

REGULATORY INTELLIGENCE

Money laundering: Buyer secrecy in the London art market

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The introduction of the Fifth Money Laundering Directive on the January 10, 2020 brought the art market into the fold of regulated sectors for anti-money laundering purposes. The new law, which amends the existing regulations (Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017), requires "art market participants" to conduct due diligence on its customers, implement adequate systems and controls, assess its risk and report suspicious transactions. The British Art Market Federation (BAMF) subsequently published guidance, approved by the Treasury, on how the provisions of the regulations should be interpreted and applied in practice.

As well as the inevitable impact on the art market, financial institutions will need to react to this change in the way that it views the risk posed by the sector when monitoring related customers and transactions. Therefore, the regulated sector needs to understand how the regulations will apply to the art market and the challenges the industry will face in being regulated, especially given that the art market is fundamentally different from the financial and professional services firms which the regulations were designed for.

The application of the regulations to the sector

The [regulations](#) bring art market participants into the scope of the regulated sector, where they are acting in the course of business carried out in the United Kingdom. Art market participants are defined as firms or sole practitioners who, by way of their business, trade in, or act as an intermediary in the sale or purchase of "works of art", where the transaction is 10,000 euros or more.

The 10,000 euros value threshold is therefore baked into the definition of who is subject to the regulations. Accordingly, as the [guidance](#) suggests, a firm must "be clear, as a matter of policy, on whether it deals, or is likely to deal, in sales of works of art over 10,000 euros". If it does so unexpectedly, it will still be required to adhere to the requirements under the regulations. Even dealers from overseas who come to the UK to sell works of art above that threshold, will be subject to the regulations.

As with other industries within the regulated sector, art market participants will need to conduct customer due diligence, identifying the customer and, where necessary, the source of the funds. Accordingly, the first question which demands an answer - "Who is my customer?" - may not be simple to resolve, especially in a world where the use of intermediaries and agents is common.

An art market participant's "customer", for the purposes of the regulations, will depend on its business model, and the nature of the transaction itself. Take for example the scenario where a dealer sells a work of art (above the 10,000 euros threshold) on someone else's behalf, to a person they know is acting as an agent. The guidance makes clear that the seller, the buyer and the agent will all be classified as the dealer's customers for the purposes of the regulations, and hence will all need to be the subject of due diligence. Moreover, the dealer will need to verify that the agent is authorised to act on the buyer's behalf.

The erosion of confidentiality

Other practices of art market consumers may be significantly impacted by the regulations' due diligence requirements. For example, the obligation to look behind corporate buyers and verify the identity of beneficial owners may represent a brave new world for many dealers, particularly given the complexity of some structures which may be used for the purchase. The recent legislation also made substantive changes to the requirements under the regulations.

One such change obliges all regulated entities, including financial institutions, to take reasonable measures to understand the ownership and control structure of the customer entity. Since art market customers may use complex offshore structures to purchase works, for tax or confidentiality reasons, dealers will inevitably be required to ask questions. The opacity of the structure and the jurisdiction in which it sits may crystallise a need to conduct an enhanced level of due diligence. Simply posing the question will not be enough. Dealers will need to get comfortable about asking probing questions and must ensure they receive a satisfactory response. Many overseas investors will not be used to this degree of scrutiny.

To what extent can art market participants avoid having these discussions, which may erode long-established customer relationships? The regulations allow for regulated persons to effectively outsource the due diligence obligations to an agent or service provider. This may allow the dealer to distance themselves from the process, but it does not avoid it. Ultimately, as the provisions stipulate, the dealer is still liable for any failure to apply the due diligence measures.

Alternatively, as with financial services institutions, there is some scope for dealers to rely on the due diligence conducted by another regulated person. An example of this, in the context of the art market, is where a dealer is selling an artwork to another dealer, who is acting on someone else's behalf. Knowing that the agent dealer is obliged to conduct due diligence on the buyer, can the selling



dealer simply rely on that fact, obviating the need to run its own checks? To a degree, yes. However, as the guidance makes clear, when relying on a third party's due diligence, a person will need (at a minimum) to know the identity of the customer and any beneficial owners, the level of due diligence which has been applied and have confirmation from the third party that they understand their obligation to make available copies of the underlying documents and information relied on. Therefore, using a regulated person agent as a buffer will not allow a customer to protect their identity.

The impact on financial services firms

For financial services firms, the introduction of the art market into the regulated sector, rightly or wrongly, sends a clear message as to how they should view the money laundering risk posed by the industry. That cannot be ignored. When performing their own due diligence on their art market customers, banks will need to consider the risks posed by a customer's business, and the wider industry. The art market participant's risk assessment - which it is obliged to prepare under the regulations - will be a good starting point. The BAMF guidance will also help financial institutions to navigate the risks posed to the industry.

Time will tell how the art market reacts to being regulated from an AML perspective, and whether the potential erosion of confidentiality impacts the health of the sector. Statistics regarding the London art market over the next few years will be a rough, but helpful, metric to assess the impact of these changes. Either way, given a rising tide of regulatory enforcement, and the potential criminal law consequences, the financial services industry will need to consider whether it's existing due diligence and monitoring of the sector is appropriately calibrated to the risk that the government (and the regulator) has implicitly stamped on it.

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