Basel II and its economic implications on the financing of Greek Shipping

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Loan margins are an exceptionally important factor that influences the returns of the shipping investment. Anything that raises that cost, or even reduces the finance percentages, will have a negative fect on Greek Shipping, especially during a period when Greek Shipping is moving forward at a fast pace in reducing its age as well as improving its investment and banking profile.

In this issue, we will present the effects of the Basel II proposal on the cost and terms of shipfinance. We will also explore which categories shall be affected the most.

The Basel II proposals were put forward by the Bank of nternational Settlements in January 2001 followed up by a working paper in October 2001. Once implemented, they are expected to have a significant effect both on shipfinance as well as loan margins paid by all shipowners, especially the small ones, which represent 2/3 of Greek shipping in number terms.

The existing Basel I regulations began in 1988 via a p published by the Basel Committee and called International Convergence of Capital Measurement and Capital Standards. It established risk weighting for loan transactions, which would, in turn, determine how much bank capital

would be allocated to each such transaction.

The rules were clear, defined but quite simplistic whe it came to risk categorisation and loan collateral implications. Corporate shipping credits for example were treated the same irrespective of the e and quality of the corporate borrower. This resulted in some banks making riskier loans for higher income without any allowance for actual risk weighting differences. A number of more sophisticated shipping b ks did develop their own internal rules which meant, however, that for a number of shipping loan transactions they were placed out of the market by being less competitive, when compared to other less sophisticated nks. Indeed, the above factor may well be one of the reasons for the withdrawal of a number of well-known shipping banks from the shipfinance scene.

The Basel II proposals have come, therefore, to address some of the risk weighting problems faced by all types of lending inclu ing that of shipping. They introduce the notion of risk weighting based on credit rating. These credit ratings can broadly be divided in o two categories. Category A being a standardised approach based on cred ratings as carried out by the international credit rating agencie ch as Standard & Poors, Moodys,etc. Category B, being an internal bank generated credit rating approach or internal approach, which permits ba ks to develop and use their own credit rating system. Under the internal approach banks may either follow standardised supervisory risk factor weightings or an advanced credit rating system, which provides them wit more freedom in assessing credit risk.

Under all systems, however, there would be strict crit disclosure requirements and consistent methodology. Interestingly ough, ships still do not count as collateral in the Basel II proposals as far as the standardized approach is concerned and as such it is expected that most shipping banks will opt for the advanced system.

In the October 2001 working paper, ships used as specific collateral for loans are classified under the 'object finance' category. However, shipping loans may also be categorized as 'corporate' credits rather than object or specialised credits.

Indeed, the paper being relatively new has yet to receive its full share of commentary and criticism. The working paper actually invites industry comments leading onto a consultation paper before it shall be finalised by the end of 2002 (probably later) and shall be implemen ed in 2005.

Already there have been voices that more time shall be needed for the consultation period and as such it may well turn out t at the implementation may be delayed beyond 2005.

Despite the 3 years or more until its implementation, Basel II will exert enormous pressure on shipping banks to develop their o internal credit rating systems. Already this is being implemented by almost all European Union Banks, especially the German state owned one tha have been continuously criticised by commercial banks that they have been underpricing their loans based on a lower cost of funding being state owned / guaranteed institutions, something that represents unfair competition in favour of state banks.

Interestingly enough, although there remains considera ime until its mandatory implementation and bearing in mind the uncertainty that still surround the proposals, as well as various anomalies, a number of banks have already begun to at least part rely on their own credit rating system, when new credits are being assessed and priced.

A number of banks have begun to use Basel II as an excuse for increasing their loan margins even though its effects are years a .

In shipping, which is regarded as a particularly risk-heavy industry, the implementation of the Basel II in whatever final form will undoubtedly lead to higher margins for all shipping credits, somet ing that has already begun. Although only EU banks are directly affected by the proposals, it is expected that the pressure for higher margins will be eagerly followed by non-EU banks. Alternatively, non-EU banks may well maintain a competitive edge over their EU rivals.

It is also expected that large corporate Greek shippin entities shall fare better than small owners. The main reason is that larg entities (public or otherwise) will be able to receive a higher credit rating based on their corporate size and other characteristics, as opposed t mall owners. The loan margins, therefore, for these companies are expected to be reduced.

According to the latest Petrofin Research ©, out of the 749 Greek shipping companies in 2002, 488 or 65.15% represent companies with fleets of 1 - 4 vessels. It is for this reason that the margins to be paid by such owners which are already higher than those of larger owners, will increase even further. Also, with increased loan margins a reduction the finance percentages of these companies is expected, something at small owners should brace themselves for.

As the proposals are still in the process of being reviewed and amended, it is premature to quantify the effects on margins for Greek shipowners. Nevertheless, it is correct to say that, as most Greek mpanies are not 'corporate' credits and are smaller on average than th ir European counterparts, once again the impact of revised regulat s this time in the banking industry will add to the regulatory weight already felt by Greek shipowners from so many sources. In the meantime, Greek shipowners should resist the obvious temptation by banks to anticipate the effects of Basel II and start enjoying higher margins than those ired by the existing Basel I regulations, even though the new prop ls will not come into effect not for at least another 3 years.

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