

# KfW Bankengruppe

## Overarching approach

### Responsible investment report 2012

#### Public report

February 2013

#### PRI disclaimer

The contents of this report are being piloted this year for signatories and stakeholders to provide feedback. The reports will be updated for the 2013/2014 reporting cycle to reflect the comments we receive on design, structure and usability.

Moreover, due to the pilot nature of the 2012 Reporting Framework, certain indicators are undergoing further changes. These changes will also be reflected in the reports for the next reporting cycle.

This document is based on information reported by signatories and responses have not been independently audited by the PRI Secretariat, PRI working groups, or any other third party. While this information is believed to be reliable, no representations or warranties are made as to the accuracy of the information presented, and no responsibility or liability can be accepted for any error or omission.

## Responsible investment policy

**We have a responsible investment policy.**

### Public availability of responsible investment policies and supplementary documents

**All of our RI policies and supplementary documents are publicly available.**

Policy name	URL
KfW's responsible investment approach	<a href="http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/index.jsp">http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/index.jsp</a>
Liquidity portfolio	<a href="http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/-Liquidity_Portfolio_of_KfW.jsp">http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/-Liquidity_Portfolio_of_KfW.jsp</a>
ESG integration	<a href="http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/-Strategies_for_Sustainable_Investment/-Integration_of_ESG_criteria/index.jsp">http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/-Strategies_for_Sustainable_Investment/-Integration_of_ESG_criteria/index.jsp</a>
exclusion criteria	<a href="http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/-Strategies_for_Sustainable_Investment/-Exclusion_Criteria.jsp">http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/-Strategies_for_Sustainable_Investment/-Exclusion_Criteria.jsp</a>
engagement	<a href="http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/-Strategies_for_Sustainable_Investment/Engagement.jsp">http://nachhaltigkeit.kfw.de/EN_Home/-Sustainable_investment/-KfWs_sustainable_investment_approach/-Strategies_for_Sustainable_Investment/Engagement.jsp</a>

Brief summary of the key elements of our responsible investment policy, philosophy or approach

see URL

## KfW Bankengruppe

### Coverage of our responsible investment policy by asset category

Assets	Coverage
Fixed income corporate	75-100%
Fixed income sovereign	75-100%

### Coverage of our responsible investment policy by markets

Markets	% of AUM covered
Developed markets	100 %

### ESG coverage in responsible investment policy

	High level policy	Detailed guidelines
Environment	✓	✓
Social	✓	✓
Corporate governance	✓	✓

## Governance and human resources

### Overview

#### Brief overview of our organisation's RI governance, management structures and processes

As a promotional bank owned by the German Federal Government and the Federal states it is KfW's mission to support the sustainable improvement of economic, social and ecological living conditions in a national and international context. In the challenging times of climate change, globalisation and demographic development, KfW bears a particular share of responsibility as a promotional bank and sets positive impulses towards those trends via its core loan business. In addition to promoting sustainability through its lending business, KfW also seeks to act as a responsible investor in the capital markets and to account for sustainability in its investment decisions. This is why it signed the PRI in 2006 and decided to develop and implement a sustainable investment approach for its liquidity portfolio. For these asset management activities, the PRI constitute the guiding principles and therefore fill an important gap. In the course of implementing the sustainable investment process, KfW established the necessary organisational structures and now has a dedicated team for this process and other issues related to the PRI and sustainable investment in general.

The liquidity portfolio is managed within KfW's treasury department and involves managing financial investments to control liquidity across KfW Group. This is designed to ensure that KfW remains capable of taking action even if it has no access to the capital markets as KfW refinances its promotional business almost solely via bond issuance in these markets. On this background, the key investment objective of the liquidity portfolio is to secure liquidity, while return targets are of secondary importance. The KfW liquidity portfolio is a pure fixed-income portfolio. At least 80% of the securities holdings must meet the criterion of being eligible as collateral for ECB repo operations. The liquidity portfolio only consists of debt securities issued by sovereigns, supranational organisations or government and/or semi-governmental institutions, government-guaranteed debt issues and bank and covered bonds.

KfW adopts a buy-and-hold strategy, which means that the bonds are held to maturity. Risk is managed on the one hand through strict minimum credit requirements for issuers, a broad regional distribution of issuers and bond duration targets. Furthermore, the maximum investment amount for each bond issuer, the so-called limit, is set according to the bank-wide single borrower limit framework. In a second step, the sustainability rating of each issuer is taken into account (see OA 02).

#### Description of how our organization addresses potential conflicts of interest in the investment process

As described, KfW's liquidity portfolio is part of its bank wide treasury operations. Any conflicts of interest that might arise in this context are addressed by KfW's overall compliance management. [http://www.kfw.de/kfw/en/KfW\\_Group/About\\_KfW/Responsability\\_and\\_Corporate\\_Governance/Integrity\\_and\\_Compliance/index.jsp](http://www.kfw.de/kfw/en/KfW_Group/About_KfW/Responsability_and_Corporate_Governance/Integrity_and_Compliance/index.jsp)

## RI responsibilities

Role	RI Oversight	RI Implementation
Board members/Board of trustees	✓	–
Chief Executive officer (CEO)	✓	✓
Chief Investment Officer (CIO)/Investment committee	✓	✓
Portfolio Managers	✓	✓
Financial Analyst	–	–
Dedicated responsible investment staff	✓	✓

## Training/other professional development possibilities attended in the reporting year

### Board members/board of trustees

None of the listed training or other professional development possibilities were attended by staff in the reporting year.

### Chief Executive officer (CEO)

None of the listed training or other professional development possibilities were attended by staff in the reporting year.

### Chief Investment Officer (CIO)/Investment committee

In-house training (structured, on an annual or more frequent basis)

### Portfolio Managers

In-house training (one-off or ad hoc)  
Responsible investment-related conferences/seminars

### Dedicated responsible investment staff

In-house training (one-off or ad hoc)  
Responsible investment-related conferences/seminars

## Performance assessment and/or reward elements in place for staff

### Board members/board of trustees

None of the listed performance assessment and/or reward elements are in place

### Chief Executive officer (CEO)

None of the listed performance assessment and/or reward elements are in place

### Chief Investment Officer (CIO)/Investment committee

None of the listed performance assessment and/or reward elements are in place

### Portfolio Managers

Responsible investment activity included in annual appraisal process

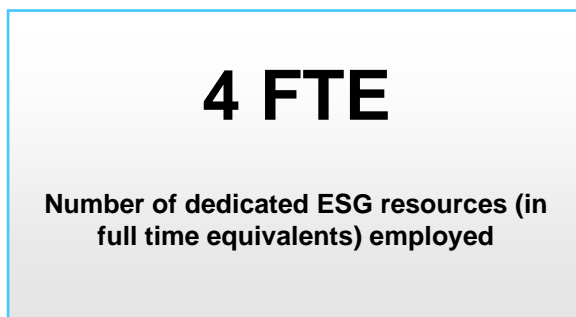
### Dedicated responsible investment staff

Responsible investment activity included in annual appraisal process

### Description of how we evaluate performance and reward staff for their performance on responsible investment in the reporting year

Portfolio management is only a small part of KfW's overall business. For comparison, KfW's liquidity portfolio has a size of EUR 20.021 bn whereas KfW's total assets amount to EUR 500 bn. Within KfW's treasury department, responsible investment activity is included in portfolio managers', sustainable investment managers' and their management's annual appraisal process.

## ESG dedicated internal resources



Activity	Time spent on each activity (% of FTEs)
ESG research and portfolio construction	60%
ESG issue related engagements	20%
Voting	0%
RI/ESG Marketing and/or sales related activities	20%

## Other internal resources

### Description of how non-dedicated ESG internal resources are involved in our RI-related activities

KfW's responsible investment-related activities are actively shared with other departments within KfW that deal with sustainability issues, e.g. Group Development & Economics or Communication.

### Priorities for other non-dedicated staff

Rank (1 is the most important, 6 the least)	Priorities
3	ESG research and portfolio construction
2	ESG issue related engagements
	Voting
1	Responsible investment or ESG marketing and/or sales-related activities

## Setting responsible investment objectives and strategies

**We have set goals/objectives for our organisation's responsible investment activities.**

- Goals/objectives are set on a systematic basis.
- Goals/objectives are set at least once a year.
- Performance against our goals/objectives is formally reviewed quarterly.

### Overview of our organisation's goal/objectives for RI activities

Our activities concerning responsible investment focus on the following issues:

- a) engagement: intensify communication with the bond issuers of KfW's liquidity portfolio
- b) cooperation with other PRI signatories: regular meetings of the German PRI network
- c) cooperation in the PRI workstream "Fixed Income"
- d) further development of our sustainable investment approach

### Portfolio turnover limits for our active equity strategies

**We do not set portfolio turnover limits for our active equity strategies.**



## Promoting responsible investment - Collaborative initiatives

**We have participated in responsible investment/ESG issue-related organisations or collaborative initiatives.**

### **Carbon Disclosure Project (CDP)**

**Our role:**

Contributed to the organisation or content of events organised by the group

**Commentary on the role we have played and the resulting outcomes:**

[http://nachhaltigkeit.kfw.de/EN\\_Home/Sustainability/Sustainability\\_Report\\_2009/index.jsp](http://nachhaltigkeit.kfw.de/EN_Home/Sustainability/Sustainability_Report_2009/index.jsp), p. 25

### **Extractive Industries Transparency Initiative (EITI)**

**Our role:**

Supported to some degree in leadership and/or in preparation of documentation

**Commentary on the role we have played and the resulting outcomes:**

[http://nachhaltigkeit.kfw.de/EN\\_Home/Corporate\\_governance/Corruption\\_prevention/KfW\\_is\\_a\\_supporter\\_of\\_EITI.jsp](http://nachhaltigkeit.kfw.de/EN_Home/Corporate_governance/Corruption_prevention/KfW_is_a_supporter_of_EITI.jsp)

### **Principles for Responsible Investment**

**Our role:**

Acted as an active spokesperson

**Commentary on the role we have played and the resulting outcomes:**

chair in corporate fixed income workstream

### **United Nations Environmental Program Finance Initiative (UNEP FI)**

**Our role:**

Provided financial support beyond membership fee

Contributed to the organisation or content of events organised by the group

Provided general support for the initiative in various non-public forums

**Commentary on the role we have played and the resulting outcomes:**

[http://www.kfw.de/kfw/en/II/II/Download\\_Center/Sustainability\\_PDFs/Statement\\_environmental\\_protection1.pdf](http://www.kfw.de/kfw/en/II/II/Download_Center/Sustainability_PDFs/Statement_environmental_protection1.pdf)

**Other: Transparency International**

**Our role:**

Contributed to the organisation or content of events organised by the group

**Other: IDFC - International Development Finance Club**

**Our role:**

Initiated collaboration

**Commentary on the role we have played and the resulting outcomes:**

[http://www.kfw.de/kfw/en/KfW\\_Group/Press/Latest\\_News/PressArchiv/PDF/2011/082\\_E\\_IDFC.pdf](http://www.kfw.de/kfw/en/KfW_Group/Press/Latest_News/PressArchiv/PDF/2011/082_E_IDFC.pdf)

## Promoting responsible investment – Investment industry

**Beyond our participation in collaborative initiatives, we have sought to promote responsible investment in the investment industry.**

### Description of the action we have taken

[http://nachhaltigkeit.kfw.de/EN\\_Home/Sustainable\\_investment/Latest\\_news/May\\_2011\\_-\\_KfW\\_Takes\\_Initiative\\_in\\_Founding\\_of\\_German\\_PRI\\_Network.jsp](http://nachhaltigkeit.kfw.de/EN_Home/Sustainable_investment/Latest_news/May_2011_-_KfW_Takes_Initiative_in_Founding_of_German_PRI_Network.jsp);

[http://nachhaltigkeit.kfw.de/EN\\_Home/Sustainable\\_investment/Latest\\_news/April\\_2011\\_-\\_KfW\\_awarded\\_as\\_Best\\_Responsible\\_Investor.jsp](http://nachhaltigkeit.kfw.de/EN_Home/Sustainable_investment/Latest_news/April_2011_-_KfW_awarded_as_Best_Responsible_Investor.jsp)

## Promoting responsible investment – Public policy

**Apart from collaborative initiatives, we have not engaged with public policy makers on ESG issues.**

### Explanation of why we do not engage with public policy makers on ESG issues

KfW is a promotional bank owned by the German Federal Government and the German Federal states. Therefore, KfW does not consider itself mandated to engage with public policy makers. However, KfW is part of a working group together with German politicians that support the idea of responsible investment. Meetings took place several times in 2011.

## ESG in asset allocation

**Considering ESG issues when making asset allocation decisions between asset categories and markets is not applicable to us.**

### Explanation of why considering ESG issues in asset allocation is not applicable to us

KfW has only one portfolio, the KfW liquidity portfolio, that is managed according to our sustainable investment approach. Therefore, we cannot allocate investment between asset classes.

## Innovation

**We believe that specific features of our responsible investment approach are particularly innovative.**

### Description of these features

As a promotional bank, sustainability is a key principle in all our actions. Whilst every area in our business must follow corporate guidelines, our approach to sustainability in portfolio management merits particular attention. KfW chose not to adopt a standard format offered by external service providers. The definition of sustainability for KfW, i.e. the selection and weighting of ESG criteria was developed in-house. From KfW's perspective, the individual definition of sustainability of any investor is key for the development of a sustainable investment approach that best fits one's unique investment needs and expectations.

This underlines the significance to integrate sustainability in investments for KfW, emphasises KfW's independence and takes into account KfW being a promotional bank and not an asset management company.

KfW is a pure fixed income investor. Internal guidelines restrict the investment universe to sovereign bonds, bonds issued by supranational or semi-governmental institutions, government-guaranteed issues, financials and covered bonds. These restrictions are a challenge for sustainable portfolio management: the two methods mainly used to introduce sustainability into portfolio management - the 'best in class' approach and exclusion criteria - are not easy to implement for KfW. The 'best in class' approach would further restrict the investment universe and would not take into account the sheer size of KfW's liquidity portfolio that amounts to approx. € 20 bn. On this background, the construction of an adequately diversified portfolio would not be possible. The introduction of exclusion criteria as is common in equity portfolios is also not applicable without significant modifications due to the different nature of the fixed income assets classes mentioned above. Nevertheless, KfW started the project to integrate exclusion criteria into its well-proven approach in 2010. The implementation of exclusion criteria started in the first quarter of 2011 (details see FIC 09).

The chosen approach to integrate ESG criteria which allows every issuer's individual sustainability rating to influence investment limits is a useful innovation. It enables the creation of a sustainable portfolio even in restricted investment areas with a relatively small universe. Whilst only 20% of all issuers maintain their limit, 80% of issuers are confronted with direct consequences from their actions and achievements in the area of sustainability. When an issuer's limits are reduced, further investment is curtailed, and will ultimately be blocked if the limit cut leads to an investment stop. The portfolio's sustainability level is continuously assessed by means of monthly rating updates and by regular re-evaluation of the approach's efficacy and outcomes.

Another positive feature of KfW's sustainable investment approach is its competitive element. Bond issuers with good sustainability ratings only maintain their limits if they defend their position in the long run. Improvements in sustainability ratings lead to a better position in the rankings.

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However, a change in the ranking of any one issuer automatically influences the position of the others and an issuer may also be demoted to a lower group under the '20-60-20' rule, with consequences for their individual limit situation.

Finally, KfW engages with the issuers in order to inform them about their current sustainability rating and the existence of exclusion criteria on an ongoing basis and to encourage them to maintain or strengthen their commitment to sustainability.

### [Benefits of this approach for our organization](#)

maintain a high degree of diversification for KfW's sizeable liquidity portfolio