PRACTICAL INFORMATION

July 2023

HERMES COVER SPECIAL

Calculation of premiums

EXPORT CREDIT GUARANTEES OF THE FEDERAL REPUBLIC OF GERMANY

Hermes Cover

► Calculation of premiums

Following the introduction of uniform international minimum premium rates for country risks in 1999, minimum premium rates also for the buyer risks covered were introduced in 2011. When the generally permissible credit periods were extended in 2023, premium discounts for credit periods exceeding 10 years were introduced.

These marked important steps towards creating a level playing field.

COST OF PROVIDING EXPORT CREDIT GUARANTEES IN THE FORM OF REVOLVING OR NON-REVOLVING SPECIFIC COVER

The cost of an export credit guarantee comprises fees and the premium for the provision of cover. No insurance tax is payable.

WHAT FEES ARISE?

An application fee of between EUR 100 and EUR 6,000 is payable upon the submission of an application. Depending on the type of cover, it is based on the following amounts:

Supplier credit cover: value of the order
Buyer credit cover: loan amount
Shopping Line Guarantee: credit line
Isolated manufacturing risk cover: cost of work
Isolated contract bond cover: guaranteed amount

This fee is charged on a per-transaction basis, meaning that it is payable only once. If, for example, a combination of supplier credit cover and buyer credit cover is applied for, the application fee must only be paid once on the higher amount.

If a final commitment for cover is not made immediately, perhaps because the contact with the foreign buyer has not yet been signed, it is possible for an “offer of cover” with a validity of six months to be issued. The application fee covers the term of this offer plus renewal by a further six months. A prolongation fee of 50% of the application fee is charged for any further six-month renewal.

An issuing fee of 0.25‰ of the aforementioned amounts depending on the type of cover is payable for the issue of the Guarantee Declaration.

In the case of combined supplier and buyer credit cover, the issuing fee is charged on both the value of the order and the loan amount. The issuing fee equals at least EUR 50 and is capped at EUR 12,500.

In the case of revolving cover, the application fee, which is based on the maximum exposure limit, is payable for the insurance year in question. Issuing fees are payable once only for the approval of maximum exposure limits and any increase.

Different rules apply to Hermes Cover click&cover.

HOW IS THE PREMIUM CALCULATED?

The premium for an export credit guarantee is calculated on the basis of a percentage (premium rate) of the amount to be covered. It is payable once in advance and, where applicable, adjusted to allow for any changes in amounts or risk periods.

In the case of revolving supplier credit cover, an advance premium is initially charged based on a horizon of risk of zero months on the maximum exposure limit. This advance premium is then netted against the monthly turnover reports on the basis of the actual horizon of risk. After the advance premium has been netted in full, a monthly invoice is issued.

In addition to the amount to be covered, the amount of the premium is determined by various risk-related factors depending on the type of cover. This chiefly entails the horizon of risk, the country risk category, the buyer risk category and, where applicable, the collateral involved.

WHAT MUST BE CONSIDERED IN CONNECTION WITH THE COUNTRY RISK CATEGORIES?

A country risk category is assigned with all forms of cover. The country risk category is an indicator of the political and economic conditions prevailing in the country in question. There are eight country risk categories, of which seven (1 = best risk; 7 = worst risk) are used for calculating the premium. In the case of credit risk cover with a horizon of risk of more than two years, as a general rule, the country risk category is mandatorily defined on an OECD-wide basis, although the German side may opt for a lower category in exceptional cases. Within the framework of the German export credit guarantee scheme the country risk catego-ries are also applied to all other types of cover.

In the case of **Category 0** countries (OECD high-income countries and euro countries), the premium rates for Country Risk Category 1 are applied. However, premiums reflecting prevailing market conditions must be charged for credit risk cover in these countries with horizons of risk of more than two years in order to avoid competitive distortion. For this purpose, a market test is conducted in accordance with the regulations of the OECD Consensus.

A market test may also be necessary in the light of EU aid considerations if the export is to an EU country.

What is a market test?

If the buyer or guarantor – i.e. the party primarily responsible for the payment – is domiciled in a so-called "market test country" (Category 0 country or high-income country of the OECD or the euro zone), it should be ensured that the premium is no less than the risk premium customary in the market. For this purpose, the OECD Consensus provides for a standard procedure how to approximate such a market risk premium. This procedure determines an indicative value for the premium which may be undercut only if specific capital market references of the buyer/guarantor (such as e.g. bonds) are available. Besides, certain collateral may mitigate the risk and thus may result in a reduction of the premium. In any case a lower limit determined in accordance with the OECD standard procedure for the premium rate is to be observed.

WHAT IS A BUYER RISK CATEGORY?

The buyer risk category reflects the results of an analysis of the credit standing of the foreign buyer or guarantor. It also factors in other risk elements arising in connection with the cover for the transaction in question.

In 2011 buyer risk categories for credit risk cover which have been harmonized on an OECD-wide basis for horizons of risk of more than two years came into force. A formula for calculating the minimum premium rate, which factors in the horizon of risk, has been allocated to each buyer risk category in connection with the corresponding country risk category on an OECD-wide basis. The formula thus includes an element for the political risk of the buyer's country and an element for the commercial buyer risk. This means that within the OECD uniform minimum premium rates apply to both political and commercial risks in the case of horizons of risk of two years or more. The allocation to a given buyer risk category does not have any permanent effect but is assigned separately for each new transaction.

► Calculation of premiums

The buyer risk categories do not make any distinction between bank and buyer risks, i.e. both the buyer and the bank issuing a guarantee or opening a letter of credit is assigned one of the buyer risk categories.

On the German side, the standardized buyer risk categories, which match the buyer risk categories defined at the OECD level, are also applied to credit risk cover with horizons of risk of less than two years.

To establish an OECD-wide basis for uniform buyer risk categories, they are largely based on the probabilities of default determined in the internationally acknowledged external ratings issued by Standard & Poor's, Moody's or Fitch. However, the state export credit agencies within the OECD are still free to determine the specific buyer risk category. As far as the export credit guarantees provided by the Federal Republic of Germany are concerned, this means that the allocation of a buyer risk category is preceded by an individual analysis even if an external rating is available. Accordingly, there is no automatic allocation of a buyer risk category on the basis of external ratings; rather, they serve merely as a reference.

OVERVIEW OF BUYER RISK CATEGORIES

The "**SOV" Buyer Risk Category** for the central bank or ministry of finance as the sovereign debtor in the buyer's country reflects the minimum premium rates in the light of the straight political risk for the buyer's country. This category is also applied to cover for subsidiaries which is restricted to political risks (POL-RIS/ POL INSOLV cover). Identical formulas for calculation are used for the Buyer Risk Category "SOV" and Buyer Risk Category CC 0. This means that private-sector buyers who are assigned this very good rating are considered to be as solvent as the buyer's country. In all the other categories from CC 1 to CC 5, a rising buyer risk portion is included.

The **number of buyer risk categories varies** according to the country risk categories. This is because each buyer risk category is based on a range of possible external rating levels. These rating levels reflect the respective country risk and the "SOV" Category is deemed to equal the best category for private buyers. In the weaker Country Risk Categories 5 to 7, the best category corresponds to a relatively low rating level. For this reason, there are fewer possibilities for a more graduated rating and, hence, fewer buyer risk categories.

A special feature is the Buyer Risk Category **"SOV+"**. Private-sector buyers may be assigned to this category if their rating is better than that for the central bank/ ministry of finance of the buyer's country. The premium rates for this category are 10% below those for the "SOV" Category.

In the German system, other public-sector debtors in the buyer's country which, unlike the central bank or the ministry of finance, do not reflect the pure country risk, are allocated to the Category **"SOV-"**. The premium rates for this category are 10% above those for the Category "SOV".

For the categorization of a buyer as a **public-sector debtor**, the material question is whether liability of the country in question can be assumed. Companies in which the government holds a share – even a majority – but which are organised according to private law are deemed to be private-sector buyers.

OVERVIEW OF BUYER RISK CATEGORIES

Buyer Risk Categories	Country Risk Categories						
	1	2	3	4	5	6	7
SOV+	SOV+	SOV+	SOV+	SOV+	SOV+	SOV+	SOV+
SOV	SOV	SOV	SOV	SOV	SOV	SOV	SOV
SOV-	SOV-	SOV-	SOV-	SOV-	SOV-	SOV-	SOV-
CC1	AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB	BB-	B+	B
CC2	A+ to A-	BBB+ to BBB-	BB+ to BB	BB-	B+	B	B- or worse
CC3	BBB+ to BBB-	BB+ to BB	BB-	B+	B	B- or worse	–
CC4	BB+ to BB	BB-	B+	B	B- or worse–	–	–
CC5	BB- or worse	B+ or worse	B or worse	B- or worse		–	–

SOV+: Private-sector buyers/banks with an external rating better than SOV for the buyer's country;
SOV: Sovereign debtor: central bank or ministry of finance; SOV-: Other public-sector debtors;
CC0 (best risk) – CC 5 (worst risk): buyer risk categories for private-sector buyers/banks (corporate category)

WHAT ROLE DOES COLLATERAL PLAY?

The premium payable is also materially determined by the collateral, which improves the risk position of the creditor to whom the receivable to be covered is owed. If the transaction involves a letter of credit or guarantee issued by a bank or a company, the credit analysis and category selected will normally be based on the provider of the collateral. If, on the other hand, collateral security in the form of liens or similar instruments is provided, it may be possible to reduce the previously calculated premium rate under certain circumstances ("buyer risk credit enhancement").

In the case of transactions covered in the form of project finance, no deductions are permitted on the premium for collateral. This is because the collateral has already been taken into account in the allocation of a given buyer risk category.

In accordance with the OECD rules, a distinction is drawn between four different forms of collateral, which may result in discounts of various amounts being applied to the premium.

In the case of collateral security such as liens, pledges or retained ownership rights, the OECD model differentiates between asset-based security and fixed-asset security. This entails not so much a legal qualification of the type of collateral as a consideration of the possibility for liquidation of the collateral in both legal and substantive terms.

ASSET BASED SECURITY

This involves collateral security giving the beneficiary the right of control over a movable asset which in the light of its nature and specific local conditions offers particularly favourable prospect of realization in both legal and substantive terms. Examples include a lien on locomotives or construction machinery. The maximum discount equals 25% of the buyer risk portion in the premium rate or 15% of the premium rate determined by a market test.

▶ Calculation of premiums

FIXED ASSET SECURITY

This entails collateral security which provides the beneficiary with certain rights of access to the goods to be delivered. However, independent liquidation is likely to lead to problems as the asset in question is firmly tied to a plot of land or an industrial plant. This does not mean that the collateral rights to mobile assets (i.e. liens) may not also be classified as fixed asset security. The maximum discount equals 15% of the buyer risk portion in the premium rate or 15% of the premium rate determined by a market test.

ASSIGNMENT OF CONTRACT PROCEEDS OR RECEIVABLES

The assignment of contract proceeds or receivables to the lender chiefly entails a possible element of collateral in connection with structured finance. The maximum discount equals 10% of the buyer risk portion in the premium rate. This type of credit enhancement is not permitted in connection with the premiums determines by a market test.

DEBT SERVICE RESERVE ACCOUNTS

A discount on the buyer risk portion may be applied if a debt service reserve account is opened in the buyer's country. The percentage discount is based on the proportion of the amount held in the debt service reserve relative to the loan amount. The maximum discount equals 10% of the buyer risk portion in the premium rate or 10% of the premium rate determined by a market test.

HOW ARE CREDIT ENHANCEMENTS FACTORED INTO THE CALCULATION OF THE PREMIUM?

Whether and to what extent credit enhancements serve to reduce the premium rate forms a key part of the risk analysis conducted for each application for cover.

In this connection, it should be noted that asset-based security and fixed asset security cannot be used together in one transaction. By the same token, however, it is quite possible to include multiple items of collateral which are allocated to one of these two classes. In addition, assignments of contract proceeds/receivables or debt service reserve accounts may also be additionally applied. If more than one credit enhancement is to be taken into account, the discount on the buyer risk portion may not exceed a maximum of 35% of the buyer risk portion in the premium rate.

Collateral can only be accepted as a credit enhancement if it is legally enforceable under applicable national law. If there are considerable doubts from the outset as to whether the collateral can be liquidated in the event of default, it does not qualify as a credit enhancement.

A corresponding discount is included if, upon the granting of cover, the collateral is stated as having a recoverable value.

If any doubts arise as to the legal enforceability of the collateral at a later stage, a distinction is drawn between two categories as regards the legal consequences.

In the case of **prescribed collateral**, the legally enforceable provision of such collateral is a precondition for indemnification in the event of a claim being asserted. If this legal enforceability cannot be proved, the Federal Government is regularly released from its obligation to indemnify (see Article 16 (2) of the General Terms and Conditions (for supplier credit cover/supplier credit cover for service providers/buyer credit cover)). Collateral is deemed to be prescribed if it constitutes a precondition for the granting of cover due to a difficult credit rating situation or specific national requirements with respect to collateral.

On the other hand, **additional collateral** is not a precondition for the provision of an export credit guarantee. For this reason, even if the provision of such additional collateral is defective and thus not legally enforceable, this on its own will not release the Federal Government from its liability under Article 16 (2).

The Guarantee Declaration sets out each item of collateral, allocating them to one of the two categories “prescribed collateral” and “additional collateral”. It also states that in the case of prescribed collateral the Federal Government may be released from its liability to indemnify in accordance with Article 16 (2). If a discount is applied, a Special Condition applies to the effect that the amount equalling the discount must be paid if it is retroactively discovered that the collateral provided is not legally enforceable.

WHAT ADDITIONAL ASPECTS MUST BE CONSIDERED?

SUPPLEMENTARY COVER

The premium for supplementary cover equals a certain percentage of the amount covered. Generally speaking, a distinction is drawn only on the basis of the country risk category. The buyer risk category is not applied.

PAYMENT

A premium amount of up to EUR 500,000 is payable at the commencement of delivery/provision of services in the case of credit risk cover or upon the commencement of disbursement in the case of isolated buyer credit cover. However, in the case of higher amounts, 25% is already payable upon receipt of the Guarantee Declaration. The premiums payable for manufacturing risk cover, supplementary cover, the advance premium for revolving supplier credit cover and the issuing fee are always due for payment upon receipt of the Guarantee Declaration. Different rules apply to Hermes Cover click&cover and Shopping Line Guarantees.

CURRENCIES

As a general rule, fees and premiums are invoiced in euros. However, export and buyer credit cover as well as contract bond cover may be granted in an accepted foreign currency, in which case the issuing fee and premium must be paid in that currency. In the case of foreign currencies it is alternatively possible to agree on cover in euros in connection with a waiver of the exchange-rate cap on indemnification. In either case, a surcharge of 10% is payable on the premium.

UNINSURED PORTION

In connection with supplier credit cover, an application may be lodged to have the uninsured portion reduced from 15% to 5% in connection with an insured commercial loss. A surcharge of 10% on the premium amount is payable for this. In the case of supplier credit cover which is combined with buyer credit cover, the uninsured percentage regularly equals 5%, and no surcharge is payable for this.

PREMIUM ADJUSTMENTS

The premium should match the risk assumed. If the amount covered is increased or the horizon of risk extended after cover has been granted, an additional premium will be correspondingly charged. However, if the amount covered is reduced or the horizon of risk shortened after cover has been granted, it is possible for part of the premium to be reimbursed under certain circumstances provided that no claim has been entered. In this connection, a deduction of 5% (max. EUR 2,500) from the amount to be refunded is retained to cover administrative expenses. In the event of premature repayment of a loan, early termination compensation is additionally payable; this normally equals 20% or, in the case of project finance, 50% of the excess amount paid. In the case of a Shopping Line Guarantee a non-utilization fee amounting to 10% of the overpayment will be retained if less than 75% of the credit line’s original amount has been utilised when it expires.

If under buyer credit cover financed and covered premium up to a threshold of EUR 250,000 (or the countervalue) has to be reimbursed, this amount must be set off against the residual value of the buyer credit. In this case, it is up to the bank to decide on how the amount is set off (e.g. against the next instalment). If the threshold is exceeded, the bank shall normally set off the amount to be reimbursed against the final instalment(s) (principal and interest).

► Calculation of premiums

HOW IS THE PREMIUM CALCULATED FOR THE VARIOUS FORMS OF COVER?

MANUFACTURING RISK COVER

The premium is calculated on the basis of a certain percentage of the cost of work covered. As a matter of principle, the rates differ according to the scope of cover. Different formulas are applied depending on whether the manufacturing risk cover includes all coverable risks or is restricted to political risks. In addition, formulas vary according to country risk category. Buyer risk categories are not taken into account. The **manufacturing period** is inserted in the formula specified for the country risk category in question to calculate the applicable premium rate. The manufacturing period covers the period starting with the commencement of manufacturing and ending with the completion of delivery. For this purpose, the commencement of manufacturing is defined as the date on which the cost of work arises for the first time. The completion of delivery is the date on which the final delivery is completed. The manufacturing period is calculated in years and broken down into three-month units. Every three-month period or part thereof equals 0.25 years.

The premium for manufacturing risk cover is initially calculated provisionally on the basis of the expected manufacturing period and is immediately due for payment upon cover being granted. After the transaction has been completed, the final premium is calculated on the basis of the actual manufacturing period.

EXAMPLE CALCULATION:
PREMIUM FOR A MANUFACTURING RISK GUARANTEE

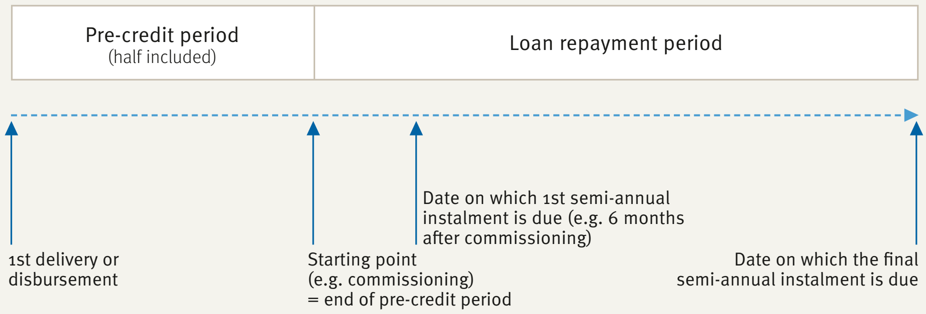
a) Calculation of the manufacturing period

Commencement of manufacturing:	01.09.2023
Completion of delivery:	01.10.2024
Manufacturing period (MP):	1.25 Jahre

b) Calculation of the premium

Scope of cover:	Inclusion of all coverable risks
Cost of work:	EUR 500,000
Country Risk Category:	3
Formula: (0.050 * MP)0.5 + 0.573 ->	$(0.050 * 1.25\ \text{Jahre})^{0.5} + 0.573$
Premium rate:	0.823 %
After commercial rounding to two digits after the decimal point:	0.82 %
Multiplied by cost of work:	0.82 % von EUR 500,000
Premium for this manufacturing risk cover:	**EUR 4,100 (plus fees that may be payable)**

CALCULATION OF HORIZON OF RISK FOR MEDIUM/LONG-TERM CREDIT RISK COVER



CREDIT RISK COVER

This term covers both supplier and buyer credit cover.

The premium is calculated on the basis of a certain percentage of the receivable covered. In addition to the country risk category, the buyer risk category is also a decisive parameter in the calculation of the premium.

The premium rate is calculated on the basis of a formula taken from a table in the brochure Fees and Premium Rates. The formulas make a distinction between credit risk cover with terms of less than two years (short-term credit risk cover) and credit risk cover with terms of two years or more (medium/long-term credit risk cover). In addition, there are differences in the way in which the horizon of risk is calculated.

In the case of **short-term credit risk cover**, the horizon of risk is calculated as the period between delivery and the due date in months. Where multiple deliveries are involved, a mean unweighted delivery date is used. The horizon of risk is calculated separately for each instalment with differing due dates.

With respect to **medium/long-term credit risk cover**, the horizon of risk is calculated on the basis of half of the pre-credit period and the loan repayment period.

The pre-credit period is the period between the first delivery (commencement of disbursements in the case of isolated buyer credit cover) and the commencement of the repayment period. The repayment period commences on the defined starting point. Frequently, this is the date of delivery or the date of commissioning.

The standard repayment profile comprises semi-annual instalments and a first repayment date 6 months after the starting point. In the event of any departure from this, the horizon of risk must be standardized, as a result of which the horizon of risk is reprofiled to a standard repayment schedule with half-yearly instalments.

The applicable formula for this is set out in the table at the intersection of the country risk and buyer risk category. The horizon of risk in years is inserted in the formula to calculate the premium rate.

PREMIUM DISCOUNT FOR HORIZONS OF RISK OF MORE THAN 10 YEARS

If the horizon of risk is longer than 10 years, premium discounts for certain buyer risks in the country risk categories 1-7 can be factored in. The amount depends on the period that exceeds the horizon of risk of 10 years and is limited to 15%. This premium discount cannot be granted in the event of a market test.

► Calculation of premiums

The Excel-based premium tool facilitates the calculation of the various premiums for the individual forms of cover and horizons of risk. It uses the formulas set out in the brochure Fees and Premium Rates. As a result, it is only necessary to enter the parameters of the export transaction. The tool can be downloaded (in German) from www.exportkreditgarantien.de.

The premium for export credit guarantees is initially calculated on a preliminary basis in accordance with the expected horizon of risk to allow for any changes after cover has been granted. After the transaction has been completed or the loan amount has been disbursed, the final premium is calculated on the basis of the actual horizon of risk.

EXAMPLE CALCULATIONS:

PREMIUM FOR SHORT-TERM CREDIT RISK COVER

Type of cover:	Supplier Credit Guarantee
Horizon of risk (HOR):	5 months
Value of order:	EUR 1,000,000
Amount of loan:	EUR 850,000
Country Risk Category:	3
Buyer Risk Category:	CC3
Formula: 0.0337 * HOR+0.86 ->	0.0337 * 5+0.86
Premium rate:	1.0285%
After commercial rounding to two digits after the decimal point:	1.03
Premium for this short-term credit risk cover:	**EUR 8,755 (plus fees)**

PREMIUM FOR MEDIUM/LONG-TERM CREDIT RISK COVER

Type of cover:	Supplier Credit Guarantee
Horizon of risk (HOR):	5 years (no pre-credit period)
Value of order:	EUR 1,000,000
Amount of loan:	EUR 850,000
Country Risk Category:	3
Buyer Risk Category:	CC3
Formula: 0.6600 * HOR+0.3448 ->	0.6600 * 5+0.3448
Premium rate:	3.6448%
After commercial rounding to two digits after the decimal point:	3.64 %
Premium for this medium/long-term credit risk cover:	**EUR 30,940 (plus fees)**

FURTHER INFORMATION

The applicable rules and formulas for calculating the premium can be found in the brochure Fees and Premium Rates. Information on the current country risk categories and the calculation tools are available on the Internet. For further information, please contact Euler Hermes' Head Office in Hamburg or any of its regional offices.

Andreas Gehring

PREMIUM CALCULATION (CONTINUED)
ALLOWING FOR COLLATERAL (CREDIT ENHANCEMENTS)

Premium discount on the buyer risk portion:	7.5 %
Premium rate calculated for CC 3 without discount (from the sample calculation on page 10):	3.64 %

In order to determine the buyer risk portion the premium rate for CC 0 has to be deducted from the premium rate for the buyer risk category in question – in this case CC 3:

Formula for CC 0: 0.3448 * HOR+0.3448 ->	0.3448 * 5 + 0.3448
Premium rate:	2.0688 %
After commercial rounding to two digits after the decimal point:	2.07 %
Premium percentage of the buyer risk:	3.64% ./. 2.07% = 1.57% points
Discount on the buyer risk portion:	7.5% of 1.57% points = 0.11775% points
After rounding to two digits after the decimal point:	0.11% points

The applicable premium rate is calculated by deducting the discount from the originally calculated premium rate:

3.64% ./. 0.11% points =	3.53%

www.exportkreditgarantien.de/en

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

Federal Ministry for Economic Affairs and Climate Action

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 have been established and effective foreign trade promotion instruments of the Federal Government 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. 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.bmwk.de/en under the heading Promotion of Foreign Trade and Investment.

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