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CLIENT ALERT

OFAC Puts Shipping Community on Notice with Expanded Guidance on Sanctions Evasion

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Over the last week, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) has issued two updated advisories, as well as issued a series of new designations of Specially Designated Nationals (SDNs), highlighting the sanctions-related risks for, and the focus on, the shipping community. Taken together, they provide important guidance for members of the shipping industry—including shipping companies, ship owners, insurance companies, and financial institutions with shipping practices, port operators, and others in the sector—on the scope of OFAC's prohibitions, red flags for sanctions risks, as well as the types of compliance practices that OFAC expects. We summarize the key takeaways below.

Advisory One: Updated Guidance on North Korea's Illicit Shipping Practices

First, on March 21, 2019, OFAC issued an update to its February 23, 2018 North Korea Sanctions Advisory (2018 DPRK Advisory) designed to provide guidance on North Korea's illicit shipping practices. In particular, OFAC updated the following elements of its guidance:

- **Provided Figures on Illicit Activity**: OFAC provided specific figures to identify the scope of the concern regarding North Korean illicit shipping. This included 263 tanker deliveries of refined petroleum in 2018 from UN prohibited ship-to-ship transfers, the resumption of North Korean coal exports in the gulf of Tonkin, specific examples of physical alteration of vessels, and specific identification of illicit shipment locations.
- **Provided Specific Guidance to Maritime Insurance Companies**: As part of Annex III, OFAC provided specific guidance to maritime insurance companies to: (1) research the Automatic Identification System (AIS) history of vessels that transport oil and operate in the East China Sea to determine if there is a pattern of AIS disablement or manipulation prior to extending coverage or at presentment of a claim; (2) consider inserting contractual language that states disabling or manipulating the AIS is an indication of potentially prohibited activity and could lead to revocation of services if illicit activity is discovered; and (3) that protection and indemnity (P&I) insurance and reinsurance companies should include an "AIS switch-off clause" for at risk vessels operating in relevant regions.
- **Additional Detail on Ship-To-Ship Transfer Risks**: OFAC provided a series of additional data points on the ship-to-ship transfer risk: (1) North Korea expanded its fleet of vessels capable of engaging in ship-to-ship transfers from 24 to 28 capable of transporting refined petroleum products (identified in Annex II of the March 21 update) and 33 capable of transporting coal; (2) OFAC further updated its regional map to identify three additional areas in which such transfers had occurred; (3) OFAC provided a new diagram showing the ports visited before and after ship-to-ship transfers of refined petroleum, identifying major ports in China, Taiwan, South Korea, and Russia.
- **Added Several Recommended Risk Mitigation Steps**: In addition to the risk mitigation steps already included in the 2018 DPRK Advisory—which included monitoring for AIS manipulation, conducting research prior to ship-to-ship transfers, reviewing all available shipping documentation, clearly communicating sanctions obligations to international partners, and leveraging all available diligence resources—OFAC added three additional recommended mitigation steps. (1) It recommended that all parties should research a ship's history to identify regular AIS manipulation,

particularly for any parties engaged in refined petroleum or coal trade in the region. (2) OFAC recommended that all parties in the shipping industry, including port operators and shipping associations, should remind oil tankers and coal vessels to maintain AIS broadcasts. (3) Finally, OFAC recommended any companies involved in the petroleum trade should conduct end-use checks to verify that all recipients are not providing oil to North Korea.

- **Identified Additional Vessels Engaged in Deceptive Activity**: OFAC expanded its previous annexes in the March 21 update identifying high-risk vessels. First, it added four vessels to Annex II listing North Korean vessels capable of engaging in ship-to-ship transfers of petroleum. Second, it newly identified 18 vessels from six flag jurisdictions (Panama, Republic of Korea, Russia, Sierra Leone, Singapore, and Togo) believed to have engaged in ship-to-ship transfers with North Korean tankers in Annex IV. Finally, in Annex V, OFAC provided a new list of 49 vessels believed to have engaged in the export of North Korean origin coal since 2017.

Advisory Two: Updated Guidance on Risks Related to Petroleum Shipments Involving Iran and Syria

Second, on March 25, 2019, OFAC issued an update to its November 2018 guidance to the maritime petroleum shipping industry to highlight risks associated with petroleum shipments to Syria. In particular, OFAC updated the following elements of its guidance:

- **Added a Deceptive Shipping Practice**: OFAC added "Vessel Name Changes" to its list of deceptive shipping practices, noting that it was therefore "essential to research a vessel not only by name but also by its [IMO] number." This supplements the previous listing of (a) falsifying cargo and vessel documents, (b) ship to ship transfers, and (c) disabling the AIS.
- **Added and Expanded Risk Mitigation Measures**: OFAC modified this in three ways. (1) It added the recommended action to "Know Your Customer" (KYC) to its previous list of risk mitigation measures. While KYC is a required element of anti-money laundering (AML) programs for regulated financial institutions, OFAC is expanding this recommendation to all members of the shipping community. Specifically, it recommends that the KYC due diligence include (a) researching companies and individuals in the transactions, (b) vessel owners and operators involved in any contracts or shipments, (c) country-of-origin and destination of goods involved in any underlying shipments, and (d) research on the vessel history by IMO number. (2) OFAC continued the theme of bringing AML concepts into the sanctions space by expanding its previous recommendation to strengthen AML and counter the financing of terrorism (AML/CFT) compliance by adding a recommendation to (a) adopt appropriate due diligence policies and procedures even for "non-financial gatekeepers" and (b) to promote "beneficial ownership transparency for legal entities." (3) OFAC specifically added a note that there is sanctions risk for underwriting, insurance, or re-insurance for "certain Syrian and Iranian maritime-related persons or activities."
- **Additional Vessel Listings**: Finally, OFAC updated its annexes in several ways in the March 25 update. First, OFAC added 16 vessels to its listing of vessels that delivered oil to Syria between 2016 and 2018 in Annex I. Second, OFAC added a new list of 33 vessels that had engaged in ship-to-ship transfers of petroleum destined for Syria between 2016 and 2019 in Annex II. Finally, OFAC added a new list of two vessels that had had engaged in shipment of petroleum from Syria from 2016 to 2019 in Annex III.

Key Takeaways

Taken together, the two advisories provide a wealth of guidance to the shipping industry. In particular:

- **Current Enforcement Focus**: The shipping industry is a primary enforcement focus for OFAC as it seeks to cut off illicit trade with both Syria and North Korea. With two advisories in a week and several recent designations for the same type of activity (*e.g.*¸ OFAC coupled its North Korea shipping advisory with the designation of two additional Chinese freight forwarding companies for allegedly engaging in deceptive activity in furtherance of North Korea trade), OFAC's enforcement attention is focused on all of the actors across the shipping industry. In that context, the advisories serve as a double-edged sword. While they provide useful guidance to identify risks, OFAC will now consider industry to be on notice and failure to take the recommended steps is likely to be seen as an aggravating factor in any potential enforcement action.
- **Focus on Non-Banking Industries**: In contrast to its typical advisories that focus on financial flows, these two advisories focus particular attention on non-banking actors, reminding the industry that actors in any sector can face sanctions-related risks. Of particular note was the focus in both advisories on the insurance industry, specifically calling out due diligence steps that insurers should be taking to mitigate such risks.
- **Continued Integration of AML and Sanctions Programs**: In both advisories, OFAC imports concepts traditionally associated with the AML obligations required of financial institutions (*e.g.*, KYC efforts, beneficial ownership research, etc.) as recommended best practices to mitigate sanctions-related risks. This builds on December 2018 remarks in which Treasury Undersecretary, Sigal Mandelkar identified detailed elements that Treasury expects to see in OFAC compliance programs for all companies – such as regular risk assessments, internal controls, periodic, independent testing, and training – which are highly similar to the AML program obligations of financial institutions.
- **Expanded Guidance Efforts**: Finally, the updated advisories continue a welcome recent trend of increased guidance from OFAC. Not only has OFAC issued other advisories (*e.g.*, on risks surrounding corruption in the Venezuelan gold sector), but it has also begun adding substantially more detail to its enforcement actions regarding the mitigating or remedial measures that it valued in its consideration.

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