

Export Credit Guarantees of the Federal Republic of Germany  
Hermes Cover



# Hermes Cover Special

► Leasing Cover

November 2003



### What leasing business is eligible for Federal Government cover?

---

Leasing cover is available both for leasing transactions involving movable objects and for real estate leasing. Eligibility for cover is not dependent on the leasing contract having a particular construction; this means that leasing cover can be given for **full payout leasing** as well as for **residual value leasing (non-full payout leasing)** contracts. This is in every case, however, with the proviso that the lease in question is **cross-border leasing**, i. e. a leasing transaction between a lessor domiciled in Germany and a lessee with his registered office in another country.

The lessor must normally be entitled to repossess the object of the lease if the lessee is in arrears with his payments, or at least be entitled to withdraw the right of use in respect of the object. If the lessor only receives the property in the leased asset from its manufacturer subsequent to its despatch, he is obliged to ensure in his relation to the latter that he is able to enforce all those rights normally accruing to the owner of the asset towards the lessee.

Leasing transactions in which the transfer and use of the leased asset is the principal purpose of the contract, and not the financing function (operating leases), are eligible for export guarantee cover as well.

### What points should be observed when arranging the terms of payment?

---

A precondition for the assumption of leasing cover is that the **credit period** complies with the basic criteria laid down by the Interministerial Committee for sales transactions on credit terms. The guidelines for export credits agreed by the member states of the OECD (known as the OECD Consensus) are the basis for these. The maximum permissible credit periods depend on various factors, in particular the type of goods concerned, the order value and the status of the buyer's country. Credit periods between

18 months and five years are usual in business involving capital goods. Longer credit periods may be covered in the case of higher order values. You can obtain more detailed information by getting in touch with Euler Hermes Kreditversicherungs-AG.

It should be noted, too, that prolongation of the contract or invoicing of the residual value of the asset to the lessee on credit terms after the expiry of the basic agreed rental period are regarded as being integral parts of the overall transaction, so that the criterion of the permissible maximum credit period applies inclusive of all of these. This also holds true if there is no intention to insure the receivables in respect of the residual value.

Payment of the leasing instalments must not be at more than **six month intervals** under the OECD Consensus. The combination of this maximum interval permitted between rental instalments and the maximum permissible credit period can in certain circumstances mean that there are restrictions placed on the size of the residual value instalment: in order to determine whether the payment terms chosen for a particular transaction still fall within the permissible parameters, the total order value (capital plus financing costs) is divided into equal instalments over the entire maximum permissible credit period. The leasing instalments arrived at in this way must be of a sufficient size that the amount paid is always equal to that which would be due if six month instalments were calculated. Payment terms which envisage relatively low leasing instalments and a high residual value (or a high final instalment) may therefore be problematic in some cases from the perspective of the Consensus.

In transactions with credit periods exceeding 2 years, **cash payments** in an amount corresponding to 15 % of the total order value (where appropriate as the initial leasing instalment) must be made. Instead of the normal practice in sales transactions on credit terms of calculating interest on reducing balances, in leasing it is permissible to set equal leasing instalments by dividing up the financing costs between the individual instalments.

## What is the object of cover?

The actual object of cover in the case of full payment leasing is the total amount of the instalments agreed under the leasing contract. In residual value leases, the amount due under the final residual value payment can also be covered in addition to the leasing instalments, if and when it is contractually enforceable against the lessee. Cover can also remain restricted to the leasing instalments, however.

**Claims for damages** are not included in cover pursuant to the General Conditions. This also applies to contractual rights to compensation, e. g. in the event that the lessee does not return the object of the lease on expiry of the lease period or following premature cancellation of the lease, in contravention of his contractual obligations.

In contrast to these claims, the amounts due under a **cancellation due to payments falling into arrears**, which assume the status, under the leasing contract, of the leasing payments originally agreed as consideration (surrogate claims) are eligible for cover.

**Manufacturing risks** incurred in connection with a leasing transaction may also be covered. Such manufacturing risk cover is always assumed in favour of the lessor. If the manufacturer and the lessor are not identical, the only option open to the manufacturer to benefit from the manufacturing risk cover is therefore by way of securing an assignment from the lessor.

## What risks are covered?

Leasing cover offers protection against the political and commercial risks involved in cross-border leasing transactions.

The covered **political risks** include

- legislative or administrative measures, war, hostilities, rebellion, insurrection, revolution, riot or civil commotion abroad which prevent the payment or collection of the guaranteed amount (the political risk as generally defined);
- the non-conversion and non-transfer of amounts duly paid by the debtor in local currency due to measures which impede the international movement of payments (the conversion and transfer risk);
- the loss of the right to payment due to contract frustration as a result of political actions;
- the loss or destruction of the goods prior to the passing of risk as a result of political actions.

The **commercial risks** covered are:

In the case of guarantees in respect of private buyers

- the uncollectability of receivables due to the insolvency of the foreign buyer, e. g. as a result of bankruptcy or insolvency proceedings, an arrangement with creditors either in or out of court, the failure of an executory judgement to bring full satisfaction, suspension of payments;
- failure to pay within 6 months following due date (protracted default);

In the case of guarantees in respect of public buyers:

- normally protracted default.

## What period is covered?

Federal Government liability to indemnify under leasing cover commences – exactly as in a sale transaction – with the despatch of the leased asset. It only terminates when payment of the covered amounts due under the leasing contract has been

fully and finally discharged. In the case of leasing cover with up-front manufacturing risk cover, the liability to indemnify under the manufacturing risk cover ends with the despatch or acceptance of the leased asset, whichever is earlier. Liability to indemnify under the leasing cover then commences at the point at which manufacturing risk liability ends.

On what conditions is Federal Government leasing cover available?

#### **a) Standard Conditions (supplier credit conditions)**

Under normal circumstances leasing cover is assumed on the same conditions as supplier credit cover (General Conditions for Export Credit Guarantees). The **uninsured percentage**, normally **5 %** in the case of **political claims** and **15 %** for **commercial claims** customary in such cover, is therefore applicable. This percentage of the claim to be borne for his own account by the exporter may not be insured or otherwise secured elsewhere, but it is permissible to pass it on to the manufacturer of the leased asset.

The **claims waiting periods** (the period before the insured event is deemed to have occurred) are 6 months in the case of the general political cause of loss and in buyer insolvency and 3 months in the case of non-conversion and non-transfer. **The claim is processed** within two months from the receipt of the full claims documentation; **payment** of the indemnifiable amount is made within a period of one month following notification of the claims settlement.

Just as in the case of supplier credits, the Federal Government will only indemnify a claim if and when the legal validity of the covered receivables in respect of the leasing transaction has been clearly established and is undisputed. If the lessee refuses to pay the leasing rentals claiming defects under the warranty provisions of his contract, no indemnification can be made. This also applies when the debtor is only entitled to enforce warranty claims under his contract exclusively against the manufacturer.

#### **b) Improved Conditions (finance credit conditions)**

In certain leasing models which are largely equivalent to a finance credit in their effect, leasing cover is available on improved conditions (finance credit conditions). This means specifically:

- the **uninsured percentage** is **5 % for all risk types**. It is not permissible to pass on the uninsured percentage to the manufacturer.
- **shorter claims waiting, processing and payment periods**: on improved conditions, all the claims waiting times and processing are reduced to 1 month, and claims payment is within 5 bank days.
- **recognizing the abstract validity of the leasing contract for claims purposes irrespective of flaws in performance**: if the lessee refuses to pay the lease instalments claiming defects in performance under the warranty provisions of his contract, this shall not have any effect on the right to indemnification under the leasing cover.

Leasing cover on such improved conditions can only be given if and when the leasing transaction concerned is largely equivalent in effect to a finance credit. The preconditions for this are specifically that:

- the lease should involve **capital goods** and have a permissible credit period exceeding 2 years;
- it is **indirect finance leasing** (i. e. the lessor is not the manufacturer of the asset, but a leasing company);
- the contract stipulates **the abstract validity of claims under the leasing contract irrespective of flaws in performance**, i. e. the lessor is released from warranty obligations, in combination with the assignment of his own rights under warranty provisions in respect of the asset to the lessee;
- the lessor is domiciled in Germany and is considered to observe standards of due diligence

comparable with those of a bank. This is generally deemed to be the case if the lessor is licensed to do banking business or is included in the consolidated accounts of one or more domestic banks. In addition, other leasing companies may be recognized as fulfilling these requirements after individual examination.

It is also mandatory for the manufacturer to give a so-called **Letter of Undertaking**. In this, the manufacturer undertakes to provide directly to the Federal Government all and any information necessary for the granting of the leasing cover; he recognizes the right of the Federal Government to give him binding instructions and accepts the obligation to release it from its liability to indemnify the lessor under certain circumstances. The manufacturer's obligation to release the Federal Government from its liability to indemnify is first and foremost effective in the event that the lessee refuses to pay the leasing instalments claiming defects in performance under the warranty provisions of his contract, and this results in a covered loss.

### Special features in connection with residual value leases

---

When granting cover for residual value leasing contracts, the Federal Government does not insist on a particular model, i. e. the form of the leasing contract does not have to comply with the leasing edicts issued by the financial authorities in the Federal Republic of Germany. There may however be certain restrictions placed on the residual value amounts under the criteria of the OECD Consensus set out above. On top of this, residual value leases with a contractual right of tender for the lessor may not receive the improved conditions (finance credit conditions) for cover of the amount due for the residual value payment.

As an alternative to covering the amount due for the residual value payment, the material risk of confiscation of the leased asset may be covered. Confiscation cover insures against the risk that the leased asset cannot be restored or can only be restored in such a state that its value is reduced as a result of political actions.

### Premia and charges

---

Handling fees are charged for processing an application for export credit guarantee cover. These include an application fee and an issuing fee.

A fee is charged for the leasing cover. The rates for this are fixed according to the generally applicable rules for export credit guarantees issued by the Federal Ministry for Economics and Labour. No insurance premium tax is payable.

If you would like further details, please consult the Information Sheet on Premia. An interactive PC program for calculating your individual premium ("Entgelttool") is available on our website.

*Gertrud Jacobshagen*

Information on the Export Guarantee Scheme of the Federal Republic of Germany  
is available on the Internet at:

**[www.agaportal.de](http://www.agaportal.de)**



Euler Hermes Kreditversicherungs-AG  
Friedensallee 254  
D-22763 Hamburg

Visiting address:  
Gasstraße 27

Phone +49 (0) 40/88 34-91 92  
Fax +49 (0) 40/88 34-91 75

E-Mail: [info@exportkreditgarantien.de](mailto:info@exportkreditgarantien.de)  
[www.agaportal.de](http://www.agaportal.de)

SMEs will receive  
special advice under  
the telephone number  
+49 (0) 40/88 34-90 08

Branch Offices:  
Berlin, Bielefeld, Bremen,  
Dortmund, Dresden, Düsseldorf,  
Frankfurt, Freiburg, Hamburg,  
Hanover, Cologne, Leipzig,  
Mannheim, Munich, Nuremberg,  
Saarbrücken, Stuttgart