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Maritime intelligence | informa

THE RISK AND COMPLIANCE GUIDES

Shining a light on compliance

The OFAC knowledge needed
to keep your business afloat

The context

The Office of Foreign Assets Control (OFAC) has issued a series of shipping advisories to alert and inform the maritime industry to current and emerging deceptive shipping practices and sanction evasions.

The most recent of these, issued in May 2020, provided detailed industry-specific recommendations across ten sectors that touch the maritime industry, including trade finance.

The new guidance uses notably measured language throughout, but when combined with recent enforcement actions from OFAC, actors in the maritime industry are now expected to assume greater responsibility for ensuring sanctions compliance.

With OFAC being explicit that this newly extended list of ten sectors are all vulnerable to enforcement, detailed due diligence and enhanced risk-based compliance programmes are essential if OFAC recommendations are to be followed. In short, there is now a heightened need for transparency, efficiency and absolute accuracy.

To provide clarity in an increasingly complicated landscape, this guide outlines what exactly the latest guidance is and why compliance with it matters. It defines the specific challenges it presents to trade finance operations, the consequences of not adhering with it, and the risk mitigation methods you can take to avoid US financial lock-out.

OFAC and what it means to you

The Office of Foreign Assets Control (OFAC) uses trade restrictions and the blocking of assets to accomplish US foreign policy and national security goals. The US plays an important role in the international fight against money laundering and terrorism financing, among other financial crimes, which it does by imposing economic sanctions against the countries, entities and individuals engaged in those activities.

In March 2020, the Division for Counter Threat Finance and Sanctions at OFAC announced new developments in several areas, all of which will have an effect on the maritime trade finance sector.

These developments were then extended and elaborated upon in the communiqué issued by OFAC in May 2020. In this, it lays out explicit guidance for compliance programmes, with a particular emphasis on active monitoring of vessels.

Deceptive shipping practices – recent OFAC guidance

As an overarching theme, the guidance puts the creation of complete and accurate shipping and due diligence documentation firmly in the spotlight. These records have always been critical to ensure all parties to a transaction have a thorough understanding of the goods, vessels, and parties involved in any given shipment. But the new guidance should dispel any doubt that the US government is focused on the shipping industry as a means by which to enforce US primary and secondary sanctions.

There are several footnotes within the May guidance which reference the fact that the recommendations are not legal requirements, and that they should not be interpreted as "imposing requirements under US law or otherwise addressing any particular requirements under applicable law."

But a contravention will likely be treated as doing exactly that. While there is no formal requirement for a compliance programme, OFAC does expect all companies to implement a "risk-based approach to sanctions compliance by developing, implementing, and routinely updating a sanctions compliance programme," including through the implementation of internal controls that are "capable of adjusting rapidly to changes published by OFAC."

> **OFAC will scrutinise companies in the maritime industry, (or those engaging with it), against these new recommendations when determining the adequacy of a company's compliance programme in an enforcement context.**

The guidance covers 7 specific areas for focus

1: Disabling or manipulating the Automatic Identification System (AIS)

2: Physically altering vessel identification

3: Falsifying cargo and vessel documents

4: Ship-to-ship (STS) transfers

5: Voyage irregularities

6: False flags and flag-hopping

7: Complex ownership or management

1: Disabling or manipulating the Automatic Identification System (AIS)

AIS monitoring recommendations have been extended to "continuous". The May 2020 OFAC guidance has focused heavily on the use of AIS monitoring, encouraging companies to use it to identify potential evasion activity. Previously, OFAC had only recommended companies "monitor" AIS when vessels were operating in high-risk areas.

The May guidance suggests companies should be monitoring AIS using a risk-based approach. In several places in the sector-specific recommendations, OFAC recommends that parties should "continuously monitor vessels," or have the "capability to monitor AIS transmissions continuously." There is also a requirement implicit in the recommendation for companies to have the ability to research AIS history.

If implemented in full, this recommendation would elevate many compliance programmes from using AIS reactively to requiring that it be proactively monitored throughout the lifecycle of a trading or counterparty relationship. It is widely acknowledged within the industry that AIS as a technology has its imperfections, that can be both manipulated and exploited, so sourcing data from reliable sources (coupled with expert knowledge and advice) is integral.

2: Physically altering vessel identification

Illicit activities have gone undetected as vessels have painted over vessel names and IMO numbers to obscure their identities and therefore avoid exposure. The May guidance reiterates that a visible name and IMO number are an obligatory addition for cargo ships of 300 GT and over. The IMO number is a permanent and unique identifier, irrespective of change of name or ownership.

3: Falsifying cargo and vessel documents

OFAC has increasingly recommended that all parties conduct "know your customer's customer" (KYCC) analyses, which includes understanding the entities, recipients, goods, and vessels involved in a given shipment, as well as acquiring ultimate beneficial ownership (UBO) information. This is in a bid to prevent the falsifying of documents. But the May guidance goes further, recommending that for vessels determined to be operating in areas at high risk for sanctions evasion, in particular, due diligence be heightened and that UBO checks may be accompanied by passport information, business and residential addresses, phone numbers, and email addresses of all individual owners of the vessel where appropriate and allowed by applicable laws and regulations.

4: Ship-to-Ship (STS) transfers

This refers to the transfer of cargo between ships at sea, which can be a perfectly legitimate practice. But the May guidance reinforces that STS transfers which take place in areas determined to be high-risk, or at night, should be subject to heightened due diligence as they are frequently used to evade sanctions by concealing the origin or destination of cargo.

Guidance issued in March 2020 focussed specifically on the Iranian oil sector and its related supply chain, but its contents are applicable elsewhere. The need to monitor any possible illicit trading through ship-to-ship transfers is explicitly mentioned.

However, industry consensus is that it is not clear how to implement efficient monitoring for illegal ship-to-ship transfers.

5: Voyage irregularities

It is encouraged that routes and destinations which deviate from normal business practices be scrutinised across the industry and by all parties. Transit and transhipment of goods should be a particular area of focus, alongside indirect routing and unscheduled detours, so the ultimate destination or origin of cargo or recipients are always apparent.

6: False flags and flag hopping

The establishment of the Registry Information Sharing Compact (RIS Compact) was announced in March 2020. It is an agreement between vessel flag registries to establish information sharing regarding what it refers to as 'bad' actors.

Its aim is to discourage flag hopping (changing the flag of a ship to reduce costs and avoid laws) by sanctioned parties and share this information with relevant authorities where laws permit. Initial signatories to the RIS Compact included Panama, the Marshall Islands, Liberia, St. Kitts and Nevis, Comoros, Honduras, and Palau – though progress on information sharing is in its early stages.

An implied KYCC obligation

The May guidance extends existing Know Your Customer's Customer (KYCC) obligations by specifically recommending that ship owners, operators, charterers, and classification societies require that counterparties maintain an "adequate and appropriate" compliance policy. While OFAC has frequently commented on the risks that customers in the downstream supply chain can create for companies, this is its most explicit recommendation to date that these parties implement a KYCC system.

7: Complex ownership or management

It is acknowledged that bad actors frequently attempt to take advantage of the inherently complex nature of global shipping. Its multi-faceted nature, which involves multiple interactions between numerous parties for even simple transactions, leaves it open to manipulation. This can be through intricate business structures, often involving shell companies, designed to mask the true beneficial owners and thus avoiding recourse on any wrongdoing. 'Bad actors' also may engage in a pattern of changes in the ownership or management of companies, or in the International Safety Management Code (ISM) used. Therefore, where the private sector is unable to reasonably identify all the real parties of interest in a transaction, performing additional due diligence to ensure it is not sanctionable or illicit is suggested.

Why this matters now

Unlike the Bank Secrecy Act (BSA), the laws and OFAC-issued regulations apply to US banks, their domestic branches, agencies, and international banking facilities – but also to their foreign branches, overseas offices and subsidiaries. They apply to both US and non-US entities.

The implication is that existing risk-based compliance programmes designed to detect and mitigate risk of exposure to US-sanctioned parties and jurisdictions should be further developed and improved. These wheels are very much in motion across the industry, but the tone of the May update would suggest acceleration is encouraged.

Ultimately, the cost of identifying and stopping those engaged in sanctions evasion or avoidance, and the development of compliance programmes, will fall at the feet of the private sector.

Failure to correctly establish this compliance could result in penalties so extensive that they will have the ability to derail even the most established of industry players.

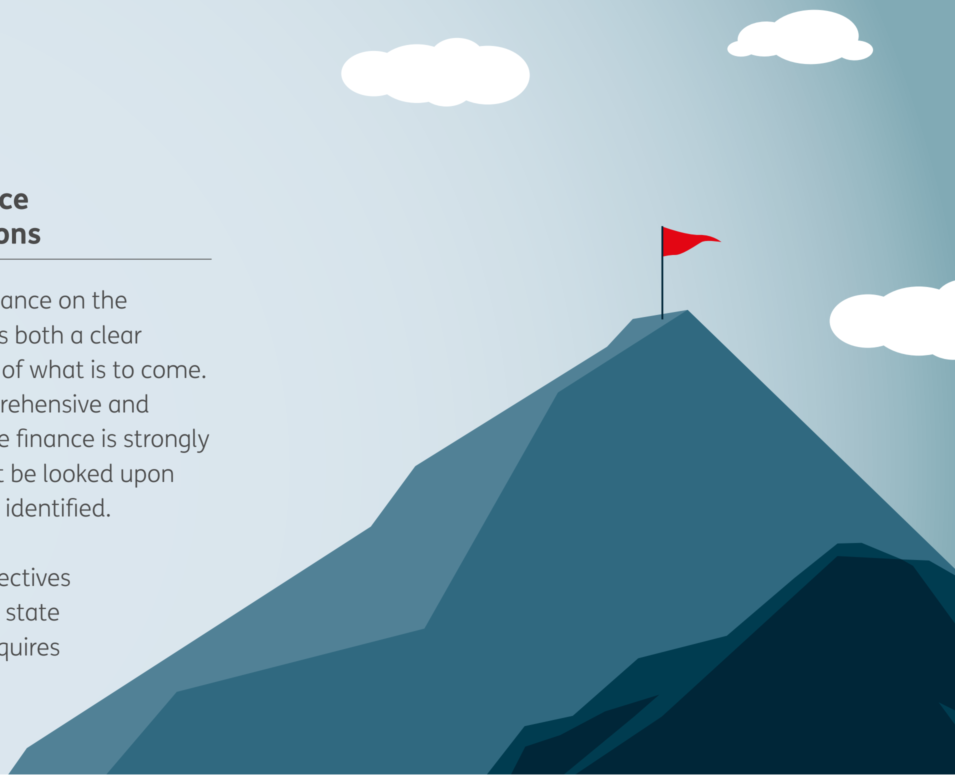
In summarising the guidance, OFAC emphasised the US Government's focus on the maritime sector, and its seriousness, by highlighting in March 2020 that over 800 shipping-related actions have been brought by this administration in three years.

OFAC has emphasised the US Government's focus on the maritime sector

Challenges the regulatory guidance presents to trade finance operations

OFAC's move to formalise and provide guidance on the development of compliance programmes is both a clear signal of what it expects and an indication of what is to come. It has now made it clear that having comprehensive and effective compliance policies covering trade finance is strongly recommended, and failure to do so will not be looked upon favourably should compliance breaches be identified.

To complicate the matter, international directives from sanctioning bodies are in a necessary state of near-constant fluidity, so compliance requires constant attention.



The primary challenge posed is that of being furnished with, and understanding, the very latest information about the sanction programmes and regulations, all the time and without fail.

Secondary to that is the challenge posed by putting the regulations into practice.

Challenges the sector faces

Technology
Constantly evolving technologies relating to each of the many data sources trade finance operations must understand, dissect, and process on a daily basis, make keeping step (and therefore compliant) a significant challenge.

Data origin
This challenge is only compounded by the fact that the data involved originates in multiple territories, arrives in consistently large volumes, in formats that take time to process.

Time
Because trade finance operations are under a relentless pressure to complete checks quickly, this can lead to human error and inaccuracies, which can expose teams to risk of missing essential information.

Integration
Ineffective, non-integrated software and processes do not facilitate peak performance management. Disconnected systems and processes increase the complexity of completing research and sharing insight and reports between teams. A cohesive cross-department, cross-company, cross-territory system allows for more effective communication and a faster more streamlined process.

Fluidity of data
Sailing schedules are largely set in advance, but the data in question can (and frequently does) change multiple times within the space of a single journey. Failure to keep up is failure to comply. Trade finance operations must have access to live data in a consistent, straightforward format.

Compliance
Superseding all these, is the need to remain compliant throughout every process, in every transaction, on every journey. Any software and processes that do not guarantee a high degree of accuracy present trade finance operations with a significant headache.

The implications of not adhering to the guidance

OFAC considers non-compliance with sanctions a serious threat to both national security and foreign relations.

As a result, the ramifications of non-compliance have the potential to be catastrophic. This is regardless of whether the action in question was the result of being uninformed or was carried out inadvertently. There are no exceptions.

Those who breach OFAC sanctions without obtaining a specific license can face severe legal repercussions – violations could result in enforcement actions, criminal and financial penalties extending as far as a complete lock out of the US financial system, as well as designation and sanctions.

Voluntary self-disclosure

OFAC has further incentivised companies through its voluntary self-disclosure programme. This enforcement approach is consistent with the US Department of Justice's updated policy on voluntary self-disclosures, which was issued in December 2019 and includes a presumption that companies that self-report "will receive a non-prosecution agreement and not have to pay a fine, absent aggravating factors". However, if aggravating factors are present, such as 'exports of items known to be used in the construction of weapons of mass destruction', 'repeated violations' and 'knowing involvement of upper management in the criminal conduct' this may still result in enforcement action.

The implications

US Financial Lock-Out

You will be unable to do business, process any transactions or have any commercial dealings with any US entity and they with you until such time as OFAC lifts the order

Implications also include:

- Designation
- Sanctions
- Civil Enforcement
- Criminal Penalties
- Monetary Penalties
- Loss of Reputation

Risk mitigation measures

Between 80-90% of the world's international trade is reliant on trade financing. It's therefore no surprise that the sector has long been identified as a potential conduit for money laundering and facilitator of sanction evasions, resulting in it increasingly being placed under the spotlight as a result. But this vulnerability can be addressed.

Mitigation is a question of monitoring, assessing and identifying weaknesses. These weaknesses could lie within people, roles, processes, audit trails, tools, data sourcing, technology or intelligence – anything that has the potential to prevent ease of process and the absolute accuracy necessary to avoid a sanctions breach.

An effective compliance programme is not only a risk mitigation measure but also a positive value proposition for every company, including large financial institutions and companies with no physical presence in the US.

The seven pillars of mitigation

Institutionalise sanctions compliance programmes

Establish AIS best practices and contractual requirements

Monitor ships throughout the entire transaction lifecycle

Know Your Customer's Customer

Exercise supply chain due diligence

Contractual language

Industry information sharing

Sanctionable activity or the processing of prohibited transactions can be mitigated by implementing the following measures:

Institutionalise sanctions compliance programmes

Adopt a single global sanctions policy standard – the implementation of US standards on an international scale has the potential to both simplify processes and ensure that OFAC sanctions, (which come with the heftiest civil and criminal penalties globally), are adhered to. Although it should be acknowledged that all OFAC sanctions aren't necessarily accepted by the EU.

Take advantage of all resources – OFAC is constantly updating its information and is a resource in itself, but the sheer volume of material available can be time-consuming to sift through and digest. Organisations that provide commercial shipping data, such as ship location, ship registry information and ship flagging information, should be utilised to best effect. Similarly, those that offer technologies and systems that streamline the access to, and use of, such data will prove invaluable for both compliance and competitive advantage. These systems should then be incorporated into due diligence best practices.

Adhere to Financial Action Task Force standards – these are designed to combat money laundering, as well as the financing of terrorism and its proliferation. They state that the adoption of stringent due diligence policies and procedures by financial institutions and non-financial gatekeepers is a necessity. Furthermore, financial institutions should exhibit beneficial ownership transparency. This is with the aim of impeding development and help ensuring that these beneficial owners, (along with their associates and facilitators) are not able to operate in secrecy.

Consider partial or full-scale automation – the automation of data aggregation and alerts would vastly simplify the screening process, whilst simultaneously saving time and considerably minimising the margin for error. Likewise, automated breach reporting procedures would significantly accelerate incident response times.

Establish AIS best practices and contractual requirements

Remain consistent and rigorous with regard to AIS manipulation – any vessels that appear to have turned off their AIS, especially those operating in the areas determined to be high risk, should be investigated by trade finance operations but also by ship registries, insurers, charterers, vessel owners, and port operators. Researching a ship's history to identify previous AIS manipulation and monitoring AIS manipulation and disablement when cargo is in transit, is therefore strongly recommended as part of routine due diligence procedures.

Monitor ships throughout the entire transaction lifecycle

Review all applicable shipping documentation – it is encouraged in the May guidance that complete and accurate shipping documentation should be requested from all individuals and entities processing transactions pertaining to shipments without exception (including on vessels leased to third parties) and reviewed accordingly. Details of the underlying voyage should be thoroughly covered, and reflect the relevant vessel(s), flag, cargo, origin, and destination. It is likewise recommended that documents relating to STS transfers should always demonstrate that the underlying goods in question were delivered to the port listed on the shipping documentation.

Knowing Your Customer's Customer

Knowing Your Customer's Customer (KYCC) helps to ensure that the there is an internal awareness of all the activities and transactions a trade finance team engages in – in short, it's a matter of continuing to conduct and extend existing risk-based due diligence. This should also extend to all the parties, geographies, and countries of origin and destination of all the goods, involved in any underlying shipment. The May guidance goes as far as to suggest photographic identification of each customer's beneficial owner, for example. This includes companies and individuals, but also vessels, vessel owners, and operators involved in any contract, shipments, or related maritime commerce.

Exercise supply chain due diligence

Supply chain due-diligence is recommended, including verification of origin and recipient checks for ships that conduct ship-to-ship transfers, requesting copies of applicable export licenses, and complete shipping documentation. Companies are also encouraged to review the details of any underlying voyage.

Verify all cargo origin – the source of all goods, though especially petroleum or petroleum products, must be corroborated, ideally with export licences. This need is heightened when goods are transported or delivered by vessels previously exhibiting deceptive behaviours or where connections to sanctioned persons or locations are suspected. The testing of cargo composition to reveal area-specific chemical signatures can be a huge help here, though there is also a significant benefit to publicising cases where certificates of origin are known to be falsified. Efforts to resell illicit commodities to alternative customers can be deterred in this way.

Similarly, private sector maritime entities are encouraged (in line with their internal risk assessment) to review the details of the underlying voyage. The May guidance specifies that this includes the vessel, cargo, origin, destination, and all parties to the transaction.

Communicate with all relevant partners – clear communication is a critical step for international transactions, especially those that involve differing or multiple sanctions regimes.

Review contractual language

The May guidance specifies that trade finance operations should incorporate the new compliance best practice recommendations in their contract documents wherever possible.

Industry information sharing

Facilitate and engage in industry information sharing where laws permit. Successful sanctions compliance programmes benefit greatly from the sharing of industry challenges, threats and risk mitigation measures.

In summary, all companies with marine sector exposure should closely review OFAC's recommendations and assess whether their current compliance programme meets the standards expressed.

Coming soon...

In the second instalment of these Risk and Compliance Guides we will focus on the methodology, systems and best practice that will help trade finance operations achieve absolute regulatory compliance, without compromising on time and workflow.

To find out more about how Lloyd's List group of solutions can help your business win please contact us on:

America Tel: +1 212-520-2747

EMEA Tel: +44 20 7017 5392

APAC Tel: +65 6505 2084

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