



Frankfurt School  
FS-UNEP Collaborating Centre  
for Climate & Sustainable Energy Finance

# National Promotional Banks as Active Financiers

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## The Case of KfW

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# KfW as an Active Financier

We argue that:

- KfW's success extends **beyond providing financing** for projects
- KfW substantially **enlarges the policy space** of the German Government
- Reasons go beyond the official task of ameliorating market failures:
  - KfW design characteristics
    - Market // Government; Access to Regulators; Technical expertise
  - KfW's dynamic engagement with the government at all stages of policy

We illustrate this through:

- Using the heuristic of the policy cycle
- Applying it to two cases: (i) greening the economy; (ii) financial crisis

# KfW – Design Characteristics

## **Market actor with economic objective & government backing**

- Designed to compensate for market failures and promote socially-beneficial projects that are underfunded
- Financially backed by the German government
- Cooperates with commercial banks

## **Access to bureaucrats and regulators**

- Can achieve policy synergy with government through “carrot and stick” strategy
- Provides essential market and on-the-ground knowledge to policymakers

## **Technical expertise**

- In-house experts: economic & sectoral & technological knowledge
- Serves as an advisor to new economic and promotional legislation

# The Policy Cycle

**Key Assumption: KfW possesses agency and endeavors to influence the context in which it operates**

## **Agenda setting**

- Placing an issue on the agenda

## **Negotiation**

- Drafting & negotiating the parameters of how a policy will be implemented

## **Implementation**

- Implementing the policy for economic actors, e.g. firms, private households (or within other regulatory targets)

## **Monitoring and enforcement**

- Monitoring compliance with targets
- Responding to non-compliance

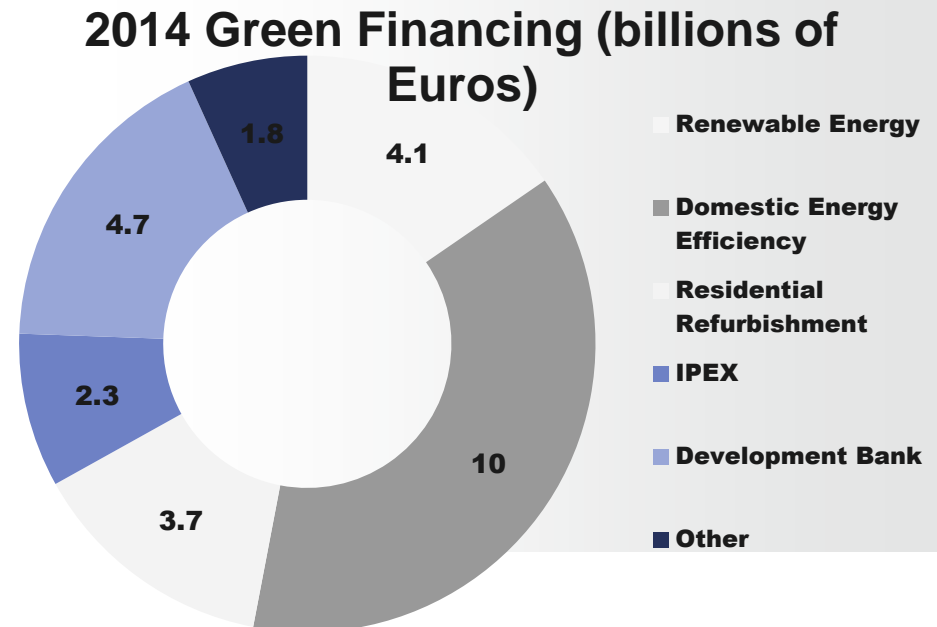
# Case 1: Green Financing – A KfW Focus Topic

Since the early 1980s, KfW has been an active promoter of green technology—in efficiency, renewables, and nat. resource protection

In 2015, approximately 37% of total lending (€26.6 billion) went to environment-related projects

KfW aims to provide subsidized financing to achieve the German government's ambitious *Energiewende* initiatives

In 2015, KfW issued €39.5 billion in Green Bonds



# Case 1: Housing Efficiency

## Agenda setting & negotiation

- History of housing promotion: post WW, re-unification, oil-crisis
- (Co-operation with research institutions)

## Implementation

- KfW - “Efficiency-house-standard”
- Parallel approach:
  - *informing (KfW standard – based on building code)*
  - *promoting (subsidies based on standard)*
  - *challenging (building code)*

## Monitoring & enforcement

- GDR “Plattenbauten” & “Altschuldenhilfe”
- Supporting empirical research, e.g. about reasons NOT to engage in energy efficiency measures



# Case 1: Renewable Energy

## Implementation

- Keeping “external” interest constant despite rising rates in the early 80s
- Helped to establish the cooperation between gov. and KfW to lend at rates below the market

## Monitoring & enforcement

- KfW contact point collecting market-feedback: financing electricity storage
- Programme “Renewables Standard” adapted accordingly

## Agenda setting

- Use of new expertise in “corporate lending” from the stimulus programme in a “green economy” context

# Case 2: 2008 Financial Crisis and Aftermath

Exemplifies the double-edged sword of being a government agency

Responsible for assets under stress / mitigating economic harm

- KfW had been asked to buy share packages. In 2007, KfW assumed 70% of the losses from the total risk protection, and provided liquidity guarantees, resulting in the raising of KfW's balance sheet risk provisions to €4.95 billion. Annual net loss >€ 6bn

Provided an important countercyclical role

- Implemented a multiyear economic stimulus plan for German enterprises (€40 billion) and for energy efficiency and infrastructure measures (€10 billion)
- Minimal losses from the Domestic Promotional Bank/SME Bank
- KfW estimated that by 2012, its financial activities had saved 370,000 jobs
- Increased European promotional activities





# Case 2: 2008 Financial Crisis and Aftermath

## Agenda setting

- KfW sought an early role to shape the securitization programme
- Helping its promotional mandate / be a modern commercial bank

## Negotiation

- Countering the volatility of the financial system
- KfW to make sure it does not take excessive losses and helps design programs that ensure it maintains its AAA credit rating

## Implementation

- “Deutschlandfonds” (lending directly and indirectly to SMEs etc. )
- Embeddedness w/commercial banks helped distinguish insolvent firms

## Monitoring and enforcement

- KfW responsible for monitoring/enforcing of the programmes
- Expanding the SME financing effort to the European level: Founded European National Securitization Initiative (ENSI) with EIF in 2016



# Replicability of KfW?

KfW supporting other NDBs & partnering with other NDBs

To what extent is KfW's model exportable to other contexts?

We offer a few cautionary notes:

## **Requires a strong legal framework**

- Necessary to avoid investment being made for political—rather than economic or social—objectives
- Reduces opportunity for corruption

## **Requires a functioning financial sector**

- KfW heavily relies on financial markets to both raise and distribute capital; it cannot serve as a replacement for financial market development

## **Requires technical capacity**

- Determining a “market failure” is inherently difficult, and implementing projects across sectors is information-intensive
- Needs policy clarity from the government: which areas are the most important



# THANK YOU !

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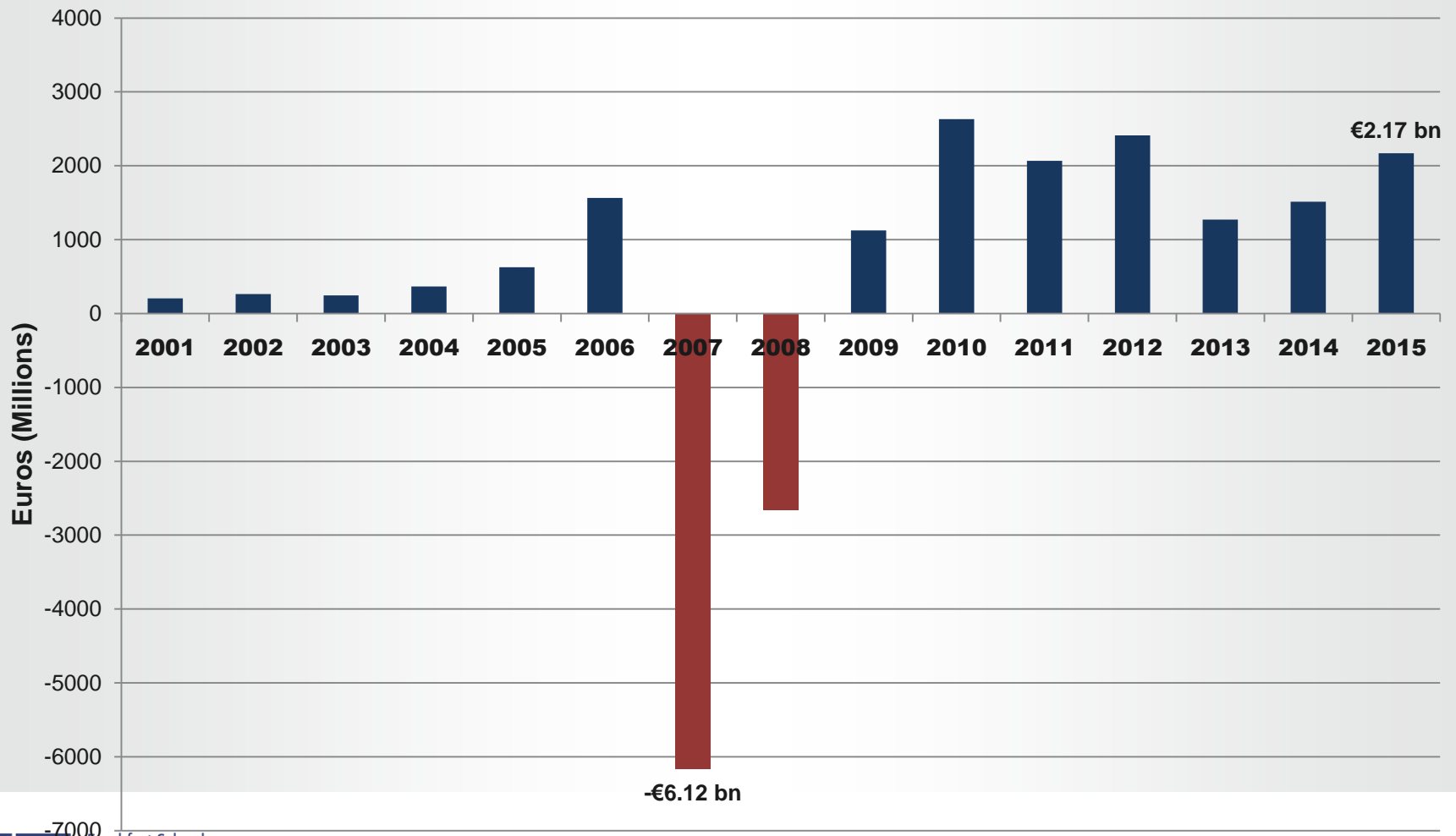


# What is KfW?

- KfW is Germany's state-owned national promotional bank (owned: 80% federal gov, 20% Länder)
- As of 2015, it is the 2<sup>nd</sup> largest NPB in the world (following the China Development Bank) in terms of total assets
- Mission: to support the German government implement or expand policies that would otherwise go unfunded by the private market
- Largest programs in green technology, energy efficiency, SME financing, and export financing



# Consolidated Profit (EUR millions): 2001-2015



# KfW in Historical Perspective (check)

**1948:** KfW founded with Marshall Plan funds (begins in 1949)

**1950:** First export financing program

**1952:** First SME program

**1962:** Adopts responsibility for Germany's international cooperation

**1971:** KfW launches the SME Programme, the first self-financing program for domestic investment

**1984:** First explicit environmental program

**1987:** First foreign currency issue (USD)

**1990:** Invests in former GDR, then Central/Eastern Europe

**2000:** First securitization program

**2002:** Restructuring after compromise with the European Commission

**2004-2016:** Variety of new financing programs for student loans, environmental protection, SMEs, and energy efficiency



# Components of KfW: International

## KfW IPEX-Bank

- Total 2015 Lending Volume: €20.2 billion
- Objective: Provides financing for German exports and foreign investments in Germany
- Operates on a commercial basis and competes with private banks



## KfW Entwicklungsbank (KfW Development Bank)

- Total 2015 Lending Volume: €6.7 billion
- Objective: Provides financing to governments, public enterprises, and commercial banks in developing countries. Use market rate loans, subsidized loans/blended finance, and concessional aid and grants.
- Particularly active in SME financing and microfinance

## DEG (German Investment and Development Corporation)

Total 2015 Lending Volume: €1.1 billion

Objective: Promotes the development of private enterprise in developing countries



# SME Programs I

SMEs are disadvantaged because they (1) lack direct access to capital markets, (2) weak bargaining position, and (3) inability to diversify risk

- KfW provides: long-term loans, equity investments, and consulting

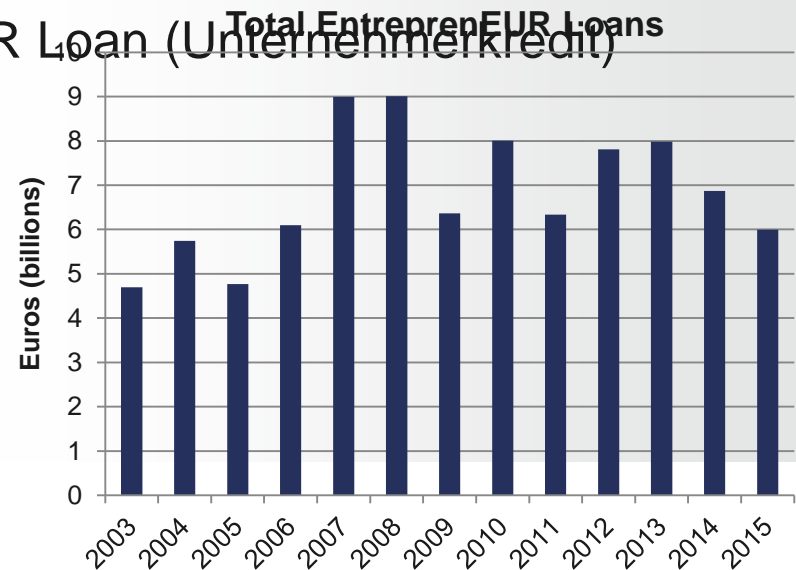
In 2015, 40% of new domestic commitments went to SMEs

Largest program is the KfW EntrepreneurEUR Loan (Unternehmerkredit)

- Started in 2003
- Targets SMEs
- Issued over 200k individual loans
- In 2007, KfW assumed 50% of the risk from the commercial

on-lending banks

- Max €25 million per project





# SME Programs II

## Entrepreneur Loan Plus

Designed to promote improved financing for innovative SMEs

- Up to €7.5 million per project
- Can finance up to 100% of eligible investment costs
- Interest rates from 1%
- Lasts 7 years in total, up to 5 years for working capital
- Firms must prove innovativeness (e.g., received a patent or EU/national research grant)

Risk-sharing : KfW and the EIB each bear 25% (total of 50%) of the the risk from the on-lending commercial bank

# New Directions for KfW

KfW has highlighted three focus areas for the future:

- Climate change
- Demographic change
- Globalization and technical progress

Further development of new financial instruments

- Securitization
- New structured funds for climate change/SMEs

Increasing coordination with EIB and European NPBs

- Growth of collaboration in joint funds

- Participation in the Juncker Plan

# Structure and Governance

KfW is composed of five primary units:

- Förderbank (Domestic Promotional Bank)
- Mittelstandsbank (SME Bank)
- IPEX (Export Bank)
- Entwicklungsbank (Development Bank)
- DEG (Private Development Finance Bank)



Ownership: 80% Federal Government, 20% State Governments

All existing and future obligations are fully guaranteed by the Federal Government (KWG, Article 1a)

Supervised by the Ministry of Finance and, as of 2013, BaFin (German

# Operations

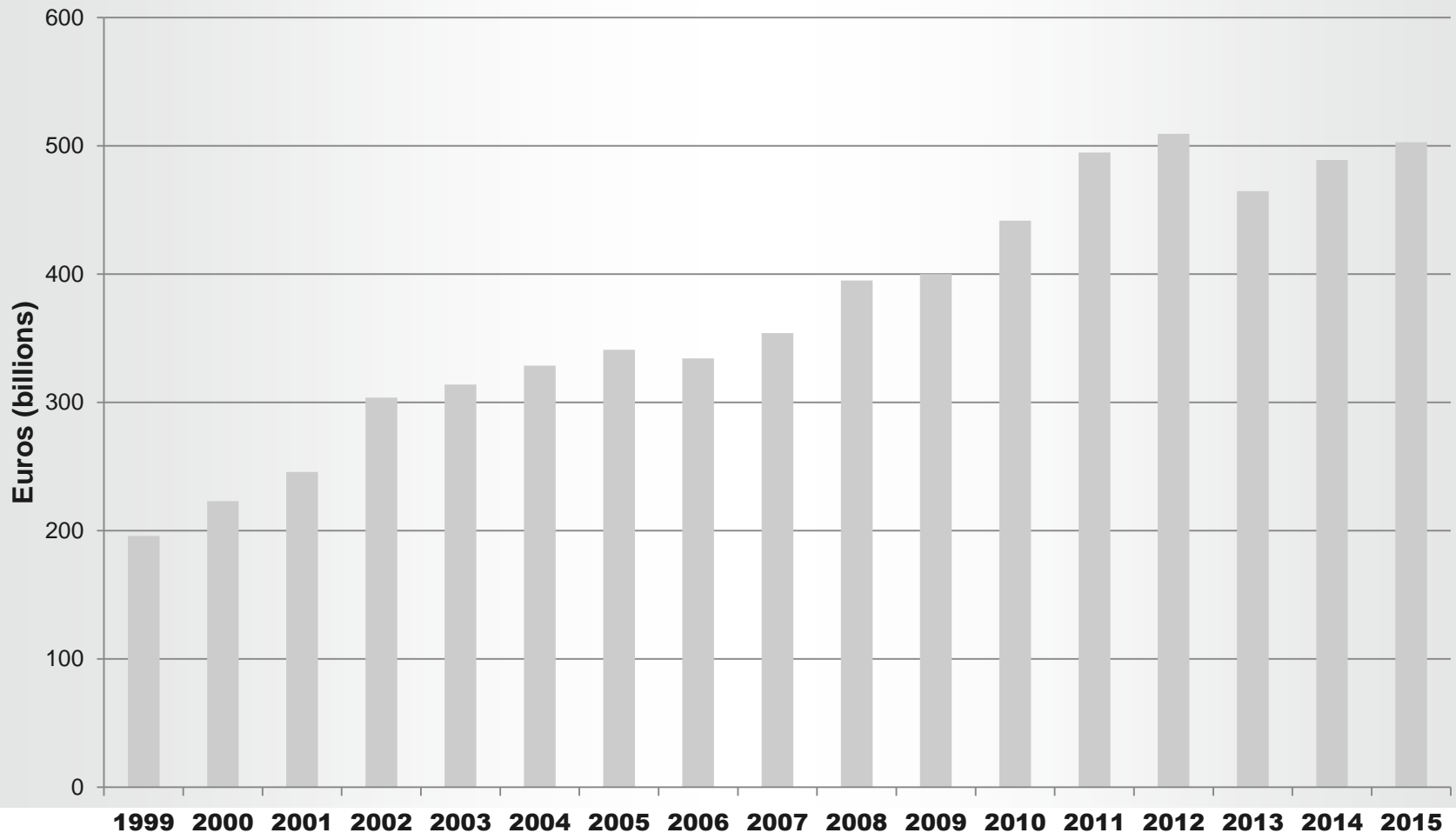
In 2015, KfW had assets of **€503 billion** and issued **€79.3 billion** in new promotional business volume

To fund its promotional business, KfW raised **€62.6 billion** on the international capital market

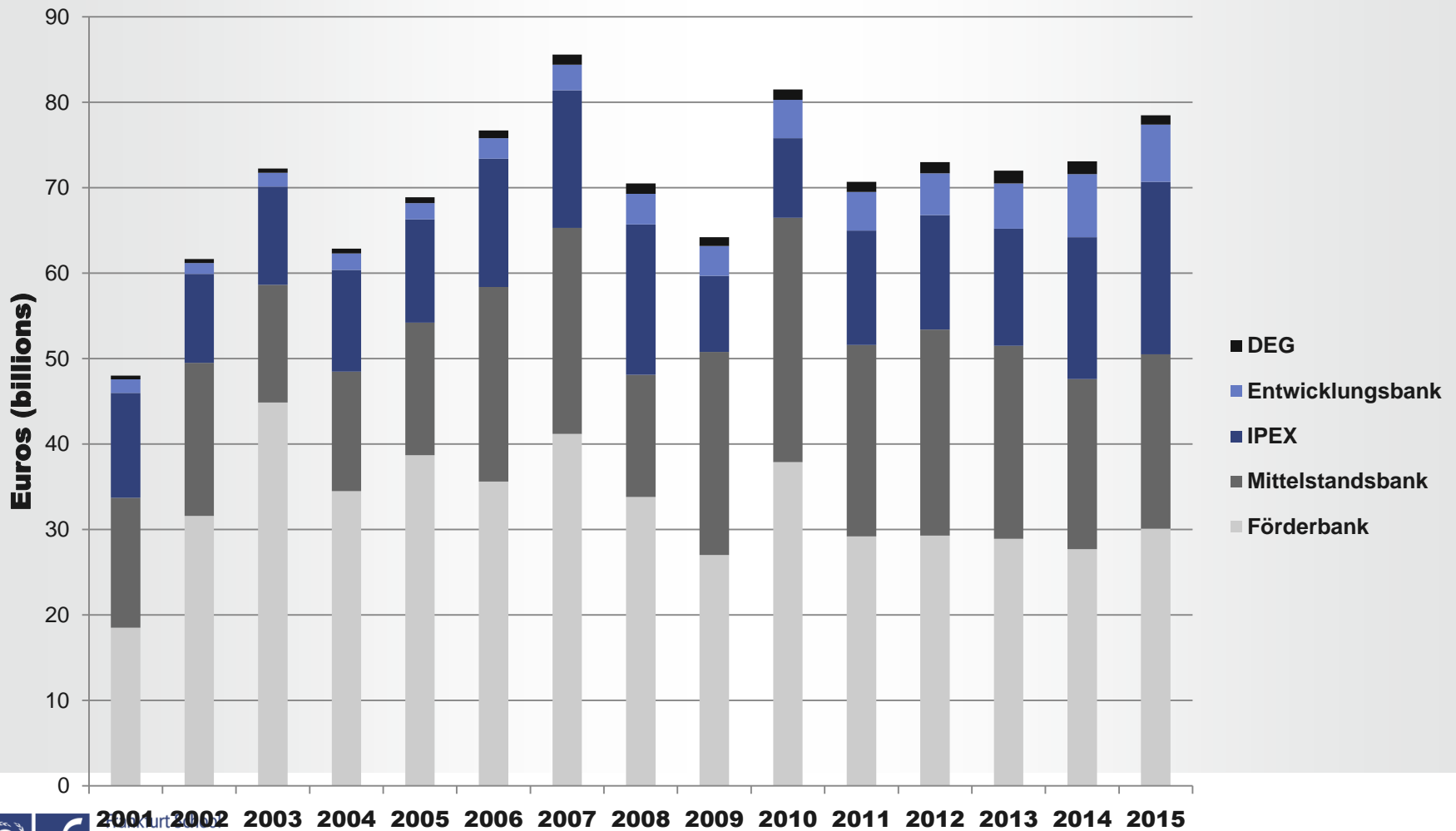
- USD (45%), EUR (37%), GBP (7%), AUD (4%), JPY (2%), others (5%)
- Issues benchmark bonds, public bonds, and private placements
- Issued first negative interest rate benchmark bond in Oct 2015

Primarily on-lends through domestic German commercial banks, takes no deposits

# Total Assets (EUR billions): 1999-2015



# New Funding by Unit (EUR billions)



# Components of KfW: Domestic I

## KfW Förderbank (KfW Promotional Bank)

Total 2015 Lending Volume: €30.1 billion

- KfW's largest "unit," comprised of municipal and private client bank/credit institutions

### Housing Investment

- Energy-efficiency loans
- Home Ownership Programme

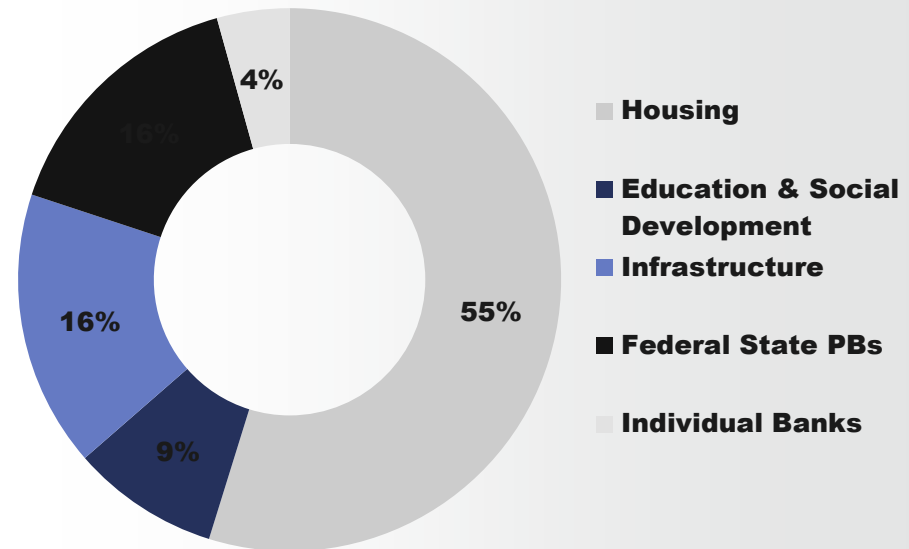
### Education/Social Development

- Student loans
- Continuing professional development

### Infrastructure

- Loans for municipal projects
- Social infrastructure (refugee housing)

2015 Promotional Bank Breakdown



# Components of KfW: Domestic II

## KfW Mittelstandsbank (KfW SME Bank)

Total 2015 Lending Volume: €20.4 billion

Projects focus on SMEs, innovation, and environment

### SME Financing:

- EntreprenEUR Loan (investments in SMEs)
- ERP loans for start-ups and young companies

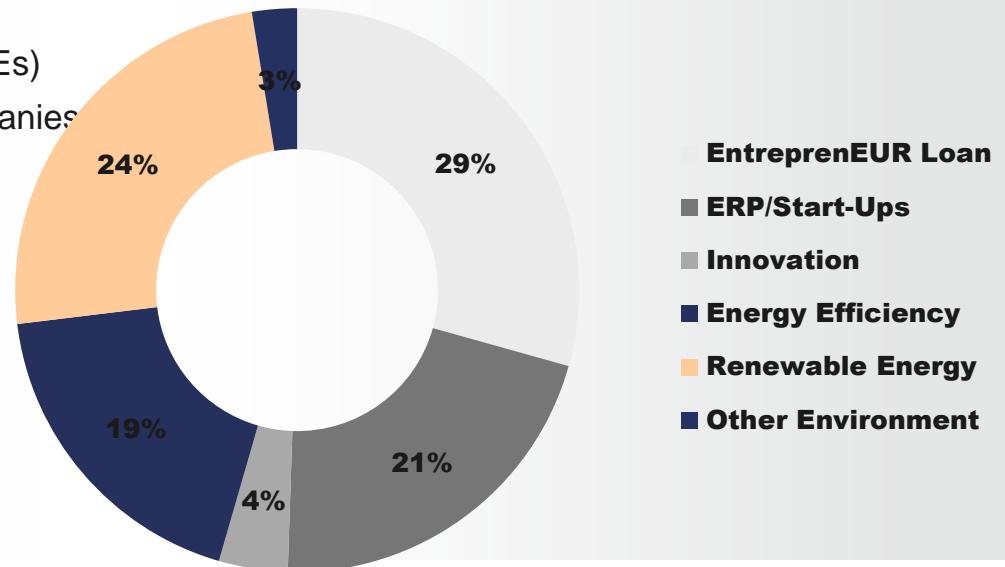
### Innovation:

- ERP Innovation Programme (R&D)
- EntreprenEUR Loan Plus (investments in innovative SMEs)

### Environmental:

- Environmental protection
- Energy efficiency projects
- Renewable energy projects

2015 SME Bank Breakdown





# Remarks regarding „New Institutionalism“

[XX I intend to leave this out XX]

- .. As the conference appears rather applied

