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Managing Money Laundering Risk In The Art Trade

By **Nicole Horowitz and Brendan Hanifin** (January 16, 2020, 5:14 PM EST)

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On Dec. 13, 2019, the U.S. Department of the Treasury's Office of Foreign Assets Control, or OFAC, designated Lebanon-based Nazem Said Ahmad, as well as certain affiliated companies, to its specially designated nationals list for their provision of financial support to Hezbollah.

The designations were made pursuant to Executive Order 13224, which authorizes the imposition of sanctions against persons who provide financial, material or technological support to designated terrorist organizations. Hezbollah was designated under EO 13224 in October 2001.

In a press release, OFAC alleged that Ahmad, who "has an extensive art collection worth tens of millions of dollars," opened an art gallery in Beirut, Lebanon, as a front to launder money to Hezbollah. OFAC further alleged that Ahmad "stores some of his personal funds in high-value art in a preemptive attempt to mitigate the effects of U.S. sanctions."

In connection with the designation, U.S. Deputy Secretary of the Treasury Justin Muzinich advised that "[a]rt and luxury goods dealers should be on alert to the schemes of money launderers who hide personal funds in high-value assets in an attempt to mitigate the effects of U.S. sanctions."

On the same day, OFAC published new frequently asked questions highlighting its sanctions compliance expectations for members of the art community whose activities are subject to U.S. jurisdiction. The FAQs state, in pertinent part:

> U.S. persons (including galleries, museums, private art collectors, auction companies, and others that conduct or facilitate transactions involving artwork) must ensure that they do not engage in transactions with persons listed ... on OFAC's [specially designated nationals] List or with persons otherwise blocked pursuant to E.O. 13224, unless authorized by OFAC.

Enforcement Activity Targeting Art Dealers

Concern over artwork as a conduit for money laundering is not new. In recent years, the U.S.

government has pursued several high-profile money laundering cases involving art dealers.

In 2018, six individuals, including art dealer Matthew Green, and four corporate defendants were indicted in both the United States and the United Kingdom for their involvement in a multimillion-dollar securities fraud and money laundering scheme. Regulators allege that the defendants defrauded the investing public through deceit and manipulative stock trading, and then endeavored to launder the proceeds through offshore bank accounts and the art market, including through the proposed purchase of a Pablo Picasso painting for approximately $9 million.

According to the indictment, an undercover agent, posing as a potential buyer, recorded an interaction in which one defendant purportedly stated that the art business is the “only market that is unregulated,” and that art is a profitable investment because of “money laundering.”

From 2010 to 2015, the U.S. Department of Justice repatriated several works that it had seized via civil forfeiture, including Jean Michel Basquiat’s 1981 painting "Hannibal," as well as artworks by Roy Lichtenstein, Henry Moore, Joaquin Torres-Garcia and Serge Poliakoff. The paintings were smuggled into the United States by Edemar Cid Ferreira, a former Brazilian banker convicted of money laundering and other offenses.

In 2013, art dealer Glafira Rosales was charged with money laundering and tax crimes in connection with an $80 million fraud scheme. Regulators alleged that Rosales sold 60 forged artworks to unsuspecting purchasers, including paintings by Jackson Pollock, Mark Rothko and Robert Motherwell.

Recent Regulatory Efforts

Some U.S. lawmakers have proposed to address perceived lack of transparency in the art trade through the expansion of U.S. anti-money laundering laws. In October 2019, the U.S. House of Representatives passed H.R. 2514, known as the Coordinating Oversight, Upgrading and Innovating Technology, and Examiner Reform, or COUNTER, Act.

Among other steps, the COUNTER Act would extend certain reporting requirements of the Bank Secrecy Act to antiquities dealers.[1] While “antiquities” is not defined in the Bank Secrecy Act or COUNTER Act, the term’s traditional definition encompasses objects that are 100 years or older, which would capture many impressionist and modern artworks by artists such as Pablo Picasso, Claude Monet, Vincent van Gogh and their contemporaries.[2]

The COUNTER Act would require antiquities dealers to report transactions exceeding $10,000. In addition, the COUNTER Act calls for a study on the facilitation of money laundering and terror finance through the trade of works of art or antiquities, the findings of which could serve as the basis for further regulation of the art trade.

The United States is not the only jurisdiction contemplating increased regulation of the art community. For example, the European Union’s 5th Anti-Money Laundering Directive — published in June 2018, with an implementation deadline of this month — expands the definition of “obliged entities” to persons trading in art, acting as intermediaries in the trade of art or storing art in freeports, if the value of the transaction or a group of linked transactions equals €10,000 or more.

Overview of Relevant Legal Regimes

U.S. Anti-Money Laundering Laws

Money laundering is the process by which persons attempt to conceal the origin or ownership of the proceeds of illegal activities, while still retaining control over those proceeds. This is accomplished, most frequently, by transferring the proceeds of illegal activity through a series of facially legitimate transactions — e.g., bank transfers, assets purchases and dispositions — to distance the tainted proceeds from their unlawful origin (a process known as layering).

The U.S. anti-money laundering regime can be broadly summarized into two components: (1) affirmative anti-money laundering compliance program requirements; and (2) criminal statutes that prohibit covered parties from committing substantive money laundering offenses. Currently, only financial institutions (which include banks, broker-dealers, pawnbrokers and dealers in precious metals, stones or jewels, among others) are subject to affirmative anti-money laundering compliance program requirements as a matter of U.S. laws.

By contrast, U.S. criminal anti-money laundering statutes prohibit all persons that conduct financial transactions within the United States, or through the U.S. financial system, from knowingly conducting or attempting financial transactions that involve the proceeds of certain specified unlawful activities.

With limited exceptions, most members of the art community are not subject to affirmative anti-money laundering compliance program requirements, such as the requirement to report suspicious transactions.[3] Accordingly, the primary anti-money laundering consideration for the art community is compliance with U.S. criminal anti-money laundering laws.

U.S. Economic Sanctions

Although U.S. sanctions come in many nuanced varieties, for purposes of this discussion, the sanctions regulations can be grouped into (1) list-based sanctions that restrict dealings with certain individuals and entities, or blocked parties, engaged in illicit activities (e.g., terrorism, narcotrafficking); and (2) country-based sanctions that restrict dealings with persons located, resident or organized in targeted jurisdictions.

Absent OFAC authorization, covered parties generally are prohibited from engaging in transactions involving blocked parties or persons located in sanctioned jurisdictions.

U.S. companies are subject to certain reporting requirements under U.S. sanctions. In particular, a U.S. company must block, or freeze, the assets of blocked persons that come within the company's control or possession.

In addition, a U.S. company is required to reject proposed transactions where the transaction would be prohibited under U.S. sanctions, but there is no blockable property interest. In both situations, a U.S. company is required to file a report with OFAC.

Pertinent to this discussion, certain OFAC sanctions programs incorporate exemptions for transactions involving "information or informational materials," defined to include artworks. However, these exemptions are subject to exceptions, and OFAC has taken the position that the exemptions are not available for transactions involving certain categories of blocked persons.

Compliance Considerations for the Art Community

Identifying (and Avoiding) Money Laundering Activity

Effective money launderers do not advertise that they are engaged in money laundering activity, and, in recent years, money laundering schemes have evolved in complexity and sophistication to evade increased regulator scrutiny.

To avoid being a conduit for money laundering, members of the art community should seek to establish two basic data points for each transaction: (1) the identity of their counterparty; and (2) the purpose of the transaction. While conceptually straightforward, the challenge of establishing this baseline information is exacerbated by two facts.

First, a substantial volume of art-related transactions is conducted through third-party intermediaries (e.g., auction houses, private art dealers or galleries). Artworks also can be stored in freeports, permitting buyers and sellers to obscure their identities during a transaction.

Second, the intent to purchase — or sell — artwork for investment reasons is a plausible explanation for virtually any transaction, such that even making the inquiry may seem extraneous. Along similar lines, the intangible aspects of art make it difficult to value, meaning that a prospective purchaser can rationalize any price for a single work.

On both points, further inquiry may reveal red flags suggesting a possibility of money laundering activity. For example, if the direct purchaser/seller is acting as agent on behalf of another party, is the agent willing to disclose the identity of the actual party in interest? Is the transaction of the type that you would expect the purchaser/seller (or its principal) to pursue, given their history, reputation and resources? Has the purchaser/seller (or its principal) been implicated in allegations of unlawful conduct?

The existence of one or more red flags does not necessarily mean that money laundering is afoot. For example, high-profile purchasers and sellers of artwork may value anonymity for justifiable reasons.

Similarly, not all prospective purchasers have lengthy track records — buyers commonly purchase artwork on a one-off basis, for home décor or as a status symbol. Nonetheless, the existence of red flags may indicate that deeper due diligence is warranted, as a prophylactic measure.

As referenced above, to sustain a criminal money laundering charge, a prosecutor must show that the defendant knew that the underlying transaction involved the proceeds of specified unlawful activity. Except in rare cases of willful misconduct, parties to transactions with would-be money launderers do not have actual knowledge of the overarching money laundering scheme.

In this regard, it is important to note that prosecutors commonly seek to establish knowledge through circumstantial evidence, which underscores the importance of investigating red flags that suggest a possibility of money laundering.

Avoiding Transactions with Sanctioned Parties

In contrast to other regulatory regimes, the U.S. sanctions regulations do not impose any minimum compliance program requirements, including with respect to detecting sanctioned parties' involvement

in transactions. With that said, U.S. sanctions are a strict liability regime, meaning that even robust due diligence may not provide a complete defense in the event a violation occurs.

The only effective method to avoid transactions involving sanctioned parties is to perform restricted party screening of counterparties to transactions. Restricted party screening is the process of confirming that an individual or entity is not the target of list-based sanctions imposed by the U.S. government (or other governments or international organizations, such as the United Nations).

If restricted party screening of a prospective counterparty (or its principal) reveals a match against a sanctions list, the transaction generally should be placed on hold to permit further due diligence and assessment of any OFAC blocking and reporting requirements.

A nuance of the OFAC sanctions regulations is that covered parties are prohibited from doing business with any entity in which a blocked party — or multiple blocked parties taken together — hold a 50% or greater ownership interest. This rule, known as the 50% rule, means that covered parties are prohibited from dealing with certain entities — majority-owned by blocked parties — that are not, themselves, included on the specially designated nationals list.

Presently, there is no universally effective method for ensuring compliance with the 50% rule, as commercially available restricted party screening solutions do not incorporate complete beneficial ownership information. This being the case, covered parties' best protection against inadvertent violation of the 50% rule is to conduct risk-based due diligence of counterparties' beneficial owners, and to carefully document the diligence steps completed.

Conclusion

U.S. lawmakers and regulators alike have identified the art trade as particularly susceptible to misuse by money launderers, terrorist financiers and other bad actors, suggesting increased enforcement attention and (potentially) new regulations. In addition to monitoring for regulatory developments, members of the art community can seek to mitigate money laundering and sanctions risk by conducting appropriate due diligence of counterparties (and documenting these efforts).

Although the current scope of affirmative U.S. anti-money laundering requirements does not extend to art dealers, the art community is on notice that regulators expect persons that conduct or facilitate transactions involving artwork to take proactive steps to mitigate money laundering risk.

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[1] Similar legislation, the 2018 Illicit Art and Antiquities Trafficking Prevention Act, was introduced in mid-2018, but stagnated on the House floor.

[2] Other federal laws, such as 18 U.S.C. § 668 (Theft of Major Artwork), similarly incorporate a 100-year benchmark for defining objects of cultural heritage.

[3] As noted above, pending legislation—if implemented in its current form—would extend certain affirmative compliance requirements to those selling antiquities, including artworks that are 100 years or older.