

**Study of the Facilitation of
Money Laundering
and Terror Finance
Through the Trade in
Works of Art**



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Department of the Treasury

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Executive Summary

Section 6110(c) of the Anti-Money Laundering Act of 2020, enacted as part of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, directs the U.S. Department of the Treasury to study the facilitation of money laundering (ML) and terror finance (TF) through the trade in works of art (the “Study”). This Study identifies art market participants and sectors of the high-value art market in the United States that may present ML and TF risks to the U.S. financial system. The Study also examines what efforts U.S. government agencies, regulators, and market participants should explore to further mitigate these risks.

Most art market participants, including some entities that provide financial services within the high-value art market, are not subject to anti-money laundering/countering the financing of terrorism (AML/CFT) obligations. Several qualities inherent to art, the high-value art market, and market participants may make the market attractive for ML by illicit actors. Specifically, the high-dollar values of single transactions, the ease of transportability of works of art, the long-standing culture of privacy in the market (including private sales and transactions), and the increasing use of art as an investment or financial asset, all could make trade in high-value art vulnerable to ML.

However, the infrequent use of cash in the high-value art market and preexisting requirements for financial institutions and commercial businesses to report high-value cash transactions, both of which are described later in this Study, may make the institutional high-value art market a poor vehicle for laundering illicit cash proceeds. The Study found some evidence of ML risk in the institutional high-value art market but found little evidence of TF risk. Furthermore, the emerging online art market may present new risks, depending on the structure and incentives of certain activity in this sector of the market (i.e., the purchase of non-fungible tokens [NFTs], digital units on an underlying blockchain that can represent ownership of a digital work of art).

To mitigate these risks, some institutional art market participants, such as certain auction houses and galleries, maintain procedures for conducting due diligence on potential buyers and sellers. Institutional art market participants have inherent economic incentives, such as credit risk issues and reputation maintenance, to collect this information. These good business practices can collect information that may help reduce ML in the art market. However, these programs are purely voluntary, and the procedures can be suspended or disregarded at the institution’s discretion without the risk of the U.S. government (USG) bringing a civil or criminal enforcement action, which presents a vulnerability to the U.S. financial system. These programs are less common in certain areas of the online art market, such as with exchanges that host digital art transactions. Furthermore, illicit actors may attempt to utilize or bribe merchants, professionals, and financial services employees in the art market to ignore policies and best practices for a desired transaction. A significant portion of ML in the high-value art market is likely conducted with the help of such complicit professionals. While the use of complicit professionals is not unique to the art market—it can happen in any profession or service—the historically private nature of the high-value art market makes it more challenging for government authorities to identify and investigate potential ML.

To address these ML risks, the Study considers several regulatory and nonregulatory actions the USG should consider. Nonregulatory options include (1) providing government support for the creation and enhancement of private sector information-sharing programs to encourage transparency among art market participants and (2) updating guidance and training for law enforcement, customs enforcement, and asset recovery agencies. Regulatory options include (1) using targeted recordkeeping and reporting requirements to support information collection and ML activity analyses and (2) applying comprehensive AML/CFT measures to certain art market participants. Weighed against other sectors that pose ML/TF risks, the Study concludes that the art market should not be an immediate focus for the imposition of comprehensive AML/CFT requirements.

Study of the Facilitation of Money Laundering and Terror Finance Through the Trade in Works of Art

On January 1, 2021, the U.S. Congress enacted the Anti-Money Laundering Act of 2020 (the AML Act) as part of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021 (NDAA).¹ Section 6110 of the AML Act includes several AML/CFT provisions related to antiquities and art. Section 6110(c) of the AML Act directs the U.S. Department of the Treasury (Treasury) to conduct a study of the facilitation of ML and TF through the trade in works of art, including an analysis of the following:

1. The extent to which the facilitation of ML and TF through the trade in works of art may enter or affect the financial system of the United States, including any qualitative or quantitative data or statistics;
2. An evaluation of which markets, by size, entity type, domestic or international geographical locations, or otherwise, should be subject to any regulations;
3. The degree to which the regulations, if any, should focus on high-value trade in works of art and on the need to identify the actual purchasers of such works, in addition to the agents or intermediaries acting for or on behalf of such purchasers;
4. The need, if any, to identify persons who are dealers, advisors, consultants, or any other persons who engage as a business in the trade in works of art;
5. Whether thresholds and definitions should apply in determining which entities, if any, to regulate;
6. An evaluation of whether certain exemptions should apply;
7. Whether information on certain transactions in the trade in works of art has a high degree of usefulness in criminal, tax, or regulatory matters; and
8. Any other matter the Secretary of the Treasury determines is appropriate.

I. Introduction

The global trade in art is a multi-billion-dollar industry. According to *The Art Market 2021*, a leading industry report published by UBS and Art Basel,² in 2020, global sales of art were valued at an estimated \$50 billion, down from approximately \$67 billion worldwide just a few years earlier.³ This decrease is likely primarily due to the ongoing COVID-19 pandemic. According to the same study, the United States, the United Kingdom, and China account for an estimated 82 percent of global art sales by value, with the U.S. share estimated at 42 percent (\$21.3 billion).⁴ Headlines consistently identify paintings sold by galleries or at auctions that are valued in the hundreds of millions of dollars.⁵ In 2017, Christie's auction house sold a painting for nearly half a billion dollars, the most expensive sale on record.⁶ High-value art has even been purchased by investors speculating with excess capital to

¹ Pub. L. No. 116-283.

² UBS is a Swiss financial institution, and Art Basel is a well-known art fair organizer. Both entity types and their relation to the wider art market are described later in the Study.

³ Clare McAndrew, "The Art Market 2021," Art Basel and UBS, 2021, available at <https://www.artbasel.com/about/initiatives/the-art-market>.

⁴ Id.

⁵ See, for example, Robert Frank, "Blockbuster art week sets record with more than \$2.6 billion in sales," CNBC, November 23, 2021, available at <https://www.cnbc.com/2021/11/23/blockbuster-art-week-sets-record-with-more-than-2point6-billion-in-sales-.html>.

⁶ Kelly Crow, "Leonardo da Vinci Painting 'Salvator Mundi' Smashes Records With \$450.3 Million Sale," Wall Street Journal, November 16, 2017, available at <https://www.wsj.com/articles/leonardo-da-vinci-painting-salvator-mundi-sells-for-450-3-million-1510794281>.

allocate,⁷ demonstrating the viability of art as an investment asset class. Economic growth, rising purchasing power, and growing disposable income in the global economy are also likely driving factors behind the thriving high-value art market. Technological innovations, such as the rise of distributed ledger technology and NFTs, have presented and continue to present new opportunities for the exploration of creative media, and financial innovations in cross-border payments have allowed the global art market to thrive and expand.

The substantial number of art-related transactions taking place globally in the high-value art market provides an opportunity for disguising illicit transactions as legitimate commercial transactions. High-net-worth individuals (HNWI) seek high-value goods or commodities for personal consumption or as an investment. Illicit actors attempting to launder large amounts of illegitimate wealth, such as kleptocrats and drug traffickers, are among those who seek out such possessions or investments.⁸ While the risk that high-value art can be a conduit to launder illicit proceeds is long-standing, this Study considers market indicators and case studies of misuse to assess the extent to which the high-value art market attracts illicit finance and whether certain sectors of the market are particularly vulnerable to abuse by criminal actors. The Study also examines what efforts should be undertaken by U.S. government agencies, regulators, and market participants to further mitigate the laundering of illicit proceeds through the high-value art market.

The high-value art market is the part of the market that is of greatest concern from a ML perspective but represents a limited portion of the broader art market. According to the UBS and Art Basel report, in 2020, less than 20 percent of works sold internationally by art dealers had values over \$50,000. Approximately 10 percent of sales by auction houses internationally in 2020 had values over \$50,000, but those sales accounted for over 85 percent of the total sales value.⁹

The high-value art market and art market participants who routinely transact in the type of high-value artworks have certain inherent qualities that make them potentially vulnerable to a range of financial crimes. These qualities include the following:

- The relatively high value of art compared to other retail goods and commodities;
- The historically opaque nature of the high-value art market;
- Subjective valuations and the lack of stable and predictable pricing;
- The transportability of certain types of artworks, including across international borders;
- The difficulty faced by law enforcement to monitor such movements and assess the value of artwork, including across borders;¹⁰ and
- The accepted use of third-party intermediaries to purchase, sell, and hold artwork while their clients remain anonymous (i.e., art dealers, advisors, interior designers, shell companies, trusts).

⁷ See, for example, Scott Reyburn and Doreen Carvajal, “Gauguin Painting Is Said to Fetch \$300 Million,” *The New York Times*, February 5, 2015, available at <https://www.nytimes.com/2015/02/06/arts/design/gauguin-painting-is-said-to-fetch-nearly-300-million.html> and Alexandra Peers, “Qatar Purchases Cézanne’s *The Card Players* for More Than \$250 Million, Highest Price Ever for a Work of Art,” *Vanity Fair*, February 2, 2012, available at <https://www.vanityfair.com/culture/2012/02/qatar-buys-cezanne-card-players-201202>.

⁸ See, for example, U.S. 2018 National Money Laundering Risk Assessment, “Corruption,” 2018, available at https://home.treasury.gov/system/files/136/2018NMLRA_12-18.pdf.

⁹ Clare McAndrew, “The Art Market 2021,” Art Basel and UBS, 2021, available at <https://www.artbasel.com/about/initiatives/the-art-market>.

¹⁰ Law enforcement agencies have difficulty tracking the movement of artwork across borders. First, border agents generally lack such expertise, and there is a dearth of art appraisers on staff who have specialized training in art valuation and authentication, a task that is more difficult than assessing values of transferable goods with fairly fixed prices (such as corn or steel). Second, border agents lack technology to assist them in valuing art (for instance, Customs and Border Protection (CBP) automated cargo systems are unable to estimate values of art). It is far easier to do so for other transferable goods, such as steel or corn, per given weight. This will continue to be a challenge when trying to sift through large shipment volumes concealing art and can allow large amounts of value to be moved across borders as high-value art.

For example, in September 2005, Brazilian financial institution Banco Santos went bankrupt, and its owner, Edemar Cid Ferreira, was convicted of bank fraud and ML in Brazil.¹¹ As part of the case, a Sao Paulo Court judge also ordered the search, seizure, and confiscation of assets that Ferreira, his associates, and members of his family had acquired with unlawfully obtained funds from Banco Santos.¹² Brazilian authorities ordered the seizure of his art collection, valued at \$20 to \$30 million, which included high-value works of art. However, when Brazilian law enforcement searched Ferreira's properties, several of the most valuable works of art were missing. In 2007, a U.S. investigation revealed that one of these high-value works of art had been illegally imported into the United States from a storage facility in the Netherlands with an invoice that valued the work at \$100; however, it had been recently appraised for approximately \$8 million.¹³

The Ferreira case highlights the ease of transfer, even across international borders, of high-value art. National border authorities can struggle to identify when high-value works are mis-declared as they lack the specialized experience to detect and appraise high-value art.¹⁴

AML/CFT and Other Reporting Requirements in the United States

In the United States, AML/CFT laws and implementing regulations require that financial institutions establish and implement AML/CFT programs, which generally include the following elements: (1) designation of a compliance officer; (2) maintenance of a system of internal compliance controls; (3) ongoing, relevant training of employees; and (4) independent testing and review.¹⁵ As part of their AML/CFT programs, certain financial institutions are also required to identify and verify the identity of the beneficial owners of legal entity customers who own, control, and profit from companies when those companies open accounts.¹⁶ Most financial institutions are also required to file Suspicious Activity Reports (SARs) with Treasury's Financial Crimes Enforcement Network (FinCEN) when they know, suspect, or have reason to suspect that a transaction or group of transactions involve funds over applicable thresholds that are designed to evade federal reporting requirements, have no business or apparent lawful purpose, involve the use of the financial institution to conduct criminal activity, involve funds derived from illegal activity or are intended or conducted in order to hide or disguise funds or assets derived from illegal activity, or when the financial institution believes the reporting may be

¹¹ See, for example, Helgi Gudmundsson, "Banco Santos bankruptcy proceedings near end," S&P Global Market Intelligence, June 10, 2019, available at <https://www.spglobal.com/marketintelligence/en/news-insights/trending/cCz6KPRXa3blfwx-IQnXQw2>.

¹² U.S. Department of Justice (DOJ), "Manhattan U.S. Attorney Announces Return To Brazil Of Two Masterpieces Linked To Bank Fraud," June 18, 2015, available at <https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-return-brazil-two-masterpieces-linked-bank-fraud>.

¹³ U.S. Immigration and Customs Enforcement, "ICE returns masterpiece linked to bank fraud to Brazilian government," May 8, 2014, available at <https://www.ice.gov/news/releases/ice-returns-masterpiece-linked-bank-fraud-brazilian-government>.

¹⁴ Under Chapter 97 in the Harmonized Tariff Schedule, original works of art such as paintings, drawings, pastels, collages, and decorative plaques are duty free on import into the United States. For works of art entering commercially at a land border with a value of under \$2,500, importers must use the Entry and Manifest of Merchandise Free of Duty CBP Form CF-7523, which collects a nominal amount of information related to value, description, and ownership. If the item is valued over \$2,500, formal entry through a Customs Broker and ACE manifest is required.

¹⁵ The U.S. AML/CFT legal framework, as amended by the AML Act of 2020, is codified at 12 U.S.C. 1829b, 12 U.S.C. 1951-1959 and 31 U.S.C. 5311-5314, and 5316-5336 (this set of laws is commonly referred to as the Bank Secrecy Act or BSA). Implementing regulations are codified at 31 CFR Chapter X.

¹⁶ Specifically, these are banks, mutual funds, broker dealers in securities, futures commission merchants, introducing brokers in commodities, and mutual funds. 31 CFR 1010.230(f) (citing 31 CFR 1010.605(e)(1)).

relevant to possible violations of the law.¹⁷

While banks are defined as financial institutions under FinCEN's implementing regulations, other participants in the art market are not subject to comprehensive AML/CFT requirements.¹⁸ Although a bank is required to establish and implement an AML/CFT program, including appropriate risk-based procedures for conducting ongoing customer due diligence (CDD), and to file SARs, it is generally the bank's customers, such as galleries, auction houses, or other art market participants, that are in a position to collect information regarding specific transactions, such as the identities of buyers and sellers and other transaction data. That said, some banks may require some supporting documentation before processing certain payments. In addition to SARs, certain financial institutions must file Currency Transaction Reports whenever a transaction in currency exceeds \$10,000.¹⁹

Though they are not subject to AML/CFT obligations, participants in the U.S. art market are subject to certain general reporting requirements. First, any person engaged in a trade or business in the United States must file a "Report of Cash Payments Over \$10,000 in a Trade or Business" (referred to as the "Form 8300") for the receipt of more than \$10,000 in cash, coins, or certain monetary instruments in one transaction or two or more related transactions (meaning that large currency and monetary instrument transactions are mandated to be reported by art industry participants that are *not financial institutions*).²⁰ A Form 8300 may also be filed voluntarily for certain suspicious transactions, even if the total amount does not exceed \$10,000.²¹ The Form 8300 provides valuable information on the movement and use of cash to the Internal Revenue Service (IRS), FinCEN, and the broader law enforcement community. Second, all U.S. persons must comply with Office of Foreign Assets Control (OFAC) regulations, including all U.S. citizens and lawful permanent residents regardless of where they are located, all individuals and entities within the United States, and all U.S. incorporated entities and their foreign branches.²² For some OFAC programs, foreign subsidiaries owned or controlled by U.S. persons also must comply. Since the enactment of the "Berman Amendment," U.S. sanctions regulations administered by OFAC generally exempt from regulation transactions related to sanctioned jurisdictions that involve "the importation from any country, or the exportation to any country...of any information or informational materials, including but not limited to...artworks."²³ OFAC has issued public guidance indicating that it does not interpret this exemption to allow blocked persons or their facilitators to evade sanctions by exchanging

¹⁷ FinCEN has implemented regulations for suspicious activity reporting at 31 CFR 1020.320 (for banks); 31 CFR 1021.320 (for casinos); 31 CFR 1022.320 (for money services businesses); 31 CFR 1023.320 (for brokers or dealers in securities); 31 CFR 1024.320 (for mutual funds); 31 CFR 1025.320 (for insurance companies); 31 CFR 1026.320 (for futures commission merchants and introducing brokers in commodities); 31 CFR 1029.320 (for loan or finance companies); and 31 CFR 1030.320 (for housing government sponsored enterprises).

¹⁸ While the AML Act amended the U.S. AML/CFT legal framework to define persons in the antiquities trade as financial institutions, the antiquities market is outside the scope of this study.

¹⁹ See 31 CFR 1010.311.

²⁰ IRS Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business, available at <https://www.irs.gov/pub/irs-pdf/f8300.pdf>

²¹ See box 1b on Form 8300 (allowing a filer to voluntarily report a transaction when it appears that a person is attempting to cause Form 8300 not to be filed, or to file a false or incomplete form).

²² U.S. Department of the Treasury, "Financial Sanctions Frequently Asked Questions," available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/topic/1501>.

²³ See 50 U.S.C. § 1702(b)(3); 50 U.S.C. § 4305(b)(4).

financial assets for high-value artwork or vice versa.²⁴ OFAC has further noted it will apply its sanctions to transactions involving artworks in which a blocked person has an interest, to the extent the artwork functions primarily as an investment asset or medium of exchange.²⁵

Outreach conducted by Treasury over the course of this Study revealed that while most art market participants are not mandated by federal regulations to maintain AML/CFT programs, many maintain voluntary programs that may include procedures for collecting information on customers. These voluntary programs can include information collection regarding “obtaining the provenance history of the object, requesting identification information from the seller, establishing credibility and plausibility references relating to the seller, referring to publicly available databases and listings relating to the parties to the transaction and the art object respectively, obtaining any relevant and available legal documents, witness declarations, expert opinions as the case may be, and checking the restoration history as appropriate and presenting circumstantial evidence when no direct documentation is available.”²⁶ Whether the establishment and implementation of these programs are due to inherent art market incentives, such as knowing the customer for credit risk issues or to maintain the reputation of art market participants, adoption of these voluntary programs appears to be a best practice in the industry for high-value art. Additionally, some trade groups that represent auction houses, galleries, or other dealers maintain certain required due diligence policies and procedures that member businesses must adhere to as a membership requirement. That said, all these programs are not legally mandated and can be suspended or amended by the institution or trade group categorically or on a case-by-case basis. Moreover, the lack of regulatory requirements for such programs also means that government authorities cannot take administrative or enforcement actions when such programs are ineffective or nonexistent.

While some art market participants may provide information in response to informal law enforcement requests, this is at the discretion of individual art market participants. There may be few other legal mechanisms for obtaining customer information other than a subpoena or court order. Based on these facts and the evidence presented throughout the rest of the Study, this report concludes that there is some evidence of ML risk in the high-value art market and little evidence of TF risk.

II. Definitions and Scoping

i. Aims and Objectives

This report assesses separate segments of the high-value art market based on their potential vulnerabilities for illicit finance, examines the types of significant participants in the market, and proposes areas for potential risk-based regulation, as well as issues that may require further review. In addition to fulfilling the requirements of Section 6110(c) of the AML Act, other objectives of this Study include the following:

1. Helping the public and private sectors better understand the ML/TF risks arising from the trade in high-value art and assess the existing measures taken to address those risks;

²⁴ OFAC has also issued a specific advisory on sanctions risks arising from dealings in high-value artwork. See U.S. Department of the Treasury, “Advisory and Guidance on Potential Sanctions Risks Arising from Dealings in High-Value Artwork,” October 30, 2020, available at https://home.treasury.gov/system/files/126/ofac_art_advisory_10302020.pdf.

²⁵ Id.

²⁶ Basel Institute of Governance, “Basel Art Trade Guidelines (2018),” available at https://baselgovernance.org/sites/default/files/2019-06/190613_WP_12.pdf.

2. Providing a better understanding of the roles of various private sector actors involved in high-value art financial transactions (e.g., dealers, galleries, auction houses, and financial institutions);
3. Addressing the specific mechanisms used by criminals to move illicit funds through the high-value art market;
4. Providing a better understanding of the role of high-value art in determining the landscape of financial products and services used within the domestic financial system; and
5. Developing an overview of potential regulatory measures to address illicit finance risks in the trade of high-value art.

ii. Art Definition and Valuation

There is not always consensus on what constitutes art, and whether a particular item qualifies as art is not always clear. According to one expert, art can be a myriad of things, ranging from pre-civilization artifacts (and thus more connected to archaeology), 17th-century masters, or fine art to modern objects that could be produced even as this report is written.²⁷

A starting point for this Study is to examine existing, but divergent, definitions used by various U.S. government agencies and international organizations. For the purposes of administering customs checks and export and import controls, U.S. Customs and Border Protection (CBP) defines art as including “paintings, drawings, and pastels, executed entirely by hand; original engravings, prints and lithographs; original sculptures and statuary, in any material; postage or revenue stamps, stamp-postmarks, first day covers, postal stationery (stamped paper) and the like; collections and collectors’ pieces of zoological, botanical, mineralogical, anatomical, historical, archaeological, paleontological, ethnographic or numismatic interest; and antiques more than 100 years old.”²⁸ The IRS also maintains working de facto definitions for art that encompass paintings, drawings, prints, sculptures, antiques, ceramics, glass, decorative arts, textiles, carpets, silver, rare manuscripts, antiquities, ethnographic art, collectibles, coins, archives, and historical memorabilia.²⁹

A comparative analysis to the 2018 European Union (EU) 5th Anti-Money Laundering Directive (5AMLD) is also useful. The 5AMLD mandated that, by January 2020, EU member states expand coverage of “obliged entities” for AML/CFT laws to persons trading in art, acting as intermediaries in the trade of art, or storing art in free-trade zones (FTZs), if the value of the transaction or a group of linked transactions equals €10,000 or more.

Despite leaving the EU, the United Kingdom has implemented provisions similar to the 5AMLD, making it one of the first countries to implement AML/CFT obligations in the art market. It has defined a “work of art” (with limited exceptions) as³⁰

- Paintings, drawings, collages, decorative plaques, or similar pictures executed by hand;
- Original engravings, lithographs, or other prints;
- Sculptures or statues;
- Sculpture casts;

²⁷ Joris Kila, Marc Balcells, Petrus van Duyne, Lena Louwe, and Melvin Soudijn, “Money, Art, and Laundering: Coming to Grips with the Risks.” In *Cultural Property Crime: An Overview and Analysis of Contemporary Perspectives and Trends*, edited by Joris Kila and Marc Balcells, 77-95. October 2014. Brill.

²⁸ Chapter 9701, Harmonized Tariff Schedule of the United States (2020) Revision 28.

²⁹ The IRS maintains this de facto definition through its administration of the Art Appraisal Services (AAS) unit in the Independent Office of Appeals. This IRS unit is discussed later in this Study.

³⁰ Exemptions to this UK definition include technical drawings, maps, or plans; pictures comprised in a manufactured article

- Tapestries or other hangings;
- Ceramics;
- Enamels on copper; and
- Photographs.³¹

Both within the USG and internationally, there are divergent views on what constitutes a work of art. The definitions used by various organizations generally appear to be adopted based on the function that art has within the mandate of the organization. For example, the IRS definition is broader, as more types of items can be used for tax write-off purposes, while CBP's definition focuses on items which could conceivably be transported across international borders. For the purposes of this Study, Treasury considered a broad definition of high-value art to include tangible, visual art. Treasury did not consider a monetary threshold for what constitutes high-value art during this Study but rather identified functional qualities of visual art (as opposed to music or other audial art) described above (such as when it is primarily used as a store of value or medium of exchange) that can make the art susceptible to ML.³²

iii. Scoping

The focus of this Study is on high-value art, which can be purchased and sold with relative ease. Examples include paintings, drawings, and sculptures that are sold in traditional, in-person art market venues, or online through certain marketplaces, and digital art sold through internet marketplaces. This Study will evaluate the extent to which this type of high-value art is susceptible to ML by illicit actors. Antiquities and the antiquities market are not a part of this Study because they are treated separately under the AML Act.³³

The unique characteristics of the high-value art market that may make it susceptible to ML also provide avenues for criminals to conduct other illicit activities in the market. These illicit activities, such as theft (tied to the ease of transporting artwork), fraud/forgery (tied to the subjectivity in authenticating works

that has been hand-decorated; and anything in the nature of scenery, including a “backcloth” used for the backdrop of a performing arts scene. Furthermore, antiquities, coins, and ethnographic materials are largely not covered under the UK definition.

³¹ The Money Laundering and Terrorist Financing (Amendment) Regulations 2019, referencing the Value Added Tax Act's Section 21(6), available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/860279/Money_Laundering_and_Terrorist_Financing_Amendment_Regulations_2019.pdf

³² Treasury maintains at least two thresholds for identifying high-value art: the IRS maintains a \$50,000 threshold for referral of an audit to the AAS, and OFAC identifies a \$100,000 threshold in its October 2020 “Advisory and Guidance on Potential Sanctions Risks Arising from Dealings in High-Value Artwork” described above. However, neither of these thresholds were specifically created to identify high-value art for the purposes of ML.

³³ Section 6110(a)(1) of the AML Act amends the existing U.S. AML/CFT legal framework by including as a type of financial institution persons engaged in the trade of antiquities, including an advisor, consultant, or any other person who engages as a business in the solicitation or the sale of antiquities, subject to regulations prescribed by the Secretary of the Treasury. Section 6110(b) of the AML Act mandates that the Secretary of the Treasury, acting through the Director of FinCEN, issue proposed rules to implement the provision. On September 23, 2021, FinCEN issued an Advance Notice of Proposed Rulemaking (ANPRM) to solicit public comment on a range of questions related to the implementation of Section 6110(a)(1) of the AML Act. See 86 Fed. Reg. 53021-53024, September 24, 2021, available at <https://www.govinfo.gov/content/pkg/FR-2021-09-24/pdf/2021-20731.pdf>. See also U.S. Treasury, “FinCEN Launches Regulatory Process For New Antiquities Regulations,” September 23, 2021, available at <https://www.fincen.gov/news/news-releases/fincen-launches-regulatory-process-new-antiquities-regulations>.

of art), and trafficking are not included in the scope of this Study because they are not discussed in the AML Act.³⁴

For example, in 2013, Glafira Rosales pled guilty to participating in a 15-year scheme to sell more than 60 fake works of modern art to two New York art galleries; the victims paid more than \$80 million for the fake works.³⁵ These types of cases deal with funds generated through the abuse of the market and do not represent use of high-value art or the market to launder the proceeds of an underlying crime (such as drug trafficking). However, if art forgeries were used to move criminal proceeds, as opposed to generate cash or funds, this could constitute ML.

III. How is Art Sold?

i. Primary vs. Secondary Market

When the retail art market first developed in the 15th century, artists themselves would introduce their work to potential buyers. Artists submitted work proposals to wealthy families, churches, clubs, and other public building managers, which were then evaluated based on their perceived merits. Winning artists were able to sell their works directly to clients, with no need for third-party intermediation.³⁶ This constituted the origins of what is known as the “primary art market,” where works of art become available for purchase for the first time, usually from the artist or the artist’s representative.

In the 16th century, a “secondary art market” began to develop in Amsterdam and Antwerp as estate sale arbitrage traders purchased clothes and other home goods, including art, from estates and then resold it at much higher prices.³⁷ In this secondary market, art is resold or traded, and the profits go to the seller or previous owner of the artwork, not the artist.

The absence of the artist makes the secondary market more vulnerable to exploitation through several channels. First, the seller may lack incentive to scrutinize the buyer’s intentions for the work. Whereas artists and their representatives in the primary market choose buyers who will enhance the artist’s reputation, in the secondary market, a seller may not have the same artist reputation concerns. Second, the relative inability of secondary buyers to accurately authenticate works can lead to the potential sale of forgeries. These types of exploitation have occasionally led to additional regulations or controls on the secondary market. For example, a rise of traders selling forgeries led governing bodies to regulate these secondary art markets.³⁸ By the 17th century, art auctions in the United Kingdom regularly printed rules and supervised the dealers and merchants that certified the works they examined prior to sale.³⁹

³⁴ Section 6110(c) of the AML Act within the 2021 NDAA specifically cites ML and TF as the crimes required for examination by this study. Other illicit financial issues are not specifically discussed by the statute and are therefore not included in the scope of this Study.

³⁵ U.S. DOJ, “Art Dealer Pleads Guilty In Manhattan Federal Court To \$80 Million Fake Art Scam, Money Laundering, And Tax Charges,” September 16, 2013, available at <https://www.justice.gov/usao-sdny/pr/art-dealer-pleads-guilty-manhattanfederal-court-80-million-fake-art-scammoney>.

³⁶ Andrea Renda, “The Evolution of the Art Market: From 15th Century Florence to the Sotheby’s - EBay Agreement,” *Libera Università Internazionale Degli Studi Sociali*, 2015, available at <https://tesi.luiss.it/15688/1/172301.pdf>.

³⁷ Id.

³⁸ Id.

³⁹ Id.

ii. The Art Market

The Institutional Art Market

Purchase prices of art depend on several factors in addition to the inherent quality of the art and the financial and artistic history of that artwork. Works can increase or decrease in value depending on the documented ownership history of the work (provenance), availability of the artist's other works, historical events, the reputation of collectors who have purchased the work, and exhibitions of the artist's works by institutions such as museums and galleries. For both collectors and artists, the desired progression through the art world is for a work of art to gain value each time that it returns to the secondary market. Getting works placed in museums can increase the prestige of an artist, which can inflate both the secondary market value of their other works and, potentially, the initial price of any new pieces the artist creates. For collectors, these price increases inflate the values of the works they own and help fuel the assets as stores of value and investment strategies.

Art, like any modern-day good or commodity, can be, and routinely is, sold and transported across national borders. The rise of the global art market over the past 30 years is clear; in the 13-year stretch between 1991 and 2004, less than 150 Western works were sold in Hong Kong, with a total value of approximately \$12 million. In 2018 alone, nearly 500 works by Western artists were sold in the same city for a total of more than \$130 million.⁴⁰ In 2020, the Chinese and UK art markets each accounted for one-fifth of the total value sold around the world.⁴¹ The rise of the global market is also reflected in the growth of art market institutions with a presence in Asia. Many of the large auction houses and some international art galleries have locations in Hong Kong, and Art Basel, an institutional art fair organizer and event planning company which puts on some of the largest art fairs in the world, opened its first Hong Kong fair in 2013.⁴² The number of wealthy art market participants in mainland China has dramatically increased over the past few decades, and the COVID-19 pandemic may accelerate the ongoing transition of some high-value art market activity in Asia from Hong Kong to mainland China.

In 2010, the United Nations estimated that the proceeds of transnational crime related to art and cultural property could be as high as \$8 billion per year,⁴³ with a more recent estimate suggesting that ML and other financial crimes through the art market amount to approximately \$3 billion per year.⁴⁴ While the

⁴⁰ Tim Schneider, "Goodbye Art World, Hello Art Industry: How the Art Market Has Transformed—Radically—Over the Past 30 Years," *Artnet News*, November 25, 2019, available at <https://news.artnet.com/market/how-the-art-world-became-the-art-industry-1710228>.

⁴¹ Clare McAndrew, "The Art Market 2021," *Art Basel and UBS*, 2021, available at <https://www.artbasel.com/about/initiatives/the-art-market>.

⁴² Flash Art, "Art Basel's first edition in Hong Kong," May 28, 2013, available at <https://flash-art.com/2013/05/hong-kong-art-basels-first-edition-in-hong-kong/>.

⁴³ Manar Idriss, Jendly Manon, Jacqui Karn, and Massimiliano Mulone, "International Report on Crime Prevention and Community Safety: Trends and Perspectives," *International Centre for the Prevention of Crime*, September 9, 2010, available at http://www.antoniocasella.eu/nume/ICPC_2010.pdf.

⁴⁴ UN Office on Drugs and Crime, "PRACTICAL ASSISTANCE TOOL to assist in the implementation of the International Guidelines for Crime Prevention and Criminal Justice Responses with Respect to Trafficking in Cultural Property and Other Related Offences," September 2016, available at https://www.unodc.org/documents/organized-crime/Publications/16-05585_eBook_English_UPDATED.pdf. See also, Tom Mashberg, "The Art of Money Laundering," *International Monetary Fund's Finance and Development*, Vol. 56, No. 3, September 2019, available at <https://www.imf.org/external/pubs/ft/fandd/2019/09/pdf/the-art-of-money-laundering-and-washing-illicit-cash-mashberg.pdf>.

level of art-related ML is significant, it is far exceeded by other predicate financial crimes such as fraud,⁴⁵ drug trafficking,⁴⁶ and cybercrime.⁴⁷

The Online Art Market

Sales of high-value art online are growing, and the popularity of online auctions has increased significantly during the COVID-19 pandemic. Despite a contraction of overall high-value art sales in 2020 from previous years, online sales of high-value art (including by galleries, dealers, and auction houses made online through their own websites, viewing rooms, and other platforms, as well as those made through third-party platforms and online art fairs) reached a record high of \$12.4 billion in 2020, more than double the online sales from the previous year.⁴⁸ A recent survey of art dealers shows that online sales are one of their top priorities for the foreseeable future.⁴⁹ The online market is split into two distinct categories: (1) online marketplaces, which includes online art fairs, purchases from the websites of galleries and auction houses, and other non-art-specialized third-party marketplaces such as social media and other sales listing sites (such as eBay) and (2) the digital art market where digital art with no physically tangible presence (such as works secured with NFTs) is traded.⁵⁰ Given that many aspects of the online and digital art spaces are still emerging, these areas of the art market will be covered separately in two sections later in this report.

IV. Art Market Participants and Their Vulnerabilities

This section identifies major types of institutional art market participants and assesses their vulnerability to ML by illicit actors. The businesses and nonprofit entity types included in this section each have their own vulnerabilities related to the type of activity they conduct in the high-value art market, and their inclusion in this section does not necessarily reflect that each market participant is at high risk for ML.

⁴⁵ Fraud, both in the private sector and in government benefits and payments, continues to be the largest driver of ML activity in terms of the scope of activity and magnitude of illicit proceeds—generating billions of dollars annually. For example, some individual investment fraud or “Ponzi” schemes can generate a billion dollars in proceeds alone. *See, for example*, U.S. DOJ, “Two Remaining Defendants of \$1.3 Billion Investment Fraud (Ponzi) Scheme – One of the Largest Ever Charged in South Florida – Plead Guilty to Mail and Wire Fraud Conspiracy,” July 13, 2021, available at <https://www.justice.gov/usao-sdfl/pr/two-remaining-defendants-13-billion-investment-fraud-ponzi-scheme-one-largest-ever>.

⁴⁶ Drug trafficking organizations (DTOs) engaged in the trafficking of a variety of drugs into the United States use numerous methods to launder proceeds, which remain predominantly cash based. In 2021, the Drug Enforcement Administration (DEA) estimated that DTOs continue to generate “tens of billions of dollars in illicit proceeds” every year. *See* U.S. DEA, “National Drug Threat Assessment,” March 2021, available at https://www.dea.gov/sites/default/files/2021-02/DIR-008-21%202020%20National%20Drug%20Threat%20Assessment_WEB.pdf.

⁴⁷ In 2020, nearly 800,000 incidents of self-reported losses by the public from cybercrime were received by the FBI’s Internet Crime Complaint Center (IC3). These losses exceeded \$4.1 billion, and complaints received by IC3 are likely only a fraction of the cybercrime occurring in the United States. *See* FBI, “Internet Crime Report 2020,” available at https://www.ic3.gov/Media/PDF/AnnualReport/2020_IC3Report.pdf.

⁴⁸ Clare McAndrew, “The Art Market 2021,” Art Basel and UBS, 2021, available at <https://www.artbasel.com/about/initiatives/the-art-market>.

⁴⁹ *Id.*

⁵⁰ While some institutional art market participants such as auction houses and galleries have begun to enter this space, the overwhelming number of transactions conducted involving digital art are not conducted through these institutions but rather through online marketplaces or through the private market as discussed below.

i. Auction Houses

Auction houses are firms that conduct the public⁵¹ sale of art, in which items are sold to the highest bidder, but may occasionally facilitate private transactions. Usually, potential purchasers make a succession of increasing bids or offers until the highest and final bid is accepted by the auctioneer. Successful bidders at auction generally pay a “buyer’s premium” to the auction house (a flat fee or percentage of the total bid). These auction houses can also facilitate private sales of art, which is when a collector comes to the auction house and wishes to sell a work outside of the auction. In 2020, international public auction sales of art were estimated to be approximately \$17.6 billion, with an additional \$3.2 billion in private sales facilitated through auction houses.⁵² Auction houses mostly operate in the secondary market, meaning they generally sell pieces owned by their clients, as opposed to representing the artist of the work or selling work that the auction houses themselves own.⁵³

While several art market participants, including many large auction houses, already maintain procedures for conducting due diligence on potential buyers, these programs are voluntary.⁵⁴ As previously discussed, there are few enforcement mechanisms if the programs are ineffective, selectively followed, or even suspended. Auction houses may have less incentive than other art market participants to adhere to their own due diligence programs since they generally operate in the secondary market and may not necessarily have artist reputations to look after. Auction houses can have a financial incentive to sell at a higher price due to the structure of the sales as auctions, as opposed to sales priced pre-transaction. These incentives may make auction houses potentially vulnerable to abuse by illicit actors for ML purposes.

ii. Galleries

An art gallery is a retail establishment that exhibits art for customers to view and potentially purchase. Galleries usually own or rent physical space and exhibit art from artists they represent. Galleries can vary greatly in size, with gross annual receipts ranging from \$50,000 to over \$60 million.⁵⁵ Some galleries hold vast inventories of over \$40 million in value, while others only take works of art on consignment, where the gallery sells the art for a commission, and ownership remains with the artist or owner until sold. Some galleries sell large amounts of low-priced items, while others sell only a few high-priced items.

Galleries generally have a direct stake in the reputations of the artists they represent, including the sale prices of the artists’ works, and can make relatively unknown artists popular in the high-value art industry through facilitating purchases by renowned art market participants, such as museums or well-known collectors. The galleries that represent the most popular artists are able to monetize their reputation and offerings by selling on consignment and not needing to invest large amounts of capital

⁵¹ The public art market includes the sale by institutional art market participants operating as businesses, such as many of the entities listed in this section. All members of the public have some ability to bid on or purchase art in the public art market. In contrast, private art sales conducted between two individuals without the use of an intermediary are not part of the public art market.

⁵² Clare McAndrew, “The Art Market 2021,” Art Basel and UBS, 2021, available at <https://www.artbasel.com/about/initiatives/the-art-market>.

⁵³ That said, according to outreach conducted by Treasury, some auction houses do occasionally own a stake in property that they sell. This activity likely does not pose any increased ML risk.

⁵⁴ See, for example, Sotheby’s, Code of Business Conduct 2021, 36 (referencing an internal AML policy), available at <https://www.sothebys.com/en/docs/pdf/code-of-conduct-2021.pdf>.

⁵⁵ IRS, “Art Galleries - Audit Technique Guide,” January 2012, available at <https://www.irs.gov/pub/irs-utl/artgalleries.pdf>.

in inventory. Depending on the size and scale of the gallery, its customer base may be local or more international. Generally, these businesses rely on a combination of continuous one-time customers and a smaller group of higher net worth repeat customers.⁵⁶

Large, well-known galleries may operate in both the primary and secondary markets. Generally, most of the larger galleries' revenues come from the primary market, but these businesses also operate in the secondary market, as they are often on the lookout for blue-chip pieces that their repeat customers are seeking. Larger galleries have the financial means to acquire these more expensive works and then sell them to a customer for a profit. By contrast, small- and medium-sized galleries operate almost exclusively in the primary market, exhibiting works from specific artists for months at a time. They generally rely mostly on a small group of clients who spend larger amounts of money on art and a smaller volume of one-time purchasers who come through the gallery doors.

In outreach for the Study, several experts on the high-value art market noted that individuals spending large amounts of money at any gallery are probably known by the gallerists, and the gallerists have market incentives to collect identifying information on their customers to maintain their galleries' reputation, which can directly affect the number of customers and quality of works the gallery is able to acquire. Small- and medium-sized galleries have an incentive to not sell their entire collections to one buyer, as these galleries stand to gain from providing the artists they represent broad exposure to a wide variety of potential future customers. Further, the pieces sold in these small- and medium-sized galleries generally may not be priced high enough to present suitable targets for ML, and there may not be enough volume to make this an efficient avenue for ML. Therefore, laundering funds through one of these businesses would require either a complicit gallery dealer or a large number of straw buyers to purchase on behalf of the final launderer, which would increase the size of the ML operation (and potential risk for detection). As a result, these businesses would likely not be the preferred venue for illicit actors to launder large volumes of funds.

iii. Art Fairs

Art fairs are large public events that galleries can attend to exhibit works for sale. These usually include works by artists they represent and other works the galleries acquired or are selling on consignment. These fairs present a unique opportunity for galleries to (1) connect with existing clients that are not in the gallery's geographic area and (2) reach a wider audience and develop a larger client base. In 2020, there were approximately 365 art fairs planned globally, but approximately two-thirds were canceled or postponed due to the COVID-19 pandemic.⁵⁷

Art fairs likely do not represent much more of a vulnerability to ML than galleries. First, sellers are not faced with sale time constraints in their access to the potential customers at the fair; although the fairs generally last a few days at maximum, many galleries measure success at fairs not by how many works are sold, or for what amount, but rather by the clients developed and what those clients buy months or years later. Therefore, gallerists generally do not have an incentive to rush due diligence procedures just to make a sale at the fair. The incentives listed above for gallerists to know their customers still exist in the art fair context. Although staff must attend the fair and artwork must be shipped and insured to

⁵⁶ Id.

⁵⁷ Clare McAndrew, "The Art Market 2021," Art Basel and UBS, 2021, available at <https://www.artbasel.com/about/initiatives/the-art-market>.

and from the fair and galleries are likely handling multiple artists and clients at once, these factors are generally seen as investments in client development, not as costs that must be recouped in the short fair timeframe. Second, the actual art fair organizers generally do not have transactional relationships with customers looking to purchase art besides registration costs to attend events. Art fairs make their money by charging galleries for floor space at the fair and generally do not help process transactions when clients seek to buy works from galleries. This lack of transactional activity likely makes art fair organizers less vulnerable to exploitation by launderers.

iv. Online Marketplaces

Online marketplaces for high-value art include (1) the use of online viewing rooms (OVRs) and individual branded websites by galleries, art fairs, and auction houses and (2) the use of social media sites, non-art-specific marketplaces (such as eBay), and encrypted messaging services to sell art.

Institutional art market participants (including auction houses, galleries, and art fairs) have increased their usage of online spaces such as OVRs and wholly owned sales webpages due to many factors, including the ongoing COVID-19 pandemic, the generational shift of art market consumers to those more mobile-focused and digitally savvy, and advances in internet and communication technologies. Online sales by these entities can pose a ML challenge with respect to the verification of even voluntary information collection. Dealers, galleries, and auction houses can struggle to verify that the bearer of collected identity documents is the same as the person listed on the documents. Video calls can be used to conduct this diligence, but the amount of effort may strain resource capacity, especially at smaller art market institutions.

While institutional art market participants' OVRs and websites generally rely on due diligence and compliance measures implemented by the various larger art market institutions, third-party marketplaces present a greater challenge. Although third-party markets, including social media marketplaces, peer-to-peer messaging apps, and other exchanges, generally host sales for lower-value art compared to traditional art market institutions, they expand the broad peer-to-peer market without maintaining any due diligence requirements. Additionally, they are not purely focused on the art market; therefore, they do not have the same market incentives as the participants in the art market, such as reputational concerns when dealing with an artist's eminence or potentially concerning counterparties. As peer-to-peer transactions cannot be easily regulated (they do not involve institutional market participants potentially subject to business regulation), these third-party marketplaces create a broader marketplace without verifying who is participating in it. This creates a ML vulnerability.

v. Museums, Universities, and Other Nonprofits

A museum is often a tax-exempt institution that is open to the public, which "acquires, conserves, researches, communicates and exhibits the... heritage of humanity for the purposes of education, study and enjoyment."⁵⁸ These institutions acquire the art they exhibit through both the purchase of art and donations of works to the museum.⁵⁹ Museums may have vulnerabilities related to tax evasion and ML through art they acquire and sell. For example, the practice of deaccessioning, whereby museums sell

⁵⁸ International Council of Museums, "Standards and Guidelines – Museum definition," August 24, 2007, available at <https://icom.museum/en/resources/standards-guidelines/museum-definition/>.

⁵⁹ Abby Schultz, "Museums Get Creative to Acquire Art," Penta, June 18, 2019, available at <https://www.barrons.com/articles/museums-get-creative-to-acquire-art-51560862800>. See also Artwork Archive, "What You Need to Know When Donating

works that have been donated to them to pay for the acquisition of a new work or operating expenses,⁶⁰ may provide an avenue for potential ML risk. Specifically, museums can be exposed to ML risk if they buy or sell a piece of art independently, without deaccessioning or purchasing working through a gallery or auction house. Museums do not maintain the same market incentives as other art market participants to collect due diligence information on the buyer and generally do not maintain compliance or business specialists on staff to address these specific issues, as these transactions are less common in the museum context.

While museums are one type of tax-exempt organization that may receive or transact in high-value art, they are not the only one. Given the tax deductibility of non-cash items like art, any tax-exempt organization could be the recipient of high-value art. For example, universities frequently purchase or receive donations of high-value art.⁶¹ According to the IRS, art donated to a university should be used to further the education of students to qualify for tax deduction, but that does not always happen. As another example, hospitals frequently receive donated art—or purchase it—and show off or display the art in ways similar to galleries. Hospitals can acquire art both for resale and therapeutic purposes. Hospital collection sizes can reach into the thousands of works,⁶² and these pieces can be sold privately (i.e., not through the public market). While hospitals and universities are required to comply with a range of state and federal regulations governing their activities, they likely do not have staff with art market or illicit finance expertise. Furthermore, these entities likely do not rely on the revenue generated from art sales and do not have many repeat customers, given that the purchase and sale of art is not undertaken in the ordinary course of their business. Therefore, while less vulnerable than museums, these nonprofit institutions may be potentially vulnerable to ML, especially if the institutions do not sell their works through a third-party art market institution such as a gallery or auction house.

vi. Third-Party Intermediaries

Other third-party intermediaries, such as interior designers and independent art advisors, represent exploitable ML vulnerabilities in the art market by intermediating between the seller and the end buyer. These intermediaries can provide anonymity to illicit actors seeking to launder funds through the purchase of high-value art by refusing to disclose to sellers or other intermediaries—specifically galleries and auction houses—who the ultimate client is. For example, interior designers may work for undisclosed clients and can buy large amounts of high-value art on their behalf directly from auction houses and galleries, and subsequently sell those pieces to clients for a markup. These intermediaries do not have any additional legal or professional obligations to disclose their end client to sellers, and they can undermine the seller's ability to conduct due diligence on the end purchaser of the art. Outreach conducted as part of the Study noted that some art market institutions have instituted policies to refuse to interact with third-party intermediaries that do not disclose the end buyers. However, some art

Your Art Collection,” available at <https://www.artworkarchive.com/blog/what-you-need-to-know-when-donating-your-art-collection>.

⁶⁰ Sebastian Smee, “This is how bad things are for museums: They now have a green light to sell off their art,” The Washington Post, April 30, 2020, available at https://www.washingtonpost.com/entertainment/museums/this-is-how-bad-things-are-for-museums-they-now-have-a-green-light-to-sell-off-their-art/2020/04/29/b5492a5e-899e-11ea-8ac1-bfb250876b7a_story.html.

⁶¹ Elizabeth Stamp, “The Best University Art Museums in America,” Architectural Digest, April 26, 2017, available at <https://www.architecturaldigest.com/gallery/university-art-museums-slideshow>.

⁶² NYC Health + Hospitals, “Arts in Medicine – Art Collection,” available at <https://www.nychealthandhospitals.org/artsinmedicine/art-collection/>.

advisors and interior designers will conduct purchases of high-value art with their own funds on behalf of their client, effectively obscuring the client's participation in the sale.⁶³

There may be some professional norms within the industry that encourage the disclosure of the names of the owners of a work. For example, the Art Dealers Association of America, a professional trade association representing many dealers in the art industry, requires that member dealers “exercise due diligence in verifying the authenticity of works of art that they offer for sale.”⁶⁴ These kinds of authentication requirements can include provenance records, or a list of prior owners of the art. If followed, the requirements would disclose the seller and purchaser of a work at the time of sale. However, not all interior designers, dealers, and advisors are members of a trade association, and even if they were, failing to follow the association's guidance is not a basis for civil or criminal enforcement action. Some intermediaries have claimed that such client disclosure requirements could lead to the targeting of their clients by other art market participants to steal client business or by potential thieves looking to steal high-value art. The lack of comprehensive information collection leaves sellers vulnerable to exploitation by illicit financial actors carrying out purchases through intermediaries.

To be clear, the ML risk described above only arises where interior designers and art advisors act as an intermediary and conceal the identity of the purchaser from the seller. Many provide only advisory or valuation services and, where they do purchase art, will disclose the name of their end client and pay via the end client's account.⁶⁵ Furthermore, a best practice among many institutional art market sellers is to identify the end customer for a work.

vii. Art Finance

Art finance companies and other art market institutions provide financial services in the art market through several lending and financing options. Several boutique art financing firms, as well as auction houses and galleries, provide personal loans to clients that are collateralized based on the assessed value of specific pieces of artwork provided as collateral. These loans can be sought and provided for several reasons, including additional investment opportunities, personal consumption needs, cash flow problems related to lifestyle or business problems, or acquiring additional artwork.

While entities that offer these services provide liquidity to owners of art using the works as collateral for loans, they do not have a legal obligation to collect any information on the ultimate owner of the art or the source of funds originally used to acquire the work. This can allow illicit actors to unlock the value of high-value artwork purchased through illicit funds without being subject to due diligence collection and scrutiny regarding the source of their funds.

Unlike regulated financial institutions, boutique art finance firms and other similarly situated institutions provide transactional services without being subject to comprehensive AML/CFT requirements, including the obligation to establish and implement AML/CFT programs, report suspicious activity, and verify a

⁶³ See, for example, Permanent Subcommittee on Investigations, United States Senate, “The Art Industry and U.S. Policies That Undermine Sanctions,” (The Auction Houses Viewed Mr. Baltser as the Principal Buyer section), July 29, 2020, available at <https://www.hsgac.senate.gov/imo/media/doc/2020-07-29%20PSI%20Staff%20Report%20-%20The%20Art%20Industry%20and%20U.S.%20Policies%20that%20Undermine%20Sanctions.pdf>.

⁶⁴ Art Dealers Association of America, “Code of Ethics and Professional Practices,” available at <https://artdealers.org/about/code-of-ethics-and-professional-practices>.

⁶⁵ Art advisors who provide intentionally incorrect valuations on works of art can be complicit in certain illicit tax issues, discussed later in this report.

customer's identity. This creates an uneven playing field for art-related loans and other financial services ripe for regulatory arbitrage, where illicit actors may target these firms to avoid providing information that more traditional lenders require as part of their comprehensive AML/CFT programs.

While it is a best practice in the art finance industry to conduct identity verification on the acquirer and assess illicit finance and credit risks, this is not universal. The CEO of one art finance firm publicly stated that his company is “solely focused on the value of luxury assets and collateralizing them at a certain percentage.”⁶⁶ This activity is a potential ML vulnerability as customers of these institutions can easily, quickly, and privately access the illicit funds placed into their art assets and layer transactions to hide the initial illicit source of the funds.

viii. Banks

Banks can have several links to the art market, including as facilitators of payments between customers and art market institutions and as advisors to clients seeking to buy art. Each of these activities poses unique ML risks.

First, as facilitators of payments between art market participants, banks have similar risks to ML and TF as in other areas of value transmission. While banks may not have complete visibility into the ultimate buyer, seller, or source of funds, they must maintain AML/CFT programs, abide by CDD obligations, and file SARs as appropriate. A review of financial institution reporting potentially related to the high-value art market showed that the overwhelming majority of such reports were filed by depository institutions, with additional filers including money service businesses, securities firms, casinos, and other financial services companies. Banks that regularly transmit payments for the art market have developed tailored policies, procedures, and tools to identify customers, conduct due diligence, and report suspicious activity. Furthermore, as these institutions have legal AML/CFT requirements, enforcement mechanisms already exist to address deficiencies identified by examiners or via criminal investigations (when there are potential criminal violations of AML/CFT laws or regulations). In Treasury's outreach for this Study, some banks noted that filing of SARs for art can be difficult, as there is no specific checkbox for art-related issues on the filing form. In March 2021, FinCEN issued a notice related to the trade in antiquities and art, which requested that financial institutions reference a specific code for activity pertaining to these markets.⁶⁷

Second, several large, multinational banks have been involved in the art market for decades as art advisors to HNWI, but this does not pose a significant ML risk. These HNWIs can range from business executives to art hobbyists, and even investors looking for a hedge on the market. In these cases, banks often have even more information on these clients than customer identification policies require. Banks can have intimate knowledge of HNWIs' financial and business dealings and access to additional contextual information. While some independent art advisors may make purchases on behalf of their clients, banks engaging in this type of advisory activity do not often conduct transactions on their clients' behalf. These factors make banks less susceptible to ML involving high-value art than other art market participants.

⁶⁶ Laurie Kahle, “20 Minutes With: Dewey Burke, Founder & CEO of Luxury Asset Capital,” *Barron's*, July 13, 2020, available at <https://www.barrons.com/articles/20-minutes-with-dewey-burke-founder-ceo-of-luxury-asset-capital-01594662638>.

⁶⁷ FinCEN Notice, “FinCEN Informs Financial Institutions of Efforts Related to Trade in Antiquities and Art,” March 9, 2021, available at https://www.fincen.gov/sites/default/files/2021-03/FinCEN%20Notice%20on%20Antiquities%20and%20Art_508C.pdf.

ix. Free-Trade Zones and Art Storage Facilities

In the United States, foreign-trade zones are secure areas under CBP supervision that are generally considered outside the U.S. customs territory.⁶⁸ Usually located in or near CBP ports of entry, they are the U.S. version of what are known internationally as free-trade zones (FTZs). FTZs may offer a variety of tax advantages to facilitate trade, as the goods stored in them can be technically labeled as items in transit. Some jurisdictions even provide tax advantages for storing goods in these locations. Generally, FTZs are not ordinarily obligated to collect or provide customer identification or ownership information to customs officials or other authorities, or to report suspicious activity. FTZs may have secure storage facilities where valuable commodities can be kept and which can be equipped with specialized hardware (e.g., climate-controlled rooms) to store luxury goods, such as high-value art.

Art storage facilities—often described as “freeports”—are not seen as export drivers but rather as areas to promote overall economic growth and facilitate international trade.⁶⁹ These art storage facilities, which exist in many countries including the United States, Switzerland, Luxembourg, the United Arab Emirates, and Singapore, are not solely located within FTZs. Some FTZs are split into several sections that can be designated as either customs areas or domestic storage areas. In the art market, art storage facilities have been identified as “black boxes,” where items can be stored anonymously and indefinitely. For example, in 2010 the Financial Action Task Force (FATF) analyzed these facilities and concluded that they can be vulnerable to trade-based and other ML through private transactions with high-value goods, such as art.⁷⁰ Critics of these businesses contend that private transactions can be conducted through art storage facilities without the parties reporting changes in ownership of stored art assets.⁷¹ Theoretically, this could allow value to be moved through the financial system with a transaction tied to art stored in a warehouse, for which ownership information is not available to authorities.

The ML vulnerabilities presented by art storage facilities holding high-value art exist in the United States. This is because, while goods held in art storage facilities could potentially be subject to compliance checks or investigation by customs authorities if those businesses maintain an FTZ area on premises, audits of U.S. foreign-trade zones, including art storage facilities on site, are rare and performed only as needed. Furthermore, art storage facilities that do not facilitate international trade may not be subject to inspection or information collection from customs authorities. Because goods held in these areas are not on their way to being imported or exported, U.S. customs authorities have limited jurisdiction over them, though they are subject to the laws and regulations of the United States as well as to those of the states and communities in which they are located. Therefore, goods held in art storage areas can be transferred between owners, and that transfer may not need to be reported to customs or other regulators.

Internationally, however, a combination of new legal requirements, voluntary practices, and customs information collection in certain jurisdictions has reduced the potential vulnerability of FTZs and art storage facilities to ML. If implemented, best practices and effective regulations for customs zones can

⁶⁸ U.S. Customs and Border Protection, “An Introduction to Foreign-Trade Zones,” March 2, 2020, available at <https://www.cbp.gov/border-security/ports-entry/cargo-security/cargo-control/foreign-trade-zones/about>.

⁶⁹ FATF, “Money Laundering Vulnerabilities of Free Trade Zones,” March 2010, available at <https://www.fatf-gafi.org/media/fatf/documents/reports/ML%20vulnerabilities%20of%20Free%20Trade%20Zones.pdf>.

⁷⁰ Id.

⁷¹ See, for example, Graham Bowley and Doreen Carvajal, “One of the World’s Greatest Art Collections Hides Behind This Fence,” *The New York Times*, May 28, 2016, available at <https://www.nytimes.com/2016/05/29/arts/design/one-of-the-worlds-greatest-art-collections-hides-behind-this-fence.html>.

serve as a barrier to this kind of ML activity for several reasons. First, customs authorities can collect information and maintain registries on the owner, country of origin, and eventual country of destination for the goods, as well as the value of goods and other transshipment data. Furthermore, customs authorities normally operate with the mandate to physically inspect any goods stored within a port or bonded facility to confirm customs data submitted by the importer or owner to verify records with information previously collected. Jurisdictions can also add extra protection by creating information-sharing mechanisms between customs actors and financial intelligence units or other competent authorities for countering ML and other illicit financial activity. Swiss facilities, for example, have traditionally been viewed as favorable locations to hide property because of insufficient regulation.⁷² However, U.S. prosecutors note that much of the formerly reported illicit financial activity in that jurisdiction has shifted to other jurisdictions. This shift comes amid several changes to the sector, including Swiss legal and regulatory implementations that have mitigated some of the potential ML vulnerabilities.

Nonetheless, because the risk that complicit professionals—e.g., art storage facility managers—can enable illicit actors to use these warehouses for illicit transactions is still significant, especially through ignoring best practices or intentionally misleading customs enforcement officials, customs authorities should maintain diligence over FTZs with art storage programs, customs warehouses, and art storage facilities. In the United States, and internationally, these risks can be heightened when warehouses are fully privately owned.

There are several legitimate reasons to hold high-value art in an FTZ like security of the art, tax purposes, insurance requirements, or the need for multiple parties to maintain access to a single asset—such as when the piece is used for collateral on a personal or business loan. FTZs around the world have come under increasingly strict customs laws, but some of the largest ones have not noticed a significant decrease in the number or size of clients. This evidence points to the possibility that art may be stored in FTZs to take advantage of the legal tax benefits rather than for the purpose of laundering proceeds of a crime. That said, art storage facilities are still vulnerable to abuse by money launderers in jurisdictions that have not adopted the above-mentioned best practices for operating these storage facilities.

V. Mechanisms to Launder Money Through Art

Several qualities inherent to art, the art market, and market participants may make the market attractive to illicit actors for ML. Specifically, the high-dollar values of single transactions, the ease of transportability of works of art, the long-standing culture of privacy in the market including private sales and transactions where prices are subjective or can be manipulated, and the increasing use of art as an investment or financial asset all contribute to the ML vulnerabilities of art.⁷³ While some art dealers and auction houses collect tax compliance information and have voluntary practices for transparency, there

⁷² See, for example, Silke Koltowitz, Paul Arnold, “Freeports boom highlights risks of shady activities,” Reuters, September 22, 2016, available at <https://www.reuters.com/article/us-swiss-freeports/freeports-boom-highlights-risks-of-shady-activities-idUSKCN11S1OL>.

⁷³ The Antiquities Coalition, “Reframing U.S. Policy on the Art Market,” September 2020, available at <https://mk0antiquitiesc6hkg1.kinstacdn.com/wp-content/uploads/2020/09/FCTF-Report.pdf>. See also Adriano Picinati di Torcello, “Why Should Art Be Considered an Asset Class?” Deloitte, n.d., available at <https://www2.deloitte.com/lu/en/pages/art-finance/articles/art-as-investment.html>.

are no comprehensive AML/CFT requirements for most U.S. participants in the art market and no legal obligation that these participants detect, investigate, and report suspicious sales or transfers.⁷⁴

i. Use of High-Value Art as a Conduit for Money Laundering

Characteristics of High-Value Art That Make It Susceptible to ML

High-value art can be bought and sold publicly and privately, and both types of sales can provide mechanisms for criminals to participate anonymously in transactions. This lack of transparency can make it difficult to monitor ownership or transactions, allowing art to become an “invisible asset” in that it is not held by a financial institution, and the related transactions are not recorded. In transactions facilitated by auction houses or galleries, it is not unusual for the seller, buyer, or both to be listed as a “private collection” and not disclosed to the other party or to potential intermediaries. Complex ownership structures, such as the use of shell companies or third-party art dealers and advisors to purchase, hold, or sell specific pieces of art and to accept and remit payment, can provide additional layers of anonymity in a private transaction. Shell companies can be used as financial conduits for the transfer and holding of funds and assets, allowing the ultimate natural person owner(s) to avoid giving their names to dealers who may screen for sanctions risk or alert law enforcement to the parties behind the transactions. In other cases, the ultimate natural person owner(s) behind a transaction may act through an agent, who may or may not inform a seller or purchaser he or she is acting on behalf of someone else. This provides another way for parties to buy and sell anonymously without the disclosure of any information on the parties involved or the source of funds to those arranging the transaction.

Whether purchased through the public market or in a private transaction, high-value art is highly mobile, making it an ideal way to transfer value internationally. While art can vary in size, some pieces of high-value art can be easily transported in vehicles or private jets. Even when art is inspected at the border, customs officials may not question the value marked on the shipping invoice. Domestic and international law enforcement officials often do not have expertise or training in identifying high-value works of art, which can allow items to evade closer inspection.

Because the value of art is subjective, prices for an individual piece of art can be raised or lowered at will. By using straw bids through shell companies or other third-party entities, potential money launderers can manipulatively bid up or down the price of a work, and then easily hide the exchange of illegitimate funds. The subjectivity of prices also allows for the manipulation of value to affect the tax burden for those who donate the asset for tax purposes. Even if a high-value work of art loses value, it can still be sold at a loss for money not connected to the original illicit proceeds.

Cross-border value transfer can also be achieved using FTZs and art storage facilities when these institutions are abused or best practices are not followed. Conceptually, once a work of art is placed in an art storage facility or other FTZ, the owner of the work can conduct financial transactions outside of the zone, using the transfer of asset ownership as the other side of the transaction, unbeknownst to law enforcement or anyone except the transaction parties and potentially the manager of the art storage

⁷⁴ All U.S. businesses must file a Form 8300 when receiving \$10,000 or more in cash for one transaction or two or more related transactions, as mentioned above. Although best practices in the industry are to maintain voluntary know-your-customer practices, these are not legally required programs. Furthermore, some regulatory obligations do exist for some art market participants, such as banks that participate in the market.

facility. This mechanism could be used to effectively move value across borders without even the transportation of a physical asset. Ownership of items held in these zones can be transferred between two transacting parties in coordination with a value transfer in another jurisdiction, allowing for the laundering of illicit funds outside of the art storage facility through the transfer and maintenance of the art asset in storage.

Cash Purchases of High-Value Art

There is also the possibility of an all-cash purchase of high-value art, which illicit actors could use to launder funds and hide cash proceeds of crime. While this method could allow for additional anonymity, as it would be difficult to trace the source of funds from a cash purchase, generally most art market institutions conducting high-value sales will not accept cash in excess of \$10,000 on an annual basis from a single customer, and industry insiders note that accepting cash over this threshold is rare. According to Treasury outreach, large cash purchases of art at galleries, auction houses, and art fairs were historically common in past decades. However, such purchase structures for high-value art have become extremely rare for several reasons, such as reputational issues, increasingly negative news coverage, and public scrutiny of art market institutions. Most sellers and intermediaries have incentives outside of illicit finance risk to not accept cash payment, such as to ensure payment in full and to protect their reputations from damage, which could hurt future business since cash purchases have been increasingly stigmatized in media coverage of the market. Furthermore, in the case of cash transactions over \$10,000, U.S. persons engaged in a trade or business are required to file a Form 8300. The infrequent use of cash in the market and preexisting reporting requirements would make it difficult to launder a large sum of cash through the purchase of high-value art.

The Use of Shell Companies in the High-Value Art Market

This Study finds that legal entities are used in the art market for a variety of legitimate purposes, including preventing the public disclosure of an owner, which could subject the owner to theft, or protecting the public reputation of buyers or sellers in times of financial hardship. It is important to note that institutions such as galleries and auction houses have market incentives to collect information on the ultimate sellers or buyers of works of art regardless of identifying potential illicit finance tied to a transaction, and best practices enacted by most players in the industry are to collect information on all buyers and sellers.

That said, shell companies have been used by illicit actors, and complicit professionals, to purchase art. For example, Arkady and Boris Rotenberg are Russian oligarchs who were sanctioned by Treasury's OFAC for acting on behalf of, or materially assisting, a senior official of the government of the Russian Federation.⁷⁵ The Rotenbergs were able to access the U.S. financial system and the art market after their OFAC designation by using shell companies to hide their ultimate ownership of art. In 2014, the brothers purchased tens of millions of dollars' worth of art from major auction houses and other art market participants after they were designated by OFAC.⁷⁶ Reports suggest that at least some professional staff

⁷⁵ U.S. Department of the Treasury, Press Release, "Treasury Sanctions Russian Officials, Members Of The Russian Leadership's Inner Circle, And An Entity For Involvement In The Situation In Ukraine," March 20, 2014, available at <https://www.treasury.gov/press-center/press-releases/pages/jl23331.aspx>.

⁷⁶ Permanent Subcommittee on Investigations, United States Senate, "The Art Industry and U.S. Policies That Undermine Sanctions," p. 7, July 29, 2020, available at <https://www.hsgac.senate.gov/imo/media/doc/2020-07-29%20PSI%20Staff%20Report%20-%20The%20Art%20Industry%20and%20U.S.%20Policies%20that%20Undermine%20Sanctions.pdf>. This

within the auction house were aware of the identities of the ultimate natural persons who purchased the art.⁷⁷

In these circumstances, the initial vehicle for moving the illicit funds into the system was the shell company, not the work of art itself. It is the ability to hold and purchase assets anonymously through these companies that is being exploited by illicit actors, and this mechanism is not something unique to the high-value art market. It could involve many other high-value goods, such as real estate, private jets, or yachts. Once illicit funds have been placed into the financial system or the art market, the art market can be used to further disguise the original source of the illicit funds—effectively laundering the proceeds. The ongoing rulemaking process to implement the beneficial ownership information reporting requirements set out in the Corporate Transparency Act, passed as part of the FY2021 NDAA,⁷⁸ will help address, to some extent, the use of shell companies for added privacy in the art market. That said, there will likely still be vulnerabilities that need to be addressed following the implementation of those rules.

ii. Examples of Money Laundering Through the High-Value Art Market

a. Art as a Medium of Exchange or Value Transfer

The acceptance of art as payment is a way to integrate illicitly generated or acquired funds into the financial system.

For example, from 2011 to 2015, Nigerian businessmen Kolawole Akanni Aluko and Olajide Omokore allegedly conspired with others to pay bribes to Nigeria’s former Minister for Petroleum Resources, Diezani Alison-Madueke, who oversaw Nigeria’s state-owned oil company.⁷⁹ In return for these improper benefits, Alison-Madueke allegedly used her influence to steer lucrative oil contracts to companies owned by Aluko and Omokore. The complaint alleges that the proceeds of those illicitly awarded contracts were then laundered in and through the U.S. financial system and were used to purchase various assets subject to seizure and forfeiture. According to the allegations, the businessmen conspired to purchase millions of dollars in real estate for Alison-Madueke and her family members, then renovated and furnished these homes with millions of dollars in furniture, high-value art, and other luxury items purchased at two Houston-area furniture stores at Alison-Madueke’s direction.⁸⁰

report includes extensive detail on transactions between 2014 and 2018 involving art that were linked to the Rotenbergs.

⁷⁷ Id., pp. 81 – 84 (The Auction Houses Viewed Mr. Baltser as the Principal Buyer).

⁷⁸ The Corporate Transparency Act (CTA) is Title LXIV of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Public Law 116–283 (January 1, 2021) (NDAA). Division F of the NDAA is the Anti-Money Laundering Act of 2020, which includes the CTA. Section 6403 of the CTA, among other things, amends the Bank Secrecy Act (BSA) by adding a new Section 5336, Beneficial Ownership Information Reporting Requirements, to Subchapter II of Chapter 53 of Title 31, United States Code.

⁷⁹ U.S. DOJ, Press Release, “Department of Justice Seeks to Recover Over \$100 Million Obtained From Corruption in the Nigerian Oil Industry,” July 14, 2017, available at <https://www.justice.gov/opa/pr/departments-justice-seeks-recover-over-100-million-obtained-corruption-nigerian-oil-industry>.

⁸⁰ Id.

1Malaysia Development Berhad (1MDB) is a Malaysian state-owned and -controlled fund created to pursue investment and development projects for the economic benefit of Malaysia and its people. According to the U.S. Department of Justice (DOJ) and as alleged in court filings, between approximately 2009 and 2014, as 1MDB raised money to fund its projects, billions of dollars were misappropriated and fraudulently diverted from 1MDB, including funds 1MDB raised in 2012 and 2013 through three bond transactions that it executed with a financial institution.⁸¹ As alleged in court filings, Low Taek Jho (aka “Jho Low”) and others conspired to launder the proceeds of their criminal conduct through the U.S. financial system. According to court documents, a co-conspirator purchased tens of millions of dollars of high-value art through a shell company, which held illicit proceeds from the scheme and “gifted” some of the works to Low and other co-conspirators as a mechanism to transfer value. These “gifts” of art purchased by the shell company were memorialized in several “gift letters” that referenced a different work or works being transferred in consideration for “friendship...charitable contribution to the world, and passion in promoting the understanding and appreciation of art works.”⁸²

In 2011, Rocco DeSimone was sentenced to 192 months in U.S. federal prison for bilking numerous investors from around the United States out of more than \$6 million in cash and property by making false representations regarding the sale or marketing of three inventions. He used the funds to purchase numerous luxury goods, including high-value art. He also used the names of well-known companies to incentivize outside investments in the alleged inventions and accepted high-value artwork as investment collateral and payment from outside investors.⁸³

b. Art Used to Hide Illicit Proceeds

The increasing use of high-value artwork as a financial asset, its use as a store of value, and the subjectivity of the prices of these works can allow criminal actors to purchase one or several works of art and hold them for years without attracting suspicion, before eventually selling off the works to realize gains. Although a slow method for layering funds, this can serve as an effective way to hold value derived from crimes. This type of slow laundering through the art market is especially prevalent for parking funds illicitly acquired through various fraud schemes, as the funds are already easily accessible in the financial system and criminals simply need to move them into art assets, which are harder to discover and confiscate. The examples below demonstrate this laundering typology.

As part of the 1MDB scheme, Jho Low and others allegedly conspired to launder the proceeds of their criminal conduct through the U.S. financial system by purchasing, among other things, luxury residential real estate in New York City and elsewhere and high-value art from a New York-based auction house

⁸¹ U.S. DOJ, Press Release, “Malaysian Financier Low Taek Jho, Also Known As ‘Jho Low,’ and Former Banker Ng Chong Hwa, Also Known As ‘Roger Ng,’ Indicted for Conspiring to Launder Billions of Dollars in Illegal Proceeds and to Pay Hundreds of Millions of Dollars in Bribes,” November 1, 2018, available at <https://www.justice.gov/opa/pr/malaysian-financier-low-taek-jho-also-known-jho-low-and-former-banker-ng-chong-hwa-also-known>.

⁸² U.S. DOJ, Criminal Complaint, “Verified Complaint for Forfeiture *In Rem*,” No. CV 17-4438, June 16, 2017, available at <https://www.justice.gov/opa/press-release/file/973671/download>.

⁸³ U.S. DOJ, Press Release, “Rhode Island ‘Career Con Man’ Sentenced to 16 Years in Federal Prison; Recovered Assets to be Used to Compensate Victims,” July 21, 2011, available at <https://archives.fbi.gov/archives/boston/press-releases/2011/rhode-island-career-con-man-sentenced-to-16-years-in-federal-prison-recovered-assets-to-be-used-to-compensate-victims>.

and by funding major Hollywood films.⁸⁴ Beginning in 2016, a landmark effort encompassing 41 civil forfeiture actions filed in the U.S. District Court for the Central District of California and one in the U.S. District Court for the District of Columbia by the Money Laundering and Asset Recovery Section of DOJ Criminal Division led to the seizure of over \$1.7 billion in stolen assets.⁸⁵ In 2019, the DOJ reached a settlement of its civil forfeiture cases against assets acquired by Jho Low and his family.⁸⁶

In 2021, a Texas man was sentenced to 87 months of imprisonment for a scheme to embezzle millions of dollars from a company headquartered in Austin where his ex-wife served as Chief Financial Officer. According to DOJ, in 2009, Tamra Maurine Villarreal (aka Tamra Creighton Villarreal) and Scott Villarreal began stealing money from the company and using it for their personal benefit.⁸⁷ The Villarreals used the stolen money to purchase a \$2.7 million residence and to pay for travel, hotels, restaurant tabs, vehicles, jewelry, rare American coins from the 1800s, gold bars, high-value art, a collection of designer handbags and clothes valued at hundreds of thousands of dollars, and firearms and illegal controlled substances. Tamra Villarreal was sentenced to 63 months imprisonment for her role in the same scheme in 2020.⁸⁸

In 2016, Philip J. Rivkin was sentenced to 121 months in prison and ordered to pay more than \$87 million in restitution and forfeit \$51 million for generating and selling fraudulent biodiesel credits in the federal renewable fuel program.⁸⁹ Related to the case, the United States filed a civil asset forfeiture complaint in 2013 seeking a collection of art containing more than 2,200 pieces and valued at more than \$15 million. The complaint alleged that the art—bought with money from the sale of fraudulent credits for renewable fuel—was transported in interstate commerce knowing that it was the proceeds of fraud and was utilized in laundering the proceeds of fraud.⁹⁰

In January 2015, Ronald Belciano was sentenced to 63 months in prison and four years supervised release after pleading guilty to conspiracy to distribute 100 kilograms of marijuana in and through central Pennsylvania and conspiracy to commit ML between December 2007 and November 2011.⁹¹

⁸⁴ U.S. DOJ, Press Release, “Malaysian Financier Low Taek Jho, Also Known As ‘Jho Low,’ and Former Banker Ng Chong Hwa, Also Known As ‘Roger Ng,’ Indicted for Conspiring to Launder Billions of Dollars in Illegal Proceeds and to Pay Hundreds of Millions of Dollars in Bribes,” November 1, 2018, available at <https://www.justice.gov/opa/pr/malaysian-financier-low-taek-jho-also-known-jho-low-and-former-banker-ng-chong-hwa-also-known>. See also, U.S. DOJ, Criminal Complaint, “Verified Complaint for Forfeiture *In Rem*,” No. CV 17-4438, June 16, 2017, available at <https://www.justice.gov/opa/press-release/file/973671/download>.

⁸⁵ U.S. DOJ, Press Release, “Over \$1 Billion in Misappropriated 1MDB Funds Now Repatriated to Malaysia,” August 5, 2021, available at <https://www.justice.gov/opa/pr/over-1-billion-misappropriated-1mdb-funds-now-repatriated-malaysia>.

⁸⁶ U.S. DOJ, Press Release, “United States Reaches Settlement to Recover More Than \$700 Million in Assets Allegedly Traceable to Corruption Involving Malaysian Sovereign Wealth Fund,” October 30, 2019, available at <https://www.justice.gov/opa/pr/united-states-reaches-settlement-recover-more-700-million-assets-allegedly-traceable>.

⁸⁷ U.S. DOJ, Press Release, “Former Austin Company CFO’s Ex-Husband Headed to Federal Prison and Ordered to Pay Over \$20M in Restitution for Embezzlement Scheme,” April 28, 2021, available at <https://www.justice.gov/usao-wdtx/pr/former-austin-company-cfo-s-ex-husband-headed-federal-prison-and-ordered-pay-over-20m>.

⁸⁸ Id.

⁸⁹ U.S. DOJ, Press Release, “Houston Man Sentenced to More Than 10 Years in Prison for Biodiesel Fraud Scheme,” March 7, 2016, available at <https://www.justice.gov/opa/pr/houston-man-sentenced-more-10-years-prison-biodiesel-fraud-scheme>.

⁹⁰ U.S. DOJ, Press Release, “Forfeiture Of More Than \$15M Worth Of Artwork Sought By U.S. Attorney’s Office,” March 1, 2013, available at <https://www.justice.gov/usao-nj/pr/forfeiture-more-15m-worth-artwork-sought-us-attorney-s-office>.

⁹¹ U.S. DOJ, Press Release, “Pennsylvania Man Sentenced To Sixty-three Months In Federal Prison For Drug Distribution And Conspiracy To Commit Money Laundering,” January 20, 2015, available at <https://www.justice.gov/usao-mdpa/pr/pennsylvania-man-sentenced-sixty-three-months-federal-prison-drug-distribution-and>.

Fifty-nine paintings, valued at over \$600,000 and purchased with proceeds of the illegal activity were found in a storage locker and at a co-conspirator's farm in Douglassville, Pennsylvania, and forfeited to U.S. authorities.⁹² In a related case, Philadelphia art dealer Nathan Isen, a gallerist who sold the art to Belciano, pleaded guilty to a charge of ML, and received three years of probation and a \$15,000 fine following a sting operation conducted by the U.S. Department of Homeland Security. The operation entailed an undercover agent posing as a drug dealer entering Isen's gallery with cash to purchase art. Isen was apprised that the cash was generated through illicit means, and he offered to keep the purchaser's name off invoices.⁹³

In 2009, Mark Bloom pleaded guilty to investment fraud charges related to a \$30 million investment partnership that he managed. Instead of using pledged money for investments, he misappropriated at least \$20 million from the partnership, which he used for personal expenditures including the purchase of high-value art.⁹⁴

c. Art Used as Collateral to Obscure Illicit Proceeds

Asset-based lending can be used to disguise the original source of funds. A work of art purchased with illicit proceeds already placed in the financial system, for example, can be used as collateral to receive a direct loan into a bank account with a financial institution for the benefit of the criminal. As far as that financial institution is concerned, this is a legitimate, non-suspicious transaction; the criminal would thus be free to spend the money, effectively unlocking the illicit proceeds from the artwork.

For example, in the 1MDB case, launderers purchased numerous high-value-works of art from an auction house. Later, a Cayman Island company controlled by Low obtained a loan of \$107 million from the asset-based lending services of a U.S.-based auction house's financial services affiliate, using several of the paintings purchased as collateral.⁹⁵ The loan was disbursed from the auction house's financial services firm to a Cayman Island bank account held in the name of a shell company controlled by Low.⁹⁶ Thus, art monetizing services can enable money launderers, as well as legitimate buyers, to access the value of a work and integrate illicit funds – perhaps unknowingly, in the case of legitimate buyers – into the financial system.

VI. *Emerging Digital Art Market*

The emerging digital art space constitutes a separate marketplace and represents something quite new.

Technological innovations in the digital art space also present potential ML challenges. NFTs are digital units, or tokens, on an underlying blockchain that represent ownership of images, videos, audio files, and other forms of media or ownership of physical or digital property. They are bearer instruments that codify the ownership of a unique digital asset, such as a piece of high-value digital art and are managed

⁹² Id.

⁹³ U.S. DOJ, Charging Document, “United States of America v. Nathan Isen,” available at <https://www.justice.gov/file/196151/download>.

⁹⁴ U.S. DOJ, Press Release, “Former BDO Seidman Partner Pleads Guilty to Investment Fraud and Tax Shelter Charges,” July 30, 2009, available at <https://archives.fbi.gov/archives/newyork/press-releases/2009/nyfo073009.htm>

⁹⁵ U.S. District Court for the Central District of California, “Verified Complaint For Forfeiture *In Rem*,” No. CV 17-4438, June 15, 2017, available at <https://www.justice.gov/opa/press-release/file/973671/download>.

⁹⁶ Id.

(e.g., minted, held, transferred, and destroyed) via smart contracts and digital wallets. The exchange of an NFT transfers that ownership between digital wallets or smart contracts, and because they are blockchain-based, NFTs are publicly verifiable, auditable, and digitally unique due to being derived cryptographically. Art market participants can purchase digital art through several avenues, but compared to virtual assets such as bitcoin, NFTs do not have a fluctuating exchange rate as they are considered provably unique digital assets. Instead, an NFT's transactional value is dependent on a single exchange between a buyer and a seller, and the value fluctuates subjectively. Recent sales of high-profile pieces of physical and digital art involving NFTs, including NFT-authenticated works such as Beeple's *Everydays: The First 5000 Days*, which sold at a Christie's auction for more than \$69 million, indicate that this nascent art sector has reached similar valuations as traditional art mediums.⁹⁷ According to U.S. authorities, in the first three months of 2021, the market for NFTs generated a record \$1.5 billion in trading and grew 2,627 percent over the previous quarter. Nonetheless, this was only a fraction of the market when compared to the total U.S. share of the art market in 2020, which was valued at more than \$20 billion.

Auction houses and other art dealers are increasingly offering NFTs in the primary market and could expand to selling these pieces in the secondary market as well. NFT platforms such as Dapper Labs, SuperRare, and OpenSea already allow owners of digital art to sell the assets on virtual exchanges. Depending on the nature and characteristics of the NFTs offered, these platforms may be considered virtual asset service providers (VASP) by FATF and may come under FinCEN's regulations.⁹⁸ Digital assets that are unique, rather than interchangeable, and that are used in practice as collectibles rather than as payment or investment instruments, depending on their characteristics, are generally not considered to be virtual assets under the FATF definition.⁹⁹ NFTs or other digital assets, however, that are used for payment or investment purposes in practice may fall under the virtual asset definition, and service providers of these NFTs could meet the FATF definition of a VASP. In this context, some NFT platforms may qualify as VASPs, depending on the characteristics of the NFTs that they offer. Similarly, platforms or other persons doing business transferring virtual assets during the buying or selling of NFTs may have U.S. AML/CFT obligations under FinCEN's rules for money service businesses if they are doing business in the United States.¹⁰⁰ To understand the application of AML/CFT obligations, it is important to consider the nature of the business dealing in NFTs and their function in practice as well as the facts and circumstances of the platform or other person doing business.

⁹⁷ Christie's, Press Release, "Beeple's opus," available at <https://www.christies.com/features/Monumental-collage-by-Beeple-is-first-purely-digital-artwork-NFT-to-come-to-auction-11510-7.aspx>.

⁹⁸ In its glossary, FATF defines VASP as any natural or legal person that operates as a business and conducts one or more of the following activities or operations for or on behalf of another natural or legal person: (1) exchange between virtual assets and fiat currencies; (2) exchange between one or more forms of virtual assets; (3) transfer of virtual assets; (4) safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets; and (5) participation in and provision of financial services related to an issuer's offer and/or sale of a virtual asset. See also FATF, "Updated Guidance: A Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers," October 2021, available at <https://www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-rba-virtual-assets-2021.html>.

⁹⁹ In its glossary, the FATF defines virtual asset as a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes. Virtual assets do not include digital representations of fiat currencies, securities, and other financial assets that are already covered elsewhere in the FATF Recommendations.

¹⁰⁰ FinCEN's regulation does not limit or qualify the scope of the term "value that substitutes for currency." It can be created either (a) specifically for the purpose of being used as a currency substitute or (b) originally for another purpose but then repurposed to be used as a currency substitute by an administrator (in centralized payment systems) or an unincorporated organization, such as a software agency (in decentralized payment systems).

Furthermore, NFTs can be used to conduct self-laundering, where criminals may purchase an NFT with illicit funds and proceed to transact with themselves to create records of sales on the blockchain. The NFT could then be sold to an unwitting individual who would compensate the criminal with clean funds not tied to a prior crime. It is also possible to have direct peer-to-peer transactions of NFT-secured digital art without the involvement of an intermediary, and these transactions may or may not be recorded on a public ledger. These digital art assets are inherently easier to transfer between transacting parties than traditional art because, in most cases, the parties do not need to physically move the art or pay for shipping services such as insurance, transport, or customs duties, although users may incur transaction fees. The ability to transfer some NFTs via the internet without concern for geographic distance and across borders nearly instantaneously makes digital art susceptible to exploitation by those seeking to launder illicit proceeds of crime, because the movement of value can be accomplished without incurring potential financial, regulatory, or investigative costs of physical shipment.

The characteristics of digital art are not the only reasons that this submarket is vulnerable to ML: the structure of transactions in the market can be different from the traditional art market as well, and these structural differences can create perverse incentives and ML vulnerabilities in the marketplace. NFT platforms range in structure, ownership, and operation, and no single platform operates the same way or has the same standards or due diligence protocols. While gallerists have an incentive to increase awareness about artists they represent, and to protect the reputation of the gallery, sellers of digital art do not necessarily have the same incentives. Smart contracts, which are digital protocols executed on a blockchain network, can be used to create or mint NFTs and can govern their ownership and transferability properties. Smart contracts can be used to generate revenue each time a transaction involving the NFT is recorded on a blockchain (for example, artists who are paid a royalty each time their work is sold). These types of contracts can create an incentive to shape a marketplace where the work is traded repeatedly in a short period. While this can ensure that artists are compensated for their work past the first sale, the activity can pose ML vulnerabilities because the incentive to transact can potentially be higher than the incentive to verify the identity of the buyer of the work, or even can create a situation where it is not possible to conduct due diligence if transactions are conducted in rapid succession. Moreover, traditional industry participants, such as art auction houses or galleries, may not have the technical understanding of distributed ledger technology required to practice effective customer identification and verification in this space.

VII. Terrorist Financing and Art: Pre-U.S. Market Activity

In December 2019, OFAC took action against two prominent Lebanon- and Democratic Republic of the Congo (DRC)-based money launderers and their affiliated companies, including those that have generated tens of millions of dollars for Hizballah, its financiers, and their malign activities.¹⁰¹ The action targeted Lebanon-based Nazem Said Ahmad, who provided financial support to Lebanese Hizballah. Ahmad, one of Hizballah's top donors, maintains a vast art collection, worth tens of millions of dollars, and many of the pieces have been on display in his gallery and penthouse in Beirut, Lebanon. Ahmad stores some of his personal funds in high-value art in a preemptive attempt to mitigate the effects of U.S. sanctions, and he opened an art gallery in Beirut that has allegedly been used as a front to launder money.¹⁰²

¹⁰¹ U.S. Department of the Treasury, Press Release, "Treasury Designates Prominent Lebanon and DRC-Based Hizballah Money Launderers," December 13, 2019, available at <https://home.treasury.gov/news/press-releases/sm856>.

¹⁰² Id.

Despite this example, there is limited evidence of a nexus between TF and high-value art; this is likely due, at least in part, to a disconnect between the high-value art market and the physical geographies where terrorist groups are most active. The Ahmad designation is one of only a handful of known cases involving the nexus of TF and high-value art and is itself noteworthy because of how unusual it is. High-value art does not usually originate from areas controlled by terrorist organizations or where terrorist groups are active, and the trade and financing of these items is not generally based near these locations. These areas tend to be conflict zones where the sale or transfer of high-value art can be quite risky for the buyer, seller, and dealer. Further, there are likely easier, quicker, and less risky ways for terrorist actors and financiers to move money than through the art market, given its distance from their held territory and the relatively longer time it takes to conduct transactions in the art market. Due to the lack of evidence that high-value art has been used to fund terrorist activities and the clear structural difficulties doing so, Treasury assesses that, at this time, TF is an area of lower risk in the high-value art market.

VIII. Utility in Tax Matters

The IRS Commissioner's Art Advisory Panel provides advice and makes recommendations to the Art Appraisal Services (AAS) unit. The Panel assists by providing value recommendations regarding the acceptability of tangible personal property appraisals taxpayers submit to support the fair market value (FMV) claimed on the wide range of works of art involved in income, estate, and gift tax returns in accordance with the Internal Revenue Code.¹⁰³ When a tax return selected for audit includes an appraisal of a single work of art or cultural property valued at \$50,000 or more, the IRS examining agent or appeals officer must refer the case to AAS for possible referral to the Panel.¹⁰⁴ With respect to the IRS and tax administration, high-value art is encountered in a limited number of circumstances. In civil tax administration, the purported valuation of artwork is a factor in the following circumstances:

When a taxpayer claims a charitable deduction for the FMV of art donated to a charity or other tax-exempt entity. The higher the donated art's FMV, the larger the potential tax deduction, which serves to reduce the taxpayer's taxable income and the resultant tax liability. If overvalued, art donations could unlawfully reduce the taxpayer's taxable income and tax liability.

The IRS requires taxpayers to prove their acquisition and maintenance costs for all investments and assets, including pieces of art. When those art assets are sold, the resulting proceeds amount is reduced by the taxpayer's costs sunk in the asset to arrive at the amount of net earned income from the sale, on which the tax will be calculated. The higher the acquisition and maintenance costs, the lower the taxable value of the disposed-of asset and, therefore, the lower the tax liability. In the context of the sale of art, sales tax benefits can be obtained through overvaluing these costs.

Criminal enforcement of tax administration laws usually involves non-reporting or under-reporting of income on the taxpayer's tax return, and the unreported income may be used to purchase high-value art, as both a means of concealment and future appreciation. In schemes to defraud the IRS by means of fraudulent expenses or deductions, the art is typically purposefully overvalued to improperly maximize the deduction. In this context, additional reporting from due diligence programs may be beneficial to tax professionals seeking to mitigate the ability of individuals and entities to criminally abuse the tax

¹⁰³ U.S. Internal Revenue Service, "Art Appraisal Services," November 3, 2021, available at <https://www.irs.gov/appeals/art-appraisal-services>.

¹⁰⁴ Id.

code. In the case of tax-exempt organizations, overvaluation of art, if reported as an inflated income figure on the Form 990, could give the appearance the tax-exempt organization is wealthier than it really is. This can allow a higher amount of expenses to be claimed and not questioned given the size of the organization. In this context, additional documentation such as the ownership history of works of art would have benefits in tax matters related to the assessment of art value.

In 2009, a former UBS banker was sentenced to 40 months in prison after pleading guilty to conspiring to defraud the United States.¹⁰⁵ According to DOJ and statements made in court, the former UBS banker assisted an American billionaire real estate developer evade paying \$7.2 million in taxes by assisting the developer to conceal \$200 million of assets hidden offshore in Switzerland and Liechtenstein.¹⁰⁶ While at UBS, the banker routinely traveled to, and had contacts within, the United States in an effort to assist wealthy Americans conceal their money in assets including high-value art held offshore and therefore evade the payment of taxes on the income generated on the money hidden offshore.¹⁰⁷

IX. Complicit Professionals

As is the case in other financial sectors, criminals can seek out complicit merchants, professionals, and financial services employees in the art market to ignore policies and best practices that have been identified in this Study to help effectuate their ML and illicit finance schemes.¹⁰⁸ For example, complicit FTZ managers could aid criminals in falsifying customs documents to cover up the true ownership of an art asset held in an FTZ. Auction house or gallery staff, to reap financial benefit, could ignore signs that customers may have acquired art or the funds to purchase art through criminal activities. Museums and art valuation advisors or specialists could help illicit financial actors abuse art valuations to illegally claim tax benefits to which they are not legitimately entitled. Firms providing art finance could neglect to collect customer identity information and lend large amounts of clean funds collateralized by a valuable work of art initially purchased with illicit proceeds. Interior designers could acquire works on behalf of an undisclosed client and accept payment for works without conducting due diligence. These kinds of activities may not be considered unusual by counterparties to the transactions due to the historical culture of anonymity in the art market.

Law enforcement continues to focus on complicit actors who abuse their professional positions to aid criminals (as well as themselves), through cases involving prosecutions of actors facilitating these types of crimes. However, because a significant portion of ML in the art market is likely conducted with the help of these complicit professionals, applying AML/CFT requirements to art market participants would provide competent authorities additional information and pathways to address these ML vulnerabilities. For example, Gregory Baltser, who served as an “art advisor” to the Rotenberg’s, actively worked to hide the brothers link to purchased art at large international auction houses.¹⁰⁹

¹⁰⁵ U.S. DOJ, Press Release, August 21, 2009, available at <https://www.justice.gov/opa/pr/former-ubs-banker-sentenced-40-months-aiding-billionaire-american-evade-taxes>.

¹⁰⁶ Id.

¹⁰⁷ Id.

¹⁰⁸ U.S. 2018 National Money Laundering Risk Assessment, “Complicit Merchants, Professionals, and Financial Services Employees,” 2018, available at https://home.treasury.gov/system/files/136/2018NMLRA_12-18.pdf.

¹⁰⁹ Permanent Subcommittee on Investigations, United States Senate, “The Art Industry and U.S. Policies That Undermine Sanctions,” p. 7, July 29, 2020, available at <https://www.hsgac.senate.gov/imo/media/doc/2020-07-29%20PSI%20Staff%20Report%20-%20The%20Art%20Industry%20and%20U.S.%20Policies%20that%20Undermine%20Sanctions.pdf>.

X. Potential Regulatory Considerations and Other Recommendations

As this Study has shown, the high-value art market is susceptible to abuse by illicit financial actors. To address this problem, Treasury should consider several nonregulatory and regulatory options. Nonregulatory options include (1) encouraging the creation and enhancement of private sector information-sharing programs to foster transparency among art market participants and (2) updating guidance and training for law enforcement, customs enforcement, and asset recovery agencies. Regulatory options include (1) using FinCEN recordkeeping authorities to support information collection and enhanced due diligence and (2) bringing certain art market participants under the AML/CFT legal framework and obligating them to create and maintain AML/CFT programs.

Enhanced Private Sector Information Sharing

During Treasury outreach, many art market participants noted that the due diligence process for onboarding clients often involves engagement with other peers in the art market to determine if the prospective client is suspicious or disreputable. A more standardized process could facilitate information-sharing requests among private sector entities and potentially allow law enforcement access to such information during investigations. An information-sharing mechanism could also serve a second function of allowing galleries, auction houses, and other art market institutions to have more visibility into first-time clients and to know if the customer has interacted with other facets of the art market. For example, the use of a single database with third-party identity services to protect and verify the identity of buyers and sellers in the market could provide helpful information to both intermediaries and law enforcement agencies. This type of registry would allow smaller players in the market to better assess their customers for potential risks without putting an insurmountable burden on entities with fewer resources and could solve additional non-illicit finance inefficiencies inherent to the art market. Whatever information-sharing mechanism is used, it would need to account for privacy requirements and address the potentially significant liability concerns of art industry participants if they do not benefit from a safe harbor provision to protect information sharing between institutions.

Furthermore, market participants also noted over the course of the Study that no formal process existed for them to make information available to law enforcement when they identified irregular or potentially suspicious activity. Information-sharing mechanisms among private sector art market participants and federal regulators and law enforcement agencies could provide a robust solution to this issue. For example, FinCEN could consider proactive outreach to share typologies or information on ML specific to the art market. This could also include outreach to market participants to make them aware of the reporting tools available to them. Private sector art market participants could make voluntary SAR filings, and conduct exchanges with law enforcement agencies to share information.

Updates to Law Enforcement and Asset Forfeiture Guidance

Law enforcement agencies could increase the focus on financial crimes involving the high-value art market in their existing law enforcement training, consistent with their own internal training priorities. Trainings could incorporate experts in the nexus of financial crimes and the art market to identify the unique risks and opportunities presented to criminals by the art market. This could include a written toolkit and specific methodology with strategies for investigating ML in this sector.

FinCEN's Use of Targeted Recordkeeping and Reporting Requirements

FinCEN could consider the use of recordkeeping and reporting requirements to seek more detailed information about what activity is occurring in the institutional high-value art market and to disincentivize criminals from attempting to launder illicit funds through the legitimate, institutional art market. For example, it could apply targeted reporting requirements to art market segments presenting heightened risk, such as certain geographic area markets or transaction thresholds, to gather additional information in those markets. Through these requirements, FinCEN could require certain covered businesses to provide information such as the identity of natural persons that are purchasing art without an intermediary; the natural persons behind, and nominees who control, shell companies used in purchases of high-value art; reporting on third-party intermediaries such as interior designers or art advisors and the clients they represent; or other data collection as FinCEN deems necessary. These approaches, however, are not without limitations and risks. For example, the informal, opaque nature of the art market presents significant enforcement and compliance challenges that could limit the effectiveness of these tools.

Potential Application of AML/CFT Requirements to Certain Art Market Participants

The cases examined in this Study indicate that high-value art can be abused as a medium of exchange or value, to hold illicit proceeds, and as collateral to obscure illicit proceeds. While these abuses may not rise to a critical national security-level threat or vulnerability, there is evidence to suggest that criminal actors sometimes purchase high-value art with illicit proceeds generated from a predicate crime and then hold that art as a way to launder such proceeds.

Furthermore, the mere perception that the art market is both vulnerable to ML and unregulated creates incentives for criminals to further abuse the art market. For instance, in 2018, six individuals and four corporate defendants were indicted in \$50 million international securities fraud and ML schemes.¹¹⁰ The defendants proposed that a client (who was an undercover law enforcement officer) purchase high-value art to launder fraudulent profits from a stock manipulation scheme. After initially proposing the use of real estate investments to launder the funds, the co-conspirators devised a scheme to “clean up the money” through the purchase and subsequent sale of art. One of the defendants described the art business as the “only market that is unregulated” and noted that art was a profitable investment because of “money laundering.”¹¹¹ This case underscores how the art market has been identified as a plausible way to launder illicit funds.

Treasury should accordingly consider the costs and benefits of applying AML/CFT requirements, to potentially include customer identification and SAR obligations to certain art market participants and consider which government authority should be charged with supervising those market participants for AML/CFT compliance.

Art Finance Services

Boutique art lending firms, auction houses with lending programs, and other art market participants that provide similar financial services should be subject to AML/CFT requirements. These entities

¹¹⁰ U.S. DOJ, Press Release, “Six Individuals And Four Corporate Defendants Indicted In \$50 Million International Securities Fraud And Money Laundering Schemes,” March 2, 2018, available at <https://www.justice.gov/usao-edny/pr/six-individuals-and-four-corporate-defendants-indicted-50-million-international>.

¹¹¹ Id.

provide financial resources and services to both buyers and sellers in the art market, including collateral-based loans and other lending facilities, without being subject to AML/CFT requirements, including the obligation to establish and implement AML/CFT programs, report suspicious activity, and verify the identity of their customers. Customers of these institutions can easily, quickly, and privately access the illicit funds placed underlying their art assets and layer transactions to hide the initial illicit source of the funds. The lack of AML/CFT coverage of art finance service providers creates a market ripe for regulatory arbitrage, where illicit actors could target these art finance service providers in order to avoid the scrutiny of institutions which are mandated to maintain comprehensive AML/CFT programs and report suspicious activity.

In the sequence of financial transactions between art finance companies and their clients, these art finance companies likely facilitate lending to the customer through banks that are already subject to comprehensive AML/CFT requirements. However, the banks that effectuate these payments may not be best positioned to obtain identifying due diligence information on art finance customers and may not have the expertise to identify suspicious activity since they generally do not maintain direct relationships with the end buyers. The art finance service providers that maintain the customer relationships are better positioned than financial institutions receiving transfers when it comes to (1) identifying the customer or the owner of an account and (2) reporting suspicious activity. Given these market factors, strong consideration should be given to applying AML/CFT requirements to entities which provide financing for high-value art, including entities which provide leveraged acquisitions, art-collateralized lending, and other financial services in the market.

Other Art Market Participants

Other art market participants, including auction houses, galleries, third-party intermediaries operating as businesses, such as dealers and interior designers; peer-to-peer marketplaces; digital art marketplaces; online retailers; and any VASPs not covered under existing regulations that offer marketplaces for NFTs have potential ML vulnerabilities as described in this Study. However, different entities analyzed in this Study may present varying levels of vulnerability to ML, and ultimately risk to the U.S. financial system. For example, entities which have lower levels of annual sales turnover (such as small galleries) and entities that only occasionally transact high-value art (such as third-party online marketplaces, museums, other nonprofits) may present less risk, while entities which have larger annual sales turnover and regularly transact in high-value art in the ordinary course of business may present a higher risk. Although some of these entities maintain voluntary compliance programs, the programs do not appear to be sufficient because they are not statutorily mandated and can be suspended at the discretion of the entity. In addition to being in the best position to collect due diligence information on their own customers and report any suspicious activity, these entities stand to profit the most from art market transactions. Outreach to industry over the course of the Study identified that historic resistance by art market participants to provide due diligence information to compliance teams at larger art market institutions, such as auction houses, has already begun to fade. Compliance teams are beginning to see more acceptance of customer information collection requirements of their existing voluntary programs, and third-party intermediaries are becoming more assured of the firewall between compliance and sales teams, which prevents client information provided for due diligence to be used by sales teams for business and client development. Previous concerns regarding client stealing have become less

prevalent, and art market customers similarly are becoming less concerned about unauthorized disclosures by compliance officers. This is indicative that art market participants may not have as much opposition to these new regulatory regimes as they have historically.

AML/CFT Program Thresholds and International Harmonization

If Treasury were to impose AML program obligations on certain categories of art market participants—which could include the entities discussed above that may present a higher risk of ML—such action would bring with it the expectation that entities subject to such program obligations would also have transaction reporting and recordkeeping obligations. A designated supervisor or self-regulatory body would also need to be identified, trained, and resourced.

This, in turn, would immediately raise the question of thresholds. Treasury would need to consider whether a transaction or aggregate sales volume threshold should apply before an art market participant is required to report a transaction to FinCEN. While banks have an existing \$5,000 threshold for reporting suspicious transactions, for example, in the world of fine- and high-value art, where even small- and medium-sized galleries regularly sell works valued at over \$5,000, that threshold may be low and not appropriately balance the risks of ML/TF in the art trade with the regulatory burden of compliance. Additionally, it remains unclear if such mandatory reporting and due diligence requirements would add additional compliance burdens if the industry is already engaged in best practices to identify the end owner of the artwork, check source of funds, and keep records.

Furthermore, many art market participants believe that harmonizing U.S. regulations with existing regulations in the EU would present less of a regulatory burden and prevent regulatory arbitrage globally than if, for example, the United States decided to impose a higher threshold for high-value art-related SARs. However, if regulators were to include institutional art market participants in AML/CFT reporting requirements, additional consideration would need to be given to the reporting threshold for suspicious transactions. While global harmonization is something to consider for market participants, it is unlikely that the €10,000 suspicious transaction reporting threshold in the 5AMLD in Europe would, in fact, reflect the risks posed by the sector in the United States, which is home to the world's largest art market. There already exists an IRS threshold that U.S. art market participants are subject to for tax purposes; when a tax return is selected for audit and includes a single work of art or cultural property valued at \$50,000 or more, the IRS takes additional steps to conduct diligence on the artwork.

Regulators should consider adopting a higher threshold for reporting requirements for high-value art sales, addressing both annual sales and individual transactions. For example, institutions selling near the range of \$500,000–\$1 million in annual sales could be subject to certain AML/CFT program requirements such as maintaining a customer identification program, implementing CDD obligations, hiring a compliance officer, and creating a system of internal controls to ensure ongoing compliance. Furthermore, SAR requirements could be considered around the \$50,000 transactional level. This level is based on a risk-based approach to the U.S. market and also takes into account the historical IRS enhanced appraisal threshold. However, given the ability of illicit actors to conduct several purchases at once, consideration should also be given to imposing reporting requirements relating to a combination of purchases by a single buyer. For example, aggregate yearly transactions adding up to \$200,000 conducted by a single buyer at a single art market institution could be subject to reporting requirements.

Applying AML Program Requirements Consistent with Illicit Finance Priorities

While high-value art and the market in which it is traded can be abused by illicit financial actors to launder funds, the imposition of additional regulatory obligations on this sector should be made while considering other gaps and vulnerabilities in the U.S. AML/CFT regime that Treasury has prioritized under its risk-based approach to applying AML/CFT requirements and that may generate a significantly greater amount of illicit proceeds. For example, high-risk real estate transactions can include those involving the purchase of high-value property, the use of legal entities to conceal the ultimate owner, all-cash purchases, and the use of intermediaries who are not covered by AML/CFT obligations. In 2020, the median price of a home sold was approximately \$309,800, while more than 80 percent of high-value art sold that same year was priced at \$50,000 or below. Further, seizures of bulk currency at the U.S. border indicate that billions of dollars in illicit proceeds are likely being moved in U.S. currency in the United States alone, let alone in the rest of the world. It is also important that sufficient supervisory and enforcement resources be identified and allocated so that any new regulatory regime can be effectively implemented. As such, it is recommended that Treasury complete its ongoing work to close outstanding gaps in the U.S. AML/CFT regime related to beneficial ownership, real estate, and potentially investment advisers and nonfinancial gatekeepers before potentially turning its attention to the high-value art market.

