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Art and Money Laundering: Shifting Regulatory Tides



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Art and Money Laundering

From time to time, headlines announce that “another” case of money laundering in the art world has been uncovered, followed by the argument that it is merely “the tip of the iceberg.” Whether or not such an extrapolation is justified, several countries around the world have responded by proposing or enacting laws and regulations specifically geared towards the art market. These laws and regulations require certain art market participants to help prevent and detect money laundering in their operations.

In light of these developments, it is important for art market participants to know which rules apply to them and what they can do to avoid unwittingly participating in a money-laundering scheme. The good news is that, in general, anti-money laundering (AML) requirements are “risk-based” and align well with common risk management approaches and thoughtful strategies for long-term sustainable success.

This article aims to raise awareness of the money-laundering risks collectors and family offices may face, and to offer some ideas on how they can mitigate those risks. Readers are encouraged to seek competent advice from legal and compliance professionals in order to maximize their AML impact.

Background

What Is Money Laundering?

The U.S. Treasury Department’s Financial Crimes Enforcement Network (FinCEN) defines “money laundering” as:

“...the process of making illegally-gained proceeds (i.e., ‘dirty money’) appear legal (i.e., ‘clean’). Typically, it involves three steps: placement, layering and integration. First, the illegitimate funds are furtively introduced into the legitimate financial system. Then, the money is moved around to create confusion, sometimes by wiring or transferring through numerous accounts. Finally, it is integrated into the financial system through additional transactions until the ‘dirty money’ appears ‘clean.’”¹⁹

FinCEN warns that money laundering can “facilitate crimes such as drug trafficking and terrorism, and can adversely impact the global economy.”

Scope of the Problem

Money laundering is a serious, worldwide problem. It is estimated that about 3-5% of global GDP is laundered globally every year, equaling an astounding \$2.17 trillion to \$3.61 trillion.²⁰

Money laundering has also been linked to terrorist financing, which encompasses the means and methods used by terrorist organizations to finance their activities. Terrorist groups often obtain their financing from illegal activities such as trafficking in weapons, drugs, people, and stolen goods. Funds derived from these crimes are then laundered to make them usable in commerce. Because of this link, anti-

¹⁹ [“History of Anti-Money Laundering Laws Link,”](#) U.S. Financial Crimes Enforcement Network, accessed February 17, 2022.

²⁰ [“Anti-Money Laundering / Counter Terrorist Financing Link,”](#) U.S. Department of State, accessed February 17, 2022.

money-laundering and combating the financing of terrorism (AML/CFT) are often discussed in the same breath.

Vulnerability of the Art World

The art world at large appears to be an appealing target for criminals with large sums of dirty money to launder, ostensibly exploiting certain inherent features of the art world, including:

- large sums of money changing hands on a daily basis;
- a lack of comprehensive AML regulations applicable directly to all art market participants;
- a lack of transparency, based in tradition and the desire for privacy;
- common use of intermediaries, contributing to the lack of transparency;
- challenges in accurately documenting provenance;
- portability of most art objects, easing cross-border transactions and concealment; and
- subjective valuation of artworks leading to high volatility and potential for abuse.

In theory, criminals could use art to launder dirty money in different ways. First, they could purchase artworks with dirty money and later sell those artworks in exchange for clean funds. Second, they could use art previously purchased with dirty money as collateral for loans. And, finally, they could hide a transfer of dirty money by over- or under-invoicing the purchase or sale of a work of art.

United States

While art market participants as such are not yet subject to AML regulations, it is important to remember that the participation in a money-laundering scheme can, nonetheless, be a federal crime, punishable by imprisonment and severe financial penalties. That can be the case if a person who plays a part in such a scheme ***knew or should have known*** that the proceeds of a specified unlawful activity (e.g., drug deals, embezzlement, stock manipulation) are laundered (1) to promote that activity; (2) to avoid taxes; (3) to conceal or disguise the nature, location, source, ownership, or control of the proceeds; or (4) to avoid certain reporting requirements.

A person “knows” that the property in question represents proceeds of some form of unlawful activity if that person has “direct knowledge” (e.g., “please take this drug money and launder it for me”), or if that person was aware of facts giving rise to a high probability of a money-laundering scheme (e.g., “please accept this bag of \$50,000 in rubber-banded \$20 bills”), or consciously avoided knowledge (e.g., “don’t tell me how you made this money — I’d rather not know”).

Trade-based money laundering (TBML) appears to be particularly suitable to the art trade. For that method of money laundering, criminals would use the legitimate trade to disguise their criminal proceeds. The method involves any one of several schemes to complicate the documentation of legitimate trade transactions, as for example:

- moving illicit goods;

- falsifying documents;
- misrepresenting financial transactions; and
- under-invoicing or over-invoicing the value of goods.

Art market participants are, therefore, well advised to take great care when completing or checking documentation and to conscientiously avoid any incorrect valuations or other material misrepresentations.

U.S. AML Laws and Regulations

U.S. AML laws, including the Bank Secrecy Act (“BSA”) and related regulations, are designed to help identify the source, volume, and movement of currency in order to assist U.S. government agencies in detecting and preventing money laundering. The laws cover banks and certain enumerated non-bank financial institutions, including casinos, securities and commodities firms, insurance companies, pawnbrokers, loan or finance companies, operators of credit card systems, and dealers in precious metals, stones, or jewels. In early 2021, Congress amended the BSA in a number of ways relevant to the art market.

Antiquities Trade to Be Covered by AML Regulations

The January 2021 law added another type of “financial institution” to the above list of financial institutions:

*“...a person 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.”*

Final regulations for these new covered entities will likely be issued sometime in 2022. While it is not yet clear what exactly these regulations will require of the antiquities trade, the regulations may well resemble the ones already in place for “**dealers in precious metals, stones, or jewels**” (31 C.F.R. Part 1027), which include:

- The written AML program:
 - Policies, procedures and internal controls
 - Risk assessment
 - Compliance officer
 - Education and training
 - Independent testing
- Reporting
- Record-keeping
- Information sharing

The regulations for the trade in antiquities will most likely also contain definitions of central terms (e.g., antiquities, trade) and may exempt certain dealers based on size and/or annual revenue.

Art Market Study

The January 2021 law also commissioned a “Study of the Facilitation of Money Laundering and Terror Finance Through the Trade in Works of Art,” obligating the Treasury Secretary to research money laundering and terrorist financing in the art market. On February 4, 2022, the Treasury Department released the results of the study.²¹

The study concluded that, compared to other industries with higher money-laundering risk, “the art market should not be an immediate focus for the imposition of comprehensive AML/CFT requirement.” The study determined that AML/CFT risks are not equally distributed across the U.S. market. Instead, while there is some money-laundering risk in the *institutional, high-value* art market and possibly in the *emerging online* art market, there is little evidence of terrorist finance risk.

Based on the perceived risk of money laundering in different sectors of the U.S. art market, the study recommended that companies which provide art financing services, such as art lending firms and auction houses with lending programs, should be covered by AML/CFT requirements; if other art market participants were to be regulated, entities with annual sales of less than \$500,000 or \$1 million should be exempted. Instead, small- and medium-sized art businesses should be assisted through the creation of an “information sharing mechanism” that would facilitate customer due diligence efforts without disproportionately increasing compliance burdens.

Pandora Papers and Aftermath

Following the Panama Papers (2016) and Paradise Papers (2017), on October 3, 2021, the “Pandora Papers” were published by a number of news organizations, leaking close to 12 million documents from 14 offshore financial services firms. The documents included information on more than 330 politicians and public officials from more than 90 countries and described the practice of using shell companies and trusts to hide billions of dollars, often to avoid the reach of tax authorities and law enforcement. One case described in the documents that received a lot of attention was that of Donald Latchford, an art dealer and leading scholar of Khmer art. Before his death in 2020, he was accused of trafficking in looted Cambodian art. The Pandora Papers reported that money related to the allegedly looted artworks passed through offshore accounts associated with Latchford.

Just a few days after the Pandora Papers were published, the “ENABLERS Act” (H.R. 5525) was introduced by a bipartisan group of federal lawmakers. The Act would add a number of art market participants to the BSA’s list of financial institutions:

*“...a person engaged in the **trade in works of art, antiques, or collectibles**, including a dealer, advisor, consultant, custodian, gallery, auction house, museum, or any other person who engages as a business in the solicitation or the sale of works of art, antiques, or collectibles.”*

In addition to those art market participants, the ENABLERS Act would also add several other categories of people and entities to the list, including lawyers and law firms, accountants, realtors, investment advisers, and public relations firms.

²¹ “Treasury Releases Study on Illicit Finance in the High-Value Art Market,” U.S. Department of the Treasury, press release dated February 4, 2022.

Whether the ENABLERS Act or a similar bill will be enacted in the United States is an open question. What is not in doubt, however, is that the U.S. government and the greater public are laser-focused on the art market, with several voices forcefully demanding broad AML regulations for art market participants. The worldwide pressure for more transparency in the art world seems to have an effect on U.S. lawmakers. Stay tuned!

The European Union and United Kingdom

European Union

As part of a comprehensive attack on money laundering and terrorist financing, the EU has issued a series of Anti-Money Laundering Directives. EU Directives require each Member State to enact domestic legislation that meets a minimum standard, including (1) risk assessment, (2) customer due diligence, (3) record-keeping, and (4) suspicious transaction reports.

The Fifth Anti-Money Laundering Directive (5AMLD) required Member States to enact domestic laws by January 2020 that specifically cover certain art market participants (persons trading works of art, including art galleries; auction houses; persons storing or trading works of art “when this is carried out by free ports;” intermediaries) if the value of a transaction is € 10,000 or more (including a series of linked transactions and any payment method).

The requirement to conduct customer due diligence is stricter for a number of cases set forth in 5AMLD’s Annex III because they indicate a “potentially higher risk,” including:

*“...transactions related to oil, arms, precious metals, tobacco products, **cultural artefacts and other items of archaeological, historical, cultural and religious importance**, or of rare scientific value, as well as ivory and protected species.”*

Such riskier transactions require “enhanced customer due diligence” (EDD), meaning that the covered entity must ask more questions and request more documentation from its business partner.

5AMLD also introduced some provisions for the purpose of increasing transparency, including central registers for ultimate beneficial ownership (UBO) information that must be created in each EU Member State; a new EU Platform will connect these central registers. Access to the information in the registers will be given to law enforcement and entities required to perform due diligence, among others.

The Sixth Anti-Money Laundering Directive (6AMLD) had to be implemented by each Member State by June 3, 2021. Among other things, 6AMLD raised criminal penalties across the EU. For example, in addition to persons who profit directly from acts of money laundering, 6AMLD added aiding, abetting, inciting, and attempting to launder money as covered offenses.

In July 2021, the European Commission introduced a bold set of legislative proposals to strengthen the EU’s AML rules, including a proposal for the creation of a new EU authority to fight money laundering. Until this new regulation becomes effective, each Member State has a different law: 5AMLD and 6AMLD provide a minimum set of rules, and a number of Member States have already enacted stricter rules than required by the EU Directives. Art market participants should, therefore, consult knowledgeable counsel in each Member State in which they are doing business.

United Kingdom

In the U.K., “art market participants” are subject to anti-money laundering and terrorist finance regulations. Because these regulations were enacted when the U.K. was still a member of the EU, the U.K. regulations very much resemble the above-described EU regulations. Even after Brexit, the U.K. has continued its leading role in combatting money laundering and terrorist financing.

One important obligation for art market participants in the U.K. is the duty to register with HM Revenue & Customs. See the U.K. government’s [website \(Link\)](#) for more information.

The required customer due diligence (CDD) process includes:

- request documents: picture ID, recent proof of residential address;
- request UBO information for companies, trusts, etc.;
- inquire into the purpose of planned transaction and source of funds;
- consult watch lists (e.g., government sanctions, “politically exposed persons” (PEPs), etc.);
- react to “red flags” by conducting EDD; and
- keep records

Other obligations resemble those in effect in the EU: the U.K. rules require staff training, the appointment of a “money laundering reporting officer” (MLRO) and deputy, as well as the submission of “suspicious activity reports” (SARs).

Suggested Approach for Collectors and Family Offices

As the above overview makes clear, collectors and family offices are well advised to consider adopting carefully tailored AML programs. There is no “one size fits all” approach, and any program should be based on the results of the particular collector’s or family office’s risk assessment. An AML program should be reasonably designed to prevent the collector or family office from being used to facilitate money-laundering activities through the purchase and sale of covered goods.

What is essential to meet regulatory expectations is: (1) that the collector or family office make a reasonable effort to mitigate the risks it faces, and (2) that it be able to document all measures it implemented and steps it took in mitigating those risks, including that “red flags” were followed up on. In many organizations, existing risk management, accounting, auditing, and other practices may provide a roadmap for an effective AML program, and existing personnel may be able to take on all or most of the new duties.

In any event, a robust AML program can be one piece of a long-term strategy for sustainable success. While the new obligations may place a significant compliance burden on art market participants in the short run, they may prove to be a blessing in disguise in the long run — when they protect art market participants from becoming unwitting participants in money-laundering schemes. An effective AML program can protect an organization from a government investigation, criminal prosecution, civil litigation by affected business partners, and the related legal fees; it can also prevent harm to the organization’s reputation as a result of negative publicity.

Most people prefer to do business with ethical organizations that have safeguards against money laundering in place. Because transparency leads to trust, collectors and family offices should regard AML procedures not as a challenge, but rather as an opportunity and possibly even a differentiator.

For more detailed, practical guidance on how to get started, art market participants are encouraged to visit the [website \(Link\)](#) of the Responsible Art Market (RAM) Initiative — a non-profit, cross market initiative formed in Geneva in 2015. For example, the RAM Guidelines on combatting Money Laundering and Terrorist Financing offer step-by-step suggestions on how to approach AML risk mitigation:²²

1. Do a risk assessment of your business and apply risk based measures
2. Know and comply with the laws where you are doing business and be alert to “red flags”
3. Know Your Clients (KYC) and establish their risk profiles: Check for client red flags
4. Research the artwork, its ownership and provenance: Check for artwork red flags
5. Know the background and purpose of transaction: Check for transaction red flags
6. Keep records
7. Train staff and monitor processes and procedures
8. If grounded suspicions exist, know how to act

On the RAM website, each of the above eight guidelines leads the user to more detailed suggestions on how to handle the issue. The website also offers (non-exhaustive) Lists of Red Flags, which can assist in identifying circumstances that would warrant further inquiry or, potentially, the rejection of a particular deal.

²² [“Guidelines on Combatting Money Laundering and Terrorist Financing Link”](#), Responsible Art Market, accessed February 17, 2022.