EMLO Conference - 2017 Hamburg

Shipping Finance - BASEL IV, shipping loans and the ECSA experience

3 November 2017
Agenda

1. Christos Gortsos: “Overview of the existing and the new regulatory framework”

2. Marco Lopez de Gonzalo: “General views on the adequacy (or not) of the security package and other covenants in shipping loans and how they are affected by insolvency laws”

3. Thomas de la Motte: “Current trends on the German ship finance market: 1) Status on the well-known German ship finance lenders, 2) ECA financing and 3) other topics”

1. Overview of the existing and the new regulatory framework
“Basel IV” and its (potentially negative) impact on shipping finance in the EU

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November 2017
1. Global and EU frameworks on bank capital requirements: an overview

• Banks established in EU Member States are required to meet the capital requirements laid down in Regulation (EU) No 575/2013 (CRR) to cover unexpected losses.

• The provisions of the CRR largely reflect the standards adopted by the Basel Committee on Banking Supervision (the 2010 “Basel III framework”), which are also applied – more or less equally – in all other major jurisdictions (USA, China, Japan, Hong Kong and Singapore).
1. Global and EU frameworks on bank capital requirements: an overview (cont.)

• For the purpose of calculating capital requirements against their exposure to credit risk banks may use:

  – the **standardised approach**, or

  – the **Internal Ratings-Based approach (IRB approach)**

> On average, the imposition on banks of higher capital requirements for a specific exposure has an impact on the lending conditions of the underlying transaction (unless a bank wishes to internalize the resulting higher cost)
2. The alternative methods
(2.1) The standardised approach

• The **standardised approach** is the least sophisticated one

• Banks’ exposures to shipping companies are included in the corporate portfolio and receive a risk weight of **100%**, unless they are rated by an External Credit Assessment Institution (*Article 122 CRR*)
2. The alternative methods
(2.2) The IRB approach

- Pursuant to the **IRB approach**, capital requirements are calculated based on the following core credit risk parameters:
  - Probability of Default (PD),
  - Loss Given Default (LGD),
  - Exposure at Default (EAD), and
  - Maturity (M)
- The IRB approach is more tailor-made, allowing banks to assign risk weights to exposures based on their own risk assessments (under specific conditions)
- Shipping loans under the IRB approach receive (on average) a risk weight of **50%**
2. The alternative methods
(2.3) The supervisory slotting approach

• If an IRB-bank cannot estimate the PD/LGD or its estimates do not meet the requirements of PD estimation, it may use (inter alia) for ship finance exposures the “supervisory slotting approach”

• Under this approach, the risk weights are determined on the basis of certain criteria underlying the exposure’s credit risk, as well as on the exposure’s remaining maturity

• Risk weights range (on average) from 70% to 90%
2. The alternative methods
(2.3) The supervisory slotting approach (con.)

• In the EU, the slotting approach has been applied to only around 25% of all specialised lending exposures under the IRB approach.

• Compared to the standardised approach, the slotting approach allows capital requirements to be determined in a more risk-sensitive way and at a lower level.

Risk weights for shipping exposures under the three approaches:
IRB (50%) < slotting approach (70-90%) < standardised (100%)
3. Towards a new “Basel IV” framework

The Basel Committee has adopted a regulatory reform programme, known as Basel IV, concerning, inter alia, the revision of:

- the **Standardised approach** (*Revisions to the Standardised Approach for credit risk, December 2015*), and

- the **IRB approach** (*Reducing variation in credit risk-weighted assets – constraints on the use of internal model approaches, March 2016*)
4. The impact of the Basel IV proposals on shipping finance

(a) The proposals

Standardised approach

• Shipping exposures must receive a 120% risk weight, unless they are rated by an Credit Rating Agency

IRB approach

• Removal of the IRB approach for shipping exposures that use banks’ own estimates of model parameters (PD, LGD, EAD, M), since according to the Basel Committee:

“Banks are unlikely to have sufficient data to produce reliable estimates of PD and LGD”
4. The impact of the Basel IV proposals on shipping finance (cont.)

(b) The impact

If the Basel Committee finally adopts the arrangements included in the consultative papers:

– IRB-banks will have to use either the standardised or the slotting approach, which implies that they will be obliged to meet significantly higher capital requirements

– Risk weights assigned by banks using standardised approach to specialised lending exposures will be increased from 100% to 120% (unless the exposures are rated)
5. Concluding remarks

(a) EU shipping is to a high extent backed by bank loans

(b) 70% of ship loans are provided by banks using the IRB approach

(c) The Basel Committee’s proposals would penalize mainly EU shipping financing, since the IRB approach is widely used among EU-based banks – hence shipping financing in the EU will be less attractive and more costly
2. General views on the adequacy (or not) of the security package and other covenants in shipping loans and how they are affected by insolvency laws
Shipping finance
Basel IV, shipping loans and
the ECSA experience

EMLO – Hamburg 3 November 2017

Marco Lopez de Gonzalo

Studio Legale Mordiglia
Evaluation of the risk factor of a shipping loan

- fixed / flexible criteria
- assets / business plan
The security package

- the mortgage
- other forms of security
Insolvency

Liquidation / continuity
Impact of Basel IV

- Competition among borrowers
- Competition among lenders
- State aid
3. Current trends on the German ship finance market:

1) Status on the well-known German ship finance lenders
2) ECA financing
3) other topics
Shipping Finance – The German Experience
German Shipowners see End of Crisis

Freight Rates and Prices for Used Vessels stabilized – Industry expected to be back in normal waters in 2019
Shipping Finance – The German Experience

Still 14.8 Billion Euro Shipping Loans
Reduction of 13 Percent in first half-year – German banking market facing major changes

2017 Amalgamation of BremerLB into Nord/LB

DVB Bank loan losses surge to $529m
Tough conditions in the offshore and container markets increase the risk of the

HSH cuts loan losses to $452m
German lender brings in $372m of new shipping business in first half.

Berenberg kauft Millionen-Portfolio von RBS
Berenberg buys million portfolio from RBS

2018 Sale of HSH
Shipping Finance – The German Experience

Credit Portfolios of German Shipfinancing Banks

2008: 123.7 Mrd. €
2016: 83.0 Mrd. €
2017: ???
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4. Ship finance and options from a shipowners’ perspective:

1) Traditional ship finance
2) Sale & Lease back
3) Equity
4) Norwegian Bonds and the ECSA experience
Ship finance and options from a shipowners’ perspective:

1) Traditional ship finance
2) Sale & Lease back
3) Equity
4) Norwegian Bonds
The ECSA experience on Basel IV

The ECSA experience

- ECSA: “Worrying for the EU shipping industry”

- BC propose to remove Internal Rating-Based approach and only allow the use of the Standardised Approach

- The reason for the concern is that shipping under the Standardised Approach will be treated as “Corporate Exposures”

- ECSA proposes specific grid for shipping

- ECSA arguments