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Moore Stephens Global Shipping Newsletter June 2019 Edition

Editorial

Welcome to the June 2019 edition of the Moore Stephens Shipping and Maritime Newsletter. For over 75 years, Moore Stephens has been synonymous with the shipping industry. Our strongholds in key locations such as Hong Kong, Singapore, London, Piraeus, Monaco and Australasia enable us to use shared global knowledge and expertise to better serve our clients.

In this edition, we take a look back at a successful Singapore Shipping Forum and the key points that were addressed as part of our co-sponsored event through Moore Stephens Singapore LLP. There are key issues around Green Finance, Cyber Security and IM2020 compliance but we also have technical updates from Panos Drakoulakos (the impact on Shipping of the discontinuation of Libor as a reference rate) and Wong Koon Min (regarding new accounting rules centred on leases). Also, there is a profile of Costas Constantinou, the Global Leader for Moore Stephens Shipping, and an example of collaboration in action.

If you have any feedback regarding the content, or wish to make future contributions please get in touch with Costas(costas.constantinou@moorestephens.gr) or MSIL Director of Global Growth and Collaboration, John Stanford (john.stanford@moorestephens.com).

Inside


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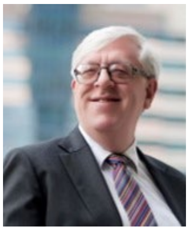

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The Shipping industry is amidst an unprecedented wave of changes presenting management with challenges in many key areas including, environmental, IT, financing, sanctions and crew. To these traditional issues we can also add, 'green' shipping, autonomous vessels, block chain /crypto currencies, generational change and the current geopolitical uncertainty.

To adapt to this constantly changing environment, management requires practical and industry specific advice to determine priorities and implement a strategy to successfully navigate the changes.

Moore Stephens has been associated with the shipping industry for over 75 years and has helped generations of shipowners through similar challenging times. The Moore Stephens Shipping Sector is comprised of similar minded member firms who collaborate closely to provide practical advice and services to help clients thrive in a changing environment.

Global Shipping Leader, Costas Constantinou, discusses how he found himself at Moore Stephens and how the network forged his love for Shipping.

My relationship with Moore Stephens was perhaps a foregone conclusion given the family connection. My father, Damianos, was the first one to establish an international firm of public accountants in Greece and given that Moore Stephens was always the leading firm in Greek shipping, this sector became my natural environment.

I grew up hearing inspiring stories about clients, their successes and how our firm helped them solve their problems, so I wanted to get involved as well. I am passionate about the industry and now, in my new role as Global Leader, I am excited that I have the opportunity to take Moore Stephens Shipping to the next stage of its development.

I believe the shipping industry will need to adapt to the fact that it is a part of a large supply chain and all parts of that chain are impacted when one of the links are subject to change. Sustainability, decarbonization, digitalization are some of the issues that affect this chain that includes mines, manufacturers, cargo owners, ports, wholesalers, retailers and, ultimately, the consumer. Therefore, it is inconceivable that transportation will remain unaffected.

Given that Shipping is a counterparty to other key services and industries, such as banks, insurance companies, shipyards, fuel suppliers and others, change is also driven by regulatory pressures on all parties and is not just a matter for Shipping alone.

Shipping Collaboration Success

Moore Stephens Greece and Monaco recently collaborated on a proposal for a listed Norwegian shipping company, based in Athens, to provide assurance on its system of internal controls. This was a competitive tender against two major firms within an extremely tight deadline.

When awarding the assignment the Company said that Moore Stephens was selected as they were confident the team would bring significant added value to the engagement due to their extensive knowledge of the industry.

Costas Constantinou, the Managing Partner of Moore Stephens Greece and Global Shipping Leader commented, “this is an excellent example of how success can be achieved through the close collaboration of offices in the key shipping locations. It was clear from the tender that the combination of our credentials and strong local presence were a perfect fit for the client’s requirements, the close personal contact allowed us to meet the strict deadline. This is an example of how collaboration can drive International success in shipping and other key sectors”.

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Global Shipping leaders debate key sector topics

Chris Johnson
Moore Stephens Singapore

Mr. Mick Aw, Senior Partner of Moore Stephens LLP, observed that part of the uncertainty in dealing with environment regulations is how potential solutions to existing regulation interact with future environment regulations.

LNG is not only one of the greenest solutions currently available to IMO2020 and beyond, it is also competitive and ready, according to speakers at the Moore Stephens – BNP Singapore Shipping Forum 2019.

According to Mr. Thomas Hansen, Commercial Director of Eastern Pacific Shipping (EPS), which recently acquired a series of 15,000 TEU LNG Dual-Fuel containerships, LNG as a marine fuel is the cleanest in the market, with statistics demonstrating that, when compared to first-generation 13,000 TEU vessels, LNG vessels can achieve reductions of more than 50% in carbon emissions, 95% of sulphur emissions, 80% of nitrogen emissions, and 100% of particulate emissions.

Mr. Nicolas Parrot, Head of Transportation Sector at BNP Paribas Singapore noted that LNG-fuelled ships and LNG bunkering vessels are capital assets that qualify for Green Shipping Bonds and Green Shipping Loans. However, BNP Paribas cautioned that methane slippages from LNG vessels should be considered in overall sustainability assessments.

LNG shipping is competitive in fuel consumption. Seminar statistics comparing LNG-fuelled ships with older-generation containerships indicated that LNG vessels consistently outperform, with fuel savings reaching in excess of 40% in some cases.

Green shipping in general including LNG-fuelled vessels, will be increasingly attractive

Mr Chris Johnson, Partner and Head of Shipping, Moore Stephens LLP Singapore providing an introduction to the panel discussion

as more companies, including the Fortune 500, publicly commit to reducing emissions, in some cases with specific goals to reduce logistics-related carbon footprints. Examples highlighted during the seminar include Nike and Adidas, who aim to reduce their logistics-related carbon footprint by 10% and 4% respectively, and Amazon, which signed the Sustainable Fuel Buyers' Principles committing to low-carbon commercial transportation solutions. Further competitive advantages include the freight premium that may come with green shipping in general, as well as port discounts and rebates for the same which are increasingly available.

Although LNG infrastructure is a frequently-cited concern, Mr. Hansen opined otherwise, noting the ready availability of LNG suppliers who are equipped with bunkering vessels for this purpose, as well as LNG bunkering infrastructure and capabilities in diverse areas including US West Coast, Caribbean, the Baltic, North Continent, Mediterranean, China, Korea, Japan, and others. As LNG becomes more widely-adopted, LNG infrastructure will become even more available. The anticipation for greater LNG demand is corroborated with statistics displayed by Mr. John D'Ancona, Senior Analyst at Clarksons Platou Asia, which showed the orderbook for LNG carriers to be 25% of the existing fleet as at April 2019, the highest of all asset classes.

Mr. Mick Aw, Senior Partner of Moore Stephens LLP, observed that part of the uncertainty in dealing with environment regulations is how potential solutions to existing regulation interact with future environment regulations. On that basis, Mr. Hansen noted that LNG is most future-proof as LNG's significant reductions in not just sulphur and carbon emissions, but also nitrogen and particulate emissions, positions it well among existing technology to deal with potential future environment regulations. Mr. Guy Platten, Secretary-General of the International Chamber of Commerce, agreed that the industry can expect more sustainability regulatory pressure going forward, with IMO 2020 being regarded as a regulatory game changer for the industry.

The Moore Stephens-BNP Paribas Singapore Shipping Forum 2019, held at The Westin on 11 April 2019, is an event hosted annually by Moore Stephens, together with co-sponsor BNP Paribas, in conjunction with the Singapore Maritime Week 2019, an event supported by both the Singapore Shipping Association (SSA) and the Maritime and Port Authority of Singapore. The session was well-attended by more than 200 delegates.

Libor discontinuation and its impact on shipping

Panos Drakoulakos
Moore Stephens Monaco

After the 2012 Libor scandal in which major international lending banks were fined by the relevant authorities and besides the measures adopted to reform the Libor market, Andrew Bailey, Chief Executive of the UK Financial Conduct Authority (FCA), has signalled with his speech on 12 July 2018 the discontinuation of Libor as a reference rate after 2021. The main argument for the discontinuation is the lack of actual transactions in the unsecured wholesale borrowing and related markets. Panel banks have been using "expert judgement" , their own estimates of what it could cost them to borrow funds.

Libor is widely used as a benchmark rate in the shipping finance industry. The discontinuation will affect ship financing loan agreements, floating rate notes ("FRNs"), leasing arrangements and derivatives among others.

With the encouragement of the Loan Market Association, banks over the last few years have introduced clauses, better known as fallbacks, to account for the case that a reference rate is unavailable due to market disruptions or other events, in any type of financial agreement.

Management and finance people should closely monitor and evaluate all their contracts where Libor is used as a reference rate and loan agreements are due to mature after 2021. They should identify the fallbacks that are included in the agreements, analyse alternative reference rate options discussed in order to replace the Libor and the relevant lender consent levels. A similar process should be performed for any derivative contracts where the US$ Libor is also used as the benchmark rate. Discussions should be held well in advance of December 2021 to allow your company and your counterparties an adequate period of time to negotiate an appropriate alternative rate. An important element in this discussion is to agree who will bear the costs of any amendment due to the change of the reference rate. Once you have agreed the alternative rate you should consider the potential implications of IFRS 9 paragraph 3.3 – Derecognition of financial liabilities. The situation perplexes a bit more for the derivative contracts such as interest rate swaps and options. For this reason, the International Swaps and Derivatives Association (ISDA) has issued detailed guidelines which, if the disruption is activated, provides a series of fallbacks which may differ from what is specified in the relevant loan agreement. The mismatch may affect the hedge effectiveness and hedge ratio, which should be re-assessed after the modification of the loan arrangement. The imperfect correlation between the modified loan and the derivative may lead to excess gains and losses and completely derail the original hedging strategy. The International Accounting Standards Board ("IASB") has recognised the significant impact the discontinuation of Libor will have on existing and future hedge accounting treatment of Libor related hedges. As a result IASB has proposed a number of changes in the accounting standards to mitigate its impact and allow companies to continue accounting for LIBOR-related hedges disregarding the discontinuation. Stakeholders should provide their comments by the 17th June 2019. The alternatives specified in the contract are only a temporary solution and, in most cases, could not be used over the long run. Some of the alternatives mentioned are interpolated rates, historical rates, reference rates and cost of funds. The cost of funds is a last resort rate and banks and their agents may not be willing to reveal this sensitive information to their customers for an extended period of time. Various alternatives are being developed by working groups in the major Libor currencies (US Dollar, Euro, Sterling, Swiss Franc and Japanese Yen).

> "Libor is widely used as a benchmark rate in the shipping finance industry. The discontinuation will affect ship financing loan agreements, floating rate notes (FRNs), leasing arrangements and derivatives among others

Currency	Proposed Risk-Free Rate	Secured/ Unsecured	Working Group
US Dollar ($)	SOFR (Secured Overnight Funding Rate)	Secured	Alternative Reference Rates Committee
Euro (€)	ESTER (Euro Short-Term Rate)	Unsecured	European Central Bank
Sterling (£)	SONIA (Sterling Overnight Index Average)	Unsecured	Bank of England
Swiss Franc (CHF)	SARON (Swiss Average Rate Overnight)	Secured	Swiss National Working Group
Japanese Yen (¥)	TONA (Tokyo Overnight Average Rate)	Unsecured	Study Group on Risk- Free Rates

The above rates are overnight rates and are risk free. The main differences with the Libor are:

1) The above rates are backward looking whereas Libor is forward looking and there are quotes for different tenors.
2) Libor is not risk-free and contains an element of credit risk.
3) Libor also contains a liquidity premium on longer term tenors.

The differences between US$ Libor and the risk free rates (RFRs) pose a significant challenge for the banking industry, in general, as it raises a number of issues. More specifically, given that the RFRs are lower compared to LIBORs, the transition to RFRs potentially creates a pricing gap, which should be taken into consideration when negotiating your new reference rate. US$ Libor is set today but is applicable in the future. This allows the borrower to know their funding costs in advance and manage their cash flow accordingly. This may not be possible with a new backward looking reference rate. So far, slow steps have been made to move away from the use of Libor as a reference rate and, since July 2018, Fannie Mae, the World Bank and Credit Suisse have issued debt tied to SOFR. Similarly, Lloyds Banking Group has issued debt linked to SONIA. There is a long way before the new reference rate is established but the consensus among financial analysts is that sooner or later the use of US$ Libor will eventually fade away.

How can we help?

Moore Stephens is one of the world’s leading shipping consultancy networks due to our specialist knowledge and wide-ranging advice and assistance. The analysis above does not cover all the implications of a debt restructuring. We are available to provide guidance on debt restructurings and how this will affect your business.

For more information or to discuss how we could help you with transitioning from US$ Libor to a new reference rate, please contact us.


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New Accounting Paradigm for leases

Wong Koon Min
Moore Stephens Singapore

From 2019, companies across the globe will be applying new accounting rules that will capitalise most leases, thereby expanding both assets and liabilities on the balance sheet. The new rules will significantly impact the growing volume of leases globally, exceeding US$1 trillion according to the Global Leasing Report 2018 (White Clarke Group, 2018).

The new accounting paradigm, captured in International Financial Reporting Standards (IFRS) as IFRS 16, is conceptually straightforward and promises to streamline the accounting for most leases. Currently, some leases are capitalised while others are not. However, the challenge posed by the new rules, is in dealing with the potentially onerous economic impact. According to a study in 2018 on 646 European quoted companies, the highest increase in liabilities resulting from the new accounting rules, of between 50-60%, will be registered in the transportation, hotel, and consumer retail industries, as compared to average asset increases of only 25-30% (Morales-Diaz, 2018).

Economic impact on businesses

Leverage ratios can deteriorate, which may cause companies to trip over bank covenants that hinge on such ratios in borderline (and, perhaps, not-so-borderline) cases. This will in turn require creditors' approval to adjust or relax covenants, possibly at an additional cost from penalties or higher rates.

The detriment to gearing arises due to various technicalities, as follows:

• Arithmetically, equal inflation of assets and liabilities adversely affects healthy gearing ratios.

• Lease assets depreciated on a straight-line basis will decline faster than the corresponding liabilities under the new rules, resulting in further detriment to both gearing and profit.

• New rules on determining “lease term” may result in more years of lease payments being capitalised than under current rules, amplifying the effect of asset and liability inflation.

Lessee companies may also experience declining profitability, as the new rules front-load the expense in the earlier years of the lease, as compared to the previous operating lease accounting model. Industries that rely heavily on leases, such as retail, transportation, and telecommunications, are most likely to experience these issues.

Business considerations

“Lease-versus-buy” decision

Depending on the extent of these effects, it may be worthwhile for companies to re-examine business models. One corporate decision that may be affected is the “lease-versus-buy” decision. Companies may choose to purchase assets outright with debt, instead of leasing, if it is less costly to do so and the financial impact is similar.

Service/ capacity contracts

Companies may also wish to consider falling back on service/ capacity contracts where their business model allows. In general, the new rules do not apply to services and capacity contracts. For example, a long-term car rental should be capitalized but a contract for daily transport services need not. Similarly, optic fibre cable leases should be capitalised but fibre optic capacity contracts need not. Companies adopting this approach must consider the rules carefully to ensure that the service/ capacity contracts are indeed exempted from capitalisation.

This may require technical help to delve into the more esoteric aspects and judgments such as:

a) Whether the subject of the contract is “physically distinct”?

b) Whether the capacity rights that are the subject of the contract comprise substantially all of the capacity of an underlying, physically distinct, asset?

c) Whether the supplier has “substantive” rights to substitute for alternative assets?

d) Whether lessee or lessor has greater decision powers on how the assets are used? This can be a potentially difficult question when different parties have different decision powers, or when key decisions are hardcoded into contracts upfront.

Secondary lease periods

Another area to consider pertains to options for secondary lease periods, and actions that incentivize take-up of such options. For example, a favourable rental rate over the secondary period suggests that the lessee will be incentivised to extend the lease, and the secondary lease payments are therefore capitalised. Similarly, heavy upfront investment by the lessee into the leased asset, as in the case of upfront renovation costs on a leased retail flagship store, suggests that the lessee will want to maximise the renovation benefits by extending the lease period. In assessing secondary lease periods, a consideration of all facts and circumstances is required, but management intention, on its own, does not suffice. These rules have broadened as compared to corresponding previous requirements, and is another area associated with technical caveats, which may require technical expertise.

Optional reporting exemptions

Businesses may benefit from optional reporting exemptions that alleviate the financial impact. Leases shorter than 12 months need not be capitalised. Neither do leases of low value items. Exemptions are also available upon transition to the new rules.

One possibly useful exemption allows leases (including multi-year contracts) to remain off-balance sheet if they end within 12 months of the adoption date (i.e. before 31 December 2019 for a December year-end entity).

While these exemptions can simplify the process of transiting to the new rules, thereby reducing accompanying costs, their election should be accompanied by a holistic consideration of all financial consequences. To illustrate, consider an exemption that allows companies to assume that lease assets are equal to lease liabilities (with minor adjustments) upon transition, thereby avoiding a full historical re-computation.

While this exemption reduces implementation effort, it also creates a larger lease asset as compared to a full historical re-computation, with higher consequent future depreciation charges and lower future profitability.

Companies may wish to consider professional advice to ensure a holistic implementation that considers multiple perspectives and consequences.

In conclusion, the new leasing rules, while conceptually simple, bears potentially significant economic consequences. Early and thorough analysis and preparation is needed to help companies prepare, minimize surprises, and communicate early with stakeholders. This summary does not cover all the requirements and professional guidance should be considered on the changes that will affect your business.

Key Events

Key events for the next quarter.

Date	Event	Location
10/09/2019	12th Annual Capital Link Shipping & Marine Services Forum	London
24/09/2019	Marine Money Week Asia	Singapore
24/09/2019	Marine Money Week Monaco	Monaco
27/09/2019	3rd Annual Capital Link Invest in Cyprus Forum	New York
02/10/2019	9th Annual Capital Link Operational Excellence in Shipping Forum	Athens
15/10/2019	Marine Money Week Athens	Athens
15/10/2019	11th Annual Capital Link New York Maritime Forum	New York

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