

# PRACTICAL INFORMATION



HERMES COVER SPECIAL NOVEMBER 2008

Inclusion of foreign content in Hermes Cover

EXPORT CREDIT GUARANTEES OF THE  
FEDERAL REPUBLIC OF GERMANY

► **Hermes Cover**

## ► HERMES COVER SPECIAL

### Inclusion of foreign content in Hermes Cover

At its meeting on February 7, 2008, the Interministerial Committee (IMC) passed a resolution to substantially extend the scope for covering subcontracted supplies (foreign content) and local costs. This had been preceded – with Germany’s consent – by a modification in November 2007 to the OECD rules on covering local costs. This prompted the Federal Government to revise the entire framework governing foreign content and local costs in the best interests of the German export sector.

In adopting these new rules, the Federal Government is responding to the repeated appeals of German exporters, who had increasingly viewed the previous system as overly restrictive in the light of international competition and thus as constituting a serious disadvantage.

This document describes the conditions for including foreign content in Hermes Cover.

#### I. PREREQUISITES FOR INCLUDING FOREIGN CONTENT IN HERMES COVER

The question as to whether foreign goods and deliveries may be included arises only if they are of a foreign origin in accordance with the German Federal Government’s definition.

##### WHAT IS THE DEFINITION OF FOREIGN CONTENT?

Goods produced in another country which are processed or modified within the Federal Republic of Germany and integrated in a product for which a German certificate of origin has been or could be issued are not classified as foreign content. This is because in accordance with the Federal Government’s definition a product for which a German certificate of origin has been issued is deemed to constitute German goods in whole regardless of whether and to what extent it contains foreign goods and services.

##### WHAT CONTRACTUAL PAYMENT CLAIMS MUST BE AGREED UPON?

The basic prerequisite for including foreign content in Hermes Cover is the existence of a direct claim for payment held by the subcontractor towards the German exporter (principal supplier).

#### II. PERMISSIBLE FOREIGN CONTENT

##### NEW RULES AS OF FEBRUARY 2008

Under the new rules, foreign content and local costs are subject to a uniform “base amount”, which may be exceeded in certain circumstances. In practice a three-tier approach is applied<sup>1</sup>.

##### WHAT MUST GENERALLY BE CONSIDERED IN CONNECTION WITH LOCAL COSTS?

It should be noted that the local costs (in the case of transactions coming within the Consensus) may only be included in cover at a rate of up to 23% of the (total) order value in each of the three tiers.

##### IN WHAT AMOUNT CAN FOREIGN CONTENT BE INCLUDED IN THE FIRST TIER?

In the **FIRST TIER**, goods and services can be included in the cover regardless of their origin up to an amount of 30% of the (total) order value (“uniform base amount”)<sup>2</sup> without any obligation to provide further reasons.

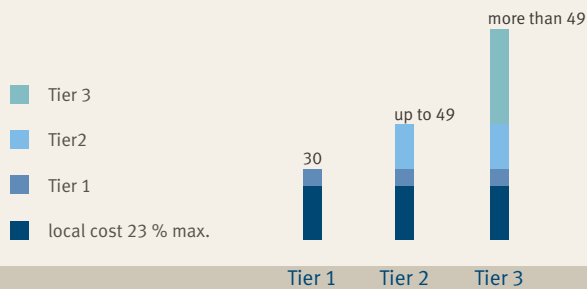
Alternatively, the base amount is available for local costs (**UP TO A MAXIMUM OF 23%**) and/or the inclusion of foreign goods/services.

<sup>1</sup> Obviously, this rule relating to the inclusion of foreign content and local costs only applies if the buyer’s country is not subject to any restrictions under the specific cover policy.

<sup>2</sup> The previous 10% limit for subcontracted foreign supplies from “other countries” has thus been raised to 30%.



### THE THREE-TIER SYSTEM FOR THE INCLUSION OF PERMISSIBLE FOREIGN CONTENT IN PERCENT OF THE ORDER VALUE



#### IN WHAT AMOUNT CAN FOREIGN CONTENT BE INCLUDED IN THE SECOND TIER?

The **SECOND TIER** entails rules for transactions for which the total amount of the foreign content to be included is between 30% and 49% of the (total) order value. In this tier, a distinction is initially drawn between countries with which an agreement on subcontracted supplies is in force (“parties to the agreement”: EU, Switzerland, Japan, Norway) and “other countries” with respect to local costs (on credit terms) and subcontracted foreign supplies.

If the subcontracted supplies come both from “parties to the agreement” and “other countries”, they can be included in this tier (up to 49%) **WITHOUT ANY FURTHER EXPLANATION** provided that the foreign content per country group does not exceed a proportion of 30%<sup>3</sup>.

In the second tier, it is also possible to include further foreign content **WITHOUT ANY FURTHER EXPLANATION** in cases in which an advance or interim payment in excess of the standard rate of 15% has been agreed upon. In this case, the amount of the advance or interim payment exceeding this standard rate can be covered regardless of the origin of the subcontracted supplies (with the exception of the buyer’s country)<sup>4</sup>.

Subcontracted supplies from subsidiaries may also result in the base amount of 30% being exceeded (up to a maximum of 49%) if the subsidiary in question is not domiciled in the buyer’s country.

In individual cases, it may be permissible for the base amount to be exceeded up to 49% provided that the applicant is able to prove the necessity of this for its business (price, technical or customer-related reasons) or provides some other type of justification.

#### IN WHAT AMOUNT CAN FOREIGN CONTENT BE INCLUDED IN THE THIRD TIER?

In the **THIRD TIER** it is possible on a case-by-case basis to cover transactions which exhibit foreign content in excess of 49%. In this case, the exporter must explain in detail why such supplies are crucial. This requires an individual decision by the Interministerial Committee on whether a transaction qualifies for cover in the light of the reasons submitted on the one hand and the degree to which the transaction deserves support on the other.

<sup>3</sup> In the case of small order values, subcontracted supplies from within the EU may comprise up to 40% of the order value.

<sup>4</sup> Deliveries from the buyer’s country are excluded as these by definition are local costs coming within the scope of the OECD Consensus.

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### III. FURTHER COVER OPTIONS

If the foreign content does not come within the scope of the national rules, it may still be possible for the German exporter to obtain cover.

In this case, cover may be provided in favor of the German exporter if and when the national credit agency in the country from which the subcontracted supplies originate assumes a reinsurance commitment. If a foreign government-sponsored export credit agency agrees to assume a **REINSURANCE COMMITMENT**, the Federal Government will only cover the credit risk for the German part, while the foreign export credit agency covers the corresponding foreign content.

Generally speaking, the collaboration between the Federal Government and the foreign export credit agency is invisible to the German exporter, who receives the cover from a single source. This is because the allocation of risk is solely a matter for the export credit agencies concerned.

The reinsurance commitment is provided on the basis of corresponding reinsurance agreements.<sup>5</sup>

If the Federal Government is unable to provide cover for foreign content and reinsurance is also not an option, the German exporter can still obtain cover by placing the payment terms agreed upon with its subcontractors on an “if-and-when” basis. In this case, cover can take the form of co-insurance.

Detailed information on these additional forms of cover can be found in the brochure Hermes Cover Special **MULTI-SOURCING PROJECTS**.

### IV. EXAMPLES

#### EXAMPLE NO. 1

30 % of a German exporter’s export transaction to a non-EU buyer’s country comprises French goods.

- As a matter of principle, there will be no problems in including the French content in the cover granted in favor of the German exporter (Tier 1).

#### EXAMPLE NO. 2

30 % of the content of a German company’s export transaction with a non-EU buyer country comprises deliveries from the EU and a further 15 % of the content deliveries from Japan/Norway/Switzerland. In addition, an advance payment of 15 % and an interim payment of 15 % have been agreed upon.

- Although the quotas for these countries of 30% each are not applied cumulatively, further subcontracted supplies are included without any additional explanation as the advance and interim payments exceed the standard rate (15%). In this case, the foreign content may account for up to 45% and is covered under Tier 2 (up to 49%).

An Excel tool for calculating the permissible foreign content can be downloaded from our website at <http://www.agaportal.de/pages/aga/downloads/antraege.html> (downloads/application forms/handling of export credit guarantees); german version only.

*Ute Cordes*

<sup>5</sup> A list of existing agreements can be found on our website at <http://www.agaportal.de/en/aga/deckungspolitik/kooperationsabkommen.html>



## DEFINITIONS

### Transit goods

The foreign content of transit goods, i.e. goods in transit customarily traded on short-term payment terms, can (still) be up to 100%.

Transit goods primarily comprise raw and basic materials, agricultural produce, fertilizers and consumer goods. The credit period is normally a maximum of 180 days or, in exceptional cases, up to 360 days.

### Subcontracted supplies from the EU

Depending on the (total) order value, up to 40 percent of the subcontracted supplies from EU member states can be included in the cover. The following options are possible in this respect:

- ▶ 40 % in the case of contracts with a value of less than EUR 7.5 million
- ▶ EUR 3.0 million in the case of contracts with a value between EUR 7.5 million and EUR 10 million
- ▶ 30 % in the case of contracts with a value of more than EUR 10 million

### Subcontracted supplies from Japan, Switzerland or Norway

In accordance with the bilateral agreements in force with Japan, Switzerland and Norway, deliveries of up to 30 % are permissible from these countries.

### Subcontracted supplies from “other countries”

Up to 30 % of the subcontracted supplies from “other countries” can also be included in the cover.

### Supplies and foreign goods provided by the foreign subsidiaries of German companies

Deliveries from the foreign subsidiaries of German exporters enjoy considerable privileges over the subcontracted supplies sourced from other companies. In this case, the Federal Government accepts foreign content of up to 49 % regardless of the country of origin (exception: buyer’s country).

### “Increased advance payment”

If an advance/interim payment in excess of the standard rate (15%) is agreed upon, further foreign content can be included in the cover as part of Tier 2 (up to 49 %) regardless of the country of origin (exception: buyer’s country) up to an amount equaling the amount by which the advance/interim payment exceeds the standard rate.

### Local costs

Goods and deliveries from the buyer’s country are generally referred to as “local costs”.

As a rule, local costs qualify for cover provided that they are directly related to the German exporter’s export transaction and form part of the receivable due from the buyer.

In accordance with the OECD Arrangement (Chapter II, Article 10d), credit terms may be applied to up to 23 % of the (total) order value (30 % of the value of the export order) of such local costs.

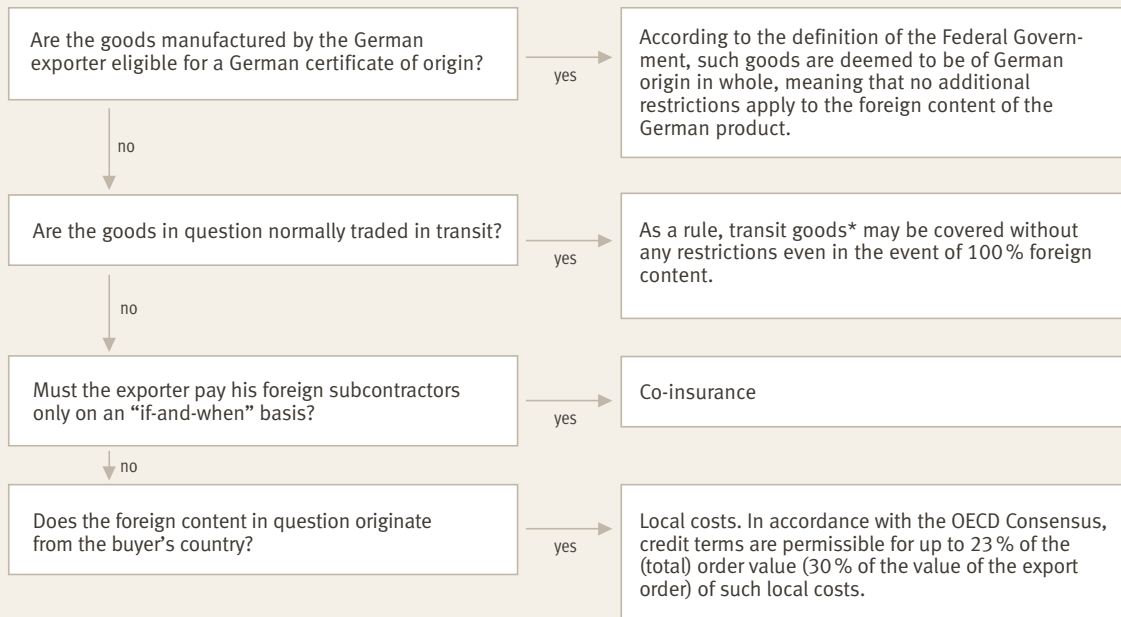
If the local costs required for executing the order exceed this percentage, they can only be covered if payment in cash is agreed upon.

Additional restrictions concerning the eligibility of local costs for inclusion in cover may arise from the specific cover policy for the specific buyer’s country.

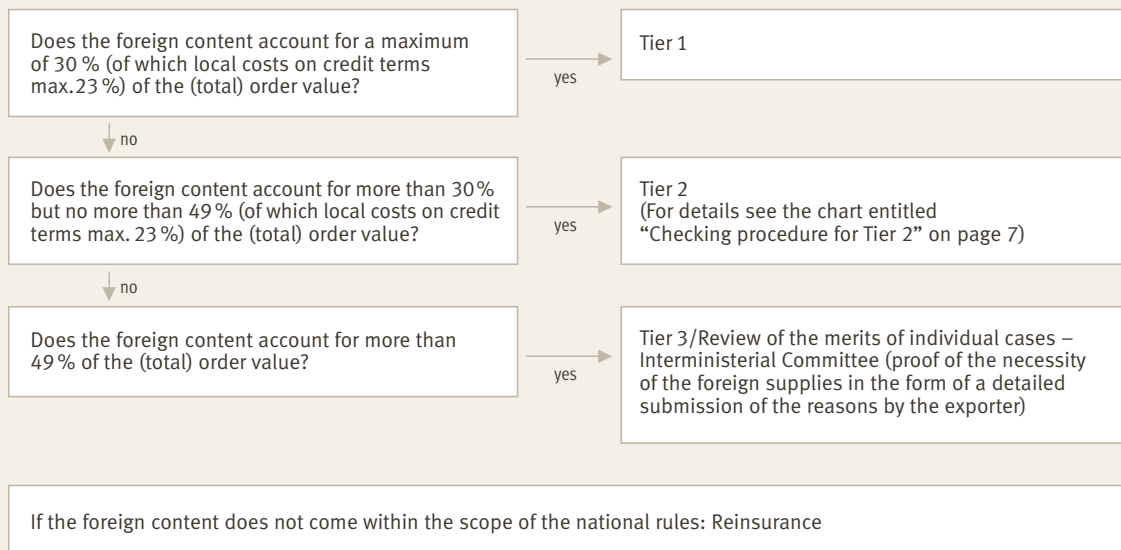
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CHECKLIST OF CRITERIA FOR DETERMINING WHETHER FOREIGN CONTENT IS ELIGIBLE FOR INCLUSION IN COVER



THREE-TIER MODEL



\* The credit period is normally a maximum of 180 days or, in exceptional cases, up to 360 days.



**TIER 2 OF CHECKING PROCESS**  
**FOREIGN CONTENT 30 - 49 % OF (TOTAL) ORDER**

1. Initially: Definition of country groups based on buyer's country/country of origin  
 The share of local costs (max. 23 % of (total) order value on credit terms) and foreign content must be allocated to the individual country groups:  
 a) EU and Japan/Norway/Switzerland  
 b) "Other" countries

2. Initially:  
 Do the local costs on credit terms not exceed 23 % of the (total) order value?

no

Local costs cannot be covered in accordance with the OECD Consensus

3. Initially:  
 Are the goods/services from subsidiaries included?

yes

The goods and services sourced from subsidiaries can be included in an amount of up to 49% of the (total) order value regardless of the country of origin (with the exception of the buyer's country).

Does the foreign content by country group equal up to 30% and does not exceed a total (plus any supplies from foreign subsidiaries) of more than 49%?

yes

Tier 2/inclusion in cover possible without any further reasons given

no

Does the foreign content attributable to a country group exceed 30% but not more than 49% of the (total) order value?

Has a higher advance/interim payment been agreed upon?

yes

The foreign content can be increased by an amount equaling the additional amount of the advance/interim payment regardless of the country group\*\*

yes

Tier 2/additional reasons must be given for the business necessity (price, technical or customer-related) or any other reasons or other factors

\* In the case of supplies from within the EU, the foreign content may comprise up to 40% of the (total) order value

\*\* Maximum of up to 49% of the (total) order value

## Cover from the Federal Republic of Germany for business transactions abroad

The German Government supports German business ventures abroad with its Export Credit and Investment Guarantee Schemes as well as the Untied Loan Guarantee Scheme, thus securing economic growth and safeguarding jobs. To this end, the Federal Republic of Germany provides guarantees against commercial and political risks in connection with export transactions as well as against the political risks of foreign direct investments. In addition to this framework, it is also possible to cover the commercial and the political risks of untied loans relating to projects which are in the overriding national interests of Germany.

The German Government has mandated a consortium formed by Euler Hermes Kreditversicherungs-AG and PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft to manage these promotion schemes.



Federal Ministry  
of Economics  
and Technology

### OUR PARTNERS



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