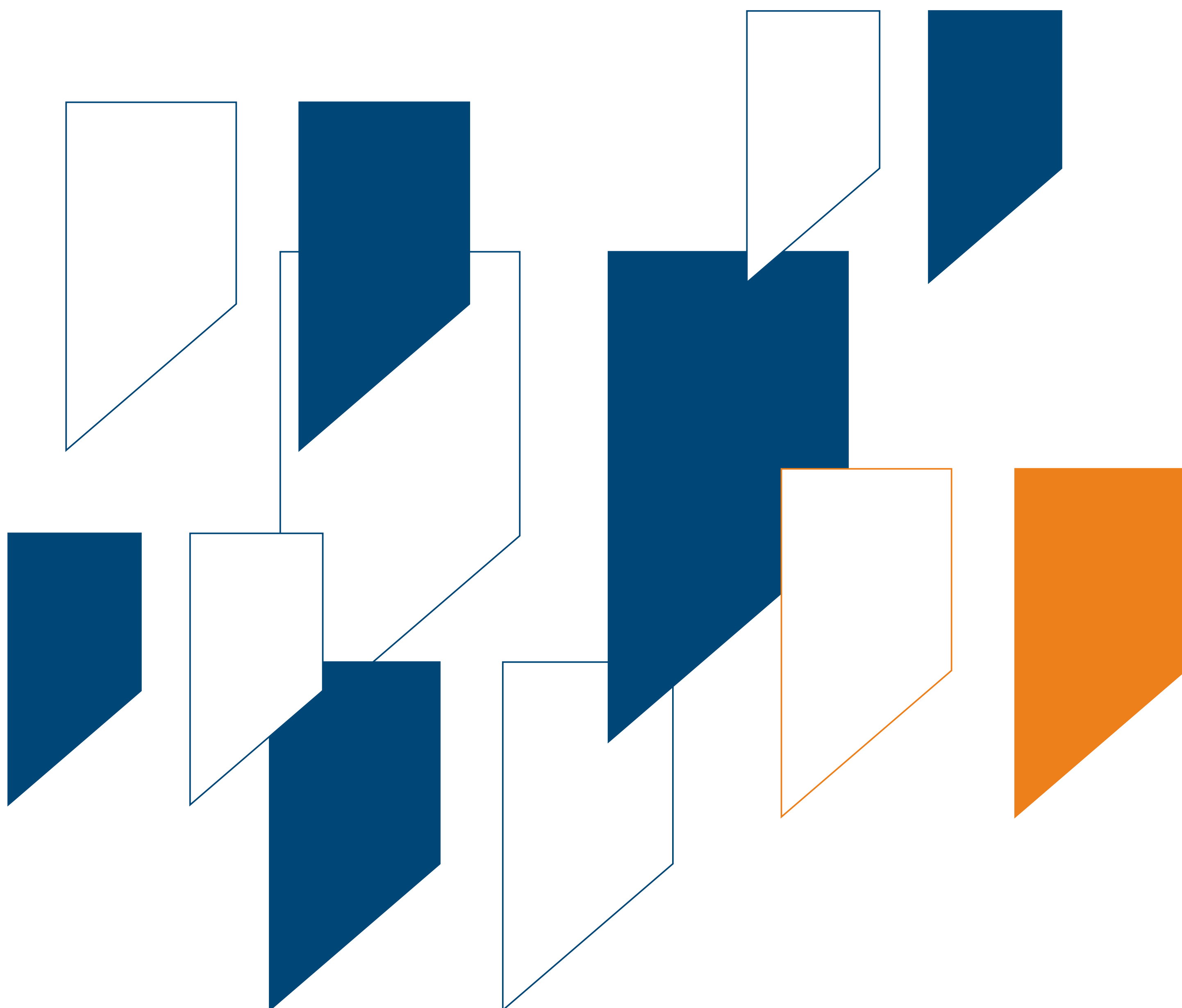
FINANCIAL REPORT

2008



KfW BANKENGRUPPE

KEY FIGURES OF THE KFW GROUP

Key income statement figures	2008	2007
	EUR in millions	EUR in millions
Net interest income	2,006	1,755
Interest rate reductions	*606*	*573*
Net commission income	218	209
Administrative expense	646	607
Operating result before valuation	**1,579**	**1,357**
Risk provisions for lending business	–2,139	–6,409
Net gains/losses from hedge accounting and other financial instruments at fair value through profit or loss	–1,747	–1,880
Net gains/losses from securities and investments	–1,974	–421
Operating result after valuation	**–4,281**	**–7,353**
Net other operating income	1,536	1,189
Profit/loss from operating activities	**–2,745**	**–6,164**
Taxes on income	–89	4
Consolidated loss	**–2,657**	**–6,168**
Consolidated loss before IRFS effects from hedging	**–2,092**	**–6,163**
Change in Revaluation reserves recognised directly in equity	–460	–249
Cost/income ratio before interest rate reductions	22.8 %	23.9 %

Key balance sheet figures	2008	2007
	EUR in billions	EUR in billions
Total assets	395	354
Volume of lending	365	341
Contingent liabilities	6	6
Irrevocable loan commitments	35	39
Assets held in trust	18	19
Volume of business	454	417
Equity	12	15
Equity ratio	3.0 %	4.2 %

Key regulatory figures	2008	2007 [1]
	EUR in billions	EUR in billions
Risk position	140	150
Tier 1 capital	11	14
Total regulatory capital	14	18
Tier 1 ratio	7.8 %	9.4 %
Total capital ratio	10.1 %	11.9 %

[1] Calculated according to Principle I

Employees of KfW Bankengruppe	2008	2007
	4,228	4,003

2008

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

MANAGING BOARD

Dr Günther Bräunig (inactive seat until 31 October 2008 during his appointment as Chairman of the Management Board of IKB, from 1 November 2008 resumption of his seat on the Managing Board of KfW) | **Dr Peter Fleischer** (until 29 September 2008) | **Dr Norbert Kloppenburg** | **Wolfgang Kroh** (Speaker from 7 April 2008 until 31 August 2008) | **Detlef Leinberger** (until 29 September 2008) | **Ingrid Matthäus-Maier** (until 30 September 2008; Speaker until 7 April 2008) | **Dr Ulrich Schröder** (Chairman of the Managing Board from 1 September 2008)

DIRECTORS

Dr Stefan Breuer
Dr Frank Czichowski
Dr Lutz-Christian Funke
Helmut Gauges
Werner Genter
Dr Volker Groß
Rainer Hartje
(until September 2008)
Klaus Klüber
Doris Köhn

Cherifa Larabi
Werner Möller
(until August 2008)
Dr Hanns-Peter Neuhoff
(until March 2008)
Klaus Neumann
Werner Oerter
Uwe Ohls
Christiane Orlowski
Joachim Rastert

Ludolf Rischmüller
Wolfgang Roßmeißl
Dr Jürgen Schneider
Dr Bernd Schreiber
Dietrich Suhlrie
Klaus Weirich
Bruno Wenn
Dr Christian Zacherl

MANAGING DIRECTORS OF KFW IPEX-BANK GMBH

Michael Ebert | **Heinrich Heims** (Speaker) | **Christiane Laibach** (from April 2008) | **Christian Murach** | **Markus Scheer**

The business areas of project and corporate finance in Germany and international project and export finance were regrouped into KfW IPEX-Bank. Since the beginning of 2008 it has been a legally independent subsidiary of KfW Bankengruppe and subject to the German Banking Act (KWG) and banking supervisory regulations.

BOARD OF MANAGEMENT OF DEG – DEUTSCHE INVESTITIONS- UND ENTWICKLUNGSGESELLSCHAFT MBH

Johannes-Jürgen Bernsen (until April 2008) | **Dr Michael Bornmann** | **Philipp Kreutz** (from May 2008) | **Dr Winfried Polte** (Chairman)

DEG was founded in 1962 and has been a 100 % subsidiary of KfW Bankengruppe since 2001. DEG is one of the largest European development finance institutions for long-term project and corporate financing. For over 40 years DEG has financed investments by private companies in developing and transition countries.

Peer Steinbrück,
Federal Minister of Finance

The Board of Supervisory Directors has continually supervised the conduct of KfW's business and the administration of its assets, and it has taken the necessary decisions on the provision of financing and the issuing of guarantees according to the conditions set forth in the Law concerning KfW and the By-Laws. For this purpose the Board of Supervisory Directors held six meetings, the Loan Approval Committee three meetings and the two committees established by decision of the Board of Supervisory Directors in February 2008, the Executive Committee and the Audit Committee, held 10 meetings and three meetings, respectively, in 2008.

At those meetings the Managing Board provided the Board of Supervisory Directors with information

- about the business activities and current developments in KfW's individual fields of activity,
- about the Group's net assets, results of operations and risk situation,
- about the respective current state of the risk protection afforded to, and the sale of, KfW's interest in IKB,
- the consequences to be drawn from the Lehman incident with respect to staff and organisation, and
- about KfW's strategic orientation.

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

- With regard to the activities of KfW Mittelstandsbank and KfW Förderbank, the Managing Board reported about KfW "Small SMEs" initiative – specifically regarding the promotional windows for small enterprises under the "ERP Regional Promotion Programme" and the "ERP Innovation Programme", as well as the improved mezzanine financing offer under the "Unternehmerkapital" programme – and KfW's renewed focal topic of climate and environmental protection. The Managing Board also informed the Board of Supervisory Directors about the KfW Special Programme 2009 and other measures with which KfW supports the Federal Government in the implementation of the agreed economic stimulus measures. Other report topics were the decline in securitisation business in the current economic environment and KfW's global loan exposure in European countries, particularly in Iceland.
- In reporting on the activities of KfW Entwicklungsbank the Managing Board reported on the steadily growing contribution being made from KfW's own funds to achieve the ODA targets set by the Federal Government as well as KfW's role as the leading bilateral financing institution in the area of natural resource and biodiversity protection.
- For KfW IPEX-Bank GmbH, which has been legally independent since 1 January 2008, a capital increase had to be performed early to account for the above-plan commitment volume of 2008. The Board of Supervisory Directors approved the capital increase in two steps at its meetings of 3 December 2008 and 22 January 2009.

In connection with the Group's net assets, results of operations and risk situation, the Board of Supervisory Directors and the Audit Committee discussed in particular the financial charges resulting from the risk protection afforded to IKB, the burdens from the financial market crisis and the impacts of the IFRS accounting standards which were applied for the first time in 2008. For this purpose the Board of Supervisory Directors and the Audit Committee were also informed in detail of the development of KfW's

securities portfolio against the background of the financial market crisis.

A topic that was discussed with particular intensity by the Board of Supervisory Directors and the Executive Committee was the risk protection for and sale of KfW's interest in IKB. The Managing Board always informed the Board of Supervisory Directors and the Executive Committee without delay of the relevant developments and involved them in decision-making as stipulated in the Law concerning KfW and in the By-Laws. Following intensive discussion and after weighing the alternatives the Board of Supervisory Directors, acting on the recommendation of the Executive Committee, accepted the sale of the IKB shares to Lone Star on 18 September 2008.

The Board of Supervisory Directors was also informed by the Managing Board without delay and in detail about the Lehman incident, its analysis with the aid of several internal and external investigations, as well as the resulting measures concerning staff changes and reorganisation. The latter included in particular the improvement of risk management as part of a comprehensive organisational restructuring of KfW under the project "Perspective". As an immediate consequence of the Lehman incident at staff level the Board of Supervisory Directors resolved on 18 September 2008 to suspend the Managing Board members Dr Peter Fleischer and Detlef Leinberger with immediate effect and on 28 September 2008 determined their dismissal as at 29 September 2008.

The Managing Board also discussed KfW's strategic orientation with the Board of Supervisory Directors. Against the background of the financial and economic crisis, the funding conditions, profitability and risk-bearing capacity were presented as the main determinants for KfW's promotional capacity. The business strategy and related planning for the year 2009 were approved by the Board of Supervisory Directors.

At the proposal of the Executive Committee, the Board of Supervisory Directors appointed the following Managing Board members in the reporting period: Dr Ulrich Schröder as the Chairman, effective as of 1 September 2008 and, on 22 January 2009, Dr Axel Nawrath, effective as of 1 April 2009. Ingrid Matthäus-Maier resigned from her position as the Speaker of the Managing Board on 7 April 2008 and retired from the Board on 30 September 2008.

As a measure to further develop KfW's corporate governance, at the proposal of the Executive Committee the Board of Supervisory Directors adopted rules of procedure for the Managing Board. The Managing Board also reported on the planned change of the auditor of the annual financial statements for the financial year 2009, who is appointed by the Supervisory Authority, the Federal Ministry of Finance, at the proposal of the Board of Supervisory Directors and in consultation with the Federal Audit Office.

The Loan Approval Committee concerned itself primarily with the loan commitments that have to be presented under the Law and By-Laws, and the Audit Committee with the quarterly and risk reports as well as the annual financial statements of the KfW Group. It made corresponding recommendations to

the Board of Supervisory Directors for the preparation of the annual financial statements and the appointment of the auditor.

As was agreed, in my capacity as Federal Minister of Finance I assumed the position of Chairman of the Board of Supervisory Directors for 2009 from my colleague Michael Glos, Federal Minister of Economics and Technology.

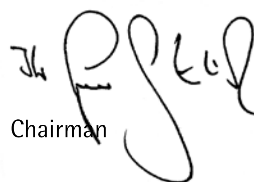
During the reporting period Michael Glos, Oskar Lafontaine, Dr Christopher Pleister, Horst Seehofer and Jürgen R. Thumann resigned from the Board of Supervisory Directors. The Board of Supervisory Directors would like to thank these former members for their work on the Board. Ilse Aigner, Dr Karl-Theodor Freiherr zu Guttenberg, Gerhard P. Hofmann, Prof Dr-Ing. Hans-Peter Keitel and Dr Gesine Lötzsch joined the Board of Supervisory Directors.

PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, who were appointed auditors for the 2008 financial year, have audited the annual financial statements and the management report of KfW as well as the consolidated financial statements and the group management report of the KfW Group, all of which were prepared as at 31 December 2008 by the Board of Managing Directors, and issued an unqualified auditor's report thereon. The financial statements and the management report were prepared in accordance with the provisions of the German Commercial Code (HGB) and the consolidated financial statements and the group management report were prepared in accordance with International Financial Reporting Standards (IFRS) as applicable within the European Union.

At its meeting on 26 March 2009 the Board of Supervisory Directors approved the financial statements and the consolidated financial statements, both of which were prepared by the Board of Managing Directors, as stipulated in Article 9 (2) of the Law concerning KfW following a recommendation by the Audit Committee.

Frankfurt am Main, 26 March 2009

THE BOARD OF SUPERVISORY DIRECTORS



Chairman

MEMBERS AND TASKS OF THE BOARD OF SUPERVISORY DIRECTORS

The Board of Supervisory Directors supervises the conduct of the bank's business and the administration of its assets. It approves the larger loans and the annual financial statements. The Board of Supervisory Directors consists of 37 members. The Chairman is the Federal Minister of Finance and the Deputy Chairman is the Federal Minister of Economics and Technology.

Peer Steinbrück
Federal Minister of Finance
Chairman
(from 1 January 2009)
Deputy Chairman
(until 31 December 2008)

Michael Glos
Federal Minister of Economics and Technology
(until 10 February 2009)
Deputy Chairman
(from 1 January 2009 to 10 February 2009)
Chairman
(until 31 December 2008)

Dr Karl-Theodor Freiherr zu Guttenberg
Federal Minister of Economics and Technology
(from 12 February 2009)
Deputy Chairman
(from 12 February 2009)

Ilse Aigner
Federal Minister of Food, Agriculture and Consumer Protection
(from 31 October 2008)

Dr Günter Baumann
Member of the Board of Managing Directors of the Association of German Chambers of Industry and Commerce (DIHK)
Representative of Industry

Anton F. Börner
President of the Bundesverband German Wholesale and Foreign Trade (BGA)
Representative of Trade

Dr Uwe Brandl
President of the Bayerischer Gemeindetag
Representative of the Municipalities

Frank Bsirske
Chairman of ver.di – Vereinigte Dienstleistungsgewerkschaft
Representative of the Trade Unions

Prof Dr Ingolf Deubel
Minister of Finance of the State of Rhineland-Palatinate
Member appointed by the German Bundesrat

Prof Dr Kurt Faltlhauser
Minister of Finance (retired) of the Free State of Bavaria
Member appointed by the German Bundesrat

Sigmar Gabriel
Federal Minister of the Environment, Nature Conservation and Nuclear Safety

Heinrich Haasis
President of the Deutscher Sparkassen- und Giroverband
Representative of the Savings Banks

Gerhard P. Hofmann
Member of the Board of Managing Directors of the Bundesverband der Deutschen Volks- und Raiffeisenbanken e.V. (BVR)
Representative of the Cooperative Banks (from 13 August 2008)

Peter Jacoby
Minister of Finance of the State of Saarland
Member appointed by the German Bundesrat

Dr Siegfried Jaschinski
Chairman of the Board of Managing Directors of Landesbank Baden-Württemberg
Representative of the Mortgage Banks

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

Prof Dr-Ing Hans-Peter Keitel
President of the Bundesverband der Deutschen Industrie e.V.
Representative of Industry
(from 1 January 2009)

Roland Koch
Minister President of the State of Hesse
Member appointed by the German Bundesrat

Jürgen Koppelin
Member of the German Bundestag
Member appointed by the German Bundestag

Oskar Lafontaine
Member of the German Bundestag
Member appointed by the German Bundestag
(until 31 December 2008)

Waltraud Lehn
Member of the German Bundestag
Member appointed by the German Bundestag

Dr Helmut Linssen
Minister of Finance of the State of North Rhine-Westphalia
Member appointed by the German Bundesrat

Dr Gesine Lötzsch
Member of the German Bundestag
Member appointed by the German Bundestag
(from 1 January 2009)

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

Dr Michael Meister
Member of the German Bundestag
Member appointed by the German Bundestag

Franz-Josef Möllenberg
Chairman of the Trade Union Nahrung-Genuss-Gaststätten
Representative of the Trade Unions

Hartmut Möllring
Minister of Finance of the State of Lower Saxony
Member appointed by the German Bundesrat

Klaus-Peter Müller
President of the Association of German Banks
Representative of the Commercial Banks

Matthias Platzeck
Minister President of the State of Brandenburg
Member appointed by the German Bundesrat

Dr Christopher Pleister
President of the Bundesverband der Deutschen Volks- und Raiffeisenbanken e.V. (BVR) (retired)
Representative of the Cooperative Banks
(until 15 July 2008)

Alexander Rychter
Managing Director of the Bundesverband Freier Immobilien- und Wohnungsunternehmen e. V. (BFW)
Representative of the Housing Industry

Christine Scheel
Member of the German Bundestag
Member appointed by the German Bundestag

Hanns-Eberhard Schleyer
Secretary-General of the Zentralverband des Deutschen Handwerks
Representative of the Skilled Crafts

Horst Seehofer
Federal Minister of Food, Agriculture and Consumer Protection
(until 27 October 2008)

Michael Sommer
Chairman of the Deutscher Gewerkschaftsbund
Representative of the Trade Unions

Gerd Sonnleitner
President of the Deutscher Bauernverband e.V.
Representative of Agriculture

Dr Frank-Walter Steinmeier
Federal Minister for Foreign Affairs

Ludwig Stiegler
Member of the German Bundestag
Member appointed by the German Bundestag

Jürgen R. Thumann
President of the Bundesverband der Deutschen Industrie e.V. (retired)
Representative of Industry
(until 31 December 2008)

Wolfgang Tiefensee
Federal Minister of Transport, Building and Urban Affairs

Heidemarie Wieczorek-Zeul
Federal Minister for Economic Cooperation and Development

MANAGING BOARD OF KFW BANKENGRUPPE

from left to right: Dr Norbert Kloppenburg, Dr Ulrich Schröder (Chairman from 1 September 2008), Dr Günther Bräunig (inactive seat until 31 October 2008 during his appointment as Chairman of the Management Board of IKB, from 1 November 2008 resumption of his seat on the Managing Board of KfW), Wolfgang Kroh (Speaker from 7 April 2008 until 31 August 2008)

DEAR READERS

The year 2008 was an unusual and difficult year for KfW Bankengruppe. The predominant theme was the global financial crisis which massively impacted on Germany's banks and economy and which will still have very negative effects in 2009 as well.

KfW did not remain immune to the deepest financial and economic crisis since the Federal Republic of Germany was founded, and it was burdened with specific themes resulting from the financial market crisis. These included the rescue and later sale of IKB, which had run into existential problems, done to prevent a loss of confidence in Germany as a financial centre, and the execution of a swap transaction with the investment bank Lehman Brothers shortly after it filed for insolvency. These events led to substantial modifications in the composition of the Managing Board. At the same time, KfW is about to take on major new functions under the economic stimulus packages adopted by the Federal Government, for which it is well equipped thanks to its 60 years of experience in promotional lending business.

Nonetheless, in its 60th year the bank can also look back on great successes. Despite the extremely difficult environment of the financial market crisis we were able to match the high promotional business volume which we achieved in the record year of 2007. We were even able to commit more financings for the German and European economy than in the previous year. Since it was founded in 1948, KfW has provided around one trillion euros in loans. This shows that, all due self-criticism apart, KfW is doing very good work for the German economy. Especially now, given the crisis of the financial markets and the recession, KfW is more important than ever.

DEVELOPMENT OF KFW'S FINANCING ACTIVITIES

A total of EUR 70.6 billion was committed for the promotion of the economy, of which EUR 69.0 billion for financing and EUR 1.6 billion for securitisations. We were able to increase the financing volume by around 3.6 % over the previous year and thereby promote the German and global economy with an additional EUR 2.5 billion. Securitisations, in turn, collapsed by more than 90 %, which is not surprising as the securitisation market has dried up. The overall volume of our promotional business volume therefore was 17.4 % lower than in the previous year.

KFW MITTELSTANDSBANK

KfW Mittelstandsbank committed EUR 14.3 billion last year for the promotion of small- and medium-sized enterprises, 41 % less than in the previous year. Here, too, the drop is principally due to the sharp decline in securitisations and global loans. The volume of actual financing operations almost equalled the high level of the previous year, at EUR 12.7 billion. Given the current cyclical downturn, this is a noteworthy result.

KFW FÖRDERBANK

We achieved nearly half our promotional business volume through KfW Förderbank. Promotional loans and global loans amounted to EUR 33.8 billion, which actually exceeded the previous year's volume by 5%.

Our top of the range product is and remains our programme family "Energy-efficient construction and rehabilitation", one of the biggest promotional programmes in Germany. With it we promote the energy rehabilitation of existing buildings as well as the construction of new energy-efficient buildings on a very high level. These programmes are the best example of how ecological and economic objectives can reinforce each other. Climate protection and employment objectives are dovetailed in these programmes. The investments co-financed since 2006 reduced CO_2 emissions sustainably by 2.4 million tonnes per year. Furthermore, the investments created or safeguarded more than 200,000 jobs in the year 2008 alone.

KFW ENTWICKLUNGSBANK

In 2008 KfW Entwicklungsbank increased its commitment volume in developing and transition countries by around 23% over the previous year to a new record level – it committed a total of EUR 3.7 billion for projects that help to sustainably reduce poverty in these countries and to boost the economy. In 2008 as well, we more than doubled the funds made available from the federal budget for Financial Co-operation by adding funds which we raised in the capital market ourselves. This mixture of KfW funds and budget funds gives us substantial leverage to contribute as a strong partner of the Federal Government to meeting Germany's growing development policy challenges and obligations, expressed primarily by the ODA (Official Development Assistance) targets.

Our assistance is directed at establishing and consolidating functioning financial systems in the developing and transition countries, a special focus of our activities. Particularly against the background of the financial market crisis, this promotion is proving to be important and effective. After all, the developing countries are also suffering from the global crisis, and neglecting them now would be fatal. We therefore actively support micro-finance institutions in order to quickly counteract a decline in lending.

Our subsidiary DEG complements the product range of KfW Entwicklungsbank with financing and advisory services that are tailored to the needs of private companies. Demand for these financings continues strong, so that DEG was able to increase its financing volume for private sector investment in developing and transition countries to EUR 1.22 billion in 2008.

KFW IPEX-BANK

A year ago we established KfW IPEX-Bank as an independent subsidiary of KfW Bankengruppe. Within the Group it is responsible primarily for international project and export finance, and its business follows the specific financing mission laid out in the Law concerning KfW (KfW Law). KfW IPEX-Bank is an important generator of earnings for the Group and renders services that are important for the economy. This was most recently confirmed by an expert opinion issued on behalf of the Federal Minister of Economics and Technology. The bank recorded a strong volume of new business totalling EUR 17.6 million, which was much higher than planned. This is an expression of the generally very high demand for financing needed to implement investment and export projects which banks are increasingly reluctant to provide owing to the financial market crisis.

FUNDING

Despite the difficult conditions, 2008 was a successful year for our funding activities. We raised a total of EUR 75.3 billion in the international capital markets – more than ever before in KfW's 60-year history. The fact that we have been able to perform so successfully even in the difficult market environment caused by the financial market crisis confirms our funding strategy. This overall achievement was recently honoured by the "Issuer of the year" award of the renowned capital markets publication IFR. KfW also received three awards from the weekly EuroWeek in recognition of particularly successful issues.

For 2009 we expect similar refinancing volumes of around EUR 75 billion in order to be able to fulfil the additional promotional tasks resulting from the Federal Government's economic stimulus packages. Given the difficult current conditions in the capital markets, this will not be an easy task since the capital markets will already be strongly challenged by the high issuing activity of state and state-guaranteed issuers. Nevertheless, we are confident that, not least because of our long-standing reputation as a reliable issuer, we will be able to meet our funding requirements – even if the conditions are different from those in the past.

EXTRAORDINARY CHARGES IN THE YEAR 2008

In the summer of 2007 KfW decided together with the banking associations and the Federal Government to provide protection for IKB Deutsche Industriebank AG, Düsseldorf, which was one of the first banks caught in the maelstrom of the financial market crisis. The aim was to prevent a collapse of IKB and to preserve it as a bank for small- and medium-sized enterprises. Most of all, however, a loss of confidence in Germany as a financial centre was to be prevented and damage to the German economy was to be averted. Fifteen months later, in October 2008, after a difficult but successful stabilisation of the bank, we sold our IKB shares to the private investor Lone Star. Although we sustained high financial burdens from our contribution to the protection measures, the decision to rescue IKB proved to be correct.

We also incurred financial burdens from the transfer of funds on 15 September to a subsidiary of the already insolvent Lehman Brothers bank. This regrettable incident has cost us money as well as reputation. Immediately after the incident we drew consequences by suspending responsible officers and making the first structural adjustments. We immediately implemented initial improvements to our risk management. Furthermore, with a view to bringing about fundamental changes we commissioned external consultants who are assisting us in reviewing our risk management in detail and in implementing proposals for improvement.

A third critical theme associated with the financial market crisis was our exposure in Iceland. KfW's business in European countries was a deliberate strategic decision because KfW promotes not only the German but also the European economy under its legal mandate, which was confirmed by the EU. We have now entered a discussion process on the scope of our European promotional activities. This must be distinguished from an investment by KfW in certain Icelandic securities. Just as other banks do, KfW maintains a broadly diversified securities portfolio – including, among others, Icelandic securities that have hitherto been rated as secure but have declined in value in the course of the financial market crisis.

CHANGES ON THE MANAGING BOARD

Extensive changes took place on KfW's Managing Board in the reporting year.

Ingrid Matthäus-Maier resigned as Speaker of the Managing Board for health reasons on 7 April and retired in September 2008. Wolfgang Kroh took over temporarily as acting Speaker. In June 2008 the Board of Supervisory Directors appointed Dr Ulrich Schröder to the newly created position of Chairman of the Managing Board, which he assumed in September. In the course of the Lehman incident in mid-September the Board of Supervisory Directors decided to suspend the Managing Board members Dr Peter Fleischer and Detlef Leinberger with immediate effect for good cause. On 1 November 2008 Dr Günther Bräunig resumed his active work on KfW's Managing Board after serving as the Chairman of the Management Board of IKB AG for 15 months. At the Supervisory Board meeting of 22 January 2009 the State Secretary at the Ministry of Finance, Dr Axel Nawrath, was appointed as a new member of the Managing Board. He will direct KfW's domestic promotional business on the Managing Board from April 2009. Finally, at its 26 March 2009 meeting the Board of Supervisory Directors appointed Bernd Loewen as the new Chief Risk and Financial Officer, thus filling the last vacant position on KfW's Managing Board.

RESULTS FOR FINANCIAL YEAR 2008

The results of operations are marked by the positive development of the operative results on the one hand and by the high burdens from the global financial market crisis and the risk protection for and sale of KfW's interest in IKB on the other hand.

The operating result before valuation was EUR 1.6 billion, clearly higher than the previous year's result, by EUR 0.2 million, despite the further increase in interest rate reduction measures.

The massive impacts of the global financial market crisis had a contrary effect. As a result of the extreme market developments, despite a conservative investment policy, valuation losses on our securities portfolio totalling EUR 2.0 billion had to be reported, part of which had to be carried directly in equity. In addition, expenses from the Lehman Brothers insolvency and the Iceland moratorium totalled EUR 0.7 billion, of which EUR 0.3 billion from securities. The IKB measures impacted the income statement with additional expenses of EUR 1.2 billion in 2008. Moreover, the extreme market disruptions led to purely IFRS-induced and not economically reasonable valuation effects in fully closed risk positions of EUR -0.6 billion. Overall, KfW thus recorded a consolidated loss of EUR 2.7 billion.

OUTLOOK

The crisis on the financial markets also harbours considerable downward risks for the real economy. As are most industrialised countries, Germany is heading towards a severe recession. For the first time in the history of the Federal Republic, an economic crisis is directly intertwined with a global financial crisis. Whereas banks and savings banks used to be able to make loans to enterprises during a phase of economic decline, today the finance industry itself is under pressure. The financing situation for enterprises has thus become considerably more difficult.

Nevertheless, we are optimistic about the future for KfW because, being a large promotional bank, we can rely on a successful and proven business model. Our explicit state guarantee gives us a funding advantage that enables us to provide promotional funds from our own income. This makes KfW an alternative for economic promotion that spares the national budget. A mere 6 % of our promotional funds comes from public coffers while 94 % is raised on the capital market. At the same time, our statutory mission defines our scope of action.

INTERNAL MODERNISATION

In 2009 KfW will have to deal with a changed situation. It is being perceived much more strongly by the public and, accordingly, its activities will be monitored intensively. In addition, it will have to conduct its business with scarce resources as a result of the financial burdens from the IKB rescue and the impacts of the financial market crisis. For this reason we have imposed on ourselves an internal modernisation so as to be equipped for the challenges ahead.

One aspect is the further development of our risk management. Triggered by the Lehman incident, we have prepared proposals together with external consultants which are now being implemented.

A further central theme is the renewal of our internal structures with the goal of achieving more customer orientation and greater efficiency. We will be even more focused on attending to the needs of our ultimate customers.

Already last September we introduced a restructuring directed towards this objective and developed a transparent sector profile for the Managing Board in which the front-office and back-office functions are separated more clearly. We have also divided our domestic business into three departments which focus on the customer groups of small- and medium-sized enterprises, private and public customers. Additionally, we have established a central sales and marketing department for the purpose of enabling closer cooperation with the onlending banks and savings banks, but also with the promotional institutions of the federal states. At the same time we are working to reduce the complexity of the programmes.

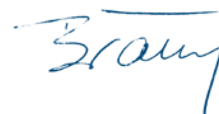
ECONOMIC STIMULUS PACKAGES

We have initiated these modernisations in order to prepare for one of our most important functions in the coming years: the implementation of the economic stimulus packages deployed by the Federal Government. We at KfW consider ourselves to be particularly called upon to intervene in support of the financial market so that an adequate supply of credit will also be available for companies in economically difficult times.

The measures which we will be implementing under the economic stimulus packages have a volume of some EUR 50 billion alone. Around EUR 40 billion of this sum will be used to finance German enterprises and some EUR 10 billion will be provided for energy efficiency and infrastructure measures. What is new for KfW is that we will now be promoting big enterprises as well because this is where the impacts of the financial crisis are currently most evident.

The current economic situation calls for rapid intervention. Having said this, however, we must bear in mind the long-term structural challenges which our economy and society are facing. KfW has defined sustainable promotion as its guiding principle. KfW will remain indispensable as a promotional bank in the future as well.

Dr Ulrich Schröder
(Chairman since 1 September 2008)



Dr Günther Bräunig
(Seat was dormant during appointment as Chairman of the Management Board of IKB until 31 October 2008; resumed mandate as a member of KfW's Managing Board on 1 November 2008)

Dr Norbert Kloppenburg

Wolfgang Kroh
(Speaker from 7 April 2008 to 31 August 2008)

GROUP
MANAGEMENT
REPORT

ECONOMIC REPORT

OVERVIEW OF THE KFW GROUP

The KfW Group consists of KfW and seven consolidated subsidiaries. KfW IPEX-Bank has been included in the Group for the first time after being legally separated as at 1 January 2008. This separation is due to the understanding reached between the Federal Republic of Germany and the European Commission on the concept of legally independent promotional banks in Germany and the Promotional Bank Restructuring Act *(Förderbankenneustrukturierungsgesetz).* In this context, KfW transferred what had, until then, been a legally dependent part of its operations to a subsidiary. The separation included business activities in the export and project finance segment, which compete with other financial services companies. This change does not impact the consolidated financial statements.

In addition, five special funds responsible for strategic asset management have been included in the consolidated financial statements in accordance with the requirements of SIC-12. In connection with the IKB sale, KfW acquired portfolio investments from IKB in the form of structured securities and credit derivatives. These were partially contributed to a newly established special fund, which was included in the Group for the first time. The development of the Group's business is largely dependent on the performance of KfW.

Composition of the KfW Group
Balance sheet total (before consolidation)

	2008	2007
	EUR in millions	EUR in millions
KfW	395,486	353,153
Subsidiaries		
KfW IPEX-Bank GmbH, Frankfurt (KfW IPEX-Bank)	28,338	–
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne (DEG)	3,825	3,254
KfW IPEX-Beteiligungsholding GmbH, Frankfurt	1,887	219
KfW Beteiligungsholding GmbH, Bonn	747	1,107
tbg Technologie-Beteiligungs-Gesellschaft mbH, Bonn (tbg)	431	600
Finanzierungs- und Beratungsgesellschaft mbH, Berlin (FuB)	49	48
KfW International Finance Inc. (KfW-Finance), Delaware, USA	0	2,782
Special purpose entities required to be consolidated		
Special funds	5,912	7,417
Investments accounted for using the equity method		
Movesta Lease and Finance GmbH, Düsseldorf (50 %)	141	193
Railpool Holding GmbH & Co. KG, Munich (50 %)	106	–
Assets held for sale (IFRS 5)		
IKB Deutsche Industriebank AG, Düsseldorf	–	63,538

GENERAL ECONOMIC ENVIRONMENT

The global economy was subject to substantial pressure in 2008. After years of strong expansion, production growth moved into a downwards cycle. This development was reinforced by substantial corrections in the real estate markets in various countries. It was in this context that the crisis in the financial markets, which originated in the United States, grew to become an extraordinary burden for the global economy. The loss in asset value led to pressure on banks around the world, in some cases threatening their very existence. At the same time, the high level of insecurity surrounding the distribution of risk-bearing securities eroded trust among banks, with the result that mutual lending practically came to a standstill. In the cases in which banks still provided liquidity, this was only with extremely high increases in risk and liquidity premiums. The trading volume of liquid securities fell sharply. The restricted opportunity to procure liquidity was accompanied by an increased risk of bank bankruptcies. Lehman Brothers, a major bank in the system, collapsed on 15 September 2008. This led to a massive heightening of the crisis. The aid packages which governments and central banks in many countries then initiated were able to prevent the crisis from augmenting still further and the financial system from collapsing through to the end of the year.

The turbulence in the financial markets is increasingly impacting the real economy. The negative outlook in the real economy resulting directly from the strong loss in asset value in combination with the more difficult access to credit slowed the readiness to make investments and accelerated the downturn in stock market prices still further. This resulted in further write-downs. The crisis in the financial markets and the downturn in the real economy were thus fuelling each other. In order to avoid a sustained downward spiral, governments and central banks around the world have launched efforts to support the real economy in addition to the aid packages for banks.

According to the data presented to date, the global gross domestic product (GDP) increased by almost 3.4 % in real terms in 2008. In other words, it was no longer possible to achieve the high growth, of sometimes more than 5 %, enjoyed in previous years. Emerging and developing countries, led by China and India, still enjoyed robust growth in 2008. However, the pace of growth in these economies was not as strong as in previous years. During the course of the year, it became apparent that these countries were not able to detach themselves from the cooldown in the Euro area and in the United States.

Real GDP in Germany increased by 1.3 % in 2008 according to initial calculations. Buoyed by strong exports and investment activities and supported by the mild winter, Germany was able to record growth in its real GDP in the first quarter. This was also supported by the strong statistical surplus from the previous year. Yet, economic growth collapsed during the remainder of the year. Exports increasingly suffered from the slump in foreign sales markets. This also reduced gross investments in equipment. Despite the excellent situation on the labour market, private consumption did not provide any major impulses. This was due , among other factors, to the strong increase in energy and food prices through to the middle of the year. The impact of the crisis affecting the financial markets also made itself felt in Germany. Some

banks had to record major write-downs on their assets. In order to prevent the systemic risk of a banking collapse, in October 2008 the German Government set up an initial aid package for banks, which included recapitalising banks, issuing guarantees and assuming risks. In addition, the European Central Bank provided extensive liquidity for banks.

The money and capital markets were characterised by substantial distortions in 2008. The euro money market relaxed somewhat starting mid-December 2007, borne by hopes of the financial market crisis ending soon. Money market rates declined to almost the same level as before the crisis after reaching an interim high, and then moved sideways through to the beginning of March. However, the increasing problems in the global banking sectors, which culminated in the Lehman bankruptcy, led to renewed major distortions in the money market, as could be seen in slightly increasing money market rates and strong growth in the spreads between collateralised and uncollateralised money market transactions. It was possible to partially correct these developments by means of the massive reductions in base rates. However, on the whole the European money market continues to be very tense.

In the course of the intensifying crisis, in particular from the middle of 2008, the conditions for banks on the capital markets also deteriorated significantly. Capital market interest rates fell strongly due to the flight of investors into secure sovereign bonds, while spreads in bank refinancing increased substantially. At present interbank swap rates are almost at the lows recorded in 2005, in contrast, spreads are very high compared to 2005.

DEVELOPMENT OF THE KFW GROUP

In financial year 2008 the KfW Group's development was mainly characterised by the following effects:

A. Continued high volume of promotional business,
B. Sustained strong operative profitability,
C. Global crisis in the financial markets and its impact on earnings,
D. Continued negative impact on earnings from the risk protection for IKB and the sale of KfW's interest in IKB.

A. High promotional business volume
In 2008, the Group continued to record a high promotional business volume totalling EUR 70.6 billion. While financing increased by 3.6% to a record-breaking EUR 69 billion, the volume of securitisation by KfW Mittelstandsbank and KfW Förderbank fell strongly as a direct result of the collapse of this market segment.

	2008	2007
	EUR in billions	EUR in billions
KfW Mittelstandsbank	14.3	24.1
KfW Förderbank	33.8	41.2
KfW IPEX-Bank	17.6	16.1
KfW Entwicklungsbank	3.7	3.0
DEG	1.2	1.2
Total volume of promotional business	**70.6**	**85.5**

B. Strong operating result
The operating result before valuation for 2008 developed positively with growth of EUR 221 million, or 16%, to EUR 1,579 million despite the increase in interest rate reduction measures.

This result also reflects the KfW Group's strong operational position, despite very difficult underlying conditions, with positive growth in net interest income and a further improvement in the cost/income ratio before interest rate reductions. At the same time, this provides a stable basis to continue promotional activities, which remain at a high level.

C. Impact of the financial market crisis
During the course of 2008, the general crisis of confidence in the financial markets caused by the US subprime crisis in the second half of 2007 spread and increased further after the Lehman bankruptcy in September 2008. High risk and liquidity premiums, even for good counterparties, and the fact that by then markets for almost all investment classes had dried up (securitisation products, but also financial and corporate bonds, for example) led to massive market distortions.

In light of these developments, the International Accounting Standards Board adopted adjustments to

central IFRS accounting standards on 13 October 2008. Under certain conditions, these allow the reclassification of market-valued financial instruments out of the categories

a) *financial assets and liabilities held for trading* and

b) *available-for-sale financial assets*

into the category *"loans and receivables"*. In the KfW Group, asset-backed securities in the category *"available-for-sale financial assets"* for which there was no longer an active market, were reclassified as *"loans and receivables"* with retroactive effect as from 1 July 2008. However, the volume is relatively low with a fair value of EUR 2.8 billion.

Despite the group-wide conservative investment policy, the extreme developments in the market resulted in valuation losses totalling EUR 2.0 billion for 2008 on the securities portfolio of around EUR 43 billion, which was partially valued using models due to the lack of active markets. Of this amount, EUR 0.5 billion was recorded directly in equity.

In addition, expenses that were directly linked to the crisis in the financial markets relating to the Lehman bankruptcy and to the Iceland moratorium totalled EUR 0.7 billion, of which EUR 0.3 billion was from securities.

Primarily as a result of substantial market distortions, earnings for 2008 were also reduced by EUR 0.6 billion due to purely IFRS-related effects in connection with the valuation of derivatives. KfW uses derivatives exclusively to hedge risks that arise, in particular, in connection with refinancing. In this respect, KfW operates in closed risk positions as a non-trading book institution. Accordingly, the resulting effects on earnings were not economically reasonable, since they will offset each other again in the future.

D. Negative impact on earnings from the risk protection for IKB and the sale of KfW's interest in IKB

In 2007, the existence of IKB – in which KfW held a 37.8 % interest at that time – was threatened as a result of problems arising in connection with the US subprime crisis. Together with three associations of the German banking industry, KfW has been providing risk protection to IKB since the end of July 2007, which covers both on-balance sheet and off-balance sheet risks.

KfW also implemented additional capitalisation measures for the benefit of IKB in 2008, as commissioned by the Federal Government and in accordance with the KfW Law. Apart from the participation in a cash capital increase of IKB in an amount of EUR 1.25 billion, these measures included providing loans with waivers of debts outstanding *(Darlehen mit Forderungsverzicht)* and agreements on compensation from future profits *(Besserungsabrede)* in an amount of EUR 1.05 billion (the "IKB loans").

On 21 August 2008, KfW entered into an agreement with the strategic investor Lone Star Funds, Dallas, USA, for the sale of all IKB shares and the IKB loans. In connection with the sale, KfW acquired risk-bearing portfolio investments from IKB in the form of structured securities and credit derivatives for a purchase price of EUR 1.0 billion. KfW's risk is initially limited to a first loss of EUR 150 million; in addition, the Federal Republic bears further risks in an amount of up to EUR 600 million. With the sale of the IKB shares to the strategic investor, the central aims of the IKB rescue package have been achieved.

Taking into account the loss participation on the part of the Federal Republic and the German banking sector, which amounts to EUR 1.5 billion, the risk protec-

tion for IKB and the sale of KfW's interest in IKB negatively affected results in an amount of EUR 1.2 billion. This figure includes the charges resulting from the portfolio investments acquired from IKB in an amount of EUR 150 million. The total charges for KfW arising in connection with the rescue of IKB thus total EUR 8.4 billion. The risks still remaining for KfW are limited.

The following key figures provide an overview of the developments in 2008:

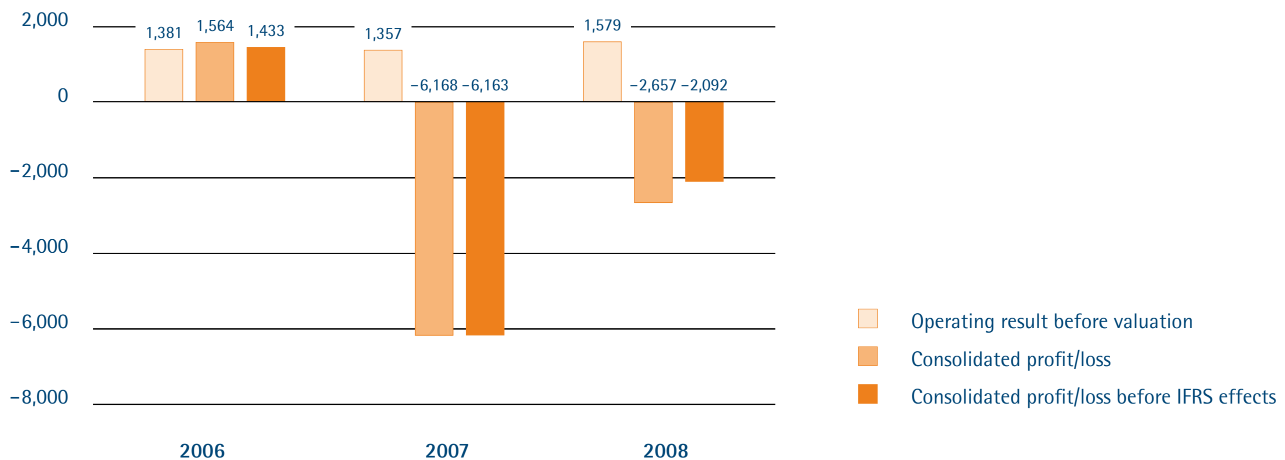
Key financial figures for the KfW Group

	2008	2007
	EUR in billions	EUR in billions
Balance sheet		
Total assets	395	354
Volume of lending	365	341
Contingent liabilities	6	6
Irrevocable loan commitments	35	39
Assets held in trust	18	19
Volume of business	454	417
Equity	12	15
Equity ratio	3.0 %	4.2 %
Income statement	EUR in millions	EUR in millions
Operating result before valuation	1,579	1,357
Operating result after valuation[1]	−2,751	−6,182
Consolidated loss	−2,657	−6,168
Cost/income ratio before interest rate reductions	22.8 %	23.9 %
Economic key figures	EUR in millions	EUR in millions
Consolidated loss before IFRS effects from hedging	−2,092	−6,163
Change in Revaluation reserves recognised directly in equity	−460	−249

[1] Including the participation of the Federal Republic and the German banking sector in the IKB activities

The **consolidated total assets** of the KfW Group rose by EUR 40.8 billion, or 11.5 %, to EUR 394.8 billion in 2008. Loans and advances (EUR 313.7 billion), in particular, developed positively with an increase in volume of EUR 27.9 billion. Derivatives with a positive fair value increased substantially by EUR 13.0 billion to EUR 21.7 billion as a result of the strong changes in market parameters relevant for valuation. Balance sheet growth was mainly funded by increased issuing activities. The volume of certificated liabilities of EUR 302.6 billion was EUR 42.2 billion higher than in the previous year.

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



The operating result before valuation developed positively, growing by EUR 221 million, or 16 %, to EUR 1,579 million in 2008 despite the increase in interest rate reductions.

However, the massive impact of the global crisis in the financial markets and the charges from the sale of KfW's interest in IKB and the risk protection for IKB resulted in a **consolidated loss** of EUR 2,657 million for 2008 (previous year: EUR 6,168 million).

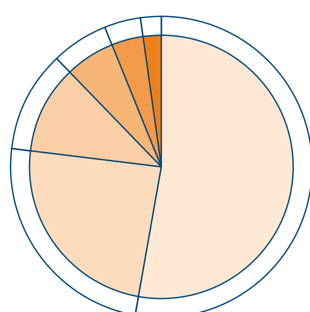
In addition, valuation losses on securities totalling EUR 460 million for 2008 (previous year: EUR 249 million) were recorded directly in equity.

The consolidated loss for 2008 includes IFRS charges not deemed economically reasonable in an amount of EUR 565 million. The consolidated loss adjusted for these effects amounts to EUR 2,092 million for 2008.

DEVELOPMENT OF ASSETS

The Group's core business is lending to banks and customers. 77 % of the Group's assets in 2008 was attributable to its lending business.

Assets
2008



	2008	2007
Net loans and advances to banks	53 %	53 %
Net loans and advances to customers	24 %	26 %
Securities and investments	11 %	13 %
Derivatives	6 %	2 %
Other receivables to banks/customers	4 %	6 %
Other assets	2 %	0 %

The **volume of lending** increased by EUR 24.2 billion, or 7 %, to EUR 365.0 billion at year-end 2008.

Volume of lending

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances	313,725	285,805	27,920
Risk provisions for lending business	−7,604	−7,671	67
Net loans and advances	**306,122**	**278,134**	**27,987**
Contingent liabilities from financial guarantees	5,996	5,850	146
Irrevocable loan commitments	35,390	38,462	−3,072
Loans and advances held in trust	17,533	18,440	−908
Total	365,040	340,887	24,153

In particular the domestic promotional loan business with its programme family "Energy efficient construction and rehabilitation" and the "Entrepreneur loan" programme contributed to the growth in loans and advances by EUR 27.9 billion to EUR 313.7 billion. Net loans and advances totalled EUR 306.1 billion at year-end 2008, representing 84 % of the volume of lending.

At EUR 6.0 billion, contingent liabilities from the Group's financial guarantee business remained unchanged compared with the previous year's level, and continued to account for 2 % of the volume of lending. Irrevocable loan commitments declined by EUR 3.1 billion to EUR 35.4 billion as a result of the high level of loan draw-downs in 2008. Within assets held in trust, the volume of loans and advances held in trust, which primarily comprises loans to support developing countries that are financed by budget funds of the Federal Republic, declined by 5 % over the previous year to EUR 17.5 billion.

Other loans and advances to banks and customers, which in particular consist of short-term funds, declined by EUR 6.0 billion from the previous year's amount of EUR 20.2 billion.

Bonds and other fixed-income securities decreased by EUR 2.2 billion to EUR 40.1 billion in 2008, whereas the volume of money market securities increased by EUR 2.0 billion to EUR 2.5 billion. In addition, the volume of securities held in the special funds for strategic investment purposes was reduced as a result of increased direct investment by KfW and the reduction in share exposure. The volume totalled EUR 5.6 billion on 31 December 2008. The total amount of securities and investments of EUR 44.2 billion decreased by 3 % compared to 2007.

At 31 December 2008, securities and investments included asset-backed securities (ABS) with a carrying amount of EUR 5.4 billion held directly by KfW.

Securities and investments

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Bonds and other fixed-income securities	42,555	42,787	−231
Shares and other non-fixed income securities	433	1,526	−1,093
Equity investments	1,230	1,205	25
Shares in affiliated entities not included in the consolidated financial statements	2	18	−17
Investments accounted for using the equity method	8	5	3
Shares in held-for-sale affiliated entities	0	204	−204
Total	44,228	45,745	−1,517

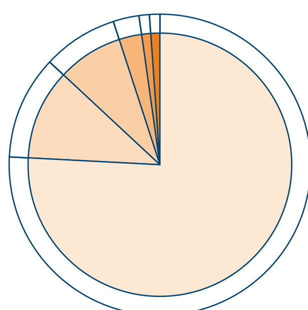
The volume of derivatives with positive fair values increased by EUR 13.0 billion to EUR 21.7 billion. Netting agreements reached with counterparties that also include derivatives with negative fair values as well as collateral agreements reduced the counterparty risk substantially to EUR 1.6 billion. Value adjustments from macro hedging for underlying portfolios of balance sheet assets increased by EUR 6.7 billion from EUR –1.3 billion to EUR 5.5 billion at year-end 2008. This significant increase is due, in particular, to the market parameters relevant for valuation which changed significantly as a result of the crisis in the financial markets.

There were only minor changes to the other balance sheet items.

DEVELOPMENT OF FINANCIAL POSITION

The Group refinances itself in the international capital markets in particular by means of benchmark bonds in euros and US dollars, other public bonds and private placements. Funds raised in the form of certificated liabilities continued to play a key role, accounting for 76% of the balance sheet total at year-end 2008.

Funding structure
2008



	2008	2007
Certificated liabilities	76%	74%
Liabilities to banks/customers	11%	14%
Derivatives	8%	6%
Equity	3%	4%
Subordinated liabilities	1%	1%
Other liabilities	1%	1%

Borrowings increased by EUR 34.0 billion, or 11 %, to EUR 347.5 billion and were the main source of funding for the expansion of the volume of business.

Borrowings

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Short-term funds	38,206	23,550	14,656
Bonds and other fixed-income securities	271,612	241,437	30,175
Other borrowings	34,386	44,739	–10,354
Subordinated liabilities	3,247	3,747	–500
Total	347,451	313,473	33,978

Funds raised in the form of issues of medium- and long-term bonds and other fixed-income securities of KfW represented the Group's principal source of funding. In 2008, such funds amounted to EUR 271.6 billion, representing an increase of EUR 30.2 billion and accounting for 78 % of borrowings at year-end. Short-term issues of commercial paper rose by EUR 12.0 billion to EUR 30.9 billion. The total amount of short-term funds raised amounted to EUR 38.2 billion. Other borrowings by KfW, in addition to promissory note loans by banks and customers, which declined by EUR 7.3 billion to EUR 18.1 billion compared with the previous year, consisted mainly of liabilities to the Federal Republic.

Subordinated liabilities include a subordinated loan totalling EUR 3.25 billion granted by the ERP Special Fund as part of the restructuring of ERP economic promotion programme in 2007. The EUR 0.5 billion reduction was due to the scheduled redemption of a subordinated loan granted by the Federal Republic.

The volume of derivatives with negative fair values rose by EUR 8.9 billion to EUR 30.1 billion at year-end 2008. This significant increase was primarily due to the strong changes in market parameters that are relevant for valuation as a result of the crisis in the financial markets.

There were only minor changes to the other balance sheet items.

Equity declined by EUR 3.1 billion compared with the previous year. The equity ratio amounted to 3.0 % compared with 4.2 % in the previous year.

Equity

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Paid-in subscribed capital	3,300	3,300	0
Capital reserve	6,254	6,254	0
Promotional reserves from the ERP Special Fund	*4,650*	*4,650*	*0*
Reserve from the ERP Special Fund	848	804	43
Retained earnings	5,356	5,862	–507
Fund for general banking risks	50	200	–150
Revaluation reserves	–551	–92	–460
Balance sheet loss	–3,436	–1,393	–2,043
Total	11,820	14,936	–3,116

A net total of EUR 0.15 billion was taken from the fund for general banking risks in financial year 2008 in order to cover charges arising in connection with the IKB sale.

Valuation losses recognised directly in equity falling in the category *"available-for-sale financial assets"* and resulting primarily from the crisis in the global financial markets were responsible for a decline in the Revaluation reserves of EUR 0.5 billion.

The balance sheet loss increased in the amount of KfW's unconsolidated net loss of EUR 2.0 billion for 2008. The remaining EUR –0.5 billion reduced retained earnings.

DEVELOPMENT OF EARNINGS POSITION

The earnings position is characterised by the positive development of the operating result before valuation. This development was offset by the massive impact of the global crisis in the financial markets and the high charges arising in connection with the sale of KfW's interest in IKB and the risk protection for IKB.

Earnings position

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Net interest income	2,006	1,755	251
Including interest rate reductions	*606*	*573*	*33*
Net commission income	218	209	9
Administrative expense	646	607	39
Operating result before valuation	**1,579**	**1,357**	**221**
Risk provisions for lending business	−2,139	−6,409	4,271
Net gains/losses from hedge accounting and other financial instruments at fair value through profit or loss	−1,747	−1,880	132
Net gains/losses from securities and investments	−1,974	−421	−1,552
Operating result after valuation	**−4,281**	**−7,353**	**3,072**
Net other operating income	1,536	1,189	347
Profit/loss from operating activities	**−2,745**	**−6,164**	**3,419**
Taxes on income	−89	4	−93
Consolidated loss	**−2,657**	**−6,168**	**3,511**
Consolidated loss before IFRS effects from hedging	***−2,092***	***−6,163***	***4,071***

The **operating result before valuation** was EUR 1,579 million for 2008, which was slightly higher than the previous year's figure of EUR 1,357 million.

Net interest income was the Group's most important source of income and totalled EUR 2,006 million, which represents an increase of EUR 251 million, or 14.3 %, compared to the previous year. It was possible to increase interest rate reductions in the promotional loan business by 5.8 % in 2008 to a current total of EUR 606 million – promotional activities were thus successfully continued despite the difficult underlying economic conditions. In particular, the successful interest rate management over the course of the year in a volatile market environment had a positive impact.

Net commission income increased slightly by 4.3 % to EUR 218 million (previous year: EUR 209 million). In particular, income from credit derivatives and processing fees in the new lending business had a positive impact. Business activities in the securitisation platforms PROMISE and PROVIDE and the resulting income fell slightly.

Administrative expense amounted to EUR 646 million, representing a EUR 39 million, or 6.4 %, increase above the comparable figure for 2007 and was thus in line with expectations. Personnel expense rose slightly by EUR 17 million to EUR 366 million as a result of salary increases due to collective pay agreements and improved performance while employee headcount also increased.

The increase in non-personnel expenses by EUR 22 million to EUR 280 million related, in particular, to other administrative expenses and was due to factors including increased expenses for third-party services.

The cost/income ratio before interest rate reduction measures improved to 22.8% for 2008 (previous year: 23.9%) as a result of stronger growth in operating income.

Expenses for risk provisions for lending business, excluding the extraordinary effects of the IKB charges and the provisions for individual exposures made in direct connection with the intensification of the financial market crisis, increased to EUR 454 million in 2008.

The recognition of portfolio valuation allowances, which primarily stem from KfW's promotional lending business, had a negative impact in 2008. However, sufficient risk provisions were put in place in 2008 for specific risks arising from the spreading financial and economic crisis. The provision for immediate credit risks was increased during 2008, in particular in the export and project finance business area.

The provisions for losses on loans and advances and the fund for general banking risks covered all immediate and latent risks and reflect the consistent implementation of the KfW Group's conservative risk policy.

The expense for risk provisions from the IKB capital measures and the increase in provisions for the liquidity lines assumed as part of the risk protection for IKB in 2007 together negatively affected the income statement in 2008 in a total amount of EUR 1.3 billion. In addition, individual impairments recognised in income totalled EUR 0.4 billion in 2008 as a result of the Lehman bankruptcy and the Iceland moratorium.

In 2008, the **net gains/losses from hedge accounting and from other financial instruments at fair value through profit or loss** were characterised by the strong market fluctuations caused by the crisis in the financial markets. These fluctuations had a significant impact on the securities portfolio and on the reporting of economic hedges under IFRSs. Additional charges resulted from the risk-bearing portfolio investments assumed as part of the sale of KfW's interest in IKB in the amount of the first loss risk of EUR 150 million to be borne by KfW. Gains from covering risk provisions in foreign currency from the risk protection for IKB had a positive impact on the foreign currency result.

This line item includes negative earnings effects of EUR 565 million for 2008 from hedge accounting and financial instruments at fair value through profit or loss in the form of debt instruments issued, including hedging derivatives which are purely IFRS-induced. In 2007, the effects almost offset each other. The derivatives measured at market values are all components of economically closed positions. However, if the other part of the respective closed position cannot be carried at fair value, or if different methods have been used in the valuation, there are mandatory fluctuations in results that fully offset each other over the term of the transaction. These effects were particularly high in the fourth quarter of 2008 as a result of the extreme developments in valuation factors, which reflect the markets' volatility.

Equity finance business recorded at fair value through profit or loss performed satisfactorily again at EUR 53 million in 2008, following the excellent results in the previous year (EUR 193 million). In addition to equity investments, this item includes valuation gains and losses on ancillary agreements in equity finance business (risk commissions/profit participations). The decline was due, in particular, to equity investments in

developing and emerging countries, the carrying value of which was influenced by the weakening global economy.

Securities recorded at fair value through profit or loss, including fair value accounting for gains and losses on special funds for strategic asset management negatively affected results in an amount of EUR 1,314 million in 2008. In addition to the realised profit and loss components, this item also includes valuation gains and losses, considered temporary, arising from the current distortions in the financial markets. ABS instruments held directly by KfW and recorded at fair value through profit or loss led to EUR 424 million in expenses.

The **net losses from securities and investments** in the amount of EUR −1,974 million (previous year: EUR −421 million) resulted primarily from the complete sale of KfW's shares in IKB, which also included the shares newly acquired by KfW in connection with the IKB capital increase, in the amount of EUR 1,421 million.

The securities affected by the Lehman bankruptcy and the Iceland moratorium were written down by a total of EUR 0.3 billion.

Disposals and valuations of securities and equity investments not accounted for at fair value through profit or loss also led to net expenses totalling EUR 316 million. Of this total, EUR 161 million was due to impairment losses from ABS products and EUR 95 million was due to charges from the equity portfolio.

The changes in the value of securities and investments that are not to be recorded in the income statement, and which were, in part, determined using valuation models, had a negative effect of EUR 460 million on the Revaluation reserves within equity. Of this total, EUR 32 million was due to ABS products, which were classified into *"loans and receivables"* retroactively as at 1 July 2008.

Net other operating income for 2008 primarily reflects the income from the participation of the Federal Republic and the German banking sector in the IKB rescue measures in the amount of EUR 1.5 billion.

Taking into account taxes on income, which had a positive effect, the **consolidated loss** totalled EUR 2,657 million after EUR 6,168 million in 2007.

The **consolidated loss before IFRS effects from hedging** is a further economic key figure based on the consolidated loss for the period in accordance with IFRSs. The KfW Group calculates this figure because the companies included in the Group are non-trading book institutions. Derivative financial instruments are entered into for hedging purposes. Under IFRSs, the requirements for recognition and valuation of derivatives and hedges nevertheless give rise to temporary effects which are reflected in the income statement. In KfW's opinion, these effects do not adequately reflect that these hedges are economically effective.

As a result, the following reconciliations were performed by eliminating temporary contributions to income in the amount of EUR 565 million for 2008 as follows:

- Valuation results from micro and macro hedge accounting; all of the Group's hedges are economically effective and do not give rise to any net gain or loss over the entire period to maturity.

- Valuation results from the use of the *"fair value option"* to avoid an *accounting mismatch* in the case of borrowings including related hedging derivatives; these economically effective hedges do not give rise to any net gain or loss over the entire period to maturity.

- Valuation results from the fair value accounting of hedges with high economic effectiveness but not qualifying for hedge accounting; these hedges do not give rise to any net gain or loss over the entire period to maturity.

The reconciled earnings position results in a net loss of EUR 2,092 million for 2008.

Overall, given the fact that growth in the operating result before valuation was positive, the main reasons for the net loss in 2008 were the massive impact of the crisis in the global financial markets on KfW's mostly conservatively structured securities portfolio and the significant charges arising in connection with the sale of KfW's interest in IKB and the risk protection for IKB.

RISK REPORT

CURRENT DEVELOPMENTS

Risk control and monitoring activities during the reporting year were mostly characterised by the turbulence on the financial markets. The internal credit ratings of many business partners in the financial sector deteriorated as a result of the negative performance on the international financial markets. The state rescue packages, which were organised largely after the Lehman bankruptcy, and their impact on the international financial sector were on the whole regarded as positive, and they have also had a positive impact on internal credit ratings. In spite of this, however, risks in the financial sector are significantly higher than in previous years. The effects of the economic and financial crisis are also increasing risks in the corporate sector, which is expected to continue in the near future. As a result, KfW has substantially intensified its risk monitoring.

During the course of the financial crisis, and after the payment mistakenly made to Lehman Brothers, KfW systematically reviewed its risk management and control workflows to assess whether structural action was required. This process focused on further developing group-wide control processes (e. g. for securities and operational risks), and expanding the real-time decision-oriented reporting system. In addition, the Group is working on increasing its investment control and further developing its early risk warning system. It is also reviewing methods of valuing structured products. Activities with regard to these topics started as projects during the reporting year, and will be continued and implemented in 2009. At the same time, rating methods were reviewed in 2008, and the associated validation concept and infrastructure were also efficiently expanded. Additionally, the rating systems also underwent vital further development based on the validation results.

BASIC PRINCIPLES AND OBJECTIVES OF RISK MANAGEMENT

The Group[1)] has a statutory promotional mandate, which provides the foundations for its special position and its institutional structure. Sustained promotion is the Group's overarching purpose. Measuring and controlling the risks entered into is a key factor in order to optimally employ the available resources to carry out this promotional mandate. As part of its risk management, the Group aims to enter into risks only to the extent that they appear viable with regard to the current and anticipated earnings and the probable course of the risks. Group risk/return management takes into account the special characteristics of a promotional bank. Banking supervisory law requirements, such as the minimum requirements for risk management (MaRisk), constitute important secondary requirements for KfW's risk management structures and procedures.

In order to establish risk management and controlling competence within the organisation of the bank, KfW offers training courses which include a modular programme on risk topics. This training programme enables employees and management staff from the entire Group to acquire orientation knowledge or to deepen their specialised know-how.

[1)] In terms of risk management, the Group comprises KfW and its subsidiaries.

ORGANISATION OF RISK MANAGEMENT AND MONITORING

Risk management bodies and functional aspects of risk management

As part of its overall responsibility, KfW's Managing Board determines the bank's risk principles and guidelines. KfW's supervisory bodies – the Board of Supervisory Directors and the Federal Ministries of Finance and of Economics and Technology, which alternate in providing the chairman and deputy chairman of the Board of Supervisory Directors – are informed at least once per quarter of the Group's risk situation. The executive committee of the Board of Supervisory Directors is responsible for particularly urgent decisions. The Chairman of the Board of Supervisory Directors decides whether an issue is urgent.

Risk management within the KfW Group is exercised by closely intertwined decision-making bodies. They are headed by the Risk Management Committee (RMC), which is responsible for the entire Group's risk profile. The RMC includes all members of the Managing Board along with representatives of KfW's business areas, some central staff departments and subsidiaries of the KfW Group. The RMC adopts major changes to existing risk principles, drafts new risk principles, and deals with risk strategy, adjustments to global limits and similar topics relating to risk management. The RMC also receives information on matters such as the development of lending business, liquidity and limit utilisation and the activities resolved in the sub-committees (SCs). The RMC is headed by the KfW board member in charge of risk controlling. Sub-committees for credit risks, market price risks and for operational risks do preparatory work for the RMC. Heads of business areas and divisions are represented on the sub-committees in order to ensure that SC decisions are taken independently.

The Market Price Risk Sub-Committee (SCM) deals with decision guidelines on subjects relating to market risk, liquidity and asset management. This includes reports on the liquidity and funding situation, assessment of currency risks and interest rate risks and discussion of the interest hedging strategy to be pursued in funding. The Credit Risk Sub-Committee (SCK) deals with credit risk methods and credit portfolio management, for example by taking decisions on the development or enhancement of rating methods and on the design of systems for limit management and collateral assessment and by preparing decisions on global limits and portfolio guidelines for the RMC. Several working groups have been established under the sub-committees. The constitutive meeting of the Sub-Committee Operational Risks (SCO) was held in March 2008. This group body reports quarterly to the Managing Board and the RMC on operational risks (OpRisk) and business continuity management (BCM). It thus creates transparency and assures the ability to take decisions rapidly for group-wide risks or significant events.

There are various working groups below these bodies. The groups report to the SCK and prepare decisions as described in the following.

The Working Group Trading Activities deals with issues connected with counterparty default risks arising from trading activities. The central task of the Working Group Trading Activities is to prepare the implementation of group-wide standards and decisions, including supervisory law issues in this context. In addition, this working group is responsible for dealing with questions of how to apply credit risk mitigation techniques that are specific to trading activities.

The Working Group Collateral is the group-wide platform in the area of collateral management for lending business. It is composed of representatives from various business areas and departments. The central functions of the Working Group Collateral are assessment of new valuation procedures and relevant decisions, revision of existing valuation procedures, definition of generally acceptable[2)] types of collateral, further development of the acceptability policy and provision of standard texts for collateral agreements.

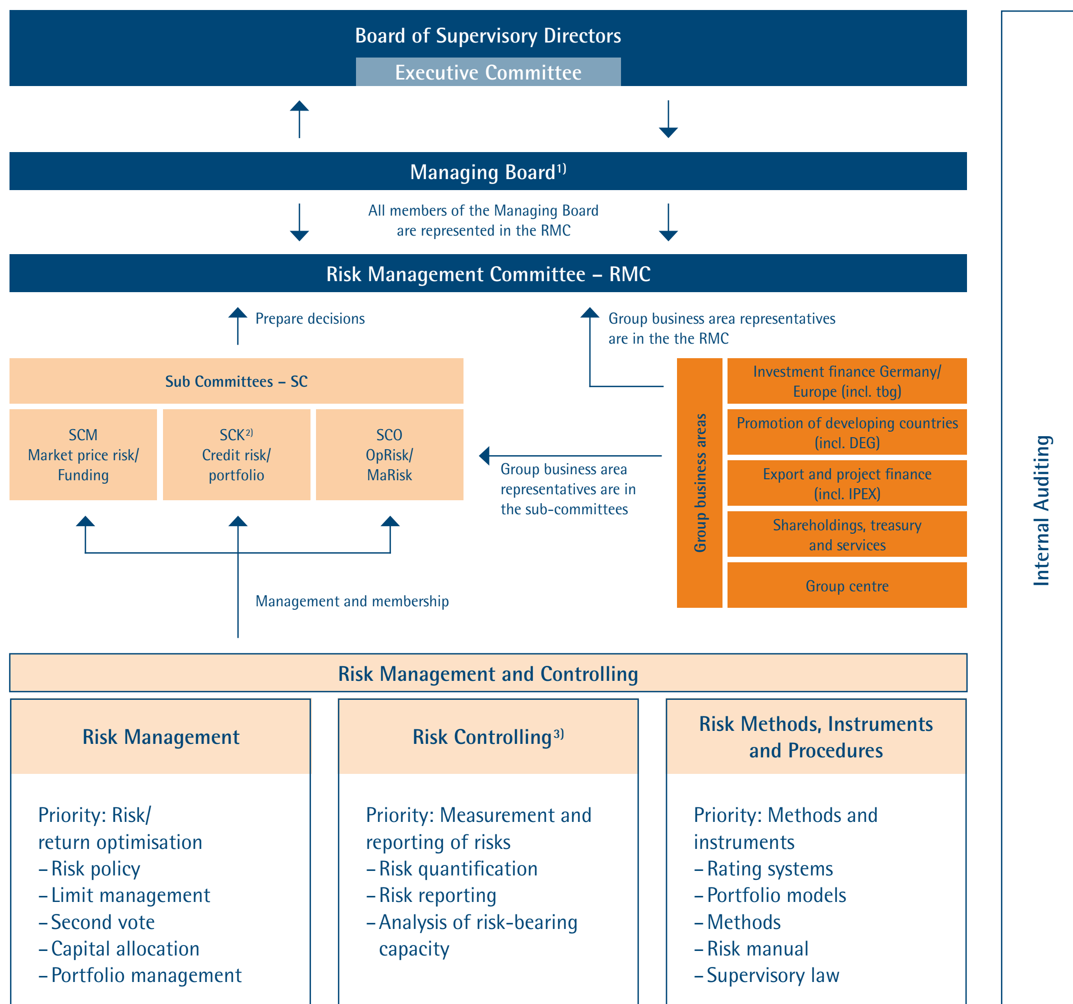
In most cases, the collateral agreement and the first steps towards the provision of the collateral are the responsibility of the respective credit departments. The collateral and transaction management departments are in charge of the final provision, valuation, ongoing administration, release and realisation of collateral. Accepted collateral is revaluated in regular intervals, at least annually, in the course of loan management. Collateral is re-examined on a case-by-case basis in the intensive loan management and problem-loan processing stages and as soon as the bank detects any substantial deterioration in its value.

The Working Group Rating Systems is a central body serving KfW and its subsidiaries which ensures sufficient understanding of all essential aspects of the rating systems, portfolio models and risk indicators including the associated reports for the management. The term "rating system" refers to all methods, procedures, and data collection and processing systems that are applied to evaluate counterparty risks, to map the derived risk assignments to (creditworthiness) categories or retail pools, or to assign default and loss rate estimates to specific types of assets. The Working Group Rating Systems derives recommendations for measures to develop (enhance) rating systems for approval/decision by the management or to take these decisions independently as part of the Working Group Rating Systems' defined range of competency. These decisions include evaluating and approving reports on validation and further development as well as deriving, planning and coordinating recommendations for measures to enhance rating systems. The Working Group Rating Systems includes representatives of all users of the rating systems, risk management and controlling, and KfW's Internal Auditing Department.

The Working Group Portfolio Management is headed by the risk management unit and is a communication platform as well as a body for preparing group-wide portfolio management decisions. Its primary objective is to initiate and coordinate measures designed to improve the risk structure.

[2)] Collateral is examined for acceptability at the KfW Group against the criteria set out in the German Solvency Regulation.

The Working Group Country Rating is the central unit for assessing country risks. It is composed of economists from the regional departments of KfW Entwicklungsbank and representatives of KfW IPEX-Bank, DEG and KfW's Transaction Management Department. It is chaired by the Risk Management Department. This working group meets quarterly or more often as required. The role of the Working Group Country Rating is to identify, analyse and assess political and economic risks (and rewards) in the global economy and particularly in the countries in which the KfW Group does or plans to do business. Proposals for risk ratings assigned to developing, transition and emerging countries are made by the departmental regional economists, while proposals for the rating of industrial countries are submitted by the Risk Management Department. Countries are ultimately assigned to risk categories on the basis of discussions conducted within the Working Group Country Rating. If no consensus is reached, a vote of the Risk Management Department is decisive. The Risk Management Department then presents the results of the meetings directly to the Managing Board.



[1] The Working Group Country Rating reports to the Managing Board.
[2] The Working Groups Collateral, Portfolio Management, Trading Activites and Rating Systems report to the SCK.
[3] Performance measurement was assigned to accounting in the reporting year.

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

Responsibility for developing and assuring the quality of the risk management and controlling lies outside the credit departments, with the Risk Management and Controlling Department. A comprehensive risk manual has been prepared for this purpose and is continually updated. The rules and regulations laid out in the risk manual are binding for the entire

Group and are accessible to all employees. Risk principles (i.e. normative rules for loan and risk management procedures) and portfolio guidelines (e.g. business restrictions and collateral requirements) make up the core of the risk manual. The risk principles and portfolio guidelines serve as the framework for the operating activities of all business areas. The risk manual ensures that uniform procedures are applied throughout the Group to identify, measure, control and monitor risks. In addition, group-wide regulations are supplemented in individual business areas by specific rules. The Risk Management and Controlling Department reviews these for conformity with group-wide regulations.

Risk Management

The primary task of the Risk Management Department is to ensure the Group's risk-bearing capacity. For this purpose, it formulates and regularly reviews the Group's risk strategy. The risk strategy builds on the basic business policy and establishes general risk principles and concrete risk policy measures in line with business strategy. A variety of instruments to control credit, market price and operational risks are used to implement the risk strategy. In addition, management measures applied to individual counterparties and portfolios (e.g. second vote for loan approvals, a limit management system and portfolio guidelines) prevent undesired expansion of concentrated risks. Stress tests are conducted to quantify capital requirements to ensure the Group's risk-bearing capacity even when cyclical conditions deteriorate substantially. Depending on the market situation, the use of credit derivatives also contributes to improving the risk profile and expanding the range of business options.

Risk Controlling

The Risk Controlling Department is in charge of measuring and reporting all risks of the KfW Group and analysing the Group's risk-bearing capacity. In this regard uniform methods and models are implemented throughout the Group at operating level.

The department is responsible for the ongoing monitoring of all key risk indicators as part of quality management for the risk indicators used in risk management and controlling, and it also provides professional support for the information systems used in reporting.

Risk reporting is in line with regulatory requirements (MaRisk). The Risk Management Committee will be informed once per month of the Group's risk situation from the start of 2009. A risk report is issued quarterly to the Group's supervisory bodies.

Risk Methods, Instruments and Procedures

The department "Risk Methods, Instruments and Procedures" is responsible for providing suitable methods and instruments for group-wide risk analysis and management. The structure of a long-term, sustainable, consistent method and instrument strategy for risk management and controlling is rounded off with regular validations and developments and enhancements of models and methods. The focus is on models to measure, control and price credit risks. In addition, the department is also responsible for the coordination and project management of the professional implementation of the requirements placed on instruments and IT systems used in risk management and controlling. In addition, it coordinates the formulation and development of group-wide risk principles as well as the procedure manual for risk management and control.

Internal Auditing

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

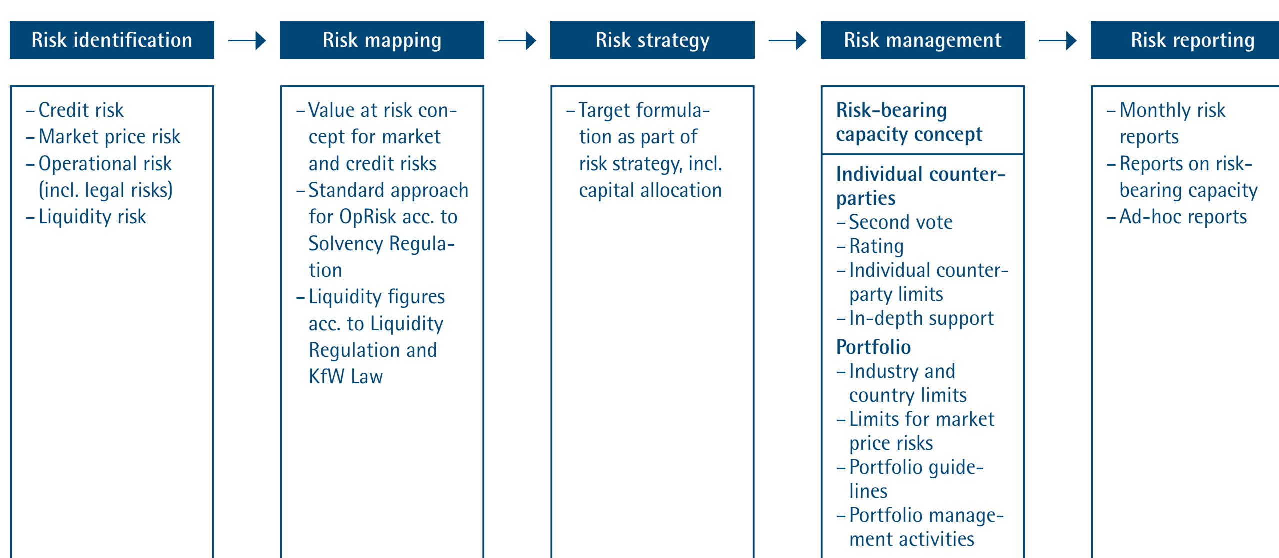
Internal Auditing derives the audit cycles for individual audit areas from an annual risk assessment of the audit areas. In so doing the department takes into account the economic capital requirements of the operations to be audited.

In addition to the promotional business, auditing activities focused on the risk management procedures and methods in 2008. The risk management audits focused on the validation of internal rating systems as well as on the methods and processes for measuring and assessing market price risks and credit risks.

The Internal Auditing Department monitored important projects, particularly the IT development projects, while retaining its independence. As in previous years, in 2008 the Internal Auditing Department monitored the further development of risk measurement procedures by participating (with guest status) in meetings of decision-making bodies.

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

RISK MANAGEMENT APPROACH OF THE KFW GROUP



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

REGULATORY RISK-BEARING CAPACITY

Indicators under supervisory law	2008	2007[1]
	EUR in millions	EUR in millions
Risk position	139,712	149,863
Tier 1 capital	10,860	14,132
Total regulatory capital	14,141	17,808
Tier 1 ratio	7.8 %	9.4 %
Total capital ratio	10.1 %	11.9 %

[1] Calculated according to Principle I

KfW is not subject to the requirements of Sections 10 and/or 10a of the German Banking Act *(Kreditwesengesetz/KWG)*. For internal purposes, the regulatory capital ratios are voluntarily calculated based on the key legal requirements. KfW has been applying the requirements of the German Solvency Regulation in this regard since the start of 2008. In-house rating methods are used for large sections of the loan portfolio to calculate the risk exposure (advanced IRB approach).

The KfW Group's regulatory **total capital ratio** as at 31 December 2008 totalled 10.1 % taking the consolidated loss into account (previous year: 11.9 %). The **Tier 1 ratio** totalled 7.8 % (previous year: 9.4 %).

ECONOMIC RISK-BEARING CAPACITY

An analysis of risk-bearing capacity as part of internal procedures must measure risks and match them against risk-covering potential. Potential financial losses are measured with the aid of two central risk-measuring tools: expected loss and economic capital, which is a measure to cover unexpected loss.

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

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

The probability of default is estimated for each borrower with the aid of rating methods. The result of the rating measures is an estimate of the probability that a counterparty will be unable to fulfil its obligations within the next 12 months. In particular, collateral has to be evaluated to estimate the magnitude of the likely loss. Expected losses are not backed by capital as they are offset in a means calculation by the risk margins (insurance principle).

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

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

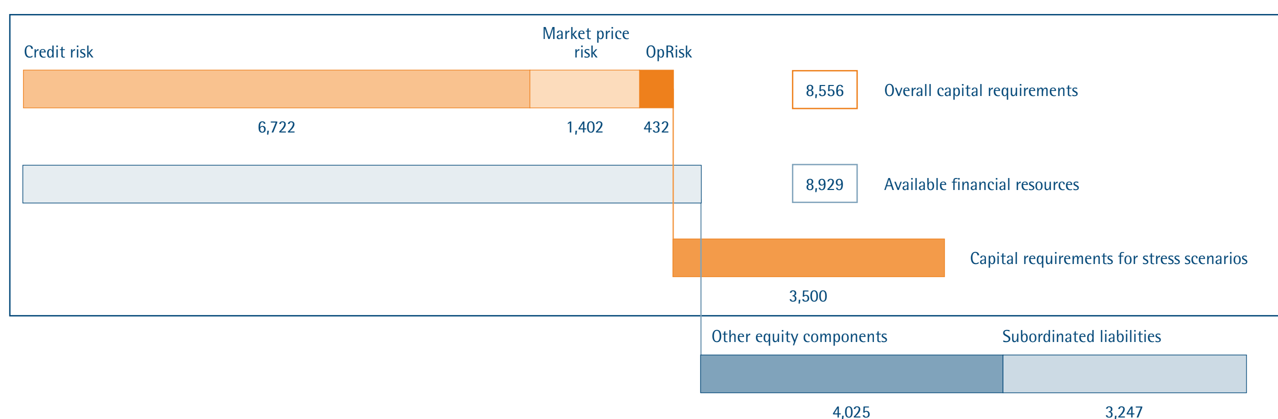
The forecast period for both risk categories is one year. The capital requirement for credit and market price risks is aggregated, taking diversification effects into account. The capital requirement for operational risks is calculated using the regulatory standard approach according to the German Solvency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

In principle, when calculating its overall capital requirements, the KfW Group takes into account potential additional capital requirements calculated in accordance with conservative standards that may result from stress scenarios for credit and market price risks. To assess the risk-bearing capacity the necessary capital requirement[3)] (economic capital requirement) is matched against the economic resources available for risk coverage (available financial resources, or AFR). The definition of available financial resources differs from the accounting and regulatory definition of equity, as available financial resources do not include part of the reserves.

[3)] KfW does not cover liquidity risk with risk capital, as it is not a loss risk to be covered on the liabilities side but a payment risk to be covered on the assets side.

On this basis, as at 31 December 2008, the economic risk-bearing capacity stands at a solvency level of 99.96 %. This means that the available financial resources cover overall capital requirements. Due to the severity of the international financial crisis and the pressure the Group is under as a result of the risk protection for IKB and the sale of KfW's interest in IKB, potential additional capital requirements for stress scenarios are only covered by the available financial resources to a limited extent.

Economic risk-bearing capacity as at 31 December 2008
(EUR in millions)



Taking additional equity components and the subordinated liabilities into account, there would also be risk coverage – including for the additional capital requirements for stress scenarios – for a solvency level of 99.99 %.

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

KfW's risk management approach is based on state-of-the-art models used in banking practice. However, each model represents a simplification of a complex reality and builds on the assumption that risk parameters observed in the past can be considered representative of the future. Not all possible influential factors and their complex interactions can be identified and modelled for the risk development of a portfolio. This is one reason why KfW carries out stress tests both in the credit risk models and in the market risk models. The Group works continually to refine its risk models and processes.

TYPES OF RISKS

Counterparty default risk

The KfW Group assumes counterparty risks[4] in the context of its promotional mandate. The main risks in the domestic promotional lending business are in the areas of start-up finance of small- and medium-sized enterprises and equity investments. In addition, KfW assumes risks in the context of export and project finance as well as loans granted under Financial Cooperation.

Debtor level	State debtors	Banks	Enterprises	Other	Validation and further development processes
Rating procedure	– Country rating	– Bank rating	– Corporate rating – SME rating	– Retail – Start-up rating – Private equity recipient/provider rating – Cash flow rating – Self-employed rating	
Borrower level	Exposure at default				
	Loss given default				
Portfolio level	Loan portfolio model				

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

In identifying the probability of default, the Group uses internal rating procedures for banks, corporations, small- and medium-sized enterprises, private equity providers, private equity recipients, start-up businesses and countries. These procedures are based on scorecards and follow a uniform and consistent model architecture. For project financings, KfW applies a cash flow-based rating method. The rating procedures aim at forecasting one-year default probability. As a rule, the transaction management departments are responsible for preparing ratings in risk-bearing business. The rating is updated at least once annually, with the exception of business partners with whom only retail business is conducted.

Depicting the default probability on a master scale which is uniform for the entire KfW Group ensures comparability of ratings using different rating procedures and issued for various business areas. The master scale consists of 20 different classes that can be summarised in four groups: investment

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

grade, non-investment grade, watch list and default. The range of default probabilities and the average default probability are defined for each master scale class.

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

Exposure at default (EAD) and valuation of collateral are heavily weighted in determining severity of loss. These are then included in the loss given default (LGD) to reduce risk. In valuating acceptable collateral the expected net revenue from collateral realisation in case of loss is estimated over the entire loan term. This estimate takes into account discounts based, in the case of personal collateral[5], on the probability of default and the magnitude of loss incurred by the collateral provider. For other collateral the discounts are chiefly attributable to fluctuations in market prices and devaluation resulting from depreciation. The determined value is an important element in estimating loss given default within the KfW Group. Depending on the availability of data, the various valuation procedures for individual types of collateral are based on internal and external historical data and expert estimates. The valuation parameters are reviewed on a regular basis. For individual collateral this guarantees a reliable valuation of the collateral position. A risk principle for loan collateral regulates uniform management, valuation and recognition of collateral across the Group. The risk of default on investments in securities and in derivatives is also limited by the conservative selection of counterparties and by collateral agreements.

The KfW Group has various portfolio guidelines to limit risks from new business. They form the basis for the second vote on lending transactions and serve as an orientation guide for loan approvals. They are also designed to ensure adequate quality and risk structure of KfW's portfolio[6]. These guidelines distinguish between types of counterparties and product variants and define conditions under which business transactions generally may be conducted.

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

[5] Due to KfW's business model, personal collateral (in particular guarantees provided by the Federal Republic) is common.
[6] These guidelines take into account the special features of KfW's promotional business.

Risk provisioning

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

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 is recorded for both economic and political risks. The basis for this is the expected loss model described above, which is adjusted for IFRS purposes. Risk provisions for irrevocable loan commitments and financial guarantees are set up using the same method of calculation. Portfolio impairment also includes a provision for specific risks resulting from the financial market crisis.

According to IFRS 7.36, the theoretical maximum exposure to credit risk for the KfW Group arising from financial instruments is the total loss of the respective risk exposures. This exposure also takes into account contingent liabilities and irrevocable loan commitments. These exposures 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. Individual impairments were also reported under Securities and investments as well as under Contingent liabilities and Irrevocable loan commitments.

Maximum risk of default
EUR in millions

	Loans and advances to banks		Loans and advances to customers		Value adjustments from macro fair value hedge accounting		Derivatives used for hedge accounting; Other derivatives		Securities and investments		Contingent liabilities, irrevocable loan commitments	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
Carrying amount as equivalent for maximum risk of default	222,935	205,253	97,366	93,081	5,451	0	21,737	8,736	44,228	45,745	41,673	44,516
Risk provisions	526	485	7,077	7,186	0	0	0	0	2	1	255	530
Carrying amount neither past due nor impaired	222,454	204,490	94,797	88,301	5,451	0	21,737	8,736	43,826	45,631	41,612	43,919
With conditions renegotiated (in the reporting year)[1]	*0*	*7*	*0*	*4*	*0*	*0*	*0*	*0*	*0*	*3*	*0*	*0*

[1] Includes financial instruments that would be overdue or impaired without renegotiation of conditions

Carrying amount of financial instruments due and not individually impaired
EUR in millions

	Loans and advances to banks		Loans and advances to customers	
	2008	2007	2008	2007
Less than 90 days past due	274	576	810	971
90 days and more past due	25	41	261	1,721

Individually impaired financial instruments
EUR in millions

	Loans and advances to banks		Loans and advances to customers		Securities and investments		Contingent liabilities, irrevocable loan commitments	
	2008	2007	2008	2007	2008	2007	2008	2007
Carrying amount	183	145	1,497	2,088	402	115	60	597
Individual impairments	393	71	6,151	6,858	0	0	180	446

At year-end 2008 EUR 2.1 billion (net after deduction of risk provisions; previous year: EUR 2.9 billion) classified as individually impaired out of EUR 433 billion (previous year: EUR 397 billion) in financial instruments outstanding. Potential losses are conservatively estimated, and individual impairments have been formed in the amount of EUR 6.7 billion (previous year: EUR 7.4 billion). This includes the provisions formed as part of the risk protection for and sale of KfW's interest in IKB totalling EUR 5.2 billion (previous year: EUR 6.2 billion).

In addition to provisions for immediate risks of default, the KfW Group makes provisions for latent risks of default (economic and political risks). As at 31 December 2008, risk provisions for performing business totalled EUR 1.1 billion (previous year: EUR 0.8 billion). On average, 78 % of loans in the KfW Group's portfolio for performing loans are collateralised (including recovery).

In 2008 the KfW Group did not take possession of any asset previously held as collateral.

There was a strong year-on-year increase in exposure for derivatives with positive fair values, for which netting agreements concluded with the counterparties that also include derivatives with negative fair values and collateral agreements, however, substantially reduced the counterparty risk.

Stress tests

KfW performs stress tests in order to identify the estimated increase in charges resulting from deterioration in the economic environment. They are calculated for various scenarios and form the basis for the calculation of the risk buffer. The risk buffer thus quantifies the rise in capital requirements in defined crisis scenarios. Taking into account the stress tests for market price risks as well as the German Government's existing aid package for banks, additional capital requirements for stress scenarios in an amount of EUR 3.5 billion were calculated.

Portfolio structure

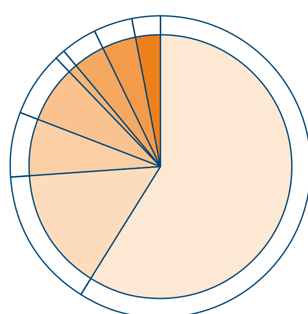
The contribution of individual commitments to the risk associated with the KfW Group's loan portfolio is assessed with the aid of an internal portfolio model. Concentrations of individual borrowers or groups of borrowers give rise to the risk of major losses that could jeopardise KfW's existence. On the basis of the economic capital concept, the Risk Controlling Department measures the risk concentrations by individual borrower, industry and country. Concentrations are measured primarily by the extent to which they require economic capital. This ensures that not only high risk volumes but also unfavourable probabilities of default and undesirable risk correlations are taken into account. The results form the basis for managing the loan portfolio and are included in the limit management system to contain concentration risks. On the basis of the limit management system, the KfW Group defines global limits which prevent losses that would put the continuity of KfW at risk. These limits are derived from KfW's risk-bearing capacity in the relevant area. The global limits provide a framework for managing counterparty risks. KfW reduces concentration risks under its risk management and active portfolio management in a targeted manner. To this end KfW uses credit derivatives (single name credit default swaps) and other instruments to hedge against individual counterparty risks.

Regions

As at 31 December 2008 the Euro area accounted for 74 % (previous year: 71 %) of the KfW Group's loan portfolio[7] in terms of economic capital. Within the Euro area, the proportion accounted for by Germany increased substantially. This was primarily due to the higher capital requirements in the German financial sector.

Economic capital by region

2008



	2008	2007
Germany	59 %	54 %
Euro area countries (excl. Germany)	15 %	17 %
EU countries (excl. Euro area)	7 %	7 %
Europe outside EU	7 %	9 %
Africa	1 %	2 %
Asia (incl. Australia and New Zealand)	4 %	5 %
Latin America	4 %	4 %
North America	3 %	2 %

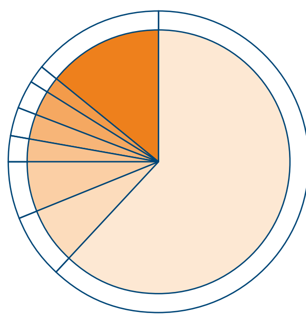
[7] The loan portfolio includes loans and securities and investments

Sectors

The high share of overall capital required for credit risks attributable to the financial industry is due to the KfW Group's promotional mandate. By far the greatest portion of the Group's domestic promotional lending business consists of loans that are onlent through banks. Reductions in ratings throughout the entire financial industry, some of which were significant, caused further substantial increases in capital requirements in this sector. In terms of the entire portfolio, the increase in capital requirements for the loan portfolio relates almost exclusively to the financial sector (capital requirements in the financial sector were 62 % compared to 51 % in the previous year). The heavy concentration in the finance sector is also reflected in terms of individual counterparties. The ten largest borrower units of the KfW Group, which included only banks, accounted for a total of 35 % (previous year: 24 %) of the total capital requirements for credit risks. Overall, the concentration of industries and individual counterparties in the loan portfolio has increased as a result of the international financial crisis.

Economic capital by sector

2008

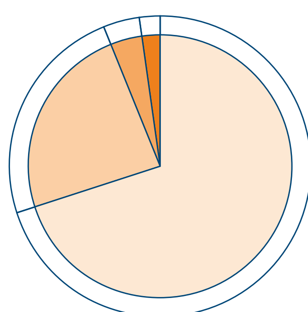


	2008	2007
Financial industry	62 %	51 %
Manufacturing industry	7 %	8 %
Private equity investment firms	6 %	8 %
Aviation	3 %	3 %
Shipping	3 %	5 %
Basic industries	3 %	4 %
Land-based transport	2 %	4 %
Other sectors	14 %	17 %

Credit quality

As credit quality itself enters into the calculation of the economic capital, it is appropriate, particularly in analysing the credit quality structure, to examine the distribution of net exposures by credit quality category. Measured by net exposure, 70 % (previous year: 79 %) of our portfolio is composed of investment-grade debt (according to internal valuation). The substantial decline is primarily due to the effects in the financial industry described above. 2 % of the net exposure is categorised as a default/probable loss, as in the previous year, and 4 % (previous year: 3 %) is assigned to the watch list portfolio (increased risk of default). Despite the negative changes in ratings, the Group's loan portfolio continues to have a good credit quality structure.

Credit quality by net exposure
2008



	2008	2007
Investment Grade (M1 – M8)	70 %	79 %
Non-Investment Grade (M9 – M15)	24 %	16 %
Watch-List (M16 – M18)	4 %	3 %
Default (M19 – M20)	2 %	2 %

Structured products in the group portfolio

According to the recommendations of the Financial Stability Forum (FSF), the Group presents its portfolio of structured products separately in this section, broken down into asset-backed securities (ABS) and platform securitisations (PROMISE, PROVIDE).

Asset-backed securities

In addition to KfW's own holdings of ABS, the Group's ABS portfolio includes both ABS investments in special funds and structured securities which KfW acquired from IKB as part of the sale of shares of its shares in IKB (nominal: approximately EUR 1.2 billion). Part of the risk from the portfolio of securities assumed from IKB is secured by a guarantee agreement concluded with the Federal Republic for EUR 600 million.

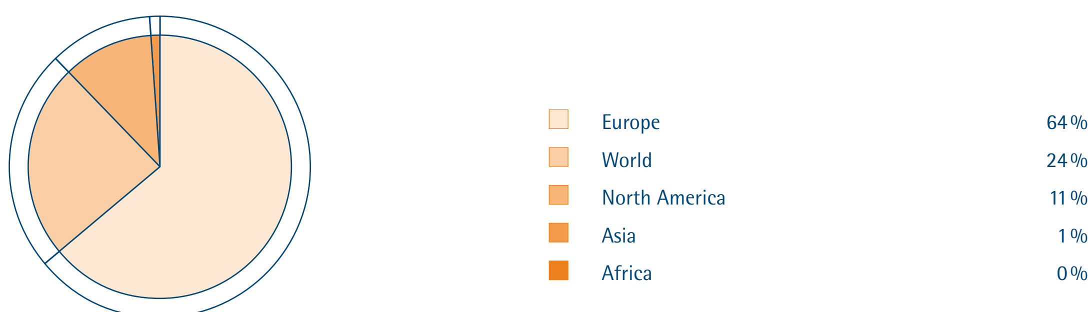
The following tables show the composition of the ABS portfolio by asset class, rating and geographic distribution of the underlyings as at 31 December 2008. The securities had a nominal value of EUR 8.2 billion on the balance sheet date. Taking the mark-to-market valuation of the securities reported at fair value into account, the portfolio had a total value of EUR 6.6 billion as at 31 December 2008.

Exposure based on nominal values
as at 31 December 2008

	CLO	RMBS	CDO	CMBS	ABS & other	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Investment Grade	2,478	1,756	564	420	309	5,528
Non-Investment Grade	138	9	231	1	0	379
Watch-List	570	169	531	253	29	1,552
Default	79	46	622	0	0	746
	3,266	1,980	1,948	674	338	8,205

The impact of the rapid deterioration in the market environment is clearly reflected in the ratings in the ABS portfolio. As the external ratings, according to internal assessment, often provide an overly positive outlook on the securities' credit quality, ABS investments are subject to strict scrutiny and an internal rating is issued in the event of an increased risk of default. As a result, the proportion of watch list and NPL (default) securities increased particularly in the second half of 2008. Although there has been a negligible amount of default to date compared to the reductions in market prices, some of which have been extreme, impairments of highly cyclical exposures also increased.

Geographic breakdown of the underlying (based on nominal)
2008



Platform business
Banks can transfer synthetic credit risks from SME loan portfolios to the capital market using the securitisation programme PROMISE. KfW rounds out its offering with its securitisation programme PROVIDE, which aims to securitise private loans for residential construction. As at 31 December 2008 the volume of securitisation via the platforms totalled some EUR 44.4 billion. Of this total, approximately EUR 42.8 billion was securitised through credit default swaps or credit-linked notes. The Group has retained risks from super senior tranches with respect to the remaining EUR 1.6 billion.

The securitisation of residential construction loans accounts for about 60 % of the securitisation volume; the remaining 40 % serves to securitise SME loans. Risk in the platform business is primarily impacted by the quality of the securitised portfolios. At present, the risk development of the underlying credit portfolios is stable. On average, the accumulated losses total just 0.08 % of the original pool volume.

Risk protection for and sale of KfW's interest in IKB Deutsche Industriebank AG, Düsseldorf

As at 31 December 2008, only the charges from the liquidity lines provided for the financing conduit Rhineland Funding were still part of the original three-pillared IKB risk protection from 2007. In 2008 KfW was fully drawn on under the reverse hedging for the SPEs Havenrock I & II and the hedging of the IKB balance sheet assets.

After deduction of the risks borne by the banking associations, losses of approximately EUR 2.1 billion were realised in connection with the IKB risk protection measures in 2008, for which provisions had already been made in 2007. Taking into account redemptions and loss realisation, receivables in the amount of approximately EUR 5.6 billion due to the purchasing companies of the Rhineland Funding conduit remain outstanding. These receivables have been written down by 93 %.

As part of the sale of its interest in IKB, KfW granted IKB collateralised liquidity facilities with a volume of up to EUR 3.0 billion with standard market terms. In addition, KfW acquired risk-bearing financial instruments in the form of structured securities and credit derivatives from IKB at a purchase price of EUR 1.0 billion. KfW bears the risk of first loss from this portfolio of up to EUR 150 million, and the Federal Republic bears risks in excess of this amount and up to EUR 600 million. As a result of deterioration in ratings in this portfolio, the risk of loss was realised in full in 2008. In addition, KfW participates in refinancing the senior tranche of a portfolio of additional structured securities of IKB in the form of a loan totalling EUR 0.6 billion. These securities were contributed to an SPE in connection with the acquisition by the strategic investor. For more information regarding the legal risks KfW has taken over from IKB in connection with the sale of its interest in IKB, see Note 10 to the consolidated financial statements.

As part of its economic capital concept KfW has capital available for unexpected losses from the risks arising in connection with the sale.

MARKET PRICE RISK

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

- interest structure (interest rate risks);
- exchange rates (currency risks); and
- other market prices (e.g. share prices, raw materials prices).

KfW and its subsidiaries are not required by the German Commercial Code to keep a trading book; consequently, their market price risks are limited to the banking book.

Interest rate risks

The main market risk component in the KfW Group is interest rate risk. The Group assumes limited interest rate risks in order to seize opportunities for returns. Additionally, interest rate risks arise from the special architecture of the domestic lending business with its off-schedule repayment options. KfW takes

this into account in its risk management by including the estimated volume of future off-schedule repayments in its funding strategy.

In the identification of interest rate risks in its banking book, KfW uses standard software that integrates all data relevant for risk assessment. The current balances of interest rate maturities (euro, US dollar and British pound) are determined with the aid of this standard software. On this basis, KfW regularly performs value-at-risk calculations to assess its interest risk position. The applied simulation-based method is based on a two-factor Cox-Ingersoll-Ross model[8], which is used to estimate the distribution of risk positions in the Group given possible changes in market interest rates and based on an assumed holding period of three months. The economic capital requirements are identified – as are credit risks – for a period of one year. Periodic stress tests supplement this calculation to estimate possible losses under extreme, standardised market conditions. Apart from a parallel shift in the yield curve, these tests include scenarios such as a twist in the yield curve and an extension of the holding period.

Currency risks

Foreign currency loans are generally funded in the same currency or secured by appropriate foreign currency hedging instruments. This also applies to individual impairments for which the corresponding replacement assets are provided. In addition, KfW has decided to make portfolio provisions in US dollars to hedge against contingent exchange rate risks from a potential default on existing debt denominated in US dollars. The earnings components generated in US dollars in the reporting year were accumulated for this purpose.

Margins and commissions received over time in other currencies are always converted into euros without delay to avoid currency risks.

Risks from open currency positions remaining at the balance sheet closing date are measured by a variance/covariance approach in the form of a value-at-risk with a holding period of three months. The required parameters are estimated from past data.

Other market price risks

Other market price risks include share price risks from exchange-traded shares in strategic asset allocation and from investments. They also include raw materials price risks from CO_2 certificates which the Group keeps in its own books. Risks from CO_2 certificates arise as a result of the Group's decision to act as an intermediary between the buyers and sellers of CO_2 certificates. As a result, KfW also keeps certificates in its own books.

Other market price risks are measured using variance/covariance approaches. The assumed holding period when measuring risk is three months, as is the case for all other types of market price risk, with a one-year capitalisation period. All of the necessary parameters are calculated using past data.

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

[8] The factors include one money market and one capital market interest rate. The parameters required for the model are estimated using past data.

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

Volatility of present value of assets funded by equity

In 2008 a change was made in calculations for backing for the potential volatility of present value of assets funded by equity. Previously, equity was used in full for these fluctuations, which were caused by changes in interest structures. However, the total risk was overestimated using this approach, as the part of equity which compensates for losses from defaulted loans is not subject to any interest rate risk in economic terms. As a result, calculations were adjusted such that only that portion of equity is subject to the interest rate risk which remains after potential losses from credit defaults have been deducted.

In total, market price risks within the Group required a total of EUR 1,402 million in economic capital as at 31 December 2008. This position is composed of the following individual risks:

Total economic capital for market price risks

	31 Dec. 2008	31 Dec. 2007
	EUR in millions	EUR in millions
Interest rate risks	919	1,120
Currency risks	26	51
Other market price risks	141	373
Volatility of present value of assets funded by equity	316	875
Market price risk	1,402	2,419

Interest rate risks fell as at 31 December 2008. This was primarily due to activities conducted to reduce risks in the leveraged euro interest rate portfolio.

As at 31 December 2008, there was an open currency position in the balance sheet in the equivalent of EUR 88 million. The main currency was the US dollar, for which there was a passive surplus amounting to USD 115 million. The economic capital for currency risks was EUR 26 million as at 31 December 2008.

With respect to the remaining market risks, required economic capital declined by EUR 232 million in 2008 compared with 2007. This is primarily due to the reduced number of shares in strategic asset allocation (SAA); the remaining holdings were sold in the beginning of 2009.

LIQUIDITY RISK

A variety of instruments and criteria are applied to manage the liquidity position and funding requirements within the KfW Group. The procedures applied in liquidity management are defined by specific risk guidelines. These guidelines include the definition of risk, objectives for liquidity management, the various instruments used in internal liquidity management and key parameters applied to meet statutory and regulatory requirements.

The KfW Group's risk definition breaks down liquidity risks into institutional and market liquidity risks. Institutional liquidity risks comprise the risk of being unable to meet existing payment obligations at all, in due time and/or in the required amount. Market liquidity risks, in turn, comprise risks associated with the market price losses of assets in the event of a necessary sale and the risk of being unable to raise necessary funds in due time and/or in sufficient volume or of obtaining them only at a disproportionately high funding rate.

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

The basis for managing the liquidity position and determining the funding requirements within the KfW Group is a computer-based liquidity management system that evaluates all known current and future payments. Additional expected payment flows (e. g. disbursements under new lending transactions, off-schedule repayments and exercise of termination rights, etc.). are added to the known payment flows. On this basis KfW performs liquidity management and planning at daily, monthly and annual intervals. Additional analyses can be performed promptly as required.

KfW also monitors its liquidity position for compliance with the KfW Law, which requires determination of the proportion of short-term to long-term obligations in order to ensure compliance with the 10 % threshold. KfW also voluntarily determines key parameters on a monthly basis according to the requirements of the Liquidity Regulation. All key liquidity figures are regularly above the minimum requirements.

To maintain liquidity KfW holds an adequate stock of money-market instruments and liquid securities that are Category I securities eligible as collateral with the European Central Bank, both for overnight funding and for regular open-market transactions. USD securities are also held as a liquid reserve for USD business. The required liquidity cushion is reviewed regularly and calculated in such a manner that KfW's operations can continue as planned even if a hypothetical extraordinary market disruption occurs and affects its funding options and the ability

to liquidate the assets held. The two key liquidity parameters and mid-term liquidity planning are reported to the Risk Management Committee monthly and long-term planning at least annually. The committee also decides on the measures to be taken when a need for action is determined. Responsibility for monitoring the liquidity situation and prompt reporting currently lies with the Treasury Department. To further improve liquidity risk measurement and control, the Group will add additional scenarios to its liquidity risk reporting from 2009, and will use a new approach for measuring the minimum amount of the liquidity. In addition, the organisational responsibilities (risk measurement and control) are being reworked.

The table below shows the contractual payment obligations (principal and interest) of the KfW Group arising from financial instruments by maturity range.

Payment obligations from financial instruments by maturity range
31 December 2008[1)]

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	5 years and more	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks and customers	6,505	4,126	4,230	19,097	22,764	56,723
Certificated liabilities	9,006	5,187	39,136	159,613	128,218	341,160
Net liabilities under derivative financial instruments	–390	969	3,140	4,273	–20,313	–12,321
Subordinated liabilities	0	0	146	539	3,516	4,201
Liabilities under on-balance financial instruments	**15,120**	**10,283**	**46,652**	**183,522**	**134,185**	**389,763**
Contingent liabilities	6,283	0	0	0	0	6,283
Irrevocable loan commitments	35,390	0	0	0	0	35,390
Liabilities under off-balance financial instruments	**41,673**	**0**	**0**	**0**	**0**	**41,673**
Liabilities under financial instruments	56,794	10,283	46,652	183,522	134,185	431,436

1) Payment obligations from derivatives are offset against the corresponding payment claims from contracts, and irrevocable loan commitments and contingent liabilities are allocated in a lump sum to the first maturity band.

Payment obligations from financial instruments by maturity range

31 December 2007[1)]

	Up to 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	5 years and more	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks and customers	5,298	7,449	6,889	21,605	37,578	78,819
Certificated liabilities	7,389	7,603	37,709	143,437	133,499	329,637
Net liabilities under derivative financial instruments	645	1,357	2,091	3,743	−8,760	−924
Subordinated liabilities	0	0	666	584	3,617	4,867
Liabilities under on-balance financial instruments	**13,332**	**16,409**	**47,355**	**169,369**	**165,934**	**412,399**
Contingent liabilities	6,054	0	0	0	0	6,054
Irrevocable loan commitments	38,462	0	0	0	0	38,462
Liabilities under off-balance financial instruments	**44,516**	**0**	**0**	**0**	**0**	**44,516**
Liabilities under financial instruments	**57,848**	**16,409**	**47,355**	**169,369**	**165,934**	**456,915**

[1)] Payment obligations from derivatives are offset against the corresponding payment claims from contracts, and irrevocable loan commitments and contingent liabilities are allocated in a lump sum to the first maturity band.

Despite the difficult market environment characterised by the financial market crisis, KfW's funding situation was not at any time negatively affected. The general uncertainty prevailing in the market prompted many investors to seek out "safe havens", which has benefited KfW particularly in terms of its short-term funding activities through the multicurrency commercial paper programme. The programme volume was increased to EUR 35 billion in 2008. This met the increased demand from investors for short-term, higher quality securities. In addition, it also allowed a general increase in funding flexibility.

For 2008, KfW had capital market funding needs of approximately EUR 75 billion (previous year: EUR 65 billion). The issue of state guarantees to various banks resulted in a new situation for KfW on the long-term capital market. The larger offering of state-guaranteed securities and the increased state issuing activities are currently leading to higher funding costs for KfW. Funding requirements of around EUR 75 billion have been identified for 2009 based on the continued high level of promotional business and KfW's involvement in the Federal Republic's economic package.

OPERATIONAL AND OTHER RISKS

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

Control of operational risks is performed centrally by the Risk Management and Controlling Department. Operational risks are managed by the individual operational departments. Furthermore, the central OpRisk Controlling Department is in charge of operational continuity management, which supports risk management.

In accordance with the definition laid out in the German Solvency Regulation, operational risks in the KfW Group are integrated into its economic management as part of a holistic management approach. Risk management is based on loss data collection, OpRisk assessments and the identification and monitoring of measures.

Operational risks are quantified and capital requirements are determined using the regulatory standard approach according to the Solvency Regulation.

Loss data collection has been further optimised. OpRisk assessments continue to be conducted in regular intervals. Both OpRisk instruments are supported by data processing systems specially tailored to the needs of the KfW Group. The management of measures was successfully implemented in 2008. A technical platform was developed for the MaRisk-compliant monitoring of measures derived from the OpRisk assessments or the ascertainment of losses. This platform supports risk management and was developed and implemented in the first quarter of 2008. Reporting (at present quarterly) to the departments and KfW's Managing Board is at the core of the comprehensive management reporting. Monthly reporting is planned. Initial early warning indicators have been surveyed since the third quarter of 2008 and included in the risk management process. At the operative level, operational risks within the KfW Group are limited by an internal control system. The IT system is under continual development and business processes are constantly being analysed and optimised. For risks that may arise from unforeseeable events, the bank has put appropriate contingency plans in place (for IT system disruptions or inability to use buildings) and has sufficient insurance coverage (e.g. for fire and water damage).

The Group addresses legal risks by involving its in-house legal department early in the process and by cooperating closely with external legal advisers in Germany and abroad. Contracts may be entered into only on the basis of unambiguous and correctly-documented arrangements. Moreover, current operations are concluded using standard contracts (e.g. ISDA contracts).

A crisis management group has been established for operational continuity management. There are emergency plans for all of the Group's critical workflows. These are tested accordingly. In addition, additional emergency workstations have been created for high priority processes at a sufficient distance. Crisis, emergency and early warning procedures have also been defined. A technical solution has already been implemented for the early warning procedures. Preparations are still underway to optimise the technical support for the planning of crisis and emergency procedures.

FORECAST REPORT

The **global economy** cooled significantly during 2008 and is undergoing a cyclical downturn, which has been substantially reinforced and accelerated by the financial market crisis. Negative effects on assets, reduced financing opportunities and the massive loss in confidence caused by the crisis in the US mortgage market have depressed global demand. The magnitude of the economic slump is heightened by the fact that the largest industrial countries and also emerging countries have suffered a major economic downturn or are in recession. KfW believes that the measures implemented by many governments and central banks to stabilise the financial markets and revitalise the economy will bring about a certain degree of stabilisation in the second half of 2009. KfW also expects global economic growth in 2009 and 2010 to be significantly lower than in the previous years. Overall, in comparison with 2008, the risks for the global economy have increased substantially.

As a result of the high degree of openness of the German economy and its strong dependence on exports, Germany is suffering greatly from the slowing growth in the global economy. In addition to the direct impact on exports, this will also depress capital expenditure. After years of strong expansion, a significant reduction in corporate investments is expected. No major impulses are expected from private consumption. KfW is forecasting a downturn in general economic activity in Germany in 2009. The effects of the more expansive monetary policy and the economic stimulus packages will allow Germany to achieve more positive growth in 2010. A key factor for this growth is regaining trust and re-enabling the capital markets to function fully. To this end, the measures put in place to stabilise the financial markets and to avoid systemic risks are essential.

In view of the current financial market crisis further developments are subject to great insecurity due to the interdependencies between the real economy and the financial sector. Once the financial market crisis starts to affect the real economy, there is the danger of dramatic increases in unemployment and a resulting downward spiral in the real economy. This would cause the situation in the financial markets to worsen still further and entail the danger of the economy being undersupplied with credit across the board. If the stimulus packages implemented throughout the world cannot prevent this kind of downward spiral, this could result in a sustained period of weakness with deflationary tendencies in some industrial countries.

Overall, the economic and financial crisis is expected to have a noticeable impact on the KfW Group's portfolio of loans and securities. The risk of poorer ratings and defaults has increased substantially compared to the previous years. This could be associated with further increases in requirements for equity and higher pressure on earnings in the portfolio. There are good chances of stabilisation in industries which can avail themselves of government stabilisation measures and industries which will benefit particularly from the current stimulus packages. Irrespective of these developments, it is expected that the risk concentration in the financial sector will increase as a result of mergers in the financial industry. Stress tests are used to assess risk-relevant scenarios.

Prompted by the challenges of the financial market crisis, KfW has initiated a target-oriented further development of its risk management processes. The focus is on optimising group-wide control processes (e.g. for securities) and on expanding the real-time

reporting used for decision-making. In addition, the comprehensive modernisation of KfW as part of the **"Perspective for KfW"** project continues to be pursued intensively. The transparent structure will be geared more closely to commercial, retail and public-sector customers, thus further improving the Group's promotional business.

Over the coming years, KfW will continue to pursue its **promotional programmes** to support the German economy on a long-term basis. In the current year, a particular focus will be on the short-term implementation of the Federal Government's **economic stimulus packages.**

KfW's SME promotion includes a broad range of offerings for the self-employed and SMEs to finance start-ups, investments and innovations. This target group can avail itself of loans, mezzanine funding or private equity depending on their financing requirements. In terms of industrial environmental protection, the main priorities remain increasing energy efficiency and the use of renewable energies.

The focus of KfW's residential promotional activities continues to be on energy-efficient construction and rehabilitation. We expect our programmes to stimulate growth, which will also benefit the SME sector, as well as show noticeable environmental effects. In light of demographic developments, a programme promoting activities to reduce barriers in residential accommodation will be launched in 2009 ("senior-friendly conversion"). In addition, KfW supports the expansion of public infrastructure and education with its promotional programmes. These are important prerequisites for sustained growth.

A special programme geared to SMEs and larger companies forms the core of KfW's offerings, which are part of the Federal Government's economic stimulus packages. This should allow financing of structurally sound companies, which have been negatively affected by the current crisis, but which are regarded as being fundamentally sustainable. Moreover, programmes to finance innovations, industrial environmental protection and energy efficient construction and rehabilitation and refurbishment will be enhanced.

Given the multitude of drivers, only a rough estimate can be given for promotional business volume. In total, KfW is forecasting a commitment volume for promotional loans of approximately EUR 55 billion; the year-on-year increase is primarily due to the Federal Government's stimulus packages.

KfW is not expecting the **securitisation markets** to normalise in 2009. Given the high hedging costs, KfW expects that banks will continue to mostly place securitisations privately and submit them to the European Central Bank to procure short-term liquidity. The situation on the markets will only improve once the deleveraging of bank balance sheets has been completed. This is rendered more difficult by the fact that certain market participants have disappeared and will not return to the market. It will thus be vital to regain the remaining investors' trust.

Provided that certain quality standards are upheld, KfW continues to believe that the instrument of securitisation makes economic sense. Accordingly, KfW aims to contribute to a stabilisation of the securitisation market. KfW plans to combat the banks' liquidity bottleneck, in particular, by offering new

securitisation products and to provide them with access to long-term, cost-effective liquidity.

In light of the fact that the global economic situation is deteriorating, **KfW IPEX-Bank** is forecasting reduced demand for export and project finance. Customers will postpone or even cancel planned investments, for example in the shipping, automotive and chemicals sectors, and also larger infrastructure projects. Furthermore, KfW IPEX-Bank believes that, as a result of the financial market crisis, fewer banks will be available as co-financers or syndication partners for larger medium- and long-term financing projects, and that the trend towards smaller-scale, bilateral transactions will continue.

KfW IPEX-Bank continues to actively offer export and project finance in the difficult environment in 2009, but it expects that new business will be down year-on-year, totalling at most EUR 8 billion.

The ongoing international financial crisis and its impact on the real economy will have an increasingly negative effect on the growth of many developing and emerging countries. This renders the role of **KfW Entwicklungsbank** as a reliable partner with a long-term perspective that, apart from its financing options, offers vast experience in development policy and competence in cooperation with developing countries even more important. KfW Entwicklungsbank's core competence in climate and environmental protection, developing financial systems and promoting the water sector are thus in greater demand than ever before. In 2009, KfW Entwicklungsbank, which is focusing on water this year, is placing particular emphasis on dealing responsibly with this scarce resource, in particular during times of climate change. In addition, investments in climate and environment are being promoted with special facilities that were put in place together with the primary client, the Federal Ministry for Economic Cooperation and Development *(Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung)*, and also with the Federal Ministry for the Environment *(Bundesministerium für Umwelt)*. There is still significantly more to do in order to master the wide range of challenges – in particular in countries where the scarcity of water and the climate changes are felt particularly strongly.

KfW Entwicklungsbank is forecasting loan commitments of almost EUR 3.7 billion in 2009. The continued growth in funding from the Federal Republic will increasingly be supplemented with KfW's capital resources. As a strong partner for the German Government, KfW will contribute to fulfilling Germany's growing development policy challenges and commitments.

The tasks of the **KfW Carbon Fund** will be continued under KfW Entwicklungsbank. This will allow the acquisition of emission certificates from projects to be implemented even more effectively in the future. The use of synergies with financing business in developing and emerging countries will also further expand and diversify the promotional potential for climate protection projects around the world. KfW will thus continue to be a partner for German and European companies that want to use these certificates to fulfil their obligations in European emissions trading. The further development of the certificates market will depend on the general economic environment and, in particular, on political framework conditions being set for the period after 2012, the end of the obligation period of the Kyoto Protocol.

DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH intends to maintain its support of private companies in developing and transition countries at a high level despite the difficult underlying economic conditions to ensure that the foundations required to improve the quality of life of the people living in these countries can be further expanded. DEG is forecasting new business of EUR 1.1 billion in 2009. Growth will then average around 7.5 % p. a. in the following years. Given the substantial deterioration in commercial financing opportunities for private investors, DEG will play a special role as a development financing bank. This will be reflected in demand for long-term credit and, in particular, also for risk capital. As a result, DEG will align the factors called for by development policy with its own risk-bearing capacity with the requisite care and based on its experience as a financing institution during the crisis.

Following the **privatisation transactions with the Federal Republic,** KfW will continue to hold stakes in Deutsche Telekom AG, Bonn, (2008: 16.9 %) and Deutsche Post AG, Bonn, (2008: 30.5 %). Further privatisation transactions will take place in line with the prevailing market conditions and the strategic requirements of the Federal Republic.

Over the next two years, KfW continues to expect high **refinancing volumes.** EUR 75 billion is forecast for 2009. The main driver will be the continued high level of promotional business, also in light of the contribution which KfW will make as part of the German Government's package of measures to strengthen the economy and growth.

In order to meet its funding requirements, KfW will rely on its successful blend of benchmark bonds, other public bonds and private placements. The importance of the benchmark programmes will, however, continue to increase. KfW believes that investor demand for the global reserve currencies, euros and US dollars, will continue, but that demand for other currencies will tend to fall. Initially, demand for structured bonds is also expected to be lower.

In view of the appearance of new, state-guaranteed securities issuers, it will be decisive for KfW to clarify to investors in which respects its presence on the market and its offers distinguish themselves from those of other issuers. The overall changed refinancing situation also entails an increase in refinancing costs for KfW, which is taken into account accordingly in calculations of interest for KfW's promotional loans. KfW expects that the environment in the international capital markets will continue to be characterised by volatility and phases of turbulence in 2009. The principles underlying KfW's activities will thus be: reliability and dependability in its activities in the financial markets and the greatest possible transparency in communication with market participants, in addition to the greatest possible flexibility with regard to selecting the right timing and maturity of new issues.

For the years 2009 and 2010 KfW expects stable **operating results before valuations.** As a consequence of the anticipated intensification of the economic crisis increased risk provisioning in the loan portfolio may be required.

In view of the fair value accounting for financial instruments under IFRSs, the Group's earnings will continue to depend greatly on future developments in the financial markets. Earnings are expected to continue to be highly volatile due to uncertainties with

respect to the development of market prices for securities. In addition, similarly to other large promotional banks, there may also be economically unfounded fluctuations in earnings from IFRS-compliant hedging relationships in the future. From an economic perspective, these effects will continue to be unaccounted for.

In light of KfW's comprehensive modernisation and the impact of the financial market crisis, KfW does not expect major growth in **employees** of the Group in 2009 and 2010. However, KfW will continue to offer the same number of apprenticeships as in the past, as one way of fulfilling its responsibility with respect to the younger generation.

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INCOME STATEMENT

Income statement

	Note(s)	2008	2007	Change
		EUR in millions	EUR in millions	EUR in millions
Interest income	(26)	28,677	27,578	1,100
Interest expense	(26)	26,671	25,823	848
Net interest income		**2,006**	**1,755**	**251**
Risk provisions for lending business	(10), (13), (27)	–2,139	–6,409	4,271
Net interest income after risk provisions		**–133**	**–4,655**	**4,522**
Commission income	(28)	406	388	18
Commission expense	(28)	188	178	9
Net commission income		**218**	**209**	**9**
Net gains/losses from hedge accounting	(7), (29)	–309	73	–383
Net gains/losses from other financial instruments at fair value through profit or loss	(10), (30)	–1,438	–1,953	515
Net gains/losses from securities and investments	(14), (31)	–1,974	–421	–1,552
Administrative expense	(32)	646	607	39
Net other operating income	(10), (33)	1,536	1,189	347
Profit/loss from operating activities		**–2,745**	**–6,164**	**3,419**
Taxes on income	(34)	–89	4	–93
Consolidated loss		–2,657	–6,168	3,511

Appropriation of consolidated profit/loss

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Consolidated loss	**–2,657**	**–6,168**	**3,511**
Additions to reserves from the ERP Special Fund	–43	–47	4
Additions to/withdrawals from retained earnings	507	–278	785
Additions to the fund for general banking risks	–50	–200	150
Reductions of the fund for general banking risks	200	5,300	–5,100
Balance sheet loss	–2,043	–1,393	–650

KfW's reserves from the ERP Special Fund are increased on the basis of contractual agreements. KfW's net loss totalling EUR 2,043 million is recorded in the consolidated financial statements as a balance sheet loss and compounded with the amount carried forward from financial year 2007 of EUR 1,393 million.

A net total of EUR 150 million was taken from the fund for general banking risks in order to cover the charges arising in connection with the IKB sale. Last year the net withdrawal to partially cover charges from the crisis at IKB totalled EUR 5,100 million.

BALANCE SHEET

Assets

	Note(s)	31 Dec. 2008	31 Dec. 2007	Change
		EUR in millions	EUR in millions	EUR in millions
Cash reserves	(37)	99	26	72
Loans and advances to banks	(9), (12), (38)	223,462	205,738	17,723
Loans and advances to customers	(9), (10), (12), (39)	104,444	100,267	4,177
Risk provisions for lending business	(10), (13), (40)	–7,604	–7,671	67
Value adjustments from macro fair value hedge accounting	(7), (41)	5,451	–1,295	6,745
Derivatives used for hedge accounting	(7), (42)	13,028	5,570	7,458
Other derivatives	(8), (9), (43)	8,709	3,166	5,543
Securities and investments	(14), (15), (44)	44,228	45,745	–1,517
Property, plant and equipment	(16), (45)	871	801	70
Intangible assets	(17), (46)	62	69	–8
Other assets	(18), (47)	2,077	1,579	497
Total		394,826	353,997	40,829

Liabilities and equity

	Note(s)	31 Dec. 2008	31 Dec. 2007	Change
		EUR in millions	EUR in millions	EUR in millions
Liabilities to banks	(9), (19), (48)	11,788	13,366	–1,578
Liabilities to customers	(9), (19), (49)	31,306	37,121	–5,815
Certificated liabilities	(19), (50)	302,559	260,315	42,244
Value adjustments from macro fair value hedge accounting	(7), (51)	13	–423	436
Derivatives used for hedge accounting	(7), (52)	10,997	4,091	6,906
Other derivatives	(8), (9), (10), (53)	19,104	17,114	1,991
Provisions	(13), (20), (54)	1,728	1,545	183
Other liabilities	(18), (55)	2,264	2,185	79
Subordinated liabilities	(21), (56)	3,247	3,747	–500
Equity	(22), (57)	11,820	14,936	–3,116
Total		394,826	353,997	40,829

STATEMENT OF CHANGES IN EQUITY

Statement of changes in equity in financial year 2008

	As at 1 Jan. 2008	Appropriation of consolidated profit/loss from financial year 2008	Changes in Revaluation reserves	As at 31 Dec. 2008
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Subscribed capital	3,750	0	–	3,750
less outstanding contributions, not requested	−450	0	–	−450
Capital reserve	6,254	0	–	6,254
Promotional reserves from the ERP Special Fund	*4,650*	*0*	–	*4,650*
Reserve from the ERP Special Fund	804	43	–	848
Retained earnings	5,862	−507	–	5,356
Statutory reserve under Section 10 (2) KfW Law	*1,574*	*0*	–	*1,574*
Special reserve under Section 10 (3) KfW Law	*1,893*	*0*	–	*1,893*
Special reserve less the special loss account from provisioning pursuant to Section 17 (4) of the D-Mark Balance Sheet Law	*21*	*0*	–	*21*
Other retained earnings	*2,374*	*−507*	–	*1,867*
Fund for general banking risks	200	−150	–	50
Revaluation reserves	−92	–	−460	−551
Balance sheet loss	−1,393	−2,043	–	−3,436
Equity	**14,936**	**−2,657**	**−460**	**11,820**

Statement of changes in Revaluation reserves in financial year 2008

	Bonds and other fixed-income securities	Shares and other non-fixed income securities	Equity investments	Effects of deferred taxes	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 January 2008	−125	34	−1	0	−92
A. Changes recognised in the income statement					
Decrease due to disposals	33	0	0	0	33
Increase due to disposals	0	−2	0	0	−3
Decrease due to impairments	244	29	1	0	274
Amortisation after reclassification	23	0	0	0	23
Total changes recognised in the income statement	**299**	**27**	**1**	**0**	**327**
B. Changes recognised directly in equity					
Changes in Revaluation reserves	−731	−62	0	4	−789
Total changes recognised directly in equity	**−731**	**−62**	**0**	**4**	**−789**
Effects of exchange rate changes	1	2	0	0	2
As at 31 December 2008	**−557**	**2**	**0**	**4**	**−551**

Statement of changes in equity in financial year 2007

	As at 1 Jan. 2007	Capital increases	Appropriation of consolidated profit/loss from financial year 2007	Changes in Revaluation reserves	As at 31 Dec. 2007
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Subscribed capital	3,750	0	0	–	3,750
less outstanding contributions, not requested	–450	0	0	–	–450
Capital reserve	1,604	4,650	0	–	6,254
Promotional reserves from the ERP Special Fund	*0*	*4,650*	*0*	–	*4,650*
Reserve from the ERP Special Fund	757	0	47	–	804
Retained earnings	5,584	0	278	–	5,862
Statutory reserve under Section 10 (2) KfW Law	*1,574*	*0*	*0*	–	*1,574*
Special reserve under Section 10 (3) KfW Law	*1,893*	*0*	*0*	–	*1,893*
Special reserve less the special loss account from provisioning pursuant to Section 17 (4) of the D-Mark Balance Sheet Law	*21*	*0*	*0*	–	*21*
Other retained earnings	*2,095*	*0*	*278*	–	*2,374*
Fund for general banking risks	5,300	0	–5,100	–	200
Revaluation reserves	157	–	–	–249	–92
Balance sheet loss	0	–	–1,393	–	–1,393
Equity	**16,702**	**4,650**	**–6,168**	**–249**	**14,936**

Statement of changes in Revaluation reserves in financial year 2007

	Bonds and other fixed-income securities	Shares and other non-fixed income securities	Equity investments	Investments accounted for using the equity method	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 January 2007	86	38	0	33	157
A. Changes recognised in the income statement					
Decrease due to disposals	2	3	0	0	5
Increase due to disposals	–1	–3	0	0	–4
Decrease due to impairments	0	–1	0	0	–1
Total changes recognised in the income statement	**1**	**–1**	**0**	**0**	**0**
B. Changes recognised directly in equity					
Changes in Revaluation reserves	–211	–3	–1	–33	–248
Total changes recognised directly in equity	**–211**	**–3**	**–1**	**–33**	**–248**
Effects of exchange rate changes	–1	0	0	0	–1
As at 31 December 2007	**–125**	**34**	**–1**	**0**	**–92**

CASH FLOW STATEMENT

Cash flow statement

	2008	2007
	EUR in millions	EUR in millions
Consolidated loss	**−2,657**	**−6,168**
Non-cash items included in consolidated loss for the period and reconciliation to cash flow from operating activities:		
Depreciation, amortisation and impairment (receivables, property, plant and equipment, securities and investments) and changes in risk provisions for lending business	2,730	7,095
Changes in other provisions	534	138
Profit/loss from the disposal of securities and investments and property, plant and equipment	−17	−3
Other adjustments (net)	536	268
Subtotal	**1,127**	**1,330**
Changes in assets and liabilities from operating activities after adjustment for non-cash items:		
Loans and advances to banks	−17,722	−14,515
Loans and advances to customers	−6,984	−7,722
Securities and investments (securities)	863	−4,320
Other assets relating to operating activities	−22,384	−1,870
Liabilities to banks	4,331	−4,623
Liabilities to customers	−11,725	−4,837
Certificated liabilities	42,244	20,229
Other liabilities relating to operating activities	9,290	6,759
Interest and dividends received	28,677	27,578
Interest paid	−26,671	−25,823
Income tax paid	−58	8
Cash flow from operating activities	**988**	**−7,806**
Cash proceeds from the disposal of:		
Property, plant and equipment	9	13
Cash payments for investment in:		
Securities and investments (equity investments)	−307	−36
Property, plant and equipment	−117	−89
Changes from other investing activities	0	1
Cash flow from investing activities	**−416**	**−110**
Cash proceeds/(payments) from capital increases/(decreases)	0	4,650
Changes from other financing activities	−500	3,247
Cash flow from financing activities	**−500**	**7,897**
Cash and cash equivalents as at the end of the previous period	**26**	**26**
Cash flow from operating activities	988	−7,806
Cash flow from investing activities	−416	−110
Cash flow from financing activities	−500	7,897
Effects of exchange rate changes	0	20
Cash and cash equivalents as at the end of the period	**99**	**26**

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

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

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

NOTES
ACCOUNTING POLICIES

(1) BASIS OF PRESENTATION

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

The KfW Group includes seven subsidiaries and six special funds (securities funds/*Wertpapiersondervermögen)* that are fully consolidated. Two jointly controlled entities are accounted for at equity.

The consolidated financial statements as at 31 December 2008 have been prepared, pursuant to Section 315a (1) of the German Commercial Code *(Handelsgesetzbuch/HGB)*, in accordance with the International Financial Reporting Standards (IFRS), as applicable in the European Union (EU), and with the interpretations set out by the International Financial Reporting Interpretations Committee (IFRIC), as mandatory consolidated accounts in accordance with Article 4 of Regulation (EC) No. 1606/2002 (IAS Regulation) of the European Parliament and Council of 19 July 2002, as well as further regulations on the adoption of certain international accounting standards. The standards and interpretations that apply are those that had been published and endorsed by the EU at the point in time at which these financial statements were prepared.

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

The consolidated financial statements were prepared in accordance with accounting policies that are uniform within the KfW Group and are based on the going concern principle. All companies accounted for at equity prepared their annual financial statements as at 31 December 2008.

The accounting policies were used consistently with the exception of the material changes described below:

- Newly acquired securities that are to be held to maturity are, on a case-by-case basis, no longer categorised as *"available-for-sale financial assets"*. Instead, they are carried as *"held-to-maturity investments"* in line with the purpose of the transaction.
- Depending on the product, newly-issued financial liabilities with embedded derivatives requiring separation are no longer categorised using the *"fair value option"*. Instead, the embedded derivative is carried independently. Measurement of the hedge has a compensatory effect, in line with the purpose of the transaction the basis contract is carried under *"other liabilities"*.
- Use of the possibility to reclassify financial assets according to IAS 39 in the version dated 13 October 2008, retroactively as at 1 July 2008 for asset-backed securities.

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

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

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

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

KfW does not expect any deviations from its assumptions or any uncertainties with respect to estimates that could result in a material risk requiring a substantial adjustment to the related assets and liabilities within the next financial year. However, in view of the current uncertainties on the financial markets and the increased use of valuation models in measuring financial instruments at fair value, this cannot be fully excluded.

(2) ASSESSMENT OF THE IMPACT OF IFRS/IFRIC STANDARDS TO BE APPLIED IN THE FUTURE

Application of IFRS 8, "Operating Segments", which replaces the former standard on segment reporting, is mandatory from 1 January 2009. There was no voluntary early application. This change is not expected to have any material impact on the bank's financial position and performance.

Application of the amended IAS 1, "Presentation of Financial Statements", in the version dated 6 September 2007 is mandatory from 1 January 2009. There was no voluntary early application. This change is not expected to have any material impact on the bank's financial position and performance.

The changes in IAS 23, "Borrowing Costs", in the version dated 29 March 2007 and IFRS 2, "Share-based Payment", in the version dated 17 January 2008, which had already been passed by the EU, are of no relevance for the Group.

IFRIC 13, "Customer Loyalty Programmes", and IFRIC 14, "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction", which had already been passed by the EU, are of no relevance for the Group.

(3) CONSOLIDATED GROUP

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

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

KfW IPEX-Bank GmbH was included in the Group for the first time after it was legally separated on 1 January 2008. This separation is due to the understanding between the Federal Republic of Germany and the European Commission on the role of legally independent promotional banks in Germany and the Promotional Bank Restructuring Act *(Förderbankenneustrukturierungsgesetz)*. As a result, KfW transferred what had, until then, been a legally dependent part of its operations to a subsidiary. The separation included business activities in the export and project financing segment, which compete with other financial services companies. There was no impact on the consolidated financial statements as a result of this.

Associates and jointly controlled entities are included in accordance with IAS 28/IAS 31 insofar as significant influence or joint control is exercised. The shares in IKB were carried as an asset held for sale according to IFRS 5 until they were sold in October 2008.

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

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

(4) BASIS OF CONSOLIDATION

Consolidation involves revaluing the total assets and liabilities of the subsidiaries at the acquisition date, irrespective of the percentage of equity instruments acquired, and incorporating them into the consolidated balance sheet. The resulting adjustments from hidden reserves and obligations are treated in accordance with the applicable standards. If the Revaluation procedure results in an excess of acquisition cost, this amount is capitalised as goodwill. At present, no goodwill is recognised.

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

Associates and jointly controlled entities are accounted for using the equity method.

KfW holds no minority interests.

(5) FINANCIAL INSTRUMENTS – RECOGNITION AND MEASUREMENT

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The KfW Group resolved to use this approach on 31 October 2008 with retroactive effect as at 1 July 2008 for its asset-backed securities for which, as part of the general crisis of confidence in the financial markets, there was no longer an active market when the decision was passed (i.e., no current, regularly occurring market transactions on an arm's length basis could be observed) and which were to be held through to maturity. The fair value on the date of reclassification is the new acquisition cost of the reclassified financial assets. Amortisation is accounted for through profit or loss under Interest income according to the effective interest method. The difference between the fair value and (amortised) cost which had been recognised directly in equity until the reclassification continues to be carried under equity as a separate equity item. Amortisation using the effective interest method is accounted for through profit or loss under Interest income.

(6) FINANCIAL INSTRUMENTS – VALUATION TECHNIQUES

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

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

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

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

2. No active market – valuation techniques
If the financial instrument is not quoted in an active market, valuation techniques are used. The valuation techniques used include, in particular, the discounted cash flow (DCF) method and option pricing models, as well as a comparison with the fair value of a financial instrument with almost identical characteristics (e.g., multiplier-based models). The

valuation techniques take account of all of the parameters that the market participants would include in the pricing process, e. g., market rates, risk-free interest rates, credit spreads or swap curves.

3. No active market – equity instruments
If in exceptional cases it is not possible to reliably determine the fair value of equity instruments that are not quoted in an active market using valuation models, they are measured at cost. The fair value cannot be calculated reliably if the range of reasonable fair value estimates for this instrument is significant and the probabilities of the various estimates cannot be reasonably assessed.

As a result of the general crisis of confidence in the financial markets, the Group ascertained, using homogeneous securities portfolios, that the criteria for an active market are also no longer to be regarded as having been fulfilled even in segments that certainly fulfilled these criteria until the crisis broke out. In particular, the market transactions and pricings for financial and corporate bonds and also covered bonds (Pfandbriefe) that could be observed on the market are characterised by very high illiquidity discounts; the criteria for regularly occurring market transactions on an arm's length basis can thus no longer be regarded as having been fulfilled.

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

Fair values are determined on the basis of the valuation category for recognition on the balance sheet and for information on financial instruments in the Notes. Fair values from active markets are applied, in particular, for bonds and other fixed-income securities –unless there are no longer any active markets as a result of the financial crisis and thus valuation techniques are used – as well as shares and other non-fixed income securities. However, valuation techniques for non-derivative financial instruments are applied in particular to the products reported under Loans and advances to banks and customers, Liabilities to banks and customers, and Certificated liabilities. Valuation techniques are also applied to OTC derivatives. Equity investments and shares which cannot be reliably measured at fair value are measured at cost.

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

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

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

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

(7) HEDGING RELATIONSHIPS

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

Under hedge accounting, i.e. the accounting for hedging instruments (derivatives) and hedged transactions in accordance with special rules, strict requirements apply to the accounting for hedging relationships. Within the KfW Group, hedge accounting is used solely in the form of fair value hedges to recognise hedging relationships between derivatives and the respective assets/liabilities. The hedging relationship is reported at the individual transaction level in the form of micro fair value hedge accounting, and at portfolio level in the form of macro fair value hedge accounting. The effectiveness of the hedging relationships is verified on a case-by-case basis using the dollar offset method or via a regression analysis.

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

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

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

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

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

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

(8) TREATMENT OF EMBEDDED DERIVATIVES

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

The KfW Group enters into contracts with embedded derivatives requiring separation particularly with respect to borrowings. As it makes use of the *"fair value option"*, KfW reports these hybrid (combined) financial instruments at fair value. In the case of certain products, the embedded derivatives requiring separation are spun off and accounted for separately. Changes in fair value are recorded in Net gains/losses from other financial instruments at fair value through profit or loss under the item Derivatives not qualifying for hedge accounting, where they have a compensatory effect on the valuation of the hedging derivatives.

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

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

(9) CREDIT DERIVATIVES

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

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

current risk premiums are reported under Commission expense.

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

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

(10) RISK PROTECTION, CAPITAL MEASURES AND SALE OF IKB

IKB was supported by measures protecting it against risks in connection with the US subprime mortgage crisis, various capital measures and additional agreements made as part of its sale to a strategic investor. In addition to KfW, three German banking associations (banking pool) and the Federal Republic of Germany are also participating in the support measures.

As part of the risk protection measures agreed in 2007, KfW assumed all of IKB's rights and obligations under IKB's liquidity lines to refinance the special purpose entities of the "Rhineland Funding Capital Corporation, New York, USA" conduit. In addition, credit derivatives were used as a means of assuming IKB's loss exposures arising from reverse hedges of this conduit up to a maximum of USD 1.5 billion. These were settled in full at their present value during 2008. Furthermore, credit derivatives and financial guarantees were used to back IKB's risks arising from specified securities portfolios up to a maximum of EUR 1 billion. These were settled in full during the reporting year. The banking pool is participating in the risk protection on a pro-rata basis up to a maximum of EUR 1.2 billion. This was also settled during the reporting year.

The "Rhineland Funding Capital Corporation, New York, USA" conduit was not consolidated by the KfW

Group during the reporting year. The provision of liquidity lines did not trigger an obligation for KfW to consolidate the special purpose entities since KfW did not "control" the SPEs within the meaning of SIC-12. KfW did not obtain any power of disposal over the SPEs or over their assets as a result of providing the liquidity lines. KfW served solely as provider of debt capital for the conduit and did not possess any decision-making powers over the assets of the SPEs or over the SPEs themselves. The fully drawn liquidity lines are reported under Loans and advances to customers. Individual impairments were recorded to account for the default risks.

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

Using this as a basis, KfW recorded individual impairments to account for the receivables resulting from the assumption of the liquidity lines.

In addition to the subscription of a convertible bond issued by IKB as part of the risk protection measures with a volume of EUR 54.3 million with subsequent conversion, KfW engaged in additional capital measures with a volume of EUR 2.3 billion for the benefit of IKB based on a mandate by the Federal Government issued in accordance with Section 2 (4) of the KfW Law, subject to the condition precedent of approval by the European Commission. This approval was issued on 21 October 2008. The capital measures included the participation in a cash capital increase by IKB in an amount of EUR 1.25 billion as well as the provision of loans with waivers of debts outstanding and agreements on compensation out of future profits *(Besserungsabrede)* in an amount of EUR 1.05 billion.

The difference between the volume of the capital measures implemented and the proceeds from the sale realised when the shares in IKB from the cash capital increase and the loans with waivers of debts outstanding and compensation agreements were sold to a strategic investor is carried as a net loss from the sale of available-for-sale assets or under Expense for risk provisions. The loss participation by the Federal Republic of Germany and the Bundesverband deutscher Banken e.V. (German association of private banks) in these capital measures totalling EUR 1.5 billion is recorded under Other operating income.

In addition, KfW granted IKB liquidity facilities on market terms of up to EUR 3 billion which are accounted for and measured according to the uniform group methods which apply to these products (loans and advances).

In connection with the sale of the shares in IKB and the loans with waivers of debts outstanding and compensation agreements, KfW also acquired financial instruments carrying risks from IKB in the form of structured securities and credit derivatives at a purchase price of EUR 1 billion. These financial instruments are accounted for according to uniform group accounting policies for these instruments. KfW's risk is initially limited to a first loss of EUR 150 million, with the Federal Republic of Germany bearing further risks in an amount of up to EUR 600 million. The guarantee agreement concluded for this purpose is recorded as a credit derivative with a positive market value under Other derivatives in line with the nature of the hedged risks. The changes in value are reported in the income statement under Net gains/losses from other financial instruments at fair value through profit or loss.

In addition, involvement by KfW in refinancing a portfolio of further IKB structured securities which were transferred to a SPE in connection with the acquisition by the strategic investor, was agreed in the form of loans totalling EUR 0.6 billion on market terms with senior redemption. The KfW Group's accounting is in line with the applicable accounting policies for these products (loans and advances). The provision of refinancing did not trigger a consolidation requirement for the SPE for KfW, because KfW did not have any control over the SPE within the meaning of SIC-12. KfW did not acquire control of the SPE or the assets in the SPE by providing refinancing. KfW served solely as provider of debt capital for the SPE and did not possess any decision-making powers over the assets of the SPE or over the SPE itself.

In addition, KfW agreed to indemnify IKB for certain legal risks in a certain amount. A legal action relevant in this respect was dismissed – not yet legally binding – at the end of December 2008. There were no charges resulting from the legal action under the indemnification agreement in 2008 and no charges are expected in the future.

(11) FOREIGN CURRENCY TRANSLATION

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

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

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

(12) LOANS AND ADVANCES TO BANKS AND CUSTOMERS

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

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

(13) RISK PROVISIONS FOR LENDING BUSINESS

The overall risk provisions for lending business include the provisions for losses on loans and advances, which are reported separately, as well as the provisions for contingent liabilities and irrevocable loan commitments.

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

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

Smaller and standardised loans are grouped into homogenous subportfolios for portfolio impairment on the basis of the default risks identified. If less impairment than expected is necessary, impairment losses may be reversed through the income statement.

For performing loans not subject to individual impairment, the risk of decreases in value that have already occurred but have not yet been individually identified is addressed by portfolio impairment. Economic risk and transfer risk are taken into account for the calculation. The key parameters are the outstanding loan volume (based on the carrying amount) as at the reporting date, the expected loss given default and one-year probabilities of default (given a LIP [loss identification period] factor of 1).

The probabilities of default are provided by credit risk control, as is the loss given default, whereby the latter is adjusted for imputed cost. The underlying assumptions of expected losses are backtested on a regular basis against the actual loss experience.

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

Non-recoverable loans, for which no specific provisions were made, are written off directly. Recoveries on loans already written off are recognised as income from risk provisions.

(14) SECURITIES AND INVESTMENTS

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

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

To ensure uniform accounting treatment for equity investments with and without significant influence, individual group business divisions that provide equity financing as part of their promotional mandate are categorised as venture capital organisations for accounting purposes provided they meet the respective requirements. These equity investments, like all other equity investments, are reported under Securities and investments.

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

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

Any changes in the value of *"financial assets at fair value through profit or loss"* are reported under Net

gains/losses from other financial instruments at fair value through profit or loss. Realised gains and losses and impairments from the *"available-for-sale financial assets"*, *"loans and receivables"* and *"held-to-maturity investments"* categories are recognised under Net gains/losses from securities and investments. Unrealised gains from *"available-for-sale financial assets"* are recognised directly in equity as Revaluation reserves. Current interest payments and dividends are reported under Interest income.

Associates and jointly controlled entities that are included in the KfW Group are also included under Securities and investments. Their inclusion is based on the equity method insofar as there is significant influence or joint control. Assets held for sale within the meaning of IFRS 5 are also included in this item. These are carried at the lower of their carrying amount or fair value, less disposal costs. Any value adjustments are reported under Net gains/losses from securities and investments.

(15) REPURCHASE AGREEMENTS

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

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

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

(16) PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTY

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

The KfW Group's land and buildings are primarily owner-occupied. There is a small volume of rental activity to third parties. These properties are reported as investment property under Property, plant and equipment and measured as such. Every five years an expert opinion determines the fair value of these properties by applying the discounted earnings method unless a significant change in the real estate market becomes detectable beforehand.

Payments in advance and assets under construction are reported under Other property, plant and equipment.

(17) INTANGIBLE ASSETS

The KfW Group reports purchased and internally generated software at cost less depreciation on a straight-line basis under Intangible assets and its impairment under Administrative expense. The useful life is determined based on expected wear and tear. The KfW Group assumes a useful life of five years. An impairment is recorded when the carrying amount of an asset exceeds the recoverable amount. A situation in which the asset is not expected to be used as originally planned leads to an impairment recognition.

In-house software under development is reported under Other intangible assets.

(18) TAXES ON INCOME

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

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

Deferred tax assets and liabilities arise as a result of differences between carrying values according to IFRSs of an asset or a liability and the respective tax bases if these are likely to result in taxable or tax deductible amounts in the future (temporary differences). Deferred tax assets relating to loss carryforwards not yet used are recognised only if there is a sufficient degree of certainty that the respective taxable entity will earn sufficient taxable income in subsequent periods to use the loss carryforward. Deferred tax assets and liabilities are recognised and measured either through profit or loss as Taxes on income or directly in equity under Revaluation reserves, depending on the underlying transaction.

(19) LIABILITIES TO BANKS AND CUSTOMERS AND CERTIFICATED LIABILITIES

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

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

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

(20) PROVISIONS

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

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

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

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

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

Under defined-contribution plans employers pay a set amount to an external service provider (such as the *Versorgungsverband bundes- und landesgeförderter Unternehmen e.V.*, the German pension association for entities benefiting from federal and state support). Beyond this employers have no legal

or constructive obligation to pay additional amounts if the external service provider does not fulfil its obligations as agreed. Contributions paid to the service provider are reported under the item Administrative expense; no provisions are necessary for defined-contribution plans.

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

Other provisions are set up primarily for obligations to employees and for audit and consultancy services at the estimated expenditure.

(21) SUBORDINATED LIABILITIES

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

Subordinated liabilities are classified as *"Other liabilities"* and carried at amortised cost.

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

Current interest expenses are recorded under Interest expense.

(22) EQUITY

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

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

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

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

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

(23) CONTINGENT LIABILITIES AND IRREVOCABLE LOAN COMMITMENTS

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

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

(24) TRUST ACTIVITIES

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

(25) LEASING TRANSACTIONS

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

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

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

NOTES TO THE INCOME STATEMENT

(26) NET INTEREST INCOME

Analysis of net interest income by class

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Interest and similar income from loans and advances to banks and customers	14,104	13,068	1,036
Similar income from financial guarantees	50	43	7
Interest income from securities and investments	2,267	1,969	298
Interest income from derivatives	12,203	12,472	–269
Other interest income	53	26	28
Interest income	**28,677**	**27,578**	**1,100**
Interest and similar expense for liabilities to banks and customers	1,807	2,127	–320
Interest expense for certificated liabilities	11,939	11,419	520
Interest expense for subordinated liabilities	163	93	70
Interest expense for derivatives	12,570	11,948	622
Other interest expense	192	236	–44
Interest expense	**26,671**	**25,823**	**848**
Total	2,006	1,755	251

Income from unwinding in the amount of EUR 84 million (previous year: EUR 43 million) is reported under Interest and similar income from loans and advances to banks and customers.

Interest income from and interest expense for derivatives includes the interest income from derivatives irrespective of whether they are designated for hedge accounting.

Analysis of interest income from securities and investments

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Interest income from bonds and other fixed-income securities	2,204	1,881	323
Income from shares and other non-fixed income securities	32	54	–22
Income from equity investments	26	34	–8
Income from shares in affiliated entities not included in the consolidated financial statements	5	0	5
Total	2,267	1,969	298

(27) RISK PROVISIONS FOR LENDING BUSINESS

Analysis of risk provisions by transaction

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Impairment charges	1,304	6,857	−5,553
Direct write-offs	1,087	118	969
Expense for risk provisions	**2,391**	**6,975**	**−4,584**
Income from the reversal of impairment losses	184	469	−285
Income from recoveries of amounts previously written off	68	97	−29
Income from risk provisions	**252**	**566**	**−314**
Total	−2,139	−6,409	4,271

The direct write-offs resulted almost entirely from the loans with waivers of debts outstanding and agreements on compensation out of future profits (*Besserungsabrede*) granted as part of the IKB capitalisation measures in 2008, which were sold to a strategic investor (EUR 1.0 billion). In addition, the impairment charges included additional charges totalling EUR 0.3 billion resulting from the risk protection for IKB.

Last year, this line item included the provisions from KfW's assumption of the liquidity lines provided for the SPEs of the "Rhineland Funding Capital Corporation, New York, USA" conduit and the provision for the guarantee covering the balance sheet risks of IKB.

(28) NET COMMISSION INCOME

Analysis of net commission income by class

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Commission income from lending business	274	266	8
Commission income from credit derivatives	12	6	6
Other commission income	119	114	5
Income from trust activities	1	2	–1
Commission income	**406**	**388**	**18**
Commission expense for lending business	166	166	0
Commission expense for credit derivatives	4	4	0
Other commission expense	18	8	9
Commission expense	**188**	**178**	**9**
Total	**218**	**209**	**9**

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

Other commission income includes fees for handling German Financial Cooperation with developing countries in the amount of EUR 84 million (previous year: EUR 84 million).

(29) NET GAINS/LOSSES FROM HEDGE ACCOUNTING

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

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Micro fair value hedge accounting	–450	–72	–378
Macro fair value hedge accounting	141	146	–5
Total	**–309**	**73**	**–383**

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

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Hedging of securities and investments	51	–3	54
Hedging of liabilities to banks/customers	–8	–3	–5
Hedging of certificated liabilities	–434	–15	–419
Hedging of subordinated liabilities	–5	–3	–2
Subtotal: Effectiveness of hedges	**–396**	**–24**	**–372**
Amortisation of value adjustments	–54	–48	–6
Total	**–450**	**–72**	**–378**

Gross analysis of valuation results from micro fair value hedge accounting: Comparison of hedged items and hedging instruments in financial year 2008

	Hedged items	Hedging instruments	Effectiveness of hedges
	EUR in millions	EUR in millions	EUR in millions
Hedging of securities and investments	731	–680	51
Hedging of liabilities to banks/customers	–73	65	–8
Hedging of certificated liabilities	–11,294	10,860	–434
Hedging of subordinated liabilities	–224	219	–5
Total	**–10,859**	**10,464**	**–396**

Gross analysis of valuation results from micro fair value hedge accounting: Comparison of hedged items and hedging instruments in financial year 2007

	Hedged items	Hedging instruments	Effectiveness of hedges
	EUR in millions	EUR in millions	EUR in millions
Hedging of securities and investments	–107	104	–3
Hedging of liabilities to banks/customers	57	–60	–3
Hedging of certificated liabilities	–280	264	–15
Hedging of subordinated liabilities	9	–12	–3
Total	**–320**	**296**	**–24**

Analysis of net results from macro fair value hedge accounting by hedged item and hedging instrument

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Valuation of the hedged risks in the portfolios of hedged items	6,310	–1,387	7,696
Valuation of hedging instruments	–6,079	1,332	–7,411
Subtotal: Effectiveness of hedges	**231**	**–55**	**285**
Subsequent valuation of hedging relationships	–90	201	–291
Total	**141**	**146**	**–5**

The result from the subsequent valuation of hedging relationships includes the amortisation of the value adjustments from the dynamic hedge designation and reversal process and the pro-rata reversal of value adjustments in the event of disposals from the underlying portfolios as well as the residual term effect of the hedging derivatives.

(30) NET GAINS/LOSSES FROM OTHER FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

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

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Securities and investments	–1,446	–237	–1,209
Assets	**–1,446**	**–237**	**–1,209**
Liabilities to banks/customers	751	284	466
Certificated liabilities	–1,838	567	–2,405
Liabilities	**–1,088**	**851**	**–1,939**
Financial derivatives not qualifying for hedge accounting	1,622	–590	2,212
Credit derivatives	–584	–1,875	1,291
Derivative financial instruments	**1,038**	**–2,465**	**3,503**
Foreign currency translation	57	–102	160
Total	**–1,438**	**–1,953**	**515**

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

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

and liabilities to banks and customers as well as securities and investments.

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

The results from the portfolio investments that KfW acquired from IKB as part of the sale of the IKB shares to a strategic investor, are limited to the risk of first loss (EUR 150 million) and recorded in Net gains/losses from securities and investments and Net gains/losses from credit derivatives (single name CDSs and portfolio CDSs).

In the previous year, Net gains/losses from credit derivatives included results arising in connection with the risk protection for IKB (assumed credit derivatives).

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

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Bonds and other fixed-income securities	−1,121	−397	−724
Shares and other non-fixed income securities	−323	2	−326
Equity investments	−2	157	−159
Total	**−1,446**	**−237**	**−1,209**

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

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Single Name CDSs	−64	14	−78
Portfolio CDSs	286	−1,662	1,947
PROMISE/PROVIDE	−3	0	−3
CDSs	*−806*	*−227*	*−579*
Issued credit-linked notes	*804*	*227*	*576*
Total	**219**	**−1,647**	**1,867**

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

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Borrowings	-1,891	624	-2,515
Hedging instruments	2,313	-668	2,981
Total (Effectiveness of economic hedges)	**422**	**-45**	**466**

(31) NET GAINS/LOSSES FROM SECURITIES AND INVESTMENTS

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

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Bonds and other fixed-income securities	-436	-19	-416
Shares and other non-fixed income securities	-25	0	-25
Equity investments	-95	-48	-47
Financial instruments	**-555**	**-67**	**-489**
Investments accounted for using the equity method	3	-277	280
Held-for-sale affiliated entities	-1,421	-77	-1,344
Total	**-1,974**	**-421**	**-1,552**

The net gains/losses from financial instruments include gains and losses realised from the sale and impairments of securities and investments classified as *"available-for-sale financial assets"* or as *"loans and receivables"*. Both the net gains/losses from shares and other non-fixed income securities and the net gains/losses from equity investments include income from the disposal of financial assets that were recognised at cost.

The net gains/losses from held-for-sale affiliated entities include expenses from the complete sale of KfW's interest in IKB, which also includes the shares newly acquired as part of the IKB cash capital increase in 2008.

In the previous year, from the date on which the intention to sell was announced the write-offs on the IKB shares were recorded under assets held for sale (IFRS 5), previously they were recorded in net gains/losses from investments accounted for using the equity method.

Disclosures on impairment of securities and investments

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Securities and investments	562	80	481
Bonds and other fixed-income securities	*405*	*18*	*386*
Shares and other non-fixed income securities	*32*	*1*	*31*
Equity investments	*125*	*61*	*64*
Total	**562**	**80**	**481**

Disclosures on the reversal of impairment losses from securities and investments

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Securities and investments	1	0	1
Bonds and other fixed-income securities	*1*	*0*	*1*
Total	**1**	**0**	**1**

(32) ADMINISTRATIVE EXPENSE

Analysis of administrative expense

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Wages and salaries	305	276	29
Social security contributions	41	41	0
Expense for pension provision and other employee benefits	20	32	–12
Personnel expense	**366**	**349**	**17**
Other administrative expense	233	216	18
Depreciation and impairment on property, plant and equipment and intangible assets	46	42	4
Non-personnel expense	**280**	**258**	**22**
Total	**646**	**607**	**39**

The non-personnel expense includes EUR 6 million for depreciation and impairment relating to finance leases (previous year: EUR 5 million).

Other administrative expense includes rental expense arising from operating leases in the amount of EUR 14 million (previous year: EUR 11 million).

(33) NET OTHER OPERATING INCOME

Analysis of net other operating income

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Other operating income	1,592	1,217	374
Other operating expense	56	29	27
Total	1,536	1,189	347

Other operating income includes the contributions by the Federal Government and the German banking sector to the IKB capital measures and the risk protection for IKB.

Additional items include rental income including investment property income of EUR 4 million (previous year: EUR 3 million), results from repurchasing own issues and income from the reversal of other provisions.

(34) TAXES ON INCOME

Analysis of taxes on income by component

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Current taxes on income	12	16	–4
Deferred taxes	–100	–12	–88
Total	–89	4	–93

In the reporting year deferred tax assets resulted in earnings of EUR 100 million (previous year: EUR 12 million).

Taxes on income mostly resulted from the first-time inclusion of KfW IPEX-Bank as an independent taxable associate.

The reconciliation presents the relationship between the calculated income tax expense for the financial year and the taxes on income.

Tax reconciliation

	2008	2007	Change
	EUR in millions	EUR in millions	EUR in millions
Profit/loss from operating activities (before taxes)	−2,745	−6,164	3,419
Group income tax rate	0%	0%	0%
Calculated income tax expense for the reporting year	**0**	**0**	**0**
Effects of tax rate differentials within the Group	−180	−178	−2
Effect of tax rate changes	−62	13	−75
Effects of previous year taxes recorded in the reporting year	−7	−1	−6
Effects of non-deductible taxes on income	3	0	3
Effects of non-deductible business expenses	2	182	−180
Effects of tax-free income	−1	−2	1
Trade tax add-ons	4	1	3
Permanent accounting differences	−1	1	−2
Effects of changes in recognised deferred tax assets	152	−7	159
Other effects	−2	−5	3
Reported taxes on income	**−89**	**4**	**−93**

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

The effects of tax rate differentials result from individual group companies being taxable and the related different tax rates. In the reporting year the tax rates ranged between 0% and 31% (previous year up to 31%).

The effects of tax rate changes result from the separation of a legally dependent part of KfW's operations to form KfW IPEX-Bank on 1 January 2008 and the related change in tax status.

The effects of changes in recognised deferred tax assets include, in particular, the non-consideration of tax losses recorded during the reporting year and of the surplus assets for deductible temporary differences. This is in line with KfW's conservative approach.

SEGMENT REPORTING

(35) SEGMENT REPORTING BY BUSINESS AREA

Primary segment information in accordance with IAS 14 follows the internal control structure of the business areas of the KfW Group.

The composition of the segments, and their products and services, are shown in the following overview:

Investment finance Germany and Europe
■ Equity financing (incl. tbg – Technologie-Beteiligungs-Gesellschaft mbH)
■ Corporate investments/industrial pollution control financing
■ Education and social finance
■ Infrastructure and home finance
■ Global loans
■ Advisory
■ Loan securitisation

Export and project finance
■ Promotion of German and European export activities
■ Financing of direct and other corporate investments

Promotion of developing countries
■ Promotion of developing and transition countries on behalf of the Federal Republic of Germany (budget funds) with complementary funds raised by KfW in the market
■ DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH (private enterprise financing)

Shareholdings, treasury and services
■ Holding arrangements for the Federal Republic of Germany
■ Shareholdings
■ Securities investments
■ Other services

The operating business areas are measured on the basis of their profit or loss from operating activities. The individual line items are based on the following methods:

- The analysis of net interest income was based on the market interest rate method[1]. The item also includes the imputed return on equity with an analysis based on equity usage.
- The allocation of administrative expense is based on the results from activity-based accounting by cost centres[2]. Administrative expense includes depreciation on property, plant and equipment.
- Risk provisions for lending business were determined based on the concept of expected losses (standard risk costs) and allocated accordingly to each segment.

[1] Refinancing at matching maturities is assumed for the calculation of interest margins in this method.
[2] The costs incurred in the organisational units are allocated to the products by means of core services.

- In contrast to former reporting, other contributions to income no longer include the valuation results which were recorded directly under equity in the Revaluation reserve. Segment reporting is thus in line with changed internal reporting. Other contributions to income now include the net gains/losses from hedge accounting, the net gains/losses from the fair value accounting for other financial instruments, the net gains/losses from securities and investments, and net other operating income.
- Segment assets include all recognised balance sheet assets less income tax assets plus assets held in trust[3].
- Contributions to income generated independently of the segments (such as income/loss from interest rate management) are allocated to the group centre.

The reconciliation/consolidation column includes the adjustments that were necessary to reconcile segment results with comprehensive income. In 2008, this related in particular to the impact of the risk protection for IKB and the sale of KfW's interest in IKB on income. In addition, it included differences between risk provisions for lending business according to the income statement and standard risk costs.

Segment reporting by business area for financial year 2008

	Investment finance Germany and Europe	Export and project finance	Promotion of developing countries	Shareholdings, treasury and services	Group centre	Reconciliation/ consolidation	KfW Group
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Net interest income	–158	548	130	232	1,079	174	2,006
Net commission income	62	28	97	11	0	21	218
Administrative expense	–244	–129	–167	–74	–24	–7	–646
Risk provisions for lending business[1]	–140	–150	–71	–7	–7	–1,764	–2,139
Other contributions to income[2]	–541	–74	–10	–1,400	–399	238	–2,185
Profit/loss from operating activities	**–1,022**	**222**	**–21**	**–1,237**	**649**	**–1,337**	**–2,745**
Total assets	**247,797**	**51,757**	**23,524**	**56,846**	**31,231**	**–16,329**	**394,826**

[1] The business areas are charged standard risk costs.
[2] Includes the net gains/losses from hedge accounting, the net gains/losses from the fair value accounting for other financial instruments, the net gains/losses from securities and investments, and net other operating income

In the Export and project finance business area, other contributions to income include the result attributable to investments accounted for using the equity method totalling EUR 3 million. As at 31 December 2008, the Export and project finance business area's assets include EUR 8 million from investments accounted for using the equity method.

[3] Segment liabilities are not shown separately because, on the assumption that assets are fully refinanced, the analysis of segment liabilities to a large extent reflects the analysis of segment assets.

Segment reporting by business area for financial year 2007

	Investment finance Germany and Europe	Export and project finance	Promotion of developing countries	Shareholdings, treasury and services	Group centre	Reconciliation/ consolidation	KfW Group
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Net interest income	–109	468	119	177	1,099	1	1,755
Net commission income	72	26	96	12	0	4	209
Administrative expense	–246	–114	–153	–69	–20	–5	–607
Risk provisions for lending business[1]	–125	–135	–61	–6	0	–6,081	–6,409
Other contributions to income[2]	–124	3	148	–555	–64	–520	–1,112
Profit/loss from operating activities	**–532**	**249**	**147**	**–443**	**1,015**	**–6,601**	**–6,164**
Total assets	**228,934**	**43,710**	**22,726**	**63,964**	**10,806**	**–16,143**	**353,997**

[1] The business areas are charged standard risk costs.
[2] Includes the net gains/losses from hedge accounting, the net gains/losses from the fair value accounting for other financial instruments, the net gains/losses from securities and investments, and net other operating income

The Shareholdings, treasury and services business area included EUR -279 million, and the Export and project finance business area EUR 1 million, for the result of investments accounted for using the equity method under Other contributions to income. As at 31 December 2007, the Export and project finance business area's assets included EUR 5 million from investments accounted for using the equity method. Shares in IKB, which were still accounted for using the equity method as at 31 December 2006, were allocated to shares in held-for-sale affiliated entities as at 31 December 2007.

(36) SEGMENT REPORTING BY REGION

Net interest and commission income and segment assets are allocated on the basis of the clients' geographical location. The imputed return on equity included in net interest income and income/loss from group interest risk management are allocated to Germany. The remaining assets that are not attributable are also allocated to Germany.

The reconciliation/consolidation column includes the adjustments that were necessary to reconcile segment results with comprehensive income. In 2008 this relates in particular to the impact of the risk protection for IKB and the sale of KfW's interest in IKB on income.

Segment reporting by region for financial year 2008

	Germany	Euro area (excl. Germany)	Rest of Europe	North America	Latin America/ Caribbean	Asia/ Australia	Africa	Reconciliation/ consolidation	KfW Group
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Net interest income	1,212	168	161	75	71	110	34	174	2,006
Net commission income	80	9	8	4	10	41	44	21	218
Segment income	**1,292**	**178**	**169**	**79**	**81**	**152**	**78**	**195**	**2,224**
Total assets	**284,449**	**42,284**	**33,912**	**15,165**	**6,911**	**21,780**	**6,654**	**−16,329**	**394,826**

Segment reporting by region for financial year 2007

	Germany	Euro area (excl. Germany)	Rest of Europe	North America	Latin America/ Caribbean	Asia/ Australia	Africa	Reconciliation/ consolidation	KfW Group
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Net interest income	1,241	121	135	70	73	84	30	1	1,755
Net commission income	75	8	22	2	9	48	41	4	209
Segment income	**1,315**	**129**	**157**	**71**	**83**	**132**	**72**	**5**	**1,964**
Total assets	**249,707**	**43,178**	**30,091**	**11,558**	**6,286**	**22,664**	**6,656**	**−16,143**	**353,997**

NOTES TO THE BALANCE SHEET

(37) CASH RESERVES

Analysis of cash reserves by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Balances with central banks	99	26	73

(38) LOANS AND ADVANCES TO BANKS

Analysis of loans and advances to banks by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market transactions	5,065	11,109	–6,044
Loans and advances	210,357	187,391	22,965
Promissory note loans	0	424	–424
Other receivables	8,040	6,814	1,226
Total	223,462	205,738	17,723

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

Analysis of loans and advances to banks by liability type

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Direct loans to banks	78,002	64,161	13,841
On-lent customer loans with full underwriting borne by the on-lending bank	129,627	120,304	9,323
On-lent customer loans with partial underwriting borne by the on-lending bank	2,406	2,734	–328
Direct and on-lent subordinated loans	321	192	129
Total	210,357	187,391	22,965

(39) LOANS AND ADVANCES TO CUSTOMERS

Analysis of loans and advances to customers by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market transactions	100	121	−21
Loans and advances	103,368	98,414	4,955
Promissory note loans	19	36	−17
Other receivables	957	1,696	−739
Total	104,444	100,267	4,177

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

Analysis of loans and advances to customers by liability type

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Direct loans to customers	95,673	90,295	5,378
On-lent customer loans without underwriting borne by the on-lending bank	690	660	30
Direct and on-lent subordinated loans	7,006	7,459	−453
Total	103,368	98,414	4,955

(40) RISK PROVISIONS FOR LENDING BUSINESS

Analysis of risk provisions for lending business by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks	526	485	41
Loans and advances to customers	7,077	7,186	−108
Provisions for losses on loans and advances	**7,604**	**7,671**	**−67**
Provisions for contingent liabilities and irrevocable loan commitments	255	530	−275
Total	**7,859**	**8,201**	**−342**

Development of risk provisions for lending business in financial year 2008 by risk assessment type

	Individually assessed risks	Risks assessed on portfolio basis	Country-specific risks	Provisions for losses on loans and advances	Provisions (individual risks)	Provisions (portfolio risks)	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2008	**6,929**	**702**	**39**	**7,671**	**530**	**0**	**8,201**
Additions	1,953	259	18	2,230	128	33	2,391
Write-offs	−2,407	0	0	−2,407	−400	0	−2,807
Reversals	−76	−59	−13	−149	−32	-3	−184
Unwinding	−84	0	0	−84	0	0	−84
Exchange rate changes	347	−4	1	343	−1	0	342
Transfers	−118	119	−1	0	−46	46	0
As at 31 Dec. 2008	**6,544**	**1,016**	**44**	**7,604**	**180**	**75**	**7,859**

Country-specific risks include risks assessed on a portfolio basis.

In 2008, EUR 183 million (previous year: EUR 92 million) in interest income was not collected for impaired loans.

Development of risk provisions for lending business in financial year 2007 by risk assessment type

	Individually assessed risks	Risks assessed on portfolio basis	Country-specific risks	Provisions for losses on loans and advances	Provisions	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2007	1,417	501	46	1,964	65	2,029
Additions	6,232	254	12	6,498	477	6,975
Write-offs	–208	0	0	–208	0	–208
Reversals	–396	–45	–16	–457	–11	–468
Unwinding	–43	0	0	–43	0	–43
Exchange rate changes	–74	–8	–3	–84	–1	–85
Transfers	1	0	0	1	0	1
As at 31 Dec. 2007	6,929	702	39	7,671	530	8,201

(41) VALUE ADJUSTMENTS FROM MACRO FAIR VALUE HEDGE ACCOUNTING

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Value adjustments to assets designated for macro fair value hedge accounting	5,451	–1,295	6,745

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

(42) DERIVATIVES USED FOR HEDGE ACCOUNTING

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

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Micro fair value hedge accounting	12,391	4,229	8,162
Macro fair value hedge accounting	637	1,341	–704
Total	13,028	5,570	7,458

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

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Interest-related derivatives	11,132	3,994	7,138
Currency-related derivatives	1,896	1,576	320
Total	13,028	5,570	7,458

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

(43) OTHER DERIVATIVES

Analysis of other derivatives with positive fair values by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Interest-related derivatives	4,265	2,042	2,223
Currency-related derivatives	4,034	1,065	2,969
Equity/index-related derivatives	5	0	5
Credit derivatives	342	11	331
Other derivatives	62	48	14
Total	8,709	3,166	5,543

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

(44) SECURITIES AND INVESTMENTS

Analysis of securities and investments by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Bonds and other fixed-income securities	42,555	42,787	−231
Shares and other non-fixed income securities	433	1,526	−1,093
Equity investments	1,230	1,205	25
Shares in affiliated entities not included in the consolidated financial statements	2	18	−17
Financial instruments, total	**44,220**	**45,536**	**−1,316**
Investments accounted for using the equity method	8	5	3
Held-for-sale affiliated entities	0	204	−204
Total	**44,228**	**45,745**	**−1,517**

In 2007, the shares in held-for-sale affiliated entities included the shares in IKB that were sold to a strategic investor in 2008.

(45) PROPERTY, PLANT AND EQUIPMENT

Analysis of property, plant and equipment by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Land and buildings	605	577	27
Plant and equipment	48	41	7
Other property, plant and equipment	189	154	35
Property, plant and equipment for own use	**842**	**773**	**69**
Investment property	29	29	1
Total	**871**	**801**	**70**

Plant and equipment includes leased assets from finance leases that are required to be capitalised.

Payments in advance and work in progress are presented under Other property, plant and equipment.

The fair value of the investment property is its carrying amount.

Development in property, plant and equipment in financial year 2008

	Purchase/ production cost	Accumulated depreciation/ impairment losses	Net carrying amount
	EUR in millions	EUR in millions	EUR in millions
Carrying amount as at 1 Jan. 2008	**1,007**	**–206**	**801**
Additions/reversals of impairment losses	105	0	105
Disposals	–14	9	–5
Depreciation	–	–29	–29
Non-scheduled impairment losses	–	–1	–1
Carrying amount as at 31 Dec. 2008	**1,098**	**–226**	**871**

Development in property, plant and equipment in financial year 2007

	Purchase/ production cost	Accumulated depreciation/ impairment losses	Net carrying amount
	EUR in millions	EUR in millions	EUR in millions
Carrying amount as at 1 Jan. 2007	**979**	**-201**	**778**
Additions/reversals of impairment losses	67	0	67
Disposals	–38	26	–13
Depreciation	–	–29	–29
Non-scheduled impairment losses	–	–1	–1
Carrying amount as at 31 Dec. 2007	**1,007**	**–206**	**801**

(46) INTANGIBLE ASSETS

Analysis of intangible assets by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Software	55	33	23
Acquired software	*7*	*8*	*–1*
Internally generated software	*48*	*25*	*24*
Other intangible assets	6	36	–30
Total	**62**	**69**	**–8**

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

Development in intangible assets in financial year 2008

	Purchase/ production cost	Accumulated depreciation/ impairment losses	Net carrying amount
	EUR in millions	EUR in millions	EUR in millions
Carrying amount as at 1 Jan. 2008	**119**	**-50**	**69**
Additions/reversals of impairment losses	13	0	13
Disposals	–6	2	–4
Depreciation	–	–16	–16
Carrying amount as at 31 Dec. 2008	**126**	**–64**	**62**

Development in intangible assets in financial year 2007

	Purchase/ production cost	Accumulated depreciation/ impairment losses	Net carrying amount
	EUR in millions	EUR in millions	EUR in millions
Carrying amount as at 1 Jan. 2007	**98**	**–39**	**59**
Additions/reversals of impairment losses	22	0	22
Depreciation	–	–11	–11
Carrying amount as at 31 Dec. 2007	**119**	**–50**	**69**

(47) OTHER ASSETS

Analysis of other assets by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Other assets and receivables	704	226	478
Prepaid expenses and deferred charges	1,125	1,305	–180
Income tax assets	247	48	199
Total	2,077	1,579	497

Analysis of income tax assets by type

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Current income tax assets	59	13	46
Deferred income tax assets	188	35	152
Total	247	48	199

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

Deferred income tax assets mostly result from valuation differences in risk provisions for loans and advances to banks and customers, the formation of provisions for personnel and the valuation of derivatives.

Analysis of deferred tax assets by balance sheet item

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks and customers	75	4	71
Other derivatives (assets)	11	14	–3
Securities and investments	11	7	4
Property, plant and equipment	2	2	0
Intangible assets	23	0	23
Liabilities to banks and customers	5	0	5
Other derivatives (liabilities)	37	0	37
Provisions	18	6	12
Other balance sheet items	4	3	1
Tax loss carryforwards	2	0	2
Subtotal	**188**	**36**	**152**
Offset against deferred tax liabilities	0	–1	1
Total	**188**	**35**	**153**

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

(48) LIABILITIES TO BANKS

Analysis of liabilities to banks by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market transactions	1,885	455	1,430
Promissory note loans	5,968	8,941	–2,973
Other liabilities	3,936	3,971	–35
Total	11,788	13,366	–1,578

Liabilities from the PROMISE and PROVIDE securitisation platforms are included in Other liabilities.

(49) LIABILITIES TO CUSTOMERS

Analysis of liabilities to customers by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market transactions	5,374	4,217	1,158
Promissory note loans	12,092	16,487	–4,394
Other liabilities	13,839	16,418	–2,579
Total	31,306	37,121	–5,815

Liabilities from the PROMISE and PROVIDE securitisation platforms are included in Other liabilities. Credit-linked notes issued in this connection are included under Promissory note loans.

(50) CERTIFICATED LIABILITIES

Analysis of certificated liabilities by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Money-market issues	30,947	18,878	12,068
Bonds and notes	271,612	241,437	30,175
Total	302,559	260,315	42,244

(51) VALUE ADJUSTMENTS FROM MACRO FAIR VALUE HEDGE ACCOUNTING

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Value adjustments to liabilities under macro fair value hedge accounting	13	–423	436

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

(52) DERIVATIVES USED FOR HEDGE ACCOUNTING

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

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Micro fair value hedge accounting	3,745	2,410	1,335
Macro fair value hedge accounting	7,251	1,680	5,571
Total	10,997	4,091	6,906

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

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Interest-related derivatives	8,402	3,340	5,061
Currency-related derivatives	2,595	750	1,845
Total	10,997	4,091	6,906

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

(53) OTHER DERIVATIVES

Analysis of other derivatives with negative fair values by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Interest-related derivatives	1,522	1,153	368
Currency-related derivatives	17,410	14,240	3,170
Equity/index-related derivatives	0	35	–35
Credit derivatives	158	1,641	–1,483
Other derivatives	14	45	–31
Total	19,104	17,114	1,991

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

(54) PROVISIONS

Analysis of provisions by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Provisions for pensions and similar commitments	965	933	33
Provisions for credit risks	255	530	–275
Other provisions	508	82	426
Total	1,728	1,545	183

Development in provisions for pensions and similar commitments in financial year 2008

	Pension obligations	Early retirement	Partial retirement	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2008	919	4	10	933
Pension benefits paid	–32	–1	–2	–35
Additions	64	3	1	67
Service cost	*15*	*3*	*1*	*18*
Interest cost	*44*	*0*	*0*	*44*
Contributions by plan participants	*5*	*0*	*0*	*5*
Reversals	0	0	0	0
As at 31 Dec. 2008	951	5	9	965

The calculation of the pension entitlements which were vested as at the valuation reference date results in actuarial gains to be amortised of EUR 186 million (previous year: EUR 121 million).

The value of the pension commitments calculated based on the projected unit credit method was EUR 771 million (previous year: EUR 769 million) as at 31 December 2008.

Development in provisions for pensions and similar commitments in financial year 2007

	Pension obligations	Early retirement	Partial retirement	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2007	**875**	**3**	**11**	**889**
Pension benefits paid	–30	–1	–2	–33
Additions	74	1	1	76
Service cost	*27*	*1*	*1*	*29*
Interest cost	*42*	*0*	*0*	*42*
Contributions by plan participants	*5*	*0*	*0*	*5*
Reversals	0	0	0	0
As at 31 Dec. 2007	**919**	**4**	**10**	**933**

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

Actuarial assumptions in % p.a.

	31 Dec. 2008	31 Dec. 2007
Technical discount rate	5.70	5.50
Rate of salary increases	2.90	3.33
Rate of pension increases	2.30	2.30
Rate of staff turnover[1)]	2.00	none

[1)] The rate of staff turnover is taken into account in the calculations in accordance with an age table.

Development in other provisions in financial year 2008

	Obligations to employees	Other provisions	Total	Tax provisions
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2008	25	57	82	5
Additions	8	460	468	3
Used amounts	−10	−32	−41	0
Reversals	0	−1	−1	−5
As at 31 Dec. 2008	24	484	508	3

The obligations to employees show other long-term employee benefits including provisions for service anniversaries. Corresponding actuarial reports have been prepared for these obligations.

Development in other provisions in financial year 2007

	Obligations to employees	Other provisions	Total	Tax provisions
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
As at 1 Jan. 2007	24	18	42	10
Additions	7	56	63	5
Used amounts	−5	−16	−21	−6
Reversals	0	0	−1	−4
As at 31 Dec. 2007	25	57	82	5

(55) OTHER LIABILITIES

Analysis of other liabilities by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Other liabilities	2,161	2,123	37
Deferred income	48	52	−4
Income tax liabilities	55	10	45
Total	2,264	2,185	79

Analysis of income tax liabilities by type

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Current income tax liabilities	2	6	−4
Deferred income tax liabilities	53	4	49
Total	55	10	45

The current income tax liabilities in the reporting year are the result of additions to tax provisions within the KfW Group.

Deferred tax liabilities are mostly due to differences in value resulting from valuing derivatives and securities and investments at fair value.

Analysis of deferred tax liabilities by balance sheet item

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Other derivatives (assets)	37	2	35
Securities and investments	15	0	15
Provisions	0	3	−3
Other balance sheet items	1	0	1
Subtotal	53	5	48
Offset against deferred tax assets	0	−1	1
Total	53	4	49

(56) SUBORDINATED LIABILITIES

Analysis of subordinated liabilities by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Subordinated liabilities	3,247	3,747	−500

In relation to the acquisition of shares in Deutsche Telekom AG, Bonn, and Deutsche Post AG, Bonn, for the continuing privatisation of these companies, the Federal Government had granted KfW a subordinated loan of EUR 500 million. The loan, which carried an agreed interest rate of 3.9475 % p.a. was repaid on schedule on 11 November 2008.

As part of the new legislation governing ERP economic promotion as at 1 July 2007, the ERP Special Fund provided a subordinated loan to KfW in the amount of EUR 3,247 million. The loan consists of three tranches with different fixed interest periods. The period during which capital is tied up in all tranches ends as at 31 December 2017. Interest is charged on the tranches at an initial rate of 4.5 % p.a.

(57) EQUITY

Analysis of equity

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Subscribed capital	3,750	3,750	0
less outstanding contributions, not requested	450	450	0
Paid-in subscribed capital	**3,300**	**3,300**	**0**
Capital reserve	6,254	6,254	0
Promotional reserves from the ERP Special Fund	*4,650*	*4,650*	*0*
Reserve from the ERP Special Fund	848	804	43
Retained earnings	5,356	5,862	–507
Statutory reserve under Section 10 (2) KfW Law	*1,574*	*1,574*	*0*
Special reserve under Section 10 (3) KfW Law	*1,893*	*1,893*	*0*
Special reserve less the special loss account from provisioning pursuant to Section 17 (4) of the D-Mark Balance Sheet Law	*21*	*21*	*0*
Other retained earnings	*1,867*	*2,374*	*–507*
Fund for general banking risks	50	200	–150
Revaluation reserves	–551	–92	–460
Balance sheet profit/loss	–3,436	–1,393	–2,043
Total	11,820	14,936	–3,116

Equity forms the basis for the available financial resources which are matched against the economic capital requirements derived from internal steering.

For details, please refer to the risk report of the group management report.

NOTES ON FINANCIAL INSTRUMENTS

(58) GAINS AND LOSSES FROM FINANCIAL INSTRUMENTS BY VALUATION CATEGORY

The following tables show an analysis of the results from financial instruments included in the various income statement items organised by valuation category. The result from foreign currency translation is not included.

Gains and losses from financial instruments by valuation category in financial year 2008

	Net interest income	Risk provisions for lending business	Net commission income	Net gains/losses from hedge accounting	Net gains/losses from other financial instruments at fair value through profit or loss	Net gains/losses from securities and investments	Net other operating income	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Loans and receivables	14,394	−2,139	54	6,751	–	−160	1,530	20,431
Held-to-maturity investments	21	–	–	–	–	0	–	21
Other liabilities	−12,125	–	0	−12,085	–	–	21	−24,189
Available-for-sale financial assets	1,607	–	0	730	–	−395	–	1,942
Financial assets at fair value through profit or loss	451	–	219	–	−1,446	–	–	−776
Financial liabilities at fair value through profit or loss	−1,930	–	−166	–	−1,894	–	–	−3,990
Derivatives used for hedge accounting	914	–	–	4,295	–	–	–	5,209
Other derivatives	−1,281	–	9	–	1,845	–	–	573
Total	2,051	−2,139	116	−309	−1,495	−555	1,551	−780

Gains and losses from financial instruments by valuation category in financial year 2007

	Net interest income	Risk provisions for lending business	Net commission income	Net gains/ losses from hedge accounting	Net gains/ losses from other financial instruments at fair value through profit or loss	Net gains/ losses from securities and invest-ments	Net other operating income	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Loans and receivables	13,199	−6,409	42	−1,512	–	−18	1,170	6,472
Other liabilities	−11,359	–	0	-161	–	–	−1	−11,521
Available-for-sale financial assets	1,485	–	0	-107	–	−48	–	1,330
Financial assets at fair value through profit or loss	419	–	223	–	−237	–	–	405
Financial liabilities at fair value through profit or loss	−2,473	–	−166	–	624	–	–	−2,016
Derivatives used for hedge accounting	−484	–	–	1,853	–	–	–	1,369
Other derivatives	1,008	–	3	–	−2,237	–	–	−1,226
Total	**1,796**	**−6,409**	**102**	**73**	**−1,851**	**−67**	**1,169**	**−5,186**

(59) BALANCE SHEET FOR FINANCIAL INSTRUMENTS BY VALUATION CATEGORY

The following tables show the assets and liabilities from financial instruments included in the different balance sheet items organised by valuation category.

Financial assets by valuation category as at 31 December 2008

	Loans and advances to banks	Loans and advances to customers	Risk provisions for lending business	Value adjustments from macro fair value hedge accounting	Derivatives used for hedge accounting	Other derivatives	Securities and investments	Assets (financial instruments)	
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	(in %)
Loans and receivables	222,878	104,380	−7,604	5,451	–	–	5,290	330,396	84.3
Held-to-maturity investments	–	–	–	–	–	–	937	937	0.2
Available-for-sale financial assets	0	0	–	–	–	–	30,962	30,962	7.9
Financial assets at fair value through profit or loss	583	64	–	–	–	–	7,031	7,678	2.0
Derivatives used for hedge accounting	–	–	–	–	13,028	–	–	13,028	3.3
Other derivatives	–	–	–	–	–	8,709	–	8,709	2.2
Total	**223,462**	**104,444**	**−7,604**	**5,451**	**13,028**	**8,709**	**44,220**	**391,710**	**100.0**

Financial liabilities by valuation category as at 31 December 2008

	Liabilities to banks	Liabilities to customers	Certificated liabilities	Value adjustments from macro fair value hedge accounting	Derivatives used for hedge accounting	Other derivatives	Other liabilities	Subordinated liabilities	Liabilities (financial instruments)	
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	(in %)
Other financial liabilities	10,052	24,758	271,220	13	–	–	214	3,247	309,503	81.6
Financial liabilities at fair value through profit or loss	1,736	6,548	31,339	–	–	–	–	0	39,623	10.4
Derivatives used for hedge accounting	–	–	–	–	10,997	–	–	–	10,997	2.9
Other derivatives	–	–	–	–	–	19,104	–	–	19,104	5.0
Total	11,788	31,306	302,559	13	10,997	19,104	214	3,247	379,228	100.0

Financial assets by valuation category as at 31 December 2007

	Loans and advances to banks	Loans and advances to customers	Risk provisions for lending business	Value adjustments from macro fair value hedge accounting	Derivatives used for hedge accounting	Other derivatives	Securities and investments	Assets (financial instruments)	
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	(in %)
Loans and receivables	204,685	100,131	−7,671	−1,295	–	–	2,022	297,872	84.8
Available-for-sale financial assets	0	0	–	–	–	–	34,243	34,243	9.7
Financial assets at fair value through profit or loss	1,053	136	–	–	–	–	9,271	10,460	3.0
Derivatives used for hedge accounting	–	–	–	–	5,570	–	–	5,570	1.6
Other derivatives	–	–	–	–	–	3,166	–	3,166	0.9
Total	205,738	100,267	−7,671	−1,295	5,570	3,166	45,536	351,311	100.0

Financial liabilities by valuation category as at 31 December 2007

	Liabilities to banks	Liabilities to customers	Certificated liabilities	Value adjustments from macro fair value hedge accounting	Derivatives used for hedge accounting	Other derivatives	Other liabilities	Subordinated liabilities	Liabilities (financial instruments)	
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	(in %)
Other financial liabilities	12,141	26,604	226,906	−423	–	–	−10	3,747	268,964	80.2
Financial liabilities at fair value through profit or loss	1,226	10,518	33,409	–	–	–	–	0	45,152	13.5
Derivatives used for hedge accounting	–	–	–	–	4,091	–	–	–	4,091	1.2
Other derivatives	–	–	–	–	–	17,114	–	–	17,114	5.1
Total	13,366	37,121	260,315	−423	4,091	17,114	−10	3,747	335,320	100.0

(60) DISCLOSURES ON THE RECLASSIFICATION OF FINANCIAL ASSETS

With retroactive effect as at 1 July 2008, the KfW Group reclassified bonds and other fixed-income securities carried under Securities and investments (asset-backed securities) with a volume of EUR 2,750 million (fair value on the date of the retroactive reclassification) with anticipated interest and capital payments totalling EUR 2,856 million from the valuation category *"available-for-sale financial assets"* in the valuation category *"loans and receivables".*

The following table shows the carrying amounts of the reclassified financial assets and their fair values.

31 Dec. 2008	Carrying amount (balance sheet)	Fair value
	EUR in millions	EUR in millions
	2,450	2,256

The changes in the fair value of the reclassified financial assets in the reporting period through to the date of the retroactive reclassification in the amount of EUR –55 million were recorded directly in equity in the Revaluation reserve, which totalled EUR –106 million on the date of reclassification. The changes in fair value in the previous year that were recorded directly in equity in the Revaluation reserve totalled EUR –54 million.

For the reclassified financial assets a change of EUR –194 million in fair value would have been recorded directly in equity in the Revaluation reserve and net gains/losses from securities and investments of EUR –60 million from financial assets would have been recorded.

The net gains/losses from securities and investments include realised gains and losses from the sale and impairment of reclassified financial assets totalling EUR –60 million. Interest income from the reclassified securities is still received unchanged.

(61) DISCLOSURES ON THE VALUATION METHODS USED FOR FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE

The following tables show the financial instruments carried at fair value according to the valuation methods used.

In the case of bonds and other fixed-income securities, for which no prices were available from active markets at the end of 2008 as a result of the general crisis of confidence in the financial markets, the fair value is determined using valuation models (DCF methods). For this purpose, the risk-free interest rate and the counterparty default risk were identified using market data that can currently be observed, whereas market liquidity was estimated on the basis of market data that can currently be observed for reference bonds. The estimates are continuously reassessed during the valuation processes. This relates to securities with a nominal volume of EUR 31.1 billion which are allocated to the category "Valuation methods based on market data that can be observed (model)". Structured securities were not valuated on the basis of DCF methods.

Financial assets carried at fair value as at 31 December 2008

	Quoted market price	Valuation method based on observable market data (model)	Valuation method based on data that were, in part, not observable on the market	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks – recorded at fair value through profit or loss	172	262	150	583
Loans and advances to customers – recorded at fair value through profit or loss	0	18	46	64
Derivatives used for hedge accounting	0	13,028	0	13,028
Other derivatives	245	8,321	142	8,709
Securities and investments – available for sale	1,458	29,007	497	30,962
Securities and investments – recorded at fair value through profit or loss	3,085	3,626	320	7,031

Financial liabilities carried at fair value as at 31 December 2008

	Quoted market price	Valuation method based on observable market data (model)	Valuation method based on data that were, in part, not observable on the market	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks – recorded at fair value through profit or loss	75	1,510	152	1,736
Liabilities to customers – recorded at fair value through profit or loss	0	6,545	2	6,548
Certificated liabilities – recorded at fair value through profit or loss	516	30,823	0	31,339
Derivatives used for hedge accounting	0	10,997	0	10,997
Other derivatives	168	18,916	20	19,104

Financial assets carried at fair value as at 31 December 2007

	Quoted market price	Valuation method based on observable market data (model)	Valuation method based on data that were, in part, not observable on the market	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks – recorded at fair value through profit or loss	310	458	285	1,053
Loans and advances to customers – recorded at fair value through profit or loss	0	9	127	136
Derivatives used for hedge accounting	0	5,570	0	5,570
Other derivatives	93	3,025	47	3,166
Securities and investments – available for sale	33,393	394	456	34,243
Securities and investments – recorded at fair value through profit or loss	8,767	268	235	9,271

Financial liabilities carried at fair value as at 31 December 2007

	Quoted market price	Valuation method based on observable market data (model)	Valuation method based on data that were, in part, not observable on the market	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Liabilities to banks – recorded at fair value through profit or loss	10	930	286	1,226
Liabilities to customers – recorded at fair value through profit or loss	0	10,401	117	10,518
Certificated liabilities – recorded at fair value through profit or loss	18,386	15,023	0	33,409
Derivatives used for hedge accounting	0	4,091	0	4,091
Other derivatives	106	15,367	1,641	17,114

(62) FAIR VALUES OF FINANCIAL INSTRUMENTS

In the following tables, the fair values of financial instruments are compared to their carrying amounts. Existing provisions for losses on loans and advances are deducted from the carrying amounts of loans and advances to banks and customers. The carrying amount of the subordinated liabilities comprises pro-rata interest and value adjustments from micro fair value hedge accounting reported in the item Other liabilities.

Fair values of financial instruments as at 31 December 2008

	Fair value	Carrying amount (balance sheet)	Difference
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks	226,709	222,935	3,773
Loans and advances to customers	100,894	97,366	3,527
Value adjustments from macro fair value hedge accounting	–	5,451	–5,451
Derivatives used for hedge accounting	13,028	13,028	0
Other derivatives	8,709	8,709	0
Securities and investments	43,603	44,220	–617
Assets	**392,942**	**391,710**	**1,232**
Liabilities to banks	11,771	11,788	–17
Liabilities to customers	32,103	31,306	797
Certificated liabilities	298,533	302,559	–4,026
Value adjustments from macro fair value hedge accounting	–	13	–13
Derivatives used for hedge accounting	10,997	10,997	0
Other derivatives	19,104	19,104	0
Subordinated liabilities	3,414	3,461	–47
Liabilities	**375,921**	**379,228**	**–3,307**

Interest-related changes in value are also taken into consideration for calculating the fair value of the financial instruments. Accordingly, when the comparison is made with the carrying amount, it is necessary to take account of the (interest-related) changes in value resulting from the recognition of loans and advances and borrowings in macro fair value hedge accounting.

Fair values of financial instruments as at 31 December 2007

	Fair value	Carrying amount (balance sheet)	Difference
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks	204,041	205,253	−1,212
Loans and advances to customers	94,804	93,081	1,724
Value adjustments from macro fair value hedge accounting	–	−1,295	1,295
Derivatives used for hedge accounting	5,570	5,570	0
Other derivatives	3,166	3,166	0
Securities and investments	45,484	45,536	−52
Assets	**353,065**	**351,311**	**1,754**
Liabilities to banks	13,912	13,366	546
Liabilities to customers	37,328	37,121	206
Certificated liabilities	260,209	260,315	−106
Value adjustments from macro fair value hedge accounting	–	−423	423
Derivatives used for hedge accounting	4,091	4,091	0
Other derivatives	17,114	17,114	0
Subordinated liabilities	3,763	3,736	26
Liabilities	**336,415**	**335,320**	**1,095**

(63) ADDITIONAL DISCLOSURES ON LIABILITIES TO BANKS

Disclosures on liabilities to banks designated at fair value through profit or loss (fair value option)

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Carrying amount	269	260	9
Repayment at maturity	1,424	1,377	47
Difference	1,155	1,117	38

Of the difference between the repayment amount at maturity and the carrying amount, EUR 1,025 million (previous year: EUR 957 million) is attributable to borrowings for which the repayment amount builds up as a result of the capitalisation over time of interest due.

(64) ADDITIONAL DISCLOSURES ON LIABILITIES TO CUSTOMERS

Disclosures on liabilities to customers designated at fair value through profit or loss (fair value option)

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Carrying amount	6,542	10,397	−3,855
Repayment at maturity	10,212	11,470	−1,258
Difference	**3,670**	**1,073**	**2,597**

Of the difference between the repayment amount at maturity and the carrying amount, EUR 2,736 million (previous year: EUR 921 million) is attributable to borrowings for which the repayment amount builds up as a result of the capitalisation over time of interest due.

(65) ADDITIONAL DISCLOSURES ON CERTIFICATED LIABILITIES

Disclosures on certificated liabilities designated at fair value through profit or loss (fair value option)

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Carrying amount	31,339	33,409	−2,070
Repayment at maturity	49,558	53,015	−3,457
Difference	**18,219**	**19,606**	**−1,387**

Of the difference between the repayment amount at maturity and the carrying amount, EUR 17,793 million (previous year: EUR 19,269 million) is attributable to borrowings for which the repayment amount builds up as a result of the capitalisation over time of interest due.

(66) ADDITIONAL DISCLOSURES ON DERIVATIVES

Analysis of derivatives by counterparty

	Nominal value		Fair value 31 Dec. 2008		Fair value 31 Dec. 2007	
	31 Dec. 2008	31 Dec. 2007	positive	negative	positive	negative
	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions	EUR in millions
OECD banks	504,224	427,549	19,070	27,436	6,967	18,913
Non-OECD banks	62	0	0	9	0	0
Other counterparties	54,639	75,150	2,318	2,655	1,721	2,212
Public sector	582	0	291	1	0	0
Total	**559,507**	**502,698**	**21,679**	**30,101**	**8,688**	**21,125**

The analysis includes stand-alone financial and credit derivatives which are presented in the items Derivatives used for hedge accounting and Other derivatives.

(67) DISCLOSURES ON REPURCHASE AGREEMENTS

Disclosures on repo transactions

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Carrying amount of securities sold under repo transactions that continue to be recognised in securities and investments	316	846	–531
Liabilities to banks (countervalue)	319	838	–518

The KfW Group does not have any collateral under repo transactions, which can be resold or repledged at any time, without the party furnishing security having defaulted.

In the previous year, the KfW Group received collateral under repo transactions, which can be resold or repledged at any time, without the party furnishing security having defaulted. The fair value of this collateral totalled EUR 17 million. The securities have been neither resold nor repledged.

Disclosures on reverse repo transactions

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks (countervalue)	7,052	5,724	1,328

Securities purchased under reverse repos are not recognised.

The KfW Group has not pledged any collateral under reverse repos which can be resold or repledged at any time, without the party furnishing security having defaulted.

OTHER NOTES

(68) CONTINGENT LIABILITIES AND IRREVOCABLE LOAN COMMITMENTS

Analysis of contingent liabilities by class

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Contingent liabilities from financial guarantees	5,996	5,850	146
Performance guarantees	55	48	7
Other contingent liabilities	232	156	76
Total	**6,283**	**6,054**	**230**

Other contingent liabilities include payment obligations attributable to investments which are not fully paid up and do not have to be consolidated.

Volume of irrevocable loan commitments

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Irrevocable loan commitments	35,390	38,462	−3,072

The irrevocable loan commitments are mainly attributable to domestic promotional lending business.

(69) TRUST ACTIVITIES AND ADMINISTERED LOANS

Analysis of trust activities by class (transactions in the bank's own name but for third party accounts)

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Loans and advances to banks	2,054	2,262	–208
Loans and advances to customers	15,478	16,178	–700
Securities and investments	48	42	6
Assets held in trust	**17,580**	**18,482**	**–902**
Liabilities to banks	98	49	48
Liabilities to customers	17,483	18,433	–950
Liabilities held in trust	**17,580**	**18,482**	**–902**

EUR 15,232 million (previous year: EUR 15,956 million) of the assets held in trust are attributable to the promotion of developing countries business area.

Volume of administered loans granted (loans in the name and for the account of third parties)

	31 Dec. 2008	31 Dec. 2007	Change
	EUR in millions	EUR in millions	EUR in millions
Administered loans	5,142	4,280	862

(70) LEASING TRANSACTIONS AS LESSEE

Disclosures on lessee agreements as at 31 December 2008

	Due within one year	Due in between one and five years	Due in more than five years	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Finance leases				
Future minimum leasing payments	6	14	0	20
Unearned finance income after remaining maturities	0	1	0	1
Present value of future minimum leasing payments	6	14	0	20
Operating leases				
Future minimum leasing payments	13	16	0	29

Disclosures on lessee agreements as at 31 December 2007

	Due within one year	Due in between one and five years	Due in more than five years	Total
	EUR in millions	EUR in millions	EUR in millions	EUR in millions
Finance leases				
Future minimum leasing payments	4	5	0	9
Present value of future minimum leasing payments	4	4	0	8
Operating leases				
Future minimum leasing payments	12	13	0	25

(71) AVERAGE NUMBER OF EMPLOYEES DURING THE FINANCIAL YEAR

	2008	2007	Change
Employees (female)	2,076	1,941	135
Employees (male)	2,152	2,062	90
Total	**4,228**	**4,003**	**225**
Staff not covered by collective agreements	*2,858*	*2,653*	*205*
Staff covered by collective agreements	*1,370*	*1,350*	*20*

The average number of employees including temporary staff but without trainees is calculated based on the levels at the end of each quarter.

(72) COMPENSATION AND LOANS TO MEMBERS OF THE MANAGING BOARD AND BOARD OF SUPERVISORY DIRECTORS OF KFW

Compensation to members of the Managing Board and Board of Supervisory Directors

	2008	2007	Change
	EUR in thousands	EUR in thousands	EUR in thousands
Members of the Managing Board	2,653	2,935	–283
Members of the Board of Supervisory Directors	218	204	14
Former members of the Managing Board and their surviving dependents	3,617	3,639	–22
Total	**6,487**	**6,778**	**–291**

The following table provides details on the compensation paid to the Managing Board in financial year 2008:

Annual compensation 2008

	Monetary compensation	Other compensation[1]	Total
	EUR in thousands	EUR in thousands	EUR in thousands
Dr. Ulrich Schröder (CEO) (since 1 Sept. 2008)	239	20	259
Dr. Günther Bräunig[2]	137	3	140
Dr. Peter Fleischer (until 29 Sept. 2008)	388	26	414
Dr. Norbert Kloppenburg	470	44	514
Wolfgang Kroh	470	20	490
Detlef Leinberger (until 29 Sept. 2008)	388	27	415
Ingrid Matthäus-Maier (until 30 Sept. 2008)	388	34	422
Total	2,478	175	2,653

[1] Other compensation mostly comprises the use of company cars and insurance premiums and the taxes and social security payments on these amounts.
[2] Resumption of tasks as an active member of the Managing Board on 1 November 2008.

The compensation to the members of the Board of Supervisory Directors is composed as follows:

- Compensation for the Chairman of the Board of Supervisory Directors: EUR 13 thousand p.a. (previous year: EUR 13 thousand)
- Compensation for the Deputy Chairman: EUR 10 thousand p.a. (previous year: EUR 10 thousand)
- Compensation for the members of the Board of Supervisory Directors: EUR 5 thousand p.a. (previous year: EUR 5 thousand)
- Compensation for membership of the Loan Approval, Executive and Audit Committees: EUR 0.6 thousand p.a. (previous year: EUR 0.6 thousand)

Members who join during the year receive their compensation on a pro-rata basis.

Provisions in the amount of EUR 41,052 thousand had been set up at the end of the financial year for pension obligations for former members of the Managing Board and their surviving dependents (previous year: EUR 41,311 thousand). The ongoing compensation totalled EUR 3,617 thousand.

The total amount of loans granted to members of the Managing Board was EUR 104 thousand as at year-end (previous year: EUR 187 thousand). Interest rates were between 2% p.a. and 5% p.a.

(73) RELATED PARTY DISCLOSURES

The KfW Group's related parties, in accordance with IAS 24, include as legal persons the consolidated subsidiaries, the non-consolidated affiliated entities, jointly controlled entities and associates.

Natural persons considered related parties in accordance with IAS 24 include the members of the Managing Board and the Directors of KfW (and their close family members), the members of the Board of Supervisory Directors of KfW, and the executive bodies of its consolidated subsidiaries.

KfW is a public law institution in which the Federal Republic of Germany (Federal Government) holds an 80% and the Federal States a 20% stake. Any transactions with the Federal Government and the Federal States in the reporting year are covered by the rules and regulations set forth in the KfW Law.

The business relationships between KfW and its affiliates and other related parties are primarily determined by the rules set out in the KfW Law. The conditions and prices are in line with standard market conditions and are concluded in accordance with KfW's general conditions for its loan programs open to the general public.

(74) AUDITOR'S FEES

	2008	2007	Change
	EUR in thousands	EUR in thousands	EUR in thousands
Audit	2,390	1,718	672
Other audit-related and valuation services	1,569	1,798	−229
Tax advisory services	41	5	36
Other services	2,014	2,651	−637
Total	6,014	6,172	−158

(75) DISCLOSURES ON SHAREHOLDINGS

Subsidiaries included in the consolidated financial statements

Name/registered office	Capital share	Equity (IFRS) as at 31 Dec. 2008
	%	EUR in millions
KfW IPEX-Bank GmbH, Frankfurt (www.kfw-ipex-bank.de)	100	2,670
KfW IPEX-Beteiligungsholding GmbH, Frankfurt	100	1,874
DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH, Cologne (www.deginvest.de)	100	1,583
tbg – Technologie-Beteiligungs-Gesellschaft mbH, Bonn	100	388
KfW Beteiligungsholding GmbH, Bonn	100	242
Finanzierungs- und Beratungsgesellschaft mbH, Berlin	100	32
KfW International Finance Inc., Delaware, USA	100	0

KfW IPEX-Bank GmbH was included in the KfW Group for the first time after it was legally separated as at 1 January 2008. This separation is due to the understanding reached between the Federal Republic of Germany and the European Commission on the orientation of legally independent promotional banks in Germany and the German Promotional Bank Restructuring Act *(Förderbankenneustrukturierungsgesetz)*. As a result, KfW contributed what had, until then, been a legally dependent part of its operations to a subsidiary. The separation included business activities in the export and project finance segment, which compete with other financial services companies.

Investments included in the consolidated financial statements using the equity method

Name/registered office	Capital share	Equity (IFRS) as at 31 Dec. 2008
	%	EUR in millions
Movesta Lease and Finance GmbH, Düsseldorf	50	16
Railpool Holding GmbH & Co. KG, Munich	50	–7

Movesta Lease and Finance GmbH, Düsseldorf, operates in the field of leasing and the project development and management of real estate and infrastructure financing. Railpool Holding GmbH & Co. KG, Munich, covers all of the key elements in providing leasing for locomotives and other railway vehicles via various operating companies. Details of the areas of operation as well as a summary of financial information can be found on the respective company's website (www.movesta.de or www.railpool.eu).

Special funds included in the consolidated financial statements

Name	Capital share	Fund volume (IFRS) as at 31 Dec. 2008
	%	EUR in millions
Frankfurt I	100	1,168
Frankfurt II	100	1,497
Atlantik	100	523
München I	100	1,053
München II	100	1,144
Cologne	100	288

The investments held in the special security funds are mostly part of KfW Group's strategic asset management. In connection with the IKB sale, KfW acquired portfolio investments from IKB in the form of structured securities and credit derivatives. These were contributed, in part, to the newly established Cologne special fund.

Affiliated entities not included in the consolidated financial statements

Six affiliated entities, eight associates, and four jointly controlled entities of minor significance to the presentation of the net assets, financial position and results of operations of the KfW Group have not been consolidated; instead, they are shown in the balance sheet under Securities and investments or Loans and advances to customers and are measured in accordance with the relevant rules. These companies account for 0.1 % of KfW Group's balance sheet total.

As part of the risk protection for IKB, KfW has made liquidity lines available to various special purpose entities of the "Rhineland Funding Capital Corporation, New York, USA" conduit. These lines were drawn down successively through to 28 January 2008. The provision of the liquidity lines has not resulted in any obligation for KfW to consolidate the special purpose entities because KfW did not exercise any control over the SPEs within the meaning of SIC-12. KfW did not obtain any power of disposal over the SPEs or over the assets in the SPEs by providing the liquidity lines. The restructuring of the "Rhineland Funding Capital Corporation, New York, USA" conduit that had been scheduled for financial year 2008 did not take place as a result of the large number of contractual partners who had to agree thereto. KfW continued to serve solely as provider of debt capital for the conduit and did not possess any decision-making powers over the assets of the SPEs or over the SPEs themselves.

A full listing of shareholdings has been published in the electronic Federal Gazette *(Bundesanzeiger)*.

STATEMENT BY THE MANAGING BOARD

The Managing Board of KfW is responsible for the presentation of the consolidated financial statements and the group management report. These comply with the requirements of the International Financial Reporting Standards (IFRS), the International Accounting Standards (IAS) and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and of the Standing Interpretations Committee (SIC) as applicable in the European Union. They are in accordance with the additional requirements of German commercial law pursuant to Section 315a of the German Commercial Code *(Handelsgesetzbuch/HGB)*.

To the best of our knowledge, and in accordance with the applicable accounting principles, the consolidated financial statements give a true and fair view of the net assets, financial position and results of operations of the KfW Group, and the group management report includes a fair review of the development and performance of the business and the position of the KfW Group, together with a description of the principal risks and rewards associated with the expected development of the KfW Group.

Dr Ulrich Schröder
(Chairman of the Managing Board)

Dr Günther Bräunig

Dr Norbert Kloppenburg

Wolfgang Kroh

Frankfurt am Main, 29 January 2009
KfW

AUDITOR'S REPORT REPRINT

Based on the final results of our audit we issued the following unqualified auditor's report dated 9 March 2009:

"Auditor's report

We have audited the consolidated financial statements prepared by KfW, Frankfurt am Main, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from 1 January to 31 December 2008. The preparation of the consolidated financial statements and the group management report in accordance with the IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § (Article) 315a Abs. (paragraph) 1 HGB ("Handelsgesetzbuch": German Commercial Code) and supplementary provisions of the Law concerning KfW (KfW Law) and By-Laws of KfW are the responsibility of KfW's Managing Board. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of the entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the Company´s Managing Board, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit the consolidated financial statements comply with the IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315 a Abs. 1 HGB and supplementary provisions of the KfW Law and By-Laws of KfW and give a true and fair view of the net assets, financial position and results of operations of the KfW Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development".

Frankfurt am Main, 9 March 2009
PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Christoph Theobald
Wirtschaftsprüfer
(German Public Auditor)

Peter Flick
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