

Transparency and ship finance

Will transparency and complete disclosure benefit or disadvantage tanker owners attempting to obtain financing for their businesses?

Increasingly, the word 'transparency' is being used within the same sentence along with 'ship finance', replacing 'secrecy' as a descriptor of an often arcane business. The word takes on differing connotations depending on the conversation, referring variously to better financial disclosures of company structure and performance and now to security issues. Transparency will indeed have a real impact on forms of corporate structure, creating some positive spin for owners raising money.

A new triangle

The 'Bermuda Triangle' of complicated and Byzantine vessel owning structures is being replaced by a new triangle. Jovi Tenev, a partner in Holland & Knight's (H & K) Maritime finance practice, talks about an interlocking triad of "transparency in both finance and operations, joined by a third leg - the adoption of best practices in corporate governance". Consider that highly regarded Eletson Corporation, consistently a trend-setter, is making its financial statements freely available, though not required to (see page 7 of this month's issue for a profile of Eletson's CEO). Tenev, in a recent presentation, notes that in a post-Enron environment, listed companies will be held to increasingly tighter standards than before. Tanker companies - in volatile markets with off balance sheet subs- listen carefully! After 2004, if the International Maritime Organisation (IMO) has its way, instant transparency of ownership and operation will no longer be optional. The consequences for ship financing go beyond the additional certificates that will be required at closing, if viewed in a bigger context. The second iteration of the Basel Accord (Basel II), slated to kick in during 2005, will require banks to hold a risk-scaled dollop of reserve capital each time a loan is made. Smaller companies with amorphous ties to real owners will measure higher on the Basel II risk matrix, with the outgrowth here being significantly higher loan spreads. One response from potential tanker sector borrowers - who already see fewer lenders aiming at the sector, is that of consolidation in their own ranks, where smaller companies join forces into a larger entity lacking the inscrutability that bring about sky high loan spreads. Emery Harper, of Harper Consultants, a New York-based expert on ship financing, registrations and regulations, suggests that "the new IMO regulations will institutionalise what quality funding sources have already required under their due diligence procedures".

The US at IMO

Financiers and would be borrowers are also keeping a weather eye on the South Bank of the Thames, where US regulators, staring into the face of rumoured terrorist fleets, sought to mandate disclosure of beneficial vessel ownership (i.e. the true corporate owner) at IMO's February intersessional meeting on the subject of ship security. However, with boilers stoked by IMO members with big tanker fleets, US proposals were rejected in favour of an approach mirroring that of the ISM code - which looks at who actually controls the vessel (i.e. directs employment, hires the crew and signs charter documents). Often, the technical control sits with a shipmanager.

The SOLAS convention, which governs safety at sea, may soon be amended to include a provision that embodies the new spirit of disclosure. In recent IMO meetings, a working group of the Maritime Safety Committee (MSC) considered a paper introduced by a handful of industrialised Flag States, along with the Baltic and International Maritime Council (BIMCO) and the International Association of

Independent Tanker Owners (INTERTANKO), proposing that Flag States issue a Continuous Synopsis Record (CSR), that would be available on all vessels above 500 gt trading internationally. The mandatory CSR would be a document to be kept aboard the vessels that would list identities/ addresses of actual owners, names and identities of bareboat charterers and the name and address of the technical manager. Additional data would be provided regarding the vessel's classification society and the identities of other certificate issuers and auditors. When vessels switch flags, the CSR would be transferred to the new registry and a new CSR issued.

Those shipmanagers who are already well entrenched will benefit greatly by recent IMO actions, as economies of scale and 'flight to quality' will begin to apply to administrative expertise, in addition to purchasing and crewing.

At Posidonia, analysts were suggesting that the new corporate organisations might coalesce around the bigger managers, who would muster big pools of tonnage in the marketplace. A leading banker, Michael Parker, managing director of Citibank's Global Shipping & Logistics activities, disagrees, noting that liability concerns may militate against this. However, Parker does envision the possibility of "pools where a major owner is the dominant partner, [who would take] a greater share of pool earnings. This would be a pre-equity type of solution where the owner contributes the ship, leaving a partner to manage it from a commercial point of view."

The CSRs, as initially proposed, will be paper documents carried aboard the vessels, but they have electronic database written all over them. The Flag States who will be issuing these new documents as early as 2004, could easily share files that will have data structure mandated by the SOLAS rules. If registries could agree to share CSR information in a central repository, the strictly voluntary Equasis (a database launched with the aim of reducing substandard shipping, backed by France, the UK, the US and a few others) would be rapidly made obsolete.

Flag into focus

Flag States are recognizing that they have an important role to play in the twin goals of facilitating deepsea commerce while keeping it secure. LISCR, Liberia's New York representative of the Liberian flag, with nearly 43m dwt. of tanker tonnage in its registry, has taken a very proactive approach. In testimony before one of the US House subcommittee's, LISCR's CEO Yoram Cohen announced a willingness to make its online data available to the US Coast Guard. Included is data on control and about the actual seafarers. LISCR's action throws down an important gauntlet to other registries.

The Marshall Islands, also an important flag for owners of large tankers, has attacked the transparency problem from another angle: the money moving through the system. The Marshall Islands adopted a banking act two years ago containing strong anti-money laundering provisions. Now, the Marshalls have established an intelligence unit that will investigate any suspected money laundering and report to the broader community if any wrongdoing is uncovered. Bill Gallagher, who runs International Registries ('managers' for the Marshall Islands registry), emphasises his commitment to "[ensuring that] the Marshall Islands' well-respected open ship registry is not abused by unidentified parties".

Transparency's impact on finance

The new emphasis on security could also accelerate the consolidation trend, at both the owner level and almost certainly at the shipmanager level - the locus of the all-important 'technical control'. Smaller operations may be uncomfortable under the microscope of financial scrutiny and the new type of potential regulatory scrutiny. First tier money sources can see the movement towards increased disclosure of inner workings of companies. Harper Consulting's Emery Harper hints that "quality money sources will now likely raise the bar on their own due diligence efforts, including looking deeper into the shadows of company ownership". Smaller outfits

may also not be willing to staff up to meet a raft of additional requirements such as mandatory security plans emerging out of IMO, such as a whole new code dealing with vessel and port security. Yet, the trend towards transparency "makes opaque companies with obscure business plans increasingly less financable", in the words of H&K's Jovi Tenev, whose speech on this subject was well received at the recent Oslo ShipFinance Forum.

The glimmers of transparency, to be phased in two and three years on, are already impacting banking practices and will hopefully make investors more comfortable with shipping equities. However, even now, brighter lights are shining on at least three US shipping equities. A noteworthy recapitalisation, still subject to the approval of shareholders, was announced by Seabulk International (ex Hvide), which brought in \$100m of fresh, high quality institutional private equity and refinanced \$180m of higher priced debt. Seabulk is among the top five players in the offshore service sector and operates a fleet of modern US flagged product tankers presently experiencing a very strong market.

As Seabulk cemented its recapitalisation, stock watchers at Lehman Brothers talked up companies traded on the US bourses. The whole sector was rated as 'overweight' (in Wall Street parlance, it means "you should load up on this group of companies") and OMI Corp in particular, with market value battered way down below book value by recent market vicissitudes, was rated as a 'Buy'. General Maritime also continues to be recommended, especially after its recent pullback.

As the season for ship finance conferences tails off, cocktail party attendees in London, Oslo, Vouliagmeni and New York have come to the consensus that the climate for public tanker equities will improve in an environment of abundant information. H & K's Tenev, spotted at a gathering in New York, applied the point beyond equities, suggesting that "companies that are demonstrably committed to quality will succeed in attracting capital through the bank, leasing and capital markets". If you agree, and you consider that quality must be revealed to investors and bankers through an open-book policy, then transparency becomes linked to the lifeblood of a tanker operation - access to capital. Citibank's Michael Parker takes a long-term view, noting that the larger entities he described, built around the transparency cornerstone, would be good candidates for public listings once profitability was achieved and might even utilise their shares as a means of acquiring tonnage from smaller owners.