

PRACTICAL INFORMATION



HERMES COVER SPECIAL **JANUARY 2009**

Basic elements

EXPORT CREDIT GUARANTEES OF THE
FEDERAL REPUBLIC OF GERMANY

► **Hermes Cover**

▶ HERMES COVER SPECIAL

Basic elements

THE BASIC ELEMENTS OF EXPORT CREDIT GUARANTEES

The export credit guarantees granted by the Federal Republic of Germany (“Hermes Cover“) enable exporters and banks to protect their export credits against the risk of bad debt losses for commercial and political reasons. The state offers a form of insurance here, since the private insurance industry does not provide sufficient cover for numerous export projects to developing countries and the threshold economies.

The capacity on offer from private export credit insurers is distinctly limited in certain areas. Especially for exports to markets with an elevated risk – and here primarily in transactions involving capital goods with extended-term payment periods – support through state export credit guarantees is the only way to realize the business. Thus the state steps into the breach where private insurers offer insufficient cover. This is why all the Western industrial countries have developed their own officially-supported export credit guarantee schemes in order to promote their national exporting industry. Hermes Cover therefore ensures a level playing field for German exporters in the international competitive environment.

POLITICAL UND COMMERCIAL CAUSES OF LOSS

Export credit guarantees protect exporters from bad debt losses due to political and commercial reasons. **POLITICAL RISKS** may have a direct impact on the insured receivables – e. g. as a result of

- ▶ prohibition of payment
- ▶ payment moratorium
- ▶ non-conversion or non-transfer of funds
- ▶ legislative or administrative measures taken by public authorities
- ▶ war or hostilities, civil commotion or revolution in a foreign country

and may lead to the receivables becoming uncollectable or may even prevent the receivable accruing in the first place because certain events frustrate the performance of the contract.

In addition, the loss of the goods prior to the passing of risk is deemed to be an insured political event if the goods are confiscated or the exporter is expropriated in some other way, or if goods are destroyed or damaged and there was no way to include such risks in the transport insurance taken out.

COMMERCIAL RISKS are protracted default on the part of the buyer or various forms of insolvency such as bankruptcy, schemes of arrangement with the creditors agreed either in or out of court, the unsuccessful execution of a judgement title or unfavourable economic circumstances of the buyer leading to a suspension of payments from him.



It is important to determine clearly whether a cause of loss is political or commercial because the **UNINSURED PERCENTAGE** and the resulting amount of loss to be indemnified are different here. The uninsured percentage is the percentage of the loss which the insured bears for his own account. In this way he retains his interest in preventing or at least mitigating any loss. Unless the uninsured percentage has been increased in individual cases, it is 5 % of the loss for political risks and 15 % for commercial risks and for protracted default. Under Wholeturnover Policies 5% of the political risks and 10 % of the commercial risks remain uninsured, while under Wholeturnover Policies Light the uninsured portion generally is 10 % for all risks. For buyer credit cover and manufacturing risk cover the uninsured percentage is 5%. Besides the percentage of the uninsured portion there is another fundamental difference between commercial and political losses: in the case of commercial losses the insured is obliged to try to collect the receivables himself, while in connection with political losses the Federal Government normally assumes this task on behalf of the insured.

APPLICATION PROCEDURE

The exporter or the bank which is financing the export transaction applies for an export credit guarantee to Euler Hermes Kreditversicherungs-AG. It considerably facilitates swift processing of the application if the applicant attaches status reports and other information material on his buyer, where available. In the case of applications with an order volume exceeding 15 million Euros, a memorandum giving details of financing, infrastructure, environmental aspects and the macro-economic impact of the project is also necessary.

Applications should be made at the earliest possible time, but in any case before the attachment of risk. In capital goods transactions it is recommended to make an application while the contract is still being negotiated. This enables the exporter to get a clear idea of the eligibility of his project for cover at an early stage in the negotiations.

An “offer of cover” issued by the Federal Government is binding: if the transaction complies with all the criteria stipulated in this – with no changes in substantive or legal status – the assumption of cover is guaranteed in the event of the export contract and, where necessary, the buyer credit contract being signed. Where contracts are put out to tender, the offer of cover gives the exporter the necessary basis to negotiate from a secure position.

After the export contract and, where appropriate, the buyer credit contract have been signed, a decision is made on whether to confirm the granting of cover. If this is decided positively, the Federal Government concludes a contract of guarantee with the insured and issues a certificate of guarantee. This contains all the details material to the cover decision, such as the type and amount of risks insured and a description of the business transaction.

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THE CRITERIA FOR MAKING A DECISION

The following criteria are taken into consideration when deciding whether to grant an export credit guarantee:

ELIGIBILITY FOR COVER

Not every export transaction is eligible for cover. The limits to eligibility arise at the point where a transaction may contravene the vital interests of the Federal Republic of Germany. Such restrictions on eligibility may be based on e. g. the type of goods concerned, the country of destination, a combination of the two, the parties to the contract, the payment terms agreed or other issues connected with environmental aspects, human rights or corruption.

JUSTIFIABILITY OF THE RISK

The transactions submitted for cover must be justifiable in terms of the commercial and political risks involved. In this context the creditworthiness of the foreign buyer is scrutinized and the country risk is examined to determine the risk based on payment record in the past and the future ability of the country to service its debts.

Particular political interests of the Federal Republic of Germany may permit the granting of cover for export transactions with a higher risk. These may involve labour market initiatives, issues of structural or regional economic importance or foreign and development aid policy.

CONTRACT TERMS

Export business is only eligible for support if the conditions agreed in the contract are in line with those generally accepted in export trade. This is particularly true in the case of the agreements reached between countries concerning payment terms. The standard conditions are regulated e. g. by the OECD Consensus.

RESTRICTIONS IMPOSED BY THE BUDGET LAW

The Federal Budget Law is the basis for decisions. Under this, export credit guarantees may not be granted if the maximum amount authorized by the Budget Law has been exhausted or if the individual transaction involves a high probability of indemnification by the Federal Government.

THE TYPES OF COVER

The types of cover available are as varied as the export transactions themselves. Cover is not only given for the risks before or after shipment; we also distinguish according to the credit period.

MANUFACTURING RISK COVER

Manufacturing risk cover is used to safeguard against risks during the manufacture of the goods, i.e. from the commencement of manufacture up to the point at which they are despatched. It is available either in isolation or combined with an export credit guarantee. It is particularly to be recommended in the case of customized goods. If such goods cannot be delivered, it may prove impossible to find another buyer for them.



The insured event for manufacturing risk cover occurs when political or commercial circumstances abroad prevent the completion or the despatch of the goods. The risk of an embargo being imposed is also covered. Manufacturing risk cover includes the actual prime costs incurred by the exporter. These are estimated in advance by him and form the basis for the maximum cover amount given. If an insured event occurs, the actual amount of the loss is ascertained by means of an expert opinion.

SHORT-TERM COVER

The Federal Government has four different forms of cover for short-term export business with a credit period of up to 12 months: short-term supplier credit cover, revolving supplier credit cover, wholeturnover policies and the wholeturnover policies light (APG-light).

SHORT-TERM SUPPLIER CREDIT GUARANTEES are given by the Federal Government for receivables due to German exporters for single transactions with foreign debtors if the credit period does not exceed 24 months. The goods principally covered here are raw materials, semi-finished goods, components, consumer goods and spare parts, for which the accepted credit period is normally only up to a maximum of six months. For high-value components and consumer durables, the acceptable credit period is 12 months.

If the exporter delivers regularly to a foreign buyer on short credit terms the Federal Government can also cover this business with a **REVOLVING BUYER CREDIT GUARANTEE**. This procedure gives the same scope of cover and the same premium rate is charged as for short-term buyer credit guarantees. It is much easier for the exporter to handle, however. The turnover achieved with a particular foreign customer during the course of one year is covered here on a revolving basis under a maximum cover amount set in advance.

A **WHOLETURNOVER POLICY** (APG) is the most suitable form of cover when a number of foreign buyers in various countries are supplied on short credit terms up to one year and there is a balanced spread of risks. The wholeturnover policy offers small and medium-sized exporters a comprehensive means of protecting their export revenues at a good price which is easy to handle and at the same time very flexible. The premium is normally considerably lower than that for supplier credit guarantees. In addition, no application or credit rating fees are charged.

Cover includes receivables due from business with all private customers in selected non-OECD countries as well as, in exceptional cases, in the OECD countries Korea, Mexico and Turkey. The particular flexibility of this policy is shown by the fact that the policyholder has the option to include new accounts in the cover per policy period.

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A wholeturnover policy offers protection from bad debt losses due to buyer insolvency, non-payment of receivables within six months following due date as well as due to political risks, especially lack of hard currency or restrictions on the international payments system.

The **WHOLETURNOVER POLICY LIGHT** (APG-light) is primarily an instrument which enables small and medium-sized exporting companies with an annual turnover of up to a million Euros to insure their export transactions with credit periods of up to four months. This form of wholeturnover cover is also suitable for larger companies which have only a minimal percentage of their turnover in export business that is eligible for cover.

As with the normal wholeturnover policy, this policy only covers export business with buyers outside the OECD and as exception in Korea, Mexico and Turkey.

The policy includes all insurable business. In the interests of simple handling, there are no special options. Receivables secured by letters of credit or receivables from the performance of services, for instance, are not covered.

There is only a single insured event: the Federal Government indemnifies an insured account if and when it remains unpaid six months after due date.

A **COUNTER-GUARANTEE** enables a German exporter to insure the claim for compensation which the bank who has issued a contract bond on his behalf has in the event of the bond being called and the bank paying it.

The Counter-guarantee complements the contract bond guarantee. Under it, the bank can be reimbursed for up to 80% of the bond amount if the bond is called by the foreign buyer, irrespective of the reason.

With **REVOLVING BUYER CREDIT COVER**, a bank insures repayments due under a loan with a maximum credit period of 12 months (in exceptional cases 24 months) which is given to finance export business transacted by a German exporter with a specified foreign buyer with whom he regularly does business.

A revolving buyer credit guarantee protects the banks against payment default if the borrower becomes insolvent or fails to make payment within one month after due date, adverse measures are taken by foreign governments or warlike events arise or local currency amounts are not converted or transferred.

COVER FOR MEDIUM- AND LONG-TERM EXPORT BUSINESS

Medium- and long-term export credits are regarded as those with an agreed payment term exceeding two years. We speak of medium-term credits in the case of credit periods up to five years, while long-term credits may, in exceptional cases, run for up to 15 years after commissioning of the plant, and only involve renewable energy projects. For other capital goods, 12 years are reckoned to be the upper limit. Wholeturnover policies or revolving guarantees are unsuitable for the protection of medium- and long-term business. Only supplier credit guarantees are available for this purpose.



The OECD countries have agreed guidelines for the cover of export business with credit periods exceeding two years. These are intended to provide a level playing field in international competition. These guidelines – also known as the OECD Consensus – envisage certain maximum or minimum conditions such as differentiated premium rates according to country risk categories or maximum credit periods for certain types of product, or according to the per capita income of the country concerned.

Cover policy for the individual buyer countries is fixed nationally by each member country of the OECD. In the case of high-risk importing countries, the maximum amount of all risks to be covered may be limited by a so-called cover ceiling. Cover may also be given only on condition that there is a bank or sovereign guarantee for the foreign buyer.

In contrast to short-term supplier credit cover, medium- and long-term supplier credit guarantees also insure the risk of protracted default. This also holds true for public buyer guarantees, which otherwise only cover the political risk.

COVER FOR TIED BUYER CREDITS

Large-scale export transactions are increasingly bank-financed. In this, the German exporter mostly gets in touch with a bank which then extends a loan to the foreign buyer, enabling him to pay the purchase price due to the Germany exporter at the time the goods are delivered. The bank thus has a claim on the foreign buyer for repayment of the loan. A buyer credit brings immediate relief for his balance sheet and increased liquidity for the exporter.

Buyer credit cover is insurance for an abstract claim under a loan contract, unconnected with the delivery of goods. Particular problems can therefore arise if the repayment of the loan is refused by the buyer on the grounds of some deficiency in the performance of the supplier's contract. For this reason, the exporter is tied to the contractual relationship with the Federal Government via a so-called Letter of Undertaking. He remains liable towards the Federal Government to provide all information concerning the underlying export transaction, must declare himself bound by instructions from the government and undertakes, under certain circumstances, to release the Federal Government from its liability to indemnify under the buyer credit guarantee.

STRUCTURED FINANCE AND PROJECT FINANCE

Structured finance constructions look primarily at the economic viability of a project. They are thus a means of granting cover for projects deserving of support despite the fact that the economic situation of the country concerned would only justify a limited amount of conventional cover. A form of structured finance which has long since established itself is project financing.

PROJECT FINANCING constructions are complex export transactions in which the operating costs and the repayment of any loans taken out are generated by the project itself. The credit standing of the foreign buyer plays less of a role here than the quality of the project. In this type of business, the emphasis is thus on an extremely careful analysis and evaluation of the project risks.

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A security construction tailored individually to each project guarantees that the revenues from the project are used to service the loans. In countries with a substantial transfer risk, it is essential that the hard currency revenues from the project are paid into offshore escrow accounts outside the country of the project.

In terms of eligibility for cover and the justifiability of the risk, the same basic criteria apply to project financing deals as to other types of business. Particular attention must be paid to whether the risk is justifiable, and here above all to the economic viability of the project. A special expertise is required for this, which must be commissioned and paid for by the applicant.

In addition there are further special forms of cover, e.g. for **CONSTRUCTIONAL WORKS** and for **LEASING BUSINESS**. Detailed information on the various forms of cover under export credit guarantees can be found in the series **PRODUCT INFORMATION**.

SUBCONTRACTED SUPPLIES FROM FOREIGN COUNTRIES

Since the export credit guarantee scheme is intended to promote German exports, the goods and services covered by them should originate for the most part in Germany. The progress towards globalisation means however that today transactions involving capital goods are more and more being carried out by exporters from more than one country working together on the same project. Due to this division of work, foreign goods and services or deliveries from foreign subcontractors in

many cases form an indispensable part of the transaction. There are a number of different ways in which cover can be given for such business:

COINSURANCE

When the primary supplier passes on his foreign risks to the subcontractor, e.g. when the latter only gets paid if and when the foreign buyer has paid the primary contractor, an application can be made for so-called coinsurance. Among EU member states, this is regulated by a Council Directive. There are bilateral agreements with other export credit agencies. Besides this, there is the option of concluding a coinsurance agreement with other state export credit agencies covering just a single transaction.

In those cases where the risk of non-payment is not passed on to the subcontractor, other models of cover are available: foreign content may be included under international agreements or with the aid of a reinsurance construction. In addition, subcontracted supplies from a company's own foreign subsidiaries can be included as long as the main portion of goods supplied is still generated in Germany.

INCLUSION OF SUBCONTRACTED FOREIGN SUPPLIES

In February 2008 the scope for covering equipment and services sourced in the buyer's country (local costs) and subcontracted supplies from third countries (foreign content) was extended considerably. As a rule foreign content can now be included in the cover up to 30 % of the total order value, in individual cases the foreign content may even exceed 49 % if the transaction is particularly deserving of support. The extended scope for covering local costs agreed by the OECD is now available to German exporters without any restrictions: the portion of local costs has been increased to 23 % of the total order value.



Deliveries from EU countries can be included in cover up to 30 %, or in the case of low order values up to 40 % of the export transaction. There are additionally bilateral treaties with Japan, Norway and Switzerland which envisage foreign content up to 30 % of the goods supplied.

REINSURANCE

Another form of cooperation is reinsurance. In this construction the primary insurer – the insurer of the main supplier – assumes the credit insurance using his underwriting tools for the entire order inclusive of foreign content. If a loss occurs, however, he has recourse to the reinsurer – the insurer of the subcontractor – in respect of the share of the loss which can be allocated to the foreign subcontractor, which is covered by the export credit agency in the country of the subcontractor under the reinsurance agreement.

The advantage of this construction is that the financing and insurance for the transaction are in a single hand as far as external partners are concerned, while the sharing of the risk is exclusively a matter for the export credit agencies involved. It is not necessary to make a specific application for this type of cover. If the Federal Government is unable to agree to the inclusion of foreign subcontracted goods, for instance because they exceed the permitted percentages or for reasons of cover policy, the possibility of supporting the transaction on the basis of reinsurance cover from the reinsurer in question is examined without the exporter or the bank having to specifically apply for it. The certificate of guarantee itself does not contain any extra special conditions with respect to reinsurance.

THE COSTS

The insured pays premium and handling fees for his export credit insurance cover.

The **HANDLING FEES** depend on the order value and consist of the following three charges.

- ▶ an **APPLICATION FEE** charged when the application is made
- ▶ a **PROLONGATION FEE** payable for each prolongation of the provisional offer of cover beyond one year
- ▶ an **ISSUING FEE** for issuing the certificate of guarantee.

Credit rating fees are not charged.

The **PREMIUM** rate depends primarily on the country risk category into which the country of the buyer falls in a harmonized OECD system. Category 0 means a very low risk and thus the lowest premium rate, while Category 7 signifies the highest risk and therefore the highest premium. The basis for calculation of premium in the case of credit risks is the amount of receivables due, while in manufacturing risk cover it is the manufacturer's prime costs. In special and secondary forms of cover the premium is calculated on the amount insured.

The premium is further influenced by the terms of payment (length of the credit period) and the status of the buyer/guarantor – public or private – and, as the case may be, the amount of the insured's retention (insured percentage). If the buyer/guarantor (e.g. bank) in question is a private entity, its creditworthiness also influences the premium rate.

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The premium is further influenced by the order value, length of the credit period and the status of the buyer – public or private, with or without a bank guarantee. Private buyers are, in addition, classified according to five buyer or bank categories in order to make a distinction between debtors (guarantors) according to their credit standing.

The premium for wholeturnover policies is calculated on the risks covered in each individual policy. For the wholeturnover policy light, a premium based on the monthly declared insurable turnover is charged. From the third year of cover onwards, the premium rate is adjusted in accordance with the claims experience in the preceding year.

THE INDEMNIFICATION PROCEDURE

If the receivables due under the export transaction are not paid as contractually agreed, the exporter or the bank submits a **CLAIM FOR INDEMNIFICATION** to Euler Hermes Kreditversicherung. The claim must under normal circumstances be submitted within two years after the due date of the insured account.

Only **LEGALLY VALID RECEIVABLES** can be indemnified. If a foreign debtor disputes his liability to pay, the Federal Government is entitled to suspend indemnification pending final clarification.

A crucial criterion when examining a claim is whether the details of the export transaction given in the application for cover are identical with the conditions actually agreed in the export or loan contract and whether the policyholder has fulfilled all his cardinal obligations under the General Conditions of the guarantee. Claims due to the occurrence of a commercial cause of loss are checked on a case-by-case basis and settled accordingly. In the case of claims under political risk cover there is normally a common cause, so that the Federal Government generally decides whether to indemnify, and on the basis of which insured event.

Under supplier credit cover, the insured will receive indemnification within one month of the claim being ascertained. With buyer credit cover, the period is five days. At this point the claim, in the amount indemnified, is subrogated to the Federal Republic of Germany. The exporter or the bank retains the uninsured percentage for its own account.



In the event of a threatening loss, the Federal Government, the exporter, the financing banks and Euler Hermes Kreditversicherung are often successful in their concerted efforts to stabilize projects which have got into economic difficulties, thus – at least partially – avoiding the need for indemnification. **RESTRUCTURING** of the debt is often possible, usually in the form of extending the repayment schedule.

The Federal Government participates in the **COSTS**, e.g. court costs or lawyers' fees. In the case of political claims, the Federal Government attempts to recover the sums indemnified, as a rule in the form of a rescheduling agreement with the country concerned.

René Andrich

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
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OUR PARTNERS



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