

One-off indemnification – option for banks under buyer credit cover and untied loan guarantees

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On 7 July 2020, the Federal Government announced the **5-point package of measures to provide the German export industry with additional support**. Consequently, arrangements came into effect on 1 July 2020 to improve the liquidity situation of exporters and importers, to facilitate finance for their business and to extend the **refinancing options** available to banks. One aspect of the measures adopted entails the introduction for an unrestricted period of time of an option for one-off indemnification for non-performing loans granted by banks under buyer credit cover provided by the Federal Government. The background to the introduction of this option, how it is exercised, its scope and the calculation of the one-off indemnification are explained in greater detail below.

1. WHY HAS THE NEW ONE-OFF INDEMNIFICATION OPTION FOR BANKS BEEN INTRODUCED?

With the introduction of the one-off indemnification option, the Federal Government is addressing the negative effects on finance covered by government export guarantees liable to result from the own funds requirements for banks stipulated by the **capital requirements regulation (CRR)** for non-performing loans. Indemnification arrangements for non-performing exposures have been made more flexible for the benefit of covered banks. Consequently, the one-off indemnification option means that banks can remove non-performing exposures from government-backed export finance business in full and in good time and do not have to make a corresponding deduction from their common equity Tier 1 capital from the eighth year of the exposure being classified as non-performing (Article 47c (4) CRR).

2. WHAT IS ONE-OFF INDEMNIFICATION AND IN WHAT WAY DOES IT DIFFER FROM ONE-SUM INDEMNIFICATION?

A) THE FEDERAL GOVERNMENT'S REGULAR INDEMNIFICATION PRACTICE FOR BUYER CREDIT COVER

Under the General Terms and Conditions for buyer credit cover (GC (FKG)), the Federal Government regularly indemnifies banks under buyer credit cover on a pro rata basis in accordance with the due dates of the loan stipulated in the loan contract, Art. 5 (1) Sentence 2 GC (FKG).

B) INDEMNIFICATION IN THE FORM OF ONE-SUM INDEMNIFICATION

Under Art. 5 (1) Sentence 3 GC (FKG), the Federal Government may at its own sole discretion provide indemnification before these due dates, if the entire remaining amount of the loan becomes due on the basis of statutory or contractual provisions. Indemnification provided **prior** to the due dates referred to in the loan contract is referred to as **one-sum indemnification**. As a general principle, one-sum indemnification is provided only if it is more favourable for the Federal Government than indemnification in instalments on the basis of documented due dates. This is because all financially effective measures taken by the Federal Government are subject to an appropriate analysis of their economic expediency under budgetary law. Under Section 7 (2) of the Federal Budget Code (Bundeshaushaltsordnung), the Federal Government is required to determine whether pro rata indemnification or one-sum indemnification is more economical.

C) INDEMNIFICATION IN THE FORM OF ONE-OFF INDEMNIFICATION

The 5-point package of measures to support the German export industry supplements the one-sum indemnification option already held (solely) by the Federal Government with an additional option in favour of banks, allowing them to request one-off indemnification by including a corresponding option in the General Terms and Conditions for buyer credit cover (GC (FKG)).

Art. 5 (1) GC (FKG) now reads as follows:

“A loss is only eligible for indemnification if the due date of the guaranteed amount has passed and the claim for payment is legally valid. If the entire balance of the guaranteed amount falls due as a result of contractual or statutory provisions, indemnification shall nevertheless be based on the due dates set forth in the loan contract. The Federal Government is entitled, however, at its sole discretion to indemnify before these due dates (“one-sum indemnification”). During the indemnification procedure, the Policyholder is entitled to request payment of the indemnification amount as a lump sum (“one-off indemnification”) at any time, irrespective of whether the entire remaining amount of the loan has fallen due or not. The amount of the one-off indemnification is limited to the lower of the amounts determined within the scope of a comparative calculation for the one-sum indemnification according to the net present value method.”¹

¹ This new provision also applies with the necessary modifications to Art. 5 (1) of the General Terms and Conditions for untied loan guarantees – GC (UFG).

If the Federal Government does not make use of its one-sum indemnification right in the course of an indemnification procedure and wishes to indemnify the bank on a pro rata basis in accordance with the due dates (originally) agreed in the loan contract and stipulated in the guarantee document, the bank may now request payment of the indemnification as a lump sum amount at any time during the indemnification procedure. In terms of terminology, a distinction is drawn between **one-sum** indemnification (the Federal Government is entitled to provide indemnification in a lump sum) and the (new) **one-off** indemnification (the bank may request payment in a lump sum). The one-off indemnification option is available irrespective of whether the entire remaining amount of the loan has been called in or not. This does not prejudice the general requirements on which payment of indemnification is contingent.

3. WHO MAY EXERCISE THE ONE-OFF INDEMNIFICATION OPTION?

All banks or branches of banks that are eligible for cover and have received an export credit guarantee from the Federal Government may flexibly exercise the one-off indemnification option at any time after the occurrence of an event of loss during an ongoing indemnification procedure within the scope of **buyer credit cover**.

4. FOR WHAT TYPES OF COVER PROVIDED BY THE FEDERAL GOVERNMENT IS THE ONE-OFF INDEMNIFICATION OPTION AVAILABLE?

The one-off indemnification option may be exercised for all types of cover for medium and long-term financing for which buyer credit cover is provided under GC (FKG) or GC (UFG) irrespective of the subject matter of the cover. This specifically includes the following types of cover:

FOR THE AVOIDANCE OF DOUBT:

The one-off indemnification option is not available for airbus guarantees. Accordingly, the bank in question cannot request one-off indemnification for these types of cover.

TYPES OF COVER WITH THE ONE-OFF INDEMNIFICATION OPTION

Type of cover	One-off indemnification option
Buyer credit cover – GC (FKG)	✓
Sector-specific buyer credit cover <ul style="list-style-type: none"> • Renewable energies • Rail finance • Ship finance • Project finance 	✓
Special forms on FKG terms and conditions <ul style="list-style-type: none"> • Credit confirmation risk cover • Shopping line cover • Framework credit cover • Credit guarantee cover 	✓
Hermes click&cover BANK	✓
Untied loan guarantees	✓

DIGRESSION: RELATIONSHIP BETWEEN THE ONE-OFF INDEMNIFICATION OPTION ON THE ONE HAND AND COVERED BOND GUARANTEES AND SECURITISATION GUARANTEES ON THE OTHER

A) ONE-OFF INDEMNIFICATION OPTION AND COVERED BOND GUARANTEE (PFD)

Covered bond guarantees are issued to banks licensed to conduct Pfandbrief (German covered bonds) business ("Pfandbriefbank") for exposures covered by the Federal Government that are to be funded under the bank's own covered bond business. With the covered bond guarantee, the Federal Government provides protection for covered bond creditors in addition to buyer credit cover against "receivable seizure risks" (Section 20 (2a) of the German Covered Bond Act) on the part of borrowers from non-EU/EEA countries. Further details on covered bond guarantees can be found in the **Product Information on covered bond guarantees**, which is available at www.exportkreditgarantien.de/en. The one-off indemnification option may also be exercised in the case of a covered claim that has been funded by means of a public covered bond entered in the cover register. As the covered bond guarantee only extends the Federal Government's liability under buyer credit cover on the merits of the case subject to the continued application of the GC (FKG), the additional issue of a covered bond guarantee does not fundamentally have any impact on the one-off indemnification option. If, however, the value required to guarantee the covered bond is prematurely repaid in connection with the exercise of the one-off indemnification option, the party responsible for registering the value of the covered assets must promptly arrange for replacement assets to be entered in the Cover Register, Section 5 (1) Sentence 3 of the German Covered Bond Act.

B) ONE-OFF INDEMNIFICATION OPTION AND SECURITISATION GUARANTEE

Securitisation guarantees can give export-financing banks access to (external) sources of funding for their loans that are covered by the Federal Government or help them raise the necessary funding on better terms. Further details on securitisation guarantees can be found in the **Product Information on securitisation guarantees**, which is available at www.exportkreditgarantien.de/en. If the Federal Government issues an additional securitisation guarantee for the funding of a covered buyer credit, the guarantee provision contract will include a provision aimed at preventing duplicate liability for the Federal Government, stipulating that any claims accruing to the export-financing bank under buyer credit cover will be suspended to the extent to which and for as long as the Federal Government is liable towards the refinancing institution under the securitisation guarantee. This applies equally to all forms of securitisation guarantees. Ultimately, the refinancing bank must prematurely terminate the funding and release the Federal Government from its liability under the securitisation guarantee before the covered bank can submit a claim for indemnification and exercise the one-off indemnification option with full legal effect.

5. DOES THE ONE-OFF INDEMNIFICATION OPTION ONLY APPLY TO NEW COVER OR IS IT ALSO AVAILABLE FOR EXISTING COVER?

The one-off indemnification option applies to both new and existing cover. In this respect, the Federal Government expressly declares that the one-off indemnification option is also available to covered banks for all buyer credit guarantees already issued in their favour. Accordingly, no adjustment is required to the cover policy already held by covered banks. In the case of new cover, this has been implemented at the contractual level by a corresponding amendment of the General Terms and Conditions (GC).

6. HOW DOES THE FEDERAL GOVERNMENT CALCULATE THE ONE-OFF INDEMNIFICATION?

A) GENERAL CALCULATION PRINCIPLES

To begin with, a payment date is set for the purposes of calculating the one-off indemnification. Then, a difference is made between the period before the payment date and the period after the payment date for the calculation of the specific indemnification amount: For one thing, the one-off indemnification includes all outstanding payments of principal and interest that have fallen due before the payment date and for which no indemnification has yet been received. For another, a comparison is also made between the sum total of all future payments of principal due from the specified payment date less the uninsured portion, on the one hand, and the sum total of all the present values of the individual payments of principal and interest to be indemnified with future due dates (less uninsured portion) on the other ("comparative calculation").

If the payment date for one-off indemnification is within a current interest period, the interest for this period is accrued at the payment date. The present value of the interest up to the payment date equals the nominal value. For this reason, only the portion of this interest that is attributable pro rata to the period after this payment date is included in the calculation of the present value. The additional interest due in the future under the covered repayment schedule is also included in the calculation of the present value.

If fixed interest rates have been agreed, the future interest included in the calculation of the present value is calculated on the assumption that regular repayments are made on the basis of the covered and contractual interest-calculation method (usually diminishing-balance calculation) and the contractual fixed interest rate.

This applies likewise to the calculation of interest on the basis of variable interest rates. Contrary to this, corresponding forward rates on the respective base rate (e.g. 6-month Euribor) plus the contractually agreed margin are applied to the maturities for which the interest rates are fixed in the future.

The present value of all payments of principal and interest due after the payment date (which may possibly be calculated on the basis of forward rates) is calculated at the interest rate applied by the Federal Government for the period between the future due date and the payment date using the act/365 interest method. This also applies if the loan contract stipulates a different calculation method.

The interest rates used in the calculation of the present value are derived from the interest structure curve using the parameters Beta0, Beta1, Beta2, Beta3, Tau1 and Tau2 (Svensson method) for publicly traded German government bonds. These parameters are published daily in the Bundesbank's time series.

Since the mechanism for calculating future interest in foreign currencies may deviate from the interest structure curve, the contractual foreign-currency amounts are converted into euros for the purposes of the comparative calculation. For this purpose, the one-sum indemnification amount is translated into euros at the ECB reference rate on the payment date. The future payments of principal and interest applied in the calculation of the present value are translated into euros at the applicable forward rates for each maturity date. Accordingly, the actual comparative calculation is regularly calculated in euros. This only applies to the comparative calculation. The actual indemnification is paid in the contractual currency shown in the cover policy.

In this context, the amount of the one-off indemnification with regard to these instalments is limited to the lower of the amounts arrived at in the comparative calculation. For this reason, the comparative calculation is completed close to the defined payment date. If the sum total of all the present values of future payments of principal and interest less the uninsured portion is lower than

the sum total of all future payments of principal less the uninsured portion, the one-off indemnification is thus capped at the former amount. If the one-off indemnification is paid in a foreign currency, the amount calculated in euros is converted at the ECB reference rate on the payment date.

EXAMPLE OF THE CALCULATION METHOD

I. COMPARATIVE CALCULATION

Repayment plan and basic data according to cover/loan contract
Payment date 25.08.2020, all amounts in EUR

Instalment	Due date	Outstanding capital	Payment of capital	Payment of interest
1	31.03.2019	600,000.00	100,000.00	6,773.43*
2	30.09.2019	500,000.00	100,000.00	5,777.21*
3	31.03.2020	400,000.00	100,000.00	4,318.81*
Payment date	25.08.2020	300,000.00	-	2,718.28**
4	30.09.2020	300,000.00	100,000.00	665.70***
5	31.03.2021	200,000.00	100,000.00	2,184.00***
6	30.09.2021	100,000.00	100,000.00	1,095.46***
			600,000.00	23,532.89

* Already indemnified

** Interest accruing prior to the payment date of 25 August 2020 not included in the comparison

*** Future interest estimated

	Base rate on	Base rate	Plus margin
	26.09.2018	-0.2670 %	2.2330 %
	27.03.2019	-0.2270 %	2.2730 %
	26.09.2019	-0.3760 %	2.1240 %
	27.03.2020	-0.2810 %	2.2190 %
Forward rate for	30.09.2020	-0.3400 %	2.1600 %
Commencement of period	31.03.2021	-0.3450 %	2.1550 %

Base rate: 6-month Euribor
Margin: 2.500 %
Interest method: act/360
Interest rate fixed: two banking days before the start of period

II. COMPARATIVE CALCULATION

1) One-sum indemnification as of 25.08.2020

(only future payments of capital included)

Outstanding amount	Capital (K)/ interest (F)	Amount	Uninsured portion 5%	Indemnification amount
Remaining capital	K	300,000.00	15,000.00	285,000.00

2) Indemnification in instalments after original due date – calculation of present value

Applicable: Date of calculation: 25.08.2020 (payment date)

Original due date	Capital (K)/ interest (F)	Amount	Uninsured portion 5%	Indemnification amount	Days	In years	Interest rate according to interest structure curve*	Present value as of 25.08.2020
30.09.2020	K	100,000.00	5,000.00	95,000.00	36	0.09863	-0.36330	95,034.11
30.09.2020	F	665.70	33.29	632.41	36	0.09863	-0.36330	632.64
31.03.2021	K	100,000.00	5,000.00	95,000.00	218	0.59726	-0.64761	95,369.36
31.03.2021	F	2,184.00	109.20	2,074.80	218	0.59726	-0.64761	2,082.87
30.09.2021	K	100,000.00	5,000.00	95,000.00	401	1.09863	-0.67101	95,705.29
30.09.2021	F	1,095.46	54.77	1,040.69	401	1.09863	-0.67101	1,048.42
		303,945.16	15,197.26	288,747.90				289,872.69

* Interest structure curve parameter according to Svensson, published by Deutsche Bundesbank (25.08.2020)

Beta0: 0.41136

Beta1: -0.60344

Beta2: -2.49210

Beta3: -1.08307

Tau1: 3.69934

Tau2: 0.29186

3) Comparison between one-sum indemnification and present value

on payment date (25.08.2020)

Present value as at 28.08.2020	289,872.69
One-sum indemnification as 25.08.2020	285,000.00
Difference in favour of the one-sum indemnification	4,872.69

**Advantage for the
Federal Government**

4,872.69

III. CALCULATION OF THE ONE-OFF INDEMNIFICATION AMOUNT

Due date/ payment	Capital (K)/ interest (F)	Amount	Uninsured portion 5%	Indemnification amount
Remaining capital	K	300,000.00	15,000.00	285,000.00
Interest until 25.08.2020	F	2,718.28	135.91	2,582.37
		302,718.28	15,135.91	287,582.37
Payment amount (amount equals the one-sum indemnification amount)				287,582.37

In this example, the payment date is 25 August 2020. The due dates of the first three payments of principal and interest are before this date, while the other three payments of principal and interest fall due on future dates.

All outstanding payments of principal and interest with due dates in the past are indemnified net of the uninsured portion. As the present value thus equals the nominal value, they are not taken into account in the comparative calculation. This also applies to the interest that accrues pro rata until 25 August 2020, as it is also

indemnified, and its present value equals the nominal value.

Accordingly, the comparative calculation in this example only includes the three payments of principal due on 30 September 2020, 31 March 2021 and 30 September 2021, resulting in an amount of EUR 285,000.00 after deduction of the uninsured portion.

The calculation of the present value of an installment-based indemnification after the original due date includes all payments of principal or interest due after 25 August 2020. However, it must be borne in mind that part of the interest due on 30 September 2020 is attributable to the period from 31 March to 25 August 2020. As the nominal value of this interest equals its present value, only the interest accruing in the period from 25 August to 30 September 2020 is taken into account (interest accrual).

In this example, the loan contract provides for a variable interest rate based on the 6-month Euribor plus a margin of 2.5% p.a. As of the payment date on 25 August 2020, the interest rates for the amounts due on 31 March 2021 and 30 September 2021 are unknown. Instead of these interest rates, forward rates for the applicable interest periods are determined and applied to calculate the interest.

All payments of principal and the interest calculated with due dates after 25 August 2020 are included in the actual calculation of present value. The present value of these amounts is now determined for the period between the agreed covered due date in accordance with the cover policy and the payment date (= present value as at 25 August 2020). The amounts are discounted using interest rates derived from the interest structure curve using the parameters Beta0, Beta1, Beta2, Beta3, Tau1 and Tau2 for publicly traded German government bonds. In this case, the figures for 25 August 2020 were applied. The present values are calculated using the act/365 method, notwithstanding the fact that the loan contract provides for the application of act/360.

In the example, the sum total of all present values results in an amount that is higher than the one-sum indemnification amount on the issue date. Accordingly, the one-off indemnification equals the sum total of all payments of principal plus the interest due as of the payment date less the uninsured portion, and thus equals the one-sum indemnification in this case.

7. PRACTICAL IMPLEMENTATION: HOW IS THE ONE-OFF INDEMNIFICATION OPTION EXERCISED?

A) WHEN CAN THE ONE-OFF INDEMNIFICATION OPTION BE EXERCISED?

The one-off indemnification option can be exercised flexibly at any time during the ongoing indemnification procedure after an application for indemnification has been submitted. It may be exercised from the date on which the first application for indemnification is submitted until the completion of the indemnification procedure.

B) WHAT FORMAL REQUIREMENTS MUST BE OBSERVED WHEN SUBMITTING AN APPLICATION?

There are no formal requirements for the application. An informal request to exercise the one-off indemnification option is sufficient. It can also be submitted by e-mail.

C) IS IT NECESSARY TO PROVIDE ANY REASONS IF THE OPTION IS TO BE EXERCISED?

No, the option can be exercised without any obligation to provide reasons. Accordingly, it is not necessary for any further documents or information to be submitted.

D) IS IT POSSIBLE TO SUBMIT AN APPLICATION FOR ONE-OFF INDEMNIFICATION EVEN IF THE FEDERAL GOVERNMENT HAS ALREADY PROVIDED PRO RATA INDEMNIFICATION?

Yes, this is possible. In principle, a covered bank can initially be granted pro rata indemnification. This may be followed in the further course of the indemnification procedure by one-off indemnification subject to submission of a corresponding application. In this connection, it should be noted that, if the full amount of the loan is called in, the Federal Government may decide during the indemnification procedure to pay one-sum indemnification in lieu of pro rata indemnification upon an examination of each new or follow-up application for indemnification. If the Federal Government decides to do this on the grounds that this is more economical in accordance with Section 7 (2) of the Federal Budget Code (BHO) in the individual case, the bank no longer has any one-off indemnification option. Otherwise, the bank's and the Federal Government's respective options co-exist until the indemnification procedure has been completed.

Export Credit Guarantees and Untied Loan Guarantees: instruments to promote foreign trade and investment provided by the



Federal Ministry
for Economic Affairs
and Energy

Commissioned to implement the federal
funding instruments Export Credit Guarantees
and Untied Loan Guarantees:



EULER HERMES

Cover from the Federal Republic of Germany for foreign business

Export Credit Guarantees and Untied Loan Guarantees as well as effective foreign trade promotion instruments of the Federal Government have been established for decades. Export Credit Guarantees (so-called Hermes Cover) protect German exporters and banks financing exports against political and commercial risks. Untied Loan Guarantees are to support raw material projects abroad regarded as eligible for promotion by the Federal Government. Both promotion instruments play an important role in fostering economic growth as well as in protecting and creating jobs. The Federal Government commissioned Euler Hermes Aktiengesellschaft to manage the federal funding instruments Export Credit Guarantees and Untied Loan Guarantees.

Information on other foreign trade promotion instruments of the Federal Government can be found at www.bundeswirtschaftsministerium.de/en under the heading Promotion of Foreign Trade and Investment.

Euler Hermes Aktiengesellschaft

Postal address:
P.O. Box 500399
22703 Hamburg, Germany

Office address:
Gasstrasse 29
22761 Hamburg, Germany

Phone: +49 40 8834-9000
Fax: +49 40 8834-9175

info@exportkreditgarantien.de
info@ufk-garantien.de
www.exportkreditgarantien.de/en

Branch offices: Berlin, Dortmund, Frankfurt,
Stuttgart, Hamburg, Munich,
Nuremberg, Rhineland