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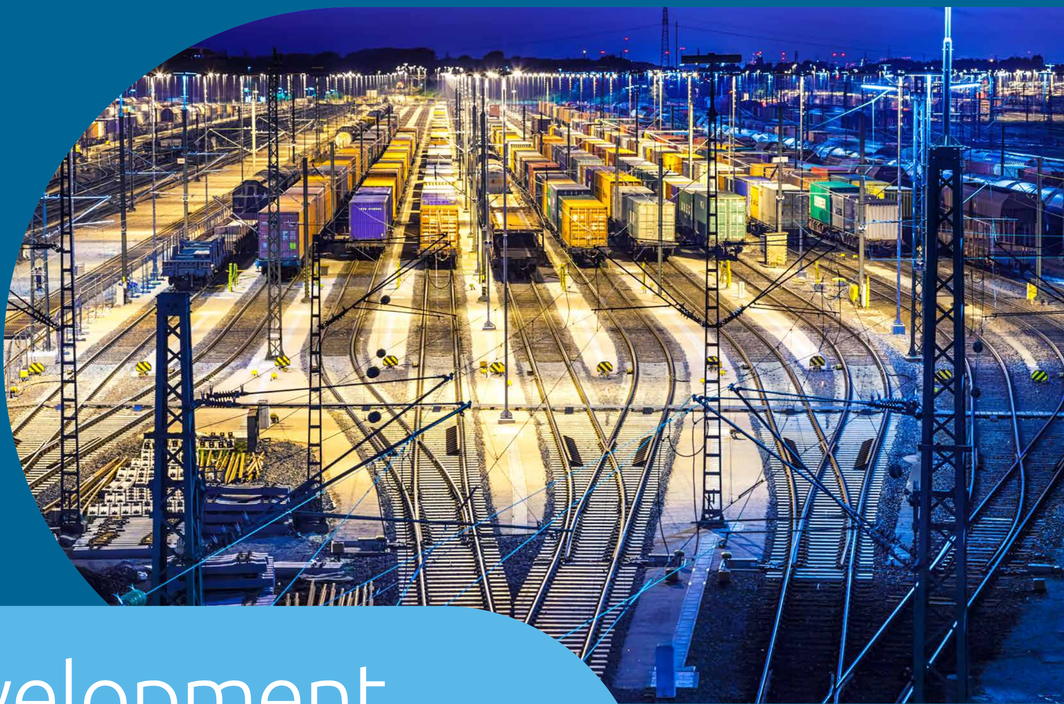

Further development of **KfW** into a climate and transformation bank

Climate & Development Advice

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Further development of KfW into a climate and transformation bank

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Dear readers,

the transformation to climate neutrality is a behemoth task that requires staying power, the use of clever political instruments, and the rapid application of new technologies, but also high levels of investment.

Providing significantly more climate financing has increasingly become the focus of discussion in recent years, as this is the only way to achieve the goals set out in the Paris Climate Agreement of limiting global warming to 1.5 degrees and successfully adapting to climate change. The countries of the Global South in particular must be supported in their efforts. The international climate conference in Baku 2024 (COP 29) will address these issues in particular. National and multilateral development banks have an important role to play in climate and development financing. Far more than commercial banks, they are not only in a position, but also obliged by their mandates to facilitate important transformation projects through particularly favorable financing conditions and by providing venture capital and to involve private investors to a much greater extent. These are important prerequisites, especially for large-volume investments such as infrastructure projects. In Germany, the Kreditanstalt für Wiederaufbau (KfW for short) is called upon to take on this role and launch the corresponding climate and transformation financing nationally and internationally in such a way that the transition to climate neutrality is accelerated and as much private capital as possible is mobilized. But is KfW fulfilling this mandate?

In this study, the Climate Neutrality Foundation examined the financing needs in the Global South, what contribution KfW has made to date and what further steps would be necessary to develop KfW into a credible and effective climate and transformation bank.

We look forward to your suggestions.

Yours sincerely,
Regine Günther

Further development of KfW into a climate and transformation bank

The transformation to greenhouse gas neutrality and climate resilience while simultaneously achieving the Sustainable Development Goals requires considerable investment in the Global South. Without these investments, the 1.5 degree target will definitely be missed, as developing and emerging countries currently emit around two thirds of greenhouse gas emissions.

The required annual investments of around USD 2 trillion are at least five times the current planned investments and, with a few exceptions such as China, the countries of the Global South are not in a position to mobilize the costs of transformation on their own. To make matters worse, most of the major emerging markets and almost all developing countries do not have the necessary investment ratings to be able to raise capital on favourable terms. At the same time, many investors avoid these countries because they are unable to adequately assess investment risks. As a result, private investors, who according to all studies should provide around 90 percent of global investment in the transformation, have so far hardly invested in the Global South and public investment alone cannot close this gap.

The study provides an overview of the transformative financing needs in the Global South and analyzes how well KfW Group is positioned for this.

Against this backdrop, a reform of international climate and development financing appears to be urgently required. Development banks, such as the German KfW, have a special role to play in lowering the cost of capital for transformation and leveraging far more private capital. To achieve this, KfW would have to invest more funds, take on more risk itself, expand its advisory capacities and quickly complete its own exit from financing fossil fuels and other investments that are not compatible with the Paris climate goals.

This study, commissioned by the Climate Neutrality Foundation, examines which measures need to be implemented in order for KfW to consistently develop into a climate and transformation bank. The study looks exclusively at the international business of KfW Group.

The study starts out by providing an overview of the transformative financing needs in the Global South and the complex difficulties in meeting them. The second part analyzes how well KfW Group is positioned with KfW Development Bank, KfW IPEX-Bank and Deutsche Investitions- und Entwicklungsgesellschaft (DEG) and what contribution it is making to the transformation in the Global South.

The analysis concludes that KfW Group does not yet live up to its claim to play a leading role as a transformation bank. The biggest deficits in the international business divisions are as follows:

1 - KfW Group continues to finance international projects that are not compatible with the Paris climate goals.

2 - Too little money is being invested in the energy, climate and environmental sectors. In 2022, these new commitments amounted to just EUR 10.7 billion, or 34% of the group's international business. A clear growth path is not discernible in the 2018 to 2022 period under review.

3 - Too little of the funds invested internationally goes to the Global South. Of the EUR 30.7 billion in new commitments in international business in 2022, only EUR 15.2 billion or 49.4% went to the Global South. The share of climate-vulnerable countries is particularly low.

4 - KfW Group mobilizes too little private and other investment with its funds. Between 2012 and 2017, just USD 3.3 billion was leveraged, which was just above the level in Denmark. France and the UK have leveraged at least twice this amount, the USA 24.9 billion US dollars.

5 - For years, KfW Group has been reducing rather than increasing its advisory and think tank capacities. These capacities are urgently needed to strengthen integrated risk management and finance more climate and transformation projects in the Global South.

6 - Although the indicator-based impact measurement for the sustainability area is being developed, it is not underpinned by a Paris-compatible target system or transformation roadmaps with clearly defined interim targets for all business divisions.

7 - KfW Group is not transparent enough with regard to its financing. For example, there is no verifiable information on what proportion of the three subsidiaries' financing is compatible with the Paris climate targets. There is also a lack of a clear definition of transformation financing that is measurable and verifiable.

8 - There is a lack of overall management in KfW Group's international business that would do justice to its own claim to be a transformation bank. For example, KfW does not yet meet the requirements of the EU taxonomy, there are no climate quotas as targets for each of the subsidiaries and no progress reports are submitted on its own transformation process.

Due to its size and importance, KfW plays an outstanding role in the protection of global public goods. It could and should play an important bridging role between public and private investors. However, important adjustments would have to be made in order to eliminate the deficits identified. Essentially, the aim is for KfW to change its conservative business model, which is characterized by a very high core capital ratio, low refinancing costs, relatively low-risk financing and consistently high profits, so that it is better able to meet the high financing requirements for climate and transformation projects in the Global South. It has the leeway to do so: It would have to take on more risk itself to protect global goods, provide more and cheaper financing and leverage much more private capital through partial risk assumption in order to reduce the existing financing gap. Who else, if not development banks acting on behalf of the public sector, should take on this crucial role? This requires a clear political mandate.

It is up to the German government to take the necessary decisions and authorize KfW Group to use more funds to de-risk private investments (e.g. via guarantees, subordinated loans or risk capital) to promote climate and transformation projects in the Global South, to reduce borrowing costs and to raise more funds on the capital markets itself in order to be able to grant more loans. If the currently very high equity ratio of 25 percent were reduced to the average level of comparable development banks, this would be possible without jeopardizing the AAA rating.

The study proposes eight steps to consistently develop KfW Group into a climate and transformation bank. Many of these could not only be adopted in this legislative period, but also at least partially implemented:

1 - Discontinuation of all financing that contradicts the goals of the Paris Climate Agreement by the end of 2024.

2 - Increase climate and transformation financing in KfW's international business to a climate quota of at least 50 percent by 2027 for all new commitments. Increase new commitments for particularly climate-vulnerable countries in the Global South to at least 50 percent of all new commitments that count towards the climate quota by 2030 at the latest.

3 - Mobilization of at least one trillion euros for transformative investments in 2024 - 2033 through increased leverage of third-party capital by reducing investment risks through guarantee and blended-finance instruments.

4 - Increase new commitments for the Global South from EUR 15 billion in 2022 to at least EUR 25 billion in 2025 (all new commitments, not just climate and transformation finance).

5 - Further development of integrated risk management for climate and transformation risks and expansion of corresponding capacities within KfW Group:

6 - Expansion of indicator-based impact measurement to include a Paris-compatible target system including intermediate targets.

7 - Creating transformation transparency for KfW Group's entire international business and establishing an overarching management system including EU taxonomy-compliant transformation roadmaps for KfW Development Bank, IPEX Bank and DEG:

8 - Annual progress reports and mid-term report 2027 by the Executive Board on the implementation of the transformation roadmap and in achieving the following key performance indicators.

Five new key performance indicators for KfW as an international climate and transformation bank:

1 - Consistent implementation of the goals and principles of the Paris Agreement, including the cessation of all new financing that is not compatible with the 1.5 degree target by the end of 2024 at the latest.

2 - Transparent climate quota of 50% by 2027

3 - Mobilisation of at least one trillion euros for transformative investments in 2024 - 2033

4 - Increase in new commitments for the Global South overall from EUR 15 billion in 2022 (49% of international business) to at least EUR 25 billion in 2025

5 - Increase new commitments for particularly climate-vulnerable countries in the Global South to at least 50 percent of all new commitments that count towards the climate quota by 2030 at the latest

Due to its size and importance, KfW plays an outstanding role in the protection of global public goods. It could and should play an important bridging role between public and private investors.

1 - Why we need new approaches to transformation financing

FOTO Yaorusheng

The continuing global rise in emissions, particularly in urban areas, in the building sector and in transportation, is representative of the major challenges of the transformation that are still far from being overcome. At the same time, it is obvious that achieving greenhouse gas neutrality, climate resilience and the goals of sustainable development in the Global South is a far greater financial challenge than in wealthy industrialized countries such as Germany. Irrespective of this, the success of the transformation remains a prerequisite for successfully limiting global warming: In a networked world, protecting the climate as a global public good can only work as a joint effort. However, timely transformation is currently at risk of failing in a large number of countries in the Global South because the financing of transformation projects is often unclear, while at the same time the consequential costs of climate change are rising ever more sharply and the debt situation of public budgets and companies is depriving these countries of their room for maneuver.

This situation is obviously no longer manageable with the traditional means of development financing. The very broad international discussions on financing the transformation, which Germany has been rather reluctant to take part in, have shown how large the financing gap is and how great the need is to reform the international financial architecture. This will not be fundamentally changed by the fact that the 100 billion US dollar climate financing pledge made by industrialized countries to developing countries is years too late anyway: Measured against global financing requirements, even this sum is more of a drop in the ocean. Nevertheless, it is currently unlikely that transfers from public budget funds from the global North to the Global South will increase significantly in the coming years, when it will be decided whether the 1.5 degree target can still be kept within reach.

New approaches to transformation financing are therefore required. It is no coincidence that increased attention is being paid to the role that national and multilateral development banks can play with their considerable potential leverage on the sufficient private capital available. Germany's development bank, KfW Group, is attracting particular attention, not only because it is one of the largest and most financially potent national development banks, but also because it has declared its own transformation into a transformation bank to be its most important strategic goal.

The Climate Neutrality Foundation commissioned Climate & Development Advice to answer the following three sets of questions.

1 - What financing needs exist in transformation-oriented countries in the Global South, what specific financing difficulties are encountered and what instruments are promising to overcome or at least mitigate these?
2 - How is KfW Group already positioned to close the existing financing gap and what specific contribution has it made so far?
3 - What would be necessary to consistently develop KfW Group into an exemplary climate and transformation bank, and what actions can be taken in this legislative period to accelerate this process?

Based on the assessment of experts and an analysis of the available literature, this paper provides an initial assessment of the potential and the measures required to consistently develop KfW Group into a climate and transformation bank. Answering these questions is of considerable relevance for a successful foreign climate and development policy, especially for the success of important transformation projects of the German government such as the new "Just Energy Transition Partnerships" and other climate and development partnerships. Adequate financing solutions are one of the key factors here.

This study uses the terms "international climate finance" and "transformation finance". By international climate finance, we mean all contributions that contribute to achieving the Paris climate goals of greenhouse gas neutrality and climate resilience. Usually, the so-called Rio markers for climate protection and climate adaptation are used in this context, provided official development assistance funds (ODA funds) are used. When recording climate financing via the Rio markers, a distinction is made between investments that primarily serve climate protection and adaptation and investments that only pursue these goals as secondary objectives. However, this important distinction is often lost in the usual reporting of climate financing by states or development banks. As a result, climate financing quotas are often higher than the core quota of investments that actually primarily serve climate protection or climate adaptation. The application of the Rio markers is not mandatory for investments that do not fall under official development finance. This makes it even more difficult to delineate how significant their contribution to climate change mitigation and adaptation is.

There is no generally accepted definition for the term "transformation financing", which is also used in this study. Our study cannot close this gap and we are not aware of any definition from KfW Group. When we use the term in this study, we primarily mean the financial extraction of the achievement of cross-sectoral greenhouse gas neutrality at a rate that is compatible with meeting the 1.5 degree target. At the same time, we use the term "transformation financing" to insinuate that it can also be used to promote a just transition, climate resilience and the achievement of sustainable development goals. Accordingly, we consider a just transition, climate resilience and SDG compatibility necessary for a successful transformation to greenhouse gas neutrality. Our understanding of transformation is thus based on that of the International High-level Expert Group (see Figure 01, page 12).

The explanations show that there is a need for further clarification in order to arrive at a transparent definition of the relevance of financing for climate and transformation. One criterion could be the contribution that investments make to achieving the targets agreed in Dubai at COP28 of tripling renewables, doubling energy efficiency and phasing out fossil fuels. In this study, we have to dispense with a clear delimitation, work with the available data, point out the limits of their informative value and accept that the climate quotas shown here for KfW Group's international business are likely to be at least partially too high.

If we succeed in transforming KfW Group into a climate and transformation bank, this would send a signal to many other development banks. However, acting as a role model requires being able to provide innovative and tailor-made answers to the transformative financing needs of countries and companies in the Global South — and ultimately to arrive at a new form of assessment and distribution of climate and transformation risks. This would have a profound impact on the business model of KfW Group and would result in a new type of development bank that focuses on the protection of global public goods.

This analysis was prepared by Thomas Hirsch (founder of Climate & Development Advice, graduate geographer) in cooperation with Sara Jane Ahmed (founder of the Financial Futures Center, Master of Science in Finance) and Martin Gück (graduate economist).

The results of consultations with experts from the German parliament and federal ministries, the financial sector, development banks and development cooperation, academia and think tanks and, last but not least, from partner countries have been incorporated. We would like to thank everyone involved for their suggestions and experiences, which have provided us with important impetus. We have invited KfW Group to comment on the analysis. In this context, KfW Development Bank provided us with additional, previously unpublished data, which we have included in our analysis (see Table 10, among others). In the course of our exchange, it once again became clear how important it is to achieve greater transparency in climate and environmental financing as well as a clear definition of transformation and transformation financing. One of the results of this exchange was to remain in discussion about this.

The authors and the Climate Neutrality Foundation as the client are solely responsible for the content of the analysis.

2 - Transformative financing needs in the Global South

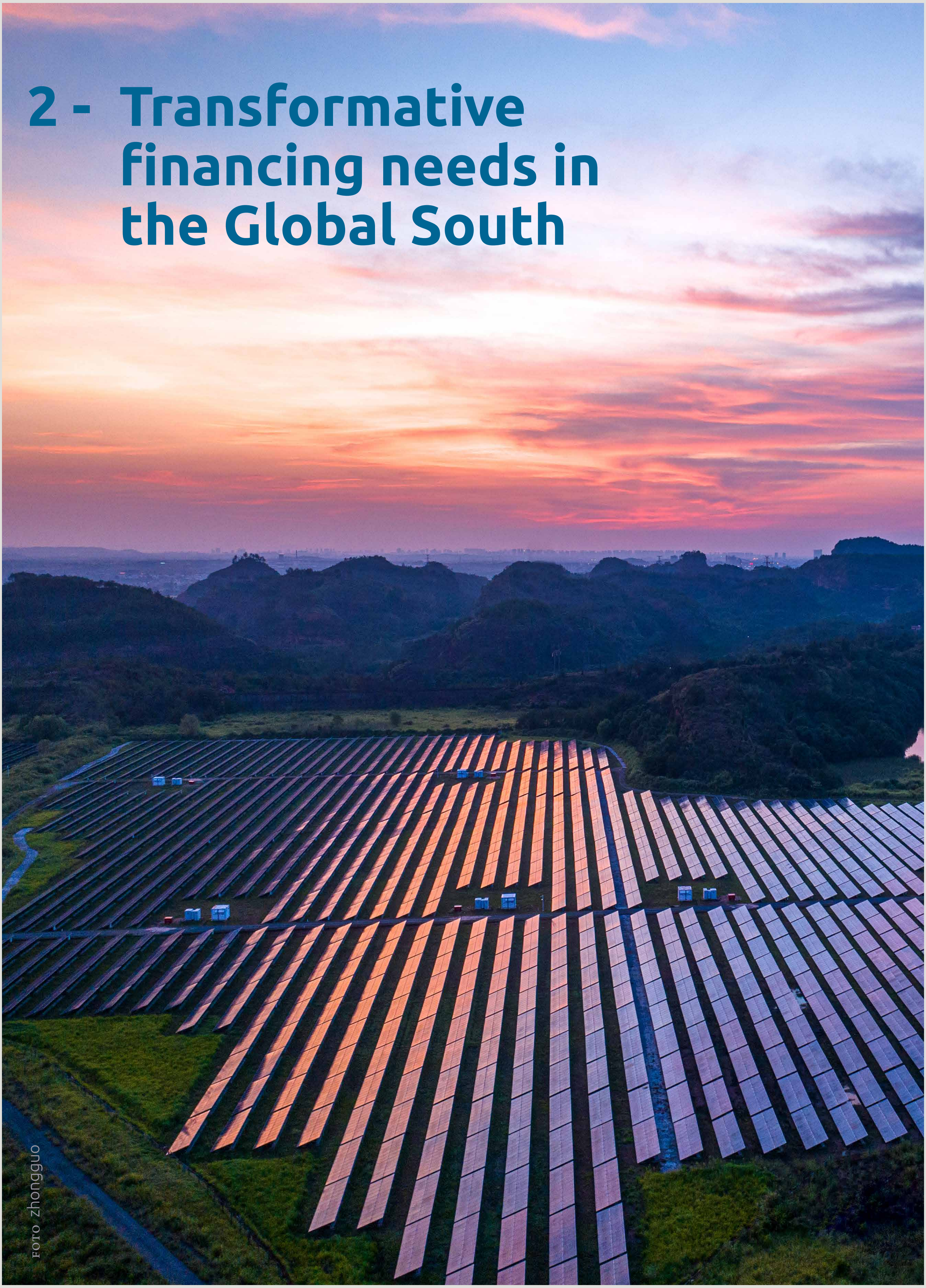

FOTO zhongguo

Financing requirements for transformation in the Global South

The commitment by industrialised countries to provide at least 100 billion US dollars in international climate finance to countries of the Global South every year until 2025 is regarded as a formal climate finance target. The figure originally goes back to COP15 (15th Conference of the Parties to the Framework Convention on Climate Change, 2009, Copenhagen). Formally adopted at COP16 in Cancún, it was confirmed at COP21 in Paris (2015) and its validity was extended until 2025. The amount of 100 billion US dollars was decided politically and is neither scientifically justified nor does it reflect the actual financing requirements, which are significantly higher. Taking into account the development of the value of money since 2015, the inflation-adjusted value today only amounts to around USD 60 billion, which is many times less than the financing requirement. For comparison: In just ten years, the 58 member states of the Climate Vulnerable Forum (CVF) alone have suffered more than half a trillion US dollars in climate-related loss and damage, according to their own figures.[1] The Standing Finance Committee of the United Nations Framework Convention on Climate Change (UNFCCC) has estimated the investment required to implement the Nationally Determined Contributions (NDCs) of the countries of the Global South at almost USD 9 trillion based on the measures planned up to 2030.[2] African countries account for 42 percent, Asia and the Pacific for 55 percent and Latin America and the Caribbean for 3 percent. The Sixth IPCC Assessment Report emphasizes that global investment in climate protection will probably have to increase by a factor of 3 to 6 in order to achieve the Paris climate targets,[3] while the report of the Independent High-Level Expert Group on Climate Finance (IHLEG) estimates the investment needs of the Global South (excluding China) at around USD 1 trillion per year up to 2025 and around USD 2.4 trillion per year in the following years up to 2030 4(broken down in fig. 01)

The international financial system therefore needs to mobilise much higher investments for transformation processes in the Global South than the annual 100 billion US dollars. The profound transformation of all economies is necessary to limit global warming to 1.5 degrees Celsius and to make the necessary adjustments to the unavoidable climate changes.

Development banks have a prominent role to play in financing the transformation: **Their investment decisions play a key role in determining the quality, scope and speed of the transformation**, as most countries in the Global South will not be able to make the necessary investments on their own, and the **international capital markets will remain closed to high-risk climate change countries as long as development banks are not prepared to significantly reduce investment risks.**As many countries of the Global South are also suffering from high and growing debts, effective transformation will require debt reduction measures in addition to favorable loans and grants from development banks as well as guarantees and risk capital in order to maintain the solvency of these countries in the transformation process.

1 V20 (2022). Climate Vulnerable Economies Loss Report.
2 UNFCCC (2021). First report on the determination of the needs of developing country Parties related to implementing the Convention and the Paris Agreement.
3 IPCC (2023). AR6 Synthesis Report – Climate Change 2023.
4 IHLEG (2022). Finance for climate action: Scaling up investment for climate and development.

FIG. 01 **Transformative investment needs in the Global South until 2030** in USD billion per year.

Investment category	Subcategory	Amount required
Power grid	Carbon-free energy generation	300 – 400
	Transmission and distribution	200 – 250
	Storage and backup capacity	50 – 75
	Early exit from coal	40 – 50
Transportation system	Low-emission transport infrastructure	400 – 500
	Electrification of fleets/conversion to hydrogen	100 – 150
Industry	Energy efficiency	100 – 150
	Industrial processes	10 – 20
Buildings	Electrification of heating/cooling networks	20 – 40
	Energy efficiency and greenhouse gas reduction	70 – 80
Green hydrogen	Production	20 – 30
	Transportation and storage	20 – 30
Just transition	Targeted programs and social security	50 – 100
Loss and damage	Coping with loss and damage	200 – 400
Climate adaptation	Investing in climate resilience	200 – 250
Conservation and restoration of natural capital	Sustainable agriculture	100 – 150
	Reforestation and nature conservation	100 - 150
	Biodiversity	75 – 100
Avoidance of methane emissions	Reducing methane emissions from fossil fuels and waste	40 – 60
Total investment requirement per year		2.000 – 2.855

SOURCE International High Level Expert Group (2022). Finance for climate action: Scaling up investment for climate and development.

Climate & Development Advice, 2024

Reasons for the funding gap

The already great financial pressure that many countries in the Global South are under due to rapidly growing climate-related loss and damage has increased dramatically again in recent years due to four main drivers:[5] the **high costs of dealing with the pandemic**, the closely associated **growing debt**, the **shift of investment capital** from the Global South to the investment markets of the North due to interest rate advantages and the **increase in fossil energy and food prices** triggered by the Russian war against Ukraine. In order to overcome the resulting massive financing bottlenecks in the Global South and to mobilize sufficient investment capital for the transformation, **three levers** in particular should be used:

Firstly, the high cost of capital, which affects the countries of the Global South that are particularly vulnerable to climate change, must be significantly reduced if

5 See for example the Bridgetown Initiative and V20 Climate Vulnerability Monitor

transformation projects are to be profitable at all: Foreign currency loans are currently subject to interest rates of 6 to 28 percent. For comparison: In the major Western economies, the cost of capital is only 1 to 4 percent and debt is mostly denominated in local currency.[6] The combination of high capital costs and significant currency risk dramatically reduces the ability of countries of the Global South to invest in low-carbon technologies and climate adaptation.

A key driver of high capital costs is the risk assessment, which is often very high for these countries with their typically underdeveloped capital markets. In addition, there are further cost-driving uncertainties and the generally limited experience of potential investors with these countries. This leads to high risk premiums. The table (Fig. 02) illustrates typical risks ranging from project-specific to general risks.

Secondly, countries in the Global South that are exposed to high climate risks urgently need **additional short-term liquidity** to manage their increasingly complex crises. Over the past few years, their foreign debt has risen steadily, partly because more and more loans had to be taken out to cope with extreme weather events and the COVID pandemic. The cumulative debt of 40 of the world's most climate-prone, mostly small economies now amounts to 818 billion US dollars. Their debt service payments will amount to USD 552 billion in 2022-2029, including USD 77.6 billion in 2024 alone.[7] This applies above all to the group of least developed countries (LDCs). The looming **liquidity crisis** here is massive, and the global financial system has so far proved incapable of responding appropriately to the new realities of climate change. As a result, more and more countries in the Global South are experiencing budget emergencies or insolvency, not primarily due to long-term insolvency, but due to an acute shortage of liquid funds in hard currency.

6 Trading Economics. Interest rate: https://tradingeconomics.com/country-list/interest-rate

7 See also: V20 (2022). V20 Debt Review. Vulnerable Group of Twenty.

These short-term liquidity problems **require the international community and central banks** to help with public funds: Debt rescheduling, debt-for-climate swaps and the introduction of natural disaster and pandemic clauses in loan agreements, which immediately suspend debt servicing and extend the term of the loan in the event of a disaster, protect the interests of debtors and creditors and can mobilize new financial resources. Even if the main creditors in the looming debt crisis are the multilateral development banks and China8, a debt relief initiative by Western countries could have a positive leverage effect.

Thirdly, **fossil energy companies** are also very influential in many countries of the Global South, which leads to structural dependencies and often considerable foreign trade deficits in countries that are dependent on fossil fuel imports. These dependencies make it difficult to reform **political and regulatory frameworks that hinder transformation**.

So far, little has been done to close the financing gap — despite the extensive possibilities offered by development banks and although there is now a lot of talk about **de-risking** to reduce the cost of capital. On the one hand, the important step of significantly allocating special drawing rights from the International Monetary Fund (IMF) to high-risk climate change countries has only been taken to a limited extent. On the other hand, the continued major influence of fossil fuel companies on entire economies is blocking an accelerated redirection of investments into the transformation.

8 See e.g. Horn, S. et al. (2023). China as an International Lender of Last Resort.

FIG. 02 **Typical reasons for financing-related risk premiums in the Global South**

Technology-related risks, which are higher for new technologies	Technology-related financial risks of projects with renewable energies or climate adaptation technologies, e.g. due to uncertainties in the energy potential analysis, forecast output, yields, construction and maintenance costs.
Risks of the business model	Risk (actual or perceived) that a new, as yet untested business model will not prove successful, e.g. because the actual revenues from a pay-as-you-go financed solar system are lower than forecast.
Operational risks	Risk that unforeseen operational challenges could significantly increase project costs.
Political risks	Infrastructure projects have a long lifespan and contract terms that extend far beyond a government's term of office. Changes of government entail political risks for investment projects, e.g. non-compliance with contracts; another example would be a public transport project that is not fully financed by users, but also partly by subsidies; these could be cancelled if a government's budget priorities change; hard political risks also include the risk of expropriation and restrictions on currency convertibility.
Regulatory risks	With a change of government, the legal framework and regulations can change in such a way that they have a negative impact on the financing model of an investment project during the construction or operating phase. For example, procedural changes in land acquisition can lead to costly delays, changes in feed-in tariffs can affect the economics of the project, future changes to off-grid electrification plans can lead to the utility exiting the grid, etc.
Risks of the contractual partner (state-owned companies)	In connection with regulatory or political risks, there may be breaches of contract or defaults by state contractual partners.
Risks of the contractual partner (private companies)	Private contractual partners or customers may default in whole or in part; the risk of default increases as their creditworthiness decreases (or does not exist). This risk is particularly high for transformation projects with vulnerable partners (e.g. small consumers, rural customers, low-income communities).
Particular difficulties of small projects or projects with small and medium-sized enterprises	Decentralized projects and projects with small and medium-sized enterprises, which are characteristic of most developing countries, usually have a limited financial scope. At the same time, the administrative requirements (e.g. due diligence) are similar or the same as for larger projects, but pose greater challenges for those involved due to their lack of experience. This often leads to financial institutions favoring large projects. Corresponding incentive systems with bonus payments reinforce this tendency.

Climate & Development Advice, 2024

Consequences of the funding gap

Delaying the transformation, not least as a result of the financing gap, will lead to a loss of prosperity, worsening global inequality and further increases in greenhouse gas emissions. At the same time, vulnerable states are becoming increasingly fragile, the pollution of environmental goods such as air and water is increasing and progress in gender equality, access to education, health and social security systems is being slowed down. The member states of the Climate Vulnerable Forum lost 500 billion US dollars in prosperity growth between 2009 and 2020 due to climate change.[9] The IMF comes to the conclusion that income inequality increases by 1.5 percentage points for every percentage point by which climate risk increases.[10] The Climate Vulnerability Monitor[11] lists the following main effects of global warming:

9 V20 (2022). Climate Vulnerable Economies Loss Report.
10 IMF (2022). For Whom the Bell Tolls: Climate Change and Income Inequality.
11 CVF & V20 (2022). Climate Vulnerability Monitor, 3rd Edition: A Planet on Fire.

Term-related risks	Due to the typically higher initial investment requirements and lower cash flow in the operating business, longer maturities are often required for climate protection and adaptation projects to ensure the economic viability of the project. The loan terms of intermediary institutions may be too short to ensure project viability due to a mismatch between assets and liabilities at the intermediary institution or due to regulations such as Basel III. This can make it more difficult to finance projects or make refinancing risk (i.e. in particular the risk of an increase in interest rates at the time of future refinancing) an obstacle.
Insufficiently structured projects	Projects with new technologies or untested business models or under new or untested legal frameworks may lack the resources or expertise to structure the projects in such a way that they are as bankable as possible. Among other things, this leads to the risk of non-bankable contracts and agreements, poorly prepared projections or project documentation.
Lack of expertise among financial institutions	Lack of information and experience of financial institutions with climate change mitigation and adaptation projects, including lack of expertise in relevant technologies, business models and regulatory factors. This can lead to high financing costs, excessive security requirements or refusal to lend.
Currency risk	Currency risks are considerable in many soft currency countries and can mean that foreign currency loans (e.g. US dollars) can no longer be serviced or that purchase prices (e.g. for green electricity) would have to be raised to a level that is no longer competitive in local currency.
Macroeconomic risk	Risks arising from the general macroeconomic environment and market dynamics, in particular the risk of an economic downturn leading to a generally poor investment result due to a decline in overall demand, profit margins, profit growth, etc.
Force majeure, climate and other natural hazard risks	Risks in connection with force majeure, including war, terrorism or damage or impairment due to extreme weather or environmental risks, including disasters in connection with climate change.

SOURCE International High Level Expert Group (2022). Finance for climate action: Scaling up investment for climate and development.

- **Global doubling of income losses** at 2 degrees Celsius of global warming compared to 1.5 degrees;
- **Up to 66 percent higher inflation** at 2 degrees Celsius compared to 1.5 degrees Celsius;
- **Average interest rates up to 0.65 percent higher** in Asia and Europe;
- **Droughts** — increase in drought events per 20 years by a factor of 4-8 at 1.5°C, by a factor of 8-12 at 2.0°C and by a factor of 12-14 for the long-term scenario without climate protection measures;
- **Falling incomes in agriculture** for 600 million farmers worldwide, 90% of whom are smallholders and subsistence farmers;

- **The number of climate-related (90 percent heat-related) deaths** in people over 65 could increase by a factor of 15 by the end of the century if no climate protection measures are taken, reaching 3.4 million deaths per year, including 1 million in India. 91 percent of the predicted increase in heat-related deaths could be avoided by limiting the rise in global average temperature to 1.5 °C, whereas it would only be 56 percent if the average temperature were to rise to 2 °C;

- Due to **heat stress**, **one in five hours of hard physical labor will be lost** by the end of the century if no countermeasures are taken. In a 1.5 degree scenario, the loss would be 7.6 percent. **Labor losses mainly affect warmer regions.** The highest increases in lost working hours are in the world's warmest latitudes — Central Africa, West Africa, South Asia and Southeast Asia.

Strategies and example projects to close the funding gap

A bundle of measures involving public, bilateral, multilateral and private investors is required to remove obstacles to transformative investments in countries of the Global South. The report of the Independent High-Level Expert Group (IHLEG) appointed by the COP presidency[12] emphasizes the need to **develop special financing programmes and create a more favourable investment climate**. The combination of these two factors must result in concrete project pipelines.[13] A good example of creating a positive investment climate are the so-called **Climate Prosperity Plans**, which are currently being developed by CVF member states as **macroeconomic transformative investment strategies** with the aim of creating a climate of confidence and showing which priority transformative investments in climate change mitigation and adaptation are planned in the respective economies by 2030 in order to put these countries on a development path that leads to prosperity despite the climate risks.[14] The doubling of adjustment measures and the dedicated consideration of the specific conditions in these countries are key factors in preserving the respective livelihoods and functional economies and meeting the special requirements of the economic structure characterized by small and medium-sized enterprises. In order to mobilize the necessary financial resources quickly, cost-effectively and precisely, **the IHLEG recommends**[15]

- rapid completion of large-scale investment projects,

- massive increases in national and international private sector investment,

12 For the list of IHLEG members see: IHLEG (2022). Finance for climate action. Scaling up investment for climate and development.
13 IHLEG (2022). Finance for climate action: Scaling up investment for climate and development.
14 https://www.v-20.org/climate-prosperity-plans
15 ibid

- tripling the annual inflow of funds from multilateral development banks (MDBs) and other development finance institutions within five years,

- the doubling of international climate finance by 2025 compared to 2019, combined with the expansion of innovative and cost-effective financing options (including special drawing rights, voluntary carbon markets, philanthropy and guarantees), and

- solving the debt and liquidity problems.

There have certainly been innovations in the international financing of the energy transition in the Global South: The ongoing negotiation of **Just Energy Transition Partnerships (JETPs)** between the G7 and selected countries such as South Africa, Indonesia, Vietnam and Senegal, and possibly also India in the future, are an example of how countries of the Global South can be helped to accelerate the growth of renewable energies and end their dependence on fossil fuels more quickly with billions of euros in international support under the leadership of the public sector.

The USD 12 billion long-term mixed credit facility set up in the case of South Africa serves to refinance the state-owned South African energy supplier ESKOM and is intended to enable it to accelerate the decommissioning of its coal-fired power plants and replace them with renewable energies at the same time. The JETP with Indonesia is expected to amount to 20 billion US dollars in public and private funds to enable an accelerated coal phase-out there. At the same time, the Asian Development Bank (ADB), as a multilateral bank, has set up the so-called Energy Transition Mechanism (ETM) to halve the operating life of coal-fired power plants and enable the switch to "clean energies" within 15 years. At the private sector level, Philippine company AC Energy (ACEN) has introduced the world's first investor-level energy transition mechanism, which has enabled ACEN to divest its 246 MW coal-fired power plant, which is being decommissioned early.

In addition, there are also increasingly **new and innovative approaches to reducing the financing risk for transformation-relevant projects in such a way that private investors participate**, which they would not otherwise do. However, this requires bilateral or multilateral public funding. The **EU guarantee program of the European Fund for Sustainable Development Plus (EFSD+)**, for example, offers guarantees for priority development projects and initiatives. An important feature of this guarantee program is that EFSD+ guarantees are not offered at commercial prices, i.e. the guarantee program is financed by donor capital. In return, the projects that are financially secured in this way are expected to promote development. Some of the projects that have been supported by this guarantee program are listed below.[16]

- Guarantee programme for agriculture and rural areas (AgreenFi), initiated by the French Development Bank (AFD), consisting of a guarantee of 156 million euros, which is intended to mobilize 526 million euros in total investments. The initiative provides guarantees to local financial institutions in sub-Saharan Africa and the EU neighbourhood to support micro, small and medium-sized enterprises operating in agriculture or rural areas or affected by the Covid 19 pandemic.

- Support programme for renewable energies for (mainly rural) areas in sub-Saharan Africa: Initiated by the Spanish development bank (COFIDES), consisting of a 20 million euro guarantee to mobilize over 81 million euros in total investment. The EU guarantee enables COFIDES to provide loans for renewable energy projects in partnership with the private sector, with a focus on rural areas in sub-Saharan Africa and areas without access to energy.

16 European Commission (2021). European Fund for Sustainable Development Plus (EFSD+).

FIG. 03 **Typology of transformative projects and their sources of funding**

KEY
- Primary source of financing
- Secondary source of financing

SOURCE Adjusted on the basis of IHLEG (2022). Finance for climate action. Scaling up investment for climate and development.

		Investment and expenditure priorities
		Forms of financing
Transforming the energy system	Power supply system	Carbon-free generation
		Transmission and distribution
		Storage and backup capacity
		Early phase-out of coal
	Transportation system	Low-emission transport infrastructure
		Electrification of means of transport/ hydrogen
	Industry	Energy efficiency
		Industrial processes
	Buildings	Electrification
		Energy efficiency and greenhouse gas reduction
	Green hydrogen	Production
		Transportation and storage
	Just transition	Targeted programs and social security
Coping with loss and damage		
Responding to climate shocks and building resilience		
Investments in natural capital		Sustainable agriculture
		Reforestation and nature conservation
		Biodiversity
Reducing methane emissions from fossil fuels and waste		

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- FMO Ventures Programme, initiated by the Dutch development bank FMO, consisting of an EFSD guarantee of EUR 40 million, which is intended to mobilize up to EUR 200 million in total investments. The FMO Ventures program is a fund structure that offers direct equity investments in young start-up and scale-up companies in the fintech, energy access and agritech sectors as well as indirect (fund of funds) investments in technology-oriented venture capital funds, primarily in Africa and the European neighbourhood countries as well as in certain parts of Asia.

	External sources of funding required to support investments and expenditure					Demand
	Private		MDB	Concessionary financing	Debt-free financing	by 2030 in billion US dollars
	Largely autonomous private finance, well-defined yields, shorter maturities	Private financing with risk mitigation, longer maturities, political and technological risks	Long-term financing through Multilateral Development Banks (MDBs), solid economic returns, long maturities and spillover effects	Concessionary financing (bilateral and multilateral), lack of clearly defined returns, low creditworthiness of countries	Debt-free financing, limited monetized return, global external effects	
						300 - 400
						200 - 250
						50 - 75
						40 - 50
						400 - 500
						100 - 150
						10 - 20
						10 - 20
						20 - 40
						70 - 80
						20 - 30
						20 - 30
						50 - 100
						200 - 400
						200 - 250
						100 - 150
						100 - 150
						75 - 100
						40 - 60

Another way in which the use of public funds can mobilize private capital are **grants** to motivate private investment. In this way, investment risks can be reduced, for example by using grants as **"first loss" capital** in mixed financing. The EU has also launched a funding program for this purpose, ensuring that the projects and their end users are the main beneficiaries. This blending program has benefited, for example:

- Green for Growth Fund: Initiated by the European Investment Bank (EIB) and KfW, consisting of subordinated (first loss) "C-shares" in local currency provided by the EU Commission and senior capital provided by the two development banks; the fund makes investments in environmentally friendly projects in selected countries, both in the form of credit lines for local financial institutions and through direct investments.

- Financing Facility for Sustainable Energy Efficiency in Kyrgyzstan (KyrSEFF), initiated by the European Bank for Reconstruction and Development (EBRD), consisting of an investment grant of EUR 6.8 million for a total facility of EUR 20 million. The KyrSEFF is a mixed fund of EU and EBRD capital that supports energy efficiency projects in private households and industry by granting loans (credit lines) to participating local financial institutions (commercial banks), which on-lend them to borrowers from the private sector.

- Africa Grow: On behalf of the BMZ and together with Allianz Global Investors, KfW development bank has launched the Africa Grow fund of funds with the aim of promoting 150 small and medium-sized enterprises and start-ups by 2030, thereby creating 25,000 new jobs. The fund provides equity for this purpose. Of the fund's initial capital of 170 million euros, 85 million come from the BMZ, 30 million from the KfW subsidiary DEG and the rest from Allianz Global Investors.[17]

The examples show **that a mix of innovative financing instruments is already being used to finance transformative projects in the Global South — but not nearly** enough. Guarantees, for example, currently account for less than five percent of total financing by multilateral institutions. Overall, **bilateral public financing, the most important indicator of the direct contribution of industrialized countries to the financing costs of transformation in the Global South, has not increased measurably since 2016.** Public bilateral and multilateral sources should be used more quickly and on a larger scale to support public investment, catalyze private financing and increase funding for particularly low-income, climate-vulnerable countries.[18] The chart above (Fig. 03, p. 18) illustrates the typology of transformation projects and their typical sources of financing according to investment needs by 2030.

Innovative approaches have also been developed to close the funding gap in coping with and reducing climate-related loss and damage. These include ex ante financing packages that are agreed before the occurrence of an extreme event (e.g. hurricane, drought) and are automatically paid out as soon as a predetermined threshold value (e.g. exceeding a certain wind speed, persistent drought over a minimum number of days) is exceeded. There have been further financing innovations in the strengthening of social security systems in the event of extreme climate events, improved regional and municipal risk transfer and the hedging of loans against extreme events, to name just a few examples. The expansion of pre-arranged financing packages is very important in order to have quick access to financial resources in the event of a disaster. Without such pre-arranged funding, it usually takes around nine months for funds to be made available after a disaster, if they are approved at all. The agreement of parametric (climate-related) triggers for triggering payments is also of great added value, so that payments are provided on the basis of scientific data and findings instead of having to carry out a cumbersome damage assessment afterwards, where the burden of proof often lies with the injured parties.

17 Allianz (2019). KfW and Allianz launch fund for joint investments in African companies.

18 IHLEG (2022). Finance for climate action: Scaling up investment for climate and development. Page 31

FIG. 04 **Mixed financing to reduce the cost of capital**

Cost of capital
A mixed financing approach through a combination of credit support to reduce the overall cost of capital

↑ ↑ ↑

Bond	Guarantees and credit support	Equity
- Long-term and in various tranches (e.g. senior, mezzanine, evergreen, convertible bonds) - Private and/or public financing from local and international banks, institutional lenders and multilateral development banks - Publicly issued securities with or without certification, including transitional or sustainability bonds	- Additional security for lenders or debtors, which enables lower costs for the debt - Can take the form of sureties, guarantees, first loss and other credit cover - Ideally provided by multilateral development banks (MDBs), donors and other ESG/impact investors	- Can be amortizing, with fixed dividends (e.g. preference shares) or a combination with ordinary shares - Private financing mostly from institutional investors and funds - Public share issues can be examined subject to regulatory requirements (e.g. no going concern due to a fixed closure date)

SOURCE Climate Smart Ventures (2023)

Climate & Development Advice, 2024

Transformative mix of financing instruments and services

Advice and brokerage

For the **development of a transformative project pipeline**, careful project planning and tailor-made project financing, **advice from experienced teams is of the utmost importance**. The provision of appropriate consulting services is also key to the **replication and scaling of successful projects** as well as the transfer of knowledge and the development of relevant expertise in the Global South. Capacities for **strategic and technical advice on value-adding transformation processes** towards greenhouse gas neutrality and climate resilience (in the sense of climate prosperity plans, for example) as well as financial advice to ensure sustainable project financing and business development are particularly important because they are underdeveloped in many countries. When it comes to financing, it is particularly important to reduce the generally very high capital costs through optimized mixed financing.

Venture capital and private equity

Venture capital and private equity funds are increasingly involved in climate financing. Venture capital is usually required in the early phase of projects, equity capital in later project phases. Climate projects in countries of the Global South **primarily require risk capital** in all project phases. The equity of venture capital and private equity companies can be made available in the form of preference shares, among other things, which can be liquidated on a priority basis but have an attractive dividend or other benefits. Investments in ordinary shares are also possible, which entails a greater investment risk, but also extended

FIG. 05 **Supportive framework conditions for transformative investments**

Legal and political framework conditions	Explanation
Rule of law and legal protection	The rule of law is an essential prerequisite for creating an environment in which contracts and property rights are respected and enforced. A solid legal framework ensures that investors are protected against unfair treatment, discrimination, expropriation and breach of contract. A reliable judicial system that enables impartial and efficient dispute resolution is crucial for investor confidence.
Stability and predictability	Investors are looking for stability and predictability in the political and legal environment. A stable framework ensures that policies, regulations and laws are not subject to constant change or unpredictable shifts. This stability enables investors to make long-term plans, correctly assess risks and have confidence in the legal security of their investments.
Investment promotion and facilitation	Investment promotion and facilitation measures, including incentives, can be effective tools to attract investment, provided they aim to correct market failures and target the strengths of a country's investment environment.
Trade policy	Trade policies can encourage investment by expanding opportunities to exploit economies of scale and facilitating integration into global supply chains, thereby increasing productivity and returns on investment.
Investor-friendly regulations	The regulatory environment should be conducive to companies and investments. Well-designed regulations and policies should strike a balance between investor protection, public interest and ease of doing business. Clear and transparent regulations without unnecessary bureaucracy promote a favorable investment climate.
Protection of intellectual property rights	Strong protection of intellectual property rights is crucial to attract investment in innovative and knowledge-based industries.
Good governance and anti-corruption measures	Transparent and accountable governance and effective anti-corruption measures are key to attracting investment. Investors are more willing to invest capital if they can be confident that their investments will not be affected by corruption or unfair practices. Measures such as transparency in public procurement, anti-corruption commissions and accountability mechanisms strengthen investor confidence.
Infrastructure and development of the financial sector	A sound infrastructure development policy ensures that scarce resources are channeled into the most promising projects and that bottlenecks that hinder private investment are eliminated. An effective financial sector policy makes it easier for companies to realize investment ideas in a stable environment.
Political stability	Orderly changes of government, the absence of major conflicts and a broad political consensus on economic policy create a favorable investment climate. A stable political environment reduces the uncertainties and risks associated with political upheaval or a reversal of policy.
Access to finance	A well-functioning financial system that offers access to capital, credit and investment opportunities supports investment activity. Solid banking systems, robust capital markets and the availability of venture capital or private equity financing contribute to an investor-friendly environment.

QUELLE OECD (2006). Policy framework for investments.

Climate & Development Advice, 2024

co-determination rights and a higher potential return. **In 2021, venture capital and equity funds invested USD 53.7 billion in climate projects. However, only a small proportion of this benefited the Global South.**[19]

Loans and bonds

Loans can be granted in the form of commercial debt instruments or bonds (securities). These may include various types of private and public debt instruments that are valued at market prices. They can also take the form of senior or subordinated bonds or loans from private investors, who generally provide larger amounts to reduce transaction costs. Investors range from international and local banks to development banks, export credit agencies, institutional investors, asset managers, funds and others and even to small investors. Given the current latent debt crisis in high-risk climate change countries, it would be important at this time to create ways to manage liquidity risk, e.g. by making it easier for vulnerable countries to access official liquidity facilities on reasonable terms and without penalties, or by **improving maturities and repayment terms for public loans**. This also reduces the risk of these countries losing their access to the private capital market, which is necessary in order to be able to continue investing.

Concessionary financing

Concessionary financing can take the **form of loans or equity capital**, and the capital costs are below the usual market conditions. It is therefore usually provided by development banks or government-related financial institutions. They can act as **anchor investors or risk mitigators** by being subordinated to other investors. In addition, concessionary financing generally has lower expected returns and/or a longer time horizon, including grace periods.

19 BNEF (2022). Venture capital, PE invest $53.7 billion in climate tech.

Reform loans

Budget support is agreed as reform loans, which KfW, for example, can grant to governments on behalf of the German government in order to implement agreed reform measures. In this way, **transformation can be promoted programmatically, i.e. beyond individual projects**. This is based on the idea that **more additional transformation-related financial investments will be leveraged** in this way, both budget funds from the partner countries and private investments. Reform loans are granted internationally by the IMF's Resilience and Sustainability Facility (RSF), for example, in the form of favorable long-term loans to countries that commit to political reforms in order to reduce climate-related risks that threaten their macroeconomic stability.[20]

Grants

Grants are the most sought-after form of financing in which mostly public donors provide money, goods or services without requiring repayment. However, because grants are scarce, they should either be used for projects that **would otherwise not be financially viable but have offer high transformation potential**, or they should be **combined with other forms of financing to reduce capital costs** or cushion certain risks.

Repayable grants are a special type of grant that must be repaid if the grants are used to initiate successful projects that in turn generate income. This can encourage the development of more projects, even by financially weak players, as the project development risk is mitigated. This instrument is used by the Project Preparation Facility of the Green Climate Fund (GCF), for example.[21]

20 IMF (2023). The Resilience and Sustainability Facility (RSF).
21 GCF (n.d.). Project Preparation Facility.

Currency hedging

Many economies in the Global South tend to have smaller capital markets, high capital costs and a national banking landscape that has difficulty adding transformative projects to its portfolio without international support. However, in order to stimulate investment, foreign investment is required, usually in hard currencies such as the US dollar, euro or yen. The soft currencies of the investment countries are generally very volatile against these. This means that **currency risks** can easily become incalculable and **must** therefore **be hedged**. Because the hedging costs are high, this can undermine project profitability. In view of the high complexity of hedging exchange rate risks, which requires highly specialized expertise, **cooperation with specialized providers** (e.g. TCX) is recommended.[22] By **using grants, currency hedging costs can be reduced** to make projects profitable.

Hedging loans

In order to motivate private investors to invest in transformation projects with potentially high financial risks in countries of the Global South, further risk-mitigating credit safeguards are often required in addition to currency hedging, which can be provided by development banks. Hedging can take place both via **guarantees and via a first-loss mechanism**[23]. Guarantee products work in different ways and usually **result in high private investments**. Guarantees can therefore leverage private funds many times over. Therefore, a **significantly increased use of guarantee instruments by development banks is one of the most effective instruments for closing the financing gap**.

Legal and political framework

Creating a positive legal and political environment is key for ensuring long-term investment security. Figure 05 provides an overview of the key elements required to attract transformative investment.

A country's creditworthiness is essential for long-term investment security, which is why the capacity development of public financial management, alongside the promotion of better management of public investments in low-carbon and climate-resilient projects, is an **important supporting measure for the expansion of transformation financing**. To mobilize more investment, both innovative financial mechanisms, including risk-mitigating instruments, and the **broadening of the investor base** are crucial. De-risking instruments and currency hedging can be used to attract a broader investor base. As experience grows, markets will expand. The legal and political framework conditions then play an increasingly important role in reducing high up-front costs, accelerating transformative investments and creating liquid markets.

In the following, we will analyze how well the institutional and strategic positioning of KfW Group meets the needs described above, what transformation-relevant management potential it has, to what extent the group-wide financing and promotional offers meet the criteria mentioned above and how transformative its international business is.

22 TCX fund (n.d.). About the fund—who we are.
23 Climate Policy Initiative (2013). Risk Gaps: First-Loss Protection Mechanisms.

3 - KfW's contribution to the international transformation

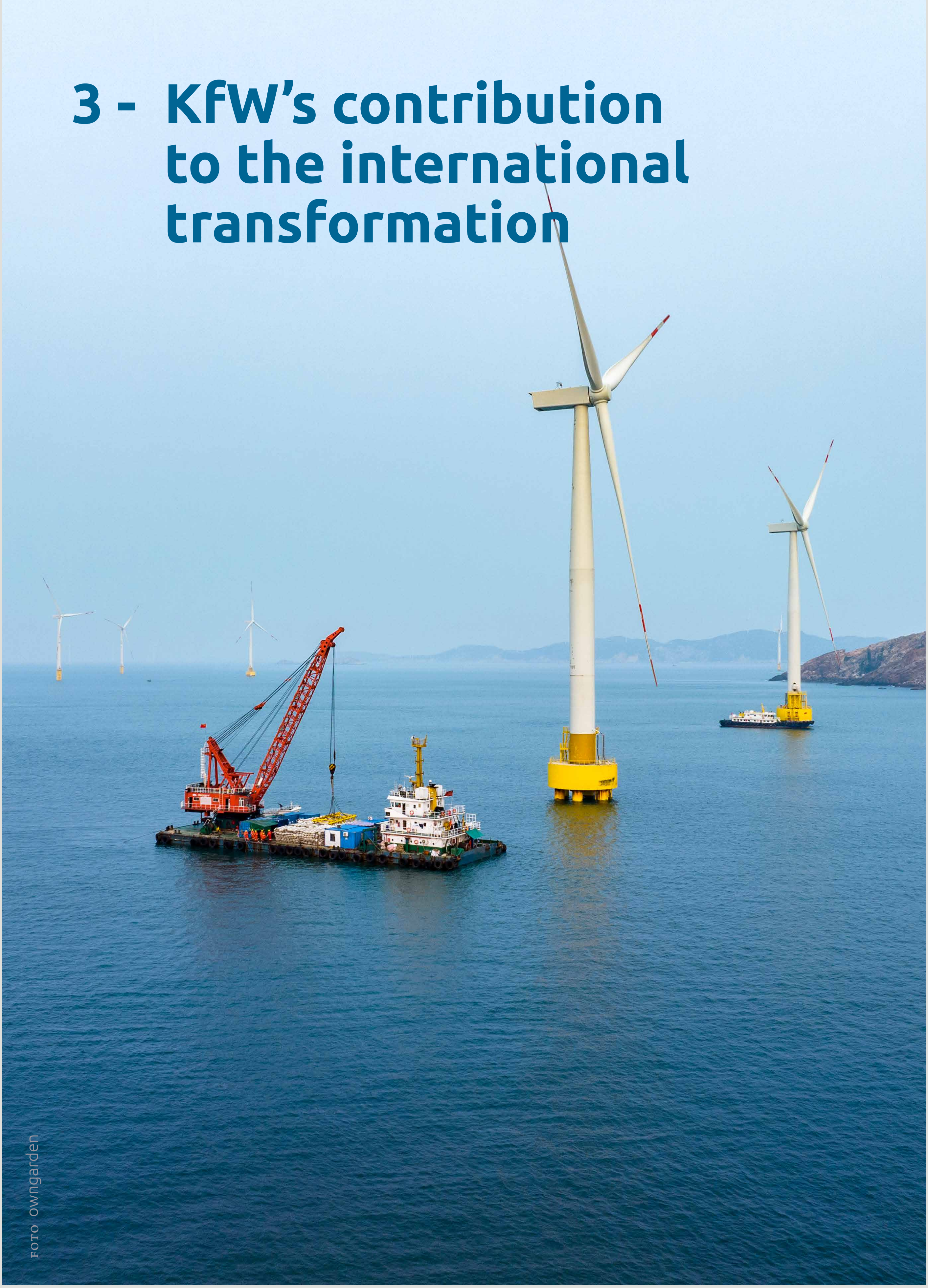


Foto owngarden

Suitability of the institutional framework for a climate and transformation bank

Legal form and business divisions

KfW Group is a **public-law credit institution** whose share capital of EUR 3.75 billion is held by the federal government (80 percent) and the federal states (20 percent). The Federal Government is liable for the loans and bonds of the KfW Group and for its loans to third parties. **Legal and technical supervision** is the responsibility of the **Federal Ministry of Finance** (BMF) and the **Federal Ministry for Economic Affairs and Climate Action** (BMWK). Inherent in the nature of dual leadership is the risk of hesitant decisions if the two ministries pursue different objectives.

The Group as a whole is divided into five divisions with total assets of EUR 554.6 billion at the end of 2022. In the same year, the volume of new business and scale of financial support increased to a total of EUR 166.9 billion, while profit fell to EUR 1.37 billion, which is in line with the average of the last five years.[24] The divisions are:[25]

- **Domestic funding** for private individuals, companies and municipalities (new business 2022: EUR 135 billion);
- **KfW Capital**, a wholly owned subsidiary that invests in German and European funds that provide venture and growth capital for innovative technology companies (new business in 2022: EUR 1.3 billion);
- **KfW development bank** for development financing primarily for states in the Global South on behalf of the German Federal Government and the EU (new business 2022: EUR 10.9 billion);
- **Deutsche Investitions- und Entwicklungsgesellschaft (DEG)** for advising, extracting and financing the German private sector for projects in the Global South (new business in 2022: EUR 1.6 billion);
- **KfW IPEX-Bank** for private-sector export and project financing, including securing raw materials and climate protection projects worldwide (new business in 2022: EUR 18.1 billion).

The central legal basis for its business activities is the **Act on the Kreditanstalt für Wiederaufbau** (KfW Act) as amended in June 2020.[26] KfW Group has been subject to the **German Banking Act (KWG)**, at least in part, since 2016, even though it is not considered a credit institution under the KWG[27] and therefore does not continue to be subject to the same banking supervisory regulations as private banks.[28] The extent to which the banking supervisory standards set out in the KWG apply to KfW Group is governed by the KfW Regulation, which was last amended in February 2023.[29] The corresponding supervision is the responsibility of the **Federal Financial Supervisory Authority** (BaFin) in accordance with Section 7 of the German Banking Act (KWG), which informs the two aforementioned ministries of any measures regarding KfW Group. Above all, the KWG requires KfW Group to back its transactions with more **equity** than before, depending on the risk weighting, to apply stricter **transparency rules** and to accelerate **digitalization**.

24 KfW (2023). 2022 Annual Consolidated Financial Results of KfW.
25 Ibid

26 KfW (2020). Law on the Kreditanstalt für Wiederaufbau.
27 Federal Court of Justice (2013). Law amending the law on the Kreditanstalt für Wiederaufbau and other laws.
28 BMF (2022). Regulation amending the KfW Regulation. Draft bill of the Federal Ministry of Finance.
29 KfW (2023). KfW Regulation.

The question of whether the partial application of the KWG to KfW will also lead to a loss of political authority over KfW and to a gradual development towards a "normal" commercial bank is the subject of controversial debate. Many critics complain that KfW Group now recruits much more (management) staff from the traditional financial sector, uses comparable bonus systems and has greatly reduced its formerly renowned think tank capacities. **In particular, they say that this reduction in staff and the realigned internal incentive systems had drastically reduced the ability to innovate and the willingness to promote smaller projects or projects that go beyond the usual standards.**[30] However, because these decisions are fundamentally reversible and because neither the mandate nor the legal form of KfW Group has changed with the partial application of the KWG, but only the transparency obligations and the requirements for financial risk management have been partially raised, there is no compelling reason to refrain from the political management of KfW Group in accordance with its public law mandate. **The mandate formulated in the KfW Law leaves ample scope for KfW Group to focus much more decisively than before on the protection of global public goods and the financing of transformation, not only domestically but also internationally and above all in the Global South**. In other words: It can take a much greater risk in financing transformation issues than it does today if the political will exists and is enforced on the Board of Directors. **Which course KfW takes is ultimately up to the political leadership or the willingness to allow more of the same to prevail.**

As a public-sector credit institution, KfW Group **benefits greatly financially from the Federal Government's liability** for all its loans and bonds as well as for the loans it grants to third parties. This enables the KfW Group to obtain **capital very cheaply**, which is reflected in its AAA rating.

30 The fact that new commitments for climate and environment-related projects at KfW Development Bank increased by 20% between 2018 and 2023, but the number of these projects fell slightly, seems to confirm the criticism that the trend is towards fewer but larger projects.

As a credit institution under public law, KfW Group is obliged to **perform tasks arising from or in the public interest**.[31] These are specified in Section 2 of the KfW Law.[32] It states that KfW Group is responsible for carrying out promotional measures on behalf of the government. On an international level, these include, among others, "**Environmental protection**", "**Infrastructure**" and "**Technical progress and innovation**" "Financing, in particular for **internationally agreed funding programs** and **development cooperation**". In addition, the KfW Law defines KFW Group's special task as "**providing other financing in the interests of the German and European economy**", including for "projects in the Community interest that are co-financed by the European Investment Bank or similar European financing institutions" and for export financing.

In order to fulfill these tasks, KfW Group may conduct transactions on the financial markets, i.e. buy and sell securities and take measures to ensure its financial liquidity and risk management.[33]

As a rule, loans granted by KfW Group must be secured directly or indirectly by standard bank collateral. However, the Board of Directors may also approve loans without collateral.[34] This passage in the KfW Law provides the decisive political leeway for risky financing that is in the public interest and covered by the KfW Law. In this respect, **KfW Group can become much more involved in risky transformative issues in the Global South if politicians give it a mandate to do so** and bring about appropriate resolutions in the Board of Directors.

31 Gabler Banklexikon (n.d.). Öffentliche Banken.
32 KfW (2020). Law on the Kreditanstalt für Wiederaufbau.
33 Ibid
34 Ibid

Governance and political control

As the highest internal supervisory body, the **Board of Directors** is responsible for the **political control of KfW Group**. Its composition is set out in Section 7 of the KfW Law,[35] which requires the Board of Directors to have 37 members, seven of whom are from federal ministries (BMF, BMWK, AA, BMDEV, BMEL, BMUV, BMZ), the Bundestag and the federal states, five from credit institutions, four from trade unions, two from industry and one each from local authorities, agriculture, the skilled trades, trade and the housing industry. The fact that, contrary to KfW Group's increasingly transformation-oriented claim, neither environmental nor development policy associations are represented on the Board of Directors has been widely criticized. The Board of Directors is chaired alternately for one year by the Federal Ministry for Economic Affairs and Climate Action, as they are also responsible for the technical and legal supervision of KfW Group. The current composition of the Board of Directors[36] includes nine members with CDU party membership, seven members each from the Greens and the SPD, three from the FDP and ten members with no known party affiliation. It should be explored how **a majority on the Board of Directors can be won for a more transformative orientation of KfW Group.**

35 Ibid
36 KfW (2024). The KfW Board of Directors and its Committees. Status in 2024.

In accordance with the KfW Law and the Articles of Association, the most important **tasks of the Board of Directors** include appointing, advising and monitoring the KfW Executive Board, monitoring asset management and strategic orientation and making certain investment decisions. The Board of Directors also decides on the approval of the annual financial statements. Whereas in the past, party affiliation was often an important factor in the appointment of KfW Executive Board members, today Executive Board members must have a specific business license, the so-called banking license, in accordance with Sections 32 and 33 of the German Banking Act (KWG) and thus demonstrate solid professional expertise and management experience in the banking sector.

The current six-member **Executive Board** of KfW Group, chaired by Stefan Wintels, is responsible for managing the company in accordance with the KfW Law and the KfW Articles of Association. Stefan Wintels was most recently on the Executive Board of Citigroup until 2021. The other board members, Katharina Herrmann (Domestic Promotion), Melanie Kehr (Operations), Christiane Laibach (International Financing), Bernd Loewen (Administration & Personnel) and Dr. Stefan Peiß (Risk Management) also worked mainly in private banks before joining KfW Group. No specific development, transformation, or climate policy background is recognisable in the current Executive Board. In view of the declared objective of transforming KfW into a climate and transformation bank, the Executive Board would now be particularly challenged to credibly emphasize with ambitious steps that the declared goals are also followed by implementation measures that make a measurable difference.

Appropriation of profits

KfW Group has been generating **consistently high net profits** of well over one billion euros annually for years. This means that its **overall earnings meet or exceed those of other major German credit institutions** — a fact that **raises questions about its current**

general focus, as KfW Group is a public-sector credit institution that has to serve the public interest.[37] The high profitability is mainly due to the **high interest surpluses**, which significantly exceed the promotional expenses. These interest surpluses are made possible by the **very low refinancing costs** as a result of the high credit rating due to the **state assumption of liability. This shows that there is considerable scope for KfW to provide more or more favorable financing or risk assumption offers. In view of a very high core capital ratio of recently just under 25 percent[38] it would be no problem to invest more in the protection of global public goods and to take far greater financial risks.** This would correspond to what is currently being discussed in the course of the reform debate on the capital adequacy frameworks of the multilateral development banks. To put this into perspective: the World Bank, whose equity ratio is around six percent lower than that of KfW Group, recently decided to reduce it by a further percentage point in order to be able to grant more loans. Experts such as Professor Hans Peter Lankes, LSE Grantham Institute and member of the G20 Panel on the Capital Adequacy of the Multilateral Development Banks,[39] considers an equity ratio of 17 percent to be sufficient for development banks.

The **KfW Law regulates the appropriation of profits in Section 10**, according to which no distribution of profits takes place. Instead, the net profit is to be used to build up reserves. Even if there is no direct inflow to the federal budget, any surpluses generated are used to set up funding programs that would otherwise have to be financed with federal budget funds. This applies in particular to domestic business.

37 See: ntv (2013). State bank KfW earns more than any other financial institution in Germany. Or: Manager Magazin (2022). KfW Bank generates billions in profit in 2021.

38 https://www.kfw.de/Über-die-KfW/Newsroom/; the core capital ratio must be at least 6 percent according to the KWG. For comparison: Deutsche Bank recently stood at around 12.5 percent.

39 CAF (2022). Boosting MDBs' investing capacity.

Strategic target system and impact measurement

The **Key Performance Indicators (KPIs)** as a traditional corporate management tool are defined by KfW Group in its strategic target system, discussed with the supervisory departments of the Federal Ministry of Finance and the Federal Ministry for Economic Affairs and Climate Action and approved by the Board of Directors.

In its current strategic target system for 2027, [40]KfW Group defines its primary strategic objective as **"the transformation of the economy and society to improve economic, ecological and social living conditions**. To achieve this, KfW, as one of the largest promotional banks in the world, promotes and finances investments by governments, municipalities, companies, financial institutions and private individuals in Germany, Europe and worldwide."[41]

In addition, a whole series of KPIs are set for **secondary targets**, including the mobilization of private capital, German SME financing (target: >40%), customer and employee orientation, risk management, equity ratio and sustainability. With regard to sustainability, for example, **the 1.5°C compatibility of KfW financing** and at least a top 5 position in the average of all relevant sustainability ratings for development banks are specified.[42] Also included in the strategic target system — and an important component of the annual KfW Sustainability Report[43] — is the **environmental quota**, which is defined very broadly and has been at least 36 % across the group since 2020. in 2022, it amounted to 59 % in the traditional extraction business, but only 36 % (or EUR 60 billion) of the total extraction volume across the Group due to unscheduled financing in the context of the energy crisis and Russia's war in Ukraine.[44]**The**

40 KfW (2022). Sustainable funding — Infographic.

41 KfW (2023). KfW Sustainability Report 2022:

42 This target has been achieved in recent years with the exception of 2021, see KfW (n.d.). The Transformative Development Bank KfW.

43 KfW (2023). KfW Sustainability Report 2022:

44 https://www.kfw.de/Über-die-KfW/Newsroom/

environmental quota was to be expanded to include a climate quota, increased and defined in line with the EU taxonomy. In the case of a "hard" climate or transformation quota, only financing models that make a truly relevant contribution to transformation or climate change mitigation and adaptation should be allowed to contribute to this quota. The Rio markers do not provide a sufficient basis for this.

Since 2020, KfW Group has started to develop an **indicator-based impact measurement** system in order to gradually make the achievement of its primary strategic objective measurable and comparable. With currently around 50 quantitative impact indicators, KfW's contribution to achieving the 17 SDGs through promotion and financing is modeled based on a theory of change via impact chains.[45] The project is being implemented as part of the two strategic KfW projects "Sustainable Finance" and "tranSForm". The bank states: "As a transformative promotional bank, KfW sees it as its responsibility to systematically record the economic, ecological and social impact of its promotional activities, to make this transparent and to derive corresponding steering impulses for greater effectiveness."[46] During impact monitoring, data is automatically recorded and evaluated for all indicators and used for customer dialog as well as for the further development of the funding instruments. Although impact measurement is initially carried out separately by business division, it is done in a way that enables a group-wide aggregated view in a central data repository.[47]

45 According to KfW, the system is based on international standards such as IRIS+ (www.thegiin.org)) and the Green Bond Principles (see ICMA (2022) Green Bond Principles. International Capital Market Association.)
46 Ibid, for the method see also: KfW (2022). The KfW Group's impact management
47 Ibid

In parallel, KfW Group is developing a **greenhouse gas accounting** system to **record and monitor its climate impact**. This is a uniform company-wide methodology for estimating the carbon footprint of all financing, which is gradually being expanded to include additional indicators such as emissions saved, GHG storage, installed electricity generation capacity with renewable energies, installed hydrogen generation capacity, energy saved, primary energy saved in buildings and other indicators. **The indicators for measuring climate resilience have so far been less differentiated**. There is room for improvement here. In addition to the climate-related impact indicators, input indicators are also used, i.e. the **financing volumes for greenhouse gas reduction and climate adaptation are recorded**.

Impact indicators were also developed for fossil energy projects, which suggests that KfW will not end its support as soon as required to comply with the 1.5 degree limit.

Overall, indicator-based impact measurement is a good, albeit expandable and insufficient control instrument on its own. In order for such a monitoring system to actually have an impact on funding and financing practices, the bank must commit to addressing key findings in the respective business areas, defining the required changes. Relatively vague statements on this can be found in the nine "KfW impact management guidelines". Guideline 3 states, among other things: "KfW addresses the risk of negative impacts of its financing and promotional activities within the framework of the respective sustainability guidelines of the business divisions." Guideline 9 is just as non-committal: "KfW uses the experience gained from group-wide impact management to ensure that its support for the transformation of the economy and society remains effective and ambitious."[48]

48 Ibid, Appendix IV

It is clear here that KfW Group's impact measurement must be underpinned by an ambitious and concrete target system, including interim targets, as a reference framework for implementing its transformation ambition, as the 17 SDGs are by no means sufficient for this. This is the only way to make a significant contribution to achieving the Paris climate targets through financing and promotional activities. The Bank has committed itself to this, defined itself as a transformation bank and made this its primary strategic objective.

Necessary political decisions for the further development of KfW into a transformation bank

- Obtain a corresponding **political mandate** and bring about the resolutions in the Board of Directors that will allow it to take greater financial risks for the promotion of transformation-oriented projects in the Global South;
- by lowering the equity ratio from 25% **to** increase the **financial scope** for the protection of global public goods;
- increase the environmental quota and expand it to include a uniformly defined and transparent **climate quota**
- underpin the **impact measurement** with an ambitious and concrete target system **as a reference framework for the implementation of the transformation claim.**

Implementation instruments for KfW's transformation claim

The following section analyzes the contribution that the implementation tools developed by KfW Group can make to achieving its own transformation ambitions.

Sustainable finance concept

The **sustainable finance concept developed in the internal transForm project, which has been in force since 2021, aims to** further develop KfW Group into "the digital transformation and promotional bank", i.e. "to play a pioneering role in the financial sector in terms of how a bank or promotional bank can make substantial contributions to achieving the UN Sustainable Development Goals and the Paris Climate Agreement with the resources it is given."[49]

The **four pillars of the sustainable finance concept are the** indicator-based impact management already presented above, **sector guidelines for Paris-compatible financing**, a **strengthening of ESG risk management** and the provision of finance-related **sustainability data for the Group-wide implementation of the EU taxonomy as central steering instruments** of a future transformation bank that is geared towards the 1.5 degree temperature limit.[50] These control instruments are briefly presented and analyzed below.

49 KfW (n.d.) Sustainable Finance.
50 KfW (2023). tranSForm: central implementation project for the Sustainable Finance Agenda of KfW Group.

FIG. 06 **Requirements for technologies according to the KfW sector guideline for the electricity generation sector**

Technologies	Description	Commitments in the period from 1/1/2023 to 31/12/2024	Commitments from 1/1/2025
Transformative technologies Challenge and support	- Onshore and offshore wind power - Photovoltaics (PV, incl. battery storage as hybrid power plants) - Concentrated solar power plants (CSP) - Hydropower and tidal power plants - Geothermal power plants - Power plants for electricity generation from sustainable biomass (certification required with regard to sustainability, e.g. Global Bioenergy Partnership (GBP), FSC or RSPO, voluntary certification systems (provisionally) approved by the European Commission) - Electricity storage (such as batteries for integration)	At least 81.2 % of the commitment volume of the power generation technologies per business division	100 % of the commitment volume of the power generation technologies per business division
Transitional technologies Limitation of the share of the commitment volume	- Natural gas power plants (without CCS) (new construction and modernization) - Oil/diesel power plants (in individual cases, new construction and modernization)	Up to 18.8 % of the commitment volume of power generation technologies per business division	No commitments for transitional power generation technologies
Technologies without quota crediting	- Natural gas power plants (including CCS) - Waste incineration without energy recovery is Paris-compatible until the end of 2024 and may be financed. From 2025, only waste incineration with energy recovery may be financed	No quota crediting	No quota crediting

SOURCE KfW (2023). Paris-compatible sector guidelines of KfW Group.

Climate & Development Advice, 2024

Paris-compatible sector guidelines

At the beginning of 2023, KfW Group published the second version of the customer version of its group-wide "**Paris-compatible sector guidelines**"[51] and last updated it in December 2023.[52] These contain **sector-related minimum requirements for KfW's financing capability** and apply **to all new projects in foreign business**. For domestic funding programs, existing funding guidelines remain in force, but are gradually being reviewed and adapted for compatibility with the sector guidelines.

The bank states the following on the function of the sector guidelines as an important transformative **management tool**: "With its sector guidelines, KfW is committed to the 1.5°C climate target and wants to take responsibility for a climate-friendly transformation in Germany and worldwide in line with this. With this in mind, KfW pushed ahead in 2022 with the further development of the sector guidelines first implemented in 2021 with a focus on the 1.5°C target. The minimum requirements for the **electricity generation, iron and steel production, automotive, aviation and buildings sectors** were derived using the "Net Zero by 2050" scenario of the International Energy Agency (IEA). A control system was developed for the **shipping** sector which, in addition to the previous technology-based

51 KfW (2023).Paris-compatible sector guidelines of KfW Group.
52 Ibid

approach based on the IEA's Sustainable Development Scenario, controls the shipping portfolio to 1.5°C using real emissions data from the financed assets. Information from the Poseidon Principles framework is used for this purpose."[53]

The sector guidelines have a steering function and, compared to many other development banks, are **for the most part relatively ambitious, specific and concrete** in their areas of application, including with regard to the **successive tightening of climate-related requirements from year to year** (see FIGURE 06 for an example). They provide orientation and planning security.

In addition to remaining questions regarding the **appropriateness of the level of ambition** and the transitional periods granted for the eligibility of projects with very limited (or non-existent) transformation potential, their **weakness** lies primarily in their **limited scope of application: A lot of of KfW's financial support in international business is not subject to the requirements of the sector guidelines**: This applies, for example, to projects by financial intermediaries (e.g. credit institutions) that cannot be defined by sector as well as general financing, i.e. financing that is not related to a specific sector (e.g. general corporate financing). This may be primarily due to the fact that specific requirements in the sector guidelines are very often based on the German legal situation and German or EU climate targets. Where these are missing or not easily transferable to other countries, **gaps arise that can quickly become loopholes. A differentiated view that attempts to do justice to the very different circumstances in Germany and in low-income countries of the Global South, for example, is only rudimentarily undertaken.** Instead, the bank limits its application of the guidelines. In the building sector, for example, all financing outside the EU is excluded. In addition, the guidelines are essentially **minimum requirements**. The guidelines do contain formulations such as "KfW Group always relies on the best technologies available and usable at the location"[54] However, this approach is not consistently pursued, remains imprecise and is not backed up with incentives such as better financing conditions.

53 Ibid
54 Ibid, p. 10

The **guideline for the electricity generation sector** is particularly controversial because, in addition to transformative (renewable) technologies, it also temporarily permits so-called fossil "bridging technologies" (natural gas) to a limited extent (maximum 18.8% of the committed volume of electricity generation technologies per business area). Although the guideline[55], which was updated in December 2024, provides for the phasing out of new subsidies for fossil-fuel power plants on 1/1/2025, it contains a **loophole** in that "business divisions can switch to a criteria-based approach for 1.5°C-compatible natural gas power plants by the end of February 2024 at the latest. This criteria-based approach only enables the financing of 1.5°C-compatible natural gas power plants beyond 2023 and excludes the financing of transitional technologies based on the above-mentioned quota of 18.8% in 2024."[56]

In other words: KfW Group reserves the right to define its own criteria for 1.5 degree compatible natural gas power plants in the electricity sector, which do not have to correspond to those in the sector guideline, which are not publicly known and may not be published, in order to continue to finance natural gas power plants. This non-transparent approach to circumventing its own sector guidelines raises considerable questions and has great potential to massively damage KfW's reputation internationally. This is incompatible with the bank's own claim to be an exemplary transformation bank. **Financing no more fossil energy projects and ending existing financing in this area as quickly as possible — across all business sectors and subsidiaries — would be the right approach in view of the compatibility of all investments with the 1.5 degree target.**

55 Ibid
56 Ibid., p. 11; at the beginning of March 2024, no new, publicly available information was available on this.

Exclusion list

KfW Group's exclusion or negative list (2023) defines the areas in which financing will not be provided under any circumstances.[57] The list is short and essentially contains products that are internationally banned or restrictively regulated. In terms of **Paris compatibility**, the exclusion list includes the exploration, extraction, transportation and combustion of **coal**, the exploration, extraction, transportation and storage infrastructure for **crude oil**, and the exploration, extraction and transportation of **natural gas and grey hydrogen**. The exclusion list is helpful **as a transformative management tool** or as a **communication tool** that shows at a glance, like a stop sign, which financing KfW Group does not offer to protect the global commons, but must then also be implemented consistently. In the area of natural gas, all ambiguities must be cleared up, as shown above.

ESG and climate risk management

The aim of ESG (environment, social, governance) risk management is to better dovetail the business strategy with the risk strategy, i.e. to manage financing in such a way that it achieves positive transformative effects in the outside world ("Save the world: inside-out") and to ensure that ESG or climate risks of the financed projects do not lead to loan defaults and thus financial risks for KfW ("Save the bank: outside-in").[58]

Clearly identifying and managing (climate) risks and their drivers **(physical such as extreme climate events and slow onset of changes, regulatory-legal, political, technological, etc.), which arise for borrowers but can also become credit or investment risks for the bank in the feedback loop, is an** essential prerequisite for successful transformation-oriented financial support. **It is in the interests of both the financing partners in the Global South and the Bank — provided that this does not result in a risk avoidance strategy that leads to the premature exclusion of financing for projects in smaller or particularly vulnerable countries in the Global South**.

As our needs analysis for the transformation in the Global South has shown, it is often the risk aversion of investors that leads to a massive financing gap, which will increase further with the foreseeable increase in climate risks. It would therefore be the task of development banks such as KfW to take on more risk themselves in order to close this gap. In this respect, **the strengthening of ESG and climate risk management** by KfW Group should not only ensure that risks and their influencing factors are clearly recognized and realistically assessed, but **also that suitable measures are identified and taken to make these risks manageable in such a way** that **transformative investments are nevertheless made at a reasonable cost of capital** — not only by the bank itself, but also by private investors through their participation. If the dovetailing and strengthening of ESG risk management had this effect, it would make a transformative contribution. **If, on the other hand, an improved risk assessment leads to a blanket exclusion of financing, this will at worst inhibit the transformation.** It is a **political management task** to ensure that KfW Group uses its risk management to protect global public goods and that transformation is also and especially promoted in the most vulnerable countries. In concrete terms, this means that ESG and climate stress tests, as envisaged by the sustainable finance concept, are not only and above all not primarily used as a management tool in line with the motto "Save the bank", but rather lead to the targeted de-risking of transformation projects in the Global South in line with the motto "Save the world".

The identification and management of risks is a process that is **intensive in terms of human resources and costly** because the risk drivers are very country-, location- and sector-specific and many other potentially relevant contextual factors need to be considered. Critics argue that KfW has downsized its sector teams, reduced or externalized expertise and cut back on advisory services for third parties in recent years in order to save costs. This **increases the risk that detailed risk analy-**

57 KfW (2023). Exclusion list of KfW Group.
58 KfW (2023). tranSForm: central implementation project for the Sustainable Finance Agenda of KfW Group, p. 24

ses will only be prepared for larger partner countries and that the financing of transformative projects in smaller, high-risk countries will be reduced or discontinued — not to mention the fact that reduced personnel resources also limit KfW Group's ability to develop transformative project pipelines, whereas our needs analysis has just shown how extraordinarily relevant good advice by development banks is for their clients, even in smaller countries. In this respect, a **massive expansion of the corresponding capacities at KfW Group to implement improved ESG and climate risk management appears to be a key lever** for transforming KfW into a transformation bank that meets the world's needs.

Reporting financial sustainability data

By strengthening financial sustainability reporting, the classification requirements of the EU taxonomy are to be implemented across the KfW Group, thereby meeting the growing transparency-related regulatory requirements.[59] KfW Group is neither a pioneer among development banks in meeting these requirements, nor has it so far given the impression that this management instrument has any real added value. Rather, it gives the impression that, from the Group's point of view, it is primarily a matter of fulfilling its obligations.[60] From an external perspective, however, this increases **transparency** — for example, an EU taxonomy-compliant definition of the KfW environmental quota would be helpful.

Overall, our analysis shows that the KfW Group has significantly strengthened its ambition to transform itself into a transformation bank, especially since 2021/22, and has also been developing an appropriate set of management tools since then. Nevertheless, there is a discrepancy between ambition and reality because these instruments have gaps in the level of ambition and loopholes. So there is a need to catch up and make more decisive progress with the conversion. **In particular, the new instruments hardly address the actual need for financial support and advisory services as they exist in the countries of the Global South, which suffer the most from the persistent funding gap for transformative projects.** In order to close this transformative funding gap, **far more specific financial support instruments would be required**, as explained in the first part of this analysis. Although there are certainly welcome approaches, these are still too weak and not sufficiently covered by political guidelines for the public-sector credit institution.

Management tools to keep KfW on track as a transformation bank

- Paris-compatible **sector guidelines** without loopholes;
- Implementation of improved **ESG and climate risk management**;
- **EU taxonomy-compliant** definition of the KfW environmental quota.

The **final litmus test** for a transformation bank, however, is **the actual business and promotional practice**, which is reflected in the actual financing flows and project pipelines of the KfW Group's foreign subsidiaries. In the next step, these will be examined in terms of their transformative orientation.

59 KfW (2023). tranSForm: central implementation project for the Sustainable Finance Agenda of KfW Group, p. 31
60 See ibid., 31-32

Business model and international climate and transformation financing

KfW development bank, **Deutsche Investitions- und Entwicklungsgesellschaft (DEG)** and **KfW IPEX-Bank** are responsible for KfW Group's international activities. The business model for all three institutions in the banking group is presented below and assessed for its suitability. It must be said at the outset that the data published by KfW Group does not allow a clear and verifiable distinction to be made as to what proportion of promotional funds flows into transformation financing in developing and emerging countries. Apart from the reasons stated in the introductory chapter, there are various reasons why this level of **transformation transparency does not exist**: firstly, KfW development bank, IPEX-Bank and DEG are three banks with different reporting forms and, above all, different levels of transparency. The reporting of IPEX-Bank and DEG is much less transparent than that of KfW development bank. However, even KfW development bank does not report in a systematic and verifiable form how much funding is used for transformation or climate projects. According to KfW, the climate portfolio increased from EUR 2.4 billion in 2010 to EUR 4.3 billion in 2020.[61] For 2021, KfW development bank gives the impression that almost the entire portfolio is geared towards transformation when it says: "In 2021, KfW committed EUR 8.6 billion to financing new development projects in order to support partner countries in achieving their development and climate goals and to significantly improve living conditions".[62] None of this can be verified by publicly accessible sources. In the OECD-DAC ODA statistics, only the grants and standard loans of KfW development bank are recorded, but not the other financing. In addition, many KfW development bank financings are reported as "non-targeted" with regard to the use of the so-called Rio markers. Added to this are the numerous methodological limitations of the Rio marker system, as the OECD-DAC itself acknowledges.[63] The German government's reports to the EU and UNFCCC also do not really help to clearly define the extent to which KfW invests in transformative projects.[64]

In view of such data collection problems, it is **not possible** for us to reliably quantify **how much KfW Group** is investing internationally to **promote transformation** in absolute or relative terms. **Creating complete transparency** in this regard is urgently needed and is something that should be done very promptly by KfW Group for KfW development bank, IPEX Bank and DEG. The **delimitation criteria** must also be made transparent.

For our analysis below, we use the key performance indicators presented by KfW Group and its subsidiaries in their annual reports on their new commitments for the energy and environmental sector, which are not very clearly delineated. These would be the new commitments for "Energy & Environment" at IPEX-Bank and "Climate Protection" at DEG. In the case of KfW development bank, we were able to draw on detailed data that KfW made available to us exclusively for the purpose of this study.

61 KfW (2021). The Challenge of Climate Change: How the KfW Development Bank Contributes to Achieving Climate Goals.

62 KfW (2022). KfW Development Bank Facts and Figures 2021.

63 OECD (2019). Aligning Development Co-operation and Climate Action. The Only Way Forward. Annex C. Methodology.

64 UNFCCC (n.d.). UNFCCC Climate Finance Data Portal.

But as long as the EU taxonomy is not implemented across the Group, the sector guidelines are not applied in accordance with the Paris agreements and without loopholes, and the sustainability reporting mentioned above is not fully applied, transparency gaps remain. **The respective sectoral DEG and IPEX portfolios — for example "energy generation and supply" — may also contain financial support for non-transformative projects, for example in the area of fossil fuels.** Studies have repeatedly shown that KfW Group is still financing projects that are not compatible with the Paris climate targets.[65] However, if these sectoral figures of the three subsidiaries were to be added together with all reservations and reported as an **"international transformation or climate portfolio"**, the volume of new "transformative or climate-related funding commitments" for 2022 would be EUR 10.7 billion — which still represents a very low overall ratio of not even 34% of all new commitments. This shows: **In its international business, KfW Group is still a long way from being a transformative bank. But there are significant differences between KfW Development Bank, DEG und IPEX.**

KFW development bank's foreign investments

KfW development bank acts as the **implementing organization of the German Federal Government's Financial Cooperation** (FC). It promotes projects with predominantly state players in the Global South. FC is based on the country strategies of the Federal Ministry for Economic Cooperation and Development (BMZ) and the development strategies of the partner country. The funded projects and programs are proposed in bilateral government negotiations. KfW development bank examines whether the proposed projects make sense in terms of development policy and are feasible.[66] The Federal Government then decides on the amount of funding to be committed. An intergovernmental agreement and a financing agreement are typically concluded between KfW development bank and the project sponsor. The funded projects are put out to tender and implemented responsibly by the project sponsors. KfW development bank employees support the project sponsors and report regularly to the German government on progress. Before a bidder is awarded the contract, the sponsor submits an evaluation report of the tender to KfW development bank, together with an award proposal and the draft contract. The contract will be awarded to the tender that is judged to be the most cost-effective in the evaluation. Contracts may only be awarded to competent and capable bidders. The approval of KfW development bank is ultimately a prerequisite for the contract to be signed.

KfW development bank is currently promoting around 2,200 projects in more than 100 countries on behalf of the German Federal Government. Its business model essentially provides for the following **financial products** and financing instruments:

- **Grants and standard loans** (i.e. highly subsidized, concessionary loans) from budget funds to less developed countries;
- **Development loans** as a **mixture of loans and grants** from the federal budget with KfW's own funds, which KfW raises on the capital market at favorable conditions. The mix of budget and KfW funds is determined in such a way that the projects can bear the financing costs and the **loans comply with international agreements on Official Development Assistance (ODA)**. The conditions of the development loans are above the conditions of the standard loans, but significantly below the market conditions;

65 See for example: Klima Allianz (2023). Press release on Chancellor Scholz's gas initiative in Senegal.

66 Specialized consulting companies are generally used for this purpose. Together with the partner, they prepare a feasibility study that evaluates key aspects of the project in terms of economic efficiency, developmental impact and potential risks.

- **Promotional loans** finance projects deemed worthy of development policy support, **primarily in countries without recognizable debt problems and with a higher level of development**. Due to their below-market conditions, **promotional loans close the gap between concessionary development loans and commercial financing**. Within the framework of FC, promotional loans are primarily used to support the **private sector** in partner countries. In KfW development bank's view, the project risks must be acceptable and the borrower's **creditworthiness** must be sufficient. Promotional loans are offered at conditions at the upper end of the range of concessionary financing, i.e. at **conditions close to market conditions.**[67]

The following tables[68] illustrate how KfW development bank's new commitments in the recent past are distributed across the above financing instruments (FIGURE 07), the ratio of budget funds to KfW funds (FIGURE 08), the weighting of new commitments with regard to developing and emerging countries in Africa, Asia, Latin America and South-East Europe (FIGURE 09) and the proportion of new commitments allocated to environmental and climate protection (FIGURE 10).

Although the above data series only cover a short period of time, some conclusions can be drawn based on the empirical trends that emerge:

67 KfW Development Bank agrees on terms, currencies and interest rate options "entirely according to the needs of the partners" (cf. KfW (2022). Introducing KfW: Roles and Facts.

68 The source of the data shown in tables 07 to 09 is the "Transparency Portal" of KfW Development Bank (transparenz.kfw.de). Our tables were last updated in November 2023. The data in the transparency portal is updated on an ongoing basis, in some cases retrospectively, and may therefore differ. KfW provided the data for Table 10 on request in February 2024.

- While the **share of budget funds in new commitments** has **increased** significantly in recent years (see FIGURE 08), NO SUCH **increasing trend** can be seen in **KfW funds**, which reveals a clear gap to reality in terms of the self-declared claim to be a sustainability bank that makes the protection of global public goods a premise of its business models and proactively promotes transformation processes in partner countries.

- The fact that the majority of new commitments in the form of development and promotional loans are hardly attractive for LDCs is reflected in the detailed breakdown of the funds granted according to their countries of destination:
It can be seen in all regions that it is primarily highly populated emerging countries **and/or middle-income countries (MICs) that receive the majority of the funds.** One important reason for this is certainly the fact that KfW development bank has committed itself to the principle of "Responsible Finance"[69] in its business policy, which is often too much for the existing financial systems, especially in LDCs, for (regulatory) political and economic reasons.

- The **share of grants and low-cost standard loans** aimed at the **least developed countries (LDCs)** appears to be far **too low** in view of the large financing gaps in terms of climate change mitigation and adaptation, especially in these countries, which are generally particularly climate-vulnerable, which is why KfW development bank has not yet made a substantial contribution to special support for the poorest and poor countries with a high exposure to climate risk.

69 The economic situation of the partner country, the level of its debt, its level of development and the conditions of the sector to be supported play a key role here and are incorporated into the conditions for the loans (cf. KfW (2019). Responsible Finance. Guiding principle of KfW in the development of financial systems).

FIG. 07 **New commitments of KfW Development Bank by financing instrument** (in EUR)

	2018	2019	2020	2021	2022
Grants	2.613.920.660	3.384.499.749	3.832.937.305	3.411.923.524	4.534.294.536
Standard loans	296.852.710	305.559.022	206.550.700	200.020.000	792.630.977
Development loans	2.959.845.597	2.411.238.647	3.719.885.053	1.948.571.703	3.688.101.458
Promotional loans	2.100.532.666	1.888.764.992	2.739.458.427	2.628.397.604	1.613.007.400
Mandates	458.395.930	590.493.776	487.029.113	426.689.015	287.724.085
Total	8.429.547.563	8.580.556.186	10.985.860.598	8.615.601.846	10.915.758.456

FIG. 08 **Source of funds for new commitments by KfW Development Bank** (in EUR)

	2018	2019	2020	2021	2022
Budget funds	2.931.761.680	3.736.072.623	4.039.488.005	3.629.943.524	5.343.425.513
KfW funds	5.039.389.953	4.253.989.787	6.459.343.480	4.558.969.307	5.284.608.858
Mandate funds	458.395.930	590.493.776	487.029.113	426.689.015	287.724.085
Total	8.429.547.563	8.580.556.186	10.985.860.598	8.615.601.846	10.915.758.456

FIG. 09 **New commitments of KfW Development Bank by region** (in €)

	2018	2019	2020	2021	2022
(Southeast) Europe	734.511.532	1.320.192.670	1.073.378.560	914.419.880	1.507.791.865
Sub-Saharan Africa	1.722.374.854	2.055.406.054	2.038.834.002	2.161.570.788	2.586.501.910
Asia	2.539.427.773	2.887.413.985	2.905.673.216	2.072.278.758	3.085.075.000
North Africa & Middle East	2.387.105.420	1.425.348.018	3.198.843.883	1.088.711.137	1.778.692.167
Latin America	1.010.099.054	719.968.486	1.263.928.619	1.535.588.342	1.568.247.975
Global	36.028.930	172.226.973	505.202.318	843.032.941	389.449.539
Total	8.429.547.563	8.580.556.186	10.985.860.598	8.615.601.846	10.915.758.456

SOURCE KfW transparency portal (transparenz.kfw.de)

FIG. 10 **New commitments of KfW Development Bank by financing instrument** (in EUR)

	Energy sector	Environmental protection in general	Other sectors with a climate component	Climate and environment as a whole	Share of all new c ommitments
2018	2.625.104.823	447.786.785	1.996.299.418	5.069.191.026	60,1 %
2019	1.865.098.303	405.351.537	2.966.768.381	5.237.218.220	61,0 %
2020	1.207.450.931	396.680.907	2.885.448.337	4.489.580.175	40,9 %
2021	937.194.979	672.830.255	2.104.954.464	3.714.979.697	43,1 %
2022	2.941.269.349	431.930.378	4.218.996.085	7.592.195.812	69,6 %
2023	2.738.055.994	756.741.346	2.543.467.718	6.038.265.058	66,8 %
2018 -2022					57 %

SOURCE KfW (2024).

Climate & Development Advice, 2024

- The share of new commitments for environmental and climate protection in total new commitments is showing an upward trend again after the slump in 2020-2021, which can be explained by special effects (including the Covid-19 pandemic).

- The combined environmental and climate quota includes all financing that includes environmental, biodiversity and climate protection as well as climate adaptation either as primary or secondary objectives (Rio Marker, score 2 and 1).[70] According to the data we reviewed, 50 percent of the funds that KfW development bank contributes to its environmental and climate quota in the period from 2018 to 2023 will go to projects that pursue climate protection as their main objective and 11 percent to projects that primarily serve climate adaptation (Rio Marker, score 2). The remaining funds either flow into projects that serve non-climate-related environmental concerns (smaller portion) or pursue climate protection and/or climate adaptation as secondary objectives. While there is no clear trend in the share of funding for projects with climate adaptation as their main purpose in the 2018-2023 period, the share of funding for dedicated climate protection projects reached a provisional high of 66% in 2023.[71] It remains to be seen whether this will result in a trend.

70 For an understanding of the Rio Markers, see OECD (n.d.). OECD DAC Rio Markers for Climate.
71 The figures are based on data provided to us by KfW Development Bank. See also the OECS-DAC database: OECD (n.d.). Development Finance for Climate and Environment.

In addition to the aforementioned financing instruments, which focus primarily on cooperation with state institutions, KfW development bank also uses public funds to mobilize private capital for development financing. **KfW development bank uses various instruments for this purpose, including in particular:**[72]

- **Structured funds:** These offer investors different asset classes (tranches) depending on their risk preference, with public funds typically providing a risk buffer (first-loss tranche), as the fund initially only consumes the capital of this riskiest tranche in the event of a loss;

- **Anchor investments** serve to leverage additional private investment funds by lowering the risk expectations of private investors;

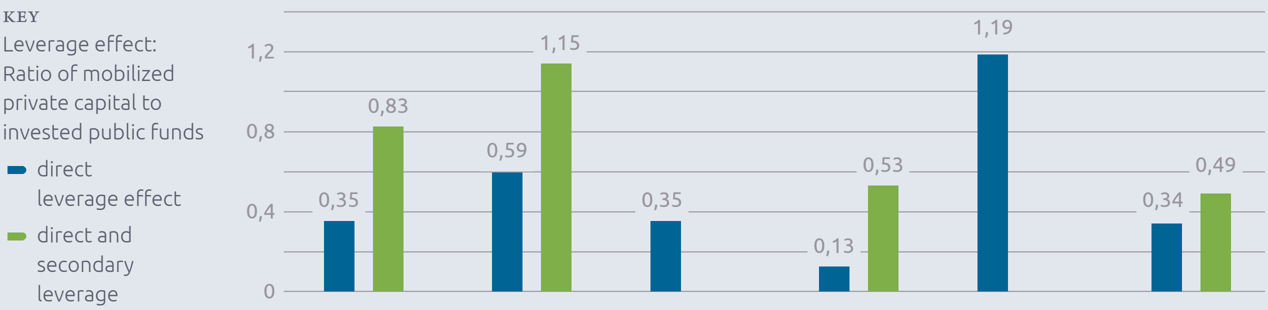
- **Subordinated loans** are basically structured like conventional loans; their difference to conventional loans comes into play in the event of the borrower's insolvency: The lender's claim is subordinated;
- **Guarantees** serve to secure private investments in order to improve the creditworthiness of the investment;

- **Credit lines**, i.e. the granting of loans to local financial institutions, which in turn use these funds for lending in a specific sector;

- **Budget support** for the budgets of reform-oriented partner countries can, in theory, also contribute to stimulating private investment for transformative projects due to its broad and programmatic orientation. They are also relatively easier to implement and simple for third parties to understand compared to other instruments.

72 Cf. KfW (n.d.) Our Financial Products.

FIG. 11 **Leverage effect for mobilizing private funds through public funds**
Mobilization levers of various KfW instruments in the period 2012-2018



		Structured funds:	Unstructured funds	Credit line	Direct investments	Guarantees	Total
Kfw investments [1]		1.153,6	445,52	5.531,95	1.164,37	58,95	**8.353,91**
Mobilized capital [1]	*direct*	406,58	263,57	1.940,25	154,24	70,0	**2.834,65**
	direct and secondary	952,64	511,75		615,75		**4.090,39**

1 in millions of euro. SOURCE Adjusted on the basis of KfW (2019). Mobilizing private capital in development finance: taking stock.

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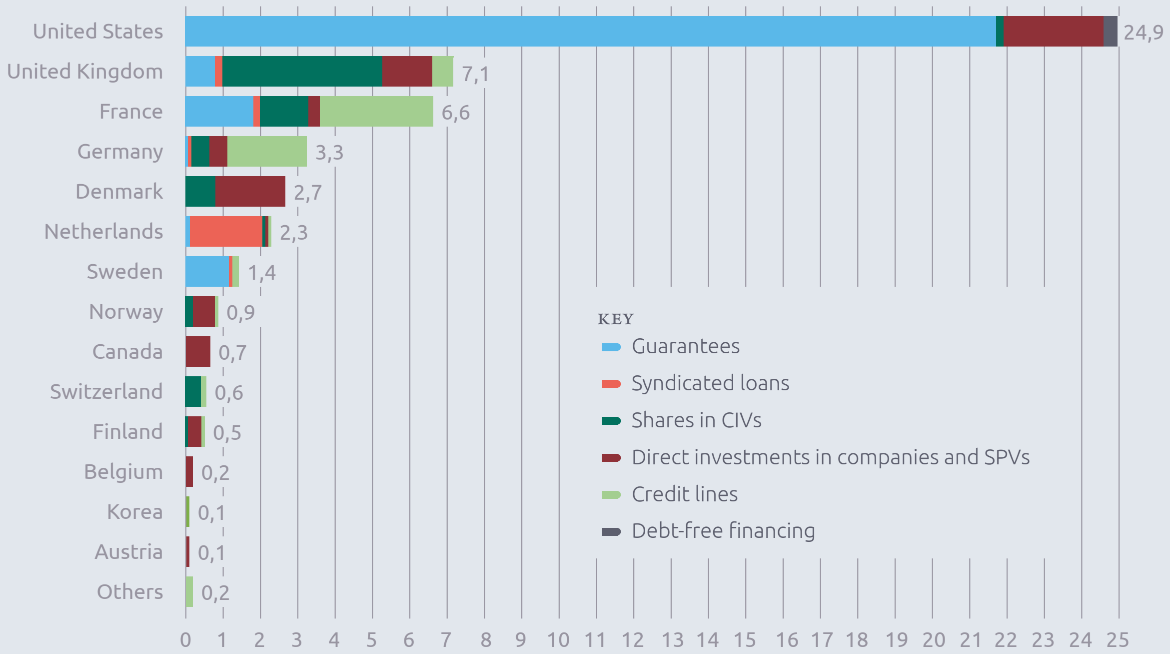
With regard to any form of mixing market funds with concessionary funds (so-called **blending**), which is the aim of the above instruments, the following principle applies regarding leverage: The lower the return and the higher the risk of the investment, the more public funds are needed to mobilize private capital. **It is therefore hardly possible to mobilize large private volumes for risky climate financing with low public funds.** The following graph on the actual mobilization leverage of the instruments used by KfW development bank clearly shows that the **mobilization effect of public funds** — not least in view of the gaps in climate financing — must be considered **modest** to date. The blue bars show the direct leverage effects relative to the funding used, while the green bars also show the secondary leverage effects. This shows that guarantees represent the greatest direct leverage.

Internationally, guarantees are by far the **most important leverage instrument**, accounting for 40% of all funds used for the development-related mobilization of private capital.[73] However, KfW development bank hardly uses this effective instrument for leveraging private capital for investments in the Global South, and it also fails to make use of various other innovative leverage instruments. As Figure 11 shows, the total of all guarantees between 2012 and 2018 amounted to just EUR 58.95 million or 0.7% of their leveraged financial resources.

The OECD-DAC statistics also show that **comparatively little private capital is mobilized through the use of leverage instruments in Germany in relation to its economic strength and foreign trade importance**, as Figure 12 shows: Between 2012 and 2017, USD 24.9 billion in private capital was leveraged for investments in the Global South through the use of ODA funds in the USA, compared to only USD 3.3 billion in

73 KfW (2019). Mobilizing Private Capital. Viewpoints on Financing for Development.

FIG. 12 **Mobilization of private capital through the use of ODA funds by country of origin** (2012-2017 in billions of US dollars).



SOURCE KfW (2019). Mobilisierung privaten Kapitals. Viewpoints on Financing for Development.

Climate & Development Advice, 2024

Germany. In a European comparison, twice as much or more funds were leveraged for private investments in the UK and France, and almost as much in the much smaller Denmark as in Germany.

As shown at the beginning, **the financing gap for transformative investments in the Global South can only be closed if much more private capital is mobilized in the future**. To this end, levers are essential in which public ODA funds are used in the interest of protecting global public goods in order to reduce investment risks for private investors to a manageable level. The above figures show that the mobilization of private capital to achieve the SDGs and climate goals is becoming increasingly important, because private investors are increasingly willing to make investments not only based on returns, but also on environmental and social aspects — even if the absolute amounts still fall far short of what is necessary and capital mobilization has so far been limited both sectorally and regionally: For example, **not even one in ten US dollars currently flows into the least developed countries (LDCs) and low-income countries (LICs)**, while in 2017, for example, 66% of the funds mobilized were invested in upper middle-income countries (UMICs). This corresponds to the results of other studies, according to which the mobilization effects are significantly lower in low-income countries with less developed financial sectors and poor ratings.[74]

This means that **less profitable sectors (e.g. climate adaptation) and countries with poorly developed capital markets or high investment risks have an even greater need for support in improving the conditions for transformative investments**. The involvement of development banks is of fundamental importance in order to create the conditions for more private investment in the first place.

74 IMF (2019). Mobilization Effects of Multilateral Development Banks.

The fact that **KfW development bank** only plays a comparatively **minor role** in this important area, both in terms of the total financial resources used to **leverage private capital** and in terms of the **private investments** actually mobilized in Germany, reveals a **major deficit**. **To ensure that climate and transformation partnerships with countries of the Global South succeed** by actually attracting private investment, **KfW Group should firstly improve the financial resources of its leverage instruments and secondly make much greater use of guarantees as an effective leverage instrument**. But Germany could also make much greater use of other leverage instruments, following the example of the Netherlands or Denmark, for example. In this respect, KfW development bank is currently more of a laggard than a pioneer, as the international comparison has shown. Whether KfW Group takes this necessary step will **also determine whether Germany implements its declared climate foreign policy objective** of effectively supporting the vulnerable but at the same time **transformation-ready states in the Global South** in new partnership models on an equal footing.

Foreign investments by IPEX-Bank

KfW IPEX[75]-Bank GmbH (IPEX-Bank) is a wholly owned subsidiary of KfW and is responsible within KfW Group for **project and export financing** — predominantly in comparatively large volumes — in the interests of the German and European economy to strengthen domestic export companies. This focus on the interests of the German export industry distinguishes it significantly from KfW Development Bank and DEG. In 2008, IPEX-Bank was spun off from KfW as a legally independent financial institution. This was due in particular to the fact that over the years, export promotion increasingly became export financing and gained in importance as a branch of KfW's business activities — which brought the European Union's competition watchdogs onto the scene, who considered KfW's activities in the field of export and project financing to be non-compliant with competition law, as they did not take place under market conditions, but rather within the protected area of a promotional bank backed by the state and were therefore deemed to give it an unlawful competitive advantage. Since then, IPEX-Bank, as a credit institution organized under private law, has been fully subject to the German Banking Act (KWG), operates on the market under competitive conditions and is subject to taxation. In this regulatory context, IPEX-Bank may only make use of the refinancing advantages in the form of the federal government's assumption of liability for promotional activities defined in a catalog of tasks.

The focus of IPEX-Bank's business model is on providing medium and long-term financing solutions — with the aim of supporting the internationalization and competitiveness of German and European companies. IPEX-Bank is active in the following **business areas**:

- **Energy** ("We are financing the energy transition"),
- Mobility ("We are transforming mobility"),
- **Infrastructure** ("We are expanding infrastructure")
- as well as **industry and trade** ("We are boosting the economy").[76]

In these sectors, the business model covers IPEX-Bank's **original market and lending business** on the one hand and the **trust business** it conducts on behalf of the Federal Government and for the account of KfW on the other.[77] A wide variety of products and services are offered, with financing options ranging from traditional delivery-linked export credits and trade and investment financing to complex, structured financing of projects such as companies with interest rate and exchange rate hedging in various currencies, including the integration of export credit insurance.

75 IPEX — International Project and Export Finance

76 Quotes according to IPEX (n.d.). Geschäftsbericht der KfW IPEX-Bank.

77 In 2022, the market business accounted for the largest share at EUR 12.4 billion. Further commitments amounting to EUR 5.1 billion were made in the fiduciary business. In addition, there was new business of EUR 0.6 billion for the refinancing of banks from the shipping, ERP and Africa CIRR (see below).

The trust business carried out on behalf of the Federal Government and for KfW as the Federal Government's contractor essentially comprises three export promotion programs:

- the **Africa-CIRR export financing program**: This is a fixed-interest program that provides budget funds to support the financing of large-volume export transactions by German companies and focuses on promoting projects in Africa. Under the program, eligible banks can grant loans to buyers of German export goods or to banks in the African buyer country at the minimum interest rate CIRR (Commercial Interest Reference Rate) set by the OECD to ensure competitive neutrality for state-supported export financing. KfW provides refinancing for the eligible credit institutions as part of the programme;[78]

- the **ERP export financing program**, which promotes loans to finance German exports to emerging and developing countries. As part of the program, which according to IPEX Bank "benefits not only developing and emerging countries, but also German exporters who use it to open up new markets", the eligible group of banks can grant loans to foreign buyers of German export goods or to banks in the buyer country at the minimum interest rate CIRR. The loans and their refinancing by IPEX-Bank are supported by funds from the special assets of the "European Recovery Program" (ERP)[79];[80]

- the **Ship CIRR funding program**: It serves to support the German shipyard industry by offering buyers of ships or ship components ordered from a German shipyard a fixed-rate loan based on the CIRR interest rate. For the financing bank, the ship CIRR program offers the incentive that the interest rate risk of the loan is assumed by the federal government for the entire term of the loan. Secondly, it does not burden the company's own liquidity because it has access to refinancing from KfW. IPEX-Bank advises shipyards, financing banks and shipping companies in the run-up to financing.[81]

For its development, IPEX has formulated the claim "to support global climate policy goals by expanding the financing of environmental and climate protection measures". It should be noted that it has made progress in focusing its expertise and financing capacities on a greater developmental and environmental impact of its business model. However, IPEX still has a long way to go, both in terms of the claim it has formulated and with regard to the requirements for a climate and transformation bank that proactively promotes the necessary transformation. This will be illustrated below using selected data on IPEX-Bank's business performance in the recent past.

78 Cf. KfW (2023). Banks CIRR refinancing of export transactions to Africa, fact sheet.
79 The ERP Special Fund, which dates back to the "Marshall Plan" after the end of the Second World War and which KfW manages on behalf of the federal government, is still used today to promote economic development in Germany.
80 Cf. KfW (2023). ERP Export Financing Program. Fact sheet.

81 Cf. KfW (n.d.). Support for the German Shipbuilding Industry. With regard to loans that are refinanced using the aforementioned export promotion programs, IPEX-Bank is obliged to point out that they contain budget funds that constitute grants within the meaning of the German Subsidies Act.

FIG. 13 **Lending volume of IPEX-Bank by selected business sectors** (in billions of euros)

	2018	2019	2020	2021	2022
Energy & Environment	14,2	15,2	14,6	15,1	16,0
Maritime industry	14,3	14,8	13,5	15,1	14,2
Aviation, mobility, transportation	9,7	9,7	9,9	10,3	10,1
Raw materials, recycling	9,7	9,3	8,9	8,4	9,2
Infrastructure	7,2	8,2	8,6	8,3	9,2
Industry & Services	7,7	8,7	8,8	8,0	9,0
Financial institutions, etc.	3,8	3,1	3,3	3,0	3,0
Equity portfolio				0,3	0,2
Total	66,6	69,1	67,5	68,5	71,1

SOURCE KfW IPEX-Bank Annual Report, https://www.kfw-ipex-bank.de/Über-uns/Geschäftsbericht/
Differences between the totals and the addition of the partial values are due to rounding differences.

FIG. 14 **New commitments & IPEX-Bank refinancing by selected business sectors** (in billions of euros)

	2018	2019	2020	2021	2022
Energy & Environment	3,4	3,2	2,8	2,7	2,8
Maritime industry	2,3	3,1	k.A.	2,4	2,2
Aviation, mobility, transportation	2,1	2,3	k.A.	1,4	2,6
Raw materials, recycling	2,5	2,6	k.A.	1,3	2,4
Infrastructure	1,7	1,9	k.A.	1,3	2,1
Industry & Services	2,2	2,9	k.A.	1,6	2,9
Total	17,7	22,1	16,6	13,6	18,1

SOURCE KfW IPEX-Bank Annual Report, https://www.kfw-ipex-bank.de/Über-uns/Geschäftsbericht/
Differences between the totals and the addition of the partial values are due to rounding differences.

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In **IPEX-Bank's total lending volume** broken down by business sector (Figure 13), **the energy and environment sector** has accounted for an average of just around **22%** in recent years. There is also **no increase** in the **absolute development of new commitments for this sector** (Figure 14) over the same period. Finally, Figure 15 shows that **the Global South** is of **secondary importance** for IPEX-Bank's business and that its activities are largely concentrated in Europe. IPEX-Bank generates a large part of its not inconsiderable profits here and in North America in particular, which gives it the role of a "**profit generator**" with regard to the consolidated result of KfW Group as a whole (see Figure 16).

FIG. 15 **New IPEX-Bank commitments by region**
(in billions of euros):

KEY
- Australia & Oceania
- North America
- Latin America
- Asia
- Africa
- Europe

* Africa, Asia, Latin America
** North America, Oceania

SOURCE KfW IPEX-Bank Annual Report, https://www.kfw-ipex-bank.de/Über-uns/Geschäftsbericht/
Differences between the totals and the addition of the partial values are due to rounding differences

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DEG's foreign investments

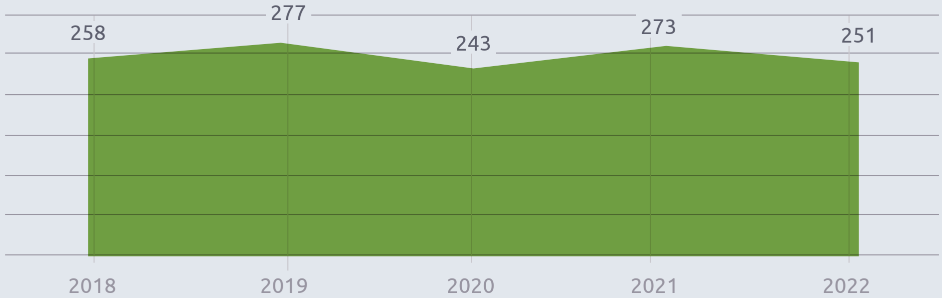
Based in Cologne, Deutsche Investitions- und Entwicklungsgesellschaft mbH (DEG) has been a wholly-owned subsidiary of KfW Group since 2001. It had previously been owned by the federal government since it was founded in 1962. Its (development) policy mandate is to **promote exclusively private entrepreneurial initiatives in developing and emerging countries in Africa, Asia, Latin America and transition countries in Central, Eastern and South Eastern Europe**. To this end, it primarily advises small and medium-sized enterprises (SMEs) and provides them with long-term capital in the form of loans or equity for investments in these countries. This financing is provided from own funds at market-oriented conditions. Tax funds are not used.

DEG is a credit institution within the meaning of the German Banking Act (KWG). BaFin has granted DEG a partially revocable exemption from its regulations. Nevertheless, DEG essentially applies the relevant standards of the KWG, in particular the minimum requirements for risk management, mutatis mutandis. According to its articles of association, DEG pursues **exclusively and directly charitable purposes**, which is why it is tax-privileged. The **balance sheet profits**, which tend to be quite generous[82], are allocated to retained earnings, thereby increasing DEG's equity capital to boost its promotional potential. According to its own information, DEG currently has an equity base of around EUR 2.5 billion and thus an adequate risk-bearing capacity to fulfill its mandate.[83]

DEG's **business activities** focus on corporate and project finance in the **agricultural, services, industrial and infrastructure sectors** as well as on **financial institutions and private equity funds**. On the one hand,

82 See the operating results for the last five years (Figure 17).
83 Cf. https://www.presseportal.de/pm/6681/5481586.

FIG. 16 **Operating result of IPEX-Bank** (in EUR million)



SOURCE KfW IPEX Annual Reports (2018-2022)

FIG. 17 **Key figures on DEG's business performance** (in millions of EUR)

	2018	2019	2020	2021	2022
Portfolio	8.362	9.039	8.487	9.242	9.866
New commitments	1.865,8	1.847,0	1.410,6	1.533,6	1.643,5
New commitments for climate protection	309,8	384,3	280,5	193,3	315,7
Operating result	212	153	200	213	248

SOURCE DEG annual financial statements (2018-2022)

it reaches its customers directly through financing with loans and participations, and on the other hand, it invests in local banks and equity funds that provide financing to SMEs in particular. As a financing partner, DEG primarily makes use of **long-term loans, equity capital, so-called mezzanine financing, guarantees and accompanying measures**[84].

DEG coordinates some of its financing activities closely with other European development finance organizations under the organizational umbrella of the EDFI (European Development Finance Institutions). It also cooperates with the World Bank subsidiary IFC (International Finance Corporation), the EBRD (European Bank for Reconstruction and Development) and a large number of local and regional development companies. The declared aim of this cooperation is to achieve a broad developmental impact and sustainability by pooling financing capacities and expertise.

DEG currently finances more than 700 companies with a credit volume of around EUR 9.9 billion.[85] This overall portfolio is broken down by region as follows: Europe/Caucasus 1.0 billion, Africa (including North Africa and the Middle East) 2.7 billion, Asia 3.1 billion, Latin America 2.7 billion and supra-regional projects 0.4 billion. A look at the investments in detail at[86] shows that the majority of financing was granted to populous emerging markets. Further key figures on DEG's business activities are shown in the following chart.

84 A mezzanine loan is a form of capital that can be classified as equity or debt capital, depending on its structure. De facto, it is somewhere between these two forms for balance sheet purposes.

85 Cf. https://www.deginvest.de/Unsere-Investitionen/.
86 Cf. https://deginvest-investments.de/.

A brief analysis of the above figures in accordance with DEG's self-declared guiding principle, namely to focus its financing more on sustainable economic activity that measurably contributes to the UN Sustainable Development Goals and is compatible with the Paris climate goals[87], must lead to the conclusion that DEG is **hardly mobilizing** the **considerable potential** that the provision of long-term investment capital holds for the purpose of mobilizing private climate finance in countries of the Global South in four respects:

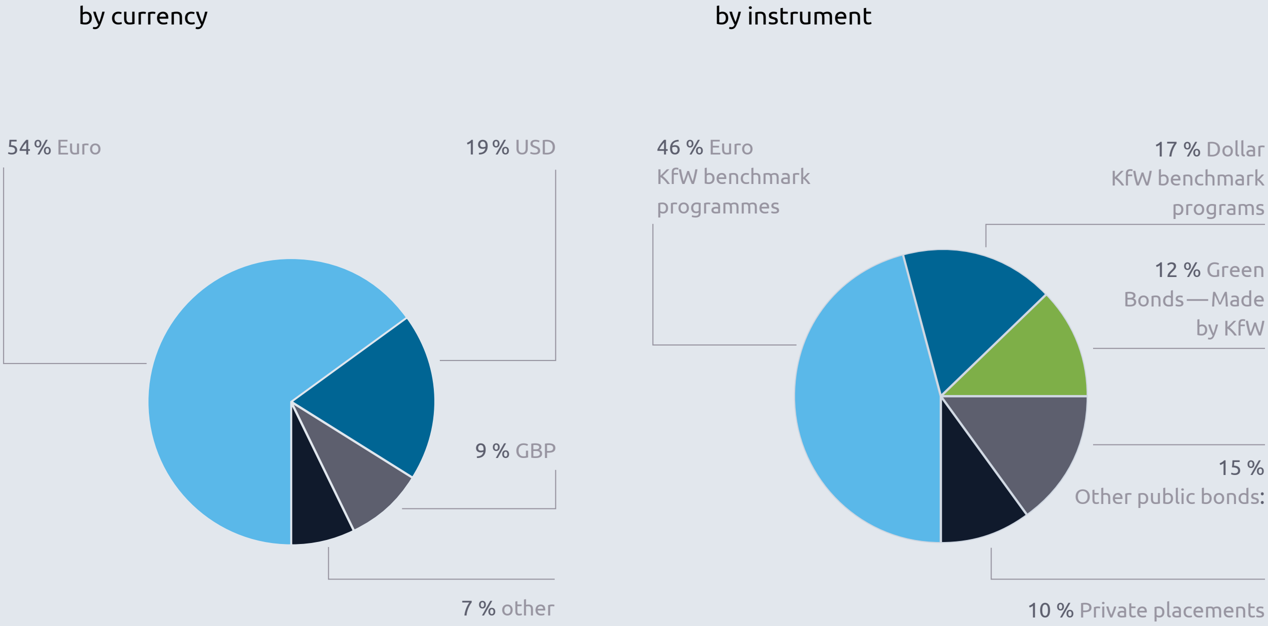
- Firstly, **new commitments for climate protection are at a low level in relation to the other sectors**, which does not even remotely correspond to its urgency.
- Secondly, the financial commitment of the new commitments and of the DEG portfolio as a whole **mainly extends to loans, while equity is only made available for investment projects to a much lesser extent**.
- Thirdly, according to its own statements, DEG granted loans amounting to 119 million euros for gas-fired power plants between 2014 and 2021 and also indirectly provided funds for the expansion of fossil energy projects.[88]According to its own statements, DEG is no longer financing any new projects by fossil energy companies and expects the portfolio of fossil energy projects to be phased out by 2038.[89]

87 Ibid
88 https://www.focus.de/earth/news/kfw-tochter-deutsche-entwicklungshilfe-foerdert-klimaschaedliche-projekte-im-ausland_id_190116770.html
89 Personal communication by DEG dated March 2024

In this respect, it can be said **that despite the progress made in its efforts to reduce greenhouse gas emissions in line with the 1.5 degree target of the Paris Agreement, DEG has so far not done enough** to ensure that its business activities can achieve a transformation worthy of the name and thus move towards climate neutrality within the remaining time window. Although DEG is committed to a portfolio-based CO_2 reduction path for its portfolio on the way to climate neutrality[90], this is not ambitious enough for 1.5 degree compatibility. So, the motto "DEG — more than financing: we shape transformation", which prominently adorns the homepage of the DEG website, has so far stood for words rather than deeds from a climate policy perspective. Precisely defining transformative investments, underpinning them with measurable indicators and making them publicly transparent, measuring the portfolio's greenhouse gas emissions (and not just estimating them on the basis of model assumptions), disclosing the results, and significantly increasing the pace of decarbonization as well as the environmental and climate quota would be suitable steps to credibly underpin DEG's transformation promise.

90 DEG (2022). Promoting Private Sector Development in Emerging Markets: DEG's pathway to higher SDG contributions and a GHG neutral portfolio.

FIG. 18 **Refinancing instruments of the KfW Group in 2022**



SOURCE KfW (2024). Refinancing statistics for the years 2004 to 2023.

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Transformation adequacy of KfW Group's refinancing pillars

This chapter will examine the transformation adequacy of the refinancing strategy used by the banks and subsidiaries of KfW Group to raise capital for their financing and lending business.

With a current annual issue volume of around EUR 70 to 90 billion and a total volume of all outstanding bonds and other securities amounting to EUR 430 billion, **KfW Group is one of the largest and most active non-governmental bond issuers on the international capital market**. Its (promotional) business is refinanced almost entirely via the international money and capital markets, primarily in euros and US dollars. Due to its high creditworthiness and the security provided by the direct guarantee of the German Federal Government, KfW has the best possible credit rating — a triple A rating — from the leading rating agencies Moody's, Scope and Standard & Poor's. As a recognized "first-class issuer", this gives it very good access to (institutional) investors and (central) banks worldwide — i.e. its capital market bonds are generally highly sought after. Since the turn of the millennium, refinancing at KfW has become increasingly dynamic. The refinancing volume was doubled within a few years.[91] According to KfW, its refinancing approach enables it to ensure refinancing at all times and to achieve the most favorable refinancing conditions possible in order to fulfill its promotional mandate.

In its bond issues, KfW pursues an issuing strategy based on four pillars:

91 Cf. https://www.kfw.de/%C3%9Cber-die-KfW/F%C3%B6rderauftrag-und-Geschichte/Geschichte-der-KfW/KfW-Themen/Kapitalmarktaktivit%C3%A4ten-und-Refinanzierung/.

- **Benchmark bonds**[92]: Among the benchmark programs, large-volume, listed bonds are issued in both euros and US dollars. They are the main source of refinancing for KfW Group. At EUR 385.8 billion as at 31 December 2022, they covered around 77% of total borrowed funds and around 63% of the refinancing volume in the 2022 financial year (see Figure 18);

- **Green Bonds**: With its green bonds ("Green Bonds – Made by KfW"), KfW is pursuing the goal of promoting the targeted financing of environmental and climate protection measures via a capital market-based instrument. KfW has been issuing these bonds as part of its refinancing program since 2014 in order to sharpen its own sustainability profile. The issue proceeds from the green bonds contribute to the refinancing of KfW as a whole and are used accordingly for KfW's general promotional activities. KfW allocates funds in the amount of the net proceeds from these green bonds to the specific loan programs defined in its green bond framework. These are used to finance projects that serve climate protection. According to KfW, at least EUR 10 billion of the EUR 80-85 billion in funds planned to be raised on the international capital markets in 2023 will be refinanced via green bonds.[93] KfW has now exceeded the threshold of EUR 60 billion total issue volume of green bonds;[94]

- **Other public bonds**: In addition to its benchmark programs, KfW issues public bonds in various maturities, currencies and formats;

- **Private placements**: KfW's refinancing product range is rounded off by private placements specifically geared to the investment needs of investors, which, in the form of bearer bonds, meet the demand of institutional investors in particular for customized products in terms of structure, currency and maturity.

KfW development bank, IPEX-Bank and DEG each conduct their business independently under the joint umbrella of KfW Group. However, the parent company KfW is responsible for refinancing all three subsidiaries, as the financing practice described above shows. The majority of the funds raised by KfW development bank for development financing are raised on the capital market. These own funds are supplemented by the budget funds made available for FC from the federal budget. IPEX-Bank also largely covers its refinancing requirements by borrowing funds from KfW.

On the basis of a **refinancing agreement** between IPEX-Bank and KfW, the latter provides the necessary funds in the currencies and maturities required to refinance IPEX-Bank's lending business at market conditions. Medium and long-term funding requirements are covered by taking out promissory note loans and issuing registered public registered mortgage bonds (Namenspfandbriefe) which are acquired exclusively by KfW Group. In addition, there is a small amount of short-term borrowing in the form of overnight money and time deposits as well as liquid bonds from KfW securities to secure liquidity requirements.[95]

DEG also has a refinancing agreement with KfW. This provides for KfW to provide DEG with the refinancing funds required for new borrowing in euros and US dollars on the dates specified by DEG at KfW's refinancing interest rate plus an internal transfer price set by KfW. Refinancing is supplemented by cash inflows from repayments and the sale of investments, for example, as well as the cash-effective operating result.[96]

92 Benchmark bonds are large-volume bonds of EUR 500 million or more that are considered to be trend-setting due to the issuer's credit rating, conditions and liquidity and are therefore included in a capital market index and listed there as a benchmark for other bonds.
93 Cf. https://www.kfw.de/About-KfW/Investor-Relations/U.S.-investors/index.html
94 Cf. https://www.kfw.de/Über-die-KfW/Newsroom/
95 Cf. https://www.kfw-ipex-bank.de/PDF/%C3%9Cber-die-KfW-IPEX-Bank/Gesch%C3%A4ftsbericht/2021/2021_KfW_IPEX-Bank_Lagebericht-und-Jahresabschluss-2.pdf.
96 Cf. https://www.deginvest.de/DEG-Dokumente/Download-Center/DEG_JAB_2022_DE.pdf.

Green Bonds — Made by KfW: A correct but insufficient step

In the following, the question will be addressed as to whether — and if so, to what extent — the way in which the banks under consideration are refinanced is relevant to their mandate as transformative promotional and development banks.

Green bonds, which have been used since 2014 as a refinancing instrument for the targeted mobilization of capital for green investments — and prominently climate financing — must be taken into account. The KfW promotional programs in the areas of renewable energies, energy efficiency and environmentally friendly transport have been significantly advanced thanks to the proceeds from these emissions. From the perspective of development financing, however, it is regrettable that **KfW's entire portfolio of green bonds is limited exclusively to OECD countries** (in 2022, 93.2 percent of the issue proceeds went to projects within Germany and the remaining 6.8 percent to other OECD countries[97]). In this way, KfW's undoubtedly important refinancing-based contribution to climate protection completely bypasses the economies of those countries that are particularly affected by climate change and that will not be able to shoulder the transformation to sustainability of their economies on their own. As our analysis has shown, these economies in particular have the highest regulatory and microeconomic hurdles to mobilizing capital for environmental and climate protection: e.g. lack of rule of law, no reliable investment regime, low analytical capacities, problems with internalizing environmental costs, information asymmetries and, in general, even greater maturity mismatches in climate finance (i.e. the need for long-term investments on the one hand and the rather short time horizons of investors on the other). These market conditions, which are particularly obstructive for private players, are structural in nature and are unlikely to change in the medium to short term. Due to their statutory promotional mandate and their (re-)financing advantages, public-sector specialist banks or banks with special tasks are best placed to provide the necessary risk cover for new, transformative projects for development towards climate neutrality. These banks are therefore very important for countries in the Global South.

If KfW Group wants to operate consistently as a climate and transformation bank, **refinancing via green bonds would have to be substantially increased in both absolute and relative terms and issue proceeds would also have to be made available for financing projects in the Global South**: The expansion of green bonds to the Global South would have a political (signaling) effect on investors and other financial institutions to invest in the transformation, in addition to the financial effect. At least for larger emerging countries (e.g. Brazil, India, South Africa), but also to a certain extent for smaller developing countries with soft currencies, KfW Green Bonds in their currencies would also be interesting, especially for interested investors in these countries themselves. This allows the project sponsor to reduce currency and exchange rate risks compared to a traditional green bond issued in US dollars. For example, the ADB has issued a green bond in Indian rupees to finance wind and solar energy projects in six Indian states.[98]
In this respect, it can be stated that there is also plenty of room for improvement with regard to the practice of refinancing at KfW and its subsidiaries in order to further increase the development and climate impact of the co-financed projects — even if the type and manner of refinancing certainly plays a lesser role for improved climate and transformation financing than the question of the design of the promotional instruments themselves.

97 Cf. https://www.kfw.de/%C3%9Cber-die-KfW/Newsroom/Aktuelles/Pressemitteilungen-Details_758464.html.

98 https://cfo.economictimes.indiatimes.com/news/adb-treasurers-detail-the-fine-print-of-rupee-linked-green-bonds/58961637?redirect=1

Interim conclusion

A **sustainable, future-proof financial system** is one of the key prerequisites for shaping the transformation of the economy in a swift and targeted manner. **Banks** play a central role here. There is currently a **major opportunity to make the financial sector a driver for more environmental and climate protection**. In view of its importance as a financial intermediary for the entire economy, it can achieve an enormous **leverage effect** with its financing when it comes to advancing the economy in terms of climate neutrality. The sector's idea of sustainability has a formative character for the concrete design of the transformation. Banks can channel financial flows specifically into sustainable projects and innovation. In terms of agenda setting for sustainable finance, the finance section of the COP 27 implementation plan in Sharm-El-Sheikh states that "delivering such finance will require a transformation of the financial system and its structures and processes, involving governments, central banks, commercial banks, institutional investors and other financial actors".[99] It is therefore not surprising that negotiations on reforming the financial sector and its multilateral, regional and national institutions are taking place not only at the international climate negotiations, but also within the G7 and G20, as they represent an effective and indispensable lever for implementing sustainable development and therefore also climate goals.[100]

However, **the consequences for multilateral, public and private banks and other financial players of a stringent implementation of the requirements of the Paris Climate Agreement, including the 1.5°C climate target, have not yet been adequately described** for international or national political contexts.[101] A basic prerequisite for the successful transformation of credit institutions into transformation banks is that the international community and national governments **create a regulatory and procedural framework** and thus a reliable **policy framework** that both provides orientation and guides action. This must be provided by the **German government**.

In this context, it is important to bear in mind that, since the early 1980s at the latest, the increasing "financialization" of the (global) economy, which has resulted in an immense increase in the importance of financial motives, financial institutions and financial elites in the overall functioning of the economy and, as a result, the entire economy has become increasingly oriented towards short-term financial indicators rather than long-term business models, has led to the establishment of a financial system that has proven to be almost impossible to regulate and, not least for this reason, extremely crisis-prone. In its current form, it hinders rather than promotes the urgently needed transformation. This is fundamentally demonstrated by the fact that sustainability is still generally understood by players in the financial world as an objective that — as an instrument for "taming the market", so to speak — runs counter to the (supposed) rationality of the financial market.[102]

99 See Engels, Making Climate Polluters Pay, in: IPG Journal of 22/6/2023. https://www.ipg-journal.de/rubriken/wirtschaft-und-oekologie/artikel/klimasuender-zur-kasse-6772/

100 Cf. Zwick, Yvonne/Jeromin, Kristina (Hrsg.), Mit Sustainable Finance die Transformation dynamisieren. Wie Finanzwirtschaft nachhaltiges Wirtschaften ermöglicht (Dynamizing the transformation with sustainable finance. How finance enables sustainable management), Wiesbaden 2023.

101 Cf. Sustainable-Finance-Beirat, Shifting the Trillions – Ein nachhaltiges Finanzsystem für die Große Transformation (A Sustainable Financial System for the Great Transformation). 31 Recommendations of the Sustainable Finance Advisory Board to the Federal Government, 2021 (https://sustainable-finance-beirat.de/wp-content/uploads/2021/02/210224_SFB_-Abschlussbericht-2021.pdf).

102 See for example https://www.spiegel.de/wirtschaft/nachhaltige-geldanlage-aktivisten-kaempfen-am-finanzmarkt-gegen-den-klimawandel-a-3cfdded8-075b-4f3c-9c6a-8381db405ef8

Instead of taking climate change as an opportunity to substantially rethink and reshape existing business policies in view of the ecological impact, climate protection is all too often seen merely as an additional opportunity to generate returns, as the extremely numerous, well-documented cases of greenwashing in the banking sector make clear.[103] Sustainable action is only taken in the lending and equity capital business where it is financially worthwhile. **Public-sector banks such as KfW Group**, which claim in their own guidelines to play a pioneering role as a transformation bank in climate protection, **should clearly align their entire business policy with the common good and thus prioritize the protection of global public goods**.

The inherent **dependence on profitability** in financing cannot be eliminated for commercial banks. As long as investments in climate protection appear to be too risky and therefore unprofitable due to insufficiently or not at all internalized climate costs, banks will see them as an incalculable financial risk and not as a welcome investment opportunity.[104] Since a sufficient change in the political framework conditions to promote the necessary climate protection investments in the Global South is currently not foreseeable, **a substantial increase in the investment volume** there can probably be achieved solely through a **significant increase** in **climate protection-related FC** (preferably in the form of grants and highly subsidized loans) as well as government **support for private climate protection investments**. The lavish profits of KfW Group offer previously unused scope for this without jeopardizing its creditworthiness.

For KfW Group — as well as for the state-owned promotional banks of other countries — this requires the development and adoption of a basic understanding of public welfare orientation with special consideration of the implementation of the Paris climate targets, which may utilize the refinancing advantages of KfW Group in the form of the assumption of liability by the Federal Government with a view to newly defined corporate purposes (i.e. the specific lending mandates and promotional activities) without this running counter to competition law.

103 See, for example, Giannetti, Mariassunta et al, "Glossy Green" Banks: The Disconnect Between Environmental Disclosures and Lending Activities, 2023 (https://www.bankingsupervision.europa.eu/press/conferences/shared/pdf/20230502_research_conference/Giannetti_paper.pdf).

104 Investments in this group of countries are often hampered by other factors in addition to the fact that the economic calculations are not profitable.

4 - Timetable for the further development of KfW into a climate and transformation bank.

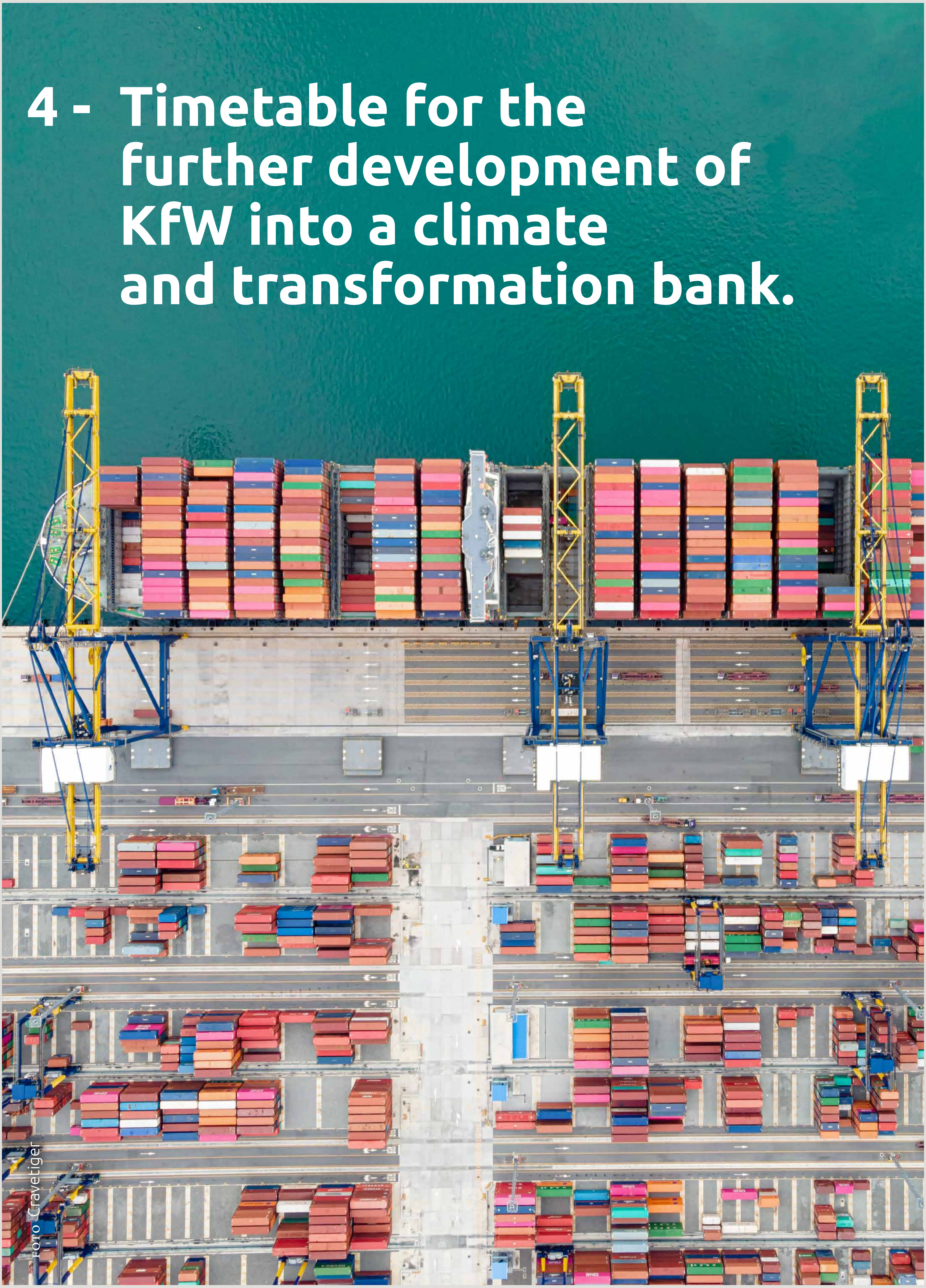

Foto: Cravetiger

KfW Group has the **potential to become a true climate and transformation bank with the protection of global public goods at the heart of its business model**. For its international business, this would mean consistently focusing its funding and financing activities on the transformation-related financing and advisory needs of projects in the Global South in particular, which pursue the implementation of ambitious goals that are compatible with the Paris Agreement and the SDGs and which could not be implemented in a timely manner without targeted international funding measures.

The analysis has confirmed that the need for this is very high and cannot be met without ambitious development banks that are prepared to develop a new "**risk culture**" for the protection of global public goods. This means that **KfW** would not only have to **allocate more funds**, but would also have to accept **higher financial risks of its own** in the future in order to contribute to the transformation in countries that cannot finance it on their own. In addition, **investments for transformation-related projects** should be **bundled much more**. KfW Group meets **important criteria** in this respect:

1 - It has **extremely low refinancing costs** due to its first-class credit rating, which in turn is largely the result of the **government's assumption of liability**.

2 - **The high surpluses continuously generated over the years, which are significantly higher than those of most other German banks and result from the positive balance between low refinancing costs and income from the financing business, but which may not be distributed according to the KfW Law, have allowed the bank's own reserves** to grow steadily.

3 - With a **Common Equity Tier 1 capital ratio of just under 25%**, KfW Group has very robust buffers to take on significantly more risk in the future to protect global public goods. If this reduces surpluses, but at the same time increases investment in transformation projects in the Global South, this would be a sustainable investment that could also have a stabilizing effect on the financial markets.

Focussing on: Reducing the cost of capital in countries of the Global South

KfW Group should massively expand the instruments it or other development banks use to reduce the high capital costs of transformation projects in countries of the Global South. This includes the following measures in particular:

- **More subsidies** should be granted, for which higher budget funds **are required,**
- **Borrowing costs** should be significantly reduced**,**
- **More reform loans** should be granted to countries willing to reform, for example as part of transformation-related partnerships.
- **Leverage instruments for mobilizing private capital** for climate, development and transformation financing, such as **guarantees, subordinated loans and venture capital** in particular, should be used to a much greater extent than has been the case to date.

Given that refinancing costs are likely to remain low, this would be possible without taking on too much risk, **provided that the company's own transformation, risk management and consulting expertise is significantly expanded at the same time**. This would be in their own interests as well as in the interests of their customers.

A **business model developed** in this way would be in line with the spirit of the **2030 Agenda**, the **Paris Agreement**, the German government's climate policy goals and KfW Group's mandate. In view of its importance as one of the largest national development banks, which sees itself as a pioneer and is pursuing the further development into a green transformation bank as its most important strategic goal, but has so far made too slow progress, **accelerating its own transformation** would have multiple benefits: for the transformation in the Global South, for achieving the German government's foreign climate and development policy goals, for other development banks that can adopt their experience, for the increased willingness of private investors to invest in the event of de-risking, and finally for KfW itself in achieving its goals.

The accelerated transformation of KfW into a green transformation bank **requires political leadership, i.e. a clear mandate from the KfW Board of Directors**. It should adopt and implement a corresponding **reform agenda before the end of this legislative period**. This requires a joint initiative by the **BMWK and the BMF**, which are responsible for the legal and technical supervision of KfW. Other federal ministries, in particular the **BMZ**, which provides the majority of FC funds for KfW Development Bank and performs a transformation-relevant steering function for trust funds and the further development of the sector guidelines, among other things, must be closely involved.

At the same time, these and other ministries, such as the **Federal Foreign Office** in particular, can play a key role in **identifying and exploiting potential for cooperation and synergies with other players in European and international bilateral, multilateral and plurilateral transformation financing** in order to create a favourable environment that maximises the impact of KfW Group's changed promotional and financing practices **in terms of foreign climate policy** transformation goals as well as other German, European and international **transformation goals**.

This also requires the **involvement of civil society and private sector actors** who are engaged in transformation-oriented climate, development, raw materials and energy partnerships and JETPs: Close and trusting cooperation and better coordination of suitable financial and technical support and advisory services are of great relevance to their success. **Close coordination with partner countries in the Global South** is equally important. A good example is provided by the V20 Group, which has made very specific proposals on how the transformation costs can be reduced so that the Climate Prosperity Plans of member states can be implemented.[105]

In principle, the **existing legal framework and the mandate of KfW Group form a suitable starting point** for such further development of the company. However, a decision by the Board of Directors to accelerate and intensify the transformation of KfW into a genuine transformation bank would be a necessary and important signal.

105 See among others https://www.v-20.org/accra-marrakech-agenda

Eight steps to a climate and transformation bank

The **European Investment Bank (EIB)**, which is comparable to KfW Group in many respects but only around half the size, adopted a "**Climate Bank Roadmap**" back in 2019. It shows how the EIB can achieve ambitious climate protection and environmental sustainability targets in the crucial decade to 2030. This includes ending all investments that are not compatible with the Paris climate goals by 2020, increasing the share of financing for climate protection and environmental sustainability to at least 50 percent by 2025 and mobilizing transformative investments of one trillion euros by 2030.[106]

We propose that KfW Group adopt a similarly ambitious plan at least for its international business:[107] In **eight steps**, KfW Group can be consistently developed into a climate and transformation bank that provides more funds to the Global South, concentrates on protecting global public goods in its international business and focuses on promoting transformation projects. Following the example of the EIB, these steps should be underpinned by **ambitious targets** from which **additional key performance indicators** can be derived that measure **KfW Group's performance as a climate and transformation bank**.

The adoption of such a "Roadmap to the Climate and Transformation Bank" requires political leadership. The **Federal Government** has the opportunity to adopt such a roadmap and take the first important steps before the end of this legislative period. This would show leadership. We suggest the following eight steps:

1 - **Consistent implementation of the goals and principles of the Paris Agreement, including the cessation of all new financing that is not compatible with the 1.5 degree target by the end of 2024 at the latest.**

106 https://www.eib.org/de/projects/topics/climate-action/cbr
107 The domestic business of KfW Group is not the subject of this study.

2 - **Significant increase in new commitments for genuine transformation and climate projects in the international business to at least 50 percent by 2027.**[108]
For comparison: In 2022, this share of new commitments was 34% (not in line with the EU taxonomy).[109] Efforts should also be made to ensure that projects in countries of the Global South with which Germany has entered into climate and transformation partnerships are given priority for new commitments. Particularly climate-vulnerable countries should also be given preferential access to financing.

3 - **Mobilization of a total of at least one trillion euros for transformative investments in 2024 — 2033 through the increased leverage of third-party investments by reducing investment risks through guarantee and blended-finance instruments:** To this end, suitable financing instruments should be further developed, firstly to make KfW's own financing for projects that serve to protect global public goods in the Global South more favorable so that these projects can be financed, and secondly to leverage more private capital for such projects by reducing their financing risks (de-risking). The following measures should be taken:

- Risk capital and grants should primarily be used to finance strategically relevant projects that could not otherwise be financed.

108 This goal is set out in the Climate Bank Roadmap of the European Investment Bank (EIB) for its overall business by 2025
109 The publicly available business figures do not allow for a precise delimitation, as no differentiation is made in the energy sector as to what proportion is attributable to renewable and fossil energy projects and EU taxonomy-compliant reporting had not yet been implemented.

- In order to broaden the private financing base for transformation projects in countries of the Global South, KfW should make much greater use of de-risking instruments such as guarantees, equity investments and subordinated loans as well as currency hedging.

- Countries in the Global South that develop multi-year investment plans for a macroeconomic transformation (such as Climate Prosperity Plans), that pursue ambitious transformation projects in the course of partnerships (e.g. transformation partnerships), or that take measures to create a more favorable investment climate for transformative projects (e.g. removal of investment barriers) should also be supported through special financing programs with reform loans, grants and other concessionary loans, as well as the provision of advisory and capacity development measures (e.g. for public financial management). Such accompanying measures contribute to an increase in transformation financing.

- Reduction in KfW financing — especially development and promotional loans — for climate and transformation projects in climate-vulnerable countries with high risk premiums. A special financing program could be set up for this purpose. In addition to the interest rate, repayment conditions and term, the hedging of loans against default risks as a result of natural hazards would be a further design element.

- In order to address the specific financing problems of micro, small and medium-sized enterprises, which often form the backbone of the economy in the Global South, special funds of funds could be set up for their transformation and climate adaptation projects. Smaller projects are bundled into these, thereby reducing transaction costs.

- The export financing provided by IPEX-Bank and the investment promotion of small and medium-sized German companies by DEG, as well as the high level of expertise and market knowledge of the two KfW subsidiaries, should also be used specifically for de-risking and the involvement of German companies in projects with high transformation potential in the Global South. As before, the range of instruments would include long-term loans on favorable terms, equity capital, mezzanine financing, guarantees and accompanying measures, as well as support for local partner banks. Only the funding focus would shift thematically.

- In order to refinance the KfW funds used, the proportion of green bonds should be successively increased.

4 - **Increase new commitments for the Global South from EUR 15 billion in 2022 to at least EUR 25 billion in 2025 (all new commitments, not just climate and transformation finance).**

5 - **Further development of integrated risk management for climate and transformation risks and expansion of corresponding capacities within KfW Group**: The further development of the integrated risk management approach that has already been initiated, which identifies climate and transformation risks that may arise for borrowers and takes them into account when determining the bank's own credit or investment risks, is an essential prerequisite for successful transformation-oriented financial support: It is in the interests of both the financing partners in the Global South and KfW Group. Their further development in the sense of strengthening ESG and climate risk management must include not only realistically assessing risks and their influencing factors, but also identifying risk-mitigating measures so that transformative investments can be made at reasonable cost. The identification and management of risks are

personnel and cost-intensive. To ensure that robust risk analyses can also be carried out for transformative projects in smaller, high-risk countries, the expansion of the corresponding capacities within KfW Group to implement improved ESG and climate risk management is another key factor.

6 - **Expansion of indicator-based impact measurement to include a Paris-compatible target system including intermediate targets:** The indicator-based impact measurement that is currently being developed is an instrument with potential, but it must be developed further so that no loopholes remain. Paris compatibility cannot be controlled with the current set of indicators. In addition to more meaningful climate resilience indicators, it is above all necessary to underpin impact measurement with a 1.5 degree-compatible target system including interim targets as a reference framework for the implementation of their transformation claim. These can be derived from adapted sector guidelines and the transformation roadmaps (see below).

7 - **Creating transformation transparency for KfW Group's entire international business and establishing an overarching management system including EU taxonomy-compliant transformation roadmaps for KfW development bank, IPEX Bank and DEG**: There should be public accountability for the financial resources used for transformation or climate used for transformation or climate projects, based on transparent criteria. The following agreements should be made as part of transparent overall management and external communication:

- Validity and monitoring of taxonomy conformity for the entire Group from 2025.

- Development and adoption of transformation plans including greenhouse gas reduction targets, decarbonization pathways and resilience targets with clearly defined milestones for all international business divisions by the end of 2024 at the latest. Transformation plans should set out scenarios for the future direction of KfW Group's financing and promotional activities. They should be manifested in the business indicators and developed in coordination with partners and on the basis of qualitatively and quantitatively specified medium and long-term goals resulting from the Paris Agreement and the SDGs or the resulting obligations for Germany.

8 - **Annual progress reports and mid-term report 2027 by the Executive Board on the implementation of the transformation roadmap and in achieving the following key performance indicators. Five new key performance indicators for KfW as an international climate and transformation bank:**

1 - Consistent implementation of the goals and principles of the Paris Agreement, including the cessation of all new financing that is not compatible with the 1.5 degree target by the end of 2024 at the latest.

2 - Climate ratio of 50% for all new commitments by 2027 (for comparison: EIB 50% by 2025 in total business)

3 - Mobilisation of at least one trillion euros for transformative investments in 2024 - 2033

4 - Increase in new commitments for the Global South overall from EUR 15 billion in 2022 (49% of international business) to at least EUR 25 billion in 2025

5 - Increase new commitments for particularly climate-vulnerable countries in the Global South to at least 50 percent of all new commitments that count towards the climate quota by 2030 at the latest

The transformation of KfW Group into a climate and transformation bank for the protection of global public goods would be an important contribution to closing the financing gap for transformation in the Global South. In cooperation with other players in the international financial architecture, KfW can help to accelerate transformative investments, rapidly expand advisory capacities, improve framework conditions, reduce investment risks and thus also investment costs, and create more liquid markets for the transformation and protection of global public goods in the Global South.

In view of these contextual factors, the **further development of KfW into a climate and transformation bank has never been more important than it is today**. The **chances of success** have never been greater either. Of course, KfW is also needed in **Germany** to contribute to climate and transformation financing. This requires a solid financial basis. However, this is not an obstacle to making a more ambitious contribution to climate and transformation financing in the Global South at the same time. To achieve this, it must take greater risks. **Without a greater willingness to take risks and embrace change, the transformation cannot succeed — neither in Germany nor internationally.**

Table of Figures

Abbreviations

AA	Auswärtiges Amt (German ministry of the exterior)
ADB	Asian Development Bank
AFD	French Development Agency
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
BMEL	Bundesministerium für Ernährung und Landwirtschaft (Federal Ministry of Food and Agriculture)
BMF	Bundesfinanzministerium (Federal Ministry of Finance)
BMUV	Bundesministerium für Umwelt, Naturschutz, nukleare Sicherheit, Verbraucherschutz (Federal Ministry for the Environment, Nature Conservation, Nuclear Safety and Consumer Protection)
BMWK	Bundesministerium für Wirtschaft und Klimaschutz (Federal Ministry for Economic Affairs and Climate Action)
BMZ	Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung (Federal Ministry of Economic Cooperation and Development)
CIRR	Commercial Interest Reference Rate
COFIDES	Companía Española de Financiación del Desarollo (Spanish development bank)
COP	Conference of the Parties to the UN Framework Convention on Climate Change
CVF	Climate Vulnerable Forum
DEG	Deutsche Investitions- und Entwicklungsgesellschaft (German Investment and Development Company)
EBRD	European Bank for Reconstruction and Development
EDFI	European Development Finance Institutions
EFSD+	European Fund for Sustainable Development Plus
EIB	European Investment Bank
ERP	European Recovery Program
FMO	Dutch Entrepreneurial Development Bank
FZ	Finanzielle Zusammenarbeit (Financial cooperation)
GCF	Green Climate Fund
IFC	International Finance Corporation (subsidiary of the World Bank)
IHLEG	Independent High-Level Expert Group on Climate Finance
IPEX-Bank	International Project and Export Finance Bank
IMF	International Monetary Fund
JETPs	Just Energy Transition Partnerships
KfW	Kreditanstalt für Wiederaufbau (Reconstruction Loan Corporation)
SMEs	Small and medium-sized enterprises
KPI	Key Performance Indicators
KWG	Kreditwesengesetz (German Banking Act)
LICs	Low Income Countries
LDCs	Least Developed Countries
MDB	Multilateral Development Bank
MICs	Middle Income Countries
NDC	Nationally Determined Contribution (climate contributions)
OECD-DAC	OECD Development Assistance Committee
RSF	Resilience and Sustainability Facility of the IMF
UMICs	Upper Middle Income Countries
UNFCCC	UN Framework Convention on Climate Change
V20	Vulnerable 20 (Group of Finance Ministers of the CVF)

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The transformation to greenhouse gas neutrality and climate resilience while simultaneously achieving the Sustainable Development Goals requires considerable investment in the Global South. Development banks such as the German Kreditanstalt für Wiederaufbau (KfW) have a special role to play in reducing the cost of capital for transformation and leveraging far more private capital. To achieve this, KfW would have to invest more funds, take on more risk itself, expand its advisory capacities and quickly complete its own exit from financing fossil fuels and other investments that are not compatible with the Paris climate goals. A reform of international climate and development financing appears to be urgently needed.

Due to its size and importance, KfW plays an outstanding role in the protection of global public goods. It could and should play an important bridging role between public and private investors. This study, commissioned by the Climate Neutrality Foundation, examines which measures need to be implemented in order for KfW to consistently develop into a climate and transformation bank.

The Climate Neutrality Foundation was established to develop robust cross-sector strategies for a climate-neutral and climate-friendly Germany. The foundation aims to provide information and advice on the basis of good research — beyond individual interests.

On behalf of

Climate Neutrality Foundation

The publication »Further development of KfW into a climate and transformation bank« is available for download as a PDF using these QR Codes.

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