



CLIENT ALERT /// May 18, 2020

U.S. Government Issues Significant New Advisory on Maritime Sanctions Risk

On May 14, 2020, the U.S. Department of State, the U.S. Department of the Treasury and the U.S. Coast Guard jointly released a long-awaited “Sanctions Advisory for the Maritime Industry, Energy and Metals Sectors, and Related Communities”¹ (“the Advisory”).²

- The Advisory provides a comprehensive analysis of sanctions risks in the maritime sector and specific guidance to categories of maritime sector participants on tailoring due diligence and sanctions compliance policies and procedures to address those risks.
- The Advisory substantially raises the U.S. Government’s sanctions compliance expectations across the maritime industry. These new expectations apply to a range of companies operating in the maritime sector, including financial institutions, insurance companies, shipping companies, port operators, and others. Leadership at these firms must pay close attention to these new expectations and ensure that their sanctions compliance programs are sufficient to meet them.
- We recommend that all companies with maritime exposure closely review the range of specific recommendations delineated in the Advisory and assess whether their sanctions compliance program currently meets these expectations.

The Advisory updates previous advisories focused on the illicit maritime activity of Iran, Syria, and the Democratic People’s Republic of Korea (DPRK).³ These countries have long exploited the maritime sector, which, according to a U.S. Government official, is “the key artery to sanctions evasion.”⁴

The Advisory builds on several significant sanctions actions against entities operating in the maritime sector, such as the September 2019 designation of certain subsidiaries of the Chinese shipping company COSCO for transporting Iranian-origin oil, specific targeting of companies involved in shipping Venezuelan-origin crude oil to Cuba, and high-profile efforts to disrupt sanctions maritime evasion, as with the *Grace 1* and *Wise Honest*.⁵

The Advisory identifies specific sanctions evasion typologies employed by illicit actors, including:

- **Automated Identification System (AIS) Disabling/Manipulation:** Vessels engaged in illicit activity will turn off their transponders for long durations or deliberately broadcast false information in order to disguise their destination or previous port visits.⁶



- **Physically Altering Vessel Identification:** In order to imitate different vessels, many crews undertaking illicit activity will physically alter or obscure their real vessel name or International Maritime Organization (IMO) number.⁷
- **Falsifying Cargo and Vessel Documents:** Sanctions evaders have falsified or manipulated a wide variety of shipping-related documentation to cover-up the origin of goods their ships are carrying.
- **Ship-to-Ship Transfers:** Transfer of cargo at sea, particularly at night or in high-risk areas, adds to the ease with which illicit actors can obscure the origin or destination of goods.
- **Voyage Irregularities:** Deviations in ship journeys or transshipments of goods that have no discernable business purpose can be indicative of efforts to throw off scrutiny of origins/destinations of illicit cargo.
- **False Flags and Flag Hopping:** Sanctions evading ships will often repeatedly register with new flag states or continue to use a previous flag status after it has been de-registered.
- **Complex Ownership or Management:** As with many sanction evasion typologies in other sectors, the use of shell and front companies is a preferred method for disguising the ultimate beneficial owner of ships or cargo.

To mitigate these risks, the Advisory advises ship owners, managers, operators, brokers, ship chandlers, flag registries, port operators, shipping companies, freight forwarders, classification service providers, commodity traders, insurance companies, and financial institutions take a number of steps to bolster their sanctions compliance programs. The Advisory includes an annex with additional specific steps that categories of maritime sector participants should take to address sanctions risk.

- **Institutionalize Sanctions Compliance Programs:** Firms are encouraged to implement a sanctions compliance program tailored to their specific risk profiles (including based on customers, transactions, and the geographies in which they operate).

The Advisory further recommends that certain firms actively engage with their counterparties to ensure that they also have a sanctions compliance program adequate to the risks in their own operations. Specifically, the Advisory recommends that firms:

1. Communicate to their counterparts the expectation that they conduct their activities in a manner consistent with U.S. and United Nations sanctions;
2. Have sufficient resources in place to ensure execution of and compliance with their own sanctions policies by their personnel;
3. Ensure subsidiaries and affiliates comply with the relevant policies, as applicable;
4. Have relevant controls in place to monitor AIS;
5. Have controls in place to screen and assess onboarding or offloading cargo in areas they determine to present a high risk;
6. Have controls to assess authenticity of bills of lading; and
7. Have controls in place consistent with the Advisory.



Example: As part of the risk-based due diligence efforts outlined in an effective sanctions compliance program, any firm operating in a sector identified in the Advisory is encouraged to verify that its counterparties are engaged in legitimate maritime business practices. For a sector like financial services, firms may wish to establish, as standard compliance practices, policies to query their maritime customers about their geographic presence, maritime services offered, and ship beneficial ownership information.

- **Use AIS Best Practices:** Companies engaged in trade involving the maritime sector should research whether vessels they use or intend to use have a track record of non-continuous AIS broadcasting. While previous U.S. Government guidance has recommended that AIS monitoring be undertaken pursuant to a risk-based approach, the Advisory goes further and recommends that ship owners, managers, charterers, and others should “continuously monitor vessels”, including their AIS broadcasts, to detect any potential red flags. This recommendation is a significant expansion on prior guidance and could require substantial investment in compliance capabilities.

Example: Ship owners, operators, and charterers are encouraged to establish policies and procedures that incorporate continuous monitoring of AIS broadcasting for vessels they control. This monitoring should be emphasized for vessels that are leased to third-parties, or for vessels that are designed to transport cargoes that are at high-risk for sanctions evasion (e.g., coal, petroleum and petroleum products, and petrochemicals). While the Advisory does not spell out how such monitoring should be established, commercial service providers offer such solutions.

- **Monitor Ships Throughout the Entire Transaction Lifecycle Using AIS and Long Range Identification and Tracking:** Companies should consider using Long Range Identification and Tracking (LRIT), a satellite-based ship tracking system, to supplement the use of AIS data to ensure a vessel's legitimate operational history. Firms should also be wary of engaging ships whose ownership has transferred frequently, or that has been transferred between companies with the same beneficial owner.

Example: Ship owners, operators, and charterers, as well as port authorities, are encouraged to use both AIS and LRIT systems to monitor ship movement for suspicious activity. While all cargoes above a certain tonnage are required to have a LRIT system, use of LRIT data is not standardized throughout the entire maritime sector. The Advisory recommends more companies in the maritime sector consider relying on LRIT. Flag registries, for example, may consider acquiring AIS monitoring capabilities and supplementing them by LRIT tracking to get a notification within 24 hours of one of their vessels' AIS being shut off.

- **Undertake Know Your Customer (KYC) and Counterparty Due Diligence:** Companies operating in the maritime sector are encouraged to employ risk-based due diligence, including keeping regular records of identifying information for beneficial owners of customers and counterparties. The Advisory outlines specific, detailed recommendations



for determining the ultimate beneficial owners (UBOs) of vessels.⁸ For example, for vessels operating in high-risk areas for sanctions evasion, the Advisory recommends that marine insurers, in addition to collecting regular KYC information, also collect a color photocopy of the passports, names, business and residential addresses, phone numbers, and emails of all individual owners of the vessel, as well as building in contractual language allowing for the release of this information to authorities if illegal activities are identified.⁹

Example: Financial institutions are encouraged to conduct a risk-based assessment of their maritime clients to assess whether they engage in business involving commodities or trade corridors susceptible to transshipment or ship-to-ship transfers and the extent to which they engage in such practices. With a substantial movement of global trade transactions from letters of credit to open account transfers, financial institutions may be losing significant visibility into important underlying trade documentation. Financial institutions should be prepared to request additional information when their clients purchase new vessels that do not fit their business profile or purchase history. They should also consider conducting due diligence on a client's acquisition or sale of vessels.

- **Exercise Supply Chain Due Diligence:** Firms are encouraged to verify the accuracy of shipping documentation throughout their supply chain. Entities should consider requesting and reviewing documents to ensure origins and destinations of cargo do not raise red flags for sanctions evasion.

Example: Commodities brokers should be aware that the purchase of certain products, including crude oil, refined petroleum, petrochemicals, and metals at below-market rates is a red flag indicator for potential illicit sourcing.

- **Include Contractual Language:** Industry participants are encouraged to incorporate best practices in contracts language related to business relationships in the maritime industry. The Advisory recommends that such language allow for contract termination or other penalties upon breach.

Example: Certain service providers, such as insurance companies, are encouraged to include provisions for terminating contracts or denying insurance claims if their counterparties engage in persistent shut-off or manipulation of AIS. Regional and global commodity trading companies should include contractual provisions that prohibit the transfer of cargo to vessels that consistently turn off or manipulate AIS.

- **Increase Industry Information Sharing:** Industry groups should consider encouraging their members to share relevant information about these risks and, consistent with applicable laws and regulations, red flags and indicators of illicit activity. Such information sharing may also include government entities, when legally appropriate.



Example: As the Advisory notes, when a protection and indemnity (P&I) club insurance company becomes aware of illicit or sanctionable activity or new tactics in sanctions evasion, it may wish to consider notifying other P&I clubs, as appropriate, redacting personally identifiable information that cannot be shared with third parties where necessary. Likewise, maritime insurance firms should consider informing the United Nations Panel of Experts on the DPRK if and when they deny insurance coverage to a vessel because of illicit activity.¹⁰

Endnotes

¹ United States Department of State and the Treasury, and the U.S. Coast Guard, Sanctions Advisory for the Maritime Industry, Energy and Metals Sectors, and Related Communities: Guidance to Address Illicit Shipping and Sanctions Evasion Practices, (May 14, 2020), available at https://www.treasury.gov/resource-center/sanctions/Programs/Documents/05142020_global_advisory_v1.pdf.

² Then-U.S. Deputy Assistant Secretary of State for Counter Threat Finance and Sanctions David Peyman previewed the Advisory in March 2020 with K2-FIN Vice President Eric Lorber, placing it in the context of the Trump Administration's effort to enlist the private sector in combating sanctions evasion. Foundation for Defense of Democracies, "U.S. Government Sanctions Priorities and Approach in 2020" (March 9, 2020), available at <https://www.fdd.org/events/2020/03/09/us-government-sanctions-priorities-and-approach-in-2020/>.

³ For an analysis of recent reports highlighting DPRK sanctions evasion activity, see K2-Intelligence/Financial Integrity Network, "DPRK Continues Expansive Sanctions Evasion and Cyber Activity," Policy Alert, Apr. 21, 2020, available at https://www.finintegrity.com/uploads/8/7/8/0/87802750/2020.4.21_dprk_evasion_policy_alert_-_final%5b2%5d.pdf. The reports of the United Nations Panel of Experts, particularly the Panel on the DPRK, have also focused on exploitation of the maritime sector. Many of the typologies they have identified, and recommendations they make to address them, are consistent with those identified in the Advisory. The DPRK Panel reports are available at https://www.un.org/securitycouncil/sanctions/1718/panel_experts/reports.

⁴ Jonathan Saul, "U.S. sets sights on shipping companies for sanctions evasion," Reuters (November 6, 2019), available at <https://www.reuters.com/article/us-shipping-usa-sanctions/u-s-sets-sights-on-shipping-companies-for-sanctions-evasions-idUSKBN1XG2CH>.

⁵ United States Department of State, "The United States Imposes Sanctions on Chinese Companies for Transporting Iranian Oil," (September 25, 2019), available at <https://translations.state.gov/2019/09/25/the-united-states-imposes-sanctions-on-chinese-companies-for-transporting-iranian-oil/>; United States Department of the Treasury, "Treasury Further Targets Entities and Vessels Moving Venezuelan Oil to Cuba," (September 24, 2019) available at <https://home.treasury.gov/news/press-releases/sm784>; United States Department of Justice, "Unsealed Warrant and Forfeiture Complaint Seek Seizure of Oil Tanker "Grace 1" for Unlawful Use of U.S. Financial



System to Support and Finance IRGC's Sale of Oil Products to Syria," (August 16, 2019), available at <https://www.justice.gov/opa/pr/unsealed-warrant-and-forfeiture-complaint-seek-seizure-oil-tanker-grace-1-unlawful-use-us>; and United States Department of Justice, "North Korean Cargo Vessel Connected to Sanctions Violations Seized by U.S. Government," (May 9, 2019), available at <https://www.justice.gov/opa/pr/north-korean-cargo-vessel-connected-sanctions-violations-seized-us-government>.

⁶ The Automatic Identification System (AIS) is a radio-based set of transmitting information about vessels underway. A ship's AIS will help it track and avoid other vessels, as well as approach port safely. The International Convention for Safety of Life at Sea (SOLAS) makes very few exceptions for ships keeping their AIS signaling broadcasting at all times.

⁷ The International Maritime Organization (IMO) requires vessels above a certain tonnage to register and obtain a unique identifier number. The number should remain the same throughout the lifecycle of a vessel, even if vessel names or ownership change. U.S. sanctions designations of vessels will almost always include an IMO number.

⁸ See Sanctions Advisory for the Maritime Industry, Energy and Metals Sectors, and Related Communities: Guidance to Address Illicit Shipping and Sanctions Evasion Practices at 9.

⁹ See Sanctions Advisory for the Maritime Industry, Energy and Metals Sectors, and Related Communities: Guidance to Address Illicit Shipping and Sanctions Evasion Practices, Annex A, at 9.

¹⁰ The Panel of Experts can be reached by email: dpa-poe1874@un.org.