How will the fifth Anti-Money Laundering Directive impact the art market?

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The last decade has been marked by trends that any observer of the art market could not have missed. On the one hand, sales have been breaking records with the value of certain

artworks going through the roof, on the other, the number of headlines related to art crimes is on the rise. Whereas there is no clear correlation between these two trends, it has thrown shade over the industry, calling out the lack of regulation and transparency. Since last June, advocates of regulation have finally found echo in the fifth Anti-Money Laundering Directive (AMLD V) published by the European Commission.

How will this Directive apply to the art market? Article 1 of AMLD V essentially widens the scope of entities that have to comply with obligations in respect to the prevention of money laundering and terrorism financing. Such entities are:

- Providers engaged in exchange services between virtual currencies and fiat currencies
- Custodian wallet providers
- 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, where the value of the transaction or a series of linked transactions amounts to €10,000 or more
- Persons storing, trading or acting as intermediaries in the trade of works of art when this is carried out by free ports, where the value of the transaction or a series of linked transactions amounts to €10,000 or more

Timing-wise, this Directive will have to be transposed in each member state by January 2020 and consequently becomes enforceable to artwork traders and intermediaries from this time onwards.

What is art?

If you were planning on trading bitcoins or competing with Google pay or Apple pay—representing the first two new groups of obliged entities—then you will be happy to know that the European Commission has provided a clear definition of what is understood by “virtual

currencies" or "custodian wallet provider". For the definition of "work of art" though, you may have to wait a little longer. As the nature of a directive is to provide guidance to be further developed and transposed by member states in their national law, the directive shall be addressed by each respective member state, leaving space for interpretation. In the context of the art market—which is cross-border by all means—this approach raises concern with regard to an efficient application of this regulation and could certainly use a harmonized scope.

According to Article 1 of the Directive, it appears that art galleries, auction houses, art-secured lenders, free ports, and potentially also carriers, will now have to comply with this regulation. It is at this time still hard to clearly define the "*persons trading or acting as intermediaries in the trade of works of art*". Transactions in the art market typically involve *some* kind of intermediary, to an extent where it is hard to distinguish the intermediary from the actual beneficiary of the transaction. In fact, various widely commented cases have illustrated this structure and this is arguably one of the reason why the art market is criticized. Considering how hard it is to identify the persons falling under these obligations, there is little to no doubt that enforcing these rules will be a challenge.

About the obligations

From the genesis of the Anti-Money Laundering European Directive in 1991, the scope of "obliged entities" has continued to expand. It was initially meant for financial institutions, but eventually engulfed accountants, real estate agents, casinos and other industries. Accordingly, financial institutions have been closely supervised from the beginning and will only need to adapt to the amendments between AMLD 4 and 5. Meanwhile, the art market will now need to find a way to apprehend a brand new framework, built over five directives and almost three decades.

Some of these rules may be tricky to understand and apply to the art market. As should be

the case in all member states, according to each national law, obliged entities are already expected "*to conduct ongoing due diligence of the business relationship including scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the professionals' knowledge of the customer***[1]**". Hence, it may cause some surprise when the time comes to determine the consistency of a transaction within a pattern, when every single transaction pertains to a unique artwork.

Under AML laws, it is expected that the professionals concerned understand what kind of customers or services expose them the most to the risks of money laundering and terrorism financing, in order to set appropriate safeguards and prevent such risks to materialize. This obligation is better known as "risk-based-approach" (RBA)[2]. In the context of an artwork trader, fulfilling this obligation may lack depth or objectivity simply because one can hardly tell how risky it is to sell an old master painting as opposed to a contemporary painting or even a sculpture. These are only a few examples of how rules that are fitted for the financial industry will cause difficulties when applied to the unique art market, so full of intricacies.

Past experiences have shown that in certain instances, it is not uncommon for an artwork trader, professional or private, to not know the *actual* identity of the seller. In the financial world, this cannot –or at least *should not*– happen because anti-money laundering rules made it an obligation to precisely identify the natural person who's ultimately benefiting from the transaction *before* or *at the time* of the transaction (the beneficial owner). Although this obligation is not new for financial institutions, it is to date one of, if not *the* most, challenging obligation to fulfil in a commercially acceptable timeframe. Beneficial owners have to be natural persons, and may be positioned behind multiple entities linked by complex shareholding schemes. Further, assuming his/her identity is known with certainty, it shall also be verified. It consists in obtaining a valid identification document or at least a certified copy of it. Despite being a routine task, in the light of potential multiplicity of beneficial owners and their locations—which can be remote from the transaction—it can be tedious to perform.

Experiences from financial institutions show that the "time for compliance" sometimes spans beyond the expected "time for business". Trying to fit this process into a black tie opening exhibition where wealthy collectors are passionately competing to purchase a unique artwork, may deter buyers if not managed properly.

The last Deloitte & ArtTactic Art & Finance Report[3] raised some concerns over the particular features of online artwork traders, one of them being the obvious lack of customer-facing interaction. Under the Directive, it is an obligation to duly identify and verify the identity of a customer. Article 13 of AMLD V now allows professionals to complete this obligation by relying on "*electronic identification means, relevant trust services as set out in Regulation (EU) No 910/2014 of the European Parliament and of the Council (*) or any other secure, remote or electronic identification process regulated, recognised, approved or accepted by the relevant national authorities: use of electronic means to identify client may increase cost of operations*". If leveraged properly, it may streamline the customer onboarding process, for customers holding a digital identity granted by a registered European Trust Service Provider.

The critical size

One of the main arguments from professional art dealer associations against this regulation is the fact that it will impose a heavy administrative burden on all types or art traders, including small businesses. If the biggest organizations such as multinational auction houses are capable of absorbing the effort, smaller houses and dealers may suffer financially. As time goes on, the regulation can lead to a concentration of the market in the hands of the biggest players. However, for the smaller entities, the easiest route towards compliance may be the mutualization of resources by leveraging the powerful networks of professional associations. Why not envision an association of art dealers, providing name-screening or transaction monitoring solutions to all its members?

Recent headlines have indicated that the European Union may not be the only area where art professionals will undergo more scrutiny. Last May, a bill was introduced in the United States House of Representatives, extending the Bank Secrecy Act to the art and antiquities market. If the bill passes, it may impose similar obligations on US artwork traders as the ones provided by AMLD V. At the time of writing, the status of this bill has not changed since its introduction.

Plan ahead

Only a few months have passed since the publishing of the fifth AML Directive, but it has already caused much debate and raised many questions, which member states may struggle to answer when transposing the Directive into national law. Further, the compliance gap created in the art market is too big to ignore and art market representatives should anticipate these obligations and stayed tuned for additional details.

[1]Luxembourg law on the fight against money laundering and terrorist financing,12 November 2004, Art. 3, §2, (c)

[2]Luxembourg law on the fight against money laundering and terrorist financing,12 November 2004, Art. 3, §2a

[3]*Addressing Money Laundering and Terrorism Financing vulnerabilities in art and collectibles*, D. Heurtevent & A. Chiariello, Deloitte Art & Finance report 2017.

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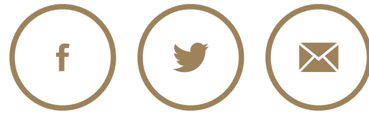

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