



ICS Examiner's Report

SHIPPING FINANCE 2012

Question 1

This question was generally well answered, with candidates identifying the main phases of the shipping cycle. Some marks were lost by students who did not discuss wider applicable economic principles, for example, that shipping is a derived demand, and generally each phase has a lagging factor behind the wider economy. Students who identified the geographical regions where scrapping traditionally takes place, as well as the present principal centres for newbuilds, also gained additional marks. With regard to scrapping, brief reference to anti-pollution aspects was also correctly mentioned by some students. Students who discussed 'market psychology' or exuberance in terms of impact upon the availability and cost of debt also gained additional marks.

Question 2

This was generally well-answered, with many students correctly providing a diagram to support their answer. Marks were lost when discussion of the tax incentives of KG finance was either absent or lacking in detail. Students who discussed the historical dimension to this form of finance, as well as its current uncertain state, were also awarded additional marks. Several students discussed the impact of this form of state interference in the shipping market in terms of building up the German ship management sector but also, in the medium term, negatively impacting upon the shipping cycle (by exacerbating its overruns): these wider considerations gained additional marks.

Question 3

Most students who attempted this question correctly identified the various forms of security, but many also lost marks by failing to discuss in detail the procedural aspects connected with each type. There was credit available for discussing, even if briefly, the different risks to lenders arising from taking each form of security.

The company was also active across several countries: this should have been addressed, possibly in terms of jurisdictional risk, and how this could be overcome, for example, through insistence upon re-registering of assets. To gain additional marks, (and students who did this achieved very high scores for this question), some reference to typical clauses found in documentation required for each form of security should have been discussed. The ICS textbook on shipping finance provides model documents and clauses at the back: these were studied by some students and this was reflected in the higher marks achieved.

Question 4

Some students provided a diagram to illustrate securitisation: this was an excellent way to proceed because it meant that each component, for example the originator and SPV, were clearly identified and discussed. It was very important to discuss the function of each participant: some students lost marks because they simply listed these without further detail.

Some students lost marks by not discussing the issue of separate legal personality of the SPV, and why this is necessary (in terms of protecting both investors in the bonds in the event of the originator's insolvency, but also the originator from legal action brought by investors, in the absence of any partial collateralisation of the SPV by the originator). Recent problems associated with securitisation, including its alleged contribution to the 2008 credit crunch, could have been discussed, as well as the failure of some of the rating agencies to correctly classify securitised bonds.

Question 5

Most students correctly identified the appropriate type of loans here, and there was some discretion to award marks if, although the answer was not strictly correct, a suitable rationale for a different type of loan was provided.

Again, the type of risks associated with each loan should have been considered and some students missed this, resulting in answers being shorter than they should have been. Some discussion of the lagging of the shipping cycle behind the wider economic cycle could have contextualised answers, and some students did do this, resulting in higher marks and more detailed explanations. References to typical clauses in such loan arrangements resulted in some students scoring particularly high marks for this question.

Question 6

Most students provided a diagram to illustrate a typical syndication, and this was an excellent way to proceed since it meant that all participants were correctly identified and their roles discussed. Students who provided practical case studies of recent bond syndications gained additional marks since this placed their answers into a practical context.

The issue of 'one-ship' companies registered in different jurisdictions should have been considered in the context of enforcement procedures (such as vessel arrest) in the event of default on bond payments by the issuer. Possible re-registering of vessels in jurisdictions acceptable to investors should have been briefly mentioned.

Question 7

This question required a very detailed and precise answer: it was not a popular question, few students attempted it, and fewer still achieved a good mark. Key issues to discuss included the historical background and composition of the Basle Committee, and the status of its recommendations (they do not have the force of law, but are implemented through national legal frameworks).

Reference should have been made to Basle recommendations I and II, and some awareness shown of the objectives of the pending provisions of Basle III. Some students failed to discuss the different forms of capital (in terms of the Basle tiers). There should also have been a detailed discussion of the (unrealistic) assumptions behind the Modigliani-Miller irrelevance hypotheses. Students who then proceeded to contextualise the hypotheses within the shipping cycle, particularly its tendency for wide swings and lagging effects (and impact of these upon asset values) scored well. Types of risk in the shipping sector should also have been briefly mentioned.

This was not an easy question, but students who had revised the specific detail in the ICS textbook on shipping finance scored high marks. Interestingly, some students took some of the principles from this topic and discussed them in their other questions: this 'thinking outside the box' inevitably gained additional credit.

Question 8

This was a very popular question and was generally well answered. In essence it required a very descriptive approach, so for students who had revised it a high score was gained. A number of students lost marks because, although they discussed the characteristics of each type of equity, they did not contextualise these within the shipping sector. As a result many answers were shorter than they should have been, resulting in borderline passes. Placing each type on the appropriate curve of the cycle gained significant additional marks.

This question shows again the importance of relating techniques or practices in finance to the shipping cycle with its own unique characteristics: too many students did not provide this linkage in their answers. Reference to some of the major international stock exchanges on which shipping equity is traded gained additional marks as did a practical dimension to answers.

Overall observations

There were many very well answered scripts this year which scored high passes, but some students lost marks for the following broad reasons:

- Failure to place concepts, techniques or practices in shipping finance within the wider context of the shipping cycle;
- Failure to provide case studies in illustration of techniques, or geographical discussion, or stock exchange location: these help give answers a practical dimension and invariably gain additional marks;
- Absence of reference to standard clauses, for example in loan or security documentation;
- Lack of willingness by some students to draw across the syllabus to 'flesh out' answers: for example, by discussing balance sheet issues, or Basle recommendations where appropriate;
- Absence of discussion of types of risks where appropriate, and how these might be reduced, for example by inclusion of jurisdiction clauses in loan documentation.