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Lloyd's List

Chinese finance still a minefield for foreigners

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by Steve Matthews

THERE has been considerable coverage of the growth of ship finance available in China to foreign owners, mostly when they are ordering ships at Chinese shipbuilders.

Shipowners ordering ships in China usually contact a Chinese bank either directly or through the shipbuilder.

The number of banks in China providing shipping loans has increased, but the practicalities before owners can get their hands on all this money is not necessarily so straightforward.

Eurofin Group chief executive Anthony Zolotas outlined the process and potential difficulties. "Chinese banks would not necessarily be owners' first choice of lender if loans are available from a traditional western shipping bank," he said.

Shipowners ordering ships in China and seeking finance there usually contact a Chinese bank either directly or through the shipbuilder. Owners often deal with the branch of the bank closest to the yard.

The bank will normally involve Sinosure, the state-run insurer that provides guarantees to the lending bank of up to 95% of the loan. This is effectively converting the risk of the shipowner into sovereign risk.

Mr Zolotas said: "Getting ship finance loans in China can be tedious, complicated and with other potential problems, such as what happens if the owner has a problem, or wants the order or the finance restructured. It can take up to six months to put the finance in place in China."

It can be more costly than a loan from a western bank. The insurance premium to cover the risk can be 2%-4%. "We are working on a project where the premium is 3%, but there is a lower margin and lower fees, which is acceptable to the owner as an overall package," Mr Zolotas said.

"Asian banks are here to stay, but it is not straightforward to get your hands on the money that is supposedly available. They will not be a ready-made replacement for western banks, but some will become substantial players.

"The presence of new Asian banks in the international ship-lending arena is one of the very few positive things that have happened to this market since the start of the financial crisis. Chinese banks have money, plenty of it.

"But financing from Chinese banks is certainly not an easy process. It takes time and a lot of patience. If you are successful, however, you become a member of a very select group of shipowners and, assuming you perform, you would have tapped into a market with huge potential."

Standard Chartered head of shipping Nigel Anton said: "[Chinese banks] are learning from us and like working with western banks. Dealing with banks in China usually involves dealing with local branches, but international expansion may take longer."

HSBC Bank director of global shipping and offshore Barry Wingate added: "Chinese banks are cautious about whom they are lending to and are working with established western banks to do initial transactions as part of this learning process."

Ship value slump hits loan ratings

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Reduced ship values have had a dramatic impact on the capital provision that banks make for loans granted on newbuildings contracted at higher prices

REDUCED ship values have had a dramatic impact on the capital provision that banks make for loans granted on newbuildings contracted at higher prices, *writes Steve Matthews*.

Zolotas: internal ratings downgrades have an exponential effect on bank capital.

This goes some way to explaining why the availability of and terms for shipping loans are much tougher.

Under the Basel II international banking rules, banks have had to provide an internal rating for all loans as a basis for making capital provisions against potential losses.

Eurofin Group chief executive Anthony Zolotas demonstrated to the Ship Finance and Investment Conference in London the effect this has on shipping loans when values fall.

He used the example of a 5,300 teu ship ordered in 2006 for delivery in 2009 and financed with a $71m bank loan. By the market peak in June 2008 the value of the ship had gone up, but the rating had come down slightly.

Loss given default is the basis of how a bank measures what it must put aside to cover the loan. In October 2006, when the ship was ordered, the market was strong and the ship was valued at $89m. At that time, the loan was internally rated 9 (BBB), the LGD at 16.1% and accordingly the capital to set aside was $1.1m.

In June 2008, when ship values peaked, the same ship was valued at about $95m. But the rating had deteriorated slightly to 10 (BBB-), the LGD was up to 13.5% and the capital required to be set aside increased slightly to $1.4m.

By April 2009, following the financial and container market crash, the value had slumped to $51m, the rating was 12 (BB) the LGD jumped to 25.2% and the capital set aside up to $3.8m. In August 2009, the value was $46m, rating 14 (B+), the LGD 26.7% and capital cost $5m.

In January 2010, when values had reached their lowest, the ship was worth $40m, the rating 20 (D), the LGD 28.6 and capital set aside had rocketed to $16.7m (see graph). “Banks do not have a liquidity problem, but they have a capital problem,” Mr Zolotas commented.

Ship values have improved since then and associated risks have reduced, but the impact on banks' capital requirements is clear. “Internal ratings downgrades have an exponential effect on bank capital and reduced collateral value also increases capital requirements,” Mr Zolotas said.

This helps explain why banks with high exposure on loans agreed at high market values have run into such problems.

Ralf Bedranowsky, global co-head of shipping finance at Deutsche Bank, said that his bank had maintained a cautious approach to lending, even through the boom. "Our stringent credit approval policies have remained the same throughout the pre-crisis and crisis period," he told Lloyd's List.

"The loan portfolio is well diversified. It avoids concentration risks through pro-active risk management strategies such as diversification in terms of vessel type, volume, age structure and country."

But regulatory pressures will continue to affect shipping, with Basel III set to impose even tougher capital requirements, and shipping banks are having to prepare already for the new regime.

"Stringent capital adequacy for banks implies more limits for financing in general and Deutsche Bank will comply with the 4.5% minimum common equity requirements by the end of 2015," said Mr Bedranowsky.

"But the impact of Basel III on availability of funds for financing will have little impact since we started to account for the changes at an early stage."