ART DUE DILIGENCE GROUP

Regulation of the art market: interview with due diligence specialists Christopher Marinello (of Art Recovery International Ltd.) and Kirk Kashefi regulatory law barrister).

Christopher Marinello of Art Recovery International (ARI) is an art recovery and restitution specialist and U.S. lawyer. He is also a member of the ADDG. For over three decades he has sought to restore priceless stolen artworks to their rightful owners, such as works by Picasso, Renoir, Matisse and Chagall.

He has successfully recovered over £350 million worth of stolen and looted art and his clients include the heirs who successfully obtained restitution of Nazi looted artwork contained in the infamous Cornelius Gurlitt hoard.

Q: You've been working within the art market for over 30 years, helping clients to recover lost or stolen artworks. Is there now more awareness of the need to check databases to investigate whether works are lost or stolen?

A: The proliferation of the Internet and social media has made the world a much smaller place. It has become a lot easier to locate stolen and looted works of art almost anywhere in the world and the ability to check the position on title of an artwork should be easier for people today.

The desirability of art, particularly high value, continues to fuel the upper end of the art market and there remains a need for greater due diligence not just on the artwork itself, but on the parties you are dealing with.

Nefarious characters continue to sell stolen or looted art and there are examples where this art appears on the open market-place rather than purely on the black market. There are also sellers and buyers who simply do not do their provenance research and check thoroughly issues of title before purchasing works of art and are at risk of lawsuits.

Potentially disparaging news of title disputes travels a lot faster than it used to and the cost of litigation has become out of reach for many. Now more than ever, it is critical to check international databases (such as Artive) and perform extensive provenance research on works of art.

Q: What developments have you seen that demonstrates an appetite by governments, police, customs authorities and the international community to address the problem of art looting and thefts?

A: Many governments worldwide have created new legislation in response to issues over Nazi-looted artwork, looted cultural property, money laundering, and the connection between looting and international terrorism.

Enforcement of these regulations has improved with the increased use of technology and law enforcement cooperation. However, law enforcement is still relatively indifferent to art related crimes and many enforcement agencies are severely underfunded.

Interpol and UNESCO have taken greater roles since the conflicts in Iraq and Syria and have tried to educate the art trade on best practices. The art trade will require guidance to navigate these new heavily legislated waters.

Q: Is more due diligence being undertaken by cultural institutions?

A: State owned cultural institutions are beginning to engage in more comprehensive due diligence procedures. However, this is true mainly for well-funded organisations.

Sadly, those institutions that are less well funded are still not conducting proper provenance research. These are the same institutions that have issues over basic security measures.

Today, it is inconceivable that one would develop and maintain a public art collection without verifying the integrity of the collection and modernising security measures to build public trust. There needs to be a considerable shift in budgetary allocation for public sector collections.

Q: Is there more due diligence now taking place in the private sector? How are they responding to the prospect of new regulation?

A: We are seeing an increase in due diligence and KYC procedures only at the very top end of the market. Many dealers and collectors still prefer to go it alone largely due to an unwillingness to absorb the cost of best practices.

At ARI, we are attempting to resolve a large number of title disputes that have arisen because of the failure of dealers and collectors to have proper written contracts in place and the absence of due diligence procedures.

It is shocking to me that transactions involving millions of pounds are still being conducted this way.

Kirk Kashefi is a barrister whose specialist practice areas include art law, corporate governance, and regulatory/financial compliance.

He has over a decade's experience in anti-money laundering (AML) and anti-bribery/corruption (ABC) cases (U. K./U. S./offshore jurisdictions – including investigation defence). He regularly advises clients across numerous sectors in AML matters.

Q: For small art businesses, it seems there are lots of compliance obligations and many different laws that have come into force over the last 10 years. What are these changes?

A: The consistently tightening compliance framework and a general culture of compliance increasingly affect all businesses. To the extent that there is any trend to be spotted, it is one of increasing levels of compliance and delegated- and/or self-regulation.

The luxury/high value goods sectors (and the art sector in particular), rather challengingly, exhibit certain specific features, which render them vulnerable to abuse, e.g. by those seeking to launder the proceeds of illegal activities and/or to finance such activities.

These features may include: high value goods; an international market and networks; a general level of opacity (which is not necessarily aided by an overall culture of discretion); common use of intermediaries for transactions, and common use of foreign/offshore structures and accounts.

Q: Can you explain how the U.K.'s Bribery Act 2010 applies to art businesses?

A: As far as the Bribery Act 2010 (UKBA) is concerned, it generally creates four offences.

These offences are concerned with the acts of: (a) giving a bribe; (b) receiving a bribe; (d) bribing a foreign official, and (e) when offences are committed by a body corporate, failing to prevent someone/an entity associated with it from committing bribery.

A bribe concerns offering, promising, requesting, giving or receiving, or agreeing to receive a "financial or other advantage" (including through a third party).

The UKBA focuses on a "relevant function or activity". For the purpose of the UKBA, a function or activity is such if it falls in any of the below:

- any function of a public nature;
- any activity connected with a business;
- any activity performed in the course of a person's employment; or
- any activity performed by or on behalf of a body of persons (whether corporate or unincorporated); and

when any of the following conditions apply to the person performance such function:

- is expected to perform it in good faith;
- is expected to perform it impartially; or
- is in a position of trust by virtue of performing it.

It is of paramount importance to consider that a function or activity is a "relevant function or activity" even if it:

- has no connection with the United Kingdom; and
- is performed in a country or territory outside the United Kingdom.

The UKBA applies to both the public and private sectors. Art businesses need to be aware of the purpose of any payments made within an art transactional process and whether these payments are being made by an agent or sub-agent or intermediary, all of whom could potentially create liability for the art business, if deemed a bribe.

Q: Can you give some examples of corruption cases where art assets have been seized?

In the last year alone, we have seen cases such as: Leonardo DiCaprio surrendering a $3.2m Pablo Picasso painting, and a $9m Jean-Michel Basquiat collage to the U. S. authorities following a hearing of the U. S. Government's civil action against certain parties involved in the making of The Wolf of Wall Street, as part of the US DOJ's aim to seize a total $1.7bn in assets (including artwork and jewellery purchases) that it says were bought with misappropriated funds from a sovereign wealth fund established by the former Malaysian prime minister.

Also, the seizure by the U. S. Government, of 95 artworks valued in the tens of millions of dollars that once belonged to the disgraced Brazilian banker Edemar Cid Ferreira, the founder and former president of Banco Santos. Ferreira was convicted of money laundering and crimes against the national financial system in 2006 and is currently appealing against a 21-year prison sentence.

Q: Under AML, what are the obligations of art businesses in terms of checking and verifying clients' profiles and sources of funds?

A: Client due diligence (CDD) (also referred to as "know your client" (KYC)) is one of the central pillars and indeed the first line of defence when seeking to prevent money laundering and it serves to ensure that a company's commercial dealings are with bona fide individuals and organisations.

Adequate CDD procedures and policies also assist – within the business' overall internal risk assessment, systems, and compliance framework – in the identification of suspicious behaviour.

Therefore, if and when a new business relationship (including a one-off transaction) is formed, specific care must be taken to ensure that the proposed client/customer is identifiable by making appropriate checks on their credentials, along with confirmation of where funds are coming from.

This process will be especially important if the parties concerned are not physically present for identification purposes and to situations where someone may be acting for absent third parties.

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (MLR 2017) came into force on 26th June 2017, thereby transposing The Fourth Money Laundering Directive (4MLD) into UK domestic law.

The approach in the MLR 2017 (as well as other frameworks such as the UKBA and GDPR) is risk-based, which is where a business must assess the risks that it may be used for money laundering or terrorist financing and put in place appropriate measures to manage and lessen those risks.

Some of the key requirements under MLR 2017 are as follows:

- a business in the regulated sector (Business) identifies its clients/customers, and verifies that identity on the basis of documents, data or information obtained from reliable sources;
- where there is a beneficial owner who is not the client/customer then the Business must identify that person and verify the identity, and where the beneficial owner is a trust or similar, then the Business must understand the nature of the control structure of that trust;
- appropriate systems of internal control must be in place to prevent activities relating to money laundering and terrorist financing;
- there must be appropriate and adequate management controls in place to identify the possibility that criminals may be attempting to launder money or fund terrorism, so as to enable appropriate action (e.g. to prevent or to report) to be taken;
- a relevant person needs to consider both the client/customer, and geographical risk factors in deciding whether simplified client due diligence (SCDD) is appropriate; and
- a Business is also obliged to monitor its business relationships on an ongoing basis, which means that the Business must scrutinise transactions throughout the course of the relationship to ensure that the transactions are consistent with its knowledge and understanding of the client/customer, and indeed to keep the information that it holds in relation to the client/customer up-to-date.

MLR 2017 saw the creation of a list of high-risk jurisdictions which, if involved in a transaction, make enhanced client due diligence (ECDD) and additional risk assessment compulsory.

ECDD under the MLR 2017 also applies both to foreign, and U. K. Politically exposed persons (PEPs) i.e. those with prominent public functions.

Q: What is a high value dealer and what are their obligations?

A: As of 26 June 2017, any business or sole trader that accepts or makes high value cash payments of €10,000 (or the equivalent in any currency) or more in exchange for goods is deemed a high value dealer and therefore are required to register under MLR with HMRC.

The types of business that are often classed as high-value dealers include: jewellers; dealers in cars, yachts, aircraft (etc.); art dealers / brokers; auctioneers; antique dealers, etc. .

The following transactions are considered to be high-value transactions by the HMRC: (a) a single cash payment of €10,000 or more for goods; (b) several cash payments for a single transaction totalling €10,000 or more, including a series of payments and payments on account, and (c) cash payments totalling €10,000 or more which appear to have been broken down into smaller amounts so that they come below the high value payment limit.

Considering the general levels of transactional sophistication and indeed the regulator's own guidance, it is clear that compliance with the established regimes that are now operational in the regulated sector is required when businesses deal, in transactions, in goods and services with an open market value of €10,000 (or the equivalent in any currency) or more.

Q: How serious are government bodies taking compliance with AML, are you seeing any prosecutions of art traders? What trends are you seeing?

A: In recent history, there has been a very clear, consistent, and progressive move – and so on a global level – in the direction of increased general transparency in relation to issues such as: AML, ABC, tax compliance, fraud prevention, data protection, property/company Ownership, etc..

This general move has, with the advent of MLR 2017, now finally approached the art, and high-value/luxury goods sectors.

Considering the proximity of art and high-value/luxury goods sectors with the financial industry, the nature of the underlying goods and services, and the truly global nature of the relevant markets, increased vigilance by regulatory and/or prosecutorial authorities on these shores (and beyond) are to be entirely expected in the future.

Therefore, it is of paramount importance that businesses take the necessary risk-based steps, and implement the necessary internal controls to monitor, assess, understand, and ultimately to seek to mitigate any inherent risks – be they business, operational, client/customer, geographical, etc. in nature – since the damage associated with any failure to do so resonates considerably beyond any specific (and serious) regulatory threat to encompass potentially irretrievable reputational harm.

Interview by Jessica Franses, director of the Art Due Diligence Group Ltd., M. D. of Vitruvian Arts Consultancy Ltd. and art lawyer (July 2018).

The Art Due Diligence Group is made up of specialists in art due diligence. To find out more about due diligence processes to manage risks within your art business, for training in AML and the GDPR or for creating internal policies and compliance to meet the new regulations, please contact us at: enquiries@artduediligencegroup.com