Ship Finance Review: Considering "SHIPTERM" & the UAE Secured Transactions Law

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1. BIMCO Enters Ship Finance with Standardised Term-Sheet

Regional banks and financial institutions in most ship finance transactions were accustomed to either the standard Loan Market Association ("LMA") or Asia Pacific Loan Market Association ("APLMA") term-sheets, or ad hoc terms sheets internally developed within such banks and financial institutions. These ad hoc arrangement led to significant time constraints, often requiring substantial input from different stakeholders to fully cover the bespoke ship related terms and conditions (e.g.; security packages, marine insurances, covenants, and undertakings).

Earlier this year a new standardised term-sheet aimed specifically at bi-lateral ship finance transactions was introduced by the Baltic & International Maritime Council ("BIMCO"). The standard form document, named SHIPTERM, is the first of its kind by BIMCO which has otherwise avoided the ship finance sector. BIMCO explain that the term-sheet is intended for secured term loan ship financing transactions between a single lender and one or more affiliated borrowers. The term-sheet is intended to be indicative only and accordingly non-binding in nature.

Operation

BIMCO have retained its familiar standard form style in SHIPTERM. Part I requires input in boxes, many of which are cross-referenced to Part II provisions, being the substantive clauses, followed by Annexures. Interestingly SHIPTERM does not provide for signatures by the parties, purportedly testament to its non-binding nature.

In terms of length, SHIPTERM spans only sixteen clauses. BIMCO's subcommittee, which were tasked with its drafting, explain that a balance was sought regarding length; being aware market practice does vary. The subcommittee further explain its caution against a document that was too long, which may risk simply becoming a first draft of the forthcoming facility agreement.

SHIPTERM includes many provisions common to generic term sheets. Its distinguishing factor is the inclusion of bespoke maritime elements. Clause 12, for example, outlines covenants. Here parties will find a section labelled "Vessel Covenants" which contains 10 characteristic ship finance covenants. These include, amongst others; maintaining registrations, restrictions on change of ownership, class maintenance, restrictions on modifications, inspections, and encumbrances.

Other central clauses also seek to address maritime specific issues. Clause 9 considers security. The clause outlines a traditional ship finance security package, containing; a first preferred ship mortgage, assignments of insurances and earnings, assignment of charterparties, and share pledges. Clause 10 continues to address insurances. The nature of cover required similarly caters to a ship finance setting, requiring; hull & machinery, P&I, war risks, and loss of hire.

Application

Most banks and financial institutions in the region have their own in-house term sheets, many of which seek to incorporate standard LMA or APLMA provisions. The difficulty often encountered in such templates is the insufficiently of shipping specific provisions. The authors suggest it is unlikely that SHIPTERM will act as an entire substitute, but more probable that it will play an important role as a check-list for amendments to the standard in-house term sheet. This is especially likely for banks and financial institutions with limited exposure to the ship finance sector.

2. Developments in UAE Secured Transactions Law

In addition to vessel mortgages and share pledges, it is typical in ship finance transactions to secure loan facilities by way of an assignment of earnings (or receivables), an assignment of insurances, and a pledge over collection accounts. Historically it has been challenging to structure security or collateral over cash flow arising out of the revenues of a mortgaged vessel, due to the floating nature of the assets. There has been a welcome change to the secured transaction law through the promulgation of Federal Law No. 20 of 2016 concerning the Mortgage of Moveable Assets to Secure a Debt ("Movable Assets Security Law"). The Movable Assets Security Law stands to fundamentally change the ability of lenders to take effective security over moveable assets, a problem both lenders and debtors have struggled with for some time.

Here the authors consider the Movable Assets Security Law's particular relevance to ship finance transactions. A more general update on the legislation, and progress regarding its implementation, may be found in this edition of Law Update's article entitled "The age of registration: An update on the Movable Assets Security Law".

Recognition of Certain Securities

The Movable Assets Security Law now recognises the assignment of rights and receivables as well as security over current and operating accounts – such securities being integral to ship finance transactions. This reform now allows lenders to take security over rights or receivables (e.g. charterparty earnings) that exist, or may arise in the future. Such receivables also need not be fixed or identifiable, which previously was a notable requirement. Further, given the specific inclusion of current, savings, and operating banks accounts under the Movable Assets Security Law, it is now possible to create security over bank accounts with a fluctuating balance, provided such security fulfils the registration requirements discussed below.

Establishment of Security Registry

The Movable Assets Security Law requires the establishment of an official security registry where recognised security interests (including the assignment of earnings and account securities) should be registered. Such registration affixes priority over the security instruments in favour of the mortgagee. It is important to note that any security over such assets created prior to the enactment of the Movable Assets Security Law need to be registered within twelve months from the date of the enactment of the law. Lenders should be mindful of these registration requirements as and when securities are officially set up. The Movable Assets Security Law does not permit registration of insurance assignments, unless intrinsically linked to the registered movable asset. Therefore, if any pledge over movable assets connected to a vessel (e.g. tools, spares, or assets of an under construction vessel) is registered, then assignment of any insurance connected with such pledge may possibly also be registered.

The security registry will not be a closed registry and lenders and other interested parties will be able to directly obtain search certificates from it to verify the particulars of any existing security (and any priorities) over movable assets of the debtors. Finally, in terms of enforcement, the Movable Assets Security Law provides different options ranging from 'self-help remedies' (in the form of set-offs, repossession, private sales, etc) to more structured court led enforcement processes.

Recommended Steps

Whilst the Movable Assets Security Law will likely be supplemented by Cabinet resolutions and executive regulations (which will provide further insights into the process and practice), it is recommended for banks and financial institutions to review their existing ship finance security packages or standard security documents in light of the Movable Assets Security Law. It is further recommended that any existing or standard security documents (e.g. assignment of earnings, account pledges or asset pledges) should be amended to enable registration as and when the security registry is established.