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CMS Maritime Overview

Spring 2021

Contents

A volatile year

The events of the past year have had a significant impact not only on how people all around the world live their lives but also on how numerous industries conduct their day to day business, and the maritime sector is no exception. The advent of COVID-19 triggered shortages of goods, plummeting cargo volumes, delays loading / unloading vessels, and prolonged difficulties with crew changes, emphasising the inherent risks in an over-reliance on a 'just in time' globalised supply chain.

Although some of the problems caused by these initial disruptions have eased, there remains significant problems for the maritime sector such as continued global travel restrictions and their impact on vessel crewing arrangements. At the same time, the wider issues facing the industry – including cyber security and the ever-increasing emphasis on environmental matters – maintain their ascent on up the sector's agenda.

Despite these challenges, the past year has also served to emphasise the importance of the shipping industry. By volume over 80% of goods traded globally are carried by ships – a number which increases to around 95% in respect of UK trade (according to Department of Transport estimates). It is unlikely that the consumer's appetite for international goods, nor the world's need for fuel transportation, nor the cruiser's desire to travel the world, will be significantly diminished in the near to medium future and that means that shipping will remain a key part of the global economy.

Over 80% of goods traded globally are carried by ships – a number which increases to around 95% in respect of UK trade

We begin this publication by examining a number of features of the shipping industry which have come under the spotlight this past year. We take a look at the outbreak of the COVID-19 pandemic and its immediate impact on shipping and have included a guide to the English law position on force majeure and an overview of some of the state aid offerings currently in existence (with a focus on Germany's aid for its indigenous yards). The CMS Hong Kong team gives its perspective on the impact of the pandemic on the industry in Asia, and we examine the consequences of Brexit on the shipping industry and the increasing cyber risk present in the maritime context as a result of the increased digitisation of the industry consequent on the lockdowns.

This is followed by a section on sustainability in the maritime sector, a topic which has and will continue to be a key area of focus in the coming years, with an update on the fuel sulphur ban, the management of ballast water, and a summary of the continued legislative pressure for de-carbonisation and ship recycling. Finally, we finish by exploring the parallel progress being made in sustainable ship finance and look ahead to the green legislation that is coming round the corner.

We very much hope you enjoy the read.

Tim Elliott and Dr. Thomas de la Motte
CMS Maritime

How global maritime has chartered its course through a pandemic

The outbreak of COVID-19 presented the international shipping industry with numerous challenges including delays to and restrictions on the movement of goods and people. One year on from the outbreak of the pandemic, the immediate disruption has largely abated but there is still a long way to go before pre-pandemic trading volumes recover and new working practices are fully adopted into standard industry practice.

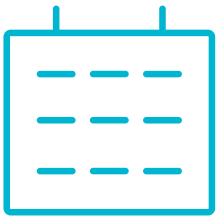
As the pandemic unfolded in the first half of 2020, forced shutdowns of businesses meant the supply of raw materials temporarily slowed while ports and shipyards faced congestion and delays, with an unprecedented number of vessels at anchor or queueing for a spot to unload cargo. As countries imposed national lockdowns and closed their borders, vessels were restricted from entering their ports, in turn causing significant issues for crew rotations.

Today, things are starting to get back onto an even keel: ports and shippers have adjusted their working practices and procedures to create safer work environments and ensure continued movement of goods and the disruptions experienced at the beginning of the pandemic have receded.

And it has become clear that the digitisation of shipping and logistics networks have played a vital role in moving supplies such as food, medical equipment, and energy across the seas quickly and efficiently. Many shippers have realised that paper-based transactions are no longer a viable long-term option. Shippers are now faced with managing the downsides of this "overnight" digitisation including a lack of standardisation and, as with everything electronic, an enhanced cyber security risk (see pg 15 for more on this).

But perhaps the most significant issue coming out of the pandemic has been in respect of seafarers. Many seafarers already spend several months at a time at sea but the restrictions arising as a consequence of the pandemic have resulted in some seafarers reportedly spending more than 17 months onboard vessels. The impact of this prolonged stay at sea on the mental and physical health of seafarers, and the resulting increase in the risk to well-being and safety of the seafarers, alongside the condition of the vessels, remains a major concern for the shipping industry. In response, many countries (including Brazil, Greece, Japan, Philippines, Korea, Singapore) have since designated seafarers as key workers – as the UK did in March 2020 – in an effort to facilitate crew changes and repatriation.

Whilst these measures have been very welcome where implemented, there are still plenty of countries which have not made this change (see pg 12 for more on this) and it will be interesting to see how national and international discussions around vaccine passports progresses in this light – many seafarers will not have priority access to vaccines and yet the need for them to fly to and from ports, often transiting one or more countries en-route, may raise yet more barriers to regular crew changes.



The restrictions arising as a consequence of the pandemic have resulted in some seafarers reportedly spending more than 17 months onboard vessels

Contractual spotlight – covid 19 and force majeure

With all sectors across the shipping industry affected by Covid-19, from passenger ships to cargo ships to oil tankers, shipping companies have been considering the force majeure provisions in their contracts as potential protection and mitigation against failures to meet their contractual obligations.

Where applicable, force majeure operates to relieve a party, partially or fully, from a failure to comply with its contractual obligations following the occurrence of certain force majeure events which are beyond the parties' control or unforeseen at the time the contract is entered into. It can also suspend the performance of an obligation or provide an extension of time for the performance of such obligations.

The party seeking force majeure protection to excuse it from any liability arising out of its non-performance bears the burden of proof to show that the contractual requirements for claiming force majeure are met – usually these requirements provide that:

— the performance was prevented/impeded/hindered (depending on the wording of the contract) by the force majeure event – the applicable contract will determine the scope of this requirement but it is generally not enough for obligations to become merely more burdensome or costly for a party;

— the force majeure event was the sole cause of the failure to perform;

— the force majeure event was beyond the parties' control; and

— there was nothing the party could have done, acting reasonably, to avoid the force majeure event or to mitigate its effects.

There is no doctrine of force majeure under English law so a party's right to rely on it will be determined by the terms of the relevant agreement. In addition to checking the governing law of the contract, this ought to be a potential claimant's starting point in assessing whether or not force majeure can be relied on.

What is a force majeure event?
Force majeure events are commonly defined as acts, events or circumstances beyond the reasonable control of the parties. However, force majeure clauses are drafted in a variety of ways, sometimes listing specific events and sometimes providing a more general description of categories of events.

Typical events that are expressly listed include acts of war, floods, earthquakes, strikes and acts of Government (which itself will be a defined term). Other force majeure clauses may be drafted more widely and simply refer to "any event beyond the reasonable control of the parties". Often a combined approach is taken – for example, Supplytime 2017 defines force majeure by reference to a list of specific events and a 'catch all' that covers "any other similar cause beyond the reasonable control of either party." In all cases, it will be a matter of contractual interpretation to determine whether circumstances can be brought within the scope of the definition and whether (for example) a list of prescribed events operates to limit the scope of any broader wording.



> It shall be considered a Force Majeure Delay if the Delivery and Acceptance of the Vessel is prevented or delayed as a consequence of extraordinary circumstances or events beyond the Builder's control, such as: Acts of God; acts of princes and rulers; requirements of government authorities; war or warlike conditions; civil commotion or riots; mobilisation; sabotage; strike or lockout… quarantines; flood; typhoons; hurricanes; storms or any other extraordinary weather conditions…; earthquakes; tidal waves; landslides; fires; explosions; collisions or stranding; import or export bans or restrictions; prolonged failure; shortage or restriction of electrical current; oil or gas; and/or any other extraordinary events beyond the control of the Builder.
>
> *Norwegian Shipowners Association*
> *Standard Form Shipbuilding Contract 2000*

Know your contract

The inclusion of a force majeure clause in a contract does not in itself act as an excuse from liability for every event which may result in a failure to perform. Force majeure clauses need to be carefully analysed on a line-by-line basis to assess whether they have been drafted widely enough to cover COVID-19.

There are several grounds typically included in these clauses, which may apply in relation to COVID-19. For example, it would likely fall within a provision or definition which:

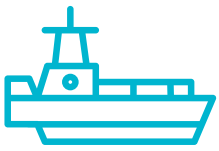
— specifically lists "epidemic" or "pandemic" or "outbreak" as a force majeure event;

— includes "acts of Government" or changes in law – much of the disruption to contract performance was due to government action and legislation, rather than the COVID-19 disease itself, through the imposition of national lockdowns and restrictions on movement, although care should be taken to distinguish between requirements that are enacted in legislation and mere guidance where compliance may not be mandatory and may fall outside the scope of a protection based on a change in law; or

— include indirect events caused by COVID-19 such as non-performance by suppliers which may also trigger a force majeure clause if the force majeure event prevents a party from performing its obligations under a contract and the clause is sufficiently widely drafted.

Proving causation

It is not enough for the force majeure event to simply have happened; the party relying on the event must also establish that it is the cause of the failure to perform in respect of which relief is sought. Showing this causation is not always straightforward. For example, a recent English Court decision in Classic Maritime Inc v Limbungan Makmur determined that an accident at a mine, where a dam forming part of the mine burst, was not sufficient to allow a charterer to rely on a force majeure provision to relieve it of obligations to make shipments, despite an express reference to "accidents at the mine" within the relevant force majeure definition. In that case causation could not be shown because other circumstances meant that the charterer would not have been in a position to fulfil the required



It is not enough for the force majeure event to simply have happened; the party relying on the event must also establish that it is the cause of the failure to perform

shipments even if the dam had not burst. As two shipments had already not been fulfilled prior to the dam bursting, the charterer could not meet the causation test.

Remedies

Since force majeure is a creature of contract, in an English law context, the contract will also define the remedies that are available in the event of force majeure. Commonly, where the test for force majeure is met, the contract will relieve parties from any liability for failure to perform their contractual obligations and will allow, for example, extra time for performance of those obligations. However, care should always be taken to consider the whole picture before asserting force majeure. Often, in addition to providing relief from liability for failure to perform the contract may also permit recission of the contract or ultimately give rise to a termination right if the force majeure event continues beyond a set period of time.

For example:

— the Shipowners Association of Japan Standard Form Shipbuilding Contract 2003: – gives the buyer the right to rescind the contract for "excessive delay" (being a delay of 210 days or more) caused by a force majeure event; and

— the BIMCO Standard Newbuilding Contract: - gives the buyer the right to terminate the contract, upon giving notice, in the event that the delivery of the vessel is delayed by more than 180 days by virtue of events that fall within the force majeure clause.

Recission vs Termination of Contract:

— **recission extinguishes a contract and restores the parties (as far as possible) to their position before contracting; and**

— **termination brings the contract to its end and absolves the parties of their obligations under the contract (save for any obligations which the contract provides survive termination).**

Additionally, a failure to perform contractual obligations which turns out to be based on an incorrect or premature assertion of a force majeure event could render a party in repudiatory breach of the contract and such repudiatory breach could result in the termination of the contract and damages being claimed by the other party.

As with the treatment of force majeure, the position regarding available remedies is not treated in the same way by all governing laws and so it is important to make sure that the contractual analysis of the force majeure provisions and any potential remedies is carried out in the correct legal context. For example, recently the Supreme Court of Saudi Arabia published a decision setting out judicial principles to be applied by the courts there in relation to contracts impacted by the Covid-19 pandemic, which included that the pandemic will be considered an event of force majeure in the event that performance becomes impossible. Kingdom of Saudi Arabia: The recent Supreme Court Decision on contracts impacted by COVID-19 (cms-lawnow.com)

Look out for other relevant clauses
If a party is seeking to rely on a force majeure clause to obtain relief from a failure to perform its obligations, it should check whether there are any other contract terms that are relevant to such a claim. For example:

— Are there any notice provisions that should be complied with? Many contracts require a party who wishes to invoke force majeure to provide notice in writing to the other party, and there are often requirements as to timing or content that it is important to comply with.

— The governing law clause will be relevant. The comments here focus on the English law position, but the concept and effect of force majeure varies significantly across jurisdictions. Many legal systems have specific legislative definitions of force majeure which apply even if the applicable contract does not refer to it. In others (like under English law) force majeure protection will rely entirely on the express agreement between the parties.

In summary, it is crucial that the precise wording of the contractual provisions surrounding force majeure and its application are reviewed carefully as these will determine what events constitute force majeure, what precisely must be shown in order to obtain relief from compliance with contractual obligations on the basis of a force majeure event, and what relief is afforded if those requirements are met.

State aid in the pandemic: how Germany is supporting its maritime industry

As the pandemic sent shockwaves through the global maritime industry, governments around the world looked at ways to support their shipping industries. This is Germany's robust approach…

In March 2020, the German government established several support programmes to assist various industries in coping with the economic repercussions of the COVID-19 crisis. Among them was the Economic Stabilisation Fund (Wirtschaftsstabilisierungsfonds or "WSF") designed to support major industry players. The WSF has, inter alia, supported the shipping and ship building industry, being one of the sectors particularly hard hit by the impacts of Covid-19.

When establishing the WSF, the German government and legislative followed the model of the Financial Market Stabilisation Fund (Finanzmarktstabilisierungsfonds or "FMS") which had previously proved helpful in 2008 in rescuing the German banking sector during the financial crisis. Like the FMS, the newly established WSF is a special fund directly held by the Federal Republic of Germany. The WSF has access to funds of up to EUR 600bn which may be used to avoid the negative long-term economic and social consequences of the pandemic by providing quick, targeted, and temporary aid to stabilise companies. The state aid that the WSF provides to affected companies by reinforcing their capital base or closing liquidity gaps is permitted under the umbrella of the Temporary Framework enacted by the European Union for state measures to support the economy in the pandemic.

Who is eligible?
The support measures of the WSF are primarily targeted at larger companies which play an important role, for example in supply chains or as employers. To be eligible for support from the WSF a company must satisfy two of the following three criteria and have:

1. more than EUR 43 million balance sheet total;
2. more than EUR 50 million annual turnover; or
3. more than 249 employees.

Furthermore, the economic difficulties of the company must be a consequence of the COVID-19 crisis. Companies already in difficulty before the outbreak of the pandemic are not eligible.

The WSF provides support either by way of state guarantees which secure loans, credit lines or similar capital market products, or by way of recapitalisations. In case of the latter, the WSF may participate in a company by acquiring preferential shares (without voting rights) or ordinary shares. Another possibility is the use of hybrid financial instruments such as silent participations, subordinated loans, or other bespoke financial instruments.

Since the measures are temporary in nature, any debt secured by the WSF guarantees is limited to having a maximum term of 5 years, whereas recapitalisation measures shall generally be terminated after 6 years, but in any event after 10 years at the latest.

So far, the highest level of support from the WSF was granted to the aircraft industry (Deutsche Lufthansa received approximately EUR 5.8bn), but companies in the shipping and ship building industry have also benefited, including the shipyards MV Werften (EUR 193m) and German Naval Yards Kiel (EUR 35m). In view of its cruise ship business, TUI, which received EUR 150m, can also be included in this list.

Support at a price

In addition to the interest and fees payable for loans, guarantees and other support measures, the involvement of the WSF comes with strict covenants for management. Managers must undertake to implement a sound business policy which secures jobs and stabilises supply chains. Furthermore, their remuneration is subject to strict regulations. Members of the board of directors or the supervisory board may only receive fixed salaries. Bonuses, share options, and other variable remunerations are not permitted. These covenants apply until the WSF's funds are repaid (in case of loans) or the WSF's participation has ended (in case of share participations).

> The involvement of WSF comes with strict covenants for management… bonuses, share options and other variable remunerations are not permitted… until funds are repaid

Short-term protection for long-term gain

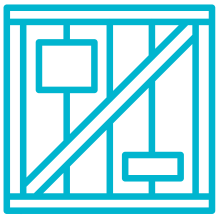
By establishing the WSF and providing aid to shipyards, the German government took robust measures to protect the German maritime industry from the immediate consequences of an unforeseen and unforeseeable worldwide pandemic. However, the WSF cannot and will not shelter companies from a competitive environment post-COVID-19. Supported shipyards and other companies have to use this temporary safety net to develop profitable and sustainable new business models which will secure their long-term success in the maritime industry.

Government backed financial support around the globe for the Maritime Shipping Sector:

1. **Italy – in June 2020 the European Commission approved the extension of support measures, under Italy's "International Registry" scheme which, among other benefits, include corporate tax reductions for companies in the maritime transport sector (with a large part of their fleet flagged in an EU or EEA state) until 2023.**
2. **France – in May 2020, CMA CGM obtained circa $1.14 billion in secured, syndicated loans backed by the government of France.**
3. **Korea – $33 billion fund launched to protect its 7 key sectors, including its shipping and ship building industries which were allocated circa $1 billion.**
4. **Taiwan – in June 2020 it was announced that shipping companies Evergreen and Yang Ming Marine Transport Corporation are to receive circa $568 million in state backed loans.**

An Asia perspective: beyond covid-19

All shipping sectors around the world have seen the development of unconventional trends throughout the year as dynamics shifted quickly with the evolution of the pandemic. The tanker market experienced a rosy first half-year as plummeting oil prices caused the demand for floating storage to skyrocket. At its peak, around 20% of the whole global very large crude carrier ("VLCC") fleet (over 150 vessels) were used as floating storage, mostly in South East Asian waters. The freight market corrected significantly amid dropping world oil demand coupled with narrowing crude price arbitrage. Pre-COVID the dry bulk sector was dominated by the China-US trade war and the pandemic further weighed on global energy demand. However, strong China iron ore imports offset other market falls and surging demand for Chinese coal imports in the second half of the year further boosted the market.



Trade rebounded towards the end of the year as demand for goods shipped from Asia built up, and liners operated at close to full capacity

Overall, the dry sector experienced a re-balanced and re-stabilised year. Container shipping saw a deep disruption of Chinese exports in early 2020 when Chinese manufacturing activities were stalled, followed by significant trade declines on key routes globally because of lower consumer demand. Trade rebounded towards the end of the year as demand for goods shipped from Asia built up, and liners operated at close to full capacity. Soaring box freight is now being driven by Asia's (largely China's) quick recovery, greater influence of e-commerce in western countries and a greater reliance on shipping as cargo planes are grounded.

Stranded crews

The worldwide population of seafarers serving on internationally trading merchant ships is estimated to be 1,647,500. Most seafarers are from developing countries in Asia, of which China is the biggest supplier of officers, followed by the Philippines, India, and Indonesia. As of December 2020, there were about 400,000 seafarers stranded onboard vessels beyond their original contracts. They cannot be repatriated or even get urgent medical assistance due to current travel restrictions. Since the outbreak of the pandemic, Asian maritime hubs have taken leading roles in assisting crew signing-off and alleviating the pain suffered by crews thanks to their early success in curbing the disease.

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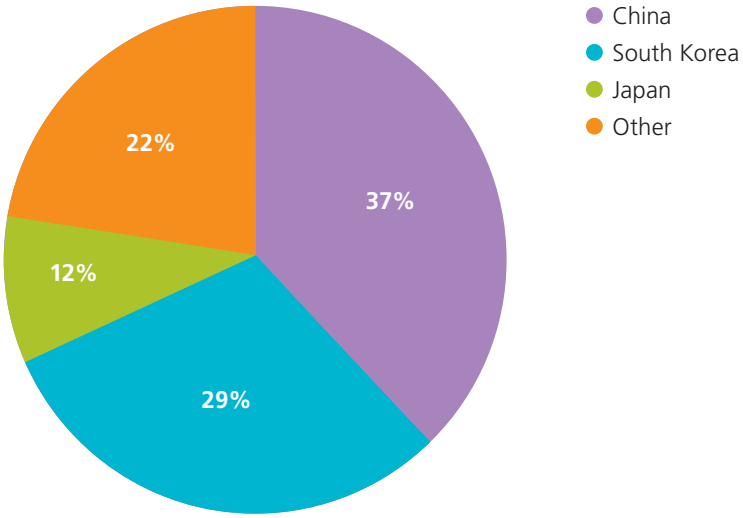
Hong Kong and Singapore were among the first ports to allow crew changes due to both authorities lessening restrictions from May 2020 onwards. The crew crisis then received more attention globally and was eventually escalated to the United Nations. Indonesia leads a coalition of 71 countries demanding global government action to immediately implement measures to allow crew changes and to ensure

access to medical care for all maritime personnel. In December 2020, the General Assembly adopted a resolution to designate seafarers and other personnel as key workers. It also calls on other governments to take steps to facilitate maritime crew changes, including by enabling embarkment and disembarkment, to expedite travel and repatriation efforts, and to ensure access to medical care.

Subdued shipyards

COVID-19 proved challenging for the world's shipbuilding heartland – China, South Korea, and Japan (see graph below). Investor appetite continued to be subdued in 2020. Only 608 vessels, with an estimated newbuild value of USD 33bn, were reportedly ordered globally, representing a year-on-year decline of 55%. The global order book to fleet ratio stands at 7.2%, the lowest point since the 1980s. This has significantly affected the top three ship builders' earnings and will potentially weigh on the newbuilding financing sectors in coming years. Figures also show that 'active yard' numbers have been reduced from 418 to 364 in the past twelve months. However, yard activities are expected to pick up again as the fleet renewal programme as part of the 'Green Transition' comes on stream. In addition, state-owned shipping companies in China are expected to receive post-pandemic subsidies as part of national stimulus packages.

% of global total merchant fleet order booksbooks in million CGT terms as at end 2020



Silver linings

Although medium to long term COVID-19 continues to hit the airline and cruise ship industries, merchant shipping has more or less emerged from the crisis. Indeed, industry participants in Asia tell us that the tanker and containership sector are enjoying some of their best days in many years. The crisis has again proved how resilient the shipping industry is as a fundamental part of the world economy and, with the global rollout of vaccination programmes, we expect to see increasing activity in the sector over the rest of the year.

UK focus: Brexit and the maritime industry

In addition to the effects of the COVID-19 pandemic on the global shipping industry, the UK and in particular the UK maritime sector has also had to deal with the impact of Brexit on the UK. Below we discuss the impact of three specific areas with particular relevance to maritime sector.

1. Movement of people and goods.
The additional cost and administrative requirements being incurred by commercial workboat owners operating across Europe is a significant by-product of Brexit. Businesses which operate '[x] weeks on, [x] weeks off' crew change patterns are discovering that they need to renew visas / travel permits for each journey, at an additional cost per journey, because UK citizens can no longer travel freely in the EU. Similar issues of course arise in relation to transporting goods.

Although an unsurprising consequence of Brexit, it is also generally accepted that because the details of the UK's new relationship with the EU were not known until late December 2020 many businesses were unable to do much, if anything, to mitigate the financial impacts or plan ahead. It therefore remains to be seen whether UK vessel providers will continue to be competitive within the European market.

2. Increased focus on social value in UK procurements
Central government in England and Wales is now required to include a minimum weighting of 10% for social value in public procurements, with policy outcomes which include supporting local communities recovering from the pandemic, creating new businesses, new jobs and new skills, increasing supply chain resilience, tackling workforce inequality, and improving community cohesion. Furthermore, simply promising to provide social value will not be enough; bid commitments will be woven into contracts and performance against these promises will be measured.

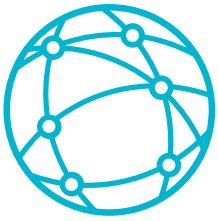
Inevitably this will trickle down through supply chains and is expected to at least be matched by similar rules in Scotland. There are enough public sector maritime requirements for this to be something the sector should be aware of and should start planning for.

3. Renewed momentum for regenerating UK shipbuilding
In 2019 the UK Government pledged to "bring shipbuilding back to the UK". There has been a degree of criticism to date around the slow rate of progress against this pledge, but the March 2021 Conference of the Society of Maritime Industries titled 'Building the future of the UK's shipbuilding enterprise' and was themed around the refresh of the 2017 National Shipbuilding Strategy, which is expected to be published in the third quarter of 2021. The Refreshed Strategy is intended to bolster the shipbuilding and maritime sector across the four UK nations and create "a supercharged, successful and sustainable UK shipbuilding enterprise" with credible, capable UK yards and value for the UK taxpayer. The Refreshed Strategy is also expected to tie in with proposed and actual alterations to UK procurement processes with a stronger focus on the social value created through vessel procurement (see point 2 above).

Accompanying the Refreshed Strategy will be a 30-year procurement pipeline setting out a "demand signal" for all government owned vessels over 150 tonnes, which is designed to support shipbuilding and the supply chain without encouraging dependence. This pipeline will set out shipbuilding opportunities not only for military vessels but also for commercial vessels, and the supply chain associated with these opportunities, and will make best use of green technology including but not limited to power, propulsion, hydrodynamics and energy management.

As yet, there is no clear answer on how Brexit will impact the shipbuilding industry, but there may be cause for optimism as a result of (i) the growing recognition of social value and local content and (ii) continued government support for jobs in the post-Covid-19, post-Brexit period. Further, the full details of the UK's proposed state aid regime are yet to be finalised, but many expect to start to see divergence from the EU regime, permitting greater UK Government support for domestic firms.

The UK is unlikely to be able to (or perhaps even want to be able to) compete with Asia on building super tankers and VLCCs, but is already focusing heavily across multiple sectors on new and greener technologies and smart designs. With a stated aim to significantly strengthen UK shipyards and with several years left in office, we may well yet see some interesting proposals from the UK government in this area.



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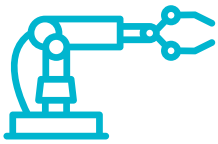
Cyber risk across our seas and ports

The challenges presented by the COVID-19 pandemic and Brexit have accelerated the reliance on automation and digital solutions in the maritime sector. As automation continues to grow and increase efficiency in maritime, the industry must also scale up its cyber security efforts.

All industries have seen a huge increase in cyber-attacks and the maritime sector is particularly susceptible to such attacks. Higher automation and digitisation engender greater efficiency in the industry but also give rise to increased vulnerability both on board and shore-side.



Higher automation and digitisation engender greater efficiency in the industry but also give rise to increased vulnerability both on board and shore-side

Such is the importance of this topic to the sector that, for example, DNV GL are now offering cyber-secure class notations for vessel design and operation, and cyber secure type approval for systems and components. There is also a wealth of guidance for vessel owners and operators including the IMO 2017 Guidelines on Maritime Cyber Risk Management, which provide high-level recommendations on maritime cyber security risk management, and the 2017 Institute of Engineering and Technology Code of Practice on Cyber Security for Ships, produced in conjunction with the Department for Transport and the Defence Science and Technology Laboratory.

Both of these publications acknowledge that ships are becoming increasingly dependent on digital and communications technologies and encourage cyber security to be considered as part of the overall risk management planning for both the vessel and the business.

More recently, the Baltic and International Maritime Council (BIMCO) has issued a 4th version of their Guidelines on Cyber Security Onboard Ships which contain general updates to best practises and improved guidance on risk and risk management. High level principles include:

— establishment of awareness of the risks;

— protection of shipboard IT infrastructure;

— protection of data to a level adequate for the sensitivity of the information;

— ensuring users have access to necessary information and no more;

— management of communication between ship and shore; and

— development of a cyber incident response plan based on a risk assessment.

BIMCO state that 'The improved risk model takes into consideration the threat as the product of capability, opportunity, and intent, and explains the likelihood of a cyber incident as the product of vulnerability and threat'.

Ports are also vulnerable, as demonstrated by the disruption caused when the Shahid Rajee terminal in Iran was hacked in 2020. Key facilitators in international trade and logistics, ports connect supply of goods by sea with inland transportation and act as a lifeline for regional economies. They increasingly have automated navigation, fleet management and logistics systems - but some consider that ports are underprepared for cyber-attacks, making them soft targets for those looking to disrupt national infrastructure.

A cyber-attack could result in vessel collisions (with resultant risk to crew safety), could adversely impact speed and efficiency of operations, and disrupt the port business including loss of cargo and/or loss of personal data. So, while ports have traditionally focussed on physical security, as automation increases, they need to shift their focus towards cyber concerns to decrease their vulnerability to cyber-attacks.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Environmental change in the maritime sector

The effects of the pandemic and Brexit may have delayed progress against environmental targets, but stricter regulation and increasing pressure from funders are collectively steering the industry towards a greener future.

Reduction of emissions is a top priority for the maritime sector which is seen as the backbone of the global economy and accounts for around 2.2% of global greenhouse gas (GHG) emissions. According to the fourth International Maritime Organisation ("IMO") GHG Study 2020, maritime emissions (mainly methane and black carbon) increased by nearly 10% between 2012 and 2018 and are expected to increase further by up to 50% by 2050. The initial IMO GHG Strategy, adopted in 2018, set ambitious targets to halve GHG emission from ships by 2050, compared to 2008, and to reduce the carbon intensity of international shipping by 40% by 2030.

There are a growing number of regulatory drivers for the maritime sector to reduce emissions both at international and at local level. Numerous voluntary initiatives for reducing emissions are also on the rise. In this section we examine how some of the key efforts to make shipping and shipping finance cleaner and greener have progressed and look ahead at what else is on the horizon for ship owners and operators in achieving a greener industry.

Impact of the global sulphur ban

Since 1 March 2020 all marine vessels have been subject to a ban on carrying high sulphur marine fuel oil ("HSFO") (oil with sulphur content greater than 0.50%) unless they have a 'scrubber' fitted. The 0.50% sulphur cap has been in place since 1 January 2020, while the related carriage ban serves to strengthen the compliance and enforcement elements of the ban. This means that vessel operators now have three options to choose from in order to comply with the new sulphur rules:

1. use IMO compliant fuel oil (subject to availability);
2. continue to use HSFO if the vessel is equipped with an approved scrubber system; or
3. use LNG or methanol as fuel.

Each option has its own draw-backs and benefits depending on the ship type, availability, and affordability of low sulphur fuel in different ports.

Why is sulphur in marine fuel problematic?

The heavy fuel oil used in international shipping contains 2700 times more sulphur that road fuel. Sulphur contained in fuel causes emissions of sulphur dioxide (SO2) and also contributes to the formation of secondary particulate matter (PM) that is particularly harmful both to humans and the environment. These emissions have a major health impact, with shipping air pollution estimated to cause around 50,000 premature deaths per year in Europe.

Sulphur, when burnt in air, converts into sulphur dioxide (SO2), which, when released into the atmosphere, can form an acidic solution, dissolving in rain to form acid rain. This causes widespread damage to the environment, affecting lakes and forests, and has been blamed for erosion damage to buildings and structures of historic importance.

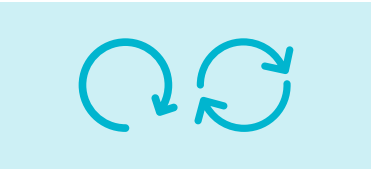
Open loop scrubber bans

The use of HSFOs results in the production of harmful gases. In order to remove these elements from the exhaust, ships use systems known as scrubbers, which come in three varieties (see panel for details).

Open loop scrubbers vs closed loop (approved) scrubbers.
The three varieties of scrubber:

Open-loop – these systems suck in seawater, spray it into the exhaust, and discharge it overboard, often without treatment. These scrubbers are the cheapest to install and operate and account for 80% of scrubbers installed on ships.

Closed-loop – have a tank of alkaline-dosed freshwater onboard, which is sprayed into the exhaust. This water is filtered to remove solid particles and then recirculated, with a small amount of 'bleed-off' water discharged overboard. Closed-loop scrubbers are the most expensive to run and account for less than 2% of scrubbers overall are closed loop.



Hybrid scrubbers – these account for about 17% of scrubbers installed on ships and can be operated in open-loop or closed-loop mode. They are more costly to run than open-loop scrubbers and are mainly used in open-loop mode but provide insurance against local restrictions on open-loop scrubber discharges.

Source: International Council on Clean Transportation.

Owing to concerns about the potential harm done to marine life from open loop scrubbers which discharge sulphur contaminated wash-water into the sea, restrictions and bans on their use were reported by the International Bunker Industry Association in September 2020 for certain ports or territorial waters, including: China (territorial waters), Singapore (within port limits), Malaysia (territorial waters), Pakistan (within ports), UAE (Fujairah and Abu Dhabi port limits), Bahrain (within port limits), Egypt (Suez Canal), Gibraltar (local waters), Spain (port of Algeciras), Portugal (port waters), France (certain ports), Belgium (ports and inland waters), Ireland (port waters in Cork, Dublin and Waterford), Scotland (ports on the Forth and Tay), Norway (heritage fjords), Sweden (port of Brofjorden), Germany (seaports adjacent to inland waterways and inland waterways), Lithuania (port waters), Bermuda (territorial waters), Panama (the Panama Canal) and the USA (Connecticut port waters and Californian waters). The list is likely to widen as air pollution reduction regulations in and around ports become more stringent.

The ban on the use of open loop scrubbers continues to have far reaching implications for ship owners, operators and managers, as well as for ports, refiners and bunkering industries. The global outbreak of COVID-19 has exacerbated the disruption, such that it is impacting the availability of low sulphur fuels. Whilst the robustness and frequency of physical inspections have been reduced, the ban itself has never been waived as such. COVID-19 specific guidance issued by the UK Maritime and Coastguard Agency stresses that "operators taking advantage of the MCA guidance should be aware that non-compliance with fundamental aspects of the relevant conventions may lead to control action being imposed by an attending Port State Control Officer". This "control action" ranges from ship arrests and port detentions to delays and refusals of entry to ports. Any such delays and detentions could have many consequences, including, but not limited to contractual claims and insurance implications, reputational damage and significant monetary fines for non-compliance.

The FONAR alternative

Owing to the lack of availability of low-sulphur fuels in certain ports, many ships have been forced to submit FONARs (Fuel Oil Non-Availability Reports) to their flag states and the competent authorities in the Port State for using non-compliant fuel oil. It is an offence to fail to present a FONAR, or to present an inaccurate FONAR, but there is no guarantee that submission of a FONAR will result in the ship avoiding sanctions.

FONARs were introduced by the IMO in recognition of the uncertainty surrounding economic availability and supply of low sulphur fuel. However, the IMO was keen to discourage over-reliance on the FONAR scheme as a waiver or a 'get out of jail free card', especially given the significant price differential between HSFO and IMO compliant fuel oil.

A FONAR does not provide an exemption from compliance. It is simply a record of the actions taken by a ship in its attempt to meet the IMO requirements and, therefore, a key document for the relevant authorities in assessing whether there are mitigating circumstances which would justify the ship's use of HSFO. What remains unclear, however, is the number of attempts a ship should make to source compliant fuel and how many fuel suppliers should be contacted before a decision is taken that all possible options have been exhausted. GISIS MARPOL Annex VI IMO database contains numerous examples of FONARs already submitted to the IMO (around 280), and it is noteworthy that the number of fuel suppliers contacted for compliant fuel on each occasion varies.

Ballast water: the risks and solutions

A changing regulatory landscape is tackling the detrimental effect of ballast water on the marine environment.

The Ballast Water Management (BWM) Convention came into force internationally on 8 September 2017. The BWM Convention is designed to tackle the problem of bio-invasion and the spread of invasive species, and applies to all vessels, regardless of size/tonnage, that are entitled to fly the flag of a party to the BWM Convention and that operate in the waters of more than one party to the BWM Convention (internationally operating vessels).

Ships subject to the BWM Convention requirements must:

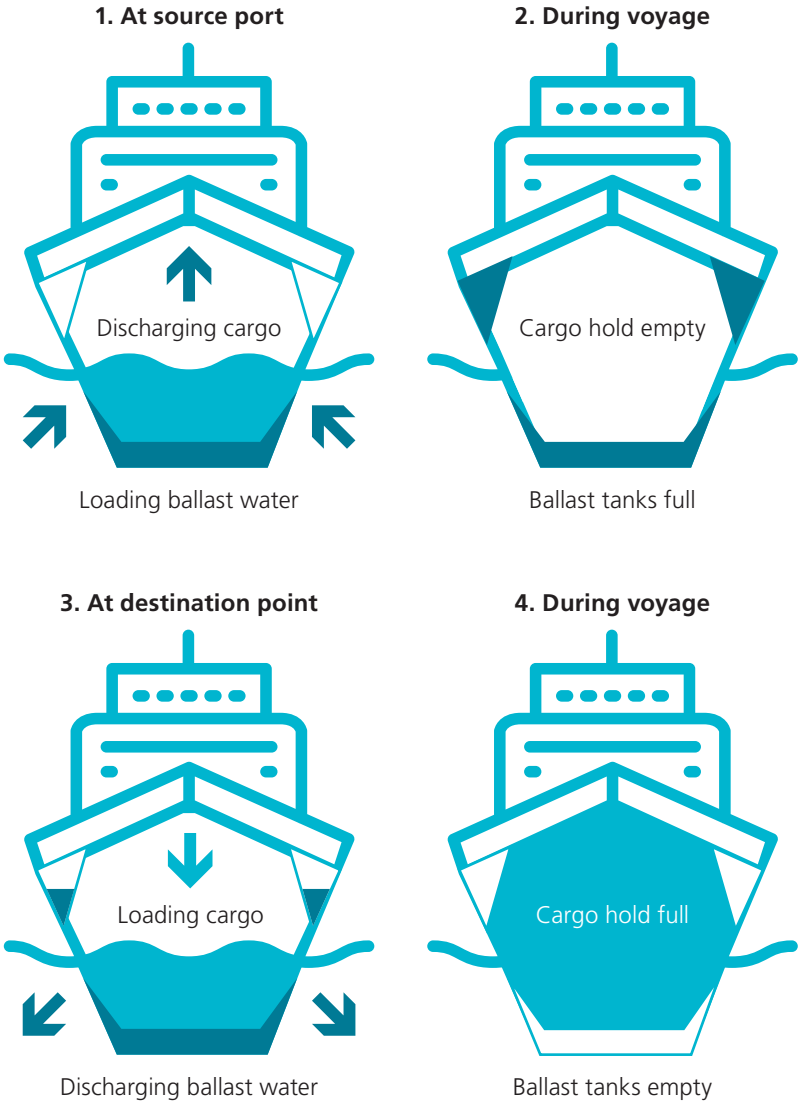
— conduct ballast water management in accordance with the provisions within the BWM Convention;

— carry and implement a ballast water management plan;

— maintain a ballast water record book which must be completed after each ballast water operation; and

— meet ballast water management standards (D1 – Ballast Water Exchange Standard or D2 – Ballast Water Performance Standard).

Ballast water management - the control of harmful invasive species



Currently, any ballast water discharged from a ship is required to meet either the D-1 or D-2 standard until such time as the D-2 standard becomes the legal requirement. Ships currently meeting the D-2 standard (usually through the use of a ballast water treatment system), can opt to meet D-1. The Convention's implementation schedule means that the use of ballast water exchange, which meets the D1 standard, as a management method will be replaced by a requirement for ballast water to meet the D2 discharge performance standard (usually through the use of a ballast water treatment system).

Ballast Water Management Convention Standards:

- **D1 (Ballast Water Exchange Standard): requirements to be met for ballast water management through replacing the ballast water mid-journey, aimed at controlling where and how ballast water is discharged. Success of this method is based on the fact that many invader species from coastal waters cannot survive in deep waters and vice versa.**
- **D2 (Ballast Water Performance Standard): requirements to be met for treated water to be discharged, aimed at controlling the number of species in ballast water that will be discharged. Success of this method is based on the use of water treatment systems on ballast water to determine when the ballast water can be discharged.**

Exclusions

The BWM Convention does not apply to ships not constructed or designed to carry ballast water, or to ships that operate only in domestic waters, or in the waters of a single party to the BWM Convention, or on the high seas. Warships, naval auxiliary ships, or ships owned or operated by a state and used only on government non-commercial service are also excluded from the scope of the BWM Convention.

In addition, the D1 / D2 requirement standards do not apply to ships that discharge ballast water to a reception facility that has been designed taking into consideration Guideline G5: Guidelines for ballast water reception facilities. Ships will be required to meet either the D1 or D2 standard until such time as they are required to meet D2. Different implementation timelines apply to the D2 standards, depending on flag state of the ship. Similarly, some exemptions are available in certain circumstances to a ship or ships on a voyage(s) between specified locations, ships which operate within a defined area, or to a ship that operates exclusively between specified locations.

Whilst the UK has yet to ratify the BWM Convention, some ship operators, particularly ferries, have installed ballast water systems ahead of schedule. Inspections and enforcement of ballast water requirements are being carried out under the International Safety Management Code (the "ISM").

Bio-invasion poses threats to:

1. **Human life: outbreaks of infectious diseases such as cholera epidemics have been linked to ballast water;**
2. **Ecosystems: the introduction of invasive species such as crabs, toxic algae, jellyfish can alter habitats and lead to the extinction of local animal and plant life and to the contamination of aquatic life which if consumed by humans can lead to illness; and**
3. **Economic welfare: the introduction of invasive species can impact the availability of commercially important species and have lead to the collapse of certain fisheries which had significant economic and social impact on the affected areas.**

Ship recycling requirements gather pace

In addition to an increased focus on environmental concerns, sustainability, including the recycling and scrapping of ships, is an increasingly important issue for shipowners and charterers alike.

Each year around 800 ships need to be broken apart and recycled and approximately 70% end up beached in India, Pakistan, and Bangladesh, being taken apart by poorly paid workers (including children) with little PPE or heavy machinery. These countries offer much higher prices for scrap steel, but the lack of health and safety standards and significant pollution of the beaches and seas can result in intense media scrutiny and adverse publicity.

The recognition of the need to impose recycling obligations on the shipping industry is not new. In 2009, the IMO oversaw the creation of the Hong Kong Ship Recycling Convention (the "Hong Kong Convention"), which sets standards for ship recycling. Concerned at the lack of progress in satisfying the conditions needed to bring the Hong Kong Convention into force, the EU published its own Ship Recycling Regulation 1257/2013 (the "Ship Recycling Regulation") in 2013, with a view to facilitating early ratification of the Hong Kong Convention both within the EU and in other countries outside the EU. As the Hong Kong Convention has yet to come into force, the 2013 regulations are vital to responsible ship recycling in the EU.

Hazardous materials

The Ship Recycling Regulation requires that, from 31 December 2020, all existing ships sailing under the flag of EU member states and non-EU flagged ships calling at an EU port or anchorage must carry on-board an Inventory of Hazardous Materials (an "IHM") with a certificate or statement of compliance, as appropriate. For EU-flagged vessels, a certificate (either an Inventory Certificate or Ready for Recycling Certificate) will be necessary, while non-EU flagged vessels will need a Statement of Compliance.

However, over the past few months, industry stakeholders have been concerned that COVID-induced restrictions would cause significant difficulties in surveying ships and producing certified IHMs. This concern culminated, in July 2020, with the Baltic and International Maritime Council and other shipping organisations addressing a letter to the EU Commission in which they requested a time-limited implementation or grace period to allow shipping companies to gear up for the IHM process while managing COVID-based interruptions.

The Commission refused to postpone the 31 December 2020 deadline, noting that it was not empowered to change the legal deadline. However, on 20 October 2020, the Commission published the 'IHM Guidelines' with the principal aim of allowing for the more flexible enforcement for a limited time-period in light of the exceptional circumstance of the COVID-crisis.

These guidelines explicitly provide that parties may not have recourse to the notion of force majeure (i.e. the unwinding of the Ship Recycling Regulation obligations by virtue of abnormal and unforeseeable circumstances that were outside the control of the party in question). They instead propose a harmonised approach for a period of 6 months after the deadline (i.e. until 30 June 2021) to deal with the following COVID-related scenarios:

— flexibility for vessels without a valid IHM and/or accompanying certificate – If a vessel arrives at an EU port after 31 December 2020 without a valid IHM and/or accompanying certificate (Inventory Certificate or Ready for Recycling Certificate for EU-flagged vessel or Statement of Compliance for non-EU flagged vessel) and the ship owner/master claims that this non-compliance is due to the Covid-19 situation, the owner/master must provide evidence that all possible measures to undertake the work and get the certification required were taken. Some guidance on possible and acceptable measures is provided, but ultimately it will be determined on a case-by-case basis; and

— flexibility for vessels with a semi-completed IHM and with an associated certificate of Statement of Compliance that does not contain on-board sampling – If a vessel arrives with an IHM that was prepared remotely without any on-board sampling where the sampling was impossible due to COVID-induced restrictions, the IHM should be rejected in principle. However, such a remote survey may be permitted, exceptionally, if certain conditions are satisfied, such as, for example, the production of evidence that the flag state had agreed to this.

The consequences of a failure to comply

Article 22 of the Ship Recycling Regulation dictates that EU member states lay down provisions on penalties applicable to infringements, including those relating to the IHM; it does not impose an upper limit on fines imposed by individual EU member states. Fines for non-compliance thus tend to vary. The Ship Recycling Regulations 2018 implemented the IHM obligations in the UK from 31 December 2020 and provide that a ship owner who is guilty of any such offence is liable on summary conviction to a fine (on summary conviction in Scotland or Northern Ireland, for example, this is in an amount not exceeding the statutory maximum of £10,000 in Scotland and £5,000 in Northern Ireland); or on conviction on indictment anywhere in the UK, to a fine or to imprisonment for a term not exceeding two years, or to both. It is also worth noting that one cannot insure against fines for criminal offences, such as a breach of the IHM rules. Thus, legal advice should be sought if the pandemic or other challenges have prevented a ship owner from securing an IHM.

The provision for UK flagged vessels post-Brexit

UK flagged vessels over 500GT that are involved in international voyages have to adhere to the UK Ship Recycling Regulations meaning that their owners are required to ensure that these ships are only recycled at facilities included in the 'European List' of ship recycling facilities. The list includes four ship recycling facilities located in the UK / Northern Ireland.

Note that with effect from the 1 January 2021, UK flagged ships are classed as 'third country ships' by EU member states. This means that EU member states are entitled to require UK ships which are subject to EU Port State Control to carry a Statement of Compliance onboard.

Vessels which are or which have been linked to the UK will continue to attract media attention if they are disposed of in a manner which avoids the Shipping Recycling Regulations – see UK cruise ships scrapped in India's 'ship graveyard' - BBC News. As a result, responsible shipowners, financiers, and long-term charterers are often now looking for contractual mechanisms to prevent irresponsible disposal of vessels at the end of their seagoing life.

Sustainable ship finance

The maritime industry is looking to become greener not only in its operations but also in its financing of the industry. The parameters for sustainable ship finance have long been uncertain but new regulations, incentives and agreements are now fuelling progress.

As part of the European Green Deal, general pan-European regulations have been adopted and proposed to create a common reference framework for the classification of sustainable activities (EU Taxonomy Regulation[1]) and furthering European sustainability goals (proposal for a EU Climate Law[2]), with industry specific regulations and standards to follow. Financing markets have been looking for ways in which their products can contribute to the worldwide sustainability agenda, giving rise to the concept of sustainable or "green" finance. Examples include the green loan principles and the sustainability linked loan principles authored by the Asia-Pacific Loan Market Association, Loan Market Association, and Loan Syndications and Trading Association and the various certification schemes by the Climate Bonds Initiative.

In the absence of established rules on what characterises sustainable ship finance, there previously seemed to be a lot of leeway for financing initiatives in the shipping sector to be labelled as sustainable. However, to avoid any claims of "greenwashing", adherence to the classification system in the EU Taxonomy Regulation now seems to be the minimum standard to be met. The EU Taxonomy Regulation creates an EU wide classification system establishing the requirements an economic activity needs to meet in order to be labelled as "sustainable". The European Commission ("EC") has clearly communicated that 'it will step up its regulatory and non-regulatory efforts to tackle false green claims'. In addition, for similar reasons an important role is attributed to ´reliable, comparable, and verifiable information'[3].

Against the above backdrop, we consider the various ways in which finance can contribute to greater sustainability in shipping.

The challenge of accessing finance

Though some feel that mere compliance with regulatory requirements is setting the bar for sustainability too low, simply accessing funding to finance such compliance in the maritime sector can be a real challenge. For example, there may be a disproportionate cost to benefit in retrofitting specific vessel types (considering vessel value and expected return on investment) and legal considerations may make it challenging to come up with appropriate security structures in retro fit financings. Any initiative creating access to finance to achieve compliance with regulatory deadlines may therefore be deserving of the label of a sustainable activity.

Funding provided pursuant to the European Investment Bank's (EIB) Green Shipping Guarantee (GSG) programme has the potential to unlock funding resources otherwise not accessible. The GSG programme is intended to finance shipbuilding projects including new vessels, conversion and retrofitting of vessels that promote sustainable transport and environmental protection.[4] The EIB has already signed framework agreements with various European lenders[5] under which various projects have been financed.[6] However, as financing pursuant to

the GSG still involves an element at least of commercial lending, for some projects and parts of the shipping market (considering the commercial complications mentioned above) initiatives of this sort may require further development.

Incentivising compliance

Given that, in many quarters, mere compliance with applicable environmental laws is not deemed worthy of a ´green label´, we are now seeing various new ways in which ship finance loans can incentivise green performance scores beyond the applicable regulatory compliance goals.

Performance can for instance be measured in the areas of reduction levels for emission of GHG's such as CO_2, SO_x or NO_x, with specific contractual benefits being attached to each reduction level reached beyond what is legally required. Likewise, performance and quality levels beyond what is required under, for instance, the regulations pursuant to the BWM Convention can be incentivised.

Likewise, and to encourage a focus on the sustainability of end of life vessels, shipowners could be required to contractually opt for compliance with (parts of) the Ship Recycling Regulations where these would not otherwise apply, whether due to flag requirements or vessel size (appreciating that in instances where these do not apply, relevant applicable provisions from the EU Waste Shipment Regulation[7] and/or the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes[8] may still be relevant). Similarly, compliance with the Hong Kong Convention (which as mentioned above is still awaiting entry into force) and related guidelines can nevertheless be voluntarily contracted in[9].

Finally, the terms and conditions of individual loan agreements may further stimulate borrowers towards sustainability by requiring adherence to the principles of the Sea Cargo Charter in respect of their chartering activities[10]. This may be more or less appropriate or feasible for some borrowers than others. Depending on the size of a borrower´s business, the administrative burden of monitoring and reporting on sustainability may be too heavy. In addition, the type of chartering activities may also be relevant to a borrower´s ability to comply with these principles: where most of the data needed for reporting would be available to most time charterers, it might for example be difficult for a particular voyage charterer somewhere down the chain to obtain such data.

Sustainability linked loans

Lenders thus have various levers to use to incentivise sustainability in shipping, and for drafting purposes they may look to the LMA´s Sustainability Linked Loan Principles for use in their loan documentation. Contractual terms and conditions in loan documents can be tailored to provide specific scores within specific sustainability focus areas, or in the context of an overall sustainability matrix, with positive scores being met by more favourable terms and conditions or other benefits and less positive scores being met by downgrading to more restrictive or onerous terms and conditions or loss of benefits. This could be by means of more or less restrictive financial covenants, interest variations in a sustainability performance related margin grid or otherwise.

Although the market is still developing, currently it seems that lenders are increasingly using margin-based mechanisms as the favoured benefit to incentivize sustainable behaviour. Examples include a USD 390,000,000 senior secured credit facilities agreement for International Seaways[11], a USD 1,300,000,000 refinancing for MSC[12], a USD 713,000,000 sustainability linked loan package for Euronav[13] and a USD 200,000,000 sustainability-linked loan for Seaspan[14]. All of these financings include a sustainability-linked pricing mechanism linked to the carbon efficiency of the borrower´s fleet (or a part thereof), with key performance indicators being calculated in a manner consistent with the de-carbonization trajectory outlined in the Poseidon Principles.

As adoption by financiers of the Poseidon Principles gathers pace, we will turn next to a review of their first ever annual report.

Poseidon Principles for assessing and reporting on the alignment of ship finance portfolios with the IMO's GHG emissions goals:

1. **Assessment of climate alignment – annual measurement and assessment of the carbon intensity of shipping portfolios against the IMO's decarbonization trajectories.**
2. **Accountability – commitment to relying on practical, accurate and objective information.**
3. **Enforcement – making compliance with the Poseidon Principles a contractual obligation.**
4. **Transparency – commitment to annual reporting on and publishing of the portfolio's alignment score.**

Poseidon Principles Annual Disclosure Report 2020

Thus far, 22 of the biggest banks and lessors that finance the maritime sector have pledged to back operators' decarbonisation efforts by working to align their portfolio of vessels with the IMO's targets, via the Poseidon Principles, with more banks and lessors expected to sign up in the coming months.

The initiative employs a carbon intensity metric for vessels, the Annual Efficiency Ratio (AER), which is increasingly used to determine the interest rates charged on ship finance. Failure to meet the AER trajectory values could either trigger new ship ordering, or lead to speed reductions, or prompt banks, looking to trim their portfolio's carbon impact, to examine measures that would reduce the risk of breaching their emissions goals by jettisoning laggard operators.

On 16 December 2020, the Poseidon Principles Secretariat published its first report on Poseidon Principles – the Poseidon Principles Annual Disclosure Report 2020 (the "Report"). The Report elicits the carbon performance of the chosen signatory banks' shipping portfolios, but preserves the anonymity of the shipping industry borrowers who submitted their carbon data to the banks earlier in 2020. In an unprecedented move, 15 out of the 20 signatory banks have disclosed their ship finance portfolio's climate alignment score and published them in the Report. The five non-reporting entities that joined up to the Poseidon Principles in 2020 were exempt from reporting on their portfolio's emissions this year and will instead do so for the first time in 2021. The assessment by each signatory bank includes emissions data from 2019, compared to a decarbonisation trajectory for the same year. A climate alignment score of 0% represents a portfolio that is exactly in line with the IMO's initial decarbonisation targets, while a negative score indicates that a portfolio's carbon intensity is lower than required by the decarbonisation trajectory.

On face value, from the key figures included below, it appears that with an average climate alignment score of +1.2% the reporting entities are collectively underperforming by only a small margin. However, that average figure conceals two important aspects of these findings. The first is that the majority of the reporting entities are underperforming quite significantly in relation to the IMO's GHG emission reduction target. The second aspect is that only 3 of the 15 reporting banks' climate alignment scores fell below zero. None of the other 12 banks' portfolios were aligned with the IMO's decarbonisation targets, and the coming year must therefore represent a period of reflection and improvement for those 12 banks.

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While the results are certainly mixed, there is an expectation in some quarters that the publication of the report will encourage greater transparency and accountability in the maritime sector, as well as more action to tackle emissions reduction in shipping fleets. The trajectory set by the IMO will likely change as part of the IMO 4th GHG Study and the AER will be changed also to align with the trajectory. Standards will only become more stringent, while the scope of the Principles will likely be expanded in the future to cover responsible ship recycling and biodiversity. There is no doubt that reputations are at stake and the 12 misaligned signatories – and particularly the 6 entities with a climate alignment score over +5% – will seek to improve their score in time for the next annual report.

A green light for the way forward?

It remains to be seen whether a green ship finance market can be achieved solely by means of financial incentives for borrowers provided for by margin-based mechanisms and/or by the growing list of signatories to the Poseidon Principles. Without a doubt, making low sustainability performance more costly than sustainable activities in general will contribute to moving towards climate change goals, yet especially against the regulatory backdrop of instruments such as the EU Taxonomy Regulation one might ask the question whether - from a macro perspective - at some point the system will also need to provide for greater checks and balances to counter any perverse stimuli. More specifically: how fragile is a system in which the lowest scores on sustainability performance generate the highest returns for financiers? And how likely is it that financiers will set pricing levels artificially higher at the front end in a margin grid to secure reasonable income levels for situations in which their borrower performs well, as is to be expected, on the relevant sustainability scorecard. A possible way in which to address this first question and increase the "green value" of sustainable ship finance might be to apply any interest proceeds obtained as higher returns triggered by a borrower's polluting behaviour towards environmental funds to combat such pollution (see for example the IMO's proposition on this score in the cut-out box below), but this is of course lost profit for the financiers. We expect these issues to play out in the coming months and they will be monitored closely by shipping participants, funders, and regulators around the world.

Poseidon Principles Annual Disclosure Report 2020 – Key Figures

15
Number of signatories reporting

+1.2%
Average climate alignment score

3
Number of signatories with scores below zero

7
Number of signatories with alignment scores of over 5%

44.92% ▶ +32%
Range of climate alignment scores


3
2
1
CARGO LINE
CARGO LINE
CARGO LINE
CC
CC
CC
CC

What's next on the maritime emissions reduction agenda?

IMO

The IMO is in the process of considering a proposal from the International Chamber of Shipping for the creation of a USD 5bn fund to develop zero-carbon marine fuels which would be backed by a fuel levy of USD 2/t on marine fuel purchases. The fund would be supervised by the IMO and managed by a new International Maritime Research and Development Board (IMRB). There is general consensus among IMO members that the levy would be welcomed by ship owners and ship operators. The IMO is also considering introducing an additional set of measures aimed at reducing air-polluting emissions which were proposed at the MEPC 75 meeting in November 2020 and which are to be adopted at the next MEPC 76 meeting in June 2021. These include, among others, draft amendments for tightening requirements on energy efficiency for existing ships from 2023 and carbon intensity targets from 2026.

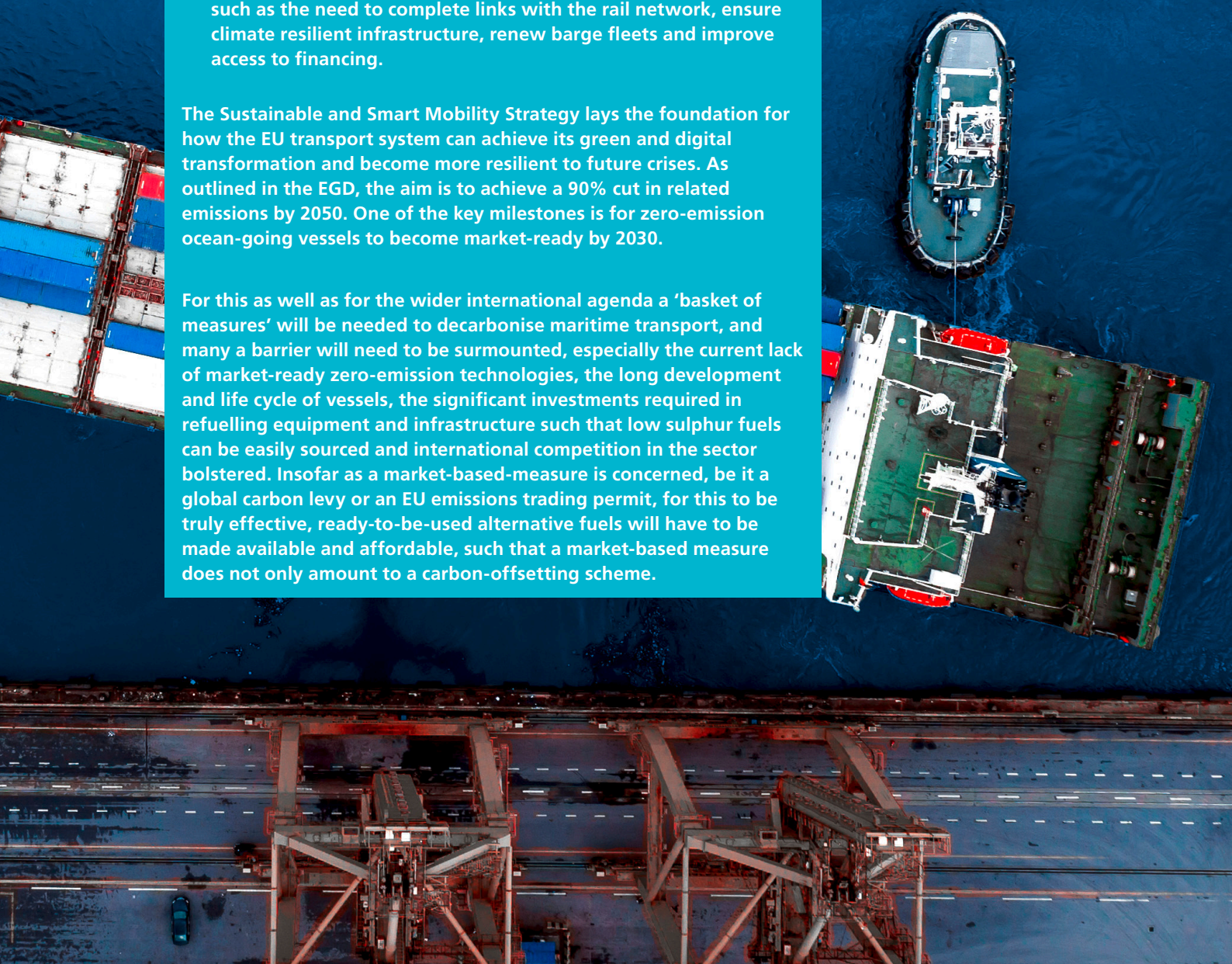
EU

In terms of the European regulatory landscape, in addition to plans to align the EU and international carbon reporting regimes (the EU MRV and the IMO DCS), on 9 December 2020, as part of the European (EU) Green Deal, the European Commission presented its 'Sustainable and Smart Mobility Strategy' together with an Action Plan of 82 initiatives that are to be introduced in the next four years. Included amongst these initiatives are plans to:

- Review the EU Ship Recycling Regulation (the UK has published its own list of UK approved ship recycling facilities).
- Include shipping emissions in the EU Emission Trading System (EU ETS) from 2022.
- Launch the FuelEU Maritime initiative in order to boost the production and uptake of sustainable maritime fuels.
- Establish a Renewable and Low-Carbon Fuels Value Chain Alliance.
- Establish clean ports and "Emission Control Areas" in all EU waters aiming at zero pollution to air and water from shipping
- Put forward the NAIADES III programme to tackle key challenges such as the need to complete links with the rail network, ensure climate resilient infrastructure, renew barge fleets and improve access to financing.

The Sustainable and Smart Mobility Strategy lays the foundation for how the EU transport system can achieve its green and digital transformation and become more resilient to future crises. As outlined in the EGD, the aim is to achieve a 90% cut in related emissions by 2050. One of the key milestones is for zero-emission ocean-going vessels to become market-ready by 2030.

For this as well as for the wider international agenda a 'basket of measures' will be needed to decarbonise maritime transport, and many a barrier will need to be surmounted, especially the current lack of market-ready zero-emission technologies, the long development and life cycle of vessels, the significant investments required in refuelling equipment and infrastructure such that low sulphur fuels can be easily sourced and international competition in the sector bolstered. Insofar as a market-based-measure is concerned, be it a global carbon levy or an EU emissions trading permit, for this to be truly effective, ready-to-be-used alternative fuels will have to be made available and affordable, such that a market-based measure does not only amount to a carbon-offsetting scheme.



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Footnotes

1 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

2 Brussels, 4.3.2020 COM(2020) 80 final 2020/0036 (COD), Proposal for a Regulation of the European Parliament and of the Council establishing the framework for achieving climate neutrality and amending Regulation (EU) 2018/1999 (European Climate Law).

3 Brussels, 11.12.2019, COM(2019)640, p. 8

4 https://www.eib.org/en/projects/pipelines/all/20150334

5 Including ING (https://www.eib.org/en/press/all/2018-036-ing-and-eib-provide-eur-300m-to-finance-green-shipping), ABN AMRO (https://www.eib.org/en/press/all/2017-137-abn-amro-and-eib-sign-eur-250m-for-smes), BNP Paribas (https://www.eib.org/en/press/all/2018-036-ing-and-eib-provide-eur-300m-to-finance-green-shipping) and Société Générale (EIB, Societe Generale Support Green Maritime Transport Plan - Offshore Energy (offshore-energy.biz).

6 Such as financings for Brittany Ferries (https://gasnam.es/blog/2017/12/14/brittany-ferries-lng-powered-newbuild-receives-eib-support-under-green-shipping-initiative/), Eureka Shipping (https://vpoglobal.com/2019/01/16/eureka-shipping-secures-eur-10-1m-for-new-carriers/) and the retrofitting of 42 Spliethoff vessels (https://freightcomms.net/ing-and-eib-provide-e110m-for-spliethoffs-green-shipping-investments/).

7 Regulation (EC) No 1013/2006 of the European Parliament and of the Council of 14 June 2006 on shipments of waste.

8 The Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal of 22 March 1989.

9 Leaving aside the discussion on whether or not the provisions of the Hong Kong Convention are less strict than those of the EU SRR.

10 17 leading ship charterers signed the Poseidon-inspired Sea Cargo Charter in October 2020 for charterers to assess and disclose their climate alignment, and their first annual report will likely be published on 15th June 2022.

11 https://www.maritimeprofessional.com/news/international-seaways-signs-refi-deal-355173

12 https://www.abnamro.nl/en/commercialbanking/corporates-institutionals/accelerating-the-sustainability-shift/abn-amro-acts-as-sustainability-coordinator-in-msc-s-usd-1-3bn-refinancing.html

13 https://www.euronav.com/media/66178/20201105-earnings-release-q3.pdf

14 https://www.offshore-energy.biz/seaspan-inks-200-million-sustainability-linked-loan/


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