INSTITUTE OF CHARTERED SHIPBROKERS

NOVEMBER 2020 EXAMINATION SESSION
THURSDAY 12th NOVEMBER 2020 – AFTERNOON

SHIPPING FINANCE

Time allowed – three hours
Answer any FIVE questions – all questions carry equal marks
Please read the questions carefully before answering

1. Answer **ALL** parts of the question.

   Discuss the types of loans which may be suitable in **ALL** of the following scenarios.
   You should also identify the risk to the lender in each case, and how this may be reduced or eliminated.

   a) A shipowner owns a fleet of bulk carriers and is trading them in a market which has been in recession for a few years. It is expected that freight rates and asset values will begin to improve next year. Several of the vessels are old and have been subject to mechanical breakdowns in recent years. The company has been struggling to meet interest payments on loans which were taken out at the peak of the last boom and now wants to refinance these. Discuss which new loans may be suitable.

   b) A shipowner has been trading vessels during a period of recovery in the shipping cycle, and it is anticipated that the peak will be reached within the next year, followed by readjustment in the sector and a sharp decline in freight rates. It has in place a balloon repayment loan which will mature during the trough of the next cycle. Advise the company on which type of loan should be taken out to refinance this arrangement, or alternatively what step can be taken now to prepare in advance to meet the principal repayment obligation on maturity of the existing loan.

   c) A shipowner trades its vessels in the spot market, retaining maximum employment flexibility. It wants to avoid taking out a long-term loan, since its earnings may make it difficult to meet regular interest payments over the medium term. However, it needs to be sure that, should the spot market enter a downturn, it will at least be able to access capital as and when needed to meet short-term operational expenses. What type of arrangement would be suitable given its present trading strategy, and its concerns for short term disruptions in the spot market?

PLEASE TURN OVER

2. Answer **ALL** parts of the question.

   A state-owned shipping company of a politically volatile country derives its revenues from a long term charterparty in which oil is transported to purchasers in Europe. It also generates earnings from spot market activities for oil companies in neighbouring states. The company wants to upgrade its fleet through acquisitions and is considering securitisation as the means by which finance will be raised. The Chief Executive Officer has asked you, as the Chief Finance Officer, to prepare a report, addressing the feasibility of this proposal. Specifically, he asks you to consider the following; whilst not being limited to them should you consider others to be relevant.

   a) The requirements of cashflows for securitisation, and whether the company's earnings qualify on these criteria.

   b) The country's credit rating is low. How can the arrangement be structured so that the bonds issued will not be affected by the sovereign ceiling, or the principle that a borrower cannot obtain finance at a lower cost than the government of the country in which it is located? In this regard you may wish to consider where you would locate the special purpose vehicle which will handle the payments to investors

   c) If there is a default in coupon payments to investors, who will be legally responsible for this?

   d) The CEO has also instructed you to provide a diagram in your report, showing all participants in a typical securitisation.

3. Explain the characteristics of any **THREE** of the following:

   a) Mezzanine finance
   b) Sinking fund
   c) Guarantee by a parent company in respect of a loan to its subsidiary
   d) Leverage
   e) Legal and equitable assignment of shares in respect of loan security

4. Banks are required to follow the Basel Committee rules on capital adequacy. As part of this they assign risk weightings to loans made to sectors such as construction, shipping, personal credit, and must hold varying amounts of capital against these to cover the risk of default. When making a loan to a privately held tanker owner in a politically unstable country, identify and discuss the risks a lender should consider in terms of the owners, trade, and assets, when calculating its risk weighting to capital ratio.

5. Discuss the main forms of security a shipping company may provide in respect of a loan to purchase additional vessels. In the case of each, discuss the risks to the lender and the covenants it will require in the loan documentation to protect its position.

6. With use of a diagram, explain the functions of participants in bond syndication for a shipowner. Describe the factors which will be considered when deciding between bidders for the mandate to lead manage the issue, and the typical costs the issuer will incur.

7. When a shipping company encounters financial difficulties, there are various stakeholders who will be affected but who will not rank equally in terms of entitlement to payment. Identify the stakeholders who will come forward when a shipping company begins to fail, how they rank between themselves in terms of priority to repayment, and how this will affect the solution which they will prefer at different stages of the cycle.

8. Answer **ALL** parts of the question.

    a) Explain the reasons why shipowners hold assets in one ship companies registered in different jurisdictions.

    b) Discuss the corporate structural changes a lender may impose before making a loan to the company which has ultimate ownership of these companies.

    c) Describe **THREE** covenants which would be included in a guarantee provided by a parent company in respect of a loan to one of its subsidiaries.