through principle in KfW group-wide limits and in KfW Group's capital budget, while representatives of the subsidiaries are included in KfW Group's risk committees. KfW also monitors the risk situation of DEG and KfW IPEX-Bank on a stand-alone basis and regularly reports to the Executive Board as part of the monthly internal KfW Group risk report.

Reputational risk

Reputational risk is the risk that the perception of the group from the point of view of the relevant internal and external interest groups will deteriorate for the long term with a negative impact on KfW Group. This negative impact could lead to a decrease in KfW Group's net assets, earnings or liquidity (e.g. decline in new business) or may be of a non-monetary nature (e.g. difficulty in recruiting new staff). Reputational risk may arise as a consequence of other types of risk, or independently.

In the risk management process, reputational risk is managed in a decentralised manner. The framework for this purpose includes sustainability management with group-wide environmental and social principles relevant to credit approvals, or basing the management of KfW Group's own securities portfolio on sustainability criteria. Furthermore, examinations of new activities in the NPP as well as of outsourced activities in outsourcing management are regularly conducted to detect potential reputational risks.

Moreover, as part of risk identification, the central reputational risk control function coordinates qualitative reputational risk assessment and creates a risk profile outlining the group's greatest reputational risks. In addition, reputational risk events that have occurred are reported on an ongoing basis.

Project risk

Original project risk comprises, in particular, planning assumptions that turn out to be inaccurate. Project risk has implications for the achievement of project objectives with regard to cost, time and quality (e.g. new technical requirements, and time constraints arising from parallel projects). KfW Group's project risk arises particularly in connection with various major long-term projects. Managing project risk is part of project management and takes place in both the project planning and execution stages.

The Central Project Management Office supports major projects in fulfilling their objectives and achieving their targets. As the central authority for project portfolio management, it provides the methodological framework for KfW Group's major project implementation and creates transparency at the level of the entire project portfolio. This enables the Project Board and Executive Board to take targeted decisions. Setting requirements in respect of methods through the Central Project Management Office enables a consistently high quality of implementation. Compliance with this framework and these requirements by major projects is also monitored and supported.

Internal monitoring procedures

Internal control system (ICS)

The aim of KfW Group's ICS is to use suitable principles, measures and procedures to ensure the effectiveness and profitability of business activities, compliance with the legal requirements applicable to KfW Group, the accuracy and reliability of external and internal accounting, and the protection of assets.

There are group-wide ICS rules as well as binding group-wide minimum requirements of the ICS. KfW Group's ICS is based on the relevant legal (bank regulatory) requirements[8], in particular those set forth in the KWG and MaRisk, and the market standard COSO model.[9]

The KfW Executive Board holds overall responsibility for the group's internal control system. At DEG and KfW IPEX-Bank, overall responsibility is held by the management. The design and implementation at the different corporate levels is the responsibility of the relevant managers according to the organisational structure.

In accordance with the COSO model, the ICS consists of the five following interrelated components: control environment, risk assessment, control activities, information/communication and monitoring/auditing. These components extend to all KfW Group's organisational entities, functions and processes.
The control environment is the environment within which KfW Group introduces and applies rules. Risk assessment includes the identification, analysis and evaluation of risks that result from implementing corporate strategy. Control activities are aimed at achieving corporate objectives effectively and detecting or minimising risks. Adequate information and communication procedures in KfW Group enable all stakeholders to be provided with the information they need in the necessary detail.

Appropriate monitoring and audit mechanisms determine the functionality and effectiveness of the ICS.

Procedural rules form the basis of the ICS. These constitute the framework for a proper business organisation within KfW Group, in the form of a binding policy.
Workflow organisational measures and controls ensure that monitoring is integrated into processes. Monitoring measures integrated into processes serve to avoid, reduce, detect and/or correct processing errors or financial loss. The effects of any planned changes to operational processes and structures on the procedure and intensity of monitoring are analysed in advance. KfW Group has implemented accounting-related controls to minimise the risk of error in stand-alone and consolidated financial statements and ensure the correctness and reliability of internal and external financial reporting. The accounting-related controls are part of the ICS.

The system is supplemented by the Compliance department, which defines and monitors compliance with relevant measures on the basis of relevant rules and norms. The Compliance function performs regular process-based and accompanying monitoring of the relevant areas of the internal control system. The results of additional second line of defence units (OpRisk in particular) are included in monitoring and the further development of the internal control system.

In ICS testing, Internal Auditing examines the proper implementation of controls relevant to ICS.

To ensure the adequacy and effectiveness of the ICS, KfW regularly scrutinises and continually refines its standards and conventions.

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

A report is rendered annually to KfW Group's supervisory bodies. The adequacy and effectiveness of the ICS is also assessed by Internal Auditing on the basis of risk-based audits carried out independently of group procedures.

Compliance

The success of KfW Group is largely based on the confidence its shareholders, customers, business partners, employees and the general public place in its efficiency and above all in its integrity. This confidence rests to a large extent on the implementation of and compliance with relevant statutory, supervisory and internal regulations and other relevant laws and rules. The Executive Board bears the overall responsibility for compliance within the Group. The Executive Board delegates the associated tasks to the Compliance department.

The Compliance organisation is structured in accordance with the Three Lines of Defence model and as the second line of defence, it is aligned with the requirements for a MaRisk compliance function. In this connection, group compliance has, for a number of years, included measures to comply with data protection regulations as well as measures for the prevention of insider trading, money laundering, terrorism financing and other criminal activities, and for monitoring legal requirements and the associated implementation measures. This also includes protection of information, buildings, individuals and the IT infrastructure as well as ensuring business continuity management. There are therefore binding rules and procedures that influence the day-to-day implementation of values and the corporate culture, which are continually updated to reflect current law as well as market requirements.

Regular training sessions on compliance and anti-money laundering are held for KfW Group employees. In addition to these classroom seminars, e-learning programmes on data protection, information security, securities compliance, and prevention of money laundering and fraud are available.

Internal Auditing

Internal Auditing is an instrument of the Executive Board. As an entity that works independently of KfW Group procedures, it audits and assesses all of KfW Group'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 in 2017 audited the decentralised risk management processes and central aspects of risk management and risk control which were relevant group-wide. Focal points included analyses of market and credit risk and reporting in support of major projects, as well as review of rating systems and operations to meet the provisions of Article 191 of the Capital Requirements Regulation ("CRR").

As in previous years, Internal Auditing also monitored the continued development of risk measurement procedures in 2017 by participating (with guest status) in meetings of decision-making bodies.

Internal Auditing also functions as KfW Group's internal auditing department. It is involved in subsidiaries' audit planning and incorporates the audit results of the subsidiaries' internal auditing departments in group-wide internal audit reporting.

Forecast and opportunity report

The following forecast and opportunity report mainly reflects the scope and content of the group forecast and opportunity report published in the group management report. As business sector planning and earnings projections are prepared at KfW Group level, a forecast and opportunity report is not prepared at individual institution level. The following forecast figures therefore relate to KfW Group.

General economic environment and development trends

KfW expects **real global growth** of 3.8% for 2018, which means somewhat stronger momentum again year on year. This is based on a broad forecast as **industrialised countries** are expected to maintain their growth momentum (2018: 2.2%), while growth in **developing countries and emerging economies** is expected to be even higher than in 2017 (2018: 5.0%). The US economy is on a sound growth path. In the UK, in contrast, the negative consequences of the Brexit referendum and the unsatisfactory course of exit negotiations are likely to become more evident. The forecast for developing countries and emerging markets is mixed. Following the recessions in Brazil, Russia and major sub-Saharan African countries, continued recovery will have a positive impact on those regions. Higher growth is expected for commodity exporters; however, some of them will still be required to make considerable macroeconomic adjustments to the comparatively low commodity prices. While India is likely to benefit from its structural reforms, China will further adapt its growth model, which will result in a moderate slowdown.

The economic upswing in the **Economic and Monetary Union (EMU)** gained momentum in 2017 and the strong recovery appears set to continue in 2018. Accordingly, KfW forecasts real GDP growth of 2.4%, with such growth meanwhile having a broad regional base. In particular, the greater momentum has now also reached Italy and France. The most important pillar of economic recovery in the EMU remains its sound domestic economic performance. Private consumption is boosted by labour market improvements and the associated rise in wages. In addition, accelerated growth worldwide provides tailwind to the export sector, compensating for the negative consequences of the strong euro. KfW expects the fiscal policy to provide a slightly expansionary impetus. Progress has also been made in cleaning up bank balance sheets – in Italy in particular. Financing conditions are thus likely to remain advantageous for the time being and, together with high capacity utilisation, prompt companies to make greater efforts to modernise their capital stock.

The **German economy** was in excellent shape at the beginning of 2018. The boost to export as a result of the steady recovery in Europe and around the world, along with stable domestic demand, ensures higher capacity utilisation. This has had a positive impact on businesses, which are likely to increase their investments. Consumption appears to remain in a clear upswing at the same time due to the steady increase in employment and rising wages. Prospects for housing construction still also appear favourable in the long term given an excess of 600,000 building permits over residential homes completed. Overall, KfW expects solid real growth of around 2.5% in 2018.

The **financial market environment** remains characterised by extremely expansionary monetary policy in 2018, although the two largest central banks will be gradually scaling back their stimulus programmes. The European Central Bank will cut its bonds purchases in half, to EUR 30 billion per month from January 2018, and has announced that it will continue to do so until September 2018. It currently appears that the purchases will also continue after September 2018, although likely at a further reduced level. The first key interest rate hikes are not expected until the beginning of 2019 as the ECB has repeatedly communicated that it will not take such measures until well after the bond purchasing programme has ended. KfW consequently expects moderate yield increases on the euro area capital market in 2018 and slightly higher interest rates on longer maturities on the money markets from the second half of the year. The US Federal Reserve is expected to continue tightening its monetary reins in 2018, with a slight hike of key interest rates as last year. Given the advanced stage of the economic cycle, KfW assumes that the Federal Reserve will hardly restrict its monetary policy any further from mid-2019 and further expects somewhat higher rate increases for short term maturities than for longer term ones.

Risk outlook – Risk situation and risk-bearing capacity

Global economic growth in 2017 recorded the highest rate in seven years. The upturn was triggered and driven, in particular, by monetary policies and recently also by fiscal stimulus and is broad-based in terms of indicators, economic sectors and number of **countries**. Short-term economic prospects thus remain fundamentally positive although the current momentum does not appear to be sufficient to achieve and secure sustainable growth and higher potential growth.

Moreover, there remain considerable downside risks, in particular relating to medium and long-term development. Such risks result, among others, from developments relating to (i) the continued uncertainty about the US's economic and foreign policy, (ii) a lack of clarity as to the impact of Britain's exit from the EU on Europe's economic environment, (iii) the prevailing structural impediments in many countries, (iv) a quicker and more stringent tightening of global financial conditions than previously anticipated if US economic policy has an inflationary impact, and (v) a persistent low inflation in industrialised countries, which leaves central banks with very little leeway to lower real interest rates in the event of a downturn in order to reinstate full employment. The current situation has further been driven by considerably heightened geopolitical risks on an international scale for some time now – from different crisis countries and regions, such as North Korea, the Persian Gulf (Iran, Qatar crisis, Saudi Arabia) and Syria. In addition, there is an increasing risk that recent signs of a broader approach to tighten monetary policy will result in a new financial crisis, particularly due to the prevalent phenomenon of high and increasing private debt levels, which has significantly increased private sector vulnerability to external shocks in many countries.

In light of the above, continued acceleration of economic growth in 2018 represents an optimistic scenario but not one that will occur automatically, as these medium-term risks could materialise as early as 2018. In addition, the Italian general election in 2018 also represents a short-term risk. If anti-European political parties are able to obtain a significantly higher share of votes than currently expected, this could trigger turbulence on euro-area government bond markets with possibly far-reaching consequences for other financial markets and the real economy. In the short term, however, there is also a chance that the positive business and consumer sentiment, supported by the continued favourable financing conditions, translates into stronger than expected economic momentum.
The low interest rate environment in Europe will persist in 2018 and, in combination with high regulatory costs and greater investment in digitalisation, continue to burden European banks' profitability, which is already at a low level. As a consequence thereof, pressure on banks to further lower costs (by reducing staff and branches) and to continue consolidation will remain high. In view of this, assessing the sustainability of bank business models and revenue drivers will be a focal point in European banking supervision in 2018.

The favourable forecast of economic growth in Germany and Europe as a whole is expected to bolster the recent increase in lending to companies and private households in 2018. This has resulted in early signs of overheating in various real estate markets. Evidence of this can already be seen on the markets in Norway and Sweden above all (but also on non-European markets, such as in Canada, Australia and New Zealand), to which particular attention should be paid.

The European Banking Authority focused, among other things, on the improvement of asset quality (above all in Italy, Portugal and Ireland) in 2017. Due to the introduction of IFRS 9, the ECB's new guidance to banks with respect to non-performing loans (NPLs) and the forthcoming EBA stress test, KfW expects a continuing reduction of NPLs in Europe in 2018, a trend that is also underpinned by the favourable economic environment. The Ecofin Council agreed to an action plan to reduce NPLs as well. Banks have been demanding the implementation of a secondary market for NPLs, as it is currently expected to be implemented by the end of 2018, for years. Further effects to be expected as a result of IFRS 9 are heightened earnings volatility and a capital adequacy burden that is nevertheless manageable. The above mentioned geopolitical risks also have the potential to create turbulence on the financial markets. The European Banking Authority will continue to focus increasingly on banks' Brexit plans due to continued uncertainty as the Brexit negotiations proceed. This should ensure that the banking system is well prepared for the looming "hard" Brexit.
In the US, the expected gradual normalisation of monetary policy is likely to have a positive impact on banks' interest margins. The tax reform adopted at the end of 2017 will result in future tax relief for banks after a one-off high burden on earnings. A possible repeal of certain regulatory requirements could give US banks further competitive advantages.
The US Federal Reserve balance sheet reduction initiated recently and anticipated further interest rate hikes could gradually cause a shortage of USD liquidity and thus divert capital flows to the US. In particular, emerging economies and their banks, which grant loans and raise funding in USD, could be among those negatively affected.

In light of stable domestic demand, positive overall performance continues to be expected for the German and European **corporate sector** in 2018. Given the high capacity utilisation, investment activity could moreover increase in Germany as well as in Europe, which would provide further positive economic impetus. Expectations for the US market are also favourable.

The positive sentiment in the German **private equity market** has continued. Both fundraising and the exit climate are highly favourable throughout all stages. The private equity scene continues to benefit from the ongoing low interest rate environment and the associated sustained investor interest in alternative investments. This is also increasingly reflected in comparatively high transaction volumes and company valuations, which, however, implies risks in the event of a potential downturn. The market outlook for 2018 remains optimistic, assuming a stable politico-economic environment.

The performance of European **securitisations** is expected to remain at a good, stable level in 2018 due to solidly hedged structures, despite various politico-economic uncertainties.

Anticipated developments in the KfW Group segments that are relevant to risk are not expected to have any material adverse effects on the risk situation in general, provided that the risks mentioned above do not materialise.

Overall, stable development is anticipated for KfW Group's **(core) tier 1 and total capital ratios** as well as for its economic risk-bearing capacity (99.99% solvency level) in financial year 2018, based on forecasts prepared in the group's internal capital adequacy process.

The liquidity situation was stable in 2017. The funding volume was in line with projections. The need for funding in 2018 has increased year on year, due to slightly higher cash inflows from repayments and higher outflows of funds compared to 2017. Unscheduled repayments can be expected to remain at a high level. No significant changes in liquidity risk are anticipated, due to the continued stable funding situation.

New business projections

Overview

KfW Group plans a promotional business volume of EUR 77.5 billion for 2018, thus expecting a growing promotional business over plan year 2017 in accordance with the bank's strategic objectives. The establishment of a subsidiary for equity finance in domestic promotion as well as the utilisation of additional public funds in development cooperation are important new developments.

In order to implement KfW Group's strategic objectives, the planning for the group's business sectors reflects measures with a strategic focus on promotional quality and an orientation of business activities towards the key megatrends "climate change and the environment", "globalisation", "social change" and "digitalisation and innovation". Establishing the new "digitalisation and innovation" megatrend sets the standard for advancing and expanding targeted promotion in this area through suitable product approaches. The aggregate portion of promotional business volume dedicated to climate and environmental protection financing of 38% is at a high stable level. The portion of planned new commitments made by Mittelstandsbank (SME Bank) in domestic promotional business will temporarily decrease somewhat and probably amount to 41%.

Domestic business

Domestically, KfW supports the German economy with the promotional programmes of the business sectors Mittelstandsbank (SME Bank) and Kommunal- und Privatkundenbank/Kreditinstitute (Municipal and Private Client Bank/Credit Institutions) through the promotion of investments by private individuals, companies, cities and municipalities as well as non-profit and social organisations.

Equity financing in the domestic promotional lending business is to be undertaken by an independent wholly-owned subsidiary in the future. The details of the specific structure and preparations for the commencement of operation are currently being developed in a project. Planning calls for a total of EUR 2 billion in venture capital to be made available over the next ten years through participation in venture capital funds for start-ups and fast-growing, innovative tech companies, in order to strengthen Germany as a centre of technology. The incorporation of a subsidiary enables a focus on equity investments, while strengthening the professionalisation and marketability of equity financing within KfW Group. The subsidiary is to be incorporated at the beginning of 2018 and commence operations mid-year.

Once the subsidiary has been formed, it will function as an independent business sector in KfW Group's domestic promotional business. An equity finance commitment volume of EUR 125 million is planned for 2018.

Mittelstandsbank (SME Bank) continues to regard itself as a reliable and goal-oriented partner of German SMEs and ministries, as well as its financing partners. With the combination of high-volume on-lending business and individual financing, its promotional offerings are tailored to the SME sector. Mittelstandsbank's long-term financings at favourable rates for investment and start-up projects, as well as for corporate succession, contribute indirectly to maintaining the competitiveness and future viability of the German economy and creating and safeguarding jobs.
The following market developments are important external factors for Mittelstandsbank:

1. Liquidity and funding terms for banks remain favourable in 2018, in particular due to the fact that the ECB is expected to depart from its ultra-expansionary monetary policy by cautiously tapering bond purchases from 2018 onwards.
2. Digitalisation is changing SMEs' economic parameters for the long term (Industry 4.0). As a consequence, innovative ability and speed will remain key to the success of German companies and the German economy, and the main focal point of the Federal Government's promotional policy, including its "Digital Strategy 2025" and "High-tech Strategy".
3. Supporting the energy transition remains highly relevant as one of the German government's chief economic and environmental policy projects. The promotional areas renewable energy and energy efficiency, which are important in meeting the objectives of the Paris Agreement on climate change, are heavily dependent on the current national and European regulatory environment and thus also on the new federal government's energy policy course from 2018 onwards.

Mittelstandsbank plans a total commitment volume of EUR 19 billion for 2018, which is somewhat below the 2017 plan level.

The focus will remain on digitalisation of all dimensions of the promotional business (products, marketing and processes). By launching the new ERP innovation and digitalisation programme, alignment of innovation promotion to the future trend of digitalisation was already undertaken in 2017. For 2018, Mittelstandsbank plans to advance and expand promotion in this area through suitable product approaches. Systematic digitalisation of the promotional business also requires upgrading KfW's relevant IT systems. To this end, the "On-lending Online 2.0" distribution platform for Mittelstandsbank's first products as well as for a number of pilot sales partners paved the way in mid-2016 for the online application and approval of commercial promotional products. Additional sales partners are being gradually included and all on-lent commercial products integrated in 2018. With over 40% of its commitment volume, Mittelstandsbank remains an important financing partner in environmental and climate protection, particularly as part of the energy transition. Further development of the product offering as part of the Renewable Energy programme enables the bank to support the important integration of renewable energy into the overall energy system and offset the volume decreases expected as a result of the Renewable Energy Sources Act 2017 *(Erneuerbare-Energien-Gesetz – "EEG 2017").*

Kommunal- und Privatkundenbank/Kreditinstitute (Municipal and Private Client Bank/Credit Institutions) continues to focus its promotional activities on the two megatrends "climate change and the environment" and "social change". Support of the progress in digitalisation is also provided in this context through products and processes. The aim is to maintain high proportions of promotion within these megatrends along with high quality of promotional products.

In addition to its focus on private clients, the long-term objective of the business sector is to continue to be a reliable partner to municipalities and municipal service companies as well as to the promotional institutions of the federal states (Landesförderinstitute). Moreover, support for leasing investment finance addresses the major importance of the SME client group. Four major factors are expected to contribute to ongoing high demand in KfW's private client business in the medium term:

1. The persistent low interest rate environment and rising incomes promote investments in residential property.
2. Climate change and Germany's energy transition bolster demand in the housing-related programmes for Energy-efficient Construction and Refurbishment.
3. Demographic change requires increasing investments in the needs-based development of housing.
4. The necessary increase in intensity of education and the needs-based training of skilled workers result in continued funding needs in educational programmes for primary and secondary school pupils, university students and those in professional training.

In particular, the Energy-efficient Construction and Refurbishment programmes, successfully established on the market for ten years, positions KfW as a key promoter of environmental protection for private and public costumers and standard-setter for energy efficiency in residential and public buildings.
The business sector pursues the strategic aim of "social change" within the framework of promotional activities through programmes to improve accessibility in existing properties, as well as through reliable and customer-focused financing offerings for housing. Moreover, the achievement of this strategic aim is underpinned by the continuation of the student loan programme and accompanying educational offerings for academic and professional qualifications. The two basic programmes "IKK – Investment Loans for Municipalities" and "IKU – Investment Loans for Municipal Companies and Social Organisations" serve to position KfW as a reliable partner to municipalities and municipal service companies. As a financing partner to the promotional institutions of the federal states, the business sector aims to ensure a business volume of programme-based global loans at the current high level. The aim in "general funding", too, is to maintain the business volume at a high level. Due to the major importance of KfW's SME customer group, the business sector's traditional domestic promotional offering is complemented by global loans for lease financing and global loans to European commercial and promotional banks for SME and energy efficiency financing.

After successfully automating the online application process for housing-related promotional programmes, the business sector continues to drive the systematic expansion of the digitalisation strategy. KfW's newly launched grant portal was also gradually further expanded in this context.
Kommunal- und Privatkundenbank/Kreditinstitute (Municipal and Private Client Bank/Credit Institutions) plans to increase new business volume to EUR 30.8 billion for 2018, a moderate increase over the 2017 plan level.

Financial markets
The business sector **Financial markets** invests in securitisation transactions in order to support improvement in the credit supply via capital market instruments. In this way, KfW contributes to the diversification and stabilisation of financing opportunities for SMEs in Germany and Europe.
SME-related securities investments of around EUR 1 billion are planned for 2018. The EIF-NPB Securitisation Initiative ("ENSI") of European promotional institutions, which was initiated by KfW and the European Investment Fund ("EIF"), continues its cooperation to strengthen capital market-based SME financing. KfW continues its purchase of green bonds to finance environmental and climate protection projects and further develop the green bond market. In 2017, the green bond portfolio target volume was raised by EUR 1 billion to EUR 2 billion, with an investment horizon of three to five years. The promotional mandate issued by the Federal Ministry for the Environment, Nature Conservation, Building and Nuclear Safety in 2015 was expanded accordingly. Green bond investments totalling EUR 300 million are planned for 2018.

For financial year 2018, the Financial markets business sector thus expects new business volume totalling EUR 1.3 billion.

International business
As a specialist financier and responsible partner, the **Export and project finance** business sector continues to pursue its objective of strengthening the German and European economies.
Economic performance in the markets relevant to the business sector is stable in Germany and overall satisfactory in the OECD countries. There are indeed regions with growth potential in the relevant developing countries and emerging economies,

such as the Andean states. Key markets such as Brazil, Russia and, in particular, Turkey continue to face challenges. Geopolitical risks, in North Korea and Iran, for example, are also relevant for the business sector. Overall, there is sufficient potential for German and European exporters and enterprises that invest in their competitiveness. Financing approaches can be developed for this purpose by the business sector.

The Export and project finance business sector (i.e., the promotional business on KfW's balance sheet and the market business of KfW's subsidiary KfW IPEX-Bank) aims to sustainably support the German and European economies with project and export financing to maintain and increase competitiveness and internationalisation. Further sustainable development of structuring competence is key to the business sector's positioning as a leading special finance provider. This specifically includes the offering of products that conserve equity, such as private risk insurance (PRI), and the assumption of selected roles in capital market transactions, including project bonds and structured corporate bonds, as well as the placement of large self-structured financings. A high priority is placed on continued improvement of risk diversification to stabilise earnings in an RWA-efficient manner in the long term. The main points are a stronger focus on marketing business that does not affect risk-weighted assets, and the increased use of hedging instruments and transfer of risk to the market (PRI and syndication) as well as more active portfolio management and the associated increase in RWA optimisation of the loan portfolio. Overall, this should result in less volatile and more limited risk costs.

Normalisation of new business development already registered in 2016 continues its course in the Export and project finance business sector, resulting in an expected new business volume for financial year 2018 of EUR 16.3 billion, a 3% increase over the 2017 projection.

KfW Development Bank expects the dynamic business growth in the Promotion of developing countries and emerging economies business sector to continue in the next few years.

In global development financing, collaboration with low-wage and fragile countries as well as emerging economies continues to be of major importance. In view of the high importance of refugee aid in Europe and combating the root causes of flight from native countries, combined with increased Federal Government responsibility in global environmental and climate protection, corresponding public funding (official development assistance – ODA) will be heavily increased. The Federal Ministry for Economic Cooperation and Development ("BMZ") focuses, among other things, on stabilising crisis countries and particularly Africa as a region. Against the background of the refugee influx, the European Commission announced an External Investment Plan (EIP) to combat the root causes of migration. The European Commission will set up regional platforms for financing which will include proven instruments but also an offer to assume risk for certain financings. In addition, assumption of the global indicator set to gauge the implementation success of the 2030 agenda raises the overall importance of the quality of promotion, monitoring and transparent presentation of effects.

KfW Development Bank aims to quickly implement additional budget funds and increase new commitments accordingly as a means of supporting the Federal Government in expanding and globally positioning German Financial Cooperation. To this end, KfW will further expand its international climate financing in climate adaptation, demand-based energy efficiency and the addition of renewable energy to energy systems, among other areas. KfW Development Bank is thus responsible for a considerable share of Germany's contribution to achieving the objectives of the Paris Agreement on climate change. Support must be extended to the Federal Government in view of the refugee influx to aid it in its civil contribution to global security and stability.

KfW Development Bank aims to continue and expand its cooperation with strategic partners in a targeted manner. KfW Development Bank has made important proposals under the EIP, including a proposal to develop a European collateral instrument. In the process, it has worked in close cooperation with bilateral European promotional institutions. In particular, a more intensive cooperation with the French development bank AFD is to be achieved in the political context of a stronger Franco-German axis.

KfW Development Bank will continue to expand its promotion from the current high level and expects new business volume of EUR 8.4 billion for 2018.

Privatisation transactions with the German Federal Government

In connection with the Federal Government's **privatisation transactions,** KfW is generally prepared to conduct further privatisation transactions in 2018, taking into account market conditions and the strategic requirements of the Federal Government.

Funding projections

As one of the world's largest non-governmental issuers, KfW issues bonds worldwide and enjoys excellent credit quality thanks to the explicit, direct guarantee from the Federal Republic of Germany. KfW has achieved a stable position in the **capital markets** with a well-diversified long term-oriented funding strategy. It enjoys an excellent reputation among international market participants and is able to react in a flexible way to rapidly changing market conditions. KfW seeks to maintain this position with great care and responsibility in order to secure the funding of KfW's promotional business. KfW expects to raise approximately EUR 70 to EUR 75 billion in long-term funds to finance its promotional mandate in 2018.

The three pillars of KfW's funding strategy remain: highly liquid benchmark bonds in euros and US dollars, public bonds and private placements. The product offering in the bond issue business will continue to be focused on investors' needs. The sustainability strategy in the capital markets will be consistently pursued in the future through the issue of green bonds in different currencies and structures.

Earnings projections

In the current group earnings projections for 2018, KfW expects Consolidated profit (before IFRS effects) of approximately EUR 0.9 billion based on anticipated macroeconomic conditions. The expected result is thus just below the strategic objective level of EUR 1 billion. Contributions from Net interest income and Net commission income (in each case before promotional expense) are at a high level similar to that of previous years; however, the ongoing low interest environment may limit the potential for additional earnings contributions from interest rate and liquidity maturity transformation and consequently become an increasing burden on Total net interest income in subsequent years.

The planned Administrative expense for 2018 exceeds the amount planned for 2017 by 5.6%. The increase is primarily attributable to regulatory requirements combined with implementation of new market trends (equity finance and expansion of Financial Cooperation). As a consequence thereof, the expected cost-income ratio (CIR) before promotional expense has been raised to 44.9%.

The projected standard risk costs, which as a long-standing historical average are considerably higher for 2018 than the actual risk provisions for the lending business in 2017 will have a negative effect on earnings. Given the macroeconomic scenario on which the projections are based, the actual risk provisions for the lending business are not likely to reach the standard risk costs level for 2018 either. The achievement of the strategic consolidated profit objective therefore appears to be possible. Market conditions permitting, KfW also expects promotional expense in 2018 to be close to the previous budget.

KfW's business model is oriented towards the medium to long term; income from the lending business (interest rate margins and net commission income) in particular is very stable. **Opportunities and risks** for consolidated profit may arise above all for the treasury result from deviating market conditions in conjunction with KfW's positioning. In addition, opportunities and risks may arise for the valuations as a result of risk provisions that may vary from those planned as well as from temporary effects on results arising from the valuation of economically effective hedges (IFRS-related effects on results). The latter have no economic basis and therefore are not explicitly included in KfW's planning.

HR strategy/development of workforce

Adequate staffing is a key requirement for implementing KfW's business strategy.

In its continuous planning, the Executive Board adopts binding FTE ceilings each year for the KfW parent company (excl. KFW IPEX-Bank and DEG) for the entire budget period. These ceilings take into account all internal staff in order to ensure business operations in normal and crisis times and to be able to react flexibly to any changed situations and/or responsibilities.

To improve personnel cost management, numerous measures, such as improved management at group-level and establishment of a cost type manager for personnel costs, will be implemented over the next few years with the aim of raising cost awareness. The applicability of the Remuneration Regulation for Institutions (*Institutsvergütungsverordnung* – "*IVV*") as of 1 January 2018, which covers all of KfW's employees, and current cost objectives result in far-reaching changes. The project that has been developed to address such changes is aimed at the mandatory implementation of supervisory requirements on the compensation and performance management system. KfW is also implementing more stringent requirements on temporary employment and false self-employment.

In **HR development,** comprehensive talent and skills management is aimed at enabling professional and personal skills training suited to the needs of all employees and managers, and establishing skills as a strategic factor, particularly in view of the modernisation, professionalisation and efficiency-enhancement projects underway at KfW. In addition, KfW continues to adapt its existing working models to the new requirements for mobile and flexible working in light of digitalisation, statutory requirements (e.g. the Caregiver Leave Act *(Gesetz über die Pflegezeit)* and the Part-Time and Limited-Term Employment Act *(Gesetz über Teilzeitarbeit und befristete Arbeitsverträge),* as well as the increased importance of reconciling work and private life, on an ongoing basis. In this manner, it creates a modern attractive working environment that is competitive on the market and that reinforces staff employability in the long term. Further development of the occupational health management initiative is an additional important component in supporting employees' health in the future, thus creating a healthy foundation for KfW. Diversity management will become a new focal point over the next few years in order to systematically include diversity at KfW as a strategic competitive advantage. Firstly, existing measures in sub-areas (e.g., gender balance, inclusion of people with severe disabilities, and knowledge transfer between younger and older employees) will be enhanced, and integrated into a holistic multi-dimensional approach, and secondly, greater attention will be paid to diversity management in the future development of personnel measures and structures.

Digitalisation as an opportunity

The **digitalisation** of the economy drives productivity, innovation and new business models. The success of this change process requires investments in digital infrastructure, adequate data security and data protection plans and the relevant skills for employees.

One the one hand, KfW supports the digital transformation of the economy via its promotional activities, for example, with suitable products in domestic promotion, projects to promote digitalisation in Germany and abroad and development of digital platforms with suitable partners. On the other hand, KfW sees the technological applications driving digitalisation as a chance to improve its own promotional offering. It thus takes a targeted approach to advancing the digital transformation at KfW with the aim of securing and further developing its promotional offering and increasing efficiency. To this end, the bank invests in digital solutions for streamlined, digital processing of promotional programmes (the digital on-lending system "BDO 2.0" and the KfW grant portal) and tests new technologies to optimise processes and workflows in the promotional business (e.g., piloting blockchains in development cooperation and bond trading).

The digital transformation at KfW also includes supporting the cultural change and employee training. The focus is on the long-term changes in working relationships, management and communication as a result of digitalisation. A digital academy serving as a central hub for exchanging knowledge and experience on digitalisation was created for this express purpose. Its expansion is a key factor in actively supporting employees in the change process accelerated by digitalisation.

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”) and apply them at KfW. The Corporate Governance Report of KfW contains the declaration of compliance with the recommendations of the PCGK.

Non-financial statement

Information on the “Summarised non-financial statement of KfW as the parent company and of KfW Group” can be found in the standard report of the 2017 Sustainability report. The report adheres to the Global Reporting Initiative (GRI) standards and can be accessed online at https://www.kfw.de/PDF/Download-Center/Konzernthemen/Nachhaltigkeit/englisch/Nachhaltigkeitsbericht-2017_EN.pdf

Report on equal opportunities and equal pay in accordance with Section 21 of the Transparency of Remuneration Act *(Entgelttransparenzgesetz)*

A commitment to ensuring equal opportunities for men and women is a key component of KfW's personnel policy. A fourth equal opportunities plan, effective for four years until 2019, has now been drafted together with the equal opportunities officer. The agreed objectives and measures are based on initiatives that have already proven successful, such as the recruitment processes and HR development tools to increase the proportion of women introduced from 2011 to 2015; they also provide new impetus in line with the German Federal Equal Opportunities Act *(Bundesgleichstellungsgesetz – "BGleiG")*, which was amended in 2015.
The systematic implementation of the equal opportunities plan is one of KfW's main personnel policy objectives. Various instruments aimed at promoting equal opportunities for men and women and paving women's way to management positions have been introduced to this end. Examples include the introduction of shadowing, mentoring and group coaching programmes. These are generally open to men and women, but also give primarily women the opportunity to assess whether a management role would be attractive to them in the future.
The proportion of women in management positions at KfW is 30% (as of December 2016). Of all management staff, 15% (the majority of which are women) have taken advantage of part-time working models. KfW will continue to pursue the objective of increasing the proportion of women in management and senior professional positions using both internal promotions and external recruitment until 2019. Where candidates have the same qualifications, KfW gives preference to women.

A variety of programmes to strike a balance between career and personal life are offered in addition to the afore-named instruments in order to continue supporting women in management positions (but also to open up new opportunities for men). These programmes are under continuous further development, also taking KfW's business requirements into account. KfW focused on the issue of combining work and care of family members in 2016 in order to achieve a better work-life balance and thus indirectly promote equal opportunities for men and women. This involved events on the subject of dementia, and the training of six "caregiver guides" within KfW.

The collective bargaining agreement for the private and public banking sector that contributes to ensuring equal pay for men and women, applies at KfW. Moreover, remuneration of employees not covered by collective agreements is governed by a staff agreement. The same principles of remuneration apply to women and men. Staff members are grouped into salary levels on the basis of uniform standards in terms of function, qualifications and responsibilities. Individual positioning within the salary bands for staff not covered by collective agreement is based on standardised and gender-neutral criteria.

Financial year 2016

Total number of employees (average)	**4,767**	
of whom female	*2,315*	*49%*
of whom male	*2,453*	*51%*
Full-time employees	3,540	
of whom female	*1,347*	*38%*
of whom male	*2,194*	*62%*
Part-time employees	1,227	
of whom female	*968*	*79%*
of whom male	*259*	*21%*

KfW financial statements 2017

Financial statements

Statement of financial position of KfW as of 31 December 2017

Assets

	see note no.	31 Dec. 2017				31 Dec. 2016
		EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Cash reserves						
a) Cash in hand				0		0
b) Balances with central banks				11,086		11,571
of which: with Deutsche Bundesbank		*11,086*				*(11,571)*
					11,086	**11,571**
Loans and advances to banks	(2)					
a) Due on demand				10,507		2,935
b) Other loans and receivables				291,521		301,739
					302,028	**304,674**
Loans and advances to customers	(3)				**102,255**	**107,416**
of which: secured with mortgages						
Municipal loans		67,181				(73,489)
Bonds and other fixed-income securities	(4), (9)					
a) Money market paper						
aa) Of public sector issuers			0			0
of which: eligible as collateral with Deutsche Bundesbank		*0*				*(0)*
ab) Of other issuers			1,328	1,328		1,247
of which: eligible as collateral with Deutsche Bundesbank		*0*				*(0)*
b) Bonds and debentures						
ba) Of public sector issuers			6,008			6,247
of which: eligible as collateral with Deutsche Bundesbank		*5,765*				*(6,083)*
bb) Of other issuers			23,190	29,197		21,914
of which: eligible as collateral with Deutsche Bundesbank		*18,600*				*(17,631)*
c) KfW's own bond issuers				8,667		9,067
Nominal amount		9,154				*(9,674)*
					39,193	**38,475**

Assets

	see note no.	31 Dec. 2017				31 Dec. 2016
		EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Equity investments	(5), (7), (9)				**1,026**	**1,045**
of which: in banks		*40*				*(42)*
of which: in financial services institutions		*0*				*(0)*
Shares in affiliated companies	(6), (7), (9)				**3,250**	**3,050**
of which: in banks		*429*				*(429)*
of which: in financial services institutions		*0*				*(0)*
Assets held in trust	(8)				**15,859**	**16,319**
of which: loans held in trust		*12,124*				*(12,727)*
Intangible assets	(9)					
Concessions, industrial property rights and similiar rights					138	125
					138	**125**
Property, plant and equipment	(9)				**872**	**866**
Other assets	(10)				**628**	**15,614**
Deferred charges	(11)				**1,586**	**1,503**
Special loss account consisting of provisions under Section 17 (4) of the D-Mark Balance Sheet Act					**26**	**26**
Total assets					**477,947**	**500,684**

Liabilities and equity

	see note no.	31 Dec. 2017				31 Dec. 2016
		EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks	(12)					
a) Due on demand				3,586		17,213
b) With agreed terms or periods of notice				4,405		4,789
					7,991	**22,002**
Liabilities to customers	(13)					
Other liabilities						
a) Due on demand			760			712
b) With agreed terms or periods of notice			8,374	9,134		10,055
					9,134	**10,767**
Certificated liabilities	(14)					
Bonds and notes				408,606		422,268
					408,606	**422,268**
Liabilities held in trust	(15)				**15,859**	**16,319**
of which: Loans held in trust		*12,124*				*(12,727)*
Other liabilities	(16)				**6,341**	**138**
Deferred income	(17)				**3,134**	**3,051**
Provisions	(18)					
a) Provisions for pensions and similar obligations				1,184		1,092
b) Other provisions				1,030		1,071
					2,214	**2,162**
Obligatory charges under the D-Mark Balance Sheet Act					**0**	**5**
Subordinated liabilities	(19)				**0**	**200**
Fund for general banking risks					**600**	**600**

Liabilities and equity

	see note no.	31 Dec. 2017				31 Dec. 2016
		EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Equity	(20)					
a) Called in capital						
Subscribed capital			3,750			3,750
less uncalled outstanding contributions			(450)	3,300		(450)
b) Capital reserve				8,447		8,447
of which: promotional reserves from the ERP Special Fund		*7,150*				*(7,150)*
c) Reserve from the ERP Special Fund				1,191		1,191
d) Retained earnings						
da) Statutory reserve under Article 10 (2) of the KfW Law			1,875			1,875
db) Special reserve under Article 10 (3) of the KfW Law			9,207			8,312
dc) Special reserve under Section 17 (4) of the D-Mark Balance Sheet Act			48	11,130		48
					24,068	**23,172**
Total liabilities and equity					**477,947**	**500,684**
Contingent liabilities	(21)					
On guarantees				755		1,114
					755	**1,114**
Other commitments	(22)					
Irrevocable loan commitments				74,398		76,089
					74,398	**76,089**

Income statement of KfW

for the period from 1 January – 31 December 2017

	see note no.	2017				2016
		EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Interest income from						
a) Lending and money-market transactions	(23)	6,871				10,207
Less negative interest from lending and money-market transactions		–186	6,685			–113
b) Fixed-income securities and bonds			58			102
				6,743		10,196
Interest expense	(23)	5,082				8,489
Less positive interest from the banking business		–80	5,002			–53
				5,002		8,436
					1,741	1,760
Current income from						
a) Shares and other non-fixed income securities				0		0
b) Equity investments				36		30
c) Shares in affiliated companies				0		0
					36	30
Commissions income				**369**		380
Commissions expense				**190**		207
					179	173
Other operating income	(24)				**118**	234
General administrative expenses						
a) Personnel expense						
aa) Salaries and wages			399			388
ab) Social security contributions and expense for pension provision and other employee benefits			142	541		57
of which: for pensions			*85*			*(3)*
b) Other administrative expenses				442		418
					983	863
Depreciation, amortisation and impairment of property, plants and equipment and intangible assets	(9)				**57**	82
Other operating expense	(24)				**22**	31

	see note no.	2017				2016
		EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Impairments of receivables and certain securities and additions to provisions for loan losses					**118**	0
Income from reversals of impairment losses on receivables and certain securities and reversals of provisions for loan losses					**0**	92
Depreciation, amortisation and impairment of equity investments, shares in affiliated companies and securities held as fixed assets					**0**	17
Income from reversals of write-downs of equity investments, shares in affiliated companies and securities held as fixed assets					**7**	0
Result from ordinary activities					**901**	1,295
Taxes on income					**5**	5
Other taxes					**1**	0
Profit					**895**	1,290
Allocation to retained earnings						
to the special reserve under Section 10 (3) of the KfW Law	(20)		–895			–1,290
				–895		–1,290
Net retained profits					**0**	0

Notes

KfW is a public law institution with registered office in Frankfurt am Main.
The financial statements of KfW have been prepared in accordance with the requirements of the German Commercial Code *(Handelsgesetzbuch – "HGB")*, the German Accounting Regulation for Banks and Financial Services Institutions *(Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – "RechKredV")* and the Law Concerning KfW (KfW Law). The special provisions of the D-Mark Balance Sheet Act *(D-Mark-Bilanz-Gesetz- "DMBilG")* have also been observed.
The KfW statement of financial position and income statement presentation of items was adjusted as follows: Equity was expanded to include the special items Promotional reserves from the ERP Special Fund as a sub-item of Capital Reserve, Reserves from the ERP Special Fund and the three sub-items in Retained earnings: Statutory reserve under Article 10 (2) KfW Law and Special reserve under Article 10 (3) KfW Law and Special reserve under Section 17 (4) of the D-Mark Balance Sheet Act. Disclosures on items in the statement of financial position which may be provided in either the statement of financial position or the notes are provided in the notes.

1) Accounting policies

Cash in hand, Loans and advances to banks and customers and Other assets have been shown at cost, notional amount or lower fair value. Differences between notional amounts and lower paid out amounts of receivables, which are similar in nature to interest, have been included in Deferred income and recognised over the term through profit or loss in Interest income. Equity investments and Shares in affiliated companies are recognised at cost. In the case of permanent impairments, assets are written down to the lower value.

Interest rate reductions are recognised in the income statement as they arise, at their present value at the time the loan terms and conditions are determined. These transactions are measured applying the parameters of the general promotional loan market the first time they are recorded at fair value. Consequently, these transactions result in interest rates below the market rate, which have a negative impact on KfW's earnings position.
The difference that normally results upon loan commitment – present value of the nominal scheduled interest rate reductions during the first fixed interest rate period – is recognised in profit or loss with a negative impact on interest expense and accounted for as an adjusting item in Loans and advances under the balance sheet items Loans and advances to banks or Loans and advances to customers. The adjustment to the carrying amount is amortised in Net interest income using the effective interest rate method. In the event of unscheduled repayment in full, this will be recognised in profit or loss under Interest income. Differences that relate to irrevocable loan commitments are reported in Provisions. Changes to the portfolio are offset via the adjustments to the carrying amounts of already disbursed promotional loans recognised on the assets side.

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 generally been applied. In some cases, hedging relationships are recognised for securities and their interest hedges (primarily interest rate swaps) in accordance with Section 254 HGB. No securities have been allocated to the trading book. Reversals of impairment losses have been accounted for in accordance with the statutory requirements. Structured securities with embedded derivatives are accounted for as one unit and are valued strictly at the lower of cost or market value.

Property, plant and equipment and intangible assets are reported at cost, reduced by straight line depreciation/amortisation over their expected useful life. Impairment is recognised as required. Minor fixed-assets items are combined to form a collective item and are depreciated/amortised over a period of five years using the straight-line method. The bank opted not to recognise internally generated intangible fixed assets.

Liabilities are recognised at their settlement amount; differences between agreed higher repayment amount and issue amount are recognised in the item Deferred charges. Zero-coupon bonds issued are recognised at their current redemption amount.

Provisions for pensions and similar commitments were valued in accordance with actuarial principles on the basis of the 2005 G mortality tables by Dr Klaus Heubeck. The projected unit credit method with the following parameters was applied to KfW's calculations for all active staff members.

	31 Dec. 2017
Actuarial discount rate (10-year average interest rate)	3.68%
Rate of salary increases (depending on pay scale)	2.20%
Rate of pension increases (depending on pension scheme)	1.00% to 2.50%
Rate of staff turnover	1.50%

Other provisions are reported in the amount of the estimated expenditure required to settle the obligation as dictated by prudent business judgement, taking future price/cost increases into account. Provisions with a remaining life of more than one year are discounted with the market interest rate published by the Deutsche Bundesbank.

Risks, primarily for lending business as a result of the structure of KfW's business, were sufficiently addressed through value adjustments and provisions. KfW distinguishes between significant receivables (volume from each individual borrower of EUR 1 million or more) and non-significant receivables. For significant receivables, an individual assessment of credit exposure regarding future payments is undertaken when there are indicators of impairment. The calculation takes into account the scope and value of the collateral as well as the political risk. For non-significant receivables, a general risk provision is created based on homogeneous sub-portfolios. Latent credit and transfer risks are covered by recognising portfolio-based impairments for the portion of the portfolio that is not already individually impaired. For non-performing loans, interest income is generally accrued based on the probability of collection. Additions and usage are recognised net in the item Impairment of receivables and certain securities and additions to provisions for loan losses or Income from the reversals of impairment losses on receivables and certain securities and reversals of provisions for loan losses. The same applies to unrealised and realised results from equity investments, shares in affiliated companies and securities treated as fixed assets. The possibility of netting in the income statement in accordance with Section 340 c (2) and Section 340 f (3) HGB has been utilised.

The assets and liabilities in foreign currencies and the cash transactions not completed on the balance sheet date have been converted into euros at the average spot exchange rate. The bank applies the principal of special cover in accordance with Section 340 h HGB in conjunction with Section 256 a HGB.

The valuation of interest-related transactions in the banking book *(Refinanzierungsverbund)* follows the management of interest rate fluctuation risk at KfW. The principle of prudence is taken into account by creating provision for anticipated losses from onerous contracts in accordance with Section 340 a in conjunction with Section 249 (1) sentence 1, 2nd alternative HGB for any excess obligations resulting from the valuation of the interest-related banking book. The requirements of the statement of the Banking Committee of the German Institute of Auditors *(Institut der Wirtschaftsprüfer – "IDW")* on the loss-free valuation of the banking book *("BFA 3")* are taken into account. To determine any excess obligation, KfW calculates the net value of all discounted future period results of the banking book. In addition to net interest and relevant commission income, this includes the associated administrative costs and risk costs in the amount of expected losses. No provision for contingent losses was required during the reporting year.

Negative interest generated as a result of the persisting low interest rate environment is reported in the statement of financial position under Interest from lending and money-market transactions and Interest expense.

Notes to the assets

2) Loans and advances to banks

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
This item includes:		
Loans and advances		
To affiliated companies	20,593	23,908
To companies in which KfW holds a stake	0	13
Without underwriting borne by the on-lending bank	1,496	1,599
Subordinated loans	1,442	1,977
Due		
On demand	10,507	2,935
Within 3 months	14,489	24,717
Between 3 months and 1 year	31,473	34,398
Between 1 year and 5 years	126,330	121,670
In more than 5 years	116,245	117,748
Accrued interest	2,984	3,205
Total	**302,028**	**304,674**

An adjusting item in the amount of EUR 1,185 million (2016: EUR 1,357 million) is reported under Loans and advances to banks due to the interest rate being below the market rate for promotional loans disbursed with additional promotional support in the form of interest rate reductions impacting KfW's earnings.

3) Loans and advances to customers

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
This item includes:		
Loans and advances		
To affiliated companies	131	70
To companies in which KfW holds a stake	0	0
Subordinated loans	2,163	2,573
Due		
With no fixed maturity	11,413	11,413
Within 3 months	7,875	12,991
Between 3 months and 1 year	6,613	6,288
Between 1 year and 5 years	35,525	33,661
In more than 5 years	40,546	42,747
Accrued interest	283	315
Total	**102,255**	**107,416**

An adjusting item in the amount of EUR 111 million (2016: EUR 142 million) is reported under Loans and advances to customers due to the interest rate being below the market rate for promotional loans disbursed with additional promotional support in the form of interest rate reductions impacting KfW's earnings.

4) Bonds and other fixed-income securities

	31 Dec. 2017	31 Dec. 2016
	EUR in millions	EUR in millions
Due within the following year		
Money market paper, bonds and notes	4,825	6,322
Notional amount	*4,787*	*6,240*
Own bond issues	2,646	338
Notional amount	*2,623*	*336*
Total	**7,471**	**6,660**
Notional amount	*7,410*	*6,576*
Listed securities	37,478	36,781
Unlisted securities	1,715	1,694
Marketable securities	**39,193**	**38,475**
Subordinated assets	353	109
Repurchase agreements	11	0

5) Equity investments

	31 Dec. 2017	31 Dec. 2016
	EUR in millions	EUR in millions
Listed securities	57	57
Unlisted securities	49	47
Marketable securities	**105**	**104**

6) Shares in affiliated companies

As in 2016, this item does not contain any listed securities.

7) Disclosures on shareholdings

	Name and domicile of company	Share held	Equity	Profit/loss for the year
		in %	EUR in thousands	EUR in thousands
1	DEG Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne[1]	100.0	2,462,893	94,947
2	KfW Beteiligungsholding GmbH, Bonn[1]	100.0	2,088,878	95,986
3	Interkonnektor GmbH, Frankfurt am Main[1]	100.0	47,203	–2,743
4	tbg Technologie-Beteiligungsgesellschaft mbH, Bonn[1]	100.0	57,938	5,381
5	Finanzierungs- und Beratungsgesellschaft mbH, Berlin[2]	100.0	5,094	–60
6	AF Eigenkapitalfonds für deutschen Mittelstand GmbH & Co. KG, Munich[2]	47.5	154,376	4,047
7	Deutsche Energie-Agentur GmbH (dena), Berlin[2]	26.0	5,605	1,079
8	Berliner Energieagentur GmbH, Berlin[2]	25.0	5,757	636
9	eCapital Technologies Fonds II GmbH & Co. KG, Münster[2]	24.8	18,487	2,342
10	Galaxy S.à r.l., Luxembourg, Luxembourg[3]	20.0	15,442	8,215

	Name and domicile of company where KfW holds at least 5% of voting rights	Share of voting rights	Equity	Profit/loss for the year
		in %	EUR in thousands	EUR in thousands
1	ProCredit Holding AG & Co. KGaA, Frankfurt am Main[2), 4)]	14.5	654,272	61,009
2	Access Microfinance Holding AG, Berlin[2]	14.3	60,018	–10,115
3	Finca Microfinance Holding Company LLC, Delaware, USA[2]	8.9	188,185	–19,179
4	Accessbank Closed Joint-Stock Company Azerbaijan[2]	8.9	28,211	–44,027
5	CJSC AccessBank Tajikistan, Dushanbe, Tajikistan[2]	7.3	1,816	–2,723
6	AB Microfinance Bank Nigeria Ltd., Lagos, Nigeria[2]	5.9	9,602	1,248

[1] Most recent available financial statements 31 Dec. 2017
[2] Most recent available financial statements 31 Dec. 2016
[3] Most recent available financial statements 30 June 2016
[4] Consolidated financial statements of ProCredit Group

	Shares in investment funds	Shares of total assets	Carrying amounts	Dividend payments	Redeemable daily
		in %	EUR in thousands	EUR in thousands	
1	Galaxy S.à r.l. SICAR	20.0	0	0	No
2	Microfinance Enhancement Facility SA, SICAV-SIF	19.2	92,971	3,473	No
3	Europäischer Fonds für Südosteuropa SA SICAV-SIF	17.7	138,778	5,598	No
4	Global Climate Partnership Fund, SA SICAV-SIF	17.4	55,449	1,378	No
5	Rural Impulse Fund II S.A., SICAV-SIF	16.5	9,177	1,412	No
6	Africa Agriculture and Trade Investment Fund, SICAV-SIF	16.0	21,561	799	No
7	Sanad Fund for MSME S.A., SICAV-SIF	14.7	28,437	708	No
8	Fondaco società di gestione del risparmio S.p.A.	14.6	9,104	0	No
9	Green for Growth Fund, Southeast Europe SA, SICAV-SIF	14.5	52,389	1,722	No
10	Advans S.A., SICAR	14.2	9,500	0	No
11	2020 European Fund for Energy, Climate Change and Infrastructure SICAV	14.1	49,892	0	No
12	MIFA Debt Fund S.A., SICAV-SIF	13.1	19,052	1,121	No
13	DWM incl. Finance Equity Fund II	10.0	3,145	0	No

Disclosure was omitted in accordance with Section 286 (3) no. 1 HGB. The list of shareholdings shows significant equity investments with a capital share greater than 20%. The other equity investments are of minor importance.

The shares in investment funds primarily serve to strengthen and support projects relating to climate protection, renewable energy and infrastructure expansion and whose main aim is promoting public interests. For this reason, the shares are reported under “Equity investments” and not under “Shares and other non-fixed income securities”. 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.
The investments are not impaired and an evaluation process takes place regularly.

8) Assets held in trust

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
Loans and advances to banks	902	918
Loans and advances to customers	11,222	11,809
Equity investments	3,735	3,592
Total	**15,859**	**16,319**

9) Fixed assets

Statement of changes in fixed assets as of 31 December 2017

EUR in thousands		Equity investments[1]	Shares in affiliated companies[1]	Securities held as fixed assets[1]	Intangible assets	Property, plant and equipment[4]	Total
Acquisition costs/ production costs as of 1 Jan. 2017[3]					175,276	1,197,100	
Additions 2017					26,482	50,215	
Disposals 2017	Changes[2]	–19,598	199,736	1,473,727	1,605	5,962	
Transfers 2017					0	0	
Acquisition costs/ production costs as of 31 Dec. 2017					200,152	1,241,352	
Accumulated depreciation/ amortisation as of 1 Jan. 2017					50,272	330,627	
Depreciation/amortisation 2017[5]					13,099	43,705	
Reversal of impairments 2017					0	0	
Depreciation/amortisation of additions 2017					841	14,554	
Depreciation/amortisation of disposals 2017					1,605	5,167	
Depreciation/amortisation of transfers 2017					0	0	
Accumulated depreciation/ amortisation as of 31 Dec. 2017					61,766	369,165	
Net carrying amount 31 Dec. 2017		1,025,365	3,249,541	29,114,388	138,386	872,187	**34,399,868**
Net carrying amount 31 Dec. 2016		1,044,963	3,049,805	27,640,661	125,003	866,473	**32,726,906**

[1] The bank exercised the option under Section 34 (3) RechKredV to consolidate Securities and investments.
[2] Including price changes
[3] The simplification under Section 31 (3) of the Introductory Act to the German Commercial Code (Einführungsgesetz zum Handelsgesetzbuch – EGHGB) has been applied.
[4] Of which net carrying amount as of 31 December 2017:
– Total amount of land and buildings used for the bank’s activities EUR 799,128 thousand
– Total amount of office furniture and equipment EUR 73,059 thousand
[5] Depreciation/amortisation 2017 includes impairments of EUR 149 thousand.

Bonds and other fixed-income securities, as well as shares and other non-fixed income securities, intended for permanent use for business activities and therefore usually held until maturity, have been included with the securities held as fixed assets. They are presented separately from current assets and are valued according to the modified lower of cost or market value principle.
The carrying amount of the marketable securities in fixed assets not valued strictly at the lower of cost or market value was EUR 29,114 million as of 31 December 2017. This includes securities with a carrying amount of EUR 3,120 million, for which an impairment loss of EUR 5 million was not recognised, as they are to be held to maturity.

10) Other assets

	31 Dec. 2017	31 Dec. 2016
	EUR in millions	**EUR in millions**
Main items:		
Adjusting item from the currency translation of derivatives	0	14,982
Amount receivable from the Federal Agency for Special Tasks associated with Unification	603	603

The adjusting item from the currency translation of derivatives was reported under Other liabilities on the liabilities side of the statement of financial position in 2017. The amount receivable from the Federal Agency for Special Tasks associated with Unification is reported due to the transfer to KfW of the insurance business of the State Insurance Company of the GDR in liquidation *(Staatliche Versicherung der DDR in Abwicklung – "SinA")*. Actuarial provisions have thus been set up in the same amount.

11) Deferred charges

The line item Deferred charges includes the differences between the repayment amount and the lower issuing amount for liabilities in the amount of EUR 603 million (2016: EUR 615 million).

Notes to the liabilities and equity

12) Liabilities to banks

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
The item includes:		
Liabilities to		
Affiliated companies	51	8
Companies in which KfW holds a stake	0	0
Due		
On demand	3,586	17,213
Within 3 months	78	95
Between 3 months and 1 year	90	138
Between 1 year and 5 years	1,159	1,206
In more than 5 years	936	956
Accrued interest	2,144	2,394
Total	**7,991**	**22,002**

13) Liabilities to customers

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
The item includes:		
Liabilities to		
Affiliated companies	58	172
Companies in which KfW holds a stake	0	0
Due		
On demand	760	712
Within 3 months	1,941	3,733
Between 3 months and 1 year	806	513
Between 1 year and 5 years	2,480	2,912
In more than 5 years	3,062	2,801
Accrued interest	85	95
Total	**9,134**	**10,767**

14) Certificated liabilities

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
The sub-item – Bonds and notes – includes:		
Liabilities to		
Affiliated companies	2,005	2,116
Companies in which KfW holds a stake	0	0
Due within the following year	110,353	111,131

15) Liabilities held in trust

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
Liabilities to banks	0	0
Liabilities to customers	15,859	16,319
Total	**15,859**	**16,319**

16) Other liabilities

Under Other liabilities, KfW reported a currency adjustment item in the amount of EUR 6,225 million (2016: EUR 14,982 million on the assets side). The foreign currency derivatives were used in the context of management of the foreign currency exposure. The previous year, the currency adjustment item was reported under Other assets on the assets side of the statement of financial position due to currency exchange rate development.

17) Deferred income

Deferred income includes discounts on receivables totalling EUR 330 million (2016: EUR 460 million).

18) Provisions

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
Main items:		
Provisions for pensions and similar obligations	1,184	1,092
Actuarial provisions in connection with the transfer to KfW of the insurance business of SinA	603	603
Provisions for variable compensation components incl. social security payments	57	57
Irrevocable loan commitments below market rate	40	44
Provisions for credit risks	38	39
Early retirement	28	33

For provisions with a remaining term of more than one year and a carrying amount as of 31 December 2017 of EUR 30 million, KfW exercised the option to retain the carrying amount without discounting in accordance with Section 67 (1), Sentence 2, of the Introductory Act to the German Commercial Code *("EGHGB")*. The value after discounting at the applicable Bundesbank interest rate totals EUR 29 million, yielding excess coverage of EUR 1 million.
Expenses of EUR 53 million resulting from accrued interest on provisions for pensions and similar obligations and other long-term provisions are recognised in Interest expense.

There was a difference of EUR 185 million between the discounting of provisions for pensions at the average market rate of the past ten years and the discounting of this item at the average market rate of the past seven years. This difference is excluded from distribution.
An adjusting item in the amount of EUR 40 million is reported in financial year 2017 under Other provisions due to the interest rate being below the market rate for promotional loans irrevocably committed with additional promotional support in the form of interest rate reductions with an impact on KfW's earnings position.

19) Subordinated liabilities

As part of the new legislation governing ERP economic promotion as of 1 July 2007, the ERP Special Fund provided a subordinated loan to KfW in the original amount of EUR 3,247 million. KfW repaid the subordinated loan, which was still reported in the amount of EUR 200 million as of 31 December 2016, to the ERP Special Fund early on 29 September 2017. The loan consisted of three tranches with different fixed-interest periods. Interest was charged on the tranches at an average rate of 1.82% in financial year 2017 (2016: 1.82%).
Interest expenses for the subordinated loan amounted to EUR 3 million in financial year 2017 (previous year: EUR 4 million).

20) Equity

	31 Dec. 2016	Net profit for the financial year	Other changes	31 Dec. 2017
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
KfW's subscribed capital	3,750	0	0	3,750
Uncalled outstanding contributions	–450	0	0	–450
Capital reserve	8,447	0	0	8,447
thereof: Promotional reserves of the ERP Special Fund	*7,150*	*0*	*0*	*7,150*
Reserve from the ERP Special Fund	1,191	0	0	1,191
Retained earnings				
a) Statutory reserve under Article 10 (2) of the KfW Law	1,875	0	0	1,875
b) Special reserve under Article 10 (3) of the KfW Law	8,312	895	0	9,207
c) Special reserve under Section 17 (4) of the D-Mark Balance Sheet Act	48	0	0	48
Equity	**23,172**	**895**	**0**	**24,068**

All of the profit for 2017 was allocated to retained earnings. As of year-end 2017, KfW's equity amounted to EUR 24,068 million.

Other required notes to the liabilities and equity

21) Contingent liabilities

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
This item includes:		
Guarantees for special loans	202	245
Guarantees for export financing	150	170
Guarantees for aircraft finance	70	149
Guarantees for synthetic securitisation platform (PROMISE/PROVIDE)	48	92
Guarantees for foreign loans	11	85
Guarantees for other financing	274	373
Total	**755**	**1,114**

The risk of guarantees is reduced by the existing possibilities of recourse to the contracting entity and is largely based on that entity's credit rating and the value of any collateral. The bank regularly assesses the risk as part of credit risk monitoring. If there are reasons for a probable outflow of funds, the bank creates individual provisions; general provisions are made for latent risks. Contingent liabilities are reduced by received cash collateral and provisions accounted for as liabilities.

22) Other commitments

Irrevocable loan commitments	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
This item includes:		
Investment finance of Kommunal- und Privatkundenbank/Kreditinstitute (Municipal and Private Client Bank/Credit Institutions)	35,928	35,969
Export and project finance	13,921	14,957
Loans for the Promotion of developing countries and emerging economies	11,840	10,936
Investment finance of Mittelstandsbank (SME Bank)	11,449	11,331
Guarantees	210	272
Forward-forward agreements	50	1,124
Other loan commitments	1,000	1,500
Total	**74,398**	**76,089**

Irrevocable loan commitments are used for regular credit risk monitoring. If there are specific findings regarding a loss from an expected outflow of funds, the bank creates an individual provision; latent risks are covered through the creation of portfolio provisions.

Provisions created for the interest rate reductions in irrevocable loan commitments granted by KfW in the promotional lending business and negatively impacting its earnings position are included.

Notes to the income statement

23) Interest income and Interest expenses

The Interest and similar income from loans and advances to banks and customers item comprises EUR 186 million in negative interest from lending and money-market transactions as a result of the persisting low interest rate environment. Of this amount, EUR 27 million is attributable to receivables from the Federal Government resulting from the privatisation of Deutsche Telekom AG and Deutsche Post AG, EUR 99 million (2016: EUR 104 million) to money-market transactions, EUR 56 million to the deposit with the central bank and EUR 4 million to promissory note loans *(Schuldscheindarlehen)* to KfW IPEX-Bank GmbH.

The Interest and similar expenses from the banking business item comprises EUR 80 million in positive interest. This includes EUR 32 million (2016: EUR 53 million) in positive interest from money-market transactions and EUR 37 million from certificated liabilities. In addition, EUR 8 million is attributable to liabilities from the interim dividend investment of the block of shares KfW holds in Deutsche Post AG and Deutsche Telekom AG, and EUR 3 million to cash collateral.

24) Other operating income and Other operating expenses

In accordance with Sections 277 (5) sentence 2 and 340 h HGB, expenditure on and income from currency conversion have been presented as gross figures in Other operating expenses (EUR 10 million, 2016: EUR 7 million) and Other operating income (EUR 2 million, 2016: EUR 6 million). Exchange rate-related value changes of specific impairments denominated in foreign currencies are also presented in Other operating expenses or Other operating income. Other operating income is largely attributable to the fee for KfW IPEX-Bank GmbH's agency agreement of EUR 91 million.

25) Auditor's fees

KfW has exercised the option under Section 285 No. 17 HGB, and refers to the breakdown of auditor fees in KfW Group's consolidated financial statements.

26) Geographical markets

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

Other required notes

27) Assets and liabilities in foreign currencies

	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
Assets in foreign currencies	52,993	63,295
Liabilities in foreign currencies	224,553	253,823

28) Other financial commitments

The bank has remaining payment obligations totalling EUR 504 million in connection with equity finance operations.
It also has remaining payment obligations to affiliated companies totalling EUR 124 million as of 31 December 2017.

In isolated cases, KfW staff or third parties appointed by KfW take on executive body functions at companies in which KfW holds equity investments or with which it has another relevant creditor relationship. The risks arising therefrom are covered by the directors and officers liability insurance policy of the respective company. Liability risks may arise for KfW in the event that such insurance coverage is not in place.

29) Derivatives reporting

KfW uses the following forward transactions/derivative products, mainly to hedge interest and exchange rate risks, and other price and credit risks:

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

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

3. Credit derivatives
   - Single name credit default swaps

The following disclosure 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 of 31 December 2017.

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

Purchased and written options are presented as Other assets or Other liabilities at the amount paid as premiums.

Volume

	Notional amounts 31 Dec. 2017 EUR in millions	Notional amounts 31 Dec. 2016 EUR in millions	Positive fair values 31 Dec. 2017 EUR in millions	Negative fair values 31 Dec. 2017 EUR in millions
Contracts with interest rate risks				
Interest swaps	429,867	418,530	10,909	13,168
Swaptions				
thereof purchases	*0*	*25*	*0*	*0*
thereof sales	*0*	*0*	*0*	*0*
Caps and floors[1]	110	56	0	0
Total	**429,977**	**418,611**	**10,909**	**13,168**
Contracts with currency risks				
Cross-currency swaps	174,750	203,445	5,955	9,695
FX swaps	31,479	25,079	96	547
Currency forwards	394	54	3	4
Spot FX deals	1	1	0	0
Total	**206,624**	**228,578**	**6,054**	**10,246**
Credit derivatives[2]				
thereof purchases	*9*	*10*	*0*	*0*
thereof sales	*0*	*0*	*0*	*0*
Total	**9**	**10**	**0**	**0**

[1] Only caps and floors which are traded on a stand-alone basis
[2] In this case single name credit default swaps

Remaining life

Notional amounts	**Interest risks[1]**		**Currency risks**		**Credit derivatives[2]**	
	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions	31 Dec. 2017 EUR in millions	31 Dec. 2016 EUR in millions
Due						
Within 3 months	11,197	22,516	31,441	37,936	0	0
Between 3 months and 1 year	49,497	39,197	38,200	24,674	0	0
Between 1 year and 5 years	193,242	199,282	107,458	127,434	9	10
In more than 5 years	176,042	157,615	29,526	38,534	0	0
Total	**429,977**	**418,611**	**206,624**	**228,578**	**9**	**10**

[1] Derivative financial instruments are shown without embedded derivatives.
[2] In this case single name credit default swaps

Counterparties

	Notional amounts	Notional amounts	Positive fair values	Negative fair values
	31 Dec. 2017	31 Dec. 2016	31 Dec. 2017	31 Dec. 2017
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
OECD banks	631,585	642,319	16,874	23,111
Banks outside the OECD	741	824	0	48
Other counterparties	2,029	139	90	50
Public authorities	2,255	3,917	0	205
Total	**636,610**	**647,199**	**16,963**	**23,414**

30) Hedging relationships within the meaning of Section 254 HGB

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

The table below details the volume of securities held as fixed assets and as a liquidity reserve (current assets), which are hedged against interest risks as of the reporting date.

	Carrying amount	Notional amount	Fair value
	EUR in millions	EUR in millions	EUR in millions
Securities held as fixed assets			
Bonds and other fixed-income securities	22,126	21,545	22,256
Securities held as liquidity reserve			
Bonds and other fixed-income securities	8,738	9,223	9,830
Total	**30,864**	**30,769**	**32,085**

KfW uses derivatives to hedge open positions only.

The option to apply hedge accounting for economic hedges is exercised with KFW's own holdings of securities as designated hedged items. The net hedge presentation method is applied to the effective portion of the hedge.

A portion of the securities held as fixed assets is hedged on a micro-basis against interest risks by designating fixed-income securities primarily with interest rate swaps. Thanks to identical conditions of the hedged item and hedging instrument, the offsetting effect is demonstrated both prospectively and retrospectively using the critical terms match method.
Through the use of the modified lower of cost or fair value principle for the fixed assets, only permanent impairment losses are recognised in the income statement.

The fixed-income securities held as a liquidity reserve are also hedged against interest risks using micro hedges (primarily interest rate swaps). Any expense related to the ineffective portion of the hedge is recognised in the income statement. In addition, hedging relationships are designated as part of the repurchase of own issues, with matching certificated liabilities as hedging instruments.

Due to the negative correlation of fair value changes and the similar risks of the hedged item and the hedging instrument, changes in fair value and in cash flows of hedged items and hedging instruments largely offset one another as of the reporting date. Considering the long-term designation of the hedging relationships, the offsetting effects are expected to continue almost fully until the hedging relationships mature.

In addition to hedging relationships pursuant to Section 254 HGB, derivative financial instruments used to hedge interest risks in the banking book and the interest-bearing hedged items are included in asset liability management. KfW manages the interest margin or fair value of all interest-bearing transactions in the banking book as a whole. Hedging relationships are also included in the loss-free valuation of the interest book (BFA 3).

31) 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 9,671 million as of 31 December 2017 (2016: EUR 9,758 million).

32) Employees

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

	2017	**2016**
Female employees	2,342	2,315
Male employees	2,525	2,452
Staff not covered by collective agreements	*3,340*	*3,256*
Staff covered by collective agreements	*1,527*	*1,511*
Total	**4,867**	**4,767**

33) Compensation and loans to members of the Executive Board and the Board of Supervisory Directors

	Salary	**Variable compensation**	**Other compensation[1)]**	**Total**
Annual compensation 2017	**EUR in thousands**	**EUR in thousands**	**EUR in thousands**	**EUR in thousands**
Dr Ulrich Schröder (Chief Executive Officer)	750.5	218.0	87.2	1,055.7
Dr Günther Bräunig	607.0	0.0	29.8	636.8
Dr Ingrid Hengster	528.5	0.0	34.8	563.3
Dr Norbert Kloppenburg[2)]	464.5	0.0	37.7	502.2
Bernd Loewen	590.0	0.0	38.6	628.6
Prof. Dr Joachim Nagel[3)]	86.7	0.0	7.2	93.9
Dr Stefan Peiß	527.8	0.0	25.8	553.6
Total	**3,555.0**	**218.0**	**261.1**	**4,034.1**

[1)] Other compensation mostly comprises the use of company cars and insurance premiums and the taxes on these amounts.
[2)] Until 31 October 2017
[3)] From 1 November 2017

Compensation to members of the Board of Supervisory Directors totalled EUR 192.5 thousand. This amount is broken down as follows:
Compensation for the members of the Board of Supervisory Directors is EUR 5 thousand p. a. and members of the Credit, Presidial and Nomination, and Audit Committees receive EUR 0.6 thousand p. a., all paid on a pro-rata basis for memberships that commence during the year. 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 for financial year 2017. Moreover, compensation for the Chair of the Board of KfW Supervisory Directors and his deputy was also set at EUR 0.

Provisions in the amount of EUR 54,808 thousand had been set up as of 31 December 2017 for obligations under pension arrangements for retired members of the Executive Board and their surviving dependants. The regular compensation totalled EUR 4,236 thousand.

There were no loans to members of the Executive Board as of 31 December 2017.

34) Group affiliation

KfW is included in the consolidated financial statements of KfW Group, Frankfurt am Main, as of 31 December 2017. The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and disclosed in German in the electronic Federal Gazette *(Bundesanzeiger)*.

35) Events after the end of the financial year

No events of particular significance for the assessment of net assets, financial position and results of operations of KfW occurred after the end of financial year 2017.

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

Dr Günther Bräunig (Chief Executive Officer since 1 January 2018)
Deutsche Pfandbriefbank AG, Munich

Dr Ulrich Schröder (Chief Executive Officer until 31 December 2017)
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne
Deutsche Post AG, Bonn
Deutsche Telekom AG, Bonn

Dr Ingrid Hengster
Deutsche Bahn AG, Berlin
ThyssenKrupp AG, Essen

Dr Norbert Kloppenburg (until 31 October 2017)
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne
Hamburger Hafen und Logistik AG, Hamburg
KfW IPEX-Bank GmbH, Frankfurt am Main

Prof. Dr Joachim Nagel (since 1 November 2017)
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne
KfW IPEX-Bank GmbH, Frankfurt am Main

Dr Stefan Peiß
KfW IPEX-Bank GmbH, Frankfurt am Main

Anna Bihler
Bioceuticals Arzneimittel AG, Bad Vilbel

Dr Lutz-Christian Funke
IKB – Deutsche Industriebank AG, Düsseldorf

Christian Krämer
ProCredit Holding AG & Co. KGaA, Frankfurt am Main

37) The bank's executive bodies

Board of Supervisory Directors

Peter Altmaier
Federal Minister
for Economic Affairs and Energy
Chair
(since 14 March 2018)

Brigitte Zypries
Federal Minister
for Economic Affairs and Energy
Deputy Chair
(27 January–31 December 2017)
Chair
(1 January 2018–14 March 2018)

Sigmar Gabriel
Federal Minister for Economic Affairs
and Energy
Deputy Chair
(until 27 January 2017)

Olaf Scholz
Federal Minister of Finance Deputy Chair
(since 14 March 2018)

Peter Altmaier
Federal Minister of Finance
Chair
(24 October 2017–31 December 2017)
Deputy Chair
(1 January 2018–14 March 2018)

Dr Wolfgang Schäuble
Federal Minister of Finance
Chair
(1 January 2017–24 October 2017)

Kerstin Andrae
Member of the German Bundestag
Member appointed by the German Bundestag
(until 31 December 2017)

Dr Holger Bingmann
President of the Federation of German
Wholesale, Foreign Trade and Services(BGA)
Representative of trade
(since 13 December 2017)

Anton F Börner
President of the Federation of German
Wholesale, Foreign Trade and Services(BGA)
Representative of trade
(until 26 September 2017)

Volker Bouffier
Minister President of the State of Hesse
Member appointed by the German Bundesrat

Dr Uwe Brandl
President of the Bayerischer Gemeindetag
Representative of municipalities

Hans-Dieter Brenner
Former Chief Executive Officer of
Helaba Landesbank Hessen-Thüringen
Representative of industrial credit
(until 31 December 2017)

Frank Bsirske
Chairman of ver.di
United Services Trade Union
Representative of the trade unions

Alexander Dobrindt
Federal Minister of Transport
and Digital Infrastructure
(until 24 October 2017)

Georg Fahrenschon
President of the German Savings Banks
Association (DSGV)
Representative of the savings banks
(until 31 December 2017)

Robert Feiger
Chairman of the Federal Executive
Committee of the IG Bauen-Agrar-Umwelt
trade union (IG Bau)
Representative of the trade unions

Klaus-Peter Flosbach
Former member of the German Bundestag
Member appointed by the German Bundestag

Sigmar Gabriel
Federal Minister of Foreign Affairs
(from 27 January 2017-14 March 2018)

Christian Görke
Deputy Minister President
Minister of Finance
of the State of Brandenburg
Member appointed by the German Bundesrat

Dr Louis Hagen
Chief Executive Officer
of Münchener Hypothekenbank eG
Representative of the mortgage banks

Dr Matthias Haß
Saxon State Minister of Finance
Member appointed by the German Bundesrat
(since 2 March 2018)

Hubertus Heil
Member of the German Bundestag
Member appointed by the German Bundestag
(since 14 March 2018)

Monika Heinold
Minister of Finance
of the State of Schleswig-Holstein
Member appointed by the German Bundesrat

Dr Barbara Hendricks
Federal Minister for the Environment, Nature
Conservation, Building and Nuclear Safety
(until 14 March 2018)

Reinhold Hilbers
Minister of Finance
of the State of Lower Saxony
Member appointed by the German Bundesrat
(since 2 February 2018)

Reiner Hoffmann
Chairman of the Confederation of German
Trade Unions (DGB)
Representative of the trade unions

Gerhard Hofmann
Member of the Board of Managing Directors of the National Association of German Cooperative Banks (BVR)
Representative of the cooperative banks

Dr Bruno Hollnagel
Member of the German Bundestag
Member appointed by the German Bundestag
(since 1 March 2018)

Andreas Ibel
President of the Federal association of independent housing and real estate companies (BFW)
Representative of the housing industry

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

Dr Markus Kerber
Director General of the Federation of German Industries (BDI)
Representative of industry
(until 31 March 2017)

Julia Klöckner
Federal Minister of Food and Agriculture
(since 14 March 2018)

Stefan Körzell
Member of the Executive Board of the German Trade Union Confederation (DGB)
Representative of the trade unions

Dr Joachim Lang
Director General of the Federation of German Industries (BDI)
Representative of industry
(since 1 April 2017)

Lutz Lienenkämper
Minister of Finance of the State of North Rhine-Westphalia
Member appointed by the German Bundesrat
(since 22 September 2017)

Dr Gesine Lötzsch
Member of the German Bundestag
Member appointed by the German Bundestag
(until 31 December 2017)

Heiko Maas
Federal Foreign Minister
(since 14 March 2018)

Dr Gerd Müller
Federal Minister for Economic Cooperation and Development

Dr Hans-Walter Peters
President of the Association of German Banks (BdB)
Representative of the commercial banks
(since 1 January 2018)

Eckhardt Rehberg
Member of the German Bundestag
Member appointed by the German Bundestag

Dr Johannes-Jörg Riegler
President of the Association of German Public Banks (VÖB)
Representative of industrial credit
(since 1 January 2018)

Joachim Rukwied
President of the German Farmers' Association (DBV)
Representative of agriculture

Andreas Scheuer
Federal Minister of Transport and Digital Infrastructure
(since 14 March 2018)

Helmut Schleweis
President of the German Savings Banks Association (DSGV)
Representative of the savings banks
(since 1 January 2018)

Christian Schmidt
Federal Minister of Food and Agriculture
(until 14 March 2018)

Christian Schmidt
Federal Minister of Transport and Digital Infrastructure
(24 October–14 March 2018)

Andreas Schmitz
Chairman of the Management Board of HSBC Trinkaus & Burkhardt AG
Representative of the commercial banks
(until 31 December 2017)

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

Peter-Jürgen Schneider
Minister of Finance of the State of Lower Saxony
Member appointed by the German Bundesrat
(until 20 November 2017)

Svenja Schulze
Federal Ministry for the Environment, Nature Conservation and Nuclear Safety
(since 14 March 2018)

Holger Schwannecke
Secretary General of the German Confederation of Skilled Crafts (ZDH)
Representative of skilled crafts

Edith Sitzmann
Minister of Finance of the State of Baden-Württemberg
Member appointed by the German Bundesrat

Dr Frank-Walter Steinmeier
Federal Minister of Foreign Affairs
(until 27 January 2017)

Dr Florian Toncar
Member of the German Bundestag
Member appointed by the German Bundestag

Prof. Dr Georg Unland
Saxon State Minister of Finance
Member appointed by the German Bundesrat
(until 28 December 2017)

Dr Norbert Walter-Borjans
Minister of Finance of the State of North Rhine-Westphalia
Member appointed by the German Bundesrat
(until 8 July 2017)

Dr Martin Wansleben
Chief Executive of the Association of German Chambers of Commerce and Industry (DIHK)
Representative of industry

Executive Board

Dr Günther Bräunig (Chief Executive Officer since 1 January 2018)

Dr Ingrid Hengster

Dr Norbert Kloppenburg (until 31 October 2017)

Bernd Loewen

Prof. Dr Joachim Nagel (since 1 November 2017)

Dr Stefan Peiß

Dr Ulrich Schröder (Chief Executive Officer until 31 December 2017)

Frankfurt am Main, 20 February 2018

Dr Günther Bräunig
(Chief Executive Officer)

Dr Ingrid Hengster

Bernd Loewen

Prof. Dr Joachim Nagel

Dr Stefan Peiß

Independent auditor's report[1)]

To KfW

Report on the audit of the annual financial statements and of the management report

Opinions

We have audited the annual financial statements of KfW, Frankfurt am Main, which comprise the statement of financial position as at December 31, 2017, the income statement for the fiscal year from January 1, 2017 to December 31, 2017, and notes to the financial statements, the recognition and measurement policies presented therein. In addition, we have audited the management report of KfW for the fiscal year from January 1, 2017 to December 31, 2017. In accordance with the German legal requirements, we have not audited the content of the declaration of compliance.

In our opinion, on the basis of the knowledge obtained in the audit,

– the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law applicable to business corporations and give a true and fair view of the assets, liabilities and financial position of the Company as at December 31, 2017 and of its financial performance for the fiscal year from January 1, 2017 to December 31, 2017 in compliance with German legally required accounting principles, and

– the accompanying management report as a whole provides an appropriate view of the Company's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development.

Pursuant to Sec. 322 (3) Sentence 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report.

Basis for the opinions

We conducted our audit of the annual financial statements and of the management report in accordance with Sec. 317 HGB and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's responsibilities for the audit of the annual financial statements and of the management report" section of our auditor's report. We are independent of the Company in accordance with the requirements of German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the annual financial statements and on the management report.

[1)] Translation of the independent auditors' report issued in German language on the annual financial statements prepared in German language by the Executive Board of KfW, Frankfurt am Main. The German language statements are decisive.

Other information
According to Art. 8 KfW Bylaws the Board of Supervisory Directors is responsible for the preparation of the annual Report of the Board of Supervisory Directors. According to Art. 19 KfW Bylaws the Executive Board and the Board of Supervisory Directors are required to annually declare that they recognise the Public Corporate Governance Code and to publish the declaration of compliance as part of the Corporate Governance Report. In all other respects, the Executive Board is responsible for the other information. The other information comprises the Corporate Governance Report, the Declaration of compliance, the non-financial statement as well as the report on equal opportunities and equal pay in accordance with Section 21 of the Transparency of Remuneration Act, which we obtained prior to the date of this auditor's report, and the Letter of the Executive Board, the Report of the Board of Supervisory Directors as well as the sections "Thinking ahead" and "Making an impact" of the Financial Report 2017, which are expected to be made available to us after that date.

Our opinions on the annual financial statements and on the management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

– is materially inconsistent with the annual financial statements, with the management report or our knowledge obtained in the audit, or

– otherwise appears to be materially misstated.

Responsibilities of the Executive Board and the Board of Supervisory Directors for the annual financial statements and the management report
The Executive Board is responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law applicable to business corporations, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German legally required accounting principles. In addition, the Executive Board is responsible for such internal control as they, in accordance with German legally required accounting principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the Executive Board is responsible for assessing the Company's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

Furthermore, the Executive Board is responsible for the preparation of the management report that, as a whole, provides an appropriate view of the Company's position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. In addition, the Executive Board is responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The Board of Supervisory Directors is responsible for overseeing the Company's financial reporting process for the preparation of the annual financial statements and of the management report.

Auditor's responsibilities for the audit of the annual financial statements and of the management report

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the annual financial statements and on the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sec. 317 HGB and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit of the annual financial statements and of arrangements and measures (systems) relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems.

- Evaluate the appropriateness of accounting policies used by the Executive Board and the reasonableness of estimates made by the Executive Board and related disclosures.

- Conclude on the appropriateness of the Executive Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German legally required accounting principles.

- Evaluate the consistency of the management report with the annual financial statements, its conformity with [German] law, and the view of the Company's position it provides.

- Perform audit procedures on the prospective information presented by the executive directors in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the Executive Board as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Eschborn/Frankfurt am Main, 27 February 2018

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

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Wirtschaftsprüferin	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

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