

Guidance for Owners and Charterers on Sanctions Compliance Practices

by The Swedish Club and Reed Smith LLP

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Introduction

This Guidance sets out the standards and procedures for sanctions compliance. Compliance with sanctions is important – both for the protection of the Club and the individual Members’ organisations. The aim of this Guidance is to be an aid in understanding and complying with applicable sanctions.

As a club, we encourage all Members to promote this Guidance within their organisations - both as to its letter and its spirit. Any questions arising from the contents of this Guidance may be addressed to Members’ respective contact at the Club.

What are sanctions?

Sanctions are political trade restrictions that are imposed to maintain or restore international peace and security, or further a country’s foreign policy objectives. Sanctions are of particular relevance to the shipping industry because of the international nature of shipping transactions, which often makes them subject to multiple sanctions regimes.

The United Nations (“**UN**”), the United States (“**US**”), the United Kingdom (“**UK**”) and the European Union (“**EU**”), as well as a number of other states and supranational bodies, have imposed sanctions:

- on countries, individuals, vessels, aircraft legal entities or organisations; and/or
- on various commercial activities, exports, imports, general financial dealings and the provision of insurance and investments in respect of goods, services and industries.

Sanctions in the maritime industry

Regulatory focus on the maritime industry has increased in recent years as governments and international organizations move to curtail illicit activities. Scrutiny has particularly increased following guidance from key sanctions regulators, which stipulate expected standards of behaviour for those within the maritime community. This includes the advisory issued by US regulators on 14 May 2020 (the “**OFAC Maritime Advisory**”). Similar guidance from the UK regulators followed in July 2020 (and then updated in December 2020) (the “**OFSI Guidance**”).

This Guidance considers:

1. The main types of sanctions and where and to whom they apply;
2. Identifying sanctions ‘red flags’; and
3. Compliance with sanctions.

This Guidance does not provide detail on the sanctions that apply to specific countries. Guidance on this can be found in our ‘Sanctions by Country’ Guides.

A. Key sanctions authorities

B. Application and scope of US, EU and UK sanctions

C. US primary and secondary sanctions

US sanctions can generally be divided into two categories: *primary* and *secondary* sanctions.

Primary sanctions are those that apply to “US persons,” which is defined as US citizens and permanent residents (e.g., green card holders); entities incorporated under the laws of the United States (and their foreign branches) and persons physically located in the United States.¹ Primary sanctions also apply to transactions in US dollars, which transit through the US financial system.

On the other hand, secondary sanctions do not require a ‘US nexus’ and apply to non-US persons. Their aim is to prevent non-US persons from engaging in transactions against US national security and foreign policy interests, by threatening their access to US markets.

The US sanctions regime is administered by the Office of Foreign Assets Control (“**OFAC**”) of the US Department of the Treasury.

D. EU sanctions

EU Sanctions apply in the following circumstances:

- to any person inside or outside the territory of the EU who is a national of an EU Member State;
- to any legal person, entity or body, inside or outside the territory of the EU, which is incorporated or constituted under the laws of an EU Member State;
- to any legal person, entity or body in respect of any business done in whole or in part within the EU;
- within the territory of the EU, including its airspace and on board any aircraft or vessel under the jurisdiction of an EU Member State.

Accordingly, unlike US secondary sanctions, EU sanctions do not apply to transactions and/or entities that do not have an ‘EU nexus.’ However, Owners / Charterers should be careful to consider whether any EU citizen employees will be involved in the transaction – as citizens of EU Members States are subject to EU sanctions whether inside or outside the territory of the EU.

¹ In the context of the US sanctions imposed on Cuba and Iran, the primary sanctions also apply to foreign entities owned or controlled by US persons.

The task of day-to-day administration and enforcement of EU sanctions lies on the competent national authorities of the Member States, which are required to establish and adopt effective and proportionate penalty provisions.

E. UK sanctions

The scope of UK sanctions is broadly similar to those imposed by the EU. The sanctions apply to:

- All individuals and legal entities who are within or undertake activities within the UK's territory, including its airspace;
- All individuals on board any aircraft or any vessel under the jurisdiction of the UK;
- Any person inside or outside the territory of the UK, who is a UK national;
- Any legal person, entity or body which is incorporated or constituted under UK law;
- Any legal person, entity, or body in respect of any business done in whole or in part within the UK.

UK sanctions are maintained by the Office of Financial Sanctions Implementation ("**OFSI**"). Of particular relevance to those in the maritime community is the Transport Sanctions Team.

F. Assessing relevant regimes

Owners / Charterers should give careful consideration as to which sanctions regimes may apply in relation to any business they undertake. Owners / Charterers should be aware that, even if they are not subject to a particular sanctions regime, one or several sanctions regimes may still be relevant if they apply to other parties within the transaction, their insurers or brokers.

G. Party related sanctions

The term 'Party related sanctions' refers to sanctions against targeted entities, vessels, bodies and individuals. Subject to certain narrow exclusions, engaging in any transactions with these parties is effectively prohibited (assuming there is a relevant 'nexus' establishing jurisdiction for the relevant sanctions regime).

Transacting with sanctioned parties carries the risk of heavy financial penalties, as well as the possibility of being added to a sanctions list. Being included on a sanctions list is likely to bring severe commercial damage to an Owner or Charterer.

Sanctions screening

Counterparty screening is, therefore, an integral part of any sanctions compliance programme. It is advised that screenings be undertaken using dedicated screening software – however, searchable sanctions lists maintained by the EU, US and UK are available online.

- The US Specially Designated Nationals and Blocked Persons List ("**SDN**") List maintained by OFAC can be found here:

<https://home.treasury.gov/policy-issues/financial-sanctions/specially-designated-nationals-and-blocked-persons-list-sdn-human-readable-lists>

- The consolidated list of EU targets can be downloaded from the Europa website here:

https://eeas.europa.eu/headquarters/headquarters-homepage_en/8442/Consolidated%20list%20of%20sanctions

- The consolidated list of UK designated persons maintained by the Office of Financial Sanctions Implementation HM Treasury can be searched here:

<https://sanctionssearch.ofsi.hmtreasury.gov.uk/>

Screenings undertaken by Owners / Charterers should include (as applicable): potential owners, charterers, Ship-to-Ship (“**STS**”) counterparts, shippers, receivers, port authorities and agents involved in any particular trade.

Under the US, EU and UK regimes, parties owned 50 percent or more (directly or indirectly) by a sanctioned party are subject to the same sanctions as their sanctioned owner. The EU and UK sanctions extend further to entities *controlled* by a sanctioned individual or entity. Accordingly, parties may be subject to sanctions even though they are not included on any sanctions list.

One of the benefits of screening software is that the ownership/control links are often identified. However, effective counterparty due diligence is, in any event, an essential aspect of sanctions compliance (as discussed further below).

H. Jurisdiction and trade related sanctions

Even if a transaction does not involve any sanctioned parties, it may still be restricted pursuant to jurisdictional or trade-related sanctions. These restrictions range from comprehensive embargos on certain jurisdictions (*e.g.*, US sanctions on Cuba) to narrower measures targeted at particular types of transactions (*e.g.*, lending capital; trade in Belarusian potash).

Further detail of these restrictions can be found in our ‘Sanctions by Country’ Guides.

I. Impact of trade on insurance coverage / class / flag / finance commitments

J. Insurance coverage

The Club’s position, in line with the approach adopted by the International Group of P&I Clubs, is that all Members are under an obligation to take all necessary steps to ensure that their actions are not unlawful, and the insured vessel is not engaged in any illicit trade.

In circumstances where an insured vessel engages in unlawful trade, associated liabilities, costs and expenses may not be covered by the Club. Further, the Club shall not be responsible for liabilities, costs or expenses, where the reimbursement or any payment in respect thereof would expose the Club to the risk of being or becoming subject to any sanctions or other prohibitions.

Importantly, insurance may cease altogether in circumstances where the Member has exposed the Club to the risk of being or becoming subject to sanctions, a prohibition or other adverse action under United Nations Resolutions or the trade or economic sanctions, laws or regulations of the EU, UK, US or other applicable state power.

K. Flag registries/Classification societies

Flag Registries and Classification societies are the subject of specific US guidance, in an effort to identify and curtail sanctionable activity, and have come under increased pressure to investigate deceptive shipping practices. These investigations can cause a vessel to be deflagged, and to lose the support of those organizations. The vessel may also be reported to the US authorities and IMO. The main Flag Registries are also part of a Registry Information Sharing Compact, to prevent “Flag Hopping”.

L. Identifying Sanctions ‘Red flags’

The OFAC Maritime Advisory identifies the following ‘red flags’ commonly used to evade sanctions and conceal illicit shipping practices:

M. Automatic Identification System (“AIS”) manipulation

Ocean going vessels (with very few exceptions) must operate AIS at all times, except where international agreements, rules or standards provide for the protection of navigational information. Although safety issues may at times justify AIS disablement, or poor transmission may occur, one of the most common indicators of potential sanctions evasion activity is when a vessel diverts course or ceases to transmit its AIS in order to mask its name, identifying IMO number or next port of call.

N. False flags and ‘flag hopping’

Sanctions evaders may falsify the flag of their vessels to mask illicit trade, change vessel flags frequently within a short period of time (“Flag Hopping”) or continue to use a state’s flag even after being de-registered to avoid detection.

O. Physically altering vessel identification

Ocean going vessels (with very few exceptions) are required to display their name and IMO number in a visible location either on the ship’s hull or superstructure. Vessels involved in deceptive practices often paint over vessel names and IMO numbers to disguise their identities and pass themselves off as different vessels.

P. Falsifying vessel and cargo documents

Shipping documentation should be examined carefully to ensure they accurately record the underlying voyage and relevant vessel(s), flag, cargo origin and destination. Bills of lading, certificates of origin and quality, invoices, packing lists, proof of insurance, and last ports of call are examples of shipping documentation that are usually produced/provided during the course of a shipping transaction. Sanctions evaders frequently falsify vessel and cargo documents in order to obscure the origin, quality and destination of the cargo.

Q. Voyage deviations

Bad actors often disguise the ultimate destination or origin of cargo or recipients by changing their route or deviating from their scheduled destination. This should be considered a ‘red flag,’ particularly if these deviations occur in high-risk countries.

R. Ship-to-Ship (“STS”) Transfers

Whilst STS transfers are a legitimate and common method of transferring cargo, they are also frequently used as a means of concealing the actual origin or destination of the cargo and evading sanctions. Particular care should be taken where STS transfers take place in high-risk areas, when dealing with sanctionable cargo (such as oil) or at night.

S. Complex Ownership / Management structure

A common tactic of malign actors is to use complex business structures, including shell companies and/or multiple levels of ownership and management, to disguise the involvement of sanctioned parties. This may include sanctioned vessel owners or cargo interests. Frequent changes to the ownership of a vessel, or the vessel’s management, is also considered a ‘red flag.’ Charterers / Owners should, where necessary, perform enhanced due diligence to ensure that there are no sanctions concerns.

T. Sanctions Compliance

Key sanctions authorities recommend a “risk-based” approach to sanctions compliance. Attention is drawn, in particular, to OFAC’s May 2019 Framework for Compliance Commitments, which provides guidance on the essential components of a sanctions compliance programme. Such programmes, if implemented effectively, both mitigate against the risk of a violation and may serve as a mitigating factor in a regulatory investigation into potential sanctions violations.

The following steps are recommended:

1. Adopting a sanctions compliance policy;
2. Conducting transactional due diligence, including evaluation of counterparty, cargo and activity risk and ensuring that adequate contractual protection against sanctions risks is in place;
3. Conducting ongoing monitoring and AIS diligence of vessels and counterparts;
4. Seeking sanctions advice from the Club and legal professionals; and
5. Implementation of a Sanctions Compliance Programme (“SCP”) and procedures.

As above, companies are strongly recommended to adopt a risk-based approach to sanctions compliance by developing, implementing, and routinely updating an SCP, the characteristics of which will vary depending on the company’s nature; *i.e.*, size and structure, goods and services, customers and counterparties and geographic locations within which the company operates.

U. Sanctions Compliance Programme (“SCP”)

There are five key components to an effective SCP: (i) management commitment; (ii) risk assessment; (iii) internal controls; (iv) testing and auditing; and (v) training.

V. Management commitment

A company’s senior management commitment and support of a risk-based SCP constitutes an important factor that determines the success of the program. The definition of the term “*senior management*” may differ among various organizations, but typically, the term should include senior leadership members, executives, and/or the board of directors.

Senior management commitment is usually expressed by the following elements:

- The organisation’s SCP has been reviewed and approved by the senior management.
- Senior management should ensure that sufficient authority has been provided to its compliance units to establish and implement its policies and procedures. To this end, senior management should ensure that direct and effective communication/reporting channels between the compliance units and senior management exist, including periodic meetings between these two elements of the organisation.
- Senior management should take steps to ensure that adequate resources, in the form of human capital, expertise, and information technology are provided to the organisation’s compliance units, and are relevant to the organisation’s breadth of operations, target and secondary markets, and other factors affecting its overall risk profile.
- These efforts can be achieved by, for example, appointing a dedicated sanctions compliance officer within the organisation and ensuring that the personnel dedicated to the SCP holds the necessary technical knowledge and expertise with respect to sanction regimes.
- The senior management within the organisation should cultivate a “culture of compliance” with sanctions regimes. This can generally be accomplished in the following ways:
 - Senior management should encourage the organisation’s personnel to report sanctions-related misconduct to senior management. The SCP should ensure that confidential reporting mechanisms exist so that the organisation’s personnel can report any suspicions without fear of reprisal;
 - Senior management should employ actions that discourage misconduct and prohibited activities, and alert organisation’s personnel to the consequences that any breach of sanctions regimes may bring;
 - The SCP should identify mechanisms through which the actions of the entire organization are controlled for the purposes of compliance with sanctions; and
 - Senior management should acknowledge the effects of potential violations of sanctions, any deficiencies, or failures on the part of the organization and its personnel

to comply with the SCP's policies and procedures and takes all appropriate measures to minimise the risk of violations in the future.

W. Risk assessment

Ongoing risk assessment, in order to identify potential threats or sanctions risks, is essential.

An effective risk assessment should generally include, but may not be limited to, an assessment of the following elements:

- Counter-parties, supply chains, intermediaries and cargo interests;
- the services offered, including how and where the service fits into other financial or commercial products, services, networks, or systems; and
- the geographic locations and reach of the organisation and its assets (including vessels).

X. Internal controls

An effective SCP should provide internal controls that allow for the effective identification of transactions and activities that may be prohibited by sanctions regulations. A company should ensure that, upon discovering a deficiency in its internal controls, it takes immediate and effective action to rectify the deficiency. Internal and/or external audits and assessments of the program should be conducted on a routine and periodic basis.

Y. Testing and auditing

Effective testing and auditing mechanisms should be included within an SCP so that an organization can identify potential weaknesses and deficiencies and be able to remediate any sanctions compliance gaps by enhancing its program. The organization should ensure that, upon identifying a negative testing result or audit finding in its compliance program, it will take immediate action, to identify and implement controls until the root cause of the weakness or deficiency can be determined and rectified.

Z. Training

A successful SCP should ensure that effective training programmes are provided to employees and personnel and, as appropriate, stakeholders (for example, clients, suppliers, business partners, and counterparties) in order to support the organization's sanctions compliance efforts.

AA. Identifying applicable regimes

A SCP should also identify the sanctions regimes that are applicable to the company and indicate any countries where trading is prohibited.

BB. **Transactional Due Diligence**

CC. Evaluating counterparty risk

As described under part 1 of this Guidance, an effective evaluation of counterparty risk should include screening of all parties involved against global sanctions lists (*i.e.*, EU, US, UN and UK) to ensure that they are not targeted by sanctions or involved in sanctionable trade. When considering the appropriate level of screening for their business, Members should consider whether to subscribe to software that will screen all major sanctions lists. Depending on the nature of the trade, consideration should be given to whether it is appropriate to screen charterers, shippers, receivers, port authorities, agents, and any other parties involved.

Those conducting sanctions checks should be mindful that entities owned or controlled - directly or indirectly - by a designated person, even if those entities are not designated in their own right, may be considered sanctioned by the relevant authorities.

DD. Cargo and activity risk

Ascertaining whether a cargo may be sanctioned, involves a combination of counterpart screening, coupled with country of origin checks and consideration of the ultimate destination of the cargo.

In order to evaluate cargo and activity risk, accurate documentation and information is key, along with consideration about whether there are any suspicious circumstances that may reveal attempts to conceal illicit practices.

The US has drawn the maritime community's attention to the following:

- i. Shipping documentation should be carefully examined to ensure that it accurately records the underlying voyage and relevant vessel(s), flagging, cargo origin and destination. Sanctions evaders commonly falsify cargo and vessel documents, such as 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.
- ii. Where a vessel has disabled its AIS, this should be considered a red flag and could entail potential evasion activity. Similarly, STS transfers can be used to transfer cargo to conceal the actual origin or destination of the cargo.
- iii. There must be clear and unequivocal communication between the parties, ensuring that your trading counterparty acknowledges their sanctions obligations.

EE. Contractual protection

Before entering into a particular activity with a trading partner, Members should ensure that there is adequate protection against sanction risks in all contracts entered into by them.

Sanction clauses provide an important means of protection but are not a complete answer to addressing sanctions risk. Sanctions-compliance is a non-delegable obligation and contractual recourse against a "bad actor" may be of limited value.

BIMCO has released a suite of sanctions clauses, responding to the increased scrutiny the maritime sector faces from regulators, and the guidance provided. These include:

- a. The BIMCO 2020 Sanctions clause for Time Charterparties

- b. The BIMCO 2020 Sanctions clause for Voyage Charterparties
- c. The 2021 container trade specific sanctions clause
- d. The 2021 AIS Anti-manipulation clause

Members may need to modify these clauses to address specific trades and specific risks, but the above BIMCO clauses represent a minimum standard of protection.

FF. Ongoing Monitoring

GG. Ongoing monitoring / screening of counterparties

Even if effective due diligence has been undertaken and no sanctions “hits” have been revealed, this does not mean that a Member’s company is and will remain entirely protected from sanctions risk. An essential part of the due diligence process is ongoing monitoring.

Sanctions change frequently, and Governments and international authorities issue, update and revoke sanctions on a regular basis. Members should carefully monitor public announcements from the relevant authorities, updates to sanctions regulations, updates to global sanctions lists and also periodically review their internal processes and adjust accordingly to ensure that compliance requirements are fulfilled.

HH. AIS diligence

As described above, an indicator of potential sanctions evasion activity is when a vessel diverts course or ceases to transmit its AIS. As part of their due diligence processes, Owners and operators are encouraged to assess the AIS history of prospective/new and existing clients and refrain from conducting business with vessels that have a history of AIS manipulation inconsistent with SOLAS.

Once the parties enter into a particular trade, routine monitoring is also an essential tool in identifying, locating and monitoring vessel movements and ensuring that the vessel is not involved in any trade, which is unknown to the Members and may pose sanctions risks.

II. Seeking sanctions advice from the Club/Legal professionals

Understanding and complying with international sanctions regimes is not always straightforward. Members are encouraged to seek assistance from the Club and/or external specialists in this field, as required.

Disclaimer: This Guidance is intended to provide only general guidance and information pertaining to the issues identified and commented upon herein. The content of this Guidance is not intended to be and should not be treated as being final and binding legal advice. If Members consider they are likely to or in fact have encountered problems or difficulties as discussed in this Guidance, they are asked to contact the Club and obtain further legal advice relevant to their specific circumstances.