

»» Corporate Governance Report 2016

»» Corporate Governance Report 2016

As a member of KfW Bankengruppe, DEG – Deutsche Investitions- und Entwicklungsgesellschaft mbH (DEG) has made a commitment to act responsibly and transparently and open up its actions to scrutiny. DEG's Management Board and Supervisory Board accept the principles of the German Federal Government's Public Corporate Governance Code (PCGC) on behalf of DEG. A first Declaration of Conformity detailing compliance with the PCGC's recommendations was made on 30 March 2011. Since then, any departures from the code have been declared and elucidated annually.

DEG has operated as a legally independent, wholly owned subsidiary of KfW since 19 June 2001. Its rules and regulations (articles of association, rules of procedure for the Supervisory Board and its committees, and rules of procedure for the Management Board) specify the basic features of the system via which it is managed and controlled by its corporate bodies.

DEG's rules of procedure for the Supervisory Board and its committees have been revised for the purpose of setting up a Remuneration Control Committee and reworking the list of tasks assigned to the committees. The new version came into force on 1 October 2016.

Declaration of conformity

The Management Board and Supervisory Board of DEG make the following declaration: "Since the previous Declaration of

Conformity on 14 March 2016, the recommendations of the German Federal Government's PCGC, as adopted on 1 July 2009, have been and are being complied with, excepting only the recommendations below."

Deductible for D&O insurance

KfW has entered into D&O insurance contracts which, as corporate insurance, also extend protection to the members of DEG's Management and Supervisory Boards. In a departure from paragraph 3.3.2 PCGC, these only include the option to introduce a deductible during the period under review. A decision on whether to exercise the option will be taken in consultation with the Chairman and the Deputy Chairman of KfW's Board of Supervisory Directors. For 2017 the Management Board has decided to introduce a deductible in the D&O insurance contracts for members of the Management Board in compliance with the requirements of paragraph 3.3.2 PCGC.

Responsibilities

With the agreement of the Supervisory Board and following a decision at the Shareholders' Meeting, the Management Board has compiled a set of procedural rules to regulate cooperation in managing the business. Under these rules, the Management Board alone lays down areas of responsibility in a schedule of responsibilities with the agreement of the shareholder, but – in a departure from paragraph 4.2.2 PCGC – without the additional agreement of the Supervisory Board. This ensures the necessary flexibility, should changes be required, and hence an efficient division of labour.

Remuneration

In a departure from paragraph 4.3.1 PCGC, responsibility for drawing up the remuneration system for members of the Management Board lies with the Shareholders' Meeting rather than the Supervisory Board. This includes setting the level of remuneration and of variable remuneration components as well as dealing with any other remuneration issues.

Conflicts of interest

In departure from paragraph 4.4.3 PCGC, all members of the Management Board must immediately declare any conflict of interest to the Shareholders' Meeting rather than the Supervisory Board. Secondary employment on the part of a member of the Management Board must be approved by the Chairman of the Executive Committee rather than the Supervisory Board. This is at variance with paragraph 4.4.4 PCGC.

Supervisory body

In a departure from paragraph 5.1.2 PCGC, the initial appointment of Christiane Laibach as a member of the Management Board is for a period of five years. This is warranted by the fact that Ms Laibach has several years' experience as Executive Director at KfW IPEX-Bank. The group takes the view that her appointment is therefore in the nature of a follow-up appointment.

Delegation to committees

The Supervisory Board is relieved of a portion of its workload by its committees, which benefit from more familiarity with the issues and greater flexibility of scheduling. In some cases, the committees not only lay the groundwork for a decision by the Supervisory Board, but, in a departure from PCGC paragraph 5.1.8, and for reasons of practicality and efficiency, take the final decision themselves.

In connection with DEG's financing business, the **Risk and Credit Committee** takes the final decision on measures and transactions of particular importance, on whether to initiate legal disputes, to waive debts beyond the scope of settlements and agree settlements where such legal disputes, waivers or settlements are of special importance. Having the Risk and Credit Committee make the final decision on such matters serves to speed up the process of finding a resolution.

Cooperation of Management Board and Supervisory Board

The Management Board and the Supervisory Board work closely together for DEG's benefit. The Management Board, especially its Chairman, maintains regular contact with the Chairman of the Supervisory Board. The Management Board discusses DEG's strategic direction with the Supervisory Board and reports at appropriate intervals on the extent to which that strategy has been implemented. The Management Board informs the Chairman of the Supervisory Board of all

and any events of significant importance to the assessment of DEG's situation and development. The Chairman of the Supervisory Board subsequently informs the other board members and, if necessary, calls an extraordinary meeting.

In the year under review, the Management Board reported to the Supervisory Board as per the provisions of Article 90 of the German Stock Corporation Act (AktG) and provided comprehensive information on all relevant corporate issues related to planning, business development, risk situation, risk management and compliance, as well as on any important changes to the economic climate affecting the company.

Management Board

The members of the Management Board conduct DEG's business with the care of a fit and proper business person in accordance with the law, the articles of association, the rules of procedure for the Management Board, and the decisions of the Shareholders' Meeting and the Supervisory Board. The allocation of responsibilities among members of the Management Board is regulated by a schedule of responsibilities.

In the year under review, the areas of responsibility were as follows:

Bruno Wenn as Chairman of the Management Board:

- Corporate Development Division
- Financial Institutions/Project Financing Division
- Legal & Compliance Division
- Human Resources Department
- Internal Audit

Philipp Kreutz:

- Finance/Risk Division
- Credit Management/Analysis Division
- In-House Services Division

Christiane Laibach:

- Corporates Division 1
- Corporates Division 2
- Customer Solutions Division

The members of the Management Board are committed to DEG's corporate interest, may not pursue any personal interests in decision-making, and are subject to a comprehensive non-compete obligation whilst acting for DEG. The members of the Management Board must immediately inform the shareholder of any conflicts of interest arising. No such case occurred during the year under review.

Supervisory Board

The Supervisory Board monitors and advises the Management Board on the management of DEG.

DEG has a voluntary Supervisory Board. Under DEG's articles of association, the Supervisory Board shall have a minimum of eight and a maximum of twelve members, of whom four shall be representatives of the German Federal Government – one each from the German Federal Ministry for Economic Cooperation and Development, the German Federal Ministry of Finance, the German Federal Foreign Office and the German Federal Ministry of Economic Affairs and Energy – and two shall be representatives of the shareholder. The German Federal Government has the right of proposal in respect of its own representatives. The selection of the other members of the Supervisory Board is carried out in consultation with the German Federal Ministry for Economic Cooperation and Development. The members of the Supervisory Board are appointed by the Shareholders' Meeting. The German Federal Ministry for Economic Cooperation and Development has the right to propose the Chairman or Chairwoman of the Supervisory Board, which it exercises in consultation with the shareholder. In the year under review, the Chairmanship of the Supervisory Board was held by Hans-Joachim Fuchtel, Parliamentary State Secretary under the German Federal Minister for Economic Cooperation and Development. The Supervisory Board had two female members in the year under review.

On 1 December 2016, the Management Board announced, by publication of a notice in the German Federal Gazette, that in its view, the composition of the Supervisory Board no longer complied with the relevant statutory provisions, since the conditions of Article 1, Section 1, Clause 3 of the One-Third-Participation Act (DrittelbG) had been met. This requires one third of the Supervisory Board's members to be employees. Since no appeal was made to the competent court as per Article 98 Section 1 of the German Stock Corporation Act (AktG) within the time limit given in Article 97, Section 2, the new Supervisory Board shall be constituted according to the provisions of the One-Third-Participation Act.

The following are excluded from membership of the Supervisory Board:

- Any member of DEG's Management Board
- Any former member of DEG's Management Board if membership of the Supervisory Board already includes two former members of DEG's Management Board
- Anyone who already serves as an executive officer in another business and is, at the same time, a member of the administrative or supervisory body of more than two further businesses
- Anyone who is a member of the administrative or supervisory body of more than four businesses

Every member of the Supervisory Board shall disclose conflicts of interest to the Supervisory Board. Where a conflict of interest is assumed to exist, the board member in question shall not be involved in discussing or deciding on that item on the agenda. Any conflicts of interest in the person of a member of the Supervisory Board which are likely to prevent that member from exercising his or her mandate over a sustained and prolonged period of time shall result in the termination of the mandate. No such instance occurred in the year under review.

In the year under review, no member of the Supervisory Board attended fewer than half the board meetings in full.

Committees of the Supervisory Board

Up to 30 September 2016 the Supervisory Board had formed three committees, specifically an Executive Committee, a Credit Committee and an Audit Committee.

Since 1 October 2016, to ensure the efficient performance of the board's tasks, there have been four committees with duties in line with the provisions of Article 25d of the Banking Act of the Federal Republic of Germany (KWG).

The **Executive and Nomination Committee** deals with HR issues and the principles of corporate governance. Where necessary, it prepares for meetings of the Supervisory Board. The responsibilities of the Executive and Nomination Committee include discussing matters to do with appointing and relieving members of the Management Board.

The **Remuneration Control Committee** handles remuneration issues. It specifically deals with drawing up appropriate remuneration systems for members of the Management Board and DEG staff.

The **Risk and Credit Committee** advises the Supervisory Board on issues related to risk, e.g. specifically DEG's overall risk tolerance and risk strategy. In connection with DEG's financing business, it also acts on behalf of the Supervisory Board by taking final decisions on measures and transactions of special importance, on whether to initiate legal disputes, to waive debts beyond the scope of settlements and to agree settlements where such legal disputes, waivers or settlements are of special importance.

The **Audit Committee** deals especially with monitoring the financial reporting process; with the effectiveness of the risk management system, especially the internal control systems and the Internal Audit; with auditing the annual financial statements and with evaluating whether the auditor demonstrates the required independence. It also sets priorities for the audits and oversees the speedy elimination of any deficiencies uncovered by the auditor.

The committee chairmen or chairwomen report regularly to the Supervisory Board. The Supervisory Board may disband the committees, regulate their duties and reclaim their powers at any time.

In its report, the Supervisory Board provides information about its own work and the work of its committees during the year under review. A summary listing the members of the Supervisory Board and its committees may be found on DEG's website.

Shareholder

DEG's sole shareholder is KfW. The Shareholders' Meeting is responsible for all matters not assigned, by law or by the articles of association, to another body as its exclusive responsibility; in particular for: approving the annual financial statements and the appropriation of the annual result or net income; determining the sum available within the company for variable remuneration components; appointing and relieving members of the Supervisory Board; discharging members of the Supervisory and Management Boards from their liability; and appointing the auditor of the annual accounts. The members of the Management Board require the prior agreement of the Shareholders' Meeting to conduct any negotiations at CEO level that exceed the scope of the company's ordinary operations.

Supervision

DEG is a credit institution within the meaning of Article 1, Section 1 of the Banking Act of the Federal Republic of Germany (KWG). The German Federal Financial Supervisory Authority (BaFin) has issued revocable exemptions to DEG as per KWG Article 2, Section 4, which partially exempt it from the provisions of the act. Nevertheless, DEG does, on the whole, apply the relevant standards of the Banking Act *mutatis mutandis*, especially the minimum requirements for risk management (MaRisk).

Public benefit

DEG exclusively and directly serves the public benefit within the meaning of the "Tax-deductible purposes" article of the German Fiscal Code (Abgabenordnung). The company's purpose is to promote development cooperation. DEG is non-profit-making.

Transparency

DEG makes key information about the company and its annual financial statements available on its website. The

Communications Department also provides regular updates on current corporate developments. The annual Corporate Governance Reports, including the Declaration of Conformity in respect of the Public Corporate Governance Code PCGC, are permanently available on DEG's and KfW's websites. As of 1 January 2015, DEG also publishes information on its website about the projects and enterprises it finances.

Risk management

Risk management and risk controlling are key management tasks at DEG. The Management Board draws up the risk strategy, establishing the framework for business activities in relation to risk tolerance and risk-bearing capacity. This ensures that DEG is able, sustainably and over the long term, to maintain an acceptable risk profile while fulfilling its specific tasks. Monthly risk reports to the Management Board present a comprehensive analysis of the bank's overall risk situation. The Supervisory Board is regularly given a detailed update on the risk situation at least once per quarter.

Compliance

DEG's success depends to a significant degree on the trust which the shareholder, customers, business partners, staff members and the public place in its effectiveness and especially its integrity. This trust is substantially rooted in its implementation of, and compliance with, the relevant legal and regulatory requirements and in-house rules, as well as other applicable laws and regulations. DEG's compliance organisation includes, in particular, provisions to ensure that the regulatory requirements of the MaRisk compliance function are met and that data protection rules are followed. It further includes provisions to guarantee securities compliance, to comply with the terms of financial sanctions, to prevent money laundering, the financing of terrorism and other criminal activities, as well as to achieve a suitable level of information security, appropriate operational continuity management, the identification of operational risks and the mapping of an internal control system. Accordingly, it has binding regulations and procedures that influence day-to-day values and corporate culture; these are continuously updated to reflect the statutory framework and market requirements. Regular training on all aspects of compliance is available to DEG employees in the form of both e-learning programmes and classroom sessions.

Accounting and annual audit

On 22 March 2016, DEG's shareholder appointed KPMG AG Wirtschaftsprüfungsgesellschaft as the auditor for the 2016 financial year. The Supervisory Board subsequently issued the audit mandate to KPMG on 6 June 2016 and established the priorities for the audit with the auditor. It was agreed with

the auditor that the Chairman of the Supervisory Board would immediately be informed of any findings and circumstances of material significance to the duties of the Supervisory Board that might arise during the audit. It was further agreed that the auditor should inform the Chairman of the Supervisory Board or include a note in the audit if, while carrying out the audit, she ascertained facts that negated the accuracy of the Declaration of Conformity with the PCGC.

Efficiency review of the Supervisory Board

The Supervisory Board regularly reviews the efficiency of its activities. It carries out an annual evaluation of the Supervisory Board and the Management Board for this purpose.

COMPENSATION REPORT

The compensation report describes the basic structure of the remuneration system for the Management Board and the Supervisory Board and discloses the individual remuneration for members of both boards. The compensation report is part of the appendix to the annual financial statements.

Remuneration of the Management Board

The remuneration system for DEG's Management Board is designed to provide appropriate compensation for board members in accordance with their remit and areas of responsibility, taking into account their performance and the company's success.

Remuneration components

On 14 March 2016, DEG's Supervisory Board voted to retain without change the remuneration system for DEG's Management Board agreed on 18 March 2010. This system meets PCGC rules on variable remuneration components and includes a balanced mix of short and medium-term incentives. For instance, only half of performance-related management bonuses, as measured by target fulfilment, is immediately

disbursed to the Management Board; the other half constitutes a provisional claim only and is paid from a "bonus account" in equal instalments over the following three years, provided business performance has not declined substantially. If the agreed profitability target is not met in subsequent years, payments from the bonus account shall be subject to a penalty.

The following summary shows total compensation for individual members of the Management Board, broken down by fixed and variable components and benefits in kind, as well as transfers to pension provision and the balance of their bonus accounts.

Responsibility

The shareholder consults on the remuneration system for the Management Board, including contractual elements, and reviews it regularly. The shareholder agrees the remuneration system following consultation with the Supervisory Board. The adequacy of the remuneration was last reviewed in March 2016.

Benefits in kind

Benefits in kind primarily include contractual fringe benefits. Members of the Management Board are entitled to a company car for both business and personal use. In keeping with current tax regulations, any costs incurred due to personal use of the company car are met by the members of the Management Board. If a second residence is required for business purposes, the costs of running a second household are reimbursed as per tax regulations.

Members of the Management Board are insured under a group accident insurance policy. Health insurance and long-term care insurance are subsidised. In respect of the risks associated with their management activities on the governing body, members of the Management Board are insured under a policy that covers their liability for monetary damages (D&O insurance) and a supplementary policy covering them for monetary damages and legal expenses. These insurance policies are designed as group insurance. Members of DEG's Management Board

Compensation for the Management Board and members of the Supervisory Board

k EUR	2016	2015	Change
Management Board	1,288	1,316	-28
Former members of the Management Board & surviving dependants	880	905	-25
Members of the Supervisory Board	29	28	+1
Total	2,197	2,249	-52

are further covered in the exercise of their duties by a special group insurance policy for employees that meets any legal expenses incurred as a result of criminal prosecution.

Like all senior executives, members of the Management Board are entitled to participate in the Deferred Compensation Scheme, a supplementary company pension plan via deferred compensation payments deducted from salary. Under DEG's general rules, they are also entitled to long-service awards.

Contractual fringe benefits further include the cost of security measures carried out at residential properties occupied by members of the Management Board. The provision of this security is accounted for under operating charges rather than as benefits in kind.

Where contractual fringe benefits cannot be granted on a tax-free basis, they are subject to taxation as non-cash benefits, with any tax payable by the members of the Management Board.

In 2016, no member of the Management Board was in receipt of a loan from DEG or KfW.

In the past financial year, no member of the Management Board received benefits, or a pledge to that effect, from a third party in respect of his or her activities as a member of DEG's Management Board.

Entitlement to a retirement pension and other benefits in case of early retirement

Under Article 5, Section 1 of DEG's articles of association, the appointment of a member of the Management Board shall not continue beyond the attainment of statutory retirement age. After they reach the age of 65 or the statutory retirement age respectively, and following expiry of their contract of employment as members of the Management Board, board members are entitled to pension payments. This also applies if their service ends due to invalidity.

In respect of contracts of employment for a term that began in 2014 or earlier, members of the Management Board may, at their own request, take early retirement after they have reached the age of 63. If their employment is not extended beforehand, and no important reason as per Article 626 of the German Civil Code (BGB) applies to the person of the member of the Management Board, he or she is entitled to agree a transitional allowance for the period until pension payments fall due.

Pension commitments for members of the Management Board and surviving dependants are based on the principles governing the employment of board members at German federal credit institutions (1992 version). PCGC provisions are taken into account when drawing up contracts of employment for members of the Management Board.

Annual compensation of members of the Management Board and transfers to pension provision for 2015 and 2016

k EUR ¹⁾		Salary	Variable compensation*	Benefits in kind ²⁾	Total	Bonus account	Transfer to pension provision
Bruno Wenn (Chairman)	2016	344.9	72.4	14.0	431.3	72.7	367.2
	2015	344.9	80.0	14.4	439.4	79.2	1,026.6 ⁴⁾
Dr Michael Bornmann	2016		44.5 ³⁾	0.0	44.5	44.5	
	2015	42.2	80.9	7.6	130.7	80.5	0.0
Philipp Kreutz	2016	344.9	73.7	11.7	430.3	74.1	194.8
	2015	344.9	79.8	12.0	436.7	78.8	277.5
Christiane Laibach	2016	344.9	27.1	9.2	381.3	27.1	94.3
	2015	300.9	0.0	8.1	309.0	0.0	2,096.3 ⁵⁾
Total	2016	1,034.8	217.7	34.9	1,287.5	218.4	656.3
	2015	1,032.9	240.7	42.1	1,315.7	238.5	3,400.4

¹⁾ For computational reasons, the table may contain discrepancies due to rounding.

²⁾ In a departure from the figures in the appendix, this table does not include the employer's contribution as per the German Social Security Act. The total for 2016 was EUR 35.7 thou. (previous year EUR 39.5 thou.).

³⁾ Dr Bornmann received variable compensation in respect of his activities as CEO.

⁴⁾ Includes entitlements from previous employment with KfW transferred in 2015.

⁵⁾ Includes entitlements from previous employment with KfW IPEX-Bank transferred in 2015.

* In a departure from the figures in the appendix, this table includes variable compensation actually paid out under a provision covering phased payments.

Where members of the Management Board were appointed or reappointed after 2011, their contracts of employment include a cap on any severance package in keeping with PCGC recommendations. Under the code, any pay-off to a member of the Management Board due to early termination of his or her activities as a board member without important cause as per Article 626 of the German Civil Code will accordingly be limited to double the annual salary, or compensation due for the remaining period of his or her contract including fringe benefits, whichever is lower.

In general, the full retirement pension entitlement is equivalent to 49% of annual fixed remuneration. At initial appointment, the retirement pension entitlement routinely amounts to 70% of the full entitlement and rises over a period of ten years by 3% for every completed year of service.

If the employment contract of a member of the Management Board is terminated or not renewed due to a significant reason as per Article 626 of the German Civil Code, any pension entitlements are void in keeping with the principles developed by employment contract case law.

In 2015 and 2016, pension payments to former members of the Management Board and their dependants amounted to EUR 904.5 thou. and EUR 879.7 thou. respectively.

A write-back in the amount of EUR -1,015.3 thou. was carried out in respect of pension obligations towards former members of the Management Board and their surviving dependants at the end of the 2016 financial year (previous year: transfer of EUR 905.6 thou.).

No loans were provided to former members of the Management Board or their surviving dependants in the 2016 financial year.

Compensation for the Supervisory Board

Members of the Supervisory Board receive compensation at a level set by the Shareholders' Meeting as per Article 13 (1) of DEG's articles of association and in keeping with the company's character as an institution serving the public benefit.

In the year under review, compensation for ordinary members amounted to EUR 5,000. Chairmanship of the Supervisory

Board attracts compensation in the sum of EUR 9,000, while the two Deputy Chairmen each receive EUR 8,000. With the exception of the Executive Committee, committee members each receive annual compensation of EUR 500, while the committee chairs receive compensation in the amount of EUR 1,000 per annum.

Where membership covers only part of a year, remuneration is paid pro rata.

An attendance fee of EUR 500 per meeting is paid (excepting only meetings of the Executive Committee) along with a daily allowance of EUR 12 per day of attendance. Any travel expenses incurred and any value-added tax payable are reimbursed.

The following tables provide details of the Supervisory Board's remuneration for the 2015 and 2016 financial years. The sums shown are EUR net and have all been paid. Travel expenses and other miscellaneous expenses were reimbursed upon presentation of receipts and are not included in the table.

There are no pension obligations towards members of the Supervisory Board.

In the year under review, members of the Supervisory Board received no remuneration for services provided in a personal capacity.

In respect of the risks associated with their activities as corporate officers, members of the Supervisory Board are insured under a policy that covers their liability for monetary damages (D&O insurance) and a supplementary policy covering them for monetary damages and legal expenses. These insurance policies are designed as group insurance. Currently, no deductible has been agreed. Members of the Supervisory Board are also covered in the exercise of their duties by a special group insurance policy for employees that meets any legal expenses incurred as a result of criminal prosecution.

No loans were made to members of the Supervisory Board during the year under review.

Cologne, 20 March 2017

The Management Board

The Supervisory Board

Retirement pensions for former members of the Management Board or surviving dependants

	Number 2016	k EUR 2016	Number 2015	k EUR 2015
Former members of the Management Board	6	620.0	6	689.9
Dependants	4	259.8	3	214.6
Total	10	879.7	9	904.5

Compensation of members of the Supervisory Board for the 2015 and 2016 financial years

EUR

No.	Name	Period of membership 2016	Supervisory Board membership	Committee membership	Daily allowance & attendance fee	Total
1.	Hans-Joachim Fuchtel ¹⁾		-	-	-	-
2.	Dr Norbert Kloppenburg ¹⁾	01.01-31.12	-	-	-	-
3.	Eberhard Brandes ²⁾	01.01-31.12	5,000	-	-	5,000
4.	Arndt G. Kirchhoff	01.01-31.12	5,000	-	1,024	6,024
5.	Corinna Linner	01.01-31.12	8,000	2,000	8,072	18,072
6.	Dr Michael Meister ¹⁾	01.01-31.12	-	-	-	-
7.	Dr Ulrich Schröder ¹⁾	01.01-31.12	-	-	-	-
8.	Stephan Steinlein ¹⁾	01.01-31.12	-	-	-	-
9.	Brigitte Zypries ¹⁾	01.01-31.12	-	-	-	-
Total net amount			18,000	2,000	9,096	29,096

EUR

No.	Name	Period of membership 2015	Supervisory Board membership	Committee membership	Daily allowance & attendance fee	Total
1.	Hans-Joachim Fuchtel ¹⁾	01.01-31.12	-	-	-	-
2.	Dr Norbert Kloppenburg ¹⁾	01.01-31.12	-	-	-	-
3.	Eberhard Brandes ²⁾	01.01-31.12	5,000	-	-	5,000
4.	Arndt G. Kirchhoff	01.01-31.12	5,000	-	1,024	6,024
5.	Corinna Linner	01.01-31.12	8,000	1,500	7,548	17,048
6.	Dr Michael Meister ¹⁾	01.01-31.12	-	-	-	-
7.	Dr Ulrich Schröder ¹⁾	01.01-31.12	-	-	-	-
8.	Stephan Steinlein ¹⁾	01.01-31.12	-	-	-	-
9.	Brigitte Zypries ¹⁾	01.01-31.12	-	-	-	-
Total net amount			18,000	1,500	8,572	28,072

¹⁾ Remuneration not claimed.

²⁾ Remuneration donated to WWF.