INTERNATIONAL

SHIPPING FINANCE & LAW

REVIEW **2024 / 25**

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The International Shipping Finance & Law Review 2024/25

Contents

INTERNATIONAL CHAMBER OF SHIPPING

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Director

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International Chamber of Shipping

BIO

Kiran, an English qualified lawyer (solicitor), is the Principal Legal Director of the International Chamber of Shipping (ICS). ICS is the international trade association and employers' organisation for merchant shipowners and ship operators. The membership of ICS comprises national shipowners' associations from 40 countries, and represents all sectors and trades and about 80% of the world fleet. ICS enjoys consultative status with the International Maritime Organization (IMO) and the International Labour Organization (ILO) and has represented the shipping industry in negotiations leading to all the international conventions dealing with safety and liability and compensation for pollution.

Kiran and the ICS Legal department advises the national associations on legal liability, competition and insurance related matters affecting shipping and shipowners generally. The department represent ICS at the IMO Legal Committee and at other UN agencies including UNCITRAL and UNCTAD on legal and insurance issues.

Prior to joining ICS, Kiran worked at a Norwegian P&I Club, heading the Defence team and before that, she was in private practice with a shipping law firm in London working exclusively in shipping litigation, dealing with claims in the London High Court and London arbitration.

International Chamber of Shipping

In recent years the shipping industry, and the seafarers upon which the industry depends, have faced unprecedented challenges. The global COVID-19 pandemic, increasing regulatory pressures, and shifting geopolitical landscapes where commercial shipping is increasingly seen as a target in regional conflicts, have all contributed to a turbulent, and increasingly dangerous, environment for those who work at sea.

These challenges are compounded by increased regional regulation, particularly concerning the environment, and new logistical challenges. While strong regulation is crucial for ensuring safety, certainty and sustainability in international shipping, such regulation should be made at a global level by the International Maritime Organisation, thereby ensuring global rules for a global industry.

The 2024/25 International Shipping Finance & Law Review provides an valuable opportunity to highlight and review these important issues, trends, and challenges facing our shipping and maritime legal communities.

> One of the most troubling trends in maritime law is the increasing criminalisation of seafarers.

Seafarers: The Human Factor

First and foremost, it is crucial to consider the human factor in international shipping. Seafarers are the backbone of the global maritime industry, yet their well-being is often overlooked. The harsh conditions faced by seafarers during the COVID-19 pandemic which included the crew change crisis, extended contracts resulting in prolonged periods at sea, and the denial of shore leave by governments, all underscored the vulnerabilities of those who work at sea and highlighted once again the need to emphasise the human element when considering maritime law and policy. The International Maritime Organization (IMO) and the International Labour Organization (ILO) have been called upon to provide clearer guidance to ensure the protection of seafarers' rights – most particularly through the recognition of seafarers as "key workers" with appropriate rights.

Criminalisation of Seafarers

One of the most troubling trends in maritime law is the increasing criminalisation of seafarers. Seafarers by the very nature of their profession, are exposed to multiple jurisdictions during their employment on board a ship. When a large casualty occurs or when illegal narcotics are discovered onboard a ship or within the ship's cargo, it is not uncommon for some or all of the crew to be detained. The Master is particularly vulnerable to detention. Global drug activity has increased by an estimated 23% between 2011 and 2021, with some 296 million users worldwide, per United Nations Organization on Drugs and Crime (UNODC). Large commercial vessels are frequently targeted, unbeknownst to shipowners and crew, by highly organized criminal cartels and gangs to smuggle drugs across the globe by sea. The international shipping industry is committed to combating the smuggling of drugs concealed on board ships and has invested heavily in preventative measures, including equipment, control procedures and crew training.

ICS fully understands the damage caused to countries by maritime crimes, such as drug smuggling, and the need to suppress and deter this criminal activity, including through the prosecution of offenders using the full force of the criminal law. However, in many cases, seafarers are often wrongly detained for extended periods without trial, simply because drugs have been found on board and before any wrongdoing on the part of the seafarers has been established, with the seafarers being held in challenging conditions while separated from their family and loved ones. In some cases, basic human rights have also been disregarded. This not only undermines the morale of seafarers, often impacting their physical and mental health, but also has a detrimental effect on the recruitment and retention of seafarers, threatening the overall stability of the maritime industry.

In 2023 the ICS, along with some states and other industry organisations, co-sponsored a document that invited the IMO's Legal Committee to consider the development of Guidelines on fair treatment of seafarers detained on suspicion of committing maritime crimes. ICS was actively involved in the subsequent work to finalise these Guidelines during the 110th and 111th session of the IMO Legal Committee in 2023-2024. These Guidelines were approved by the IMO Legal Committee at its 111th session in April 2024 and are intended to apply whenever a seafarer is detained on suspicion of committing any crime during the course of their employment on board. These Guidelines will be further refined at the meeting of the 3rd Joint IMO-ILO Tripartite Working Group to identify and address seafarers' issues and the human element (JTWG 3) to be held in Geneva on 26 to 28 November 2024. Although the Guidelines recognise that the sovereignty of individual states must be respected, once finalised it is hoped that these Guidelines will reinforce the need for due process during any investigation into an alleged crime; serve as a reminder that the human rights of any detained seafarers must be respected throughout; and assist in ensuring more balanced and just treatment of seafarers, when detained on suspicion of a crime.

Erosion of Flag State Jurisdiction

There is growing concern about the potential erosion of flag state jurisdiction within the industry. Pursuant to the United Nations Convention on the Law of the Sea 1982 (UNCLOS), the vessel's flag State has jurisdiction over and the primary responsibility for implementing and enforcing global regulation over ships as are agreed at IMO. However, increasing national and regional regulation, particularly in the context of environmental protection, introducing stricter standards than those agreed at IMO level, not only raises concerns about a fragmented regulatory environment, where shipping companies must comply with multiple, and sometimes conflicting, sets of rules; but it also has the potential to erode the fundamental principles enshrined in UNCLOS of innocent passage in the territorial sea and/or freedom of navigation in the EEZ of a coastal State.

Fraudulent Registration/Fraudulent Registries

In order to ensure that the system of Flag State jurisdiction is not undermined by fraudulent or illicit activity ICS is actively involved in the work of the IMO Legal Committee to address fraudulent registries, the fraudulent registration of ships and the fraudulent use of the IMO identification number schemes. This includes considering the elements of due diligence to be exercised in the process of registration of ships by flag State administrations when involving vessels in the IMO unique company and registered owner identification number scheme. This work will also consider whether a new output to draft on guidelines or best practices on the registration of ships would be desirable.

Supporting a Sustainable Salvage Industry

A healthy and sustainable salvage industry is essential for the safe operation of global shipping. Salvors provide critical services in emergencies, saving lives and preventing environmental disasters and their future viability is important to preserve for the entire shipping industry.

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LOF Default Clause

The Lloyds Open Form of Salvage contract (LOF) is an essential contract entered into by shipowners and salvors when a vessel is in need of salvage assistance. For over a century, the LOF has been pivotal in ensuring maritime safety, enabling swift and effective responses to situations where the ship is in danger. It contains provisions designed to rewards salvors for attending vessels in danger and to encourage them to continue to invest in emergency response as well as training and equipment to meet the challenges of new shipbuild technology and the cargoes and fuel on board.

Recent years have seen a decrease in the use of LOF in situations for which it was designed, in favour of other fixed price contracts that require negotiation on price and the salvage service to be provided, This creates a risk of delay which can be dangerous for the safety of the crew and ship and cargo and the environment. In order to promote and support the use of the LOF, the Lloyds Market Association has worked with the ICS over the last 12 months to produce a clause for inclusion in the shipowners' hull policy to give clarity around the process for contracting for emergency and non-standard tug services. In particular, the clause is designed to clarify that in the event of an emergency, the appropriate contract is the LOF and master and / or owners decision to use LOF to obtain salvage services is supported by their insurers; it further sets out a process for owners to notify hull underwriters of such incidents and take their views as to the appropriate contract to be used when this is practicable and it sets out a procedure for discussion with insurers when dealing with incidents where there is no immediate danger but nonetheless the master/owners perceive that assistance is required.

> A key area of focus should be the strengthening of legal frameworks at global level while ensuring the operational efficiency and environmental sustainability of the shipping industry.

The overall objective is that this will encourage dialogue between owners and their underwriters and, ultimately, restore confidence in this vital contract, ensuring that it remains a cornerstone of maritime safety for years to come.

Strengthening Legal Frameworks and International Cooperation

As the industry moves forward, it is essential to strike a balance between the needs of seafarers, shipping companies, and the global community. This requires a collaborative approach, with input from all stakeholders, including national governments, international organisations including seafarer organisations, and industry leaders.

A key area of focus should be the strengthening of legal frameworks at global level while ensuring the operational efficiency and environmental sustainability of the shipping industry. Success will depend on global engagement at IMO and ILO and effective implementation and enforcement of any resulting regulation.

International cooperation is crucial. Regional and fragmented regulation, with varying standards across different jurisdictions, creates confusion and can undermine efforts to improve safety and sustainability. A more harmonised approach to regulation, where international standards are consistently applied and enforced, would benefit all parties involved. This would not only improve compliance but also reduce the legal and operational risks faced by shipping companies and seafarers.

Future Outlook

Looking ahead, the shipping industry will continue to face significant challenges as it navigates the complexities of modern global trade. The push towards decarbonisation will require innovative solutions and substantial investment, while the legal landscape will need to evolve to address emerging issues such as cyber security, autonomous vessels, and the impact of climate change on shipping routes and operations.

By prioritising seafarers, strengthening legal frameworks, and fostering international cooperation, the industry can navigate these challenges effectively, ensuring a safer, more sustainable future for global maritime operations. The continued evolution of maritime law and policy will be key in shaping the future of this vital industry, balancing the needs of seafarers, shipping companies, and the global community.

MICHAEL KYPRIANOU

BIO

Kyriakos is a partner in Shipping and Finance team of Michael Kyprianou & Co.LLC. He is frequently involved in shipping transactions and he specializes in cross-border financing transactions, shipping financing transactions and covers a broad range of shipping finance matters including drafting, negotiation and implementation of Cyprus law security documents such as ship mortgages, account charges and share pledges. His clients include international financial institutions and corporations as well as investors and high-net-worth individuals. Kyriakos is also involved in corporate law matters, including joint ventures and cross border mergers and he has experience in advising clients in relation to real estate and Sports Law matters.

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The development of the Shipping Finance sector - Cyprus' opportunities

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The current status of the Shipping Finance Sector

The Shipping Industry has faced enormous changes and challenges over the last years as a result of many factors, such as the consequences of Covid-19 crisis and the subsequent impact on the market demands, the regulatory changes and the shift to the ESG, the substantial increase over the freight rates and the inevitable increase in the cost of new-builds ships.

Inevitably, these radical developments have affected the area of the ship financing as a core sector of the industry. As a result, the area is currently facing the high capital requirements for the shipbuilding or the retrofitting of the ships, the increase in the interest rates of the banking institutions, the market volatility which is further affected by the geopolitical tensions and the subsequent worldwide unsteadiness.

Key Trends and the role of traditional financing

> "The Shipping Industry must maintain multiple sources of financing and rely on a stable structure and sustainable solutions.

In order to overcome the challenges that have arisen in this ever-changing environment, the Shipping Companies have explored alternative financing options, such as private equity or through the investment of their cash flow, so as to address the rapid increase in the interest rates along with the demands for transforming into a "green area" in order to satisfy the environmental requirements.

The profitability of the Shipping Companies has also increased the investments in the digitalization and technology, a development that has a positive impact on the investors' and financiers' interest.

Despite the alternative routes of financing, the anticipated decrease in the interest rates is expected to initiate the return of the Shipping Companies towards the traditional sources of financing, rendering the bank institutions the most common route to financing and simultaneously enhancing the access of the Companies to a lower cost of lending.

However, what derives as a lesson learned from the recent experience, is that the Shipping Industry must maintain multiple sources of financing and rely on a stable structure and sustainable solutions, in order to be in a position to overcome any market disruption and thus safeguard both the owner's and the lender's interests.

Cyprus' case – the opportunities ahead

Cyprus, as one of the leading maritime centres, has developed rapidly in the area of ship financing, safeguarding at the same time a prominent role in the formulation of global shipping policies.

This is attributed to several reasons, which include, inter alia:

1. The location and history of Cyprus as a Shipping Hub
2. The well-developed legal framework and the protection provided to the lenders
3. The attractive maritime and corporate tax regimes
4. The establishment of a dedicated Shipping Deputy Ministry
5. The high quality of professional services in maritime industry

1. Cyprus as a Shipping Hub

Cyprus is a modern, efficient and integrated shipping cluster, with a prominent worldwide position, encompassing a full range of shipping and shipping-related services. As a shipping centre, it combines an international registry, recognised for its prestige and quality, as well as a wide range of shipping and related services, including management, fuelling, technology and shipping agents. Cyprus currently ranks as the 11th largest merchant fleet worldwide and the 3rd largest fleet in the European Union. As a third-party ship management centre, it is the largest in Europe and amongst the top three worldwide. More than 20% of the world's third-party management fleet is managed by companies based in Cyprus.

2. The legal framework

Cyprus position in the Shipping Industry is grounded on its well-developed legal framework which provides clarity and certainty to the shipowners, borrowers, bankers and lawyers to operate in a regulated environment. Cyprus' familiar legal environment is attributed to a large extent to its close connection with the English law.

As it derives from the below brief description of the relevant procedures, Cyprus has formulated a structured framework for ship financing in order to provide the necessary safety nets in this demanding and constantly transforming market of the shipping industry.

The pledge of shares of a Cyprus Company and the mortgage over a vessel are (along with the charge of the bank account), the main security financing tools with which the financing of a shipping company and/or a vessel can be secured in accordance with Cyprus legislation:

A. Pledge of Shares of a Cyprus Company owning the ship

The pledging of shares of a Cyprus Company is a widely used tool as it offers commercial security in Cyprus. It is also used as a security in the shipping finance area in cases where the ship is owned by a legal entity which is incorporated in Cyprus. The pledging of shares is created by the execution of a share pledge agreement, which specifies the terms of the pledge and provides that upon execution specific documentation must be simultaneously provided to the pledgee i.e. the specific security mechanisms that will facilitate the effective out of court enforcement of the pledge.

The documentation shall enable the pledgee to enforce the pledge in the event of default without the need for engaging in time-consuming court procedures. Therefore, the documentation provided to the pledgee by the pledgor, enables the pledgee to transfer the shares in his name, if the obligations specified in the share pledge agreement fail to be discharged. Pledged shares should be fully paid up and no other charges should be registered against them.

A pledge is a form of real security providing to the pledgee proprietary rights over the shares belonging to the pledgor. The possession of the pledged property may be actual or it may, more commonly, be constructive. Actual possession of the property brings concerns regarding risk and the duty of care. Therefore, constructive possession is a more commonly used practice.

B. Ship Mortgages

The most common way of security in ship financing are ship mortgages. The relevant Cyprus legislative framework (the Merchant Shipping Law) allows a vessel or a share over a vessel to be registered as security for the creation and/or securitization of a loan. More explicitly, a security over a ship, will be used by a Ship owner as a tool for obtaining the relevant financing for purchase and/or build of a vessel while at the same time a lender will acquire an interest in the mortgaged vessel. A mortgage must always be accompanied by a collateral deed of covenants where the commercial/ contractual terms of the agreement between the mortgagor and mortgagee are included, which, to a large extent, reflect the agreed provisions between the lender and the borrower, as they have been incorporated in the underlying document (the facility agreement).

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> The pledging of shares of a Cyprus Company is a widely used tool as it offers commercial security in Cyprus.

The mortgage and the deed of covenants are registrable with the Registrar of Cyprus Ships and where the shipowner is a legal entity registered in Cyprus, is also registrable with the Registrar of Companies.

C. Registration of foreign law security documents

The sections 90 and 99 of the Cyprus Companies law provide that all the security documents, including the foreign law security documents, are registrable with the Registrar of Companies and the internal registers of a Cyprus' Company.

3. The attractive corporate and maritime tax regimes

Cyprus business environment is grounded on an open, service-based economy supported by a stable and business-friendly tax and legal system.

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> The implementation of the TTS and the approval of Cyprus as an "EU approved Open Registry" has been a popular development for the shipping community.

Undoubtedly its advantageous position for shipping activities benefits from the favorable tonnage tax system and the tax benefits.

A. Corporate Tax Rate:

The corporate tax rate in Cyprus is 12.5% and is one of the lowest in the European Union.

B. Cyprus Tonnage Tax System (TTS):

The TTS is a well-developed and attractive Shipping Tonnage Taxation System which was renewed in 2019, following the approval of the European Commission and has been extended until 2029, rendering Cyprus an "*EU approved Open Registry*". It provides long term fiscal stability for Cyprus Shipping.

Qualifying owners of Cyprus and foreign ships, charterers and ship managers who opted and are accepted to be taxed under the TTS are subject to an annual tax, which is calculated on the basis of the net tonnage of the qualifying ships they own. The owners of Cyprus ships fall automatically within the scope of the TTS.

The implementation of the TTS and the approval of Cyprus as an "EU approved Open Registry" has been a popular development for the shipping community. Its positive impact is demonstrated by the increased number of shipping companies registered under this regime (282 – 63% increase) since 2018.

The *EU approved "Open Registry" with legally endorsed* ***Tonnage Tax System*** *available to shipowners, ship managers and charterers provides full exemption from corporate taxation of:*

- *Profits from exploitation of a qualifying ship in a qualifying shipping activity;*
- *Profits from the disposal of a qualifying ship.*
- *Profits from rendering crewing and/or technical ship management services to a qualifying ship.*
- *Full tax exemption of dividends paid out of profits falling within the TT regime.*
- *Full tax exemption of crew salaries or other benefits of a qualifying shipping activity.*

It is noted that Cyprus continues to develop new and progressive programs to support the maritime sector.

Exemption for payment of Stamp Duty: Pursuant to the provisions of 4.3(e), First Schedule of the Stamp Duty Act of 1965, the ship mortgaged documents are exempted from any stamp duty obligation. This parameter is of course an additional incentive for the parties interested in acquiring and registering a vessel under the Cyprus flag.

C. Double Tax Treaties: Cyprus has a wide network of double tax treaties, which can help reduce withholding taxes on dividends, interest, and royalties paid to foreign entities and enhancing at the same time its appeal as a business hub by providing favourable tax treatment.

D. Merchant Shipping Bilateral Agreements: Cyprus has signed 25 Merchant Shipping Bilateral Agreements, demonstrating the status of Cyprus' Flag in the global Shipping Industry.

Cyprus' attractive tax system contributed to the stability and further improvement of the competitiveness of Cyprus shipping industry, as it constitutes a significant incentive for the companies that choose Cyprus as the their corporate and business centre.

It also increases the profitability while providing to the company the benefit to fulfil its legal obligations towards its financiers / lenders or any equity investor who is interested in the timely repayment of their investment.

4. The establishment of a dedicated Shipping Deputy Ministry

The establishment of a Shipping Deputy Ministry in 2018, demonstrates Cyprus' commitment to constantly develop, safeguard and further support Cyprus shipping as a safe, socially responsible and sustainable industry. This structural change has contributed to the progress of the sector and has provided the pathway to follow speed up and high-quality customer-oriented processes.

Cyprus maintains physical representation in the main maritime locations such as Piraeus, London, Hamburg, Rotherham, New York and Brussels. Cyprus has a prominent role in the formulation of global shipping policies with a strong presence in maritime fora and international organizations. Cyprus flag is a top-quality sovereign flag which duly adheres to all safety and security standards deriving from the Paris and Tokyo MoUs and is in the "White List" of both MoUs.

5. Quality of professional services in maritime industry

Undoubtedly, the establishment of a country as a commercial and shipping hub, requires the corresponding quality from its workforce, in order to be able to follow the high-standards of services. Cyprus has a high availability of highly educated, multilingual, motivated individuals specialized in a variety of areas including shipping, finance, insurance and law.

The high level of expertise gained through the years in the field of shipping industry, ensures the provision of an advanced and wide spectrum of services, encompassing the full range of shipping and shipping-related issues along with the continuous development of the sector and the substantial protection of the parties involved.

The way forward

As it derives from the aforementioned, Cyprus has developed a comprehensive, well-structured nexus in the shipping industry in general and subsequently in the sector of the shipping finance and it has shown resilience over the years.

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> Cyprus' attractive tax system contributed to the stability and further improvement of the competitiveness of Cyprus shipping industry.

However, the challenges the industry faces as a global sector within a competitive and volatile environment, derive from several fields and are always increasing. The continuous upgrading and the strengthening of the level of the services provided is one of the main pillars that will ensure Cyprus' prominent presence in the sector. The aim should be to expand new global opportunities, emphasizing on investments as these are the driving force for further growth of the sector.

In this respect, Cyprus' competent authorities have adopted, as part of this evolving process, the "SEA Change 2030", a long-term strategic vision for Cyprus shipping. The strategy aims to further improve the Cyprus flag's competitiveness in international shipping, as well as to simplify the procedures and the operating regime of Cypriot shipping companies owning Cyprus-flagged vessels. The Strategy focuses, amongst others, on digital transformation, as this is an area that affects substantially the sector's operational level and it has a direct effect on investors' and financiers' decisions.

A notable action implemented within the context of the Strategy is the formulation of an ad hoc regulatory and administrative framework for the incorporation of Shipping entities. In this respect, a legislation has been introduced, namely the "Shipping Limited Liability Company Law" of 2022 (the "SLLC Law"), which includes a comprehensive set of rules and procedures covering a spectrum from the establishment of an entity to its liquidation. The scope of the new legislation concerns exclusively the shipping companies, in an attempt to increase the clarity of the system, simplify the procedures and thus to reinforce the competitiveness of the Cyprus' flag. The aim of the law is the establishment of a one-stop-shop for the shipping owners, under the authority of the Shipping Deputy Ministry, distinguishing the shipping companies from the companies that fall under the authority of the Cyprus Registrar of Companies. Undoubtedly, the enactment of this legislation marks another step forward and demonstrates Cyprus' continuous efforts for the evolvement of the industry.

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> The successful implementation of concrete initiatives will create the conditions for Cyprus shipping to become more resilient and sustainable.

The successful implementation of concrete initiatives will create the conditions for Cyprus shipping to become more resilient and sustainable, maintaining its role as a leading maritime hub. Within this context, Cyprus has the required tools and the ability to play a decisive role in the transforming market of the Shipping Industry, by offering attractive, secure and convenient solutions to both financiers and shipowners looking to develop or update their fleet.

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EGYPT

Protection of the sea carrier in Egypt at the legislative and judicial levels
"A focused outlook on the transport of goods using containers"

ELDIB ADVOCATES

BIO

Ahmed Said joined our team in October 2016. We are happy to have him on board, as he has an extensive record of legal expertise.

Furthermore, Said has acquired a wide experience in handling maritime claims as he has participated in numerous cases in the Gulf and the Red Sea region, which afforded him extensive knowledge and enabled him to handle conservatory arrests of vessels and other general maritime claims, resulting from collision accidents, pollution, maritime transport, demurrage claims, sinking of vessels and writes off, salvage, mortgage, supplies provided to the vessels, ownership disputes, etc.

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BIO

Ahmed Fahim joined our Firm in 2006 and has since worked on cases regarding intellectual property, Egyptian customs law and maritime law.

Ahmed is a keen member of our team and has acquired exceptional experience in handling intellectual property cases. We are proud to say that, on numerous occasions, our team has successfully handled IP claims and our efforts have materialised in elimination a multitude of "imitation goods".

Ahmed is also very experienced in handling cases for shortage and damage sustained to the cargoes of oil and grains shipped in bulk onboard vessels. He has also acquired large experience in completing the necessary formalities of setting-up companies in Egypt, and he is experienced in handling labour cases.

Protection of the sea carrier in Egypt at the legislative and judicial levels
"A focused outlook on the transport of goods using containers"

ELDIB الديب
advocates محــــامـــون

In our modern era, the sea transport of containerised cargo is considered as one of the most important instruments produced by the trade exchange operations around the world. Since the emergence of containers as a means of transporting goods by sea, all parties in the field of maritime transport have tended to develop all the elements that enabled the containers to be ranked as the most common means for cargo transport.

The "sea carrier" holds the prominent role in the maritime transport process, where he draws a sea carriage contract with the shipper or his representative and bears the consequences of loading, transporting and maintaining the goods until they are delivered in proper condition to the consignees at the port of destination.

Moreover, the sea carrier bears numerous responsibilities associated with the transport process, starting from providing a seaworthy vessel from a navigational and commercial aspects to transport the goods, and then receiving, loading, stowage and transporting the goods and thereafter discharging these goods to deliver them to the consignees at the same condition they were shipped at and at the time specified for delivery.

> "Since the emergence of containers as a means of transporting goods by sea, all parties in the field of maritime transport have tended to develop all the elements that enabled the containers to be ranked as the most common means for cargo transport.

the carrier's bears the responsibilities and risks associated with the sea carriage and in return, he is entitled to receive protection and legal guarantees which would create such needed balance among the parties of the sea carriage contract.

In Egypt, the provisions of the local legislation regulating the maritime transport operation (Maritime Trade Law No. 8 of 1990) are enacted in a manner that is consistent with the United Nations Convention on the Carriage of Goods by Sea "Hamburg 1978" in terms of the guarantees granted to the carrier, whether regarding providing the carrier with the right data, condition and description of the goods, or such guarantees related to the payment of the freight or its accessories and the setting cases for limitation of carrier's liability.

The aforementioned Egyptian Maritime law has uniquely developed flexible solutions for one of the most vital problems faced by the sea carrier in the transport operation, where the consignee does not apply for taking delivery of the cargo and devanning of the container, or when the consignee applies for obtaining a delivery order but does not complete the final customs clearance.

Whether the responsibility for non-receipt of the goods is due to the shipper or the consignee, the carrier has the right to receive his container instead of leaving it as a good's warehouse for an indefinite period, which constitutes direct losses to the carrier for depriving him from using the container, which is an essential tool for transporting the goods and disrupting the usage of the container in successive transport operations.

In this respect, the Egyptian legislator addressed these problems by granting the carrier the right to apply before the Judge of Provisional matters (Le juge des référés) requesting for a permission to deposit the goods with a trustee to be appointed by the judge and to receive the empty container while granting the carrier a lien over the cargo for settlement of the freight and/or other associated claims arising from the sea carriage contract. As a result, this has contributed to reducing the number of unclaimed containers and their accumulation in the ports.

The receipt of the container puts an end to the damages resulting from the non-receipt of the goods, and this does not prevent the carrier from his right of judicial recourse against the responsible for the demurrage, which is usually specified in the maritime transport contract as well as in the payment of any amounts resulting from the none of receipt, such as demurrage - port expenses - destruction costs …etc.

Through the specialisation of our firm in handling marine transport disputes, we have succeeded in obtaining numerous court rulings holding in favour of the "sea carrier" to compensate for any damage that may be caused as a result of the breach of the sea carriage contract.

MORI HAMADA & MATSUMOTO

BIO

Ryutaro Kawamura has broad experiences in international investments, especially on cross-border shipping, infrastructure and real estate development projects in Southeast Asia, and financing for those projects. He has been actively involved in the projects in Singapore, Malaysia, Indonesia, India, Vietnam, Thailand, and Philippines. Such projects include shipping finance, utilising his work experience in international shipping transactions and dispute resolutions. For recent years, he has led the maritime practice of the firm as the Head of the practice group.

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BIO

Yusuke Nakajima has extensive experience in asset financing transactions and real estate financing transactions, and co-leads the asset financing team at Mori Hamada & Matsumoto.

He has considerable experience in a wide range of asset financing work, including ship and aircraft JOLs and JOLCOs. He also has considerable experience in a wide range of real estate work, including logistics, accommodation, residential and other commercial properties. He advises both international and domestic financial institutions, leasing companies, commercial companies and investors on all aspects of asset financing transactions, including acquisitions, disposals, leasing and financing transactions. He also covers regulations applicable to asset financing transactions and real estate transactions including structuring funds for investment.

MORI HAMADA & MATSUMOTO

Overview of JOCLO (Japan Operating Lease with Call Option) for Ship Financing

MORI HAMADA & MATSUMOTO

1. Introduction

In this chapter, we will introduce the "Japan Operating Lease with Call Option" ("**JOLCO**"), which is a unique financing structure in Japan used for ship financing. We will also provide an overview of the reform of the maritime law in 2018.

2. General Overview of JOLCO

A JOLCO is a structure adopted for ship financing transactions arranged by Japanese leasing companies. This structure is also used for financing transactions for aircraft, containers, and other valuable equipment.

(1) Outline of the structure

(i) Origination

In a JOLCO transaction, a special purpose company (the "**Registered Owner**") incorporated in a foreign jurisdiction (usually the jurisdiction where the ship is registered), which is usually a wholly-owned subsidiary of a leasing company, purchases a ship with the funds received from the SPC and registers it in the relevant jurisdiction.

Another special purpose company (the "**SPC**") incorporated in Japan, which is also usually a wholly-owned subsidiary of a leasing company, purchases a ship with funds financed by way of (i) a non-recourse loan from third party lenders, secured by the ship and (ii) a "*tokumei kumiai*" ("**TK**") investment from equity investors (the "**Investors**"), as more fully described below.
In order for the Registered Owner to maintain legal title to the ship for the registration, the purchase price is paid on an instalment basis. The SPC pays a substantial portion of the purchase price at the beginning, and a nominal residual amount will be paid in the future.
Although the amount of capital contribution by the leasing company is nominal, the leasing company as a parent having control over the Registered Owner and the SPC is often required to provide a comfort letter or keep-well letter (called "parent undertaking") in favour of the lenders or charterer, as the case may be.
In the context of structured financing transactions involving special purpose companies in Japan, lenders often require that the special purpose companies be an orphan entity (for bankruptcy remoteness). However, in a JOLCO transaction, it is usually not required in practice.

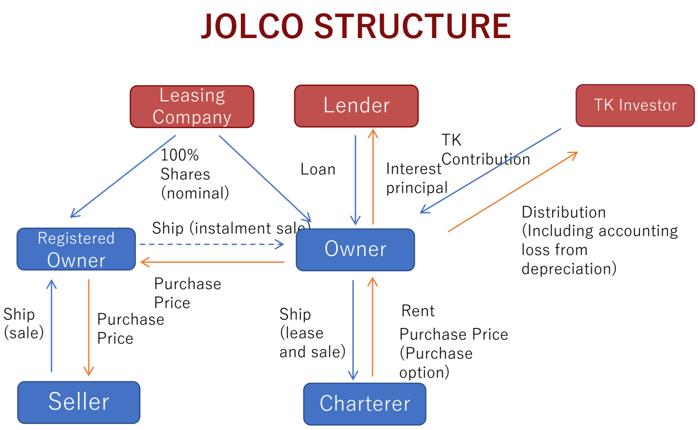
(ii) Charter Period

During the charter period, the SPC bareboat-charters the ship to a shipping company (the "Charterer") and receives charterhires from the Charterer. The charterhires from the Charterer are first applied to payments of interest and/or principal of the non-recourse loan, and the remaining rents charterhires are distributed to the Investors.

(iii) Purchase of Ship by Charterer

Under the bareboat charter agreement, the Charterer is given an option to purchase (call-option) the ship at a certain price, exercisable after a certain period from the commencement of the charter.
In practice, it is usually anticipated that the Charterer will exercise this option and purchase the ship.
However, since, legally speaking, this is an option for the Chatterer, it is not guaranteed that the Charterer will purchase the ship. If the ship is purchased by the Charterer, the proceeds from the sale are first applied to payments of the outstanding amounts in respect of the loan and the remaining proceeds are distributed to the Investors.

Below is a sample chart of a typical JOLCO structure.



(2) Relevant Japanese Laws

In JOLCO transactions, the main areas where Japanese laws are involved are as follows:

- **Governing law**

The following matters/documents are governed by Japanese law:
- Incorporation and governance of the SPC (i.e., the Companies Act of Japan);
- Certain security agreements to be entered into to create a security interest in favor of the lenders e.g. share pledge agreement (SPC's share) and account pledge agreement (when the bank is a Japanese bank); and
- TK agreements with the Investors.

Other transaction documents (e.g. a purchase and sale agreement, instalment sale agreement, bareboat charterparty agreement, loan agreement, and security assignment of certain contractual rights) are usually governed by English law or New York law. The mortgage agreement is governed by the law of the jurisdiction where the ship is registered (e.g. Panama, Liberia, Marshall etc.).

- **Regulatory law**

- Financial Instruments and Exchange Act of Japan (the "FIEA"): Since the TK Investment (defined below) constitutes a "security" (yuka-shoken) under the FIEA, a leasing company usually has a Type II Financial Instruments Business License, which enables the leasing company to solicit investors to purchase the TK investment. Please also see section 3.(3) below for more details.

3. Key Japanese Law Issues

(1) TK Investment

(a) Nature of TK Investment

In JOLCO transactions, the investors make contributions to the SPC by way of a Japanese anonymous or "silent" partnership (*tokumei kumiai*) investment under the Commercial Code of Japan ("**TK Investment**"). The TK Investment has the following nature:

- A TK investor executes a TK agreement with the SPC. A TK agreement is a two-party agreement between an operator and an investor. Thus, if there are multiple Investors, the SPC enters into a TK agreement with each Investor, resulting in a number of TK agreements executed by the SPC. A TK investor makes a capital contribution to the SPC pursuant to the TK agreement, and the SPC as a TK operator will carry out the TK business (i.e. purchase, charter and sale of a ship).
- A TK investor has no voting right or any right to be proactively involved in the management of the TK business. Simply said, a TK investor is a "passive" investor.
- A TK agreement does not establish any distinct legal entity. All rights and obligations of the TK business to third parties solely vest in the TK operator, and the TK investor never has any right, or incurs any obligation, directly to third parties. The TK investor is effectively behind the TK operator in relation to those third parties.

- In JOLCO transactions, since a TK investor never has a direct relationship with a third party, the TK investor does not usually appear in the operative documents vis-à-vis the TK business. As such, the TK business is conducted by the SPC as if the SPC were acting on its own behalf.
- The net profit and loss of the TK business are allocated to the TK investor for accounting and tax purposes (i.e., pass-through treatment). In other words, Japanese corporate tax is not imposed on the profit of the TK business at the level of the TK operator (the SPC).
- A TK investor is also entitled to a cash distribution from the net profit (if any) of the TK business from the TK operator but return of principal is not guaranteed. Since the distribution is made from net profit (after paying other claims, loan etc.), a TK Investment is different from loans or bonds, which constitute definitive rights for repayment of agreed-upon amounts. A TK Investment is more akin to equity (at least in an economic sense), although once the concrete claims for distribution accrue pursuant to a TK agreement, the TK investor has the same priority as other claimants just like claims for distribution with respect to stocks or trust beneficial interests.
- Although the accounting loss is allocated to a TK investor, the TK investor is not required to make additional contributions to the TK business unless otherwise agreed in the TK agreement.
- In general, a TK investor is like a limited partner and its risk is, at maximum, the amount of the principal which it contributed. Please note, however, that in JOLCO transactions, it is sometimes agreed that the TK investor must make additional contribution to the TK Operator up to a certain amount in the event of shortfall in the TK business.
- In JOLCO structures, a majority of the TK investors are ordinary business companies (not institutional investors), including family offices in Japan.

(b) Tax Benefit for TK Investors

The most unique features of JOLCO transactions are the tax benefits for TK investors. Just like other asset financing transactions, TK investors can enjoy (i) distribution of profits made out of charterhires payable by the charterer during the charter period, and (ii) proceeds from the sale of the ship at the end of the lease period.

In addition, the accounting loss from the depreciation of ship is allocated to the investors in JOLCO transactions. A ship can generally be depreciated faster than other assets and, during the first couple of years of the lease, the accounting loss from the depreciation is larger than the profit from charterhire payments. As a result, the investor can off-set that loss against profits from its ordinary business other than the ship leasing business and consequently defer its tax payment. Furthermore, as the economic life of a ship is longer than the depreciation period, the investors may be able to recoup additional value when they exit the investment (i.e. sale of the ship).

(2) Form of SPC

In JOLCO transactions, an SPC is used from commercial points of view to own and hold a ship (although the legal owner of the ship is the Registered Owners). If a leasing company relies on the exemption with respect to an underwriting business under the FIEA (for more details, see sub-section (3) below), the SPC must be a stock limited liability company, which is a *kabushiki kaisha* ("**KK**") (including a Japanese *Tokurei Yugen Kaisha* (special limited company) under the Companies Act), under the Companies Act of Japan.
In practice, KK is most commonly used in JOLCO transactions.

A KK has shareholders and directors. Usually, directors are dispatched from the leasing company. The directors operate the company's business and are generally responsible for executing any contract which the company is to become a party to. Internal authorisation is made by the directors' decision or shareholders' approval at a shareholders meeting, as the case may be.

(3) Financial Instruments and Exchange Act

A leasing company originates a transaction and solicits equity investors to invest in a ship leasing business in the form of a TK. TK Investments are included in the list of securities defined under Article 2, paragraph 2 of the FIEA ("**Type II Securities**"). A person who engages in the sale and purchase of Type II Securities is required to have a "Type II Financial Instruments Business" license under the FIEA.

Apart from the foregoing, a "Type I Financial Instruments Business" license under the FIEA is required to conduct an "underwriting" business even if the underwritten securities are Type II Securities. A Type I Financial Instruments Business license is subject to more stringent regulations than those applicable to the Type II Financial Instruments Business license. However, there is an exemption specifically tailored for equipment leasing transactions. If (i) a person who intends to underwrite TK Investments has a Type II Financial Instruments Business license, (ii) that person is a 100% parent company of the TK operator which is a KK, (iii) the TK operator conducts its equipment leasing business as the TK business, and (iv) certain other conditions are met, that person will not be required to obtain a Type I Financial Instruments Business license in order to underwrite the TK Investments.

4. Reform of Maritime Law in 2018

In Japan, the major source of maritime law is Part III of the Commercial Code (Maritime Commerce). This part has rarely had substantial reform since the Commercial Code was enacted in 1889. In 2018, in response to the changes in social and economic conditions following the enactment of the Commercial Code, Part III of the Commercial Code was revised alongside the Act on the International Carriage of Goods by Sea to modernise the rules of transportation and maritime commerce.

Although the reform is quite extensive, in terms of the ship financing, the reorganisation of the maritime liens is the most important.

Under the revised Commercial Code (Article 842), a creditor who has any of the following claims is entitled to maritime liens:

(i) a claim to compensation for loss or damage due to harm to an individual's life or person that has arisen in direct connection with the operation of the ship;
(ii) a claim for the salvage charges or a claim based on the contribution of a general average to be borne by the ship;
(iii) a claim that can be collected pursuant to the National Tax Collection or using procedures for collecting national taxes and that arises in connection with the ship's entry into a port or use of a port or in connection with other navigation of the ship; or a claim for pilotage charges or towage charges;
(iv) a claim for costs necessary for continuing a voyage; and
(v) a claim held by the master or other officer/crew arising from an employment contract.

Under the Japanese law, in addition to the maritime liens under the revised Commercial Code above, maritime liens are granted to the holders of a claim subject to limitation under the Act on Limitation of Shipowner Liability and the Act on Liability for Oil Pollution Damage.

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Mori Hamada & Matsumoto is a full service international law firm that provides exemplary service to clients and continuously aims to achieve the best results for its clients in every matter. The firm has its headquarters in Tokyo with offices in Osaka, Nagoya, Fukuoka, Takamatsu, Sapporo, Yokohama and ten overseas offices. Our team contributes significantly to the constant evolution and development of the Japanese legal system, and to the creation of a legal infrastructure that enables our local and international clients to excel.

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UK

Key developments & the latest trends in the UK - from a legal perspective

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BIO

Recognised as a recommended lawyer by Legal 500, Dora heads Stephenson Harwood's global maritime, trade and offshore practice group and specialises in advising major international financial institutions, owners and other players in relation to general finance, maritime finance, sale and purchases, restructuring, secondary trade and leasing matters.

Her specialism is maritime and offshore finance, including ECA-backed finance transactions, sale and purchase, leasing, joint ventures, shipbuilding contracts, ship registration matters, secondary trade transactions, restructuring and enforcement. Dora has experience in these fields and regularly advises on high profile international financing and restructuring matters.

More recently, Dora has become an industry expert and leader in relation to green/sustainability-linked finance and maritime decarbonisation. She has also contributed to the fourth edition of the leading ship finance industry handbook, Shipping Finance, and the eBook Maritime Decarbonisation.

Dora's direct, commercial, pro-active and pragmatic approach is highlighted and appreciated by clients.

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BIO

Ian is a partner and head of global maritime, trade and offshore finance practice group. He is an expert in the asset finance sector, specialising in ship, offshore and superyacht finance. Ian has broad experience of various financing transactions, from conventional debt, private equity and Islamic finance to leasing and restructuring. He provides quality advice in a commercial context with exceptional levels of service. Ian is recognised in The Legal 500 UK 2024 guide as a leading individual and in Chambers UK 2024 guide as a notable practitioner.

Ian acts for a mixture of financial institutions, ship-owners and operators, joint ventures, funds, private equity groups and shipbuilders in a broad variety of transaction types, which allows him to anticipate the issues that his counterparts will raise and enable him to offer commercial solutions.

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BIO

Julie specialises in ship financing. She has extensive experience of advising lenders and borrowers on a variety of transactions and in a variety of sectors. She produces and negotiates sophisticated documentation and structures to reflect the increasing corporatisation of ship financing and the innovative financing techniques now being used.

Julie's experience has been gained over a number of years through her involvement in various parts of the shipping cycle. She acts for lenders and borrowers on everything from complex cross-border financial transactions to simple ship sales and purchases in relation to all vessel types. Julie's particular focus is on the cruise sector.

She led the consulting editor team for, and is a contributor to, the fourth edition of Stephenson Harwood's leading ship finance industry handbook, Shipping Finance, and is also a co-author of the pre-delivery ship finance chapter of the Frankfurt School of Finance & Management's handbook, Grundlagen der Schiffsfinanzierung.

STEPHENSON HARWOOD

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This Chapter sets out the key developments and latest trends in the ship finance market from an English law perspective.

Green and sustainable finance

Decarbonising the global shipping fleet remains a key focus as shipping companies strive to comply with regulatory frameworks and initiatives developing at the UK level[1], the European level[2] and the international level[3]. In particular, to achieve the target of the International Maritime Organisation ("**IMO**") of reaching net zero by 2050, shipowners require finance to purchase cleaner newbuild vessels powered by alternative fuels (such as liquified natural gas, liquified biogas, hydrogen and ammonia) or to improve the carbon impact of their existing fleet with engine retrofits and the installation of new energy saving technologies.

> “Many financiers feel more pressure to justify their investment choices in a transparent manner based on sustainability and environmental risk.

Having signed up to the Poseidon Principles, joined the Getting to Zero Coalition or implemented internal goals for the carbon intensity of their shipping portfolio, many financiers feel more pressure to justify their investment choices in a transparent manner based on sustainability and environmental risk. Many borrowers are therefore now required to provide their fleet renewal plans and climate objectives at loan inception stage.

This has led to various developments in English law loan agreements[4].

Green loans

In 2018, the Loan Market Association ("**LMA**") published the Green Loan Principles[5] to define a green loan and create a framework for the green loan market. Green loans are designed to finance or refinance a new or existing "Green Project".

These loans are scarce in ship finance other than for some well-established shipowners. Green loans typically take the form of a green tranche in a new or existing loan facility to finance, for example, fitting a more fuel-efficient propeller, research and development costs for low-carbon or decarbonisation solutions or fitting a dual LNG engine. On rare occasions, the entire loan facility is used to purchase a "greener" vessel.

In an English law loan agreement, this translates into the need for a clear definition of the Green Project, a requirement to use the proceeds of the loan for the project, some annual reporting requirements and independent expert verification.

The key challenge for shipowners when seeking finance for retrofits relates to the strength of the security; existing vessels will normally already be encumbered by a first priority mortgage and financiers are reluctant to rely solely on security over equipment or chattels or on a second priority mortgage.

1. E.g. the Merchant Shipping (Prevention of Air Pollution on Ships) Regulations 2008 as amended in 2019; the Merchant Shipping (Monitoring, Reporting and Verification of Carbon Dioxide Emissions) and the Port State Control; Maritime 2050, UK Clean Maritime Plan, etc.
2. E.g. Directives on the reduction in the sulphur content of certain liquid fuels and on the monitoring, reporting and verification of carbon dioxide emissions from maritime transport; EU Emission Trading System, etc.
3. E.g. MARPOL convention, Ballast Water management convention, etc.
4. Further reading: Green shoots: the rise of the green finance revolution (shlegal.com) and Ship finance green finance bulletin (shlegal.com).
5. These were updated in 2021 and 2023.

Sustainability-linked loans ("SLLs")

In comparison, the volume of SLLs is growing, although the pace slowed down in 2023/2024. The purpose of SLLs is to motivate borrowers to become "greener" by introducing sustainability targets in the operation of their business. Financiers typically offer better interest margins if borrowers meet key performance indicators ("**KPI**").

In 2017, the LMA published the Sustainability Linked Loan Principles[6], which are voluntary guidelines to create a high-level recommended framework for loans to be recognised as "sustainable". The emphasis of a SLL is on the "ESG" performance ("E" for Environment, "S" for Social and "G" for Governance). In 2023, the LMA also published draft model provisions that can be inserted (and adapted) into English law LMA-based loan agreements. However, the choice of KPIs remains market-specific and any definitions and provisions in this respect require bespoke drafting.

In ship finance, the most commonly used KPI is the fleet's annual efficiency ratio ("**AER**") - i.e. the ratio of the fleet's carbon emissions per actual capacity-distance (e.g., deadweight/nautical miles sailed). The AER uses the parameters of fuel consumption, distance travelled, and design deadweight tonnage. Some loans will also refer to Social KPIs (e.g., the annual number of crew training hours, the number of female seafarers or the total number of annual recordable crew injuries).

Offshore wind finance

One sector that has been flourishing in the UK and Europe is the offshore wind market. Due to the high capital requirement of a wind power project, funding usually comes from several sources. Most often, this is based on a traditional pre-delivery loan provided by a syndicate of lenders with a maturity of up to 15 years after the completion of construction. Other sources of capital include loans from international financial institutions, private or public placement of bonds, leasing instruments, loans from suppliers and manufacturers[7], government support[8] and ECA backing.

Sector-specific considerations for financiers include the shipowner's experience in the sector, the quality of the management team, whether the project is speculative and whether the vessel's design and technology will meet the market requirements and be competitive. It is also important for financiers to review the building contract, refund guarantee(s) and charter(s) as early as possible to mitigate general and sector-specific risks.

EU ETS

From 1 January 2024, Directive 2003/87/EC, establishing a system for greenhouse gas emission allowance trading within the European Union ("**EU**") as amended by Directive (EU) 2023/959 ("**EU ETS**"), was extended to cover CO2 emissions from all vessels of 5,000+ gross tonnage ("**GT**") transporting cargo or passengers for commercial purposes which call at EU ports, regardless of the flag they fly and the country of incorporation of their owner[9]. From January 2025, vessels between 400 GT and 5,000 GT and offshore vessels over 5,000 GT which call at EU ports will also become subject to the scheme.

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One sector that has been flourishing in the UK and Europe is the offshore wind market.

6. These were updated in 2021 and 2023.
7. For an example of funding from UK shipyard Diverse Marine, see: [Diverse Marine Launch UK First Finance & Lease Programme].
8. For an example of UK government backing for offshore wind, see: [Offshore wind wins big in advance of the fourth CfD allocation round (shlegal.com)].
9. The UK has implemented its own emissions trading scheme through the Greenhouse Gas Emissions Trading Scheme Order 2020. This largely mirrors its EU counterpart but it does not cover international maritime transport (this is expected to be included sometime in 2026).

Shipowners and operators are now required to measure and report on the carbon emissions of their vessels which call at EU ports over each calendar year. The report must be externally verified and submitted to the relevant EU authority by 31 March of the following year. For each ton of CO2 (or CO2 equivalent) emitted, the shipping company is required to purchase and surrender one EU allowance by 30 September of that same year. Failure to do so will lead to (a) the shipping company being put on a public list of entities in breach of EU ETS, (b) penalties and (c) the risk that the affected vessels will be expelled from, or detained in, EU ports.

> Shipowners and operators are now required to measure and report on the carbon emissions of their vessels which call at EU ports over each calendar year.

This has led to additional provisions in relevant English law charterparties, management agreements, lease documents and sale and purchase documents covering which entity will be responsible for, and bear the costs of, purchasing such Allowances. BIMCO has published some template provisions that parties can use, however, many shipping companies prefer to use bespoke provisions to reflect their different structures and relationships. Financiers therefore require that (a) their borrowers comply with their EU ETS obligations so that they are not subject to penalties and (b) any vessel being financed which trades in the EU is not prevented from trading in the EU or liable to detention by a Member State as a result of non-compliance with the EU ETS. This is because any penalty or suspension in trade may affect the borrower's ability to service its loan. While the general compliance with laws and environmental laws provisions address the issue, when the vessel financed is expected to call at EU ports during the loan period, financiers may wish to add express provisions to ensure compliance with the EU ETS[10].

Vessel recycling

The International Convention for the Safe and Environmentally Sound Recycling of Ships, also known as the Hong Kong Convention, is set to enter into force on 26 June 2025. It will apply to (a) vessels of at least 500 GT entitled to fly the flag of a country signatory to the Convention or operating under its authority; and (b) vessel recycling facilities operating under the jurisdiction of a country signatory to the Convention. Qualifying vessels will need to maintain an Inventory of Hazardous Materials prepared, verified, and regularly updated in accordance with the IMO's guidelines. Therefore, increasingly, English law loan agreements contain covenants in respect of vessel recycling.

Sanctions against Russia

The UK regulatory framework for sanctions against Russia (contained in the Russia (Sanctions) (EU Exit) Regulations 2019, as amended from time to time by amendment regulations) broadly mirrors the EU sanctions packages from Council Regulation (EU) No. 833/2014 of 31 July 2014 (as amended from time to time).

The sanctions packages include some restrictions that affect shipping, such as (a) a requirement to include a no-export to Russia clause in some contracts when EU entities' vessels transport some restricted goods to third party countries[11], (b) a prohibition to supply crude oil or petroleum oil to Russia[12], (c) a prohibition on the sale of tankers that transport crude oil or petroleum oil to Russian nationals or entities and (d) a prohibition on processing any payment in any currency to/from designated Russian individuals and entities[13].

10. Further reading: Demystifying decarbonisation: putting a price on decarbonisation - emissions trading (shlegal.com) and Microsoft Word - 102142895_1 (esglegalhub.com).
11. This requirement has not yet been implemented in the UK sanctions regulations.
12. Further reading: UK sanctions: prohibition on the maritime transportation of crude and petroleum oil and products (shlegal.com).
13. Further reading: UK sanctions: Russian-owned customers? Beware extended payment terms (shlegal.com).

While these sanctions packages have affected ship finance transactions as borrowers, financiers, lessors/lessees and escrow agents perform tighter KYC checks on their counterparts and divest themselves of connections with Russia and Russian nationals and entities, they have not had a significant impact on English law documentation because existing sanctions provisions are wide enough to capture the latest restrictions. However, some entities request the inclusion of bespoke clauses for certain types of vessels, especially in leasing documentation.

UK Government Shipbuilding Credit Guarantee Scheme

In July 2023, the UK Department for Business and Trade ("**DBT**") launched its Shipbuilding Credit Guarantee Scheme. Under the scheme a partial government guarantee is issued in favour of the lender to cover the buyer/borrower's repayment obligations under a loan made to finance newbuildings, or to undertake refits or retrofits for, or repairs to, existing vessels, at UK shipyards. The partial guarantee will cover up to 80% of the risk to the lender[14].

The eligibility criteria disclosed to date are that the shipyard must be carrying on business in the UK and the lender as well as the underlying financials and contractual structure must be "*acceptable*".

Other details of the scheme presently remain unclear (e.g., when the guaranteed obligations can be triggered to enable the lender to recover its loan). Needless to say, this information will be critical in assessing the usefulness of the scheme. Further, there is no clear guidance on the cost of the scheme, as the DBT only states that the premium is determined "*on a case-by-case basis*".

While this scheme is unlikely to materially change a lender's credit committee's decision-making, it gives lenders an additional level of protection and may well encourage them to support projects that would not otherwise proceed[15].

Basel IV impact on lending

The deadline for all eurozone banks to implement Basel IV is 1 January 2025. In the UK, the rules will be introduced from 1 July 2025 and phased in over 4.5 years to ensure full implementation by 1 January 2030.

As a result, many European banks will need to revise their methodology to calculate their capital requirements and adapt their internal processes. This is likely to lead to higher margins for shipping loans (this could be somewhere between 20 and 40 bps) and the exit of more European banks from the shipping market (or at least a reduction in the size of their shipping loan portfolios).

Banks who choose to continue to lend to shipping companies are expected to apply increasingly stringent criteria in evaluating credit risk. This means that European banks are likely to shift away from lending to small to medium sized companies and focus on larger long-established shipping companies with better credit ratings.

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As a result, the recourse to alternative sources of ship finance is expected to increase. There may be an increasing number of syndicated English law loans offered exclusively by Asian banks (rather than a combination of European and Asian banks). The role of private equity is also set to become even more prominent and lead to increasingly complex financing structures that broaden credit exposure, with syndicates of UK and European banks providing senior debt finance to equity funds which, in turn, would provide financing to shipping companies. Finally, sales and leasebacks (from traditional structures to newer ones in shipping, such as JOLCOs) are expected to become more prevalent.

14. Compared against China and Korean government export credit support at 90-95%, this is a relatively low percentage.
15. Further reading: [UK government unveils its Shipbuilding Credit Guarantee Scheme (shlegal.com)](shlegal.com).

From a documentation perspective, negotiations around the exclusions to the increased costs provisions are likely to reopen between ship finance borrowers and their financiers[16].

Interest rates

Following the discontinuation of USD LIBOR[17], most financiers in ship finance have settled for their preferred replacement reference rate for dollars. The LMA also published various drafting options for English law loan agreements depending on whether the parties wish to use Term SOFR [18] or Daily Non-Cumulative Compounded SOFR[19]. Sophisticated financiers tend to offer both rates to their customers, sometimes with an option to switch (once or a number of times) from one to the other during the loan period. Smaller financiers favour the use of Term SOFR to minimise complex calculations for each interest period[20].

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While the LMA has published various drafting options for euro loans to incorporate a temporary switch or permanent switch to Term €STER or Compounded €STER [21]should EURIBOR cease to be available, most ship finance parties hesitate to incorporate such provisions in their English law loan agreements as to date there has been no formal announcement that EURIBOR will be discontinued.

Our Maritime, Trade and Offshore Finance team is here to help you navigate this period of transition in the ship finance market.

16. Further reading: What Basel IV means for maritime finance (shlegal.com).
17. Background reading on LIBOR discontinuation Transition from LIBOR to risk-free rates | Bank of England.
18. For information on Term SOFR, refer to Term SOFR - CME Group.
19. For information on Daily Non-Cumulative Compounded SOFR, refer to ARRC_SOFR_Synd_Loan_Conventions.pdf (newyorkfed.org).
20. Further reading: USD loans - Countdown to SOFR … but which one? (shlegal.com) and Current US dollar LIBOR transition options for ship finance lenders, agents and borrowers (shlegal.com).
21. For more information of €STER, refer to Euro short-term rate (€STR) (europa.eu).

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