

Dark Arts:

How tighter AML legislation will affect the art world

The EU's Fifth Money Laundering Directive will regulate all UK art market transactions above a threshold of €10,000 from January 2020, adding a further layer of compliance on top of sanctions legislation that already restricts dealing with certain entities. Helen Mulcahy, Francesca Titus and Vivien Davies consider the impact of the new rules and discuss how those trading in the art market can prepare for increased scrutiny.

The EU's [Fifth Money Laundering Directive](#) (5MLD) is in the process of being drafted into UK legislation, and many in the art market are keenly awaiting guidance from HM Treasury on how the new law will be applied.

This guidance may not be available until November or December this year, leaving little, if any time for many to prepare ahead of the implementation deadline of 10 January 2020.

5MLD aims to bolster the framework for preventing money laundering (ML) and countering terrorist financing (CTF) across the EU, by encircling a broader range of industries within its remit.

The directive expands the scope of obliged entities to include those trading in art; intermediaries involved in transactions exceeding €10,000; and entities holding art on behalf of others, where the transaction or a group of linked transactions amounts to €10,000.

It will cover "transactions related to (...) cultural artefacts and other items of archaeological, historical, cultural and religious importance, or of rare scientific value, as well as ivory and protected species", encompassing the business of art galleries, auction houses and free ports.

Even though the UK is due to leave the EU in the foreseeable future, the UK government indicated some time ago that it will transpose 5MLD into domestic law, meaning that British art traders, including those with international offices, need to be ready for the new regulations, regardless of Brexit.

Additional obligations

In recognition that certain activities are particularly exposed to laundering illicit funds, art intermediaries are already regulated for AML/CTF purposes if they are classified as high-value dealers under the UK's existing [Money Laundering Regulations](#).

But the further incursion of AML law into the art world through 5MLD has raised compliance questions from dealers, collectors, auction houses, gallery owners and agents.

Many fear being tripped up by rules designed to catch criminals, but which could implicate ordinary people who fail to perform the required checks on clients.

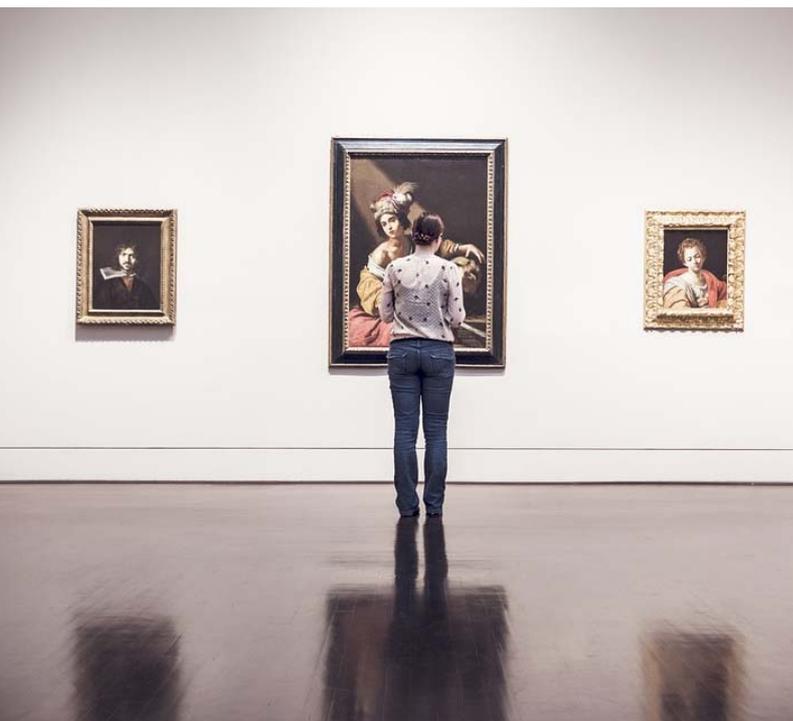
Unfortunately for legitimate dealers, the art market is particularly susceptible to ML.

Unlike property, which has traditionally been used to launder the proceeds of crime, paintings and other portable works are relatively easy to transport and, if necessary, hide.

The value of artworks can increase rapidly, which is a bonus for money launderers since there is usually a significant cost attached to laundering, diminishing the value of the illegally acquired cash.

Another benefit of art from a criminal perspective is that provenance issues are not uncommon in the art world, as works may have gaps in their ownership records, meaning it may not automatically arouse suspicion if a seller cannot readily explain where the art came from.

Criminals can also seek to hide behind requests for confidentiality, with valuable pieces often sold to anonymous buyers.



The lengthening arm of the law

The bad news for criminals and potentially anyone who unwittingly facilitates their actions is that the world has never been smaller from a law enforcement perspective.

International standards on AML are set by the Financial Action Task Force (FATF) – an intergovernmental body tasked with fighting ML across the globe.

FATF currently has 39 members, including the UK, most EU countries and the US.

As an active member of FATF, the UK introduced ML offences as far back as 1988 and the Money Laundering Regulations came into force in 1993, so the transposition of 5MLD into UK law will not represent a major overall shift.

For the art market, however, compliance is likely to involve drastic changes to the way galleries, dealers and small-to-medium-sized auction houses are run.

It is important to note that the €10,000 figure, which triggers the obligation to perform AML checks, extends beyond cash transactions.

The [Proceeds of Crime Act 2002](#) (POCA) outlines three main offences which art dealers risk committing if they fail to perform appropriate due diligence on clients:

1. Concealing, disguising and converting the proceeds of crime;
2. Entering into or becoming concerned in an arrangement to facilitate the acquisition or control of criminal property; and
3. Acquiring or using criminal property.

All three require knowledge or suspicion that ML was involved in a transaction.

This means art dealers need to ensure they are in a position to say they carried out appropriate checks and consequently did not have any knowledge or suspicion that a sale involved laundered cash.

Because of the nature of the offences, anyone involved in an art transaction is at risk of committing a crime if it turns out ML was involved. Customer-facing staff as well as backroom employees who deal with paperwork can all be implicated.

Under UK law, company officers and the company itself can be prosecuted for POCA offences, meaning that, in some circumstances, employers can face prosecution for an employee's actions.

HMRC, which has both civil and criminal enforcement powers, is expected to supervise the enforcement of 5MLD through UK law.

Financial investigators, who typically pursue AML crimes, come under the police umbrella and have wide-ranging powers to access details of businesses and their activities, before contacting them for information.

The dedicated art and antiques unit within London's Metropolitan Police does not deal with financial aspects of art crime, but does look into suspicious antiquities from conflict zones, forged modern art, museum thefts, illegal metal detecting, cultural property enquiries and international enquiries.

The Met unit may also work with financial investigators to ascertain whether ML is connected with a suspect item.

Dedicated art units also exist in law enforcement in the US and across Europe and these speak directly to each other.

Bodies such as [Eurojust](#), an EU agency that deals with criminal matters across member states, work with multiple police forces to ensure a coordinated approach and that arrest warrants are executed in numerous jurisdictions simultaneously.

In such cases, an overseas organisation may have no jurisdiction over an individual in another country, so taking legal advice in these situations is advisable.

Sanctions

Sanctions are generally used as enforcement tools to effect change in the behaviour of a specified target. The target can be an individual, an organisation, a sector or an entire country.

For UK art dealers, there are three main sets of sanctions to be concerned about: UK, EU and US sanctions.

The UK implements its own sanctions, overseen by the [Office of Financial Sanctions Implementation](#) (OFSI), as well as EU sanctions, a dual approach that is likely to continue post-Brexit.

Both UK and EU sanctions have similar jurisdictional reach, applying to all EU persons and businesses incorporated in the EU, even if part of a business or its customers are outside the EU.

US sanctions apply to US companies as well as foreign companies with a presence in the US.

The US' [Office of Foreign Asset Control](#) (OFAC), the government department that oversees compliance with US sanctions, is increasingly seeking extra-territorial reach to target foreign entities, and has created a new concept referred to as "secondary sanctions" for this purpose.

Secondary sanctions allow OFAC to target foreign individuals who facilitate transactions with entities sanctioned under US primary sanctions, even if the entity or the transaction has no connection to the US.

Individuals caught by secondary sanctions may find themselves sanctioned, or blocked from using the US banking system.

Although the EU has tried to neutralise the extra-territorial effect of US sanctions by introducing a [Blocking Statute](#) and a trade vehicle called the Instrument in Support of Trade Exchanges (INSTEX), most international organisations remain wary of OFAC's ability to levy multi-billion dollar fines for non-compliance with its rules.

This compares to OFSI, which has the power to impose fines of up to £1 million or 50% of the estimated value of the breach, but which has so far barely flexed its muscles.

Assessing AML and sanctions risk

Complying with sanctions goes hand in hand with AML compliance.

Business owners in the art world need to assess the risk profile for their particular organisation and its exposure to ML and sanctions, based on its activities, size, where it operates and who its customers are.

Guidance on due diligence for art transactions can be found on the [Basel Institute of Standards](#) and [Responsible Art Market](#) websites.

At a basic level, a risk assessment should involve three stages:

1. Consider the parties to the transaction;
2. Examine the artwork; and
3. Look objectively at the nature of the transaction as a whole.

1. *Parties to the transaction*

For the purposes of both AML and sanctions, art dealers need to think about a client's identity, rather than taking them at face value.

Verification should be built into the client on-boarding process and involve more than a simple passport check.

Businesses can quite easily make use of tools, such as the OFAC and OFSI websites and other open-source data to crosscheck names against publicly available sanctions or Politically Exposed Persons (PEP) lists.

Third party screening services are also available (for a fee).

If the client is the seller, the dealer or buyer needs to consider the provenance of the artistic object being sold. If the client is the buyer, the dealer should ask questions about their source of funds.

Verification obligations do not end after the on-boarding process has been completed, as law enforcement agencies expect a company to remain vigilant for the duration of a transaction or client relationship, and to keep track of any changes in AML and sanctions legislation.

With this in mind, art dealers may want to take other measures, such as placing an express obligation on a client to notify the dealer when there is a change of beneficial owner of an object or funds.



Screening should extend to all parties to the transaction, including any intermediaries as well as counterparties, especially where an intermediary is acting for an undisclosed seller or buyer, as client confidentiality does not displace AML or sanctions obligations.

Other signs of the need for further enquiry include offshore companies or trusts that only appear to hold one key asset; complex structures that operate through multiple private companies without plausible explanation; and individuals claiming to represent a syndicate.

In non face-to-face transactions, dealers need to be extra vigilant.

2. *Nature of the artwork*

If suspicions arise about a work of art, the first step is to identify its country of origin and how it left that country, including any countries it may have transited through before it came to be the subject of the transaction in question.

A dealer may need to undertake enhanced due diligence in relation to sanctioned jurisdictions, such as Syria or Iraq, or with respect to anything that appears to be cultural property.

If there is no recent provenance or there are unexplained gaps in the provenance of the work, this is a red flag that a dealer needs to carry out enhanced due diligence.

If a seller changes their story about how they acquired an artwork, or if they fail to produce insurance or storage records for high-value items, these also warrant additional queries.

3. *The nature of the transaction*

In considering the nature of a transaction, it is sensible for art dealers to gain a sense of why an artwork is being bought or sold.

If either the buyer or seller seems to be especially hurried, or if the value of the art appears to be artificially inflated, this should prompt dealers to ask further questions to satisfy themselves that the deal is legitimate.

If payment is coming from a third party, there may be a plausible explanation for this, but law enforcement will expect art dealers to do some due diligence on who is making that payment.

Paying for high-value items in cash, either as a lump sum or in multi low-value instalments, is a valid reason for probing for more details about the parties involved and why payment is in cash.

Records of conversations should also be maintained.

Companies should also have policies and procedures for AML and sanctions compliance and staff need to be trained on how to implement them.

UK criminal law expects people to behave proportionately, so policies need only reflect the regular activities of a particular company, but it is necessary to review and update these policies and communicate their importance to staff.

Even if a business is typically selling artworks for under €10,000, it is still sensible to do some basic customer due diligence.

This should avoid the problem of creating “trusted customers” who slip through AML or sanctions nets when they make a large purchase, or a make a series of low-value purchases which accumulate into significant sums.

Having a standard procedure also gets staff into the habit of checking customers as a matter of course and may avoid confrontations with clients who feel they are being unfairly targeted.

An [OFSI case](#) in February this year, where a UK bank was fined £5,000 for handling £200 from a sanctioned individual (the fine was reduced by 50% because the bank had self-reported to OFSI), further illustrates why companies should perform AML and sanctions checks for transactions under the €10,000 threshold.

How to deal with enquiries from law enforcement

When law enforcement ask for assistance with their enquiries under AML legislation, many choose to seek legal advice.

There are some limited occasions where it may not be lawful to seek legal advice, but in most cases it will be reasonable to do so.

For instance, it is reasonable to ask law enforcement officers questions about how the information being requested will be used.

In some circumstances, an individual may wish to involve lawyers before responding to an initial enquiry, as the legal and reputational ramifications of responses can be far-reaching and unforeseeable to a non-legal expert.

There are many legitimate reasons for taking this cautious approach, not least data privacy issues under GDPR.

Many art dealers state in their standard terms and conditions that they will not divulge information about their clients to law enforcement unless forced, so it is perfectly reasonable to fall back on this small print.

The same usually applies to employees under contracts of employment.

However, there may be situations where it is appropriate to hand over information without coercion – for example, if someone is at immediate risk.

Depending on the particular circumstances, an art dealer might be able to ask a client or employee’s permission to give the police information relating to them.

But, in general, anyone approached by law enforcement should avoid tipping off individuals about financial crime investigations, as this can be an offence under POCA.

Ideally, art dealers should have procedures in place for what to do with staff and customers who are present, if and when law enforcement arrives at a premises unannounced.



Compliance approaches

There is no one-size-fits-all when it comes to risk assessment.

What is an appropriate approach will depend on the size and particular circumstances of an individual business.

In all cases, it is essential that businesses keep a paper trail to demonstrate that reasonable steps were taken to comply with AML and sanctions legislation.

If the worst happens, being able to show this to law enforcement will mitigate any potential fine.

Having a plan should help to limit any reputational damage and allow the business owner to retain control of communications with the enforcement agencies.

If officers are entering a premises with powers that compel the occupier to let them in, they should explain what the owner or occupier is allowed to do in terms of seeking legal advice.

Businesses with international locations

The current trend in the UK is towards making offences multi-jurisdictional.

Both the [Bribery Act 2010](#) and the [Criminal Finances Act 2017](#) allow people to be prosecuted in the UK for offences that happened overseas, so art dealers should bear in mind that UK law will not make allowances for how business is done in other jurisdictions.

At present, prosecutors claim that it is difficult for prosecutors to secure a conviction unless they can prove the parent company had knowledge or suspicion that activities taking place in subsidiaries thousands of miles away were illegal.

Prosecutors are arguing for a general failure to prevent economic crime offence to be put into UK law; a development that could create difficulties for parent companies obliged to monitor the actions of subsidiaries.

If a corporate crime is committed, UK law dictates that criminal liability rests with the directing mind and will of the company, although there are calls to move closer to the US system of vicarious liability.

Conclusion

International and UK AML and sanctions legislation is likely to become even tighter, and the art market will soon need to adapt to carrying out checks, as other industries have in the past.

Risk assessments and policies for dealing with AML/sanctions and enquiries from law enforcement help minimise the risk of prosecutions and fines for non-compliance with the law, but will not eliminate it.

6MLD, which was passed by the EU in 2018 and is expected to be replicated in UK law in either late 2020 or 2021, is mainly aimed at standardising AML law across the EU.

In the meantime many question whether it is appropriate to expect private companies to police AML and sanctions, especially when some jurisdictions do not carry out checks.

It is possible that these queries will gather more support, pending consultations on the proportionality and effectiveness of the government's implementation strategy.

However in our experience, requirements for improved scrutiny tend always to increase in tandem with the size of transaction, and greater international co-operation.

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