National Promotional Banks as Active Financiers – The Case of KfW

Ulf Moslener
Matthias Thiemann
Peter Volberding

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KfW as an Active Financier

We argue that:

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

We illustrate this through:

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

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

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

Technical expertise
- In-house experts: economic & sectoral & technological knowledge
- Serves as an advisor to new economic and promotional legislation
The Policy Cycle

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

Agenda setting
- Placing an issue on the agenda

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

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

Monitoring and enforcement
- Monitoring compliance with targets
- Responding to non-compliance

(See, e.g., Blum and Schubert 2009; Abbott and Snidal 2009)
Case 1: Green Financing – A KfW Focus Topic

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

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

KfW aims to provide subsidized financing to achieve the German government’s ambitious Energiewende initiatives.

In 2015, KfW issued €39.5 billion in Green Bonds.

2014 Green Financing (billions of Euros)

- Renewable Energy: 4.1
- Domestic Energy Efficiency: 3.7
- Residential Refurbishment: 10
- Development Bank: 1.8
- IPEX: 2.3
- Other: 4.7
Case 1: Housing Efficiency

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

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

Monitoring & enforcement
- GDR “Plattenbauten” & “Altschuldenhilfe”
- Supporting empirical research, e.g. about reasons NOT to engage in energy efficiency measures
Case 1: Renewable Energy

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

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

Agenda setting
- Use of new expertise in “corporate lending” from the stimulus programme in a “green economy” context
Case 2: 2008 Financial Crisis and Aftermath

Exemplifies the double-edged sword of being a government agency

Responsible for assets under stress / mitigating economic harm

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

Provided an important countercyclical role

- Implemented a multiyear economic stimulus plan for German enterprises (€40 billion) and for energy efficiency and infrastructure measures (€10 billion)
- Minimal losses from the Domestic Promotional Bank/SME Bank
- KfW estimated that by 2012, its financial activities had saved 370,000 jobs
- Increased European promotional activities
Case 2: 2008 Financial Crisis and Aftermath

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

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

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

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

KfW supporting other NDBs & partnering with other NDBs
To what extent is KfW’s model exportable to other contexts?
We offer a few cautionary notes:

**Requires a strong legal framework**
- Necessary to avoid investment being made for political—rather than economic or social—objectives
- Reduces opportunity for corruption

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

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

Ulf Moslener
Matthias Thiemann
Peter Volberding
What is KfW?

- KfW is Germany’s state-owned national promotional bank (owned: 80% federal gov, 20% Länder)

- As of 2015, it is the 2nd largest NPB in the world (following the China Development Bank) in terms of total assets

- Mission: to support the German government implement or expand policies that would otherwise go unfunded by the private market

- Largest programs in green technology, energy efficiency, SME financing, and export financing
Consolidated Profit (EUR millions): 2001-2015
KfW in Historical Perspective (check)

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

1950: First export financing program

1952: First SME program

1962: Adopts responsibility for Germany’s international cooperation

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

1984: First explicit environmental program

1987: First foreign currency issue (USD)

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

2000: First securitization program

2002: Restructuring after compromise with the European Commission

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

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

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

**DEG (German Investment and Development Corporation)**
- Total 2015 Lending Volume: €1.1 billion
- Objective: Promotes the development of private enterprise in developing countries through loans, guarantees, and equity stakes.
SME Programs I

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

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

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

Largest program is the KfW EntreprenEUR Loan (Unternehmerkredit)

- Started in 2003
- Targets SMEs
- Issued over 200k individual loans
- In 2007, KfW assumed 50% of the risk from the commercial lending banks
- Max €25 million per project
SME Programs II

EntreprenEUR Loan Plus

Designed to promote improved financing for innovative SMEs

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

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

Total commitments up to €500 in the next few years
New Directions for KfW

KfW has highlighted three focus areas for the future:

- Climate change
- Demographic change
- Globalization and technical progress

Further development of new financial instruments

- Securitization
- New structured funds for climate change/SMEs

Increasing coordination with EIB and European NPBs

- Growth of collaboration in joint funds
- Participation in the Junker Plan
KfW is composed of five primary units:

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

Ownership: 80% Federal Government, 20% State Governments

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

Supervised by the Ministry of Finance and, as of 2013, BaFin (German Financial Supervisory Authority)
Operations

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

To fund its promotional business, KfW raised **€62.6 billion** on the international capital market:
- USD (45%), EUR (37%), GBP (7%), AUD (4%), JPY (2%), others (5%)
- Issues benchmark bonds, public bonds, and private placements
- Issued first negative interest rate benchmark bond in Oct 2015

Primarily on-lends through domestic German commercial banks, takes no deposits.
New Funding by Unit (EUR billions)
Components of KfW: Domestic I

KfW Förderbank (KfW Promotional Bank)

Total 2015 Lending Volume: €30.1 billion

- KfW’s largest “unit,” comprised of municipal and private client bank/credit institutions

Housing Investment
- Energy-efficiency loans
- Home Ownership Programme

Education/Social Development
- Student loans
- Continuing professional development

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

2015 Promotional Bank Breakdown

- Housing: 55%
- Education & Social Development: 16%
- Infrastructure: 16%
- Federal State PBs: 9%
- Individual Banks: 4%
Components of KfW: Domestic II

KfW Mittelstandsbank (KfW SME Bank)

Total 2015 Lending Volume: €20.4 billion

Projects focus on SMEs, innovation, and environment

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

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

Environmental:
- Environmental protection
- Energy efficiency projects
- Renewable energy projects

2015 SME Bank Breakdown

- EntreprenEUR Loan: 29%
- ERP/Start-Ups: 19%
- Innovation: 21%
- Energy Efficiency: 4%
- Renewable Energy: 3%
- Other Environment: 24%
Remarks regarding „New Institutionalism“

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