

Sanctions: Red flags and risk

Introduction

The global sanctions landscape has changed a great deal in 2020. The impact of sanctions breaking, or even being perceived to have broken sanctions is often severe and may put a company out of business, effectively shutting it out of the financial market. To navigate the quickly changing sanctions landscape and mitigate the risks posed by sanctions breaking requires comprehensive due diligence routines implemented by parties involved in maritime activities.

On 14 May 2020, the Office of Foreign Asset Control (OFAC) in the US issued a Global Maritime Advisory aimed at parties active within the maritime sector, providing detail on the level of due diligence and other compliance activities expected of parties whose business activities run a risk of engaging in trades that may breach US sanctions. The advisory covers, among others, shipowners, operators, charterers, and brokers as well as

The advisories are relevant reading and a good starting point for all organisations developing a sanctions compliance program, not only for US and UK entities.

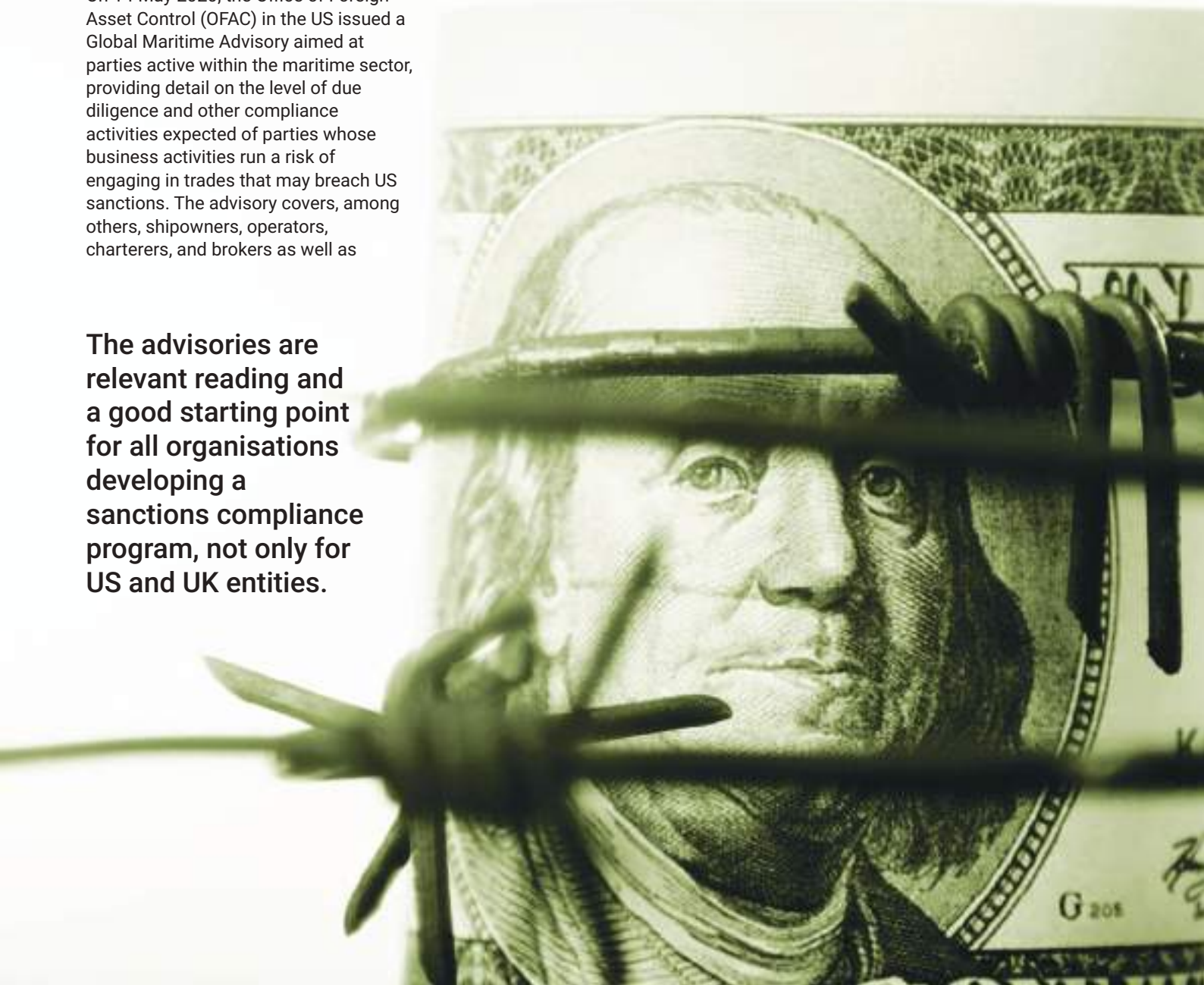
insurers active within the maritime sector. On 27 July 2020, the UK equivalent to OFAC, the Office of Financial Sanctions Implementation, produced a similar advisory setting out the UK's expectations for parties involved in maritime activities. Thus, similar standards are now expected from UK persons and entities.

The significance of these advisories lies in the fact that they represent an attempt by US and UK governments to set out the standards by which the maritime industry will be judged if they are linked to sanctions breaking. As such, the advisories are relevant reading



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Taking a risk-based approach to sanctions compliance



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The requirements imposed by US sanctions, even on non-US entities, are immense and complex. Each sanctions program is unique, but in general, non-US entities may be punished for 'significant' or 'material' transactions with individuals and entities on its Specially Designated Nationals (SDN) list. Moreover, transactions utilising the US financial system, that may otherwise be legal, may violate sanctions.

In the wake of increased enforcement against non-US persons in the maritime industry, shipowners and charterers alike must ensure they are taking a risk-based approach to sanctions compliance. Here, we address the potential sanctions risks, as well as practical guidance for compliance and due diligence.

'Red flags'

The Office of Foreign Assets Control (OFAC) issued guidance to the maritime industry in May 2020 (<https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20200514>), focusing on deceptive tactics commonly used to evade sanctions, and recommends that the

following 'red flags' be considered in due diligence and incorporated into compliance processes:

AIS manipulation: One of OFAC's main concerns is the practice of 'going dark' i.e. disabling a vessel's Automatic Identification Signals (AIS) or 'spoofing' - manipulating AIS to mask a vessel's name, identifying number, or next port of call.

'Flag hopping': Sanctions evaders may repeatedly change vessel flags within a short time period, or continue using a country's flag after a vessel has been deregistered.

Vessel disguise: Sanctions evaders may physically alter a vessel's identifying marks, such as painting over the vessel's name or IMO number.

Strange deviations: When AIS data shows a vessel engaging in indirect routing or unscheduled detours, that may indicate a sanctions violation, particularly if those deviations occur in high risk areas.

Ship-to-ship (STS) transfers: Transferring cargo to another ship may

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indicate that parties are trying to conceal sanctioned cargoes, entities, or destinations. STS transfers that take place in high risk areas or at night are of special concern.

Falsified paperwork: Sanctions evaders commonly falsify cargo and vessel documents, like bills of lading, certificates of origin, invoices, insurance certificates and last ports of call, to conceal goods from a sanctioned country or the presence of an SDN.

Opacity, shifting ownership: One practice is to use shell companies, with multiple levels of ownership, to disguise the Ultimate Beneficial Owner (UBO). Another tactic is to transfer vessels between companies controlled by the same UBO. Sanctions evaders may change the company ownership or management, or the vessel's management company, for International Safety Management Code purposes. If there is no discernable legitimate purpose for such changes, there may be a sanctions concern.

Risk-based compliance programs

Because having a robust sanctions compliance program is a significant mitigating factor in enforcement actions, owners and charterers should

consider implementing (or enhancing) a compliance program that includes the following key elements:

Assessment: OFAC recommends that organisations conduct routine risk assessments, including taking a holistic review of their 'touchpoints to the outside world'. This includes customers, supply chains, intermediaries, counterparts, products, and geographic locations of the foregoing.

Internal controls: Written policies/procedures prevent misconduct by identifying, stopping, escalating and, if appropriate, reporting violations. Companies should also implement and document their sanctions screening process. The failure to screen for SDNs in a voyage or other transaction will be an aggravating factor (and likely cause of) an enforcement action.

AIS diligence: OFAC has been encouraging stricter policies against AIS manipulation. Owners and operators should assess the AIS history of new and existing clients, and refrain from conducting business with vessels that have a history of AIS manipulation inconsistent with SOLAS.

'AIS switch-off' clause: To encourage best industry practices, OFAC recommends owners and operators

include in their agreements an 'AIS switch-off' clause providing for termination where clients demonstrate a pattern of AIS manipulation. This language should explicitly prohibit AIS disablement or manipulation inconsistent with SOLAS. Any AIS 'spoofing' or 'switch-off' not necessary for safety purposes, should be grounds for contract termination.

Vessel monitoring: Vessel owners should monitor ships to ensure that AIS is consistently used. Monitoring AIS is recommended especially for vessels capable of transporting cargoes that are susceptible to STS transfers, like coal and petroleum products.

Management commitment: In an enforcement action, OFAC will consider the extent to which senior management is committed to sanctions compliance and creates a 'culture of compliance,' including ensuring compliance personnel have adequate resources, training, and authority to complete their function.

Confidential reporting/staff protections: Organisations should implement confidential mechanisms for employees to report suspected or actual violations of law or sanctionable conduct. Employees who reveal such behaviour should be protected from retaliation. 🚫

