

## **Examiner's Report, Shipping Finance. November 2025 sitting.**

The recent entries for the Shipping Finance exam, November 2025, gained some excellent results, with several scores in the 80s and 70s. The level of detail (since Shipping Finance is all about detail) was a pleasure to see and demonstrated a deep understanding of the subject. A result of lack of preparation rather than an absence of understanding of the topics—an important distinction—was that some students could have achieved better marks. This means that for students resitting, if they plan their revision carefully, review past papers, understand the required level of detail, and apply it to exam scenarios, they may succeed next time.

Students should recognise that topics are rarely discussed in isolation: for example, when examining a securitisation or bond issue in a syndication, incremental marks will be awarded for considering, even briefly, how these products are marketed. This makes sense: after all, bonds and shares do not exist in a vacuum — they must be sold or placed with willing investors. Their behaviour will also be influenced by the stage of the shipping cycle at the time of the issue. Similarly, it is not feasible to talk about a particular type of loan without also evaluating the risks to both the lender and the borrower, along with typical covenants that will be included to mitigate these risks.

With these general comments in mind, the detailed feedback for each question now follows.

### **Question 1.**

This question focused on convertible bonds. In essence, it required a definition, the advantages and disadvantages for issuers and investors, the extent to which issuance is influenced by the shipping cycle, and the different types. It was of average popularity, attempted by just over half of the students. Of these, a significant minority achieved failing marks; this was because their answers lacked detail, did not fully understand the nature of hybrid financial instruments (debt combined with an embedded equity conversion trigger), and did not explain the relevance of these bonds at different stages of the cycle. For example, in a 'bull' market where freight rates are booming and share prices are rising, it is relatively easy to issue convertibles because potential investors mistakenly believe that share prices will simply continue to increase, making the embedded equity component more valuable. This also encourages issuers to set the trigger price too high: the right to convert may only be triggered if the share price jumps by fifty percent, which is usually unachievable. As a result, and as share prices begin to fall, the chances of conversion diminish further, leaving the holder with a 'busted' convertible— a bond where the right to convert into equity will never materialise. And the cost? A convertible tends to pay a lower coupon compared to a plain vanilla bond. This means the holder will have received less than if they had invested in a plain vanilla, and they will not profit because the right to convert into shares will simply not occur. This can be a costly mistake, resulting in the investor holding bonds nobody wants to buy; they will continue to generate a coupon, but it will be lower than that payable on a plain vanilla instrument.

Conversely, during a bear market when share prices have fallen perhaps too sharply, astute investors will recognise an opportunity. The likelihood is that the price will increase in the short term, perhaps gradually at first, then more rapidly as the market recovers. This makes the conversion feature more valuable. When is the best time to buy shares, convertibles, or assets? In a depressed market where the upside potential is greatest, not in a boom when prices are inflated and the market is likely to turn downwards.

This question emphasises the importance of not guessing about a subject: here, convertibles. If a student does not have the details, a failing mark is likely. This paper always has at least one vague question; it should be attempted if a student has run out of topics they have revised. Don't guess at technically complex questions if you have not revised them; vague questions on the paper at least put you in with a chance!

## **Question 2.**

This was a popular question that all students answered in the exam. There was only one failure, which was due to a lack of detail. Only one person failed this question for the same reason. Overall, the marks were high. Most students performed well in describing the organisations listed but some could have gained more marks if they had addressed the second part of the question, which asked how each piece of information was used by lenders to decide on granting a loan to a borrower. For instance, if a shipowner has been in dispute with the ITWF, it indicates there may be underlying problems with the borrower, such as poor treatment of crew, strikes, hazardous working conditions, or unseaworthy vessels. It also implies that the shipowner might encounter similar disputes in the future, leading to a vessel being detained and, consequently, preventing it from generating revenues needed to service interest and principal payments. Always read a question carefully: it may require not just a 'describe' element but also an 'apply and explain' component.

## **Question 3.**

This was not a popular question, with just over half of students attempting it, though some achieved high marks. The word 'irrelevant' in the question was intended to prompt discussion of capital structure irrelevance theory as proposed in the Modigliani-Miller hypothesis. This will not be explained here, as a simple Google search will reveal its main elements and why it does not apply in practice due to the unrealistic assumptions it makes. That said, students who did not mention the MM hypothesis but discussed how the availability of capital in the form of debt and equity varies across different phases of the shipping cycle would still have gained a good pass. For example, during a recovery, asset values typically improve; this increases security for lenders in the form of mortgages over vessels. Consequently, debt becomes easier to raise, and the interest rate payable should, all else being equal (which they rarely are), be lower as the perceived risk diminishes. Conversely, during a recession, lenders tend to become very cautious, primarily because the main security for loans decreases in value, creating further problems with loan-to-value covenants on existing loans.

Focusing on the equity side, investors have a habit of leaving their common sense and cautious scepticism during this period, throwing money at companies when, at the peak, there's only one direction for the cycle—downward. At the peak, if investors are willing to acquire shares, it may be the optimal time to settle debts and replace them with equity, since servicing debt is always necessary, whereas dividend payments are discretionary. Similarly, in a recession, attracting investors is challenging because they may worry that the market still has further to fall, and companies struggle to cover operating expenses (OPEX) let alone generate profits for dividends. However, now could be an opportunity to approach niche investors via a private placement: they will understand that the best time to buy shares is during a recession when prices have fallen too far and the potential for upside is substantial. The ideal time to buy, whether shares or vessels, is when they are heavily discounted and undervalued—not at the peak, when the opposite is true. These are the key issues that should have been discussed in this question. Students should also be aware that the MM hypothesis can be questioned regarding shares and debt generally, to earn discretionary marks by introducing tangentially relevant theoretical concepts.

#### **Question 4.**

This was an intriguing question and a slight variation from previous styles on the topic. The question concerned syndication, but the second part related to the practices of ratings agencies. Even if a student was unfamiliar with these, they should have been able to use common sense to identify the risks and opportunities considered when rating a bond issued by a shipping firm. These would include factors such as the current level of debt, asset values, governance, past debt servicing records, equity structure, and revenue stability. The question required a diagram accompanied by a detailed discussion of all participants. Students should be well acquainted with the few diagrams required for this course, including those for securitisation. Participants to be discussed include the underwriters, fiscal agent, issuer, lead manager, management group, and selling group. In diagrams, it is crucial that connections between participants are shown with arrows on the lines to indicate the flow of information or resources, for example, payments and bond issues.

#### **Question 5.**

This question required students to demonstrate an understanding of the different types of equity and when each is suitable at various stages of the shipping cycle. For example, in a stable trading environment, it might be appropriate to issue plain vanilla or ordinary shares, with voting rights attached, and an expectation from investors for payment of future dividends and share price appreciation. However, if investors are cautious or sceptical, there may need to be alternative 'menu options' offered to them. For instance, partly paid shares, where investors have the right to receive full dividend payments, if available, and full voting rights, but will only pay in stages. The risk is that if the company becomes insolvent, investors will have to pay the full outstanding amount on their shares to the liquidator.

An alternative would be cumulative preference shares, where investors have priority over ordinary shareholders for future dividend payments if they are not paid in the current year: in other words, cumulative payments and priority over ordinary shareholders. The issue of dilution of earnings and control that accompanies a new issue should also be considered. These types of shares may appeal to investors and should be marketed by the company as such, due to the prospect of a short-term significant improvement in profits. Given that the company in question is struggling to cover OPEX, it would be advisable to issue these shares since, in the short term, the company is unlikely to be able to pay dividends, and potential shareholders will be aware of this.

Regarding the CEO's intention to keep secret the winning of the lucrative charterparty, this is not feasible: investors will have the right to demand information, and this is no longer the CEO's private matter. If investors are misled, there could be serious criminal implications under the Sarbanes-Oxley Act, which should be noted considering the company is listed on the NYSE.

The CEO might invest in the company and acquire equity, which could be a way to prevent dilution or further dilution of the company's control.

Regarding a private placement, this could be a good idea if the wider market of general investors is hesitant to invest. The advantages of such a placement include avoiding the costs of an IPO—which should be cheaper—and being able to benefit from the expertise of niche investors who see the opportunity in depressed assets and share prices. The disadvantage is that they might demand representation on the board in the form of non-executive directorships and could also seek a short-term exit strategy, which may not align with the longer-term goals of the CEO.

## **Question 6.**

This was a popular question, with most candidates answering it correctly and scoring highly, apart from one outlier who completely misunderstood the requirements. Improving understanding of the requirements would be beneficial. It is not necessary to go into detail here: the question required a discussion of the difference between a legal (registered) mortgage and a subordinate equitable mortgage. Students should ensure they understand this distinction, not just for the exam but also for their career in shipping finance if they pursue it, given its significance for lenders' security over assets. Covenants should be known for the same reason: it is important that students are familiar with a standard loan agreement and its key terms. Covenants (among many others) could include the following:

Not to pay dividends to shareholders;

Not to dispose of assets without the lender's consent;

To provide information at the lender's request;

To pay interest and/or principal as stipulated in the loan agreement;

Not to trade the vessel illegally;

Not to reorganise the business;

To notify the lender of any pending legal proceedings.

Regarding actions in personam and in rem, students should distinguish between legal actions against 'the thing' or the vessel, versus actions against the company or individual who holds it (in personam), and how this distinction influences the procedure for arresting a vessel following default on a loan.

### **Question 7.**

It was surprising that only half of the candidates answered this question on securitisation, given its popularity and frequent repetition as a topic in the examination for this subject, with the examiner. Marks scored were mixed, with half being passes and half fails. Cash flows must meet three criteria before they are suitable for securitisation. They must be: stable and predictable; homogenous; and have the legal right to be assigned to a third party (the special purpose vehicle). With these in mind, this question was simply about identifying which of the cash flows in the scenario met these criteria. The charterparty to transport oil is unsuitable because it has been provided as security for a prior loan (there is no legal right to assign it to the SPV). Spot market earnings are unsuitable because they are not stable and predictable: they are volatile. The series of charterparties are not suitable because they are not homogenous, although any one of them (not a mixture) may be suitable.

Based on the above reasons, it seems that none of the cashflows can be securitised, unless there is a minor issue concerning one of the short-term charterparties (although, by definition, these might not be sufficiently long-term, stable, and predictable).

The financial product to be issued is invariably a floating rate note. Mentioning how this would be marketed would have improved a student's mark because it is a practical aspect that issuers and their advisors must always consider.

A diagram was required: students who did not include arrows to show the direction of cash flows, payments, and FRNs lost marks because of this minor but important omission.

Regarding the second part of the question, this did not relate to the scenario in the first part but was instead a general question about methods for narrowing the basis point spread on an FRN in a securitisation. It is essential to always read the facts of a question carefully: two separate parts may not necessarily be connected.

Methods of reducing the basis point spread would include:

Parent guarantee (relevant in the facts of the question because the parent is cash rich);

Transfer of assets, such as re-registering vessels to the SPV.

Transfer of shares;

Use of a sinking fund to reassure bondholders that at least part of the principal will be repaid at maturity, and not necessarily from the proceeds of asset sales. It must be managed by a reliable and reputable third party, usually a financial institution, without access to it by the borrower-issuer.

Wrap-around insurance (usually, the premium will be prohibitive).

### **Question 8.**

Nearly all candidates answered this question, except for one, which was the most popular! Excellent marks were achieved, apart from a few outliers who did not provide sufficient detail. Each of these loan types will not be explained here, as they can be easily found through a simple internet search, and students should be familiar with them anyway. Instead, the following points are presented here.

The question asked is not only for an explanation of the type of loan but also for the risks involved and the covenants that accompany it. Additionally, each should align with the phases of the cycle; for example, a moratorium or back-ended loan would be suitable during a recession or depression, when the borrower cannot cover OPEX, let alone interest and principal payments. Conversely, during a boom when earnings are strong, the borrower should opt for a front-ended loan, reducing debt in anticipation of a downturn, when the market begins to decline and it becomes difficult to continue meeting high debt and interest payments.

Risks include a decline in asset values, meaning the lender will receive even less at the end of the moratorium than they would have if they had simply pushed the borrower into insolvency. Secondly, there is a risk that at the end of the moratorium, the borrower will be unable to meet the higher above-market interest rate payments, which are intended to compensate the lender for being deprived of payments for perhaps the previous two years. Concerning an RCF, the risk is that the borrower will draw down on the facility but be unable to repay. The lender will have missed out on facility fees because this is exactly what an RCF aims to provide to a borrower, instead of a series of loans. Regarding covenants, refer back to question 6 in this report. Perhaps one of the most important is the nonpayment of dividends (to retain liquidity in the business) and maintaining the assets in good repair and insured; after all, this is the main source of security for the lender.