



## Renaissance Risk

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Changing the odds in your favour

### Who's afraid of the big bad Banker?

Banking is no longer boring. As expounded at the recent Mare Forum, with the end of easy credit and the downturn in rates, Shipmanagers have to consider options to manage risk and protect their businesses and the assets that they manage on behalf of the Shipowners.

There's universal agreement that economic conditions in 2009 are going to be treacherous. Consumers will continue to tighten their belts. The volatility, which makes it so hard for businesses and investors to plan, is unlikely to dissipate. Shipmanagers will have nervous financiers to contend with, not to mention owners; Shipowners will have concerns that their assets are exposed.

There are options and, for some at least, help on the horizon; but before I explain further, let's take a look at why we are in this mess.

In January 2009, Chinese exports had dropped more than 17% compared with the same month the year before, the biggest decline in more than a decade, and imports to China declined by a dramatic 43%.

Many had been expecting a much steeper contraction in China's exports given the recent trade figures from other large Asian exporters. This is no downturn like any we've seen in living memory, for two reasons: it's global; and its primary cause is the bursting of a massive debt bubble.

Banks have been forced into reducing their dependence on diminishing sources of wholesale funds, which is why they've been lending less.

### Smoke and mirrors

When loans were used to buy assets, these loans pushed up the value of assets. This rise in the value of assets sparked yet more lending, which in turn pushed up asset prices further.

At the beginning of 2007, whether you were borrowing a billion dollars to buy a company or a few million to buy a ship, lenders were prepared to lend 100% of the purchase price with no questions asked.

Now, falling asset prices are leading to losses for those who borrowed to buy those assets. As they struggle to pay debts, they sell other assets, driving down the price of those assets and causing losses for other borrowers. And when they can't repay banks, the resources of banks are depleted, which means there's less credit available – and no 100% ship mortgages or other loans – which drives down asset prices further, which leads to a further contraction of lending, and so on in a vicious cycle of decline.

So don't expect financial institutions to cease contracting the amount of credit they'll provide unless and until the price of assets stops falling.

The survival of the global banking system now depends on the goodwill of taxpayers around the world. From Australia, to South Korea, to Germany, France, the UK and the US taxpayers' financial support for the banking system is equivalent to more than one quarter of global GDP. As they say: \$10 billion here, \$10 billion there, and very soon you are talking real money.

Even big name shipping banks are now asking good owners with good projects to wait a long time for funds. If the unfettered movement of capital, goods and services is going to survive, if there's not going to be a reverse-globalisation that could impoverish the future of shipping over the longer term, there will have to be a new model.

### **It's uncertainty, not tight credit**

Certain bankers have indicated that fear has seized the market, chilling Shipowners and Shipmanagers who might otherwise want to take on new debt. "They're unsure of the future," one said. "And the way the current crisis has been talked up has led them to pull back, and to not want to move forward with plans of expansion."

Other bankers have seen increased lending in the final quarter of 2008, with one stating "I believe the banking industry is prepared to provide liquidity to the markets ready and willing but there's a crisis of confidence that is holding people back from moving forward."

What is universal, and is key, is that the financial institutions want to ensure that they do not replace the subprime risks that have been offloaded to governments and taxpayers with other toxic risks. Capital is still flowing and loans can be provided although "the bar has been set a lot higher".

So what should Shipmanagers and Shipowners with ambition do now to make sure they are first in the queue for any money banks still have to lend?

### **Light at the start of the tunnel**

A year ago I spoke about risk management being an essential component of the strategic planning of any company who wanted to better the storm. With lenders looking to manage asset risk, one positive step forward is to consider Residual Value Insurance (RVI), an excellent mechanism to manage and control the residual value risk of assets.

A growing class of insurance due to added underwriting capacity and increased demand, RVI provides the asset owner and their financiers with asset value certainty at a pre-determined time in the future, and is therefore an invaluable means of balancing exposures in volatile markets and removing asset risk from the balance sheet.

In the current financial environment, RVI is also valuable to help secure finance or enhance financial arrangements. By being included in financing deals RVI can provide leverage to help improve overall finance terms.

Any transaction where the payment stream does not amortise the full principal amount can benefit from RVI. For example, a shipyard may guarantee the future value of an asset to differentiate against the competition. The guarantee may result in the transaction being

accounted for as a lease. However, with residual value insurance, the manufacturer can still recognise the transaction as a sale for accounting purposes.

RVI may also be used to increase the final (“balloon”) payment to be made at the end of a finance period, thus reducing cost, increasing cash flow, and supporting higher debt to equity ratios.

Recognising the increased demand, and the need for an intermediary who can add value to the transaction through a deep understanding of the market, Jardine Lloyd Thompson (JLT) have created a centre of excellence to focus on this class of business. Based in London, and with assistance from Renaissance Risk, the team will work closely with JLT’s Marine Division to help ease the issue of financing to the maritime industry in general, and shipping in particular.

Shipping is a strong industry which thrives on volatility. But one can have too much of anything, and there is now a huge concern about the future. Shipowners need not be afraid of the future if the risks are understood and managed, and RVI is a key tool to help in the management process.

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