SAFELY NAVIGATING BUSINESS AT SEA
The sea is the engine of globalization and, as such, is intimately engaged with the financial sector and its institutions.

As a result, the maritime sector itself is a complex commercial and financial ecosystem that includes transportation and infrastructure investment, insurance, trade finance, energy, supply chains, commodity exchange and security.
INTRODUCTION

OUT AT SEA

For a long time, being out at sea meant being out of sight and out of reach, with the consequence that the remoteness and specialized character of activity at sea provided ample opportunities for criminal acts, not only piracy and slavery, but also violations of international law, sanctions breaches and trafficking of all kinds.

In recent years, the maritime sector has benefited from more intrusive scrutiny and surveillance, principally from significant improvements in satellite coverage, communications and innovative imaging technology, that now mean that it is increasingly difficult to escape notice on the high seas or in remote areas of ocean. In addition, the International Maritime Organization’s International Convention for the Safety of Life at Sea requires an Automatic Identification System (AIS) to be fitted aboard international voyaging ships with 300 or more gross tonnage (GT), and all passenger ships, regardless of size. This enables a great deal of information about ships, such as their location, course, speed and other characteristics, to be exchanged via satellite and viewed by subscribers. Meanwhile, specialist companies use artificial and other intelligence (AI) to interpret the visual images and profiles of ships at sea, with the ability to assess the tonnage of their cargo and their draft in the water by examining the shadow cast on the sea and by the shape of its wake.

Another important implication of the vast amount of data available in real time to shipping companies and traders is that cargoes, especially oil and gas, can be bought and sold while in transit in response to market demand and shifting commodity prices. Satellite tracking is giving traders near real-time data on where oil and assets are located, their content and when they will arrive. This means they can respond much more quickly to sudden shifts in price and demand, but also means that trading across a rapidly shifting spectrum of ownership and assets offers opportunities for illicit activity.

1 Planet Labs – a private space firm that has launched 331 satellites since 2014.
2 Such as TankerTrackers.com.
3 The fuller the vessel is, the lower it sits in the water. This metric determines the size of the shadow based on the sun’s altitude at the time.
4 In this way, ships involved in sanctions breaches with Iran and in delivering fuel oil to North Korea by offshore ship-to-ship transfer have been detected, sometimes actually in the act of transfer.
5 Vortexa applies AI to satellite and market data to interpret global energy markets.

Join the conversation: #FightFinancialCrime
Unfortunately, the complex, ambiguous character and international footprint of the maritime sector and its networks continue to frustrate attempts at the eradication of marine fraud and illegality. Even in an interconnected world, with its artificial intelligence-enabled information systems, sophisticated supply chains and extensive technological surveillance, there are numerous ways in which criminal and illicit activity still takes place, often within and at the edges of legitimate trading patterns.

For example, although the IMO regulations require that AIS operates at all times, it is a simple matter for those ships engaging in illicit activity to switch off their AIS transponders for all or part of their transit.6 A typical case was reported by Reuters in March 2019. A super tanker, the Grace 1, had been undetected on AIS for two weeks (between Nov. 30 and Dec. 14, 2018). Its AIS eventually revealed that on 14 December 2018 it was near Bandar Assaluyeh in Iran and its draft indicated that its oil tanks were full. Between Jan. 16 and 22, 2019, it was transferring fuel oil to two smaller vessels off Fujairah (United Arab Emirates), which were full when they disengaged. Meanwhile, the Certificate of Origin of one of the smaller tankers claimed that the oil had been obtained from Basra in Iraq. Investigation showed that the documentation had been forged, with faked signatures and loading dates for a ship that, according to port records and AIS, had not been in Basra.7 In a similar case, on March 2, 2019, a Royal Navy frigate discovered the North Korean-flagged vessel, the Saeboyl, conducting a prohibited ship-to-ship transfer at night “alongside a ship of unknown nationality” off the coast of Shanghai.8

The ownership profile of the Grace 1 highlights a major regulatory loophole, that of multiple ownership, of ships and cargoes. Although Panamanian-flagged, the Grace 1 was nominally managed by Singapore-based shipping services company whose offices could not be located.9 More widely, precise accountability for ships is often obscured by this complicated relationship between those entities and individuals who own, manage, lease or operate individual ships.6

---

6 There are some exceptions. Warships, for example, are not always obliged to transmit on AIS.
9 Ships Management Pte Ltd.
Indeed, the beneficial owner (“one who enjoys the benefit of a property of which another is the legal owner”) is often deliberately obscured, not least by the practice of shipowners establishing shell companies as the legal owners of their ships. In addition, the cargo or contents of a ship are likely (as we have seen) to belong to, or be held on account, by different companies, with the value traded (sometimes several times in whole or in part) even while a ship is on passage.

Illicit practices at sea also rely on “flags of convenience,” the business practice of registering a merchant ship in a sovereign state different from that of the ship’s owners and flying that state’s civil ensign on the ship. It enables the owners to evade the more onerous safety, employment and regulatory requirements and enforcement mechanisms of their own state. Despite over a decade of regulatory pressure, it remains easy and inexpensive to establish a complex web of corporate entities to hide the identities of beneficial owners, especially those engaged in sanctions breaches and criminal facilitation. These almost impermeable corporate structures are often multilayered and spread across numerous jurisdictions. Arms smuggling, money-laundering, trafficking in drugs, goods and people, and other illegal activities, as well as UN sanctions breaches, environmental damage, and illegal fishing, also thrive in the unregulated havens which the flag of convenience system provides. In addition, under flags of convenience, some ships are effectively low-wage “sweatshops,” characterized by the evasion of labour regulation in the country of ownership, the payment of low wages in tandem with long working hours and unsafe working conditions.

Another issue is that of “phantom” ships – vessels without a valid or regular classification which are not registered with a recognized ship registry and which in many cases are operated by illegal or quasi-legitimate interests. Most phantom activities involve state-sponsored or criminal networks in the theft or hijack of ships and their cargoes, with the aim of selling on, or utilizing for other uses, both the ship and her contents. Other cases involve straightforward ship identity theft. Their use is stimulated by corrupt or weak registration arrangements, poorly regulated flags of convenience regimes and the use of temporary front companies and financial transfer vehicles established simply for the period and purposes of specific transactions or operations.

Unsurprisingly, a recent United Nations Panel of Experts (PoE) has reported sins of omission and weak compliance mechanisms within the financial community in relation to the maritime sector. It noted that “Global banks and insurance companies continue unwittingly to facilitate payments and provide coverage for vessels involved in ever-larger, multi-million dollar, illegal ship-to-ship transfers of petroleum products, as well as an increasing number of ship-to-ship coal transfers and attempted transshipments.”

It highlighted the disguising of vessels through ship identity theft and false Automatic Identification System (AIS) transmissions and criticised “most global and regional commodity trading companies, banks and insurers, whose due diligence efforts fall extremely short.” In particular, “insurers do not monitor the AIS of the vessels for which they provide coverage and services.” Other methods of evasion included the physical disguise of North Korean tankers, the use of small, unregistered vessels; illegal name-changing and other forms of identity fraud; night transfers; and the use of additional vessels for transshipment. It also noted the extensive use of front companies and the establishment of accounts in multiple jurisdictions.

10 The Philippines and China provide the greatest number of seamen to flag of convenience ships, especially those who registered in Panama, the Bahamas, Liberia and the Marshall Islands. On average in some cases, Filipinos and Chinese able seamen earned between 7 and 10 percent of the wages of their U.S. equivalents, while among chief engineers, Filipinos earned roughly 10 percent in comparison (The American Bureau of Labor Statistics: www.bls.gov/iag/tgs/iag483.htm, accessed March 17, 2019).
The Trump administration has significantly stepped up pressure on illicit activity in the maritime sector, notably within the context of suppressing sanctions breaches associated with the Bashar al-Assad regime in Syria, with Iran and with North Korea.

Intensified efforts since September 2018 have targeted Iranian, Russian and Syrian entities and their networks. In November 2018, the U.S. Department of the Treasury issued a global advisory note directed at the petroleum shipping industry, describing the methods employed by sanctions evaders and proscribing 35 vessels. The advisory note also advertised the shipping registries of violating vessels, such as Panama, Liberia, Russia, Tanzania, Thailand, Namibia and several small island states, reminding them of their responsibility to uphold maritime law and monitor illicit activity. The Treasury also encouraged marine insurers to help deter sanctions busters by declaring that switching off AIS would invalidate or condition marine insurance cover.

This initial salvo was followed up by two further Office of Foreign Assets Control (OFAC) global advisory statements in March 2019. These, while increasing regulatory action in support of sanctions against North Korea and Syria, provided important general guidance for the maritime industry – including shipping companies, shipowners, insurance companies, financial institutions with shipping practices, port operators and others in the sector – on the scope of OFAC’s prohibitions, red flags for sanctions risks and the compliance practices that OFAC expected.

In particular, the first note highlighted the misuse of AIS as a primary indicator and encouraged insurance firms to withdraw or invalidate protection and indemnity (P&I) insurance and reinsurance cover in the event of AIS disabling or manipulation. The second note of March 25, 2019 detailed “deceptive shipping practices,” such as vessel name changes at variance with IMO registration numbers; falsifying cargo and vessel documents; undocumented ship-to-ship transfers; and deliberately disabling the AIS. It extended the concept of Know Your Customer (KYC) to the shipping industry, with due diligence covering research into companies and individuals in the transactions; vessel owners and operators involved in contracts or shipments; country of origin and destination of goods involved in any underlying shipments, and the vessel history by IMO number. In addition, it introduced the theme of AML into the sanctions space by recommending AML/CTF due diligence; beneficial ownership transparency for legal entities; and the idea of a sanctions risk for underwriting, insurance or reinsurance for certain (Syrian and Iranian) maritime-related persons or activities. The novel aspect of these advisory notes was that, in contrast to its normal advisories that deal with financial flows, OFAC increased attention and pressure on nonbanking actors, reminding them that any sector could face sanctions-related risks. Of particular note was the emphasis in both advisories on the insurance industry, specifying due diligence measures that insurers should have been taking to mitigate risks. The U.S. Treasury and OFAC are now clearly sharpening their focus on several areas beyond financial services, including the maritime sector.

---

12. 32 more ships were added in March 2019.
15. In December 2018, U.S. Treasury Undersecretary, Sigal Mandelker, identified detailed elements that the 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 very similar to the AML program obligations of financial institutions. https://home.treasury.gov/news/press-releases/sm563, accessed April 20, 2019.
Risk mitigation in this sector relies critically on the screening of transactions and relationships.

SOLUTIONS

All these issues represent a veritable minefield for the potential investor or partner in a maritime enterprise. The risk does not simply apply to large vessels, such as container, cargo and oil and gas carriers, but also cruise liners, leisure craft and fishing vessels that form part of a wider investment vehicle or portfolio, especially those arranged through third parties. There can also usually be tangible links to the more familiar forms of financial crime, including money laundering, terrorist financing, arms trafficking and illegal fishing activity, all facilitated by marine documentation and the opaqueness caused by ship registration and faulty ownership documentation.

Risk mitigation in this sector relies critically on the screening of transactions and relationships that have shipping or maritime features through a combination of sector intelligence reports, vessel and company profiling and dynamic surveillance of shipping movements. Very often, illicit activities and their enabling networks can only be detected by detailed examination and systematic interpretation of the labyrinthine subsidiary interests and personal associations of key individuals. As always, the secret is the ability to "connect the dots," by exploiting industry best practice and the precautions recommended by regulators to ensure that investors and traders are compliant with the relevant international and sanctions law. The best solutions are "one-stop shops" that incorporate Enhanced Due Diligence (EDD) as standard and require the screening, tracking and monitoring of ship and cargo identity, location and ownership, backed up by comprehensive, dynamic databases relating to relevant sanctions, links to illicit activity and persons and companies of interest to governments and regulators.
Given the risks, investors and traders will recognise that they need to apply as much attention, compliance and due diligence to their transactions in the maritime sector as they do to their normal financial dealings ...

BOTTOM LINE

The sea is the primary medium of global access and exchange and has been described as the physical equivalent of the World Wide Web.

Everything that passes virtually on the Internet, actually travels in reality across, under or above the sea. As such, those engaged in illicit activity at sea can be seen as malware that disrupt and corrupt the legitimate operation of the watery World Wide Web that is the sea.17

Given the risks, investors and traders will recognise that they need to apply as much attention, compliance and due diligence to their transactions in the maritime sector as they do to their normal financial dealings, to ensure that their exposure to risks from patterns and incidences of illicit activity at sea can be identified and avoided. Financial institutions are at least as vulnerable to sanctions risk and other forms of risk from the malware of the watery World Wide Web as they are from cyberattack in the conventional digital space.

17 The analogy appears even closer when it is considered that almost all Internet traffic is carried by fibre-optic cables under the sea.
AUTHOR BIO:

Rear Admiral Chris Parry CBE PhD, Managing Director,
Merl House Strategic Forecasting and Risk

Chris Parry spent 36 enjoyable, rewarding years in the Royal Navy as an aviator and warfare officer, with experience in combat, several operational commands and five senior policy appointments. Nowadays, he runs his own strategic forecasting company, advising governments, leading companies and banks about geo-political and strategic issues, future trends, disruptive technologies and systemic risk. He is also an internationally regarded expert on all aspects of terrorism, criminality and illicit activity, as well as the maritime sector. He received a Masters degree from Jesus College, Oxford and a PhD from the University of Reading.

Refinitiv is one of the world’s largest providers of financial markets data and infrastructure, serving over 40,000 institutions in over 190 countries. We are new market pioneers with 167 years of confidence. We provide leading data and insights, trading platforms, and open data and technology platforms that connect a thriving global financial markets community - driving performance in trading, investment, wealth management, regulatory compliance, market data management, enterprise risk and fighting financial crime.