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US and EU Efforts to Combat International Money Laundering in the Art Market are no Masterpiece

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Notes:

US and EU Efforts to Combat International Money Laundering in the Art Market are no Masterpiece

ABSTRACT

Despite the lack of significant, tangible evidence of money laundering through fine art and antiquities dealers, the EU recently passed the Fifth Anti-Money Laundering Directive adding art dealers to the list of businesses obligated to comply with record keeping and due diligence requirements. Shortly thereafter, a similar measure was proposed in the U.S. House of Representatives. However, one-size-fits-all unilateral regulations will fail to protect the fine art and antiquities industry and will place crippling burdens on many art market participants. Instead, soft law agreements, used for most international finance regulation, should be the main tool to establish international standards. This Note suggests that the Financial Action Task Force, an international anti-money laundering institution, should create a flexible framework for risk-based regulations and international information sharing.

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I. INTRODUCTION

Government corruption, shell corporations, “The Wolf of Wall Street,” and a Picasso or two—no, not a new Dan Brown novel—but details from the latest case of money laundering involving the art industry.¹ An ongoing international investigation revealed in 2016 that Malaysian government officials and their co-conspirators hid more than \$1 billion worth of embezzled funds in the United States in assets such as real estate and artwork.²

Throughout history, criminals have sought ways to “clean” illicit money acquired through illegal activities. The process of “cleaning money,” commonly referred to as money laundering, is accomplished through a range of techniques that allow criminal proceeds to enter legitimate financial markets. As regulators and law enforcement tighten control over traditional methods used to launder money, art and cultural artifacts are becoming increasingly appealing tools for money laundering.³

The art market’s tradition of secrecy and discretion relating to purchases and sales presents a challenge to regulators. Terrorist financiers, in addition to money launderers, have also identified the

1. Louise Story, *U.S. Targets \$1 Billion in Assets in Malaysian Embezzlement Case*, N.Y. TIMES, July 20, 2016, <https://www.nytimes.com/2016/07/21/world/asia/1mdb-malaysia-us-assets-seized.html> [<https://perma.cc/2GQP-ZPPE>] (archived Aug. 5, 2019).

2. *Id.*

3. See Rick St. Hilaire, *Shouldn’t Art and Antiquities Sellers Be Subject to Anti-Money Laundering/Counter-Terrorist Financing Laws?*, CULTURAL HERITAGE L. (Aug. 9, 2016), <http://culturalheritagelawyer.blogspot.com/2016/08/shouldnt-art-and-antiquities-sellers-be.html> [<https://perma.cc/XY4A-NJ8P>] (archived Aug. 5, 2019).

fine art and artifacts markets as potential avenues to fund their activities.⁴ The highly publicized illegal sales of cultural artifacts from war-torn parts of the Middle East⁵ and the release of the Panama Papers in 2015⁶ highlighted the misuse of the art market for illicit gain and attracted increased scrutiny over financial transactions involving art.⁷ Since the art market serves a global clientele, domestic law enforcement is frequently inadequate or limited in its ability to investigate and prosecute these crimes.

International organizations, including the Basel Institute on Governance, have issued new guidelines aimed at making the art industry less susceptible to money laundering.⁸ These recommendations include enacting new domestic regulations requiring art dealers, galleries, and auction houses to maintain detailed records about their clientele and requiring the reporting of suspicious financial activity within these institutions.⁹ International art market players approached the Basel Institute as early as 2008 to draft rules focusing on self-regulation.¹⁰ However, this approach failed to ease concerns or gain widespread acceptance.¹¹ The Financial Action Task Force (FATF), the world's leading international anti-money laundering

4. See Michaelene K. Wright, *Financing Cr-ISIS: The Efficacy of Mutual Legal Assistance Treaties in the Context of Money Laundering and Terror Finance*, 52 VAND. J. TRANSNAT'L L. 229, 230 (2019) (discussing domestic law enforcement's reliance on mutual legal assistance treaties to investigate international crimes).

5. Deborah Lehr, *Art and Antiquities: Conduits for Money Laundering and Terrorist Financing*, ACAMS TODAY (Dec. 20, 2018), <https://www.acamstoday.org/art-and-antiquities-conduits-for-money-laundering-and-terrorist-financing/> [<https://perma.cc/HTG2-DE8X>] (archived Aug. 5, 2019). Although not directly linked to terrorists, Hobby Lobby was forced to forfeit thousands of artifacts smuggled out of Iraq and pay a \$3 million fine. Press Release, Dep't of Justice, United States Files Civil Action to Forfeit Thousands of Ancient Iraqi Artifacts Imported by Hobby Lobby (July 5, 2017) (on file with author).

6. Scott Reyburn, *What the Panama Papers Reveal About the Art Market*, N.Y. TIMES, Apr. 11, 2016, <https://www.nytimes.com/2016/04/12/arts/design/what-the-panama-papers-reveal-about-the-art-market.html> [<https://perma.cc/S9TL-C8W2>] (archived Aug. 5, 2019).

7. See European Commission Statement/18/3429, Statement By First Vice-President Timmermans, Vice-President Dombrovskis and Commissioner Jourova on the adoption by the European Parliament of the 5th Anti-Money Laundering Directive (Apr. 19, 2018); Rick St. Hilaire, *Proposed Bill Enlists Art & Antiquities Dealers in the Fight Against Money Laundering*, CULTURAL HERITAGE L. (May 21, 2018), <http://culturalheritagelawyer.blogspot.com/2018/05/proposed-bill-enlists-art-antiquities.html> [<https://perma.cc/7KU3-H2W3>] (archived Aug. 5, 2019).

8. *Basel Art Trade Anti-Money Laundering Principles*, BASEL INST. ON GOVERNANCE 3 (Jan. 2018), <https://www.baselgovernance.org/sites/default/files/2019-01/Basel%20Art%20Trade%20AML%20Principles%202018.pdf> [<https://perma.cc/S7DE-AR8Z>] (archived Oct. 1, 2019).

9. Hilaire, *supra* note 7.

10. See Thomas Christ, *The Basel Art Trade Guidelines 10 Years On*, FOREIGN CORRUPT PRAC. ACT BLOG (Jan. 30, 2018, 8:28 AM), <http://www.fcpcablog.com/blog/2018/1/30/dr-thomas-christ-the-basel-art-trade-guidelines-10-years-on.html> [<https://perma.cc/PJC6-VU7Z>] (archived Aug. 5, 2019).

11. See *id.*

organization, subsequently labeled the art market in some countries as “high-risk” for financial crimes.¹²

In response to these concerns, the European Union passed the Fifth Anti-Money Laundering Directive on April 19, 2018.¹³ The directive requires listed entities to conduct customer due diligence searches, commonly referred to as know your customer (KYC) requirements, and to identify and notify the proper authorities of suspicious activity by clients via suspicious activity reports (SAR) or an equivalent process.¹⁴ Prior directives required auditors, tax advisors, real estate brokers, gambling services, and credit and financial institutions to follow the SAR and KYC requirements.¹⁵ The Fifth Anti-Money Laundering Directive adds “persons trading or acting as intermediaries in the trade of works of art, including . . . art galleries and auction houses, where the value of the transaction . . . amounts to EUR 10,000 or more” to the list.¹⁶ Similarly, on May 18, 2018, Representative Luke Messer introduced H.R. 5886 to the House of Representatives.¹⁷ The bill, titled the “Illicit Art and Antiquities Trafficking Prevention Act,” amends the Bank Secrecy Act (BSA) to include dealers in art or antiquities on the list of businesses that are required to follow record keeping guidelines and report possible criminal activity.¹⁸

Unfortunately, these new laws offer minimal deterrence to potential money launderers and shift the burden of detecting and reporting money laundering from law enforcement to art and antiquities dealers. Further, dealers already face significant responsibilities to ensure the authentication of works and compliance with domestic and international laws regarding art theft, looting and trade in goods from endangered species.¹⁹ Adding to their burden could prove devastatingly expensive and ineffective. However, self-

12. *See id.*

13. Eileen Kinsella, *Art Dealers Push Back Against the European Union's New Money-Laundering Regulations*, ARTNET NEWS (Apr. 30, 2018), <https://news.artnet.com/art-world/european-union-tightens-art-market-oversight-1275338> [<https://perma.cc/DFQ4-2YDD>] (archived Aug. 5, 2019).

14. Council Directive 2018/843, art. 1, 2018 O.J. (L 156/53) (EU); *see Fact Sheet on Strengthened EU rules to prevent money laundering and terrorism financing*, DIRECTORATE-GENERAL FOR JUSTICE & CONSUMERS (July 9, 2018).

15. Council Directive 2015/849, art. 2, 2015 O.J. (L 141/73) (EU).

16. Council Directive 2018/843, *supra* note 14; *see Fact Sheet on Strengthened EU rules to prevent money laundering and terrorism financing*, *supra* note 14.

17. H.R. 5886, 115th Cong. (2d Sess. 2018).

18. *See id.*; Hilaire, *supra* note 7.

19. *See Code of Ethics*, CONFÉDÉRATION INTERNATIONALE DES NÉGOCIANTS EN OEUVRES D'ART (CINOA), <https://www.cinoa.org/cinoa/codeofethics> (last visited Sept. 2, 2019) [<https://perma.cc/VFT8-XWXM>] (archived Aug. 5, 2019) (describing CINOA's ethical guidelines); *see generally* Leonard D. DuBoff, *Controlling the Artful Con: Authentication and Regulation*, 27 HASTINGS L.J. 973 (1976).

regulation raises additional problems without seeming to impose a significant check.²⁰

International money laundering in art and antiquities illustrates both the complex challenges of regulating international finance and the tangible impact that well-intentioned regulation can have on legitimate business dealings. This Note will provide a background of money laundering in the art market, followed by an analysis of the enacted EU and proposed US measures and conclude that a uniform, international strategy is necessary to protect the art market and art businesses from abuse by money launderers.

Part II of this Note presents the history of money laundering through art, and also documents efforts, both domestic and international, to regulate it. Since a large segment of the international art market is located in the United States and the European Union, this Note will focus on those jurisdictions.

Part III will focus on new measures introduced in the United States and enacted in the European Union, and provide an analysis of the intended goals, strengths and the arguments against the measures. This analysis will require an exploration of how international soft law dominates most international financial regulation.

Part IV proposes an alternative strategy for discouraging and preventing money laundering in the art market by focusing on international soft law agreements and uniform FATF guidelines that use a risk-based approach to regulation and encourage greater information sharing.

II. MONEY LAUNDERING IN THE ART MARKET

A. *The Problem of Money Laundering*

Money laundering dates back more than two thousand years to a group of prosperous Chinese merchants who engaged in illegal activities and looked for ways to “cleanse” their profits.²¹ The term “money laundering” was coined in the United States during the 1920s and quickly became popularized because of the notorious rise in crime during the Prohibition era.²²

Money laundering is defined as the “disguising or concealing of the illegal origin(s) of the proceeds of crime.”²³ There are three main

20. See, e.g., Lisa Bernstein, *Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 158 (1992) (concluding that effective self-regulation in the diamond industry is only effective where participants' interests align with industry norms).

21. Hannah Purkey, Note, *The Art of Money Laundering*, 22 FLA. J. INT'L L. 111, 114 (2010).

22. *Id.*

23. *Id.*

steps to the process: placement, layering, and integration.²⁴ The first step is collecting and placing illegal funds in multiple bank accounts or other financial institutions.²⁵ Next, illegal funds are layered, meaning the funds are transferred from various banks in various locations to conceal when and where the funds enter the financial system and the time and place they will eventually leave.²⁶ During the final step, integration, illegal funds are mixed into the legitimate economy and markets.²⁷ These funds now are virtually indistinguishable from their legitimate counterparts and create a significant challenge to any regulator or law enforcement official attempting to “follow the money” and detect or trace the original criminal activity.²⁸

The archetypical example follows. Criminal proceeds are collected by a money launderer and placed in bank accounts or used to purchase a series of monetary instruments that are deposited into accounts at another location.²⁹ The money launderer layers the funds by using a complex chain of domestic and international shell company accounts, utilizing virtual currencies or by using trade-based techniques such as purchasing high-value goods and then shipping and reselling the goods overseas.³⁰ Finally, the laundered funds are returned to clients for investment or asset acquisition, which could include the purchase of luxury goods.³¹

Financial institutions play a critical role in the money laundering process.³² Governments responded by imposing record keeping and reporting requirements, such as know your customer (KYC)³³ and suspicious activity reporting (SAR), on a range of financial institutions through measures such as the US Bank Secrecy Act (BSA) in 1970.³⁴ KYC is an internal record keeping and verification requirement.³⁵ The

24. FIN. ACTION TASK FORCE, PROFESSIONAL MONEY LAUNDERING 15–16 (2018), <http://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf> [<https://perma.cc/JD8D-FWLQ>] (archived Oct. 1, 2019) [hereinafter PROFESSIONAL MONEY LAUNDERING].

25. *Id.* at 15.

26. *Id.*

27. *Id.*

28. See Mark Motivans, *Money Laundering Offenders, 1994–2001*, U.S. DEP'T OF JUST., BUREAU OF JUST. STAT. 2 (July 2003), <https://www.bjs.gov/content/pub/pdf/mlo01.pdf> [<https://perma.cc/FMT2-Z689>] (archived Oct. 1, 2019).

29. PROFESSIONAL MONEY LAUNDERING, *supra* note 24, at 18; *Money Laundering FAQ*, FIN. ACTION TASK FORCE, <https://www.fatf-gafi.org/faq/moneylaundering/> (last visited Sept. 23, 2019) [<https://perma.cc/8EVF-V273>] (archived Oct. 1, 2019).

30. PROFESSIONAL MONEY LAUNDERING, *supra* note 24, at 30.

31. *Id.* at 19.

32. *Id.* at 17–18.

33. Some jurisdictions refer to these programs as customer information programs (CIP) or customer due diligence (CDD).

34. Purkey, *supra* note 21, at 111; Anna Louie Sussman, *Galleries Could Face “Unnecessary and Onerous” Regulation under New Legislation*, ARTSY (May 24, 2018), <https://www.artsy.net/article/artsy-editorial-galleries-face-unnecessary-onerous-regulation-new-legislation> [<https://perma.cc/F4S5-WLZU>] (archived Aug. 5, 2019).

35. *Basel Art Trade Anti-Money Laundering Principles*, *supra* note 8.

exact information an institution is required to collect and the level of verification required varies by industry and the nature of the financial transaction.³⁶ Generally, KYC programs require “covered financial institutions . . . to obtain, verify, and record the identities of the beneficial owners.”³⁷ SARs are filed electronically and are available to federal and local law enforcement agencies.³⁸ Originally designed to prevent domestic money laundering, the BSA has expanded to combat terrorism financing and other financial transaction crimes.³⁹ Since governments are heavily involved in the regulation of banks and financial institutions, tightening regulations and reporting requirements to combat money laundering in financial markets and institutions is widely accepted and minimally burdensome to regulated entities.⁴⁰

Laundering money through real estate assets is also an attractive option.⁴¹ Traditionally, real estate, like art, is “classified as non-financial, and therefore lacks the regulation and rigid, standardized controls in place for the financial sector.”⁴² However, in the United States for example, lawmakers expanded the BSA to cover most real

36. In the United States, these requirements are separated into Customer Identification Program (CIP) and Customer Due Diligence (CDD). CIP requires the collection of personal information and document verification of that information. Customer Due Diligence Requirements for Financial Institutions, 31 C.F.R. §§ 1020.220, 1023.220, 1024.220, 1026.220 (2018). CDD applies to legal entities customers and requires: “(1) identify and verify the identity of customers; (2) identify and verify the identity of the beneficial owners of companies opening accounts; (3) understand the nature and purpose of customer relationships to develop customer risk profiles; and (4) conduct ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.” 31 C.F.R. §§ 1010, 1020, 1023, 1024, 1026.

37. *Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions*, FIN-2016-G003, FIN. CRIMES ENFT NETWORK (July 19, 2016), https://www.fincen.gov/sites/default/files/2016-09/FAQs_for_CDD_Final_Rule_%287_15_16%29.pdf [<https://perma.cc/VBP5-ZZ5T>] (archived Oct. 1, 2019).

38. *Mandatory E-Filing FAQs*, FIN. CRIMES ENFT NETWORK, <https://www.fincen.gov/mandatory-e-filing-faqs> (last visited Oct. 1, 2019) [<https://perma.cc/975Y-9FPZ>] (archived Aug. 6, 2019); *Law Enforcement Overview*, FIN. CRIMES ENFT NETWORK, <https://www.fincen.gov/resources/law-enforcement-overview> (last visited Oct. 1, 2019) [<https://perma.cc/YEN3-FGYC>] (archived Aug. 6, 2019).

39. See Sussman, *supra* note 34 (providing background information on the Bank Secrecy Act).

40. See Purkey, *supra* note 21, at 111. *But see* Lanier Saperstein & Geoffrey Sant, *Account Closed: How Bank ‘De-Risking’ Hurts Legitimate Customers*, WALL ST. J., Aug. 12, 2015, <https://www.wsj.com/articles/account-closed-how-bank-de-risking-hurts-legitimate-customers-1439419093> [<https://perma.cc/QV8Q-RE4E>] (archived Oct. 1, 2019).

41. *The FATF Recommendations*, FIN. ACTION TASK FORCE 15 (2012), <https://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html> (last updated June, 2019) [<https://perma.cc/QT26-2SJJF>] (archived Oct. 1, 2019).

42. FAUSTO MARTIN DE SANCTIS, *MONEY LAUNDERING THROUGH ART: A CRIMINAL JUSTICE PERSPECTIVE* 58 (Springer 2013).

estate transactions.⁴³ This action imposed a number of requirements to deter money laundering, such as KYC and SAR requirements overseen by the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN).⁴⁴ These regulations are supplemented by FinCEN's issuance of geographic targeting orders that require real estate companies in high-risk areas to report high-end, all-cash residential real estate transactions.⁴⁵

Art and similar assets can be used at all three money-laundering stages—placement, layering, and integration—making the art market a particularly appealing target for financial criminals. It is also important to note that none of the previous efforts to regulate financial institutions or real estate have completely deterred money launderers from using these vehicles.⁴⁶ Instead, these efforts have alerted criminals to the added scrutiny faced by these institutions.⁴⁷

Beyond its facilitation of the underlying crime, money laundering brings potential negative macroeconomic consequences including “inexplicable changes in money demand, prudential risks to bank soundness, contamination effects on legal financial transactions, and increased volatility of international capital flows and exchange rates due to unanticipated cross-border asset transfers.”⁴⁸ Tightening anti-money laundering regulations can effectively combat the original crime by making illegal activity unprofitable.⁴⁹

B. *International Money Laundering in the Art Market*

Money laundering, in and of itself, is a criminal offense in most jurisdictions.⁵⁰ In the United States, an individual is criminally liable if they act with knowledge “that the property involved in a financial transaction represents the proceeds of some form of unlawful activity,” and that individual “conducts or attempts to conduct such a financial transaction which in fact involves the proceeds of specified unlawful activity” with the intent to facilitate the underlying specified unlawful activity or to violate the Internal Revenue Code.⁵¹ A violation is punishable by a maximum fine of \$500,000 or twice the value of the

43. *U.S. Regulators Tackle Money Laundering in the Luxury Home Market*, REUTERS, <https://legal.thomsonreuters.com/en/insights/articles/u-s-regulators-tackle-money-laundering-luxury-home-market> (last visited Sept. 2, 2019) [<https://perma.cc/V9B6-8DRW>] (archived Aug. 6, 2019).

44. *Id.* (“FinCEN estimates that requiring the mortgage lending industry to file SARs puts 78% of residential purchases in the U.S. subject to BSA/AML compliance.”).

45. *Id.*

46. Purkey, *supra* note 21, at 117.

47. *Id.*

48. *Money Laundering FAQ*, *supra* note 29.

49. *See id.*

50. 18 U.S.C. § 1956 (2018).

51. *Id.*

property involved.⁵² However, money laundering is rarely the sole charge against a defendant and by its very nature, usually is part of a larger illegal conspiracy.⁵³ This subpart focuses on money laundering generally and how it fits into a criminal enterprise by describing techniques to launder money using art, the characteristics of the art market that make it susceptible to money laundering, and the scope of the problem.

1. How Art is Used to Launder Money

There are many strategies to launder money in the art market.⁵⁴ Falsely describing goods and services is a common way to hide or transfer assets. The former Brazilian banker, Edegar Cid Ferreira, utilized this technique in 2013. According to court documents, Ferreira used art—including a work by Jean-Michel Basquiat worth \$8 million—to transfer illegal funds across international borders.⁵⁵ The painting was originally purchased in 2004 for \$1 million by a Panamanian company, under Ferreira's control, which later tried to sell the painting for \$5 million.⁵⁶ In 2007, the company moved the work through four shipping agents in two countries before the painting arrived in New York.⁵⁷ In the United States, merchandise valued at less than \$200 may enter without customs documentation, duty, or tax.⁵⁸ The crate containing the painting had an air bill stating that the unnamed painting inside was worth \$100 and it was cleared for entry into the country with minimal scrutiny.⁵⁹ Though Ferreira was later caught, this incident exemplifies how art provides an appealing vehicle for criminals to transfer and disguise proceeds from criminal activity. By misrepresenting the value of an item, criminals can transfer value between parties and across borders.⁶⁰

Further, art market professionals may facilitate deals directly with criminals. Nathan Isen, an art dealer in Philadelphia had a history of selling art to a local marijuana dealer, Ronald Belciano.⁶¹

52. *Id.*

53. *Criminal Resource Manual*, U.S. DEP'T OF JUST., 2101–99, <https://www.justice.gov/jm/criminal-resource-manual-2101-money-laundering-overview> (last visited Sept. 2, 2019) [<https://perma.cc/AKG5-GBFY>] (archived Aug. 6, 2019).

54. Purkey, *supra* note 21, at 126.

55. Patricia Cohen, *Valuable as Art, but Priceless as a Tool to Launder Money*, N.Y. TIMES, May 12, 2013, <https://www.nytimes.com/2013/05/13/arts/design/art-proves-attractive-refuge-for-money-launderers.html> [<https://perma.cc/PPG5-FFKS>] (archived Aug. 6, 2019).

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. See Purkey, *supra* note 21, at 126.

61. Steve Volk, *The Curious Case of Nicky Isen*, PHILA. MAG. (Aug. 9, 2015, 5:59 AM), <https://www.phillymag.com/news/2015/08/09/nathan-nicky-isen-art-philadelphia/> [<https://perma.cc/T5RG-5K5P>] (archived Aug. 6, 2019).

Federal investigators never charged Isen with laundering money for Belciano, but fifty-nine works of art sold by Isen to Belciano were later seized by federal agents during an investigation of Belciano.⁶² Subsequently, in 2015, the U.S. Immigration and Customs Enforcement conducted a sting operation⁶³ that led to Isen pleading guilty and receiving three years of probation and a \$25,000 fine for accepting funds he was told were from criminal activity.⁶⁴

Additional methods include over- and under-invoicing and multiple invoicing. The over- and under-invoicing method requires that the price of a good be artificially inflated and then deflated to transfer value between two parties, such as a seller and buyer or an importer and exporter.⁶⁵ Over- and under-invoicing takes advantage of volatile pricing in the art market.⁶⁶ The latter method, multiple invoicing, involves creating multiple charges for the same good or service.⁶⁷ The price is left alone at the correct value, but by duplicating the transaction, money launderers create a gap between the recorded price and what is being paid.⁶⁸ A fraudulently duplicated transaction can be challenging for authorities to distinguish from a mistakenly duplicated transaction.⁶⁹ These techniques both create artificial paper trails that later can be used by money launderers to mislead art dealers' investigations into the provenance of the artwork or bankers' investigations as to the origins of the funds.

2. Weaknesses and Susceptibilities in the Art Market: Pricing, Theft, and Anonymity

Many observers, fueled by headline-grabbing cases, now view the art market as an appealing target for large-scale money laundering.⁷⁰ The art market is particularly susceptible to financial crimes because of the speculative value of its items, the notorious secrecy in the industry, the prevalence of art-related crimes, and the combined international nature of the market and the portability of the objects.⁷¹

62. *Id.*

63. *Id.*

64. David Heurtevent & Adrien Chiariello, *Addressing Money Laundering and Terrorism Financing Vulnerabilities in Art and Collectibles*, in ART & FINANCE REPORT 258 (5th ed. 2017).

65. Purkey, *supra* note 21, at 126.

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.* at 118; see generally Christ, *supra* note 10; Eric Reguly, *The link between art and money laundering*, THE GLOBE & MAIL (Sept. 3, 2015), <https://www.theglobeandmail.com/report-on-business/international-business/european-business/economists-urge-tighter-regulations-to-curb-money-laundering-in-art-market/article26217852/> [<https://perma.cc/5AWX-6GGP>] (archived Aug. 7, 2019).

71. Purkey, *supra* note 21, at 126; see DuBoff, *supra* note 19, at 973.

Much of the art market's vulnerability to money laundering arises from the speculative value of objects, which may allow for improper price manipulation.⁷² For example, in 2005, at an estate auction, a painting of Jesus Christ thought to be painted by a follower of Leonardo da Vinci sold for less than \$10,000.⁷³ The work, then claimed to be from the master himself, was offered for sale in 2012 for \$200 million but failed to sell until it sold in 2013 for \$80 million.⁷⁴ The work quickly sold again for \$127.5 million.⁷⁵ Then, at a historic auction at Christie's in New York City in 2017, the painting, now widely believed to be by da Vinci,⁷⁶ sold for \$450.3 million, currently the world record for a work of art.⁷⁷

Art appraisers consider the artist, era, provenance, size, aesthetic appeal, and trends in the market to project the value of an object.⁷⁸ Consumers rely on art dealers and appraisers' expertise to determine value and to authenticate works they currently own or intend to sell. Authentication relies on both scientific testing and stylistic opinions, but the process is far from perfect.⁷⁹ After its "discovery" in 2005, the painting, now believed to be by da Vinci, went through more than six years of research and investigation to establish its authenticity.⁸⁰ The painting's inclusion in the National Gallery London's⁸¹ 2011–12 exhibition of da Vinci's surviving paintings solidified its authenticity in the eyes of most in the industry.⁸² However, leading up to the world record sale at Christie's, art historians and da Vinci specialists

72. Purkey, *supra* note 21, at 126.

73. Robin Pogrebin & Scott Reyburn, *Leonardo da Vinci Painting Sells for \$450.3 Million, Shattering Auction Highs*, N.Y. TIMES, Nov. 15, 2017, <https://www.nytimes.com/2017/11/15/arts/design/leonardo-da-vinci-salvator-mundi-christies-auction.html> [<https://perma.cc/UM9B-Q3PL>] (archived Aug. 6, 2019).

74. *Id.*

75. *Id.*

76. There are fewer than twenty works acknowledged as being from Leonardo's own hand and all others are in museum collections thus unlikely to become available for private ownership. *Leonardo's Salvator Mundi Makes Auction History*, CHRISTIE'S (Nov. 15, 2017), <https://www.christies.com/features/Leonardo-and-Post-War-results-New-York-8729-3.aspx> [<https://perma.cc/TH3F-G5G3>] (archived Aug. 6, 2019) [hereinafter CHRISTIE'S].

77. Pogrebin & Reyburn, *supra* note 73.

78. See DuBoff, *supra* note 19, at 973.

79. *Id.*

80. CHRISTIE'S, *supra* note 76. It was also established that the painting sold in 1958 at Christie's rival, Sotheby's, for £45. Jonathan Jones, *Leonardo's 'lost' Christ, sold for £45 in 1956 – now valued at £120m*, GUARDIAN, July 12, 2011, <https://www.theguardian.com/artanddesign/2011/jul/12/leonardo-portrait-of-christ-salvator-mundi> [<https://perma.cc/98WG-V6M5>] (archived Aug. 20, 2019).

81. Public institutions can play a significant role in driving up a work's value. See Paul Sullivan, *A Museum's Seal of Approval Can Add to Art's Value*, N.Y. TIMES, Oct. 14, 2016, <https://www.nytimes.com/2016/10/15/your-money/a-museums-seal-of-approval-can-add-to-arts-value.html> [<https://perma.cc/N5LN-WYRC>] (archived Aug. 20, 2019).

82. The painting had been significantly obscured by overpaints and labeled a copy. See *Leonardo's Salvator Mundi Makes Auction History*, *supra* note 76.

criticized the work claiming “it’s a good studio work with a little Leonardo at best.”⁸³

Authenticators’ incentives play a role in the process and may not always align with their clients’ interests. Discovering a long-lost masterwork or discrediting a painting headlining a prestigious auction can gain an authenticator international notoriety.⁸⁴ Alternatively, the costs of inaccurate authentication, both financial and reputational, may be career ending.⁸⁵ After their death, many modern artists’ estates set up authentication panels to control the authentication process.⁸⁶ Recently, disgruntled art owners have brought multiple lawsuits against such panels, claiming their artworks have been unfairly discredited.⁸⁷ These panels were designed to provide stability to the market by giving buyers an alternative to relying purely on seller’s opinions of authentication, which also has led to lawsuits.⁸⁸ Even once authenticated, experts struggle to accurately predict value as many works are frequently sold for significantly more or less than their sticker price or projected value.⁸⁹

The art market is known for its secrecy and discretion.⁹⁰ Works are frequently offered for sale anonymously and buyers are often represented by auction house employees on the phone with their clients. This practice occasionally results in unfortunate situations. Ownership challenges are sometimes made when works are advertised for sale at auction, which may result in sales being put on hold.⁹¹ Additionally, anonymity can be further complicated when buyers and sellers are represented by agents. The da Vinci’s previous owner, a Russian collector, is currently engaged in a worldwide legal battle against his former art advisor whom he accuses of inflating artwork prices while the advisor acted as his agent.⁹² The art advisor claims he

83. Pogrebin & Reyburn, *supra* note 73.

84. DuBoff, *supra* note 19, at 973.

85. *Id.*

86. Eileen Kinsella, *Judge Throws Out Closely Watched Lawsuit Against the Agnes Martin Authentication Committee*, ARTNET NEWS (Apr. 5, 2018), <https://news.artnet.com/art-world/judge-dismisses-lawsuit-agnes-martin-committee-1260539> [<https://perma.cc/3MTL-MZNT>] (archived Aug. 6, 2019).

87. *Id.*; Complaint at 1–3, Mayor Gallery Ltd. v. Agnes Martin Catalogue Raisonnee LLC, No. 655489/2016 (N.Y. Sup. Ct. Aug. 30, 2018).

88. Kinsella, *supra* note 86.

89. See Purkey, *supra* note 21, at 115.

90. See Graham Bowley & William K. Rashbaum, *Has the Art Market Become an Unwitting Partner in Crime?*, N.Y. TIMES, Feb. 19, 2017, <https://www.nytimes.com/2017/02/19/arts/design/has-the-art-market-become-an-unwitting-partner-in-crime.html> [<https://perma.cc/K3JT-JE8Y>] (archived Oct. 1, 2019).

91. See, e.g., Anemona Hartocollis, *Despite Court Ruling, Christie’s Pulls Painting From Auction*, N.Y. TIMES, Nov. 8, 2006, <https://www.nytimes.com/2006/11/08/arts/09picasso.html> [<https://perma.cc/57U7-FEMC>] (archived Aug. 7, 2019).

92. Katya Kazakina, *Billionaire Slaps Sotheby’s With \$380 Million Lawsuit*, BLOOMBERG (Oct. 2, 2018, 5:13 PM), <https://www.bloomberg.com/news/articles/2018-10-02/billionaire-rybolovlev-slaps-sotheby-s-with-380-million-lawsuit> [<https://perma.cc/5HKY-DPT5>] (archived Aug. 7, 2019).

was merely acting as a middleman and resold works to the Russian collector instead of representing him.⁹³

Additionally, certain storage facilities, called freeports, pride themselves in providing secure and discrete storage for high-value goods.⁹⁴ Freeports and similar storage facilities allow owners to avoid paying import taxes, since the stored item has yet to legally enter the country.⁹⁵ At one of the most famous freeports in Switzerland, a specialist art journal estimated 1.2 million works of art were stored there.⁹⁶ The Swiss government has made efforts to tighten regulations on freeports;⁹⁷ however, new ones are opening across the globe.⁹⁸

Market participants defend the practice of concealing identities by pointing to the legitimate reasons clients may prefer secrecy. Many major art sales follow what the industry calls the “three D’s: death, debt, and divorce.”⁹⁹ Clients prefer anonymity to prevent the added embarrassment of having their personal lives on display to the world.¹⁰⁰ A variety of legitimate concerns could arise from revealing their participation in transactions.¹⁰¹ Fear of negative backlash over

93. *Id.*

94. David Honig, *No Secrets About Money Laundering*, CTR. FOR ART LAW (July 17, 2016), <https://itsartlaw.com/2016/07/17/no-secrets-about-money-laundering/> [<https://perma.cc/XRX4-Z5L5>] (archived Aug. 7, 2019).

95. See David Segal, *Swiss Freeports Are Home for a Growing Treasury of Art*, N.Y. TIMES, July 21, 2012, <https://www.nytimes.com/2012/07/22/business/swiss-freeports-are-home-for-a-growing-treasury-of-art.html?mtrref=www.google.com&gwh=9129EF794047C904522844EAC5B2FD27&gwt=pay&assetType=REGIWALL> [<https://perma.cc/L89C-NPJM>] (archived Aug. 20, 2019).

96. Rachel A.J. Pownall, *TEFAF Art Market Report 2017*, EUR. FINE ART FOUND., <http://1uyxqn3lzdsa2ytyzj1asxmmmpt.wpengine.netdna-cdn.com/wp-content/uploads/2017/03/TEFAF-Art-Market-Report-20173.pdf> (last visited Sept. 2, 2019) [<https://perma.cc/AAD2-6U2Z>] (archived Oct. 1, 2019) (“There is no way to know how much is held in these warehouses, although it is predicted that 1.2 million artworks are held by Geneva Free Ports.”).

97. Efforts to reform practice at Swiss freeports are in motion such as tighter KYC requirements and the closing of some of the tax loopholes. See Katie L. Steiner, Note, *Dealing with Laundering in the Swiss Art Market: New Legislation and its Threat to Honest Traders*, 49 CASE W. RES. J. INT’L L. 351, 366 (2017); see also Henri Neuendorf, *Switzerland’s Tough New Stance on Freeports Will Shake the Art World*, ARTNET NEWS (Nov. 19, 2015), <https://news.artnet.com/market/switzerland-freeport-regulations-367361> [<https://perma.cc/QRJ4-8JET>] (archived Aug. 6, 2019).

98. Freeports have recently opened in Singapore, Monaco, China, and Luxembourg. See *Intergovernmental Committee for Promoting the Return of Cultural Property to its Countries of Origin or its Restitution in Case of Illicit Appropriation*, U.N. EDUC., SCI. & CULTURAL ORG. (UNESCO) ¶ 12 (July 2016), http://www.unesco.org/new/fileadmin/MULTIMEDIA/HQ/CLT/pdf/2_FC_free_port_working_document_Final_EN_revclean.pdf [<https://perma.cc/BY6P-59XG>] (archived Oct. 1, 2019).

99. Richard M. Smith, *The Art of Auctions: Christie’s CEO Edward Dolman*, NEWSWEEK (Feb. 11, 2010), <https://www.newsweek.com/art-auctions-christies-ceo-edward-dolman-74999> [<https://perma.cc/NGX7-K6RD>] (archived Aug. 7, 2019).

100. Purkey, *supra* note 21, at 115.

101. *Id.*

extravagant purchases and becoming a target for art thieves or other criminal activity might motivate a collector to remain unknown.¹⁰²

Art crime further complicates the industry.¹⁰³ Art theft is one of the most profitable illegal trades in the world, with approximately \$6 billion worth of art stolen worldwide per year.¹⁰⁴ With many countries, including members of the European Union and the United States, only loosely regulating the importation of art, there is little deterrence to moving stolen goods across borders.¹⁰⁵ Additionally, art theft frequently goes unreported due to fear, embarrassment, and confusion.¹⁰⁶ However, if the thieves attempt to sell the work through a legitimate market, large international databases of stolen art exist and are routinely checked by major dealers and large auction houses before they agree to accept the work for sale.¹⁰⁷

Finally, as highlighted by the aforementioned story of Brazilian banker Edemar Cid Ferreira, the industry's global presence and the portability of goods can make art objects exceedingly difficult to track or detect.¹⁰⁸ Ferreira brought an \$8 million painting into the United States undetected by claiming it was worth only \$100.¹⁰⁹ Moving one painting is significantly more appealing than other goods of comparative value. For comparison, \$8 million worth of gold would weigh approximately 574.88 pounds and \$8 million worth of one-hundred-dollar bills would weigh 176 pounds.¹¹⁰ Undoubtedly, that amount of gold or one-hundred-dollar bills would raise significantly more eyebrows at customs.

102. Steiner, *supra* note 97, at 366.

103. Authentication and art crime frequently go together. For example, in 2013 a Long Island art dealer was involved in a \$30 million scheme selling forgeries out of two Manhattan galleries claiming the works were masterpieces by artists such as Jackson Pollock, Mark Rothko, and Robert Motherwell to unsuspecting buyers. Press Release, U.S. Att'y's Office, S.D.N.Y., Long Island Art Dealer Indicted for Massive Art Fraud, Money Laundering, and Tax Scheme (July 17, 2013) (on file with the U.S. Dep't of Justice).

104. Kenneth Polk, *Art Theft*, ENCYC. BRITANNICA, <https://www.britannica.com/topic/art-theft> (last visited Sept. 2, 2019) [<https://perma.cc/HY39-VKHP>] (archived Aug. 20, 2019); see Nathan Vardi, *The World's Biggest Illicit Industries*, FORBES (June 4, 2010, 12:02 PM), https://www.forbes.com/2010/06/04/biggest-illegal-businesses-business-crime_slide.html#5083afa0760a [<https://perma.cc/B8EU-DC2F>] (archived Oct. 1, 2019).

105. Purkey, *supra* note 21, at 119.

106. See *id.* at 120 (noting museums are known to underreport art theft because they do not want to draw additional attention to their minimal security levels).

107. Polk, *supra* note 104.

108. Cohen, *supra* note 55.

109. *Id.*

110. Honig, *supra* note 94.

3. Scope of the Art Market

The size, wealth, and international presence of the art market presents significant challenges to regulators while making it an appealing target for money launderers. The international art market continues to grow, becoming a \$63.7 billion industry in 2017, up 12 percent from the previous year.¹¹¹ Three countries capture most of the art market. The United States accounts for 42 percent of the market, with China and the United Kingdom at 21 percent and 20 percent of the market, respectively.¹¹² Art market participants include auction houses, dealers, and galleries, who may offer a range of services beyond buying and selling, including appraisals, authentication, and storage. Art dealers and galleries make up approximately 53 percent of the market value by sales,¹¹³ with auction houses capturing approximately 47 percent.¹¹⁴ While many headline-grabbing sales take place at auction houses, the industry is dispersed across many smaller galleries across the globe.¹¹⁵

Despite the size of the industry, known examples of art used to launder money are few. A 2017 report by the consulting firm Deloitte struggled to determine the exact scope of illicit trafficking of cultural goods in the European Union.¹¹⁶ Currently there are no widely accepted estimates on the amount of money laundered in the art market, although the general belief is that it is enormous and expanding as regulations on other asset classes are more rigidly regulated.¹¹⁷ The United Nations Office on Drugs and Crimes estimates that the total amount of money laundered globally is roughly

111. *Global Art Market Reaches USD 63.7 billion in 2017, with Dealers Taking the Lion's Share*, ART BASEL, <https://www.artbasel.com/news/global-art-market-reaches-usd-63-7-billion-in-2017-with-dealers-taking-the-lion-s-share> (last visited Sept. 2, 2019) [<https://perma.cc/JC2P-AXQ4>] (archived Aug. 7, 2019).

112. *Id.*

113. Clare McAndrew, *The Art Market 2018*, ART BASEL & UBS 30 (2018), https://d2u3kfw92fzu7.cloudfront.net/Art%20Basel%20and%20UBS_The%20Art%20Market_2018-1.pdf [<https://perma.cc/6N3S-WHP7>] (archived Oct. 1, 2019).

114. Henri Neuendorf, *The \$11 Billion Global Auction Market Rebounded by 25% Last Year, Says New Report*, ARTNET NEWS (Jan. 17, 2018), <https://news.artnet.com/market/art-auction-market-report-2017-1200992> [<https://perma.cc/UVP4-DQYC>] (archived Aug. 7, 2019) (the three major auction houses, Christie's, Sotheby's, and Philips increased global auction sales by 25 percent in 2017 from the previous year); *id.*

115. McAndrew, *supra* note 113, at 30 ("The share often shifts more towards auctions when the market is buoyant and there is an optimistic outlook for sales, with sellers enticed to the public auction market by its potential for greater than anticipated prices. While this appears to have been the case in 2017, it was also due to the small number of very high-value auction sales, which masked weaknesses evident in some segments of the auction market.")

116. Rep. of the European Comm'n Report, *Fighting Illicit Trafficking in Cultural Goods: Analysis of Customs Issues in the EU*, at 27 (June 2017).

117. Reguly, *supra* note 70.

2–5 percent of global GDP or \$800 billion to \$2 trillion annually.¹¹⁸ Economists, such as Nouriel Roubini of New York University's Stern School of Business, have been pleading for greater regulation of the global art market.¹¹⁹ However, only 40 percent of wealth managers, 24 percent of art collectors, and 23 percent of art professionals favor governmental regulation over self-regulation.¹²⁰

International auction houses Sotheby's and Christie's boast internal policies and procedures to detect money laundering.¹²¹ Christie's claims its anti-money laundering program includes "client, transaction and artwork due diligence, monitoring, record keeping and payment policy."¹²² Their program includes compliance checks on new clients and it requires corporate clients to prove the company's ultimate ownership, making it harder for clients to hide behind shell corporations.¹²³

Auction houses and dealers may face local licensing requirements that vary in stringency by jurisdiction.¹²⁴ Art dealers and auction houses, along with almost all other industries in the United States, are required to file reports of large cash payments to government regulators.¹²⁵

C. New EU and Proposed US Laws

Motivated by growing concerns, the European Union recently passed new regulations to detect and prevent money laundering in the art market, and the United States is considering similar measures. The new legislation in the European Union and proposed legislation in the United States attempt to apply the same anti-money laundering policies that apply to banks, real estate transactions, casinos, and precious stones, to art dealers.

118. *Money-Laundering and Globalization*, U.N. OFFICE OF DRUGS & CRIME (2019), <https://www.unodc.org/unodc/en/money-laundering/globalization.html> [https://perma.cc/C47Y-GQHD] (archived Aug. 20, 2020).

119. Reguly, *supra* note 70.

120. ART & FINANCE REPORT 2017, DELOITTE & ART TACTIC 243 (5th ed. 2017).

121. Samuel Rubinfeld, *Art World's Response to Money-Laundering Concerns Draws Critics*, WALL ST. J., Feb. 27, 2017, <https://blogs.wsj.com/riskandcompliance/2017/02/27/art-worlds-response-to-money-laundering-concerns-draws-critics/> [https://perma.cc/8Y83-MQVF] (archived Aug. 7, 2019).

122. *Selling at Christie's: Liability Terms & Conditions*, CHRISTIE'S (Apr. 1, 2019), <https://www.christies.com/selling-services/selling-guide/financial-information/> [https://perma.cc/WQ9A-SB9D] (archived Aug. 7, 2019).

123. Rubinfeld, *supra* note 121.

124. Purkey, *supra* note 21, at 121.

125. See *FinCEN's Mandate from Congress*, FIN. CRIMES ENFT NETWORK, <https://www.fincen.gov/resources/fincens-mandate-congress> (last visited Feb. 28, 2019) [https://perma.cc/633L-LCSK] (archived Aug. 20, 2019).

In the European Union, the European Parliament adopted the Fifth Anti-Money Laundering Directive on April 19, 2018.¹²⁶ The directive's stated goals are: to enhance the powers of the EU Financial Intelligence Units and increase their ability to find true owners of companies and trusts; to prevent risks of money laundering from virtual currencies and prepaid cards; to improve safeguards for financial transactions involving high-risk countries; to enhance access of financial law enforcement to bank records; and to centralize financial data systems in all member states.¹²⁷ The directive also expands the entities covered by the rules to include persons trading in works of art.¹²⁸

Member states will implement the directive independently by January 20, 2020.¹²⁹ Although the directive provides some minimal standards, it will be up to member states to clarify these rules and regulations.¹³⁰

The directive expands the requirements to perform KYC searches for customers paying in cash over €10,000, when establishing a business relationship, or when conducting occasional transactions that amount to €15,000 or more.¹³¹ Additionally, a catchall provision requires investigation when covered entities have mere suspicion of money laundering or terrorist financing, or when those covered entities doubt the legitimacy of previously gathered customer identification data.¹³² The KYC measures require art dealers to verify the identity of sellers and buyers, determine the beneficial owner and assess and obtain information on the purpose and intended nature of the proposed business relationship, and conduct ongoing monitoring of the business relationship.¹³³ There are caveats that allow member states to conduct

126. Council Directive 2018/843, *supra* note 14; see *Fact Sheet on Strengthened EU rules to prevent money laundering and terrorism financing*, *supra* note 14; Anna Brady, *European Union tightens anti-money-laundering rules in the art market*, ART NEWSPAPER (Apr. 30, 2018, 8:23 AM), https://www.theartnewspaper.com/news/eu-extends-anti-money-laundering-rules?utm_source=daily_april30_2018&utm_medium=email&utm_campaign=email_daily&utm_source=The+Art+Newspaper+Newsletters&utm_campaign=be3cf07448-EMAIL_CAMPAIGN_2018_04_18&utm_medium=email&utm_term=0_c459f924d0-be3cf07448-61063325 [https://perma.cc/L4AK-NGMC] (archived Aug. 7, 2019).

127. See European Comm'n Statement/18/3429, Statement By First Vice-President Timmermans, Vice-President Dombrovskis and Commissioner Jourova on the adoption by the European Parliament of the 5th Anti-Money Laundering Directive (Apr. 19, 2018).

128. *Fact Sheet on Strengthened EU rules to prevent money laundering and terrorism financing*, *supra* note 14.

129. *EU 5th Anti-Money Laundering Directive Program Notes*, CULTURAL PROP. NEWS (Mar. 19, 2019), <https://culturalpropertynews.org/notes-from-an-aba-program-on-eu-5th-anti-money-laundering-directive/> [https://perma.cc/V5G8-R2RA] (archived Aug. 7, 2019).

130. *Id.*

131. Council Directive 2015/849, *supra* note 15, at art. 11.

132. *Id.*

133. *Id.* at art. 13.

risk assessments, which examine the nature of an industry, before deciding how stringent these KYC requirements should be.¹³⁴

Member states are also required to have Financial Intelligence Units to detect and effectively combat money laundering and terrorist financing.¹³⁵ Obligated entities, now including art dealers, are required to file SARs, by their own initiative, “where the obliged entity knows, suspects or has reasonable grounds to suspect that funds, regardless of the amount involved, are the proceeds of criminal activity or are related to terrorist financing.”¹³⁶

In May 2018, Representative Luke Messer introduced a bill in the U.S. House of Representatives that adds art and antiquities dealers to the list of financial institutions covered by the Bank Secrecy Act.¹³⁷ The bill’s stated goal is to aid law enforcement’s efforts to uncover international money laundering and terrorist financing schemes.¹³⁸

The Bank Secrecy Act, created in 1970, is designed to prevent money laundering in major financial institutions by requiring KYC and SAR procedures.¹³⁹ Similar to the EU directive, the bill adds art dealers to the list of covered institutions.¹⁴⁰ The proposed legislation, if passed, would direct FinCEN, the agency tasked with creating and enforcing reporting and recordkeeping requirements under the statute, to create new regulations that could require art and antiquities dealers to establish internal anti-money laundering programs.¹⁴¹ For example, dealers in precious metals, precious stones, or jewels must implement an “anti-money laundering program reasonably designed to prevent the dealer from being used to facilitate money laundering and the financing of terrorist activities through the purchase and sale of covered goods.”¹⁴² Failure to follow these rules may result in steep fines.¹⁴³

Like the EU directive, many of the specific details of this bill are unsettled.¹⁴⁴ For example, the bill currently does not clarify who

134. *Id.* at arts. 13, 15, 17.

135. *Id.* at art. 32.

136. *Id.* at art. 33.

137. H.R. 5886, 115th Cong. (2d Sess. 2018).

138. *Id.*

139. Zachary Small, *Art Dealers Could Be Under More Financial Scrutiny with New US Bill*, HYPERALLERGIC (June 25, 2018), <https://hyperallergic.com/448705/bank-secrecy-act-art-dealers-luke-messer/> [<https://perma.cc/E3HY-T4QR>] (archived Aug. 8, 2019).

140. 31 U.S.C. § 5331 (2018); *FinCEN’s Mandate from Congress*, *supra* note 125; Small, *supra* note 139.

141. See Tim Schneider, *The Gray Market: Why Congressional Regulation Would Be a Gut Punch to Most American Art Dealers and Other Insights*, ARTNET NEWS (May 7, 2018), <https://news.artnet.com/market/gray-market-congressional-regulation-1280003> [<https://perma.cc/L46Q-6GQD>] (archived Aug. 8, 2019).

142. Customer Due Diligence Requirements for Financial Institutions, 31 C.F.R. § 1027.210 (2018).

143. Small, *supra* note 139.

144. See *EU 5th Anti-Money Laundering Directive Program Notes*, *supra* note 129.

qualifies as a covered dealer of art and antiques, leaving the task of writing specific regulations to FinCEN.¹⁴⁵ Generally, America's anti-money laundering and counter terrorist financing laws require luxury and cash-intensive industries to satisfy recordkeeping requirements and report possible criminal activity.¹⁴⁶ At a minimum, recordkeeping requirements will require art dealers to report cash payments over \$10,000.¹⁴⁷ Although a US law is yet to be enacted,¹⁴⁸ the art community has interpreted its introduction as a signal that the United States intends to follow the European Union's lead in the near future.¹⁴⁹

III. EVALUATION OF NEW REGULATIONS AND INTERNATIONAL FINANCIAL REGULATION

The Financial Action Task Force (FATF),¹⁵⁰ the leading international money laundering watchdog group, recently labeled the art market as a high-risk industry in multiple country reports.¹⁵¹ Industry reports, such as one produced by Deloitte in 2017, attempted to quantify concerns about money laundering in the industry, reporting that 65 percent of wealth managers surveyed, up from 56 percent the previous year, believe that money laundering is a serious threat to the art market.¹⁵² With the two largest art markets, the European Union and the United States, enacting and proposing new regulations, change is coming to the art market.¹⁵³ This Note will now turn to two related questions: will the regulation in the European Union and the

145. Sussman, *supra* note 34.

146. See Hilaire, *supra* note 7.

147. See *id.*

148. Bill H.R. 5886 died in committee in the U.S. House of Representatives, but in March 2019, the House Financial Services Committee released three proposed bills one of which included the addition of "dealers in art or antiquities" to the Bank Securities Act. Peter D. Hardy, *Art and Money Laundering*, NAT'L L. REV. (Mar. 20, 2019), <https://www.natlawreview.com/article/art-and-money-laundering> [<https://perma.cc/8SA5-T754>] (archived Aug. 8, 2019).

149. See, e.g., Rubinfeld, *supra* note 121; Small, *supra* note 139.

150. "FATF is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas." *About*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/about/> (last visited Sept. 2, 2019) [<https://perma.cc/BR2V-Z5HY>] (archived Oct. 1, 2019).

151. Christ, *supra* note 10.

152. ART & FINANCE REPORT 2017, *supra* note 120, at 237.

153. See McAndrew, *supra* note 113, at 34 (noting that the EU has 33 percent of world sales by value, while the US has 42 percent of such sales).

proposed changes in the United States prove effective at combating money laundering? And, if not, what will?

A. Arguments for and against New EU and US Regulation

1. Shortcomings of Regulatory Requirements

Many believe the enacted EU measure and the proposed US measure are too broad, impose undue burdens, and will have a chilling effect on the industry.¹⁵⁴ Three arguments made against the new laws warrant exploration: (1) fears that the regulations will change the nature of the industry, pushing clients seeking discretion to dealers willing to circumnavigate regulations; (2) concerns that regulations will place an undue financial burden on medium to smaller dealers who cannot afford the requisite compliance departments and rely on a small, loyal customer base and; (3) worries that benefits gained by new regulations will be extremely limited, leaving significant loopholes for money launderers to exploit.¹⁵⁵ However, supporters of these measures counter justifiably that calls made by industry leaders and organizations for self-regulation have fallen on deaf ears and, thus, governmental action is needed.¹⁵⁶

First, the very characteristics that make the industry attractive to its customers, its discretion for buyers and sellers and the inherent evolving aesthetic trends, make the industry vulnerable to money laundering. Thus, dramatic changes to standard practices potentially will chill the art market's recent growth.¹⁵⁷ Sellers and buyers may prefer anonymity for a variety of legitimate reasons. Sales frequently coincide with financial struggles and seller anonymity helps avoid added publicity and embarrassment when a family or individual is forced to part from artwork.¹⁵⁸ Although the regulations do not mandate client information to be made public, requiring dealers to collect more extensive client information creates a greater opportunity for that information to be leaked or inappropriately accessed.

As explained above, many legitimate reasons can trigger fine art price fluctuation, a commonly noted vulnerability of the industry.¹⁵⁹ For example, within a catalogue for a high-end auction, there is usually a glossary of terms outlining the different levels of confidence the

154. *EU 5th Anti-Money Laundering Directive Program Notes*, *supra* note 129.

155. *Id.*; *CINOA Position Paper on the Proposed Revision of the 4th EU Anti Money Laundering Directive*, CONFÉDÉRATION INTERNATIONALE DES NÉGOCIANTS EN OEUVRES D'ART (Apr. 3, 2018), <https://www.cinoa.org/cinoa/perspectives?action=view&id=AWJwp9yN1B8GfYskag3i> (last visited Sept. 2, 2019) [<https://perma.cc/VU94-KUXF>] (archived Aug. 8, 2019) [hereinafter *CINOA Position Paper*]; Saperstein & Sant, *supra* note 40.

156. *Reguly*, *supra* note 70.

157. *See McAndrew*, *supra* note 113, at 15.

158. *Purkey*, *supra* note 21, at 121.

159. *Id.*

auction house has that a particular work was created by the stated artist.¹⁶⁰ A change in the level of confidence, made for perfectly legitimate reasons, could result in a dramatic change in value. Fluctuations in the art market and taste may also contribute to volatility in price. Kathryn Tully of Forbes illustrates this phenomenon using artistically similar works by Lee Bontecou, an American sculptor of the 1960s and 1970s.¹⁶¹ Tully notes prior to 2003, Bontecou's auction record stood at \$46,000.¹⁶² Then, in that year, the artist was "rediscovered," and one of her sculptures sold for \$300,000.¹⁶³ In 2010, one of her sculptures sold for \$1.87 million.¹⁶⁴ While these dramatic changes in value may raise red flags in other financial industries, they are commonplace in the art market.¹⁶⁵ Requiring art dealers to not only track but also investigate these changes in value and the motives behind them is impractical and burdensome.

De-risking, a concern frequently associated with new financial regulation for banks, may also affect the art market.¹⁶⁶ Instead of managing and monitoring the risks of a particular client, banks will cut off an entire group of clients who live in a particularly at-risk part of the world.¹⁶⁷ Individuals wanting to participate in the fine art business and struggling due to a lack of financial services might be forced to turn to less reliable alternatives, such as physically transporting assets or illegal activities.¹⁶⁸ As a result, many human rights and immigrant communities strongly oppose de-risking

160. See generally CHRISTIE'S, IMPRESSIONIST AND MODERN ART DAY SALE AUCTION CATALOGUE, LONDON 280 (Feb. 28, 2019) (listing the glossary of terms for authorship includes, named artist, attributed to artist, studio of artist, circle of artist, style of . . . Follower of artist, Manner of artist, and After artist each with its own separate meaning).

161. Kathryn Tully, *Art Prices: What Goes Up Can Also Come Down*, FORBES (Apr. 23, 2013, 5:51 PM), <https://www.forbes.com/sites/kathryntully/2013/04/23/art-prices-what-goes-up-can-also-come-down/#450c60b150b> [https://perma.cc/JNV4-2YZL] (archived Aug. 8, 2019).

162. *Id.*

163. *Id.*; see Price Database, ARTNET, <http://www.artnet.com> (last visited Sept. 2, 2019) [https://perma.cc/NJ3F-8SR6] (archived Oct. 20, 2019) (follow "Use the Database" hyperlink; then search for "Lee Bontecou") (the artwork is a welded steel construction on canvas with copper wire that was estimated to sell between \$50,000–70,000).

164. *Id.*

165. *Collecting and Investing in Art*, ART PRICE, <https://www.artprice.com/artprice-reports/the-art-market-in-2017/collecting-and-investing-in-art> (last visited Sept. 9, 2019) [https://perma.cc/G9Y8-HD9H] (archived Oct. 20, 2019) ("The appeal of Art as an investment stems from the exponential value increases that affect certain works and, in certain cases, the media coverage they attract."); see also FIN. ACTION TASK FORCE, RBA GUIDANCE FOR DEALERS IN PRECIOUS METAL AND STONES 23 (June 17, 2008). For example, the Financial Action Task Force lists "a transaction that makes no sense, or that is excessive, given the circumstances, in amount, or quality, or potential profit," as a risk factor for dealers in precious stones and metals. *Id.*

166. Saperstein & Sant, *supra* note 40.

167. *Id.*

168. *Id.*

regulations, such as anti-money laundering laws, that could endanger the lives of people in unstable parts of the world.¹⁶⁹ However, the decision of banks and—as of late—art market participants to de-risk in the face of regulations is justified.¹⁷⁰ For example, although later overturned by statute, in 2008, the Seventh Circuit Court of Appeals interpreted “violent acts or acts dangerous to human life” in an antiterrorism statute to include money transfers to terrorist groups.¹⁷¹ This suggested that anyone who sent money to such a group, even as part of a business transaction, could be guilty for up to fifty years for damage caused by the group.¹⁷² The statute addressed this potential interpretation, but the situation highlights how wide a net new regulations could cast and why businesses may respond overly cautiously in the face of new regulation.¹⁷³ As written, neither measure addresses de-risking or ensures access to financial markets for at-risk communities.

2. Effect on Small and Medium-Size Dealers

The regulatory burden of the new measures will be felt by the many middle-tier and smaller art dealers, with perhaps dramatic consequences. The major players in the industry, international auction houses like Sotheby’s and Christie’s, already have internal compliance departments and, because of previously adopted internal policies, likely comply with the proposed requirements or can easily internalize any additional cost.¹⁷⁴ It is at these auction houses where the headline-grabbing sales and a majority of the industry’s growth is taking place.¹⁷⁵

Medium and small art dealers, however, are not benefiting from the industry’s growth nearly as much as the top end of the market.¹⁷⁶ The industry relies on these middle-tier dealers to discover new artists, yet the rate of new galleries entering the market has dropped by 87 percent from 2007 to 2017.¹⁷⁷ Further, these dealers run much smaller

169. *Id.*

170. *EU 5th Anti-Money Laundering Directive Program Notes*, *supra* note 129.

171. Saperstein & Sant, *supra* note 40.

172. *Id.*

173. *Id.*

174. *Buying at Christie’s*, CHRISTIE’S, <https://www.christies.com/buying-services/buying-guide/financial-information/> (last visited Sept. 20, 2019) [<https://perma.cc/7745-DQ2U>] (archived Oct. 1, 2019) (Christie’s claims to have “a robust [anti-money laundering] Programme which is managed by a global Compliance Team.”); *Code of Business Conduct*, SOTHEBY’S, <https://www.sothebys.com/content/dam/sothebys/PDFs/code-of-conduct-2019.pdf> (last visited Oct. 1, 2019) [<https://perma.cc/6RUY-LFVN>] (archived Oct. 1, 2019) (Sotheby’s states that they have adopted anti-money laundering guidelines and encourages those who have suspicious about a transaction or customer to contact their compliance or legal departments).

175. *See* McAndrew, *supra* note 113, at 17.

176. *See id.* at 16.

177. *Id.*

operations without the capacity to support an elaborate compliance department. These galleries rely on their customer service, expertise, and discretion to retain clients and compete against the much larger players in the field. They will be hit the hardest by the new regulations.¹⁷⁸

Dealers may face liability if they fail to inform authorities about clients who trigger any of a series of red flags including: art prices significantly below or above market value; antiques from areas of recent conflict; minimal documentation; buyers insistence on cash payments; multiple small cash payments for a single transaction; agents acting on behalf of undisclosed buyers or sellers; and payments made through third parties.¹⁷⁹ However, each of these supposed red flags could result from completely benign motives.¹⁸⁰ This situation places galleries relying on the business of a few loyal customers, who prefer discretion, in the uncomfortable position of making judgment calls regarding their client's finances or face potential penalties. Many of these galleries are run by art experts in fields such as nineteenth century American painting or Han dynasty porcelain, who are ill-suited to make judgment calls about potentially criminal acts.¹⁸¹

Instead, dealers will likely turn to regulatory technology companies to remain in compliance with new regulations.¹⁸² Not surprisingly, some of these businesses are vocal supporters of additional money laundering regulation.¹⁸³

Responding to the new regulations in the European Union, the International Federation of Dealer Associations (CINOA) claims that "these proposed amendments are built on the false assumption that the European Union is subject to a high level of trafficking in cultural property that is funding illegitimate interest."¹⁸⁴ They point to a report commissioned by the European Commission that shows little evidence of terrorism financing stemming from the art market within the European Union.¹⁸⁵ Further, they argue the low threshold of €10,000 captures an extremely wide proportion of sales, since more than one-

178. See *EU 5th Anti-Money Laundering Directive Program Notes*, *supra* note 129.

179. See Phoebe Kouvelas, *Money Laundering Through Art: What All Stakeholder Must Know*, PRIVATE ART INV. (Apr. 30, 2018), <https://www.privateartinvestor.com/art-business/money-laundering-through-art-what-all-stakeholders-must-know823/> [<https://perma.cc/55EP-37UN>] (archived Aug. 8, 2019).

180. See *supra* Part II.B.2.

181. See Henri Neuendorf, *Art Demystified: The Gallery Breakdown*, ARTNET NEWS (Sept. 8, 2016), <https://news.artnet.com/market/art-demystified-gallery-workers-638201> [<https://perma.cc/SR6P-29C8>] (archived Oct. 8, 2019).

182. Tony Ravel, *Three Anti-Money-Laundering Trends Financial Institutions Should Know in 2019*, FORBES (Mar. 7, 2019, 8:15 AM), <https://www.forbes.com/sites/forbestechcouncil/2019/03/07/three-anti-money-laundering-trends-financial-institutions-should-know-in-2019/> [<https://perma.cc/CG63-HNQT>] (archived Aug. 8, 2019).

183. *EU 5th Anti-Money Laundering Directive Program Notes*, *supra* note 129.

184. See *CINOA Position Paper*, *supra* note 155.

185. See *id.*

quarter of all paintings and sculptures sold by dealers in the European Union are priced at €45,000 or more.¹⁸⁶ These same dealers are mostly small businesses with annual turnovers under €1 million.¹⁸⁷ Thus, CINOA believes dramatic expansion of the due-diligence obligations will force dealers to pass on the cost of complying with the regulations to clients or be forced out of business.¹⁸⁸

3. Benefits of Additional Regulation

Although many arguments against the measures have merit, they fail to recognize the possible added deterrence, aid to law enforcement, and reputational benefits the new EU and potential US measures provide.

Specific quantification of the impact of money laundering proves challenging. Between 1994 and 2001, 9,169 defendants were convicted of money laundering in US district courts.¹⁸⁹ During the same time period, about 60 percent of the laundering offenses prosecuted involved an underlying property offense, such as embezzlement or fraud.¹⁹⁰ Approximately nine in ten defendants prosecuted were convicted with an average prison term of just over four years.¹⁹¹ The relatively low number of defendants¹⁹² and high conviction rates lead some to argue current measures are catching launderers effectively.¹⁹³

FinCEN claims that its data collected under the BSA “has proven to be of considerable value in money laundering, terrorist financing and other financial crimes investigations by law enforcement.”¹⁹⁴ Yet the challenges advocates face in quantifying and defining the scope of the problem makes it difficult to measure the potential benefits of the new EU or US laws.

Further, the perceived significance of the issue is highlighted by the amount of money involved. The international investigation into 1Malaysia Development Berhad (1MDB), the example referred to in the first line of this Note, highlights how unwitting institutions, such

186. *See id.*

187. *Id.*

188. Steiner, *supra* note 97, at 351, 366.

189. Motivans, *supra* note 28 (noting that money laundering defendants amounted to 1.8 percent of all cases filed in U.S. district courts).

190. *Id.*

191. *Id.* The national conviction rate in 2016 was 91 percent. Mark Motivans, *Federal Justice Statistics, 2015–2016*, U.S. DEP’T OF JUST., BUREAU OF JUST. STAT. 9 (Jan. 2019), <https://www.bjs.gov/content/pub/pdf/fjs1516.pdf> [<https://perma.cc/57GE-BMFB>] (archived Oct. 1, 2019).

192. Motivans, *supra* note 28.

193. *Id.*

194. *The Value of FinCEN Data*, FIN. CRIMES ENF’T NETWORK, https://www.fincen.gov/resources/law-enforcement/case-examples?field_tags_investigation_target_id=674 (last visited Feb. 28, 2019) [<https://perma.cc/97GS-BU7F>] (archived Aug. 8, 2019).

as those in the art market, can be manipulated into causing significant harm to taxpayers. 1MDB was a domestic fund created by the Malaysian government to benefit the Malaysian people.¹⁹⁵ Instead, officials skimmed up to \$6 billion to purchase luxury items including art.¹⁹⁶ Unwitting players, such as the art market, facilitated this theft. The actor Leonardo DiCaprio voluntarily surrendered two paintings, a \$3.2 million Picasso and a \$9 million Basquiat, that were gifted to him by an individual associated with the misappropriated funds.¹⁹⁷ This saga is far from over, and the mastermind behind the illegal spending spree is currently thought to be hiding in China.¹⁹⁸ While the 1MDB example highlights the need for strengthened regulations, it also demonstrates the limitation of domestic regulations that contain loopholes and lack international enforcement.

B. Structure of Current International “Soft Law” Regulation of Money Laundering

Despite the lack of data, money laundering in the art market has drawn the attention of international leaders.¹⁹⁹ At the 2017 G20 summit, world leaders issued a statement for all countries to “address all alternative sources of financing of terrorism” including the looting and smuggling of antiquities.²⁰⁰ International organizations, such as the Responsible Art Market Initiative among others, have sprung up to provide new guidelines and recommendations for the industry.²⁰¹ However, no formal effort is being made to solve the problem. China, a rapidly growing player in the art world,²⁰² has a reputation of extremely lax regulation of the art market.²⁰³ By acting unilaterally, the European Union and United States may push more of the industry to conduct business in other countries as consumers look to avoid higher costs and regulatory disclosures.

Though the European Union and United States are by far the largest players in the international art market,²⁰⁴ their failure to

195. Elizabeth A. Harris & Alexandra Stevenson, *A Yacht, a Monet, a See-Through Piano: The U.S. Collects on a Fugitive's Shopping Spree*, N.Y. TIMES, Dec. 9, 2018, <https://www.nytimes.com/2018/12/09/arts/jho-low-1mdb-assets-piano.html> [https://perma.cc/3T4J-TWJW] (archived Aug. 8, 2019).

196. Heurtevent & Chiariello, *supra* note 64, at 258.

197. *Id.*

198. Harris & Stevenson, *supra* note 195.

199. See ART & FINANCE REPORT 2017, *supra* note 120, at 242 (noting that sixty-five percent of wealth managers, sixty-one percent of art professionals and forty-nine percent of collectors surveyed felt that money laundering is a serious threat to the credibility of the art market).

200. Heurtevent & Chiariello, *supra* note 64, at 256.

201. ART & FINANCE REPORT 2017, *supra* note 120, at 237.

202. See McAndrew, *supra* note 113, at 15, 28, 34.

203. See ART & FINANCE REPORT 2017, *supra* note 120, at 237.

204. *Id.*

involve the greater international financial regulatory community will undermine and limit the effectiveness of their measures. Efforts toward a formal agreement, such as an international treaty, face added complexities based on the nature of international financial regulation. The shortcomings of the EU and US measures stem from their limitations as domestic measures. More comprehensive regulation is available through international cooperation utilizing existing international financial regulation strategies.

1. Overview of International “Soft Law” Agreements

International law is commonly characterized as hard or soft.²⁰⁵ Hard law includes legally binding obligations that delegate authority to interpret and implement a legal rule.²⁰⁶ Soft law is best described as a wide category of agreements that acts as a “continuum . . . running between fully binding treaties and fully political positions.”²⁰⁷ Soft law includes nonbinding rules or agreements that shape our understanding of binding legal rules or act as promises that create expectations of future conduct.²⁰⁸

International hard law dominates areas such as international trade and monetary affairs that are regulated by the World Trade Organization and the International Monetary Fund, respectively.²⁰⁹ Hard law agreements generally are viewed as more credible commitments, since they have direct legal effect on countries and usually carry higher costs for violation, in the form of legal sanctions or reputational costs.²¹⁰ Additionally, hard law agreements usually allow for easier monitoring by other parties and establish dispute resolution procedures.²¹¹ Critics of hard law note that they contain high sovereignty costs, meaning that countries may forgo their current domestic best interest because of the high consequences of renegeing on past hard law agreements.²¹² These sovereignty costs are thought to be particularly high when hard law agreements involve accepting an external authority over significant political or economic decisions.²¹³ Because countries may be skeptical of binding themselves in the

205. See Gregory C. Shaffer & Mark A. Pollack, *Hard vs. Soft Law: Alternatives, Complements, and Antagonists in International Governance*, 94 MINN. L. REV. 706 (2010) (discussing the range of definitions and classifications for hard and soft international law).

206. *Id.* at 714–15.

207. Andrew T. Guzman & Timothy L. Meyer, *International Soft Law*, 2 J. LEGAL ANALYSIS 171, 173 (2010).

208. *Id.* at 174.

209. See Chris Brummer, *Why Soft Law Dominates International Finance—And Not Trade*, 13 J. INT’L ECON. L. 623, 623 (2010) [hereinafter Brummer I].

210. Shaffer & Pollack, *supra* note 205, at 717–18.

211. *Id.*

212. Brummer I, *supra* note 209, at 631–32.

213. *Id.* at 632.

future, hard law agreements are frequently filled with vague commitments with few details, which then reduces the value of the original agreement.²¹⁴

In contrast, most international financial law is informal and nonbinding, with intergovernmental institutions setting “best practices” guidelines via consensus and countries enacting domestic regulations in accordance with these guidelines.²¹⁵ Central banks, regulatory agencies, and finance ministers act as the primary negotiators for international financial policies.²¹⁶ Additionally, independent international organizations assist in setting standards over narrower areas of finance.

The Financial Action Task Force (FATF), an example of a “specialist’ standard-setting body,” is tasked with preventing money laundering in foreign financial centers.²¹⁷ This type of organization usually issues regulations in the form of best practices, which, in reality, reflect the generally accepted practice in the international community.²¹⁸ Additionally, these agencies issue regulatory reports, which examine deficiencies or issues with current practice or regulatory schemes.²¹⁹ These reports, in many instances, work in a similar manner to formal commitments since signatories are expected “not to engage in behavior contrary to or conflicting with the values or norms expressed in the reports.”²²⁰ Because of this underlying expectation of compliance, parties vigorously negotiate these reports.²²¹

Soft-law international agreements offer many advantages, such as lowering the costs of entering into agreements, increasing flexibility, allowing for “deeper” cooperation, and developing common norms.²²² Andrew Guzman and Timothy Meyer suggest four theories that may motivate a country to prefer soft law for an international agreement.²²³ First, soft law may solve a coordination problem.²²⁴ Once countries establish a set of rules, they may have faith that those same rules will remain effective into the future without additional pressure.²²⁵ Second, soft law agreements allow countries to exercise efficient breach, similar to contract law.²²⁶ Third, soft law offers countries the opportunity to

214. *Id.* at 633.

215. *Id.* at 627.

216. *Id.*

217. *Id.*

218. *Id.* at 628–29.

219. *Id.* at 629.

220. *Id.*

221. *Id.*

222. Shaffer & Pollack, *supra* note 205 at 719.

223. Guzman & Meyer, *supra* note 207 at 171.

224. *Id.* at 176.

225. *Id.*

226. *Id.* at 177 (Hard law is thought to have greater “compliance pull” than soft law because of greater costs for volition. The costs include lost reputation, retaliation or

encourage amendment of the rules unilaterally.²²⁷ Finally, soft law standards issued by international institution allow for thorough, complex regulations to be established that may not have been reached if each rule needed unanimous support before agreement, such as a hard law treaty.²²⁸

Soft law is preferable in areas such as financial regulation since it allows for greater experimentation—allowing regulators or motivate countries to adjust and modify policies as their impact becomes clear.²²⁹ When problems are increasingly complex and poorly understood, states may be skeptical of any binding agreement. Instead, soft law agreements allow “parties to agreements . . . to see the impact of rules in practice in order to better assess their benefits...[while] retain[ing] the flexibility to avoid any unpleasant surprises the rules may hold.”²³⁰

Some see soft law as an illegitimate form of international agreement because of the lack of formal, binding commitment.²³¹ However, international financial regulation carries additional incentives for compliance—markets.²³² Healthy markets will attract investment and confidence while inefficient rules and regulations will push business elsewhere.²³³

Another common criticism of international financial regulation concerns the membership composition of organizations such as the FATF.²³⁴ Many groups, while claiming to be open to all interested countries, are founded and motivated by developed and wealthier nations.²³⁵ The result is that most of these international standard-setting bodies’ membership are made up exclusively of wealthy, developed countries.²³⁶ This allows wealthy countries to create regulations and then effectively demand that developing nations who wish to participate in the global marketplace adhere to them.²³⁷ Critics view this paternalistic approach as motivated by protecting developed countries’ interests to the detriment of global welfare.²³⁸

reciprocal noncompliance. Unlike efficient breach when one party gains from the noncompliance, these costs are simply lost, creating an inefficiency.)

227. *Id.* at 178.

228. *Id.* at 201–02.

229. Brummer I, *supra* note 209, at 632.

230. *Id.* at 633.

231. See Prosper Weil, *Towards Relative Normativity in International Law*, 77 AM. J. INT’L L. 413, 414 (1983) (criticizing the expansion of soft law since it fails to strengthen the international system and dilutes international obligations).

232. Brummer I, *supra* note 209, at 638.

233. *Id.* at 639.

234. *Id.* at 642 (noting legitimacy criticism and developing countries’ lack of influence is not limited to soft law international institutions and is also a criticism of the World Trade Organization).

235. Saperstein & Sant, *supra* note 40.

236. Brummer I, *supra* note 209, at 633.

237. Saperstein & Sant, *supra* note 40.

238. Brummer I, *supra* note 209, at 642.

2. The Role of the FATF in Anti-Money Laundering Regulation

International financial regulation is currently governed by soft law agreements.²³⁹ Commentators note that there is no prospect of a hard law international treaty and very little support for one.²⁴⁰ The reality is that not all countries support greater anti-money laundering regulations, which frequently undermine law enforcement's ability to *follow the money*.²⁴¹ The most prominent regulatory authority for international financial crimes is the Financial Action Task Force (FATF).

The FATF was launched in 1989 and in 1990 drafted a comprehensive set of good governance standards to address financial crimes and to promote international cooperation.²⁴² The FATF issued new standards after concern over terror financing through international financial crimes rose in 2001.²⁴³ The FATF then completely reviewed and updated its guidelines in 2003.²⁴⁴ Currently, thirty-seven countries are members of the FATF.²⁴⁵ The organization now monitors the implementation of recommendations through on-site reviews and analysis of the legislative and regulatory frameworks of high-risk and noncooperative jurisdictions.²⁴⁶

Currently, the FATF labels fourteen jurisdictions as having strategic anti-money laundering or combating the financing of terrorism deficiencies.²⁴⁷ Though the FATF does not have the ability to pursue punishments or reforms on its own, it encourages its members to adopt countermeasures against uncooperative states that are failing to combat money laundering schemes.²⁴⁸ The "punishment" usually comes from G-7 conferences, meetings involving the largest

239. *Id.*

240. See Jean Galbraith & David Zaring, *Soft Law as Foreign Relations Law*, 99 CORNELL L. REV. 735, 784 (2014).

241. See Chris Brummer, *How International Financial Law Works (And How It Doesn't)*, 99 GEO. L.J. 257, 295–96 (2011) [hereinafter Brummer II].

242. *Id.* at 296.

243. *Id.* at 297.

244. *Id.*

245. *FATF Members*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/countries/#FATF> (last visited Aug. 3, 2019) [<https://perma.cc/2QSB-Z5VG>] (archived Aug. 8, 2019) (members include Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Denmark, Finland, France, Germany, Greece, Hong Kong, Iceland, India, Ireland, Israel, Italy, Japan, South Korea, Luxembourg, Malaysia, Mexico, Netherlands, New Zealand, Norway, Portugal, Russia Federation, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States).

246. See Brummer II, *supra* note 241, at 297.

247. *High-risk and other monitored jurisdictions*, FIN. ACTION TASK FORCE, <http://www.fatf-gafi.org/countries/#high-risk> (last visited Aug. 3, 2019) [<https://perma.cc/B9SF-ZVBH>] (archived Aug. 8, 2019) (the high-risk jurisdictions include Bahamas, Botswana, Cambodia, North Korea, Ethiopia, Ghana, Iran, Pakistan, Panama, Sri Lanka, Syria, Trinidad and Tobago, Tunisia, and Yemen).

248. See Brummer II, *supra* note 241, at 290, 296.

economies in the world, and unilateral actions taken by the United States, who imposed costly requirements on US institutions doing business with a similar list of “noncooperative jurisdictions.”²⁴⁹

In July 2018, the FATF released a report which concentrates on professional money launderers who specialize in assisting criminals in evading anti-money laundering and counter terrorist financing safeguards and sanctions.²⁵⁰ The report stresses the importance of international information sharing to ensure effective policing.²⁵¹ Many large-scale professional money launderers work as a network.²⁵² They may employ professionals from a variety of fields, including accountants, lawyers, bankers, and also dealers in precious metals or stones.²⁵³

Although the FATF recognizes that the art market is susceptible to money laundering and terrorist financing, the authority has not created guidelines and best practices to apply to its members.²⁵⁴ This has prevented more coordinated action among international players.

IV. REFORM TO EFFECTIVELY DETER AND CATCH MONEY LAUNDERING IN THE ART MARKET

While acknowledging that the EU and US measures include many of the essential first steps to protect the art market from exploitation by money laundering, the measures fall short in two critical respects. First, the lack of international involvement greatly limits the potential effect of regulation, and second, the measures fail to establish international information sharing to support regulatory and law enforcement efforts.

As money launderers become more attenuated from the original illicit act, their apprehension will remain difficult.²⁵⁵ In order to effectively combat international money laundering, countries must coordinate efforts internationally to prevent international players from avoiding domestic regulations.²⁵⁶ Since art is an attractive tool for international money laundering, effective preventative measures must be international in scope. While the European Union and United States comprise 75 percent of the art market, this percentage will drop by 21 percent if or when the United Kingdom exits the European

249. *Id.*

250. PROFESSIONAL MONEY LAUNDERING, *supra* note 24, at 30.

251. *See id.* at 17.

252. *Id.*

253. *Id.* at 18.

254. Christ, *supra* note 11.

255. *See* PROFESSIONAL MONEY LAUNDERING, *supra* note 24, at 17.

256. *See generally* Wright, *supra* note 4.

Union.²⁵⁷ Although the United Kingdom will continue to follow domestic measures enacted under the current EU directives, such as the Fifth Anti-Money Laundering directive, this situation highlights the limitations of unilateral regulation.²⁵⁸ Further, the reported high-profile examples of art market money laundering schemes, many of which have been mentioned in this paper, all involve countries other than the US and EU members.²⁵⁹ As this problem reaches beyond the United States and European Union, the solution must also be international in scope.

Soft law provides a practical and effective path for additional money laundering standards and international coordination. Meyer suggests soft law is effective in the face of uncertainty surrounding a common interest or in the face of shifting power dynamics between countries.²⁶⁰ Soft law is thought to contain comparably lower penalties for noncompliance with international norms than hard law, which directly creates new legal obligations.²⁶¹ Lower penalties for noncompliance encourages states to agree to rules developed by international organizations, since renegeing on these rules later carries lower costs.²⁶² Soft law will be particularly appealing to the United States and European Union who currently amount for a majority of the international art market. Where one or a small group of countries is more powerful in a particular issue, they are likely the only states with incentives to innovate and create new regulations.²⁶³ This scenario is playing out as these two actors are implementing and proposing regulations without greater international participation. Soft law will provide a means for the major stakeholders to establish international norms, which other countries will likely join, without overly restricting their own future behavior.²⁶⁴ This approach mirrors the solution currently in place to address other international financial concerns through the FATF.²⁶⁵

257. See McAndrew, *supra* note 113, at 34; *New Anti-Money Laundering Regulations Target the Art Market*, ART@LAW (Sept. 18, 2018), <https://www.artatlaw.com/archives/new-anti-money-laundering-regulations-target-art-market> [https://perma.cc/98BD-D3JN] (archived Aug. 8, 2019).

258. *Id.*

259. Harris & Stevenson, *supra* note 195; Cohen, *supra* note 55.

260. Timothy L. Meyer, *Shifting Sands: Power, Uncertainty and the Form of International Legal Cooperation*, 27 EUR. J. INT'L L. 161, 162 (2016).

261. *Id.*

262. *Id.*

263. See Timothy L. Meyer, *Soft Law as Delegation*, 32 FORDHAM INT'L L.J. 888, 918–19 (2009).

264. *See id.*

265. See FATF Guidance, *Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion* (Nov. 2017), <http://www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf> [https://perma.cc/F3N8-BNKQ] (archived Oct. 1, 2019).

The FATF's effectiveness highlights the importance and impact that soft law agreements can have for financial regulation.²⁶⁶ The thirty-six members of the FATF include China, representing the second largest segment of the art market, as well as Brazil and Malaysia—all countries involved in the high-profile art market money laundering examples mentioned above.²⁶⁷ The FATF structure is ideal for the development of best practice standards for countries involved in the art market. The FATF has considered the complexity of money laundering regulation and examined many of the concerns explained in this Note, including de-risking, the financial burdens of regulation, and the strengths of a risk-based approach.²⁶⁸ Such a forum will allow rules to be developed that are tailored to the art market in contrast to simply expanding preexisting money laundering statutes and leaving the details to be decided later. Previously, the FATF has issued best practices for other industries including the legal profession, casinos, and traders in precious metals and stones.²⁶⁹ By issuing best practice guidelines for the art market, the FATF can quickly establish an international norm for art dealers and regulators worldwide.

The FATF guidelines for the art market should focus on two main areas: KYC requirements for all participants in the art market and international standardization to facilitate information sharing to assist enforcement efforts. Art market participants must be required to gather client information. Without KYC requirements, luxury goods purveyors and art dealers can continue to claim that they were misled by international money launderers and express sympathy to those harmed, without taking responsibility.²⁷⁰ The FATF KYC guidelines for the art market should focus on the type of information to be gathered and the required process to verify. Many groups have already suggested specific criteria, some of which are covered in the EU and proposed US measures. The Basel Institute's risk-based approach asks art dealers to create risk profiles that consider: location of sale, past location of art object, delivery method, type of service provided, payment method, client profiles, and the value of the art object.²⁷¹ This risk-based approach recognizes the interests of the global community to regulate, without placing undue burden on low-risk operations.²⁷² By monitoring risk, standards and rules can be differentiated

266. See Brummer II, *supra* note 241, at 256.

267. *FATF Members*, *supra* note 245; Harris & Stevenson, *supra* note 195; Cohen, *supra* note 55.

268. FATF Guidance, *supra* note 265.

269. See generally RBA GUIDANCE FOR DEALERS IN PRECIOUS METAL AND STONES, *supra* note 165.

270. See Harris & Stevenson, *supra* note 195.

271. See *Basel Art Trade Anti-Money Laundering Principles*, *supra* note 8.

272. See RBA GUIDANCE FOR DEALERS IN PRECIOUS METAL AND STONES, *supra* note 165, at 6 (suggesting that the potential benefits of a risk-based approach include better management of risks, effective allocation of resources, focus on identifiable threats and flexibility).

depending on the nature of a business or dealer, with specific guidelines to ensure resources are deployed strategically.²⁷³

Consistent with other anti-money laundering best practices, the FATF should also list red flags that may signal attempted money laundering. Borrowing again from the Basel Institute, red flags should include: reluctance to provide identifying information, cash payments, multiple payment methods, questioning suspicious activity procedures, artificially low or inflated prices, individuals known to be associated with individuals under investigation, and those who live in high-risk jurisdictions.²⁷⁴ Finally, the guideline should mandate that art market participants identify beneficial owners on both the supplier and buyer sides of a transaction.²⁷⁵ A beneficial owner is defined by the Basel Institute as a natural person, a company on a publicly accessible register, or a publicly traded company.²⁷⁶ Requiring beneficial owner identification prevents launderers from using shell corporations to hide the identities of parties to a transaction. The Panama Papers exposed the prevalence of such practices.²⁷⁷ If a client provides all of this information without raising red flags, the transaction may proceed.

However, if there is suspicion over the transaction, then the FATF guidelines should require participants to verify client data. Placing this requirement on art dealers alone could be financially ruinous and encourage willful ignorance.²⁷⁸ Instead, the FATF should create guidelines for domestic law enforcement to share the responsibility. The suggested verification requirement can be satisfied in two ways: by verification for client information on an approved domestic database, such as one operated by FinCEN for SARs,²⁷⁹ or by private/in-house investigation. Submitting a red-flagged client to this database in good faith will protect the art business from liability. A similar safe harbor provision operates for SAR submissions allowing a financial institution to gain peace of mind by taking proactive action.²⁸⁰

The goal of domestic databases is twofold. First, weighing money laundering red flags is outside the expertise and profession of art dealers and should be handled by experts. Second, while businesses are emerging that provide KYC services, requiring middle-tier and small dealers to pay for these investigations, either internally or by third parties, will be crippling. Database verification and maintenance can

273. *See id.* at 3.

274. *See Basel Art Trade Anti-Money Laundering Principles, supra* note 8.

275. *Id.*

276. *Id.*

277. Reyburn, *supra* note 6.

278. *See supra* Part III.A.2.

279. *See Customer Due Diligence Requirements for Financial Institutions*, 31 C.F.R. § 1010.540 (2018).

280. 31 U.S.C. § 5318(g) (2018); 31 C.F.R. § 1020.320(e).

easily live under the jurisdiction of FinCEN and their equivalent institutions. The databases will create paper trails for clients of the art market, allowing for law enforcement to spot suspicious activity.

Domestic government-run databases will allow art market participants to quickly and economically investigate clients. Using the database would act as a safe harbor from money-laundering liability; if a client is on the database without a red flag, those facilitating the transaction will be immune from prosecution.²⁸¹ This process will incentivize use of the database, especially by smaller dealers without the capacity to investigate clients on their own. These databases will be monitored by domestic law enforcement, who will be responsible for flagging potential money launderers posing as legitimate clients.

By creating globally standardized systems, countries will be able to better share information internationally. The FATF's standards will create a uniform system for information collection and may facilitate further international sharing.²⁸² If clients are flagged domestically, a country is in a better position to share that information with other FATF members. Further, by communicating flagged clients to all participating countries, money launderers will be unable to escape detection by avoiding a particular jurisdiction.

Art market participants will not be forced to use the databases. Institutions who have the capabilities to investigate their clients will be allowed to do so, so long as they comply with KYC minimum requirements outlined above. Larger businesses may prefer this option to offer premium clients added discretion or added confidence in the other party to the transaction. Participants who choose to have in-house investigation systems must make them available for audits by domestic financial regulatory agencies and will not receive safe harbor protection. While this may look like a burdensome responsibility for regulatory agencies, transactions at the top of the art market are mainly captured by Sotheby's and Christie's, the two largest international auction houses, leaving few other businesses with the ability to support internal investigations.²⁸³ This means in practice, agencies will only have to conduct a few audits, since many participants will opt for the low-cost shared database.

A KYC requirement will likely achieve wide acceptance, as many art dealer associations have suggested that such procedures are best

281. See 31 C.F.R. § 1010.540 (stipulating how a voluntary information sharing program operates for financial institutions and how by sharing information voluntarily, an institution generally is protected from liability).

282. Formal information sharing for criminal investigations is governed by mutual legal assistance treaties which are beyond the scope of this Note. See Wright, *supra* note 4, at 256–62 (reform of the mutual legal assistance process in the face of terrorist financing); see also Magnus Hornquist, *Sovereign Display and Fiscal Techniques: Some Notes on Recent Strategies to Counteract Money Laundering and Terrorist Financing*, 50 VAND. J. TRANSNAT'L L. 933, 960 (2017).

283. See generally ART & FINANCE REPORT 2017, *supra* note 120.

practices to protect the integrity of the industry.²⁸⁴ One of the leading industry-supported organizations, Responsible Art Market, suggests similar guidelines that incorporate a risk-based approach, red flag factors, KYC requirements, and staff training.²⁸⁵ Additionally, providing a low-cost alternative to conducting in-house verification will lessen the regulatory burden on medium and smaller size participants.²⁸⁶ By making the database voluntary, regulators are less likely to face pushback from the larger art market participants who may choose to continue to use internal anti-money laundering procedures. With 77 percent of art professionals preferring self-regulation to government regulation, creating a flexible system is potentially a realistic compromise.²⁸⁷

This strategy will only be effective if sufficient resources are dedicated to law enforcement efforts. The relatively few examples of money laundering in the art market perhaps indicate the problem is not yet widespread; however, the low number may also speak to a lack of serious commitment by law enforcement. Examples, such as the 1MDB investigation which spans years and literally the entire world, illustrate that researching and prosecuting international money laundering is a costly, time-intensive process.

Further analysis of current law enforcement efforts and the data gathered must be conducted before more stringent regulations go into effect. At present, FinCEN collects a massive amount of information from financial institutions across the country to aid law enforcement officials.²⁸⁸ While FinCEN claims this data is critical in law enforcement, the lack of substantial statistical information is a barrier to establishing corollary regulations. As a result, law enforcement efforts should be coupled with the commissioning of further reports and analysis of money laundering in the international art market. If money laundering in the art market amounts to even a minor portion of the projected scale of the international money laundering problem, more stringent requirements will be warranted.²⁸⁹

284. See *Code of Ethics*, *supra* note 19.

285. Hardy, *supra* note 148.

286. See *supra* Part III.A.2.

287. ART & FINANCE REPORT 2017, *supra* note 120, at 237.

288. See *What is the BSA Data?*, FIN. CRIMES ENFT NETWORK, <https://www.fincen.gov/what-bsa-data> (last visited Feb. 28, 2019) [<https://perma.cc/3NH4-Y9WE>] (archived Aug. 8, 2019) (“Over 15 million BSA reports are filed each year by more than 25,000 U.S. financial institutions, providing a wealth of potentially useful information to agencies whose mission is to detect and prevent money laundering, other financial crimes and terrorism.”).

289. See *Money-Laundering and Globalization*, *supra* note 118.

V. CONCLUSION

Despite the lack of significant, tangible evidence of money laundering through fine art and antiquities dealers, international regulators, governments, and the media have brought increased scrutiny on the art market. With concerns related to terrorist financing and headline-grabbing international incidents, it seems domestic legislators in the two jurisdictions hosting the majority of the art industry appear ready to initiate new regulations designed to detect and deter money laundering. However, unilateral regulations will fail to protect the industry and may place crippling burdens on many art market participants. The international soft law regulations proposed by this Note provide a flexible, practical path to utilize current international financial regulatory strategies to close loopholes created by the international nature of the industry and detect criminal efforts to hide proceeds from their illegal activities in the art market.

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