Locke Lord QuickStudy: OFAC Issues New Guidance to Maritime Industry Stakeholders and Insurers to Focus on Rising Sanctions Evasion Tactics

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On October 31, 2024, the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") released guidance to the maritime shipping industry to help stakeholders identify and avoid sanctions evasion tactics. The guidance leverages scenario-based case studies to highlight common due diligence challenges and provides best practices for compliance. The guidance underscores OFAC's encouragement for entities to employ a risk-based approach to sanctions compliance, particularly for those engaged in high-risk regions or trades where sanctions evasion tactics are prevalent.

This new guidance is directed at a wide range of maritime industry stakeholders, including commodities brokers, insurers, ship management service providers, shipbroking companies, and port authorities, all of whom are critical players to assist in sanctions compliance.

Heightened Risks in the Maritime Sector

The maritime shipping sector is a primary target for sanctions evasion efforts, with sophisticated deceptive practices becoming increasingly common. As discussed in our prior QuickStudies, OFAC's guidance highlights evasion tactics including manipulation of vessel location data, falsification of trade documentation, and obfuscation of vessel ownership. Offending shipowners often use these tactics to mask a vessel's ties to sanctioned jurisdictions, entities, or activities. To combat these practices, OFAC advises maritime stakeholders to redouble due diligence when engaging transport services.

For example, industry stakeholders are encouraged to confirm vessels' Automatic Identification System ("AIS") data and verify trade documentation to ensure that the data reflects the cargo's true origin and destination. OFAC's guidance also includes examples that illustrate specific red flags and best practices to mitigate sanctions risks.

Scenarios Illustrating Potential Sanctions Evasion

OFAC's guidance highlights several scenarios designed to illustrate recent sanctions evasion tactics. Below are three notable examples:

1. Deceptive Shipping Practices to Conceal Cargo Origins

In one scenario, an oil trading company contracts with a commodities trader to transport crude oil originating in the Middle East. During a routine port inspection, the certificate of origin indicates the cargo was loaded in Oman. However, the vessel's AIS data and voyage logs reveal the ship likely loaded the oil elsewhere, suggesting an attempt to mask the cargo's true origin. Further investigation showed the vessel's past illicit ship-to-ship transfers of Iranian-origin crude, which could expose U.S. persons or U.S.-linked entities to violations of the Iranian Transactions and Sanctions Regulations. OFAC advises stakeholders to conduct additional due diligence when cargo originates from high-risk regions or findings of AIS data gaps or manipulation.

2. Identification of Specially Designated Nationals ("SDN") on Trade Documents

Another scenario addresses a U.S.-based ship management company that discovers a designated SDN listed as a freight forwarder on trade documents. When confronted, the counterparty provides a revised document with an alternate forwarder, raising further compliance concerns. The ship management company responds by terminating the contract and initiating an audit, recognizing that engaging in business with SDNs could trigger secondary sanctions. This example highlights the importance of vigilant OFAC screening and having protocols to address instances where counterparty documents might indicate ties to blocked persons. Self-reporting of these violations will usually mitigate regulatory fines and penalties.

3. Use of Sanctions Exclusion Clauses for Vessels with Obscured Ownership

In the final scenario, a UK-based insurer unknowingly provides term property and casualty coverage to a vessel that was later determined to be ultimately owned by a Russian state-owned enterprise which is a blocked entity under U.S. sanctions. After an incident prompted a claim, the insurer learned that it can neither pay the claim nor continue coverage without violating U.S. sanctions. OFAC recommends that maritime stakeholders, especially insurers, reinsurers, and producers, incorporate robust sanctions exclusion clauses in contracts and adopt practices to verify the ownership and control of vessels to mitigate exposure to sanctionable activities.

To avoid the potential for insurers and their agents to violate sanctions laws, we recommend insurers include a variation of OFAC's standard sanctions exclusionary language such as "*No insurer, reinsurer, or producer shall be deemed to provide cover and no insurer, reinsurer, or producer shall be liable to pay any claim or provide any benefit or service hereunder to the extent that the provision of such cover, payment of such claim or provision of such benefit or service would expose such party to any sanction, prohibition or restriction under United Nations resolutions or the trade or economic sanctions, laws or regulations of the European Union, United Kingdom or United States of America.*"

In cases where an innocent third party has losses due to the acts of an insured SDN, the insurer may need to apply to OFAC for a license to pay the third party, the subject policy would be blocked, and the insurer, reinsurer, and producer may be required to sequester any premium received.

Key Takeaways for Maritime Stakeholders

OFAC's guidance emphasizes several key points to help the maritime industry detect and avoid potential

sanctions risks. Among these recommendations are:

- <u>Enhanced Transaction Due Diligence</u>: OFAC advises maritime entities to rigorously verify the origin, destination, and cargo details, particularly where documentation irregularities or AIS manipulation may exist; the risk increases when transacting in certain regions with history of sanctions evasion.
- <u>AIS Data Monitoring</u>: OFAC encourages stakeholders to assess the accuracy of AIS data. Abnormal AIS patterns, such as long periods of silence or suspicious voyage paths, can indicate attempts to disguise a vessel's location, posing both sanctions and environmental risks.
- <u>Sanctions-Specific Contractual Clauses</u>: Incorporating sanctions exclusion clauses in contracts provides stakeholders with a mechanism to terminate agreements if sanctioned entities are involved, protecting parties from inadvertent violations.
- <u>Due Diligence for SDN Involvement</u>: OFAC reminds U.S. and foreign entities alike to conduct thorough counterparty screening to ensure compliance with SDN restrictions. Red flags include abrupt changes to trade documents and reluctance from counterparties to provide additional information.
- <u>Transparency in Ownership Structures</u>: For vessels with complex or obscured ownership, OFAC advises insurers, underwriters, and brokers to conduct additional diligence to understand the chain of ownership, especially when dealing with newly formed entities in high-risk jurisdictions.

Conclusion

As sanctions evasion tactics become more sophisticated, maritime stakeholders must stay vigilant to prevent unintentional involvement in sanctionable activities. By adopting a risk-based compliance approach including enhanced documentation review and data verification processes, the maritime industry can effectively contribute to global sanctions enforcement efforts and avoid fines, penalties, and reputational damage. OFAC's guidance publication is a reminder that even unintentional sanctions violations can have severe consequences. It is important stay informed about compliance obligations to mitigate sanctions risks.

This paper is intended as a guide only and is not a substitute for specific legal or tax advice. Please reach out to the authors for any specific questions. We expect to continue to monitor the topics addressed in this paper and provide future client updates when useful.

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