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ABBREVIATIONS

**Advanced Countries**  
Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia

**CIF**  
Cost, Insurance and Freight, indicating that the seller's price includes charges for the cargo, insurance and the freight and that the seller arranges the transport of the cargo

**Cross Trade**  
Trading between countries other than of the vessel's own registered port or country of origin.

**Dwt**  
Deadweight Tons - the weight of cargo, water, bunkers and constant weights (a fixed allowance for stores, spare parts and the crew's effects) that may be carried when a vessel is down to its load-line mark

**Early/Intermediate Countries**  
Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan

**FDI**  
Foreign Direct Investment

**FOB**  
Free on Board, indicating that the buyer is responsible for the freight charges and insurance, and that the buyer designates the carrier of the cargo

**GDP**  
Gross Domestic Product

**GMDSS**  
Global Maritime Distress & Ship Safety

**Gt**  
Gross Tons

**MARPOL**  
International Convention for the Prevention of Pollution from Ships

**Mgt**  
Million Gross Tons

**Sector**  
Shipping & Shipbuilding

**SOLAS**  
International Convention for the Safety of Life at Sea

**ULCC**  
Ultra Large Crude Carrier

**UNCTAD**  
UN Conference on Trade and Development

**VLCC**  
Very Large Crude Carrier
1. PRESIDENT'S RECOMMENDATION

This recommendation and the attached Report are submitted for consideration and approval by the Board of Directors.

This document is the Bank's first Shipping Operations Policy which formally sets out the Bank’s strategy in this sector, although there was a Shipping Guidelines document approved by the Board in December 1994 (BDS 94-161).

Since the early 1990s, the Bank has been active in financing the Shipping Sector and has been catalytic in introducing western financial institutions to shipping companies in the region. The Bank’s role continues to be relevant because many banks are still unable or reluctant to consider investing or providing long-term finance directly to companies operating in the region without the comfort and involvement of the Bank. This is demonstrated by the fact that out of a cumulative commitment to-date of Euro 664 million, assisting a total investment cost of Euro 1.19 billion, the Bank has mobilised more than 50% of its total financing, involving 22 commercial banks, in its co-financing efforts.

The Bank’s involvement has so far concentrated on debt financing for the acquisition and construction of various types of cargo vessels. The Bank will continue to finance deep-sea shipowners, including its existing clients, in their on-going efforts to modernise their fleets. However, the Bank will also seek to diversify its portfolio to finance the renewal of other types of vessels including passenger and river ships. The majority of the shipping fleet (including river vessels) in the region are in imminent need of replacement and this renewal process is critical for the sector if it is to maintain or improve its competitiveness, and eliminate sub-standard vessels in order to improve crew safety and address environmental concerns. All Bank financed shipping projects should comply with IMO standards for safety and protection of the environment and ships should be operated in open and commercial markets.

Although the Bank has reviewed several proposals from a number of shipyards, it has not completed any operations in this sub-sector to-date. The Bank is intensifying its efforts to develop appropriate structures for projects in the shipbuilding industry.

Besides acting as a catalyst in channelling long-term financing to the region, the Bank’s involvement will provide the opportunity to achieve its transition goals. For the Bank’s future operations in the Sector, the following transition objectives have been identified:

- Promotion of competitiveness through fleet renewal
- Promotion of privatisation and restructuring
- Transfer of technical know-how and management skills
- Promotion of good corporate governance and best business practice
- Promotion of safety and environmental consciousness
- Development of appropriate regulatory and legal framework
- Facilitation of regional trade
These objectives will be appropriately adapted depending on the transition stage of the relevant country. Russia, where most of the Bank’s existing shipping projects have been located, will continue to be an important country for the Bank's operations. However, in order to expand and diversify the country profile in this Sector a new focus is being developed in other countries of operation, notably in the Baltics, Caucasus and Caspian regions.

The Bank will face a considerable challenge in the river shipping sub-sector in which companies operate along many of the large inland waterways located in the region. This is because domestic legislation governing mortgagees’ rights in this sub-sector has still to be fully developed.

In shipbuilding, the Bank will continue to explore and structure projects that are not only sustainable, but also encourage the much needed and invariably difficult restructuring process. In shipbuilding, including conversion and repair, the Bank will not finance projects which receive state subsidies in excess of levels permitted under any applicable (EU, WTO and OECD) guidelines. In this sub-sector the Bank will seek to identify shipyards which have either benefited from strategic investors, have proven strong management or where the relevant national government has a clear commitment to the restructuring and privatisation of their shipbuilding activity.

The Bank is aware that this sub-sector is of significant social importance in many of its countries of operation and provides employment to a large workforce. Accordingly, any significant job loss and its concomitant social impact will have to be carefully considered and mitigation steps agreed with the relevant authorities.

The Bank recognises the challenges ahead, both in the Early and Intermediate Countries and the Advanced Countries and will be flexible in adapting its stated transition objectives. The Bank will build on its experiences, including lessons learned so far, in this highly complex sector and treat its transition goals as the platform from which the Bank's contribution to the transition of the Shipping and Shipbuilding Sectors can be further enhanced.

I submit the Shipping Operations Policy for the approval of the Board of Directors.

Jean Lemierre
President
2. SHIPPING IN THE COUNTRIES OF OPERATION

2.1 SECTOR DEFINITION

• The Bank's standard industrial classification for the shipping sector covers all business activities directly related to water transportation services. The sector definition therefore encompasses (1) short and deep-sea transportation of cargoes and passengers, and (2) ship-building and related services.

• Historically, the Bank’s involvement in the Sector has concentrated on the financing of newbuildings i.e. construction of new vessels. However, it is anticipated that the portfolio will diversify in the medium term, to include financing of shipyards and other types of ships, such as passenger and river vessels. Opportunities for these types of projects are only now being cautiously explored due to the lack of established strategic sponsors, and more importantly, the legal uncertainty regarding perfection and enforcement of security under certain domestic legal frameworks.

• The Bank’s strategy is to carefully select projects which will produce strong transition impact and additionality, and to provide financing structures that will minimise credit risk in line with the Bank’s sound banking principles.

• Given the complexity of the shipping industry, the attached Annex A - Overview of the Shipping Industry and Annex B - Overview of the Shipbuilding Industry provide a summary of its operational environment and market segments.

2.2 RECENT MARKET DEVELOPMENTS

2.2.1 Shipping

• Since the early 1990's, there have been significant developments within the industry in general and in the Bank's countries of operation in particular. In order to meet the global expansion of international trade and to keep unit cost of shipping transportation competitive, ships are getting larger and technically more sophisticated. The industry is also becoming highly regulated due to increasing awareness of safety and environmental issues.

• In the Bank’s countries of operation, the Sector has undergone significant structural changes that will continue to affect the future development of the maritime industry in the region. The following are the most notable developments:
  - Liberalisation of seaborne trade, in particular the export trade;
  - Increased competition from foreign ship owners and operators;
  - Financing of fleet renewal programmes funded by private sector sources;
  - Privatisation of the state owned entities; and
  - Establishment of maritime codes through legal and institutional reforms.

• These developments are inter-linked and can have repercussions on one another. The liberalisation of seaborne trade, for example, means that export cargoes, such as
minerals, crude and oil products, are now being sold on FOB instead of CIF basis and are no longer controlled by domestic carriers. This has led to increased competition from foreign shipowners and loss of market shares by the domestic companies.

- The region’s share in the world fleet has fallen from 7.20% in 1981 to 3.10% by 1999 as illustrated in the chart 2.2.1(a) below.¹

- In river-sea transportation, Russia has one of the most extensive river waterways system in the region and its ships are capable of navigating in sea, inshore lake and ice conditions. However, this sector has also suffered significant decline and lack of investments. The current traffic accounts for less than a third of the volume transported in 1992. The decline is largely due to the loss of construction related cargoes, such as sand and gravel and partly due to poor port infrastructure. As a result, the fleet is in decline with significantly over aged vessels.

### 2.2.2 Shipbuilding

- The shipbuilding industry, like the shipping market itself, is also cyclical in nature and prone to imbalances in supply and demand (see *Annex B - Overview of the Shipbuilding Industry*). However, in tandem with the expansion of world trade, the annual newbuilding activity has been increasing each year since 1988 (except for a short contraction period in early 1990s and 1997/98), reaching an almost two-fold increase of more than 45mgt. by 2000, as illustrated in the chart 2.2.2(a) below.

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¹ For Hungary and Poland, the statistics are provided up to 1995 only.
• The majority of the shipyards in the Early and Intermediate Countries have not been able to benefit from the growth in this sector due mainly to weak governmental commitment to restructure and/or privatise the industry. Many of these yards have obsolete production methods, insufficient working capital, and are plagued by excessive debt burden. However, certain privatised yards in Poland and Romania have made a successful transition through restructuring and forming strategic alliances with foreign investors. Chart 2.2.2(b) below depicts the region's declining share of the world market compared to other countries.

• Most Shipyards have a dual activity base in both shipbuilding and repair. During a depression in the sector, there is often a shift from ship-construction to ship-repair as repair contracts have shorter time-scale, are easier to secure and do not require substantial working capital. Certain yards have managed to make the transition step by concentrating on conversion and repair works, and construction of hulls, thereby giving rise to a sub-sector of "hull building" and steel fabrication on behalf of foreign yards. These half-fitted hulls are then transported to the customers' yard for completion.
• On the whole, the level of transition in Eastern European shipyards continues to be staggered, reflecting the different strategies adopted by the shipyards themselves and the respective governments.

• The direction and extent of these developments in both the shipping and shipbuilding sectors, when carefully managed by the respective governmental agencies can contribute to the transition towards open market economies. In this respect, the Bank will continue to have an important role to play in facilitating this process by promoting the Banks' Operational Objectives as outlined under Section 3.3.

2.3 SECTOR MANAGEMENT WITHIN THE BANK

The Bank has been actively engaged in providing finance to the shipping industry in its countries of operation since its establishment; and its first operation was signed in 1994 with the Nakhodka based Primorsk Shipping Company. Prior to 1998, the Bank’s shipping projects were managed by various country teams and not along sector line. However, in recognition of the specialist nature of shipping finance, the Bank set up a new unit for Shipping Finance in late 1998; it became fully operational in September 1999 when all shipping projects were transferred to the unit.

2.4 EBRD'S INVOLVEMENT IN THE MARKET TO DATE

• To date, the Bank has provided Euro 664 million in mainly long-term debt financing (with a related aggregate project value in excess of Euro 1 billion) to shipping companies. See Annex C: Overview of Signed Projects for a full list of shipping sector transactions.

• The Bank has been able to develop this portfolio and secure the participation of commercial financial institutions through the use of asset-based project finance techniques, involving secured senior A/B loans to offshore subsidiaries of the relevant sponsor. Financing of special purpose offshore companies, with each owning individually an offshore registered vessel, is a traditional ship financing structure adopted by most of the international banks lending to the sector. Any financing of offshore subsidiaries is performed in compliance with the Bank's internal procedures and by ensuring that any offshore company is duly approved by the relevant onshore authorities.

• From an enforcement viewpoint, such a financing structure is effective because the established offshore registries recognise, and thus protect, the priority rights of mortgagees over moving assets trading worldwide across different jurisdictions. Furthermore, these registries have clear and internationally recognised operating and manning rules, important for the maintenance of the ships and safety of the crew. It is important to note that these offshore companies are nameplate companies only, and no

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The flow of funds ever takes place through such off-shore countries. Their accounts are usually held with well established and internationally recognised banks.

- The Bank’s involvement in the Sector has been with privatised or partially privatised entities, which have embraced the Bank’s objectives and thereby lead to demonstrable transition impact. PED has post-evaluated five of the Bank's shipping operations and concluded that the Bank’s experience has been generally satisfactory, except for the Sakhalin Shipping project. In this project, the Bank has had to enforce its security over the ships in order to recover the loan.

- Although the Bank has reviewed several financing proposals from various shipyards, it has not to date completed any operations in this sub-sector. However, the Bank is increasing its marketing and intensifying its efforts to develop appropriate structures for projects in the shipbuilding industry.

- With reference to the existing portfolio, the Bank intends to expand the loan volume for the purpose of effective portfolio management. This would enable the Bank to acquire critical mass and an industry presence in the respective sub-sectors.

2.5 Project Evaluation and Lessons Learned

2.5.1 EBRD

Five of the Bank's shipping operations have been post-evaluated, of which four involved fleet modernisation financing to Russian shipping companies at privatisation or post-privatisation stages. The following salient lessons were extracted by PED:

- **Offshore registry:** The Bank's shipping portfolio has signalled to international financial markets via syndication that Russian shipping companies can be acceptable risk with variations of offshore and domestic registry and "dual flagging". The Bank should seek new structuring variants for additionality reasons and to enhance transition impact.

- **Structuring for enhanced domestic transition impact:** Deal structuring in ship financing should seek to affect the ultimate client and other domestic parties concerned with shipping (including financing agents) to enhance transition impact. Project designs should encourage restructuring and facilitate know-how transfer in marketing and chartering to the domestic shipping organisation.

- **Retained state ownership stakes:** Retained state ownership stakes in shipping companies will tend to slow down market-driven reform, including fleet adaptation and modernisation as well as new chartering modes.

- **Appraisal and mitigation of risk in shipping:** Shipping and shipping-related markets are cyclical. This adds to numerous other risks in financing to shipowners in the region which typically lack satisfactory credit records. Therefore, shipping project proposals and their market projections must be critically appraised and structured by bankers with profound industry insight, capable of informed independent judgement.
• **Tailored structuring and conditioning of shipping deals:** The Bank should continue its accumulation of sector experience. Applying this to asset financing, such as in shipping, presents opportunities to enhance the quality of investments and transition impact from sustainable projects.

2.5.2 IFC

In addition to learning from its own experience, the Bank can gain insight from lessons learned at IFC. In the main, IFC shares the experience of the Bank with respect to volatility of the shipping industry, the importance of professional appraisal, structuring and monitoring of projects, and banking staff expertise. In addition, IFC has recorded the following lessons learned:

- Risks in the shipping industry can be significantly reduced by purchasing second-hand ships when market prices are unusually low, focusing on types of vessels with relatively stable freight rates. (The Bank should therefore be prepared to consider financing modern second hand vessels);
- Having a trustworthy, competent, and committed sponsor is essential for a successful project;
- Be wary of investing in ventures where the market is heavily dependent on government policies that are subject to change, e.g., import bans, tax breaks and other subsidies, or financing of ship purchases by government-controlled entities.
- The standard loan/investment agreements covering project financing transactions are not generally suited to the dynamic nature of the shipping sector. Hence, close supervision of the financial covenants and frequent waivers are required to keep pace with the ever-changing environment. More flexibility in investment agreements and the use of specialised external counsel could lead to more efficient supervision.
- A proactive approach and constant follow up with sponsors and other stakeholders can be crucial for saving an investment in jeopardy and enhancing lenders' position.
- Important elements in a well-managed venture include (i) a long-term strategic perspective on the part of local management and the technical partner, (ii) good working relations between local management and the technical partner, (iii) good teamwork within the company, and (iv) emphasis on hiring, training, and retaining capable staff based on attractive compensation arrangements and maintaining the reputation of being a good employer.
3. STATE OF THE SECTOR: TRANSITION CHALLENGES

In global terms, the region's share of world fleet is quite small. However, the shipping and shipbuilding industry remains an important sector in the Bank's countries of operation due to its significant economic, social, and environmental impact.

3.1 SHIPPING

- **Declining Fleet Size.** Fifteen of the Bank's countries of operation are involved in shipping and the majority have experienced a significant decline in their merchant fleet, which includes almost all types of vessels. Russia, traditionally with the largest shipping fleet, has probably experienced the greatest decline; between 1992 and 2000, its deep sea merchant fleet shrank by 57.4% from a total deadweight of 10.6 mt to 4.5 mt. This decline is partly due to the lack of fleet replacement and partly to the transfer to offshore registries by companies wishing to access the international finance market. Consequently, the volume of cargo transported by the Russian fleet also declined from 90 million tons in 1992 to 40 million tons in year 2000 (See Chart 3.1 below).

- **Safety and Environmental Concerns.** The shipping fleet in the region is also ageing. For example, the average age of the Russian fleet is more than 20 years old compared to the world average of 14 years. The majority of the fleet is characterised by poor maintenance, obsolete equipment and a small proportion is below international safety and environmental standards. The poor condition of the fleet not only makes the companies uncompetitive, it also makes their financing difficult because such ships would be unacceptable as collateral.

![Volume of Cargo Transported by Russian Fleet](source: Ministry of Transport/Shipping Maritime Services)

- **Fleet Renewal.** A handful of companies, including Novoship and Primorsk Shipping have raised new financing by pledging their existing debt-free fleet as collateral and successfully renewed their fleet. The most significant challenge for the Bank, in this sector, is to continue to finance fleet renewal by acting as a catalyst for channelling international finance and investment into the region. The Bank remains highly additional in this process as many banks are still reluctant to accept the political and shipping risks of the region.
• **Offshore versus Domestic Registration.** In Russia and most of the Early and Intermediate Countries, shipping legislation relating to mortgagee's rights is not yet sufficiently developed. Therefore, commercial financiers see a continued need to protect their rights under the offshore registries. However, a number of countries in the region are discouraging the transfer of their ships to offshore registries, due to the perceived loss of prestige and potential revenues. The Bank would promote dual-registration as a compromise under which, vessels can continue to remain on the national flag while allowing the mortgagees to benefit from the protection established under the offshore registries. See *Annex D: List of National and International Registries* - listing the countries with established and internationally recognised registries. The offshore registries accepted by the Bank are signatories to the required International Maritime Conventions on safety and manning regulations. In the course of any financing of offshore subsidiaries, the Bank will continue to ensure that such financing is performed in compliance with the Bank’s internal procedures and by ensuring that any offshore company is duly approved by the relevant onshore authorities.

• **Need for Further Legal Reforms.** Parallel with legal and institutional reforms in the region, the Bank is also faced with the challenge of considering the acceptability of new legislation for which legally binding precedents are not yet established. Russia, for example has now become a signatory to five international maritime conventions, including the International Convention on Maritime Liens and Mortgages (1993) and the Arrest of Seagoing Ship Convention (Brussels, 1950). Its new merchant Shipping Code of May 1999, for example, is an attempt to bring its shipping legislation into line with international standards; and it introduced for the first time the concept of maritime liens and priority rights of the mortgagees. However, there is still insufficient clarity and transparency in the procedural guidelines to engender the required level of confidence in the new legislation.

• **Financing under Domestic Mortgage.** As part of its general transition objectives, the Bank will continue to maintain a constructive dialogue with the respective authorities on development of further legislative reforms. This is of particular relevance to the financing of inland river vessels. Due to the restrictive trading pattern of these vessels (they do not go beyond their national coast line), enforcement of mortgage over them would rely on the local jurisdiction and its mortgage law. The challenge to the Bank would be to demonstrate financing inland river shipping transactions under domestic mortgage where such security would otherwise not be acceptable to our co-financiers due to the enforcement difficulties discussed above. The Bank’s view is based on the rationale that enforcement procedures and priority rights vary according to the jurisdiction in which the vessel is arrested. Therefore, the protection offered under offshore registries may not be as relevant for inland vessels as ocean-going vessels. The Bank would demonstrate to the commercial financiers that in selective cases, such structure can be justified, if the risk can be mitigated by other factors, such as the availability of other secondary security, robust cash flow and the support of strong sponsors.
• **Role of SME and Technical Co-operation Funding.** Access to international finance is also hindered by poor management skills. Many smaller companies in the Early and Intermediate Countries have yet to make the transition to international standards of management. The lack of professional know-how, coupled with poor reporting standards, further diminishes the appeal of these companies, as potential clients of international banks. In this regard, the Bank's involvement together with its SME and Technical Co-operation Funding would be invaluable in assisting them in the transition goals identified below (see Sections 3.3.3 and 3.3.4).

• **The Importance of Conditionality.** The Bank's financing activities in this sector are mainly in the form of debt finance; direct investment from other international sponsors is low compared to other sectors. This is partly attributed to a relatively lower level of transparency, and lesser adherence of good business practice and corporate governance in some of these companies. In this regard, the Bank's conditionality of investment is an important tool in improving these practices. The Bank would seek strong but realistic conditionality or milestones that are meaningful and achievable in the sector and country context. It would work with sponsors who are willing or have demonstrated a reasonable level of commitment to adopt the Bank’s conditionality over a period of time.

3.2 **SHIPBUILDING**

• **Contracting Market Share.** There are 9 shipbuilding countries in the region which traditionally have tended to build vessels of a more basic design. These yards are very large in comparison to their Western European counterparts, employing a large number of people and with a major physical capacity. In common with other sub-sectors, the region's shipbuilding industry is also contracting; in a decade, it fell from almost 11% to less than 7% of the world total output.

![Shipbuilding Tonnage in Eastern Europe](source: Lloyd's Register - World Fleet Statistics 1999)

![Chart 3.2(a)]

• **The Experience of Poland and the Baltic States.** Poland is by far the largest (ranked 5th in the world) and the most successful country in the Bank’s countries of operation, based on its gross tons output. Gdynia Shipyard for example, has made impressive progress in terms of productivity and competitiveness in the world arena. The Baltic
States have experienced some degree of success having received a reasonable level of foreign investments. For example, some domestic yards in Estonia and Lithuania have received investment from Scandinavian sponsors.

- **Need for Restructuring.** Ukraine, Romania, Croatia and Bulgaria, all have a reasonably large building sector, but few yards have made the transition into market oriented entities. Within Russia, there is little evidence of an internal restructuring process (in both commercial and naval yards), or orientation towards the international shipbuilding market. Some of the authorities are making efforts to support the industry through subsidies. In certain circumstances, for instance where the relevant government is fully committed to the restructuring and privatisation of its shipbuilding industry and dependent upon the conditions attached to the subsidies, limited and temporary state subsidies may be an appropriate tool to assist in these goals and foster the transition process. However, such subsidies should not be in excess of levels permitted under any applicable guideline. Furthermore, without such conditionality subsidisation will provide neither long-term solutions nor have any transition impact.

- **Barriers to Investment and Financing.** The survival of many yards in the Early and Intermediate countries still heavily depends on government subsidies. Against a backdrop of weak national economies, which are subject to, *inter alia*, high inflation and exchange rate volatility, many yards have yet to be privatised or restructured. Specifically, many yards suffer from weak management, outdated technology, low productivity and liquidity problems - which are barriers to much needed investment and finance.

- **Hull Building as a Step Towards Transition.** The development of 'hull building' in the region has prompted some foreign yards to view these regional yards as potentially attractive investments because of their lower operating cost base. This has paved the way for their successful privatisations. Besides the Daewoo-Mangalia joint venture, which was one of the earliest privatisations in Romania, recent examples include the Galatz, Braila and Tulcea yards in Romania and the Rousse yard in Bulgaria. These structural changes will assist these yards in regaining or maintaining their competitiveness and market share.

- **Need for Long Term Finance.** The future success of those yards that have reached a certain stage of transition, whether as a result of strategic alliances with international sponsors or through self-generated restructuring, will need to include further strengthening of their capital base. Such long-term financing requirement will be a challenge to the Bank's role as a catalyst, and must be balanced against the Bank's commitment to sound banking principles.

- **Social Impact of Restructuring.** The challenge is high for the shipbuilding industry in the region as transition and turn-around takes not only time, but also the political will of the respective governmental authorities involved in the sector. It is inevitable that as the industry goes through a process of consolidation and restructuring, many yards will be sold, closed or merged with others. However, the Bank recognises the significant social
importance of many yards in the Bank’s countries of operation. Therefore, should the
Bank become involved in this restructuring process and where the restructuring
involves a significant level of job loss, it would consider including certain social aspects
(such as retraining and attrition schemes) in the financing agreements to ensure that
such employment dislocation is managed in a socially acceptable manner.

3.3 THE BANK’S OBJECTIVES (TRANSITION GOALS)

The Bank’s medium term priorities are outlined in “Moving Transition Forward:
Operational Priorities for the Medium Term” (BDS99-24 (Rev.1)). Based on these
guidelines, the Bank will pursue projects in the shipping sector which promote the
following:

3.3.1 Promotion of Competitiveness through Fleet Renewal

Domestic carriers, especially those operating in the export cargo trade, have suffered
substantial loss of market shares to foreign competitors. To compete, these companies
must offer better services and competitive pricing. Fleet modernisation and renewal
programmes are therefore vital if they are to remain competitive. With the onset of
many new environmental and safety regulations, over-age and sub-standard vessels
are now precluded from certain trade routes, e.g. older generation of single-skin
tankers are no longer allowed to trade to the US under the Oil Pollution Act 1990 and
the EU is seeking to phase out single hull tankers from its waters. It is therefore
essential for these companies to maintain a modern fleet if they are to remain
competitive. The Bank has and will continue to play a catalytic role in providing debt
financing for fleet renewal of deep-sea and river-sea vessels.

3.3.2 Promotion of Privatisation and Restructuring

Many shipping related enterprises, especially in the sub-sector of shipbuilding,
remain under state ownership, and lack the motivation to restructure and adjust to a
market economy. Such operations typically lag behind in terms of technological
development and are inefficient and unprofitable. Many continue to rely on state
subsidies for their continued operation. It is the Bank’s objective to promote,
wherever possible, the restructuring and eventual privatisation of these entities. In
cases where a yard has a proven track record and/or strategic partners are involved,
the Bank will consider investing alongside these investors in the privatisation process
through equity as well as debt financing.

3.3.3 Transfer of Technical Know-How and Management Skills

The Bank will actively target projects in the sector, which involve joint venture
partners or international sponsors who are more likely to implement these objectives.
The Bank will aim to encourage the sponsors to adopt these objectives in their
business plans, by linking, as far as possible, completion milestones to different
tranches of disbursement. In addition, this process will also create backward linkages
in developing expertise required in other ancillary services such as shipbroking and
chartering.
3.3.4 Promotion of Good Corporate Governance and Best Business Practice

These objectives will be continually reinforced as part of the Bank’s efforts to promote transition impact in the region. Shipping Sector operations will typically include covenants which foster transparency, protection of minority interests (in the case of equity investments), good corporate governance, and best business practice. In this regard, the Bank has already successfully introduced and assisted several of its clients in adopting IAS for its financial reporting; formulating the appropriate restructuring plans (some involving spinning off of non-core activities); and implementation of management information system to improve efficiency and management control. Other good business practices set by the Bank include, *inter alia*, the need to comply with procurement rules, particularly in shipbuilding contracts.

3.3.5 Promotion of Safety and Environmental Consciousness

Following a number of high profile oil pollution disasters, the promotion of safety and environmental objectives is of particular public concern. All proposed shipping projects considered by the Bank must undergo environmental due diligence according to the Bank's Environmental Procedures and be in compliance with all the regulations laid down by the relevant insurance bodies, international maritime organisations and conventions, such as MARPOL (International Convention for Prevention of Pollution from Ships) and SOLAS (International Convention for the Safety of Life at Sea). Furthermore, the Bank requires all of its project vessels to be classed by a member of the International Association of Classification Societies to ensure the vessels are maintained at all times to international best practices and standards. The Bank will continue to monitor these issues with existing clients and ensure compliance through regular ship inspections. In addition, the Bank will continue to encourage its countries of operation which have not already acceded to these conventions to do so.

3.3.6 Development of Appropriate Regulatory and Legal Framework

The Bank has so far been able to attract participation of other lenders by adopting the offshore structure for its shipping portfolio. This has been necessary as certain countries in the region have yet to accede to many of the International Maritime Conventions. In certain countries of operation, the lack of a clear legal framework for the protection and enforcement of mortgagees’ rights has impeded direct debt financing and foreign investments. The Bank will assist in the development of an appropriate and acceptable regulatory framework for shipping in general and the sub-sectors in particular. The Banking teams will, in co-operation with the Legal Transition Team, work towards this very important objective.

3.3.7 Facilitation of Regional Trade

Even in a globalised economy, economic transition and development go hand in hand with a deepening of regional economic ties. “Moving Transition Forward” directs the Bank to take an active role in addressing transition challenges, where appropriate, in a cross-border framework. Shipping operations that improve cross-border transport
infrastructure and reduce transportation costs can play an important role in fostering regional trade.
4. INVESTMENT PRIORITIES AND OPERATIONAL APPROACH

The underlying principles of the Bank’s investment priorities aim to address the individual market needs on a case-by-case basis and to be at the forefront of market developments. Investment priorities are also premised by their ability to satisfy the Bank’s guiding principals of transition impact, additionality and sound banking. Additionally, the Bank will not consider projects (particularly in the shipbuilding sub-sector) which have an enhanced financial rate of return (‘FRR’) due to state subsidies in excess of the level permitted under any applicable OECD, WTO or EU guidelines. Furthermore, in respect of operations in EU accession candidate countries, the Bank will liaise with the European Commission given the implications for these countries on such issues as safety, environmental protection and the regulatory framework.

4.1 SHIPPING

- The Bank will continue to provide finance through either debt or equity to deep-sea operators, including its existing clients, for their on-going efforts to modernise their fleet. In selective cases, where the need for a ‘top-up’ financing can be supported by strong cash flow and acceptable security, the Bank may consider providing ‘mezzanine’ loans with longer maturity. These loans can then be converted to share options, to be exercised in the event of further privatisation.

- In order to maintain a balanced country profile, the Bank will expand its activities to other countries of operation besides Russia and Ukraine. It will endeavour to assist shipping related enterprises in the Baltic, Caucasus and Caspian regions, where shipping is an important part of the transport infrastructure for oil exports.

- The Bank will also seek to assist companies that operate along the large inland waterways across much of the Bank’s countries of operation. These companies have to date received less attention due to the inherent lack of mortgagees’ protection and enforcement laws and the on-shore nature of their operation.

- The Bank is currently exploring innovative leasing structures, which may overcome some of these difficulties. It is envisaged that new structured finance arrangements would enable new ships to be built for the benefits of lessees, who will assume ownership of the ships at maturity of the loan/lease. From the sponsors/lenders’ perspective, leasing (including cross-border leasing) could be an attractive option due to certain tax advantages and in enabling lenders to retain direct control and ownership of the assets until the loan is repaid.

- The Bank will also seek to assist companies in the process of privatisation, or further privatisation. Besides providing debt for post privatisation development, the Bank may consider investing alongside strategic partners in cases where there is a clear and acceptable exit strategy.

4.2 SHIPBUILDING

- The Bank will consider providing financing for three types of shipyards:
1) Yards that have benefited from foreign strategic investors in terms of infusion of management know-how and capital;

2) Privately owned yards that have proven management experience, comply with (or are willing to implement) EBRD requirements on good business practice and corporate governance and have the ability to conduct a successful business together with a clear long-term viability for their operations; and

3) Yards in countries where the relevant governments are committed to, and where EBRD involvement would bring about, restructuring and privatisation.

- The most commonly sought after types of financing are working capital, refund guarantees, or ad hoc construction finance. Such financing will have to be well structured and secured by acceptable security and may be granted initially on a short-term revolving basis but could, depending on the level of commitment and the strength of potential foreign sponsors, include equity and long-term capital investment loans. As with shipping, the Bank will also consider participating in selected privatisation offerings where there is a clear exit strategy.

- It should be noted that in all three types of shipyards, subsidies in various forms are not uncommon. The Bank will seek to identify these subsidies (if any), and assess their justification (e.g. as a limited and temporary tool in fostering the restructuring and privatisation of a yard or securing environmental benefits from retiring old and polluting ships) and consistency with applicable (EU, OECD, or WTO) guidelines. The Bank will demonstrate the economic justification of such projects (reflected in an adequate economic rate of return) and their financial viability even in the absence of subsidies. The Bank will also demonstrate the consistency of projects with applicable guidelines for the maximum level of subsidies. In all cases where the subsidies are above the ceilings permitted under the applicable guidelines, the Bank will reject such projects.

### 4.3 TECHNICAL COOPERATION

The Bank's operation in the sector has so far consisted of mainly private sector projects involving relatively acceptably established companies where the requirement for Official Co-financing is minimal. However, Technical Co-operation will be necessary for certain projects in the Early Countries, where the industry is still in its embryonic stage.

### 4.4 CO-FINANCING SOURCES

- The Bank has mobilised co-financing for 6 shipping projects.

- In common with other operations in the Bank, co-financing with commercial banks has been accomplished on a participation basis with an A/B loan structure. In this respect,

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4 See *Standard Shipbuilding Contract Payment Terms*, page 32.
the sector has successfully sourced long-term finance from 22 western European banks, many of which are heavily involved in shipping finance (see Annex D: Overview of Co-Financing).

- The Bank has yet to achieve co-financing opportunities with IFI's and export agencies, but will continue to identify projects in the sector suitable for such co-financing sources which are more inclined to provide longer loan maturities.
- The Bank also aims to develop co-investment with international private equity investors and institutional investors.

4.5 LEVEL AND COMPOSITION OF EBRD FINANCING

- Given the cyclicality of the sector, annual signings can vary from year to year. However, average annual signings of Euro 50 -100 million are projected by the Bank, although the growth would depend on the resources allocated by the Bank and the state of the markets.
- The Bank’s portfolio in the sector as of 31 December 2000 concentrated almost entirely in Russia with the exception of one operation in Ukraine. However, concerted marketing efforts have been and are currently being undertaken with the view of further strengthening a strong pipeline in the Advanced Countries, such as Croatia, Poland, Latvia, Lithuania and Estonia, as well as in the Early and Intermediate Countries.
- As of 31 December 2000, the fleet financed by the Bank's consisted of 49 ships with a total deadweight of 693,558 tons, including: (i) a short-sea fleet of 20 general dry cargo ships, and 10 river/sea ships, with an average age of 10 years and, (ii) a deep-sea fleet of 7 container ships, and 12 product tankers, with an average age of 5.4 years.

4.6 PROCUREMENT

- All of the Bank’s Shipping Sector projects to date are classified as being private sector for procurement purposes. Construction of newbuildings financed by the Bank had been based on competitive selection procedures managed by the clients. However, the Bank also consults independent shipping brokers and technical experts to ensure that costs are in line with market prices and that procurement and implementation processes are satisfactory.
- The Sector will continue to be focused on private sector projects, and its current methodology in managing procurement issues.

4.7 SAFETY AND ENVIRONMENT

- Projects financed by the Bank must comply with all the appropriate safety and environment regulations laid down by the three main bodies; IMO, the international Classification Societies and Ship Registries (see Annex F: Major IMO Conventions).
Besides the three main bodies, other secondary organisations such as port authorities and coast guards also act as deterrence to non-compliance through stringent inspection process when a ship calls at a port.

- Following the 'Exxon Valdez' collision, off the Alaskan coast line in the late 1980's, the US's Oil Pollution Act of 1990 has been the single most influential legislation for the protection of environment. As a result, a new generation of technical specification including fabrication of 'double-hull' and 'double-bottom' for tankers have been built to minimise the pollution risk of tankers to the seas and coast lines in the event of a casualty. The European Union has recently agreed to consider adopting the newly established IMO guidelines on phasing out single hulled tankers by 2015.

- For crew safety, the SOLAS regulation remains highly relevant, together with the flag ships regulations governing terms of employment and safety conditions. New legislation under the GMDSS guidelines in force also greatly enhances the safety of the crew.

- The industry is highly regulated, and the level of compliance is generally high. However, unscrupulous practices cannot be entirely eliminated. The Bank will continue to ensure compliance through its normal monitoring process of regular inspections of its mortgaged vessels and to promote awareness of the importance of safety and environmental issues as part of its transition objectives.
5. ANNEXES

ANNEX A - OVERVIEW OF THE SHIPPING INDUSTRY*

Introduction

- Shipping is an international business. From a user viewpoint, it is essentially a service industry whose prime task is moving cargo around the world. As the world economy expands, seaborne trade also increases. Between 1950 to 1995, seaborne trade - measured by tonnage of cargo carried - grew from 0.55bt to 4.3bt, making shipping one of the fastest growing sectors of the post-war economy.

- There is a close correlation between seaborne trade and GDP growth as shown in the two graphs below. In newly industrialised countries, efficient transport (including shipping) is one of the prime factors responsible for growth of trade. Due to the development of 'cross-trade' and globalisation, shipping services can be bought on the international market. As a result, efficient transport links and growth in seaborne trade does not necessarily require a developed national fleet. However, a national merchant fleet would generate economic benefits and foreign exchange income for the national economy and, if successfully managed, could enjoy certain cost advantages. Historically, most of the matured economies and industrialised nations have had a significant merchant fleet at the time of their economic take-off.

- Shipping is a highly complex industry comprising of two fundamentally different commercial sub-sectors; liner and bulk shipping - which carry different cargoes and provide different services and consequently have a different economic structure. These two main sectors are further divided into sub-sectors. Shipowners often move certain types of ships in

their fleets from sub-sector to sub-sector in response to changing economic pressure, thus making the industry a single market trade rather than a series of isolated sub-sectors. In addition, specialists such as charterers, brokers, marine underwriters and classification societies, interact with each other over different aspects of the business.

- Due to low entry and high exit barriers and long construction periods, the supply of ships and shipping services often lag behind changes in demand, resulting in volatile cycles of freight rates and ship values. As illustrated below, the average tanker rate plummeted from more than USD 50,000 to USD 7,000 per day in a few months between July 1990 and February 1991 and the values of 5 year old VLCC tankers fluctuated between USD 60 million in December 1993 to USD 47 million in early February 1994.

- In general, shipping cycles tend to follow the pattern of the world economy, although lagging 6-12 months behind. However, the industry is also sensitive to political events and governmental interventions, such as tax incentive schemes, subsidies, and regulations regarding liner conferences, safety, and environment.

**Demand and Supply of Shipping Services**

**Demand for Shipping Services - Commodities Traded by Sea**

- In 2000, a world fleet of approximately 85,000 merchant ships transported in excess of 4 billion tonnes of cargo world-wide. The commodities traded were (i) energy trades (crude oil, oil products, liquefied gas and thermal coal) accounting for 45% of the seaborne trade, (ii) agricultural trades (cereals, animal feedstuffs, sugar, molasses, fertilisers) accounting for 13% of the trade, (iii) metal industry trades (raw materials and products of the steel and non ferrous metal) totalling 25% of the trade, (iv) forest products, (v) other industrial materials (cement, salt, gypsum, mineral sands, asbestos) and (vi) other manufacturers (such as textiles, machinery, capital goods, vehicles) which in tonnage terms account for only 3% of the trade, but due to high intrinsic value their share in value terms is approximately 50%.
Supply of Shipping Services

Bulk Cargo and Bulk Shipping

- A cargo that is large enough to load an entire ship is **bulk cargo**. The main categories of bulk cargo are (i) liquid bulk (crude oil and products, liquid chemicals and wine), (ii) the 'five major bulks' (iron ore, grain, coal, phosphates and bauxite), (iii) minor bulk (steel products, cement, gypsum, sugar, salt, forest products, sulphur, wood chips and chemicals) and (iv) specialist bulk cargoes (motor vehicles, refrigerated cargo, and special cargoes such as a cement plant or prefabricated building).

- The **bulk shipping industry** transports cargoes on the principle of "one cargo, one ship." For a specific voyage, a ship is loaded with one type of cargo only. Many different types of ships carry bulk cargoes, but the main types are: tankers (liquid bulk cargo), general purpose dry-bulk carriers (dry bulk), combined carriers and specialised bulk vessels.

- The challenge of the bulk industry lies in cost minimisation through exploiting economies of scale by using large ships (thereby minimising cost per ton), and optimising cargo handling.

General Cargo and Liner Shipping

- **General cargo**, on the other hand, consists of consignments of less than one ship size, and therefore too small to justify setting up a bulk shipment operation. The main types of cargo are: (i) loose cargo (individual items, boxes, pieces of machinery), (ii) containerised cargo (standard boxes, usually 8' wide, 8'6'' high and 20', 30' or 40' long), (iii) palletised cargo, (iv) pre-slung cargo, (v) liquid cargo (travelling in deep tanks, containers or drums), (vi) refrigerated cargo, and (vii) heavy and awkward cargo. General cargo vessels are employed either by tramping from port to port or on a liner basis.

- The **liner shipping** transports cargoes that are too small to load an entire ship and need to be carried with other goods. Liner ships, typically container vessels, operate a regular advertised route between designated ports and transport cargo for fixed pre-set prices for each container or commodity.

- The industry is highly management intensive. The liner operator needs to handle substantial paperwork related to vast amount of small cargoes, manage finances to produce profit in spite of fixed revenues and variable costs, and manage the cargo and the voyage time to a fixed schedule calling at many ports. In addition, because of the high overhead expenses and the need to operate the route even if ships are not fully utilised, the liner industry is exceptionally sensitive to competitors’ prices.

- **Liner Conferences.** The majority of liner companies are members of one or more liner conferences, which are in fact a form of cartel. The conference system was first developed in 1875 to deal aggressive price competition which resulted in many companies going into bankruptcies. Today, the liner conferences are regulated by UNCTAD and other international codes and conventions, and are often exempted from...
anti-monopoly law. The US Conferences are regulated by the US Maritime Commission.

The chart illustrates the interaction of demand and supply of shipping services. On the demand side, cargo in need of transportation is divided into bulk and general cargo, and transported by bulk and liner shipping industries. On the supply side, ships are operated by owners or traded on a charter market for a long or short term (voyage) hire. Source: Martin Stopford, 1997

Types of Ships and Ship Design

- The flexibility of ships to carry different types of cargo varies. Some ships are specialised to a degree they can only transport one type of cargo (e.g. certain type of tankers can only transport certain type of liquid cargo), whereas multi-purpose vessels with a higher lateral cargo mobility factor can transport a variety of goods. In the last thirty years the trend has been towards specialisation, with the fastest growing sectors being tankers, bulk carriers, container ships and vehicle carriers, all of them highly specialised. The major classes of vessels are:

1) **Ships for the liner trades** are container ships (ships specialised in carriage of containers filled with various cargo), ro-ro ships ("roll on, roll off" ships with through decks and roll-on access by ramps), multi-purpose cargo liners ("lift on, lift off" ships with a capacity to carry containers as well as general
cargo), barge carrying vessels (with floating holds able to carry general cargo or small bulk parcels), and the 'tweendeckers'.

2) **Ships for the dry bulk trades** have large cubic capacity and efficient cargo handling equipment. There are four main categories: Handy bulk carriers (10,000-30,000 dwt), Handymax bulk carriers (30,000-50,000 dwt), Panamax (50,000-80,000 dwt) and Capesize (over 80,000 dwt).

3) **Ships for the liquid bulk trades** are mainly tankers. They are divided into four main categories for transportation of crude oil: Aframax (70,000-100,000 dwt), Suezmax (100,000-200,000 dwt), VLCC (200,000-300,000 dwt) and ULCC (over 300,000 dwt). The oil products and chemical products are carried in smaller tanker sizes such as Handy-size tankers (10,000-50,000 dwt) and Panamax tankers (50,000-70,000 dwt). Special cargo such as liquid natural and petroleum gas is carried in special liquefied gas tankers.

4) **Combined Carriers**, often referred to as OBO (oil/bulk/ore), are designed to carry a full cargo of dry or liquid bulk, offering an opportunity to switch between the tanker and dry bulk markets depending on freight rate advantages to be gained.

5) **Ships specialised for one commodity**, including ore carriers, forest products carriers, cement carriers, vehicle carriers, refrigerated vessels, and heavy lift vessels.

**Key Players in the Shipping Industry**

**Maritime Financiers**

- Shipping is a capital-intensive industry. The most important financiers of the shipping industry are commercial banks, consisting of mainly European banks such as Fortis, ABN Amro, Royal Bank of Scotland, Deutsche Schiffsbank, Christiana Bank and Den norske Bank.

- The banks offer term loans for periods between 2-10 years. The financing amount is usually based on a certain percentage of the market value of the financed ship, unless credit enhancement is used (such as time charter, mortgages on sister-ships in the fleet, sponsor guarantee), in which case debt/equity ratio can move up to 70-80%, possibly with mezzanine financing.

- The financing structure is usually an asset-based ship-mortgage loan, whereby the ships are individually owned by special purpose offshore companies acting as borrowers. The ships are registered with one of the established offshore ship registries, such as Panama and Liberia, which are by far the largest ship registries in the world. The banks register their interest in the ships at these registries so as to protect their mortgagee's rights of enforcement or repossession in the event of a default. Such loans are often supported by guarantees - either 'Personal' (which is more common in the Greek market) or
'Corporate'. Larger industrial shipping corporations however, prefer financing their fleets through corporate loans, secured on their balance sheets, sometimes without mortgages on the vessels.

- Other investors are investment and merchant banks (arranging and underwriting loan syndications, public offerings of equity, and private placements of both equity and debt), brokers (with separate shipping departments offering specialised financing packages), leasing companies and specialist ship mortgage banks.

The Regulators and Regulatory Regimes

The regulatory system in shipping consists of an *ad hoc* mix of rules and regulations enacted and enforced by a diverse group of bodies, including classification (self regulating) societies, international organisations, and states having or claiming legal jurisdiction over the trading ships.

1) **Classification societies** design rules for ship construction and maintenance and issue 'class certificates' reflecting compliance, required by insurance companies and laws of coastal states. The ten most reputable societies, such as Lloyds Register of Shipping, Germanischer Lloyd, Bureau Veritas, Det Norske Veritas, American Bureau of Shipping, and Nippon Kaiji Kyokai are organised under the International Association of Classification Societies ("IACS").

2) **Flag states** (register states) hold the primary legal authority to govern the activities of registered ships and are responsible for regulating every aspect of their commercial and operational performance, as well as terms and conditions of employment of crew. See Annex D: List of National and International Registries for a list of flag states.

3) **Coastal states**, have jurisdiction over ships trading in their territorial waters. The extent of rights depends upon the zones of the sea, ranging from territorial sea (up to 12 miles from the shore) belonging to the coastal state, to the high seas (more than 200 miles from the coast), where the coastal state has no rights. The division of jurisdiction between flag states and coastal states was settled by the UN Convention on the Law of the Sea (1982).

4) **International Maritime Organisation (IMO)** founded in 1958, with 155 member states, is the shipping arm of the United Nation. Its main aim is to develop a comprehensive body of conventions, codes and regulations for the maritime industry. During the 40 years of existence, IMO has enacted a broad range of mandatory shipping conventions. For a detailed description of the main regulation, see Annex F: Major IMO Conventions.

5) **Other maritime organisations** include the International Transport Federation ("ITF"), the International Labour Organisation ("ILO") and UNCTAD.
**Maritime Insurers**

Insurance accounts for 15-40% of operating costs of trading ships. Most important insurance covers are:

1) **Hull and Machinery**, insuring physical damage or loss of the ship, usually obtained from a marine insurance company or through a broker, backed by Lloyds underwriters. Most important considerations are record of claims and value of the ship.

2) **Protection and Indemnity Insurance (P&I)**, covering potential damage caused to third parties, including injury or death of crew, passengers, or third parties, pilferage or damage of cargo, collision damage, and pollution. Insurance is obtained through P&I clubs. Premium is mainly affected by the record of claims and the age of the vessel.

3) **War Risks insurance**, covering damage to a ship or losses of earnings caused by a war breakout in the territorial waters where the ship is trading.

**Maritime Brokers**

- The operation of the shipping market largely relies on shipbrokers, active in almost all aspects of the industry, such as the freight market, sale-and-purchase market, and the demolition market.

- **Chartering Brokers**: A shipper, or a charterer, with a volume of cargo to transport, appoints a shipbroker to arrange the transport. The broker researches the supply and asking prices for the relevant shipping service on the market, negotiates the deal, assists with closing, and provides ancillary services such as processing, dispute resolution, and accounting.

- **Sale and Purchase (S&P) Brokers**: acting on an instruction of a shipowner who wishes to sell a ship, S&P brokers circulate particulars of the ship to be sold to interested parties and sweep the market for potential buyers. S&P brokers with specialised desks also participate in the demolition market, arranging sales of old ships to demolition yards.
ANNEX B - OVERVIEW OF THE SHIPBUILDING INDUSTRY

Introduction

- There are approximately 380 major shipyards in about 30 countries that are active in the international commercial shipbuilding markets. Over the last two decades, Japanese and Korean yards have become the dominant market leaders. In the face of this strong competition from Far Eastern yards Europe has been experiencing a reduction in its market share - from 47% in the early 1970s to less than 20% (of which one third is from Eastern European yards) in recent years. In gross tonnage terms, Japan and Korea now occupy over 70% share of the market, with the rest of the world (excluding Europe) accounting for the balance of 10%, inclusive of China which is increasing its market share.

- Shipbuilders generally follow the market rather than focus on any particular ship type, although certain yards have strong linkage to particular niche markets, e.g. the dominance of Italian yards in the cruise ship market. Japan and Western Europe have a significant share of the higher added value and more complex vessel types as they are no longer able to compete with other lower cost production countries.

- Looking forward, world newbuilding demand is estimated at 135 mgt for the period 2001-5 and 126.5 mgt for the period 2006-10. In average annual terms, this approximates to 26-28 mgt for the first half of the next decade and 20-25 mgt for the following half-decade. This is comparable with the annual newbuilding output of 25.5 mgt for the preceding period of 1997-2000 (see graph below).

![Forecast World Shipbuilding Output and Capacity to 2010](graph.png)

Source: Appledore International Consultancy Service

3 The EU, under Council Regulation 1540/98 has been analysing the situation of the world shipbuilding market with particular reference to alleged anti-competitive practices from South Korean shipyards.
Factors Affecting the Shipbuilding Industry

- Demand for shipbuilding is closely correlated to developments in world trade and economic growth as these are important determinants of seaborne trade. The age profile of the world shipping fleet also affects the level of new orders. With increasingly stringent safety and environmental regulations, the need to replace obsolete and over-age tonnage also drives shipbuilding output.

- Conversely, supply-led factors such as building capacity and competition also affect the level of newbuildings being ordered. In times of excess yard capacity, Far Eastern yards are often prepared to offer very competitive prices based on series ordering. This is particularly evident amongst major shipbuilding conglomerates such as Mitsubishi, Daewoo and Hyundai in times of depression.

- Shipbuilding is also particularly sensitive to fluctuations in the US dollar exchange rate. Following the devaluation of several Asian currencies in 1997/8, notably the Korean won, the dollar prices for many newbuildings quoted by many Far Eastern yards have become extremely competitive and for some sectors, prices are actually lower than previous years. Due to these low prices being offered, many owners have taken the opportunities to place new orders.

- The types of ships being built also fluctuate from time to time depending on the age profile and changes in trading patterns. Tankers account for by far the largest volume of new building activity in the near-term (about 34%), although significant volumes of bulk carrier (30%) and container ship (23%) tonnage are also set to be constructed.

Standard Shipbuilding Contract Payment Terms

- Shipbuilding contracts are normally paid by instalments due in accordance with 5 key milestones in the construction process. Upon reaching a milestone, a percentage of the contract price will be made, starting from 10% on signing of contract. These payment instalments are known as ‘advance payments’.

- Upon receipt of an advance payment, the shipyard is obliged to arrange with its own bank to issue on its behalf a ‘refund guarantee’ in favour of the shipowner. The purpose of the refund guarantee is to protect the interest of the shipowner, so that under certain specific events, he is able to claim back the payments already made to the yard. Typically, these events are:
  1) Non-compliance of specifications or performance failure of the vessel;
  2) Late delivery beyond the agreed time, allowing for agreed force majeure clauses and other acceptable delays;
  3) Bankruptcy of the yard resulting in non-delivery of the vessel.
• The standard payment terms negotiated by many established shipyards are often evenly spread, thus providing the necessary working capital for the yards. However, the terms are often dictated by the negotiating strength of the parties. In time of low demand, a yard would tend to demand less advance payments in order to secure contracts. Conversely, a yard would negotiate higher advance payments when its order book is full.

• If a yard is unable to offer refund guarantees, it will not be able to negotiate any advance payments. Therefore, it would not be able to procure the necessary working capital unless it is able to arrange such a facility from its own bank. A Refund Guarantee facility is therefore a very important source of working capital for a yard.
### ANNEX C: OVERVIEW OF SIGNED PROJECTS

#### Shipping Team Signed Projects as of 31 December 2000 (EURO '000)

<table>
<thead>
<tr>
<th>Projects Signed</th>
<th>Signing</th>
<th>Country</th>
<th>Class</th>
<th>Status</th>
<th>Total Cost</th>
<th>Total Finance</th>
<th>EBRD Finance</th>
<th>Syndicated</th>
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<tbody>
<tr>
<td>Primorsk Shipping Co</td>
<td>11/10/94</td>
<td>Russia</td>
<td>Private</td>
<td>Completed</td>
<td>264,249</td>
<td>83,804</td>
<td>50,282</td>
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<td>Estline Marine Co</td>
<td>14/01/93</td>
<td>Estonia</td>
<td>Private</td>
<td>Completed</td>
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<td>22,006</td>
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<td>Ukraine</td>
<td>Private</td>
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<td>18,437</td>
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<td>9,218</td>
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<td>Ukraine</td>
<td>Private</td>
<td>Repaying</td>
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<td>19,128</td>
<td>12,760</td>
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<td>Private</td>
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<td>48,047</td>
<td>25,700</td>
<td>22,348</td>
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<td>Private</td>
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<td>3,766</td>
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<td>Far Eastern Shipping Co I</td>
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<td>Russia</td>
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<td>Repaying</td>
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<td>72,392</td>
<td>43,243</td>
<td>43,243</td>
<td>-</td>
</tr>
</tbody>
</table>

* Although SFAT is classified as a shipping transaction because it has a shipping division, it is primarily a rail-wagon company. The Bank’s equity investment and loan were provided for non-shipping related purposes.

**Total Shipping**: 1,192,159 664,266 301,939 362,327
## Annex D: List of National and International Registries

<table>
<thead>
<tr>
<th>International Registries</th>
<th>Total registered tonnage</th>
<th>Tonnage owned by nationals</th>
<th>% owned by foreigners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Panama</td>
<td>98,409</td>
<td>0</td>
<td>100%</td>
</tr>
<tr>
<td>Liberia</td>
<td>92,291</td>
<td>0</td>
<td>100%</td>
</tr>
<tr>
<td>Cyprus</td>
<td>36,604</td>
<td>999</td>
<td>97%</td>
</tr>
<tr>
<td>Bahamas</td>
<td>34,787</td>
<td>205</td>
<td>99%</td>
</tr>
<tr>
<td>Norwegian Intl. Registry</td>
<td>29,151</td>
<td>25,992</td>
<td>11%</td>
</tr>
<tr>
<td>Malta</td>
<td>25,610</td>
<td>214</td>
<td>99%</td>
</tr>
<tr>
<td>Danish Intl. Registry</td>
<td>7,117</td>
<td>6,949</td>
<td>2%</td>
</tr>
<tr>
<td>Bermuda</td>
<td>4,751</td>
<td>0</td>
<td>100%</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>2,077</td>
<td>0</td>
<td>100%</td>
</tr>
<tr>
<td>Total International</td>
<td>330,797</td>
<td>34,359</td>
<td>90%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>National Registries</th>
<th>Total registered tonnage</th>
<th>Tonnage owned by nationals</th>
<th>% owned by foreigners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>52,065</td>
<td>50,880</td>
<td>2%</td>
</tr>
<tr>
<td>Japan</td>
<td>28,784</td>
<td>23,429</td>
<td>19%</td>
</tr>
<tr>
<td>United States</td>
<td>21,243</td>
<td>13,675</td>
<td>36%</td>
</tr>
<tr>
<td>Norway</td>
<td>32,867</td>
<td>28,575</td>
<td>13%</td>
</tr>
<tr>
<td>China</td>
<td>24,934</td>
<td>23,166</td>
<td>7%</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>15,257</td>
<td>6,987</td>
<td>54%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>8,558</td>
<td>5,196</td>
<td>39%</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>10,637</td>
<td>9,721</td>
<td>9%</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>15,794</td>
<td>14,319</td>
<td>9%</td>
</tr>
<tr>
<td>Germany</td>
<td>6,600</td>
<td>6,168</td>
<td>7%</td>
</tr>
<tr>
<td>Sweden</td>
<td>2,384</td>
<td>2,136</td>
<td>10%</td>
</tr>
<tr>
<td>Singapore</td>
<td>21,021</td>
<td>7,867</td>
<td>63%</td>
</tr>
<tr>
<td>India</td>
<td>11,614</td>
<td>11,208</td>
<td>3%</td>
</tr>
<tr>
<td>Denmark</td>
<td>7,617</td>
<td>7,204</td>
<td>5%</td>
</tr>
<tr>
<td>Other national flag</td>
<td>90,131</td>
<td>68,237</td>
<td>24%</td>
</tr>
<tr>
<td>Total National</td>
<td>349,506</td>
<td>278,768</td>
<td>20%</td>
</tr>
</tbody>
</table>
### ANNEX E: OVERVIEW OF CO-FINANCING

<table>
<thead>
<tr>
<th>Projects Signed</th>
<th>Project Country</th>
<th>Co-Financier</th>
<th>Country of Origin</th>
<th>Finance Type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primorsk</td>
<td>Russia</td>
<td>Hill Samuel Bank Ltd</td>
<td>UK</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MeesPierson NV</td>
<td>Netherlands</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Nedohip Bank</td>
<td>Netherlands</td>
<td>Participation</td>
</tr>
<tr>
<td>Novoship</td>
<td>Russia</td>
<td>ABN Amro Bank NV</td>
<td>Netherlands</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MeesPierson NV London</td>
<td>UK</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Banque Indosuez</td>
<td>France</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Banque Nationale De Paris</td>
<td>France</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Credit Lyonnais SA</td>
<td>France</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>DNI Inter Asset Bank NV</td>
<td>Netherlands</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Industri &amp; Skipsbanken ASA</td>
<td>Norway</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>KB Financial Services</td>
<td>Ireland</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The Long Term Credit Bank of Japan</td>
<td>Japan</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Royal Bank of Scotland</td>
<td>UK</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Surzur Overseas Limited</td>
<td>France</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Finance Company Viking</td>
<td>Switzerland</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Westdeutsche Landesbank</td>
<td>Netherlands</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Westland/Utrecht Hypotekarbank</td>
<td>Netherlands</td>
<td>Participation</td>
</tr>
<tr>
<td>NWSC</td>
<td></td>
<td>Bank of Scotland</td>
<td>UK</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Moscow Narodny Bank</td>
<td>Russia/UK</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Raiffeisen ZentralBank Osterreich AG</td>
<td>Austria</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Gambro</td>
<td>Sweden</td>
<td>Participation</td>
</tr>
<tr>
<td>FESCO</td>
<td>Russia</td>
<td>Fortis Bank</td>
<td>Netherlands</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Societe Generale</td>
<td>France</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Christiana Bank</td>
<td>Norway</td>
<td>Participation</td>
</tr>
<tr>
<td>SASCO</td>
<td>Russia</td>
<td>Paribas (Suisse)</td>
<td>Switzerland</td>
<td>Participation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Societe Generale</td>
<td>France</td>
<td>Participation</td>
</tr>
<tr>
<td>SFAT</td>
<td>Russia</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Ukrichflot</td>
<td>Ukraine</td>
<td>Bank of Scotland</td>
<td>UK</td>
<td>Participation</td>
</tr>
</tbody>
</table>
### ANNEX F: MAJOR IMO CONVENTIONS

<table>
<thead>
<tr>
<th>No.</th>
<th>Instrument</th>
<th>Entry into force</th>
</tr>
</thead>
<tbody>
<tr>
<td>7.</td>
<td>COLREG: Convention on the International Regulations for Preventing Collisions at Sea, 1972, as amended</td>
<td>15 July 1977</td>
</tr>
</tbody>
</table>