

Select Committee on the European Union

EU Financial Affairs Sub-Committee

Oral evidence: Brexit: the European Investment Bank

Wednesday 14 November 2018

11.30 am

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Members present: Baroness Falkner of Margravine (The Chairman); Lord Bruce of Bennachie; Lord Butler of Brockwell; Lord Cavendish of Furness; Lord De Mauley; Lord Desai; Lord Giddens; Baroness Liddell of Coatdyke; The Earl of Lindsay; Lord Thomas of Cwmgiedd; Lord Vaux of Harrowden.

Evidence Session No. 6

Heard in Public

Questions 65 - 75

Witness

[I](#): Eva Witt, Director, Federal and European Affairs, KfW.

Examination of witness

Eva Witt.

Q65 The Chairman: Welcome, Ms Eva Witt of the KfW, or the Kreditanstalt für Wiederaufbau. It is very good to have you here. I have to do some administrative things to get them on the record. Welcome to the EU Financial Affairs Sub-Committee inquiry on the European Investment Bank and Brexit. This is a public evidence session. You have a declaration of members' interests. The session is being broadcast live, on parliamentlive.tv, and a full transcript is being taken and will be made available to you to make any corrections, shortly after the session.

We are coming to the closing stages of this inquiry. We are conscious that KfW was established long before the EU was established and has seen the path as we move forward. It is an enormously large and well-funded institution. With regard to the architecture in Germany, and your role there, what are the benefits to having an institution such as yours,

compared with schemes run directly by the Government? I saw that you were sitting in the back of the room, so you heard our discussion about how infrastructure projects are done here. What is the benefit of your model versus a Government-run model?

Eva Witt: Thank you very much for having me here today as a witness. It is a great pleasure.

You need to look at the question from different sides. First, there is the customer, the final borrower, and his needs. Where would he go with his project ideas? KfW works in Germany mostly through the German banking sector; the relationship between the bank and the final customer stays with the bank. When they analyse the project, they know that they can go to KfW. There is one point of entry for the client.

Secondly, with regard to taxpayers' money and the governance structure, there is just one big institution, not each ministry with its own institution. There are joint administration departments. KfW is a regulated bank, so there is a certain cost to that, but being a bigger bank the cost is absorbed more easily than if different institutions were being regulated. You would need a compliance department, an HR department, accountants and so on.

If you look at our history, you can see that there were two SME banks: KfW, although it does not only do SMEs, and the Deutsche Ausgleichsbank. It was under the Economic Affairs Ministry, while we were under the Finance Ministry, so there was a bit of a conflict of interest in working together while being competitors, with clients trying arbitrage and going from one bank to the other. At some point, we were asked to take over the Deutsche Ausgleichsbank, and now our programmes are more transparent for everybody.

The Chairman: Thank you. That was pretty clear.

Q66 **Lord Desai:** What market gap do you fill? What do you do that the private sector cannot do? Are you better at risk taking and crowding in private investment? What is it that you specifically do?

Eva Witt: Our model is to be an on-lender. We work through the whole German banking sector, so each and every bank can get funding from our programmes. We have a certain neutrality and offer really long tenors. Not all institutions do that, and especially after the financial crisis in 2008-09 there was a lack of long tenors. All the banks could access our programmes and give longer tenors to their clients, which at that point they were no longer able to do. The credit risk analysis is done by the banks, so we do not do risk analysis, except in cases of risk sharing, when we too would look at the client or the customer. So there are long tenors, and there can be risk sharing.

When it comes to fund investments, yes, we would try to crowd in private funds as well; we would take the riskier portions, for instance. Being an AAA institution, we fund ourselves on the capital market with a huge volume, so we have cheap funding costs, or cheaper compared with the

German banking sector. We also on-lend that. To the degree that it is state aid free and acceptable, we have some sort of subsidy. We work with interest rate subsidies or direct subsidies. Depending on the economic goal that the Government want us to achieve, those are the different offers that we have to support the German economy.

Q67 Lord Thomas of Cwmgiedd: In your presentation, you set out very clearly the representation on the various boards. I want to ask you about the reality of the political dimension. To what extent do political priorities and directions from your Ministers, who we see are compelled to work together, influence your investment decisions?

Eva Witt: One needs to look at two levels. One is when we design a new programme, or the Government or a ministry come to us and request us to do so. For example, when the climate agenda was defined, and we needed to reduce CO₂ emissions, the Government came to us and asked us to develop a certain programme. We work together on programmes and define the criteria; then we execute the programmes on behalf of the German Government, but only according to the criteria—who has access, what kind of indicators you have and what you want to achieve.

With individual projects, when as a bank you take risk and give credit, politicians on our supervisory board would only intervene or need to approve above certain limits. If it is a big corporate loan, depending on the credit risk, they would get an internal credit document to give their approval. In that sense, there is no political influence on decisions on loans.

There is another aspect. For instance, in the financial crisis, the Government wanted to support Spain and Greece, so they requested that we give Greece and Spain a loan on behalf of the German Government, and we got a 100% guarantee on those programmes. In that sense, there is an influence, but it would be a direct request from the Government; they do not do that very often, and the public administration is very transparent when they do it.

Lord Thomas of Cwmgiedd: I notice that the Federal Ministries for Finance and Economic Affairs and Energy alternate as your chairmen. Do you manage to get a degree of co-ordinated strategy from them?

Eva Witt: Yes, in the sense that it is always on KfW household affairs, to put it that way. It is on our business plan, and other aspects, such as approving certain credits, if they have higher volumes. In that case, yes.

We have a different kind of relationship with the Ministry of Finance, which supervises us legally, from the KfW law perspective. With the Economic Affairs Ministry, it is more about economic development and what it is aiming for in that regard. In that sense, every year you would see a bit of a difference, but it is not that they work against each other.

Q68 Lord Vaux of Harrowden: Could you explain how you interact with the work of the EIB, whether you work together and how the overlap happens? Do any specific benefits arise from having a national institution

such as KfW versus relying on the EIB as a supranational entity?

Eva Witt: I shall talk first about the EIB and then go on to the EIF, because we have a different working relationship. The EIB is an AAA-rated institution, as we are, so we do not depend on funding from the EIB to us, because we have similar refinancing conditions. We work mostly in a co-financing mode, depending on the project, either in Germany or within Europe. When it comes to the EIF, because the EIF executes guarantee instruments such as COSME and InnovFin, we use those two programmes through the EIF; we use COSME for our SME start-up financing, getting the EU guarantee and doing a risk-sharing programme for our start-up clients in Germany.

There is a third area. KfW is also in charge of development finance. The EU has funding that it calls EU blending, where we work together on co-financing projects in developing and emerging countries. That is how we work together operationally.

For a long time, we have been on the board of directors of the EIB as an adviser, and we are a shareholder of the EIF. Apart from that, we have a close relationship; there are regular board meetings of the two institutions and exchanges of information. For instance, at the moment we are looking at the whole aspect of tax avoidance, where the EU Commission wants us to have some regulations. We are trying to exchange information on how it is doing that and how we are doing it. We have staff exchanges as well, to foster the relationship between the two institutions.

On your second question, being a national promotional bank, we are familiar with national needs and what the financing gaps are. We have a very close relationship with our Government and know what policies they want to execute through KfW. The EIB is further away from that, at European level. The value added of the EIB is that it can support the young national promotional banks that you find in some countries. Depending on the credit rating—we have AAA—and they may have a lower rating, so, for refinancing, it makes a lot of sense. There are some differences, in that we are regulated and have to abide by state aid, whereas the EIB is not regulated and is state aid free.

Q69 Lord De Mauley: Given the nature of some of your investments, what special arrangements do you have with the Commission to enable you to operate without breaching state aid rules?

Eva Witt: We have to abide by state aid rules. If we design a new programme with our Government, as I mentioned, we would conceive it in such a way that it is state aid free. For example, we work a lot with private individuals in our housing programme. We take note of the EU reference rate. When we work on equity investment, or when we look into a venture debt programme, we have to do the private investor test, which means working either with a private bank or with EIB to get it state aid free. We abide by and are in compliance with all the state aid rules

and regulations. When we founded KfW Capital, our Government sent information to the Commission.

Lord De Mauley: Nevertheless, there must have been instances when the Commission had concerns about that. How were those resolved?

Eva Witt: Before 2010, our export and project finance activities were within KfW. At some point, the EU requested that we look into a different model, which is when we founded the KfW IPEX-Bank. It is 100% owned by KfW but is arm's length and regulated as a commercial bank. That was the agreement we negotiated with the Commission at the time.

The Chairman: I do not know whether you were here when we took evidence earlier and we were told that the authorisation given by the EU to the British Business Bank is for five years at a time. Do you have any such constraints, or do you just have blanket authorisation? Do you need to go back to the EU periodically for a renewal or review of the authorisation?

Eva Witt: Not as an institution, because we always just go for programmes, if we have new programmes.

Q70 **Lord Cavendish of Furness:** In spite of your excellent English, I may have missed your reference to KfW Capital, which I think has been recently established to further develop venture capital financing in Germany. How will it supplement the ongoing work of the European Investment Fund?

Eva Witt: First, to explain the history of KfW Capital, we made some venture capital investment before the financial crisis of 2008-09, and then, when the market hit and those investments had heavy losses, we were requested by our supervisory board to sell. It took us some time to get back into the venture capital business, because of the losses we had made on our portfolio.

The last Government requested that we do more in the venture capital field, so we did a gap analysis of the German market and found that it was not so much that seed funding in the VC market was missing; it was the growth phase that was missing, as it probably is in the UK as well. We worked very closely with the German Government, in that case with the Economic Affairs Ministry, in a working group looking at how we could foster and strengthen the VC market in Germany to support start-ups. There were different models, one within KfW and one outside. In the end, it was decided that we should have a subsidiary, KfW Capital.

When we started again with new programmes in VC funds, we worked closely with the EIF. We are a shareholder of the EIF and know it well; we work together very closely, and in that case we worked alongside it. At the beginning, it was a bit different from what the BBB was saying; we followed what the EIF was doing at the beginning.

KfW Capital is more about knowledge transfer. The EIF is supporting our colleagues. Nevertheless, we have developed further, as the BBB was

explaining, and have done VC funds without EIF participation. We know our business and how we need to do it, and the plan is to do €200 million per annum in new VC funding.

Lord Cavendish of Furness: That was a very full answer. Thank you.

- Q71 **Lord Giddens:** I was interested to see how important responding to mega-trends is in the brief of your organisation. You mentioned globalisation, climate change and the digital revolution—three things that interest me a lot. Could you expand a bit on how you orient the bank towards those longer-term issues? That is really important. To me, when you put them together, they are the issues of our time. With those three things, and a few other things as well, this is a different world from any world that anyone has lived in before.

How does the bank go about that response, and would you say that one of its great advantages, to ask the question I am supposed to ask, is that it has a holistic approach rather than a more fragmented one? That is what most other countries have, I think. I do not know of any direct parallel to what you do, in those respects, in any other country that I have come across.

Eva Witt: It was about trying to redirect our programmes under the four mega-trends. When the climate agenda appeared, we supported the Government right from the beginning. We have a very strong portfolio on energy efficiency, especially in the housing sector. Every second newly constructed flat or apartment has a KfW energy efficiency loan. There are energy efficiency programmes for the SME sector and the municipalities.

On digitisation and innovation, we started a new programme this year. It skyrocketed and went completely through the roof, and within months we had a €3 billion programme set up. That worked really well. It was an SME digitisation programme; SMEs looked into what they could do and needed to do to become more digital.

Lord Giddens: Would that be to try to put Germany in the forefront of the digital revolution and challenge American dominance?

Eva Witt: We are lagging so far behind. If you look at the analysis of where Germany is, it is just trying slowly to close the gap. There is a huge effort still ahead of us in Germany.

The Chairman: To narrow down that question to get a more direct answer, because we are a little pressed for time, you mentioned earlier that, in one of your programmes to help Greece and Spain, the Government came to you. Are you guided by the Government's priorities, or do you initiate your own market-failure analysis and go to the Government to tell them where there is market failure and you need to do something? How does it work? Do they come to you, or do you go to them?

Eva Witt: Both ways.

The Chairman: Thank you, that is very helpful.

Lord Butler of Brockwell: Could I follow up Lord De Mauley's question on state aid? You said that you comply with the rules on state aid, if there is a problem, by lending through a wholly owned subsidiary. If it is wholly owned by you, and you are fully guaranteed by the federal Government, how does that enable you to steer a way through the state aid rules?

Eva Witt: Do you mean state aid, or do you mean the issue of being part of government debt?

Lord Butler of Brockwell: No, sorry, I was asking a question about the state aid rules in this case. I am going to come on to the government debt issue; you are quite right, that is the question I was going to ask. But could I first ask how you manage to comply with EU state aid rules simply by lending through a wholly owned subsidiary?

The Chairman: Can I add a little to that question, because it is significant? It is a very important one, and I am not sure that we really understood your earlier answer. We have something called the Green Investment Bank, which was recently privatised and has become more commercial. We were told that it would have been in conflict with state aid rules and that you are not subject to the same constraints as our Green Investment Bank. Do you have any understanding of that?

Eva Witt: I would need to look at that. When we founded KfW Capital, we found a bit of the same issue. It is a subsidiary of KfW. We tried to make it work on commercial conditions, but, nevertheless, our ministry went to the EU Commission to present the case or, at least, give it information, and it was accepted. That is why I am a bit confused about the question. I do not know whether that bank had a different governance scheme or used a more subsidised interest rate than we do, and that is why it was not in compliance with the state aid rules. I am thinking aloud, but that could be the answer. We get subsidies, but we try to be within the EU reference rate and thus in compliance with state aid rules.

Q72 **Lord Butler of Brockwell:** May I go on to the question that you thought I was asking? You are fully guaranteed by the state, yet your liabilities do not show up in the measure of German public debt. To British eyes, that is extraordinary. Is it at all controversial in Germany? Have people said that KfW's liabilities ought to be part of public debt as it is fully guaranteed by the federal Government?

Eva Witt: No. We do our own analysis, as well, because the question has been asked. In the ESA framework, there are two criteria: first, that you are a financial intermediary, and, secondly, that there is operational autonomy. We are a financial intermediary; we take credit risk on our own balance sheet and expose our capital like a normal bank. Our KfW law gives the basis for our operational autonomy, as I was trying to explain; it is our executive board's decision as to how the bank is run, not

the supervisory board's decision. It works like a normal supervisory board.

We are classified as a financial intermediary on the European Central Bank list of monetary financial institutions, so that is another argument. In the Greece case, it would be counted as public debt. In cases when we have to do something on behalf of the German Government that we as a bank would not do because, commercially, it would not make sense to give Greece a big loan when it was in crisis mode, if the Government want us to do it, they have to take it on as public debt.

Lord Butler of Brockwell: If all your financial liabilities were counted as part of public debt, would it inhibit your activities at all?

Eva Witt: We never have, and we do not look at that question, to be honest.

The Chairman: It has never been a problem for you.

Eva Witt: No; that is why. For us, how ESA defines the framework is very clear, and we feel comfortable with it the way it is.

Lord Desai: One of the explanations was that UK rules for writing public debt are different from those in Germany, so it is our fault that we do this.

The Chairman: Yes, it is a rod to beat our own back.

Q73 **Baroness Liddell of Coatdyke:** You will have heard from the previous session that we are very interested in the fact that you can raise money in the capital markets. What are the benefits of that, and what are the risks? I would be very interested to know how you achieved your AAA credit rating.

Eva Witt: Looking at KfW's history—it is our 70th anniversary this year, so we are very proud of that—I did not know until recently that, after we were founded in 1948, in 1949 we did our first bond issue. That was still at the time of reconstruction in Germany, so I do not even know how our management board at the time managed to get a bond issue done.

From the beginning, we have always relied on our capital market activities. We do not take deposits. In the early days, we had the Marshall plan funding—the European Recovery Program—so there were funds coming in from that, but from the beginning we tried to have our own capital market activities. It is a programme of over €70 billion, which we take on the capital markets. It is right that we pay a bit of a premium compared with German bunds, because the German bund has a much bigger volume than we do and is much more liquid. Nevertheless, as we on-lend to the German banking sector, we still have an advantage for German banks, when we on-lend those refinancing conditions to them.

We have the AAA rating, first of all, because we are 100% owned by the federal Government and state, and Germany has the AAA rating, too. In

the old days, we had something called the Anstaltslast, a legal German thing, which was an indirect guarantee for our bonds. When the KfW law was changed, it was put in as a first paragraph in the law that there is a direct guarantee by the German Federal Republic on our debt side, which really helped us a lot in the financial crisis. Even so, we noticed that our bonds were selling off heavily at a time when we could not issue any new bonds for a few weeks. Having paragraph 1 in our KfW law helped us to be active again during the financial crisis and to issue bonds and get liquidity.

Baroness Liddell of Coatdyke: You see it all as positive, without a downside. There is no risk element.

Eva Witt: We work like an independent commercial bank, managing risk from both sides of the credit portfolio and the issuance side. If markets dry up, liquidity dries up; so, yes, there is a risk. We had it in the financial crisis of 2008-09, but we did not need to go to our Government or the ECB. Nevertheless, we had those options, in case of need. The crisis was the test, I think.

Q74 **Lord Bruce of Bennachie:** I am not sure whether you regard KfW as unique. You said at the beginning that you had a relationship with the banking system that is structured differently from ours, both in the way it works and in how it relates to your economy, as well as in the stake it takes. Are there other banks like yours around the world, or are you unique? Is there anything we can learn? From everything you have said, there is a clear cultural difference between Germany and the UK. Obviously, we make our own choices, but are there things we can learn from you, and are there other kinds of institutions we should consider, which might act as a model for the way we are heading?

Eva Witt: The European and international promotional banks all had a reason to be founded. For KfW, it was after the Second World War. The SBCI in Ireland was founded after the financial crisis in 2008-09.

Lord Bruce of Bennachie: And now we have Brexit.

Eva Witt: Exactly. There is always something happening in an economy, when the Government realise that they need an instrument. This is not really the answer to the question, but in 2008-09 Germany used KfW as an economic stimulus programme to support the German economy in the financial crisis, and it really helped. That is when other Governments came to us, saying that they would like something similar to KfW. In 2009 and 2010, we had many visits to Germany from people asking how KfW works and whether they could do something similar.

Lord Bruce of Bennachie: Who followed it through?

Eva Witt: The Irish did, and there is the BBB as well; at least, we had some contact with the UK Government at that point. Portugal is still working on it, and the Dutch are still slowly getting theirs, so there are other institutions.

Lord Bruce of Bennachie: You cover the whole panoply. You do development, so you incorporate what would be our Commonwealth Development Corporation. This is a minor detail, but does that cause any difficulties in how you define official development assistance, given that you operate in countries both commercially and in development terms? More to the point, what is the advantage of having all those things in one institution? Do you think that the UK will benefit from it? It can just be your personal opinion, if you like, from your experience. Are there advantages from having more siloed institutions?

Eva Witt: In the French system, they have three institutions. They have the CDC, which is more about infrastructure and social housing programmes; Bpifrance is the SME bank; and the AFD is the development aid institution. For some programmes, when it comes to SME financing, CDC and Bpifrance have to talk to each other about who is doing what. For export finance, because Bpifrance has the export credit agency in its institution, it finances international business, but then the AFD comes along and does development aid. At least in our house it is all under one roof, and we try to organise ourselves within the institution.

On your first question, the on-lending model of KfW has worked very well within Germany. A recommendation would be to have the on-lending model, because you go through the financial and private sector, and they take the risk and have the relationship with the client. We have a lot of staff, but we do not need branches; we do not need to go into the countryside, because the banking sector does that and has the relationship with the customer. Those are lessons learned with other institutions, and they have worked very well for KfW.

What is important is the state guarantee for the funding side, as I mentioned with capital markets, at a certain level of growth. If you want your own capital market activities, the state guarantee helps.

Lord Bruce of Bennachie: What are your 80 representative offices doing? They are presumably all outside Germany.

Eva Witt: They support development aid projects. They are really very operational. IPEX has some offices as well.

Lord Bruce of Bennachie: That is the equivalent of your overseas aid country programmes.

Eva Witt: Exactly. It is all ODA; they are only allowed to do ODA, except for the export and project finance, which is 100% commercial, and never ODA.

Q75 **The Earl of Lindsay:** How important to KfW is your co-ownership model, which is reflected in your governance and management? Are you surprised that the BBB has not followed a similar model, given that in Britain we have devolved Administrations?

Eva Witt: Sorry, what do you mean?

The Earl of Lindsay: I am talking about co-ownership between the federal republic and the states.

The Chairman: You are 20% owned by the Länder.

Eva Witt: Yes, exactly. Germany has a very federal system, which is reflected in our shareholder structure. Nevertheless, we see ourselves as the national promotional bank, because the different federal states have their own regional promotional banks. We have a very funny system in Germany.

The Earl of Lindsay: Is there any linkage between the state investment in promotional banks and the KfW? Do you work in concert with them?

Eva Witt: We do, and having the federal states as a shareholder is important for the transparency of what we do. They see that we are not competing in their federal state, for instance, or with their regional promotional bank. That is important. We support them; we have programmes together and we give them refinancing. We work together with the different Landesförderinstitut, as we call them in Germany. The system in Germany is a bit complex.

The Earl of Lindsay: You suggested that transparency was one benefit of the 20% ownership of KfW by the states. Does it help the whole integration of effort between federal and local?

Eva Witt: Exactly; because they are also part of KfW. They have only 20%, so they are not the majority shareholder; that is always the federal Government. Nevertheless, they are part of KfW and of our programmes.

The Chairman: Thank you very much.