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Price Cap on Russian Oil is a Board-Level Risk for the Tanker Sector

The United States' intent to enforce a price cap is a board level risk, and stakeholders would be wise to take the advice of a consultant or a lawyer.

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On September 9, the US and its allies unveiled the next step in their plan to cap the price of Russian-sold oil – a bold next step that goes above and beyond initial embargoes.

So, what does this move really mean?

Impeding Russian oil sales is no small move. The bulk of Russia's 11.3 million-barrels-a-day production in January 2022 was crude oil (10 million barrels a day) according to the IEA. Now, the agency forecasts that Russian oil production could fall by 1.9 million barrels a day by February, once the EU embargo on imports comes into force. Vortex estimates the decline at 2.5 million bpd.

From a monetary perspective that means that the reality is different from the intention. Indeed, Russia seems to be making more money, not less money, in spite of all these sanctions – including recent decisions by the US and the EU banning imports of oil and oil products.

The goals of the new guidance, backed by US, the G7 and the EU, are threefold:

1. Maintain a reliable supply of seaborne Russian oil to the global market.

2. Reduce upward pressure on energy prices – a huge impact on soaring inflation in the West.

3. Reduce the Russian Federation's revenue from oil.

By going after Russia's global market, these new sanctions stand to influence Russian trading beyond those independently set up by the US and the EU. In terms of regulation, this is perhaps the most complex – and novel – regulations on trading and shipping the world has ever seen.

But it's not the first of its kind. Let's rewind by two years: Effectively, the first significant sanctions regulations on global shipping was issued by the Trump administration in May 2020. These regulations established a set of expectations for all relevant parties – from traders and banks, to shipping companies, insurers, ports and other related parties – to start rigorously screening for "deceptive shipping practices" beyond the standard vetting of simply "list matching" (i.e. checking that someone you do business with isn't blacklisted).

These recent sanctions stand on the shoulders of the May 2020 edict in that they effectively tell companies how to carry out maritime transactions – not to mention that although these two regulatory decisions are unique, the uncertainty each has caused within the shipping and trading ecosystem is comparable.

So, What's New?

This new advisory means that companies aren't allowed to offer maritime services – including transportation, insurance, maintenance, and more – to anyone trading above the price cap. It also mandates that anyone involved in the wider shipping supply chain must continually screen any trade partners for deceptive shipping practices – both those outlined in May 2020, alongside additional risk factors and abnormal patterns.

These guidelines bring about several key changes:

- Historically, most sanctions focused solely on dirty oil tankers, while the new regulations make clean petroleum a key part of the equation. In the past, not only were clean oil tankers subject to few – if any – compliance checks or audit trials, but trading desks and trade banks dealing in clean petroleum were largely unregulated. These new guidelines will bring tighter compliance standards to approximately 5,500 additional ships.
- Traders and related parties must now screen every transaction and document the whole chain of prices through every deal. Only once a deal is confirmed to be under the price cap and the services are at market price, can the deal go through.
- It extends the audit trail to five years.
- It expands the risk factors that companies must screen for – new company vetting, abnormal patterns, and more.
- Finally, it puts many more companies in the spotlight and raises widespread scrutiny around sanctions enforcement.

The Significance

So why do these sanctions matter so much?

Firstly, the shipping and trading world is far from binary and can't just be broken down into good guys and bad guys. Accordingly, most of the affected shipping and trading companies are Western or trade in the West. For instance, it's reported that a majority of Russia's oil is transported by Greek shipowners, who operate in the EU and are now direct targets of this advisory.

Secondly, the US, EU and G7 are guiding these sanctions. Considering the sway these national entities have on global affairs, the effects will be further reaching than just G7 countries. While the May 2020 sanctions were exclusively American, these new restrictions could involve 30-plus additional new countries as partners in enforcing this price cap.

On the flip side, we can almost certainly expect that Russia and its partners will align with maritime transportation operators outside of the G7, EU, and the coalition allies. That means we'll see more and more companies formed in the GCC area – China, Russia, Turkey – who will be buying ships and setting up insurance or finance facilities.

Major Challenges to Implementation

This manufactured, artificial means of controlling and containing oil prices can easily backfire – it will take a very fine balancing act to ensure that the measure is adopted, heeded, and achieves the right outcome. It also gives Russia an "out" to continue selling its oil and getting a benefit, so even if prices are capped and regulated in some capacity, it erodes and bypasses the intentions and effectiveness of initial sanctions.

Enforcing these regulations will be very difficult even if every transaction is documented. How will this be policed? By whom and when? The "speed cameras" analogy probably holds true here – will videoing a few people who commit felonies impact the rest of the market?

There is the risk that companies might do larger deals in parcels or fragment deals in order to get around the oil price cap.

The cost of implementing all the necessary controls for these restrictions will put many reputable companies off. By the time any big company implements this, we may be past the need for it.

While the US has released its advisory, we will have to wait for the European version of this same guidance because that is where all this really matters and where the impact on curtailing Russian oil is felt. This might be difficult to obtain due to the consensus way of making decisions in the EU.

So, does it make things more complicated or easier?

The new regulation focuses on two areas – pricing and maritime transportation. In a sense we believe this actually makes it much easier for firms to apply the sanctions, even if the task to maintain these standards is Sisyphean.

Although tracking flows of cargoes of Russia oil and the origin of each product is quite complicated, especially since bills of lading can and are being forged, this system does help properly define who are Tier 1, Tier 2,and Tier 3 players as laid out in the US Treasury Department's advisory, and it lays out different requirements for each of them.

An example of the impact of this price cap are the two million barrels a day that are being shipped via Russia's Baltic ports and require tugboat services to cross the Baltics. Without proof of trading under the price cap, these tugboat services will not be allowed to be rendered, thus impairing these exports.

Board Level Issue

Considering that recent sanctions have raised tensions, one thing is clear: it's becoming more complicated to trade safely in this world. It requires more technology, more processes, more know-how – and sometimes, more sanctions. And the risk just took one huge step up. The US said clearly that they'll be looking to enforce.

The United States' bold statement of intent to enforce these sanctions is a board level risk, and all relevant stakeholders would be wise to take the advice of a consultant or a lawyer to review their processes and risk policies and decide on concrete next steps. While the guidance only comes into effect on December 6, players in the shipping game will only get there safely if they start moving now.

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Featured image: The Primorsk Oil Terminal near St. Petersburg (file image)