

Art Business AML legislation Sarah Barker

Soon to be implemented in the UK, the 5th Anti-Money Laundering Directive looks set to have a significant impact on the British art market. Art businesses will need systems in place to combat money laundering – and they should already be preparing to meet the new obligations

It has been estimated that at least £100 billion is laundered through the UK financial system every year. That is twice the size of Panama's whole economy.

In July 2018 the 5th Anti-Money Laundering Directive (MLD5) was adopted by the EU as part of the Juncker Commission's response to the terrorist attacks of 2015 in Paris and Belgium, the Panama Papers scandal, and increased scrutiny of free ports following the Yves Bouvier affair. The UK has until 10 January 2020 to transpose MLD5 into national law. Theresa May's government confirmed the UK will implement MLD5 despite Brexit.

Money laundering can take many forms, as funds derived from criminal activities are passed through corporate entities, businesses, bank accounts and/or assets in order to disguise their true origins. In the art sector examples might include a criminal exchanging 'tainted' funds for high-value assets that are then returned to the dealer, with 'clean' funds refunded, or simply buying an artwork with the proceeds of crime at a very high price and then anonymously selling it to a third party (possibly at an undervalue). Another example might involve borrowing 'clean' money using art purchased with proceeds of crime as collateral.

It is said that the art sector could be fertile ground for money laundering due to the extremely high value of some artworks, their inherent portability, and the secrecy that is customary in the industry. Use of art agents and intermediaries, offshore companies and free ports can lend itself to the creation and preservation of secrecy. This secrecy can of course be for entirely legitimate reasons. However, it is also helpful to those who have more nefarious intentions – which seems to be how the European Commission saw it after the leak of the Panama Papers.

There are currently two main UK acts that deal with anti-money laundering (AML). The three primary money laundering offences are set out in the Proceeds of Crime Act 2002 (POCA), and, very broadly, they are committed by anyone who knows or suspects that they are or may be involved with the transfer or acquisition of criminal property, or that they are facilitating such an arrangement. Therefore, under the current law, if a dealer does not know or suspect at the time (on a subjective basis) that they are involved in an arrangement involving proceeds of crime, they are unlikely to be found guilty of a money-laundering offence (albeit they may not deliberately 'turn a blind eye').

The Money Laundering Regulations 2017 (MLRs) impose certain additional obligations upon those deemed to be part of the 'regulated sector'. Currently, high-value dealers (those art dealers accepting *cash payments* above a certain value) are the only art-market players within the regulated sector under the MLRs.

MLD5 has extended the scope of the existing legislation to certain art-market participants who will, when MLD5 is implemented, become part of the 'regulated sector' irrespective of payment method accepted. These are defined as 'persons trading or acting as intermediaries in the trade of works of art, including when this is carried out by art galleries and auction houses' and 'persons storing, trading or acting as intermediaries in the trade of works of art when this is carried out by free ports'. In each case there is a threshold for applicability, where the value of the transaction (or a series of linked transactions) amounts to €10,000 or more.

At the time of going to press, the government's response to its consultation on the implementation of MLD5 and the draft UK

legislation are still awaited. Nevertheless, based upon the current obligations to which regulated-sector businesses are subject, the impact on art-market participants is likely to be significant. A senior auction-house lawyer has predicted that this will be the biggest legal change ever to affect the UK art market.

Art-market participants carrying out business in the UK will be required to have certain systems and controls in place to combat money laundering and terrorist financing; failure to comply with these requirements could carry a penalty of two years' imprisonment, a fine, or both. The systems and controls required will likely include: undertaking an internal risk assessment and creating an internal AML policy; undertaking initial and ongoing client due diligence (CDD); documenting CDD carefully and maintaining records; training staff; and appointing a nominated officer to make reports to the National Crime Agency.

Broadly speaking, CDD means identifying clients (including beneficial owners of corporate clients) and verifying those identities using independent documentation. Additionally, it means that regulated businesses must form an understanding of the source of funds and the transaction (which includes understanding who all the parties to the transaction are, determining whether the whole transaction makes sense or whether there are elements of it that the dealer is not aware of, and understanding things that do not immediately add up, such as circular transactions or transactions at an under- or overvalue). CDD is conducted on a risk-based analysis (considering the overall risk profile of the business, the client and the particular transaction) and should typically be carried out *prior to* carrying out the transaction. Dealers will need to give thought as to how to

manage their CDD in various scenarios: how, for example, will they respond to a new client wishing to make an impulse purchase at an art fair.

POCA contains additional offences applicable to those in the regulated sector, which will also become relevant to art-market participants. Most notably, if a person working in a business in the regulated sector knows or suspects or *has reasonable grounds for knowing or suspecting* that another person is engaged in money laundering and fails to disclose that to the National Crime Agency, then they can commit a crime. (This failure to disclose offence could attract 5 years in prison and/or a fine.) This offence includes an objective test (i.e. whether a reasonable person would have concluded that there are reasonable grounds for knowing or suspecting that the arrangements concern proceeds of crime). Ignorance is no defence.

There are many questions as to what these new laws will mean for art-market participants on a practical basis. One of the key issues will be how they are to deal with CDD on ultimate clients. If an art agent comes to a newly regulated dealer to buy a valuable artwork, that dealer must do CDD on that agent. However, if the dealer has reason to think that the agent must be buying on behalf of another person (the agent's principal) because that agent would be unlikely to have the funds to buy the artwork on their own account, what does the newly regulated dealer do about undertaking CDD on that ultimate client? Will the dealer be able to rely on the fact that the agent will also be regulated and therefore should be doing their own CDD on their principal, or must the dealer conduct CDD on the agent's principal too? The dealer will likely need to understand the source of funds, the transaction and the identity of the principal, but how

£100 billion

Estimated extent of money laundered annually through the UK financial system

10 January 2020

Deadline for the 5th Anti-Money Laundering Directive to pass into UK law

€10,000+

Value of art-market transactions to which the new laws will apply

can the dealer go about that when the agent will wish to keep the identity of their client secret so that they do not get cut out of the transaction? It is hoped the government will provide useful guidance to the sector.

Auction houses, art dealers, agents and other art intermediaries need to start planning now and educating themselves in relation to their enhanced obligations. They will likely need to put in place systems and controls and adopt comprehensive AML policies. Putting in place the requisite systems and controls, and then complying with CDD and reporting obligations on an ongoing basis, may be burdensome for the industry. However, as with other regulated industries, the imposition of regulation may be the precursor to a culture change across the sector.

Making appropriate enquiries and keeping records should mean that dealers are better able to avoid committing money laundering offences. Even as the law currently stands, it would be best practice to make appropriate enquiries, so that dealers do not inadvertently assist criminals in their money-laundering endeavours. In addition to the potential reputational damage associated with such unwitting assistance, the moral arguments for rooting out serious organised crime – the social and economic costs of which are said to cost the UK in excess of £37 billion pounds each year – are profound. **A**

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