

Shipping Finance Exam, spring 2024.

1. With reference to the usual **forms of security** taken by financial institutions when making loans to shipowners, discuss how the stages of the shipping cycle affect value, risks, and covenants applicable in each context. In your answer you may discuss but without being limited to the following:

Increases and decreases in asset values across the cycle.

Stability of earnings.

Maintenance and upkeep of assets.

Capability to manage operational expenses across the cycle.

2. An oil tanker owner has charterparties with several oil producers. These contracts are denominated in US Dollars; some are very short term and unpredictable in terms of the likelihood of being extended; one of the charterparties is for ten years. Part of the owner's other earnings are generated from providing oil storage facilities to other oil companies. The owner is looking to raise finance for future fleet expansion, and the Chief Executive Officer has asked you to prepare a briefing report regarding the suitability of securitisation for his plans. As Chief Finance Officer you are aware of the following facts:

-Several years ago, a large loan was taken out with another bank; mortgages were taken over several of the owner's tankers, as well as a charge over future earnings from the long term charterparty.

-A bond issue was made several years ago, and earnings from the short term charterparties are being used to service a sinking fund. The owner has provided a corporate guarantee in respect of the bond issue.

You are required to prepare a briefing report addressing the suitability of securitisation, discussing but without being limited to the following issues:

-The qualities required of cashflows to be suitable for securitisation. This part of your report should address the present sources of earnings of the owner.

-The type of financial product issued in a typical securitisation.

-The methods by which the basis point spread on the financial product can be reduced, bearing in mind the owner's existing commitments.

You must provide a diagram in your report.

3. Write notes on any **FOUR** of the following, and their relevance to shipping finance:

Mezzanine finance.

Residual value insurance.

Ballon payment on maturity of a bond issue.

Loan to value covenants and consequences of a breach.

Non-disclosure of material facts to an insurer from the perspective of a lender taking security over the asset insured.

Information covenants, and the range of information required by lenders.

4. Discuss the **types of loans** which would be suitable in **ALL** the following scenarios, and the covenants and risks which are associated with each of them.

- i. A shipowner with cash reserves is considering making vessel acquisitions soon but may need additional outside financial assistance. It does not want to take out a loan for the time being since this will incur costs for capital which may not be used. Instead, it would prefer to have access to cash, as and when needed.
- ii. A shipowner is trading in a booming market but already has a significant amount of debt raised during a previous cyclical downturn. It realises that as the market begins to decline it will become increasingly difficult to maintain payments on this prior debt.
- iii. A shipowner is struggling to meet operational expenses during a market recession. It has a high level of existing debt, but it is becoming increasingly difficult to meet interest payments.
- iv. A shipowner is looking to raise finance at an interest rate below prevailing rates, and during a cyclical downturn. It is anticipated that the market will have recovered by the time the loan matures, enabling assets to be disposed of at a high price.

5. Answer **ALL** parts.

- i. Describe the characteristics of convertible bonds which distinguish them from plain vanilla bonds, providing examples of types of convertibles. Your answer should relate these characteristics to the specific risks and opportunities (volatility) of the shipping sector.
- ii. Discuss the advantages and disadvantages of convertibles from the perspectives of issuers and investors.

6. Answer **ALL** parts.

- i. List but do not explain the duties of the borrower provided in a typical ship mortgage.
- ii. List but do not explain the powers of the lender provided in a typical ship mortgage.
- iii. Discuss with explanation the issues which should be considered by a lender before providing a loan to an international shipowner, secured by a ship mortgage.

7. Answer **ALL** parts.

- i. Explain the reasons why shipowners use one ship company structures.
- ii. What are the risks to a lender when making a loan to a shipowning company which holds its vessels in a multi-jurisdictional corporate structure?
- iii. List but do not explain the ways in which a corporate structure comprising one ship companies can be used to manipulate reported earnings and profits, assets acquisitions and disposals, across the group.

8. A shipowner is looking to raise capital for vessel purchases. The Chief Executive Officer has asked you to explain how a syndicated loan could meet this need. He has informed you that although his stated intention will be to use finance raised for purchases, he may use part of this to pay off previously raised high interest-bearing debt. He has informed you that this is not to be disclosed in the prospectus to be issued to potential investors. He also plans to make a further bond issue, with subsequent investors being given priority over investors in the present syndication. The CEO has asked you, as Chief Finance Officer, to describe the structure of a typical syndication. You must provide a diagram, showing all participants. You must also advise on the following:

-The fees associated with a typical syndication.

-Factors taken into consideration when deciding between competing financial institutions as to which should be appointed as lead manager.

-The role of underwriters in the issue.

If the terms of the syndication contain a negative pledge clause, how will this affect your advice regarding the CEO's intention to raise future higher-ranking debt?

What will be the consequences of the CEO's intention to lie to investors in the prospectus regarding the use of funds to pay off prior debt, assuming the issue is to be made on the New York Stock Exchange?

9. 'Shipping finance has nothing to do with ethics, and everything to do with economics'.

Discuss this from the perspectives of borrowers, lenders, and intermediaries such as brokers.

10. Answer **BOTH** parts.

i. Discuss the main principles underlying Islamic finance, and how these affect the structure of specific financing arrangements (you may want to discuss ijara, musharakha, mudharaba in this context).

ii. List but do not explain the impediments to the expansion of Islamic finance in shipping.