

Senate Subcommittee Report Highlights Money Laundering and Sanctions Risks in the Art Industry

August 27, 2020

On July 28, 2020, following a two-year investigation, the Senate Permanent Subcommittee on Investigations (“PSI”) released a report suggesting that high-value art transactions present an attractive vehicle for money laundering and sanctions evasion. The report further describes specific transactions that may have been used for such purposes, including by Arkady and Boris Rotenberg, who are subject to U.S. sanctions.¹ For these reasons, the PSI recommends imposing regulatory compliance obligations on auction houses and art dealers in the United States, similar to those already in effect in the European Union. The PSI also suggests taking steps to ensure greater transparency and accountability in the industry – what the report calls the “largest legal, unregulated market in the United States.”²

In this Debevoise In Depth, we summarize the PSI’s investigation as well as key findings and recommendations in the resulting report. We also outline potential implications for the art industry should U.S. regulatory and law enforcement authorities implement any of these recommendations.

The PSI Investigation and Report

The PSI’s investigation began not as an effort to expose the art industry as a potential source of illicit activity, but rather to understand why sanctions designed to cut off Russian oligarchs from the U.S. financial system “have not been more effective.”³ The investigation focused on international art markets only after evidence emerged that high-value art transactions appear to play a role in allowing sanctioned individuals to continue moving money into and through the United States.

¹ Staff of Senate Permanent PSI on Investigations, The Art Industry and U.S. Policies that Undermine Sanctions (July 29, 2020) <https://www.hsgac.senate.gov/imo/media/doc/2020-07-29%20PSI%20Staff%20Report%20-%20The%20Art%20Industry%20and%20U.S.%20Policies%20that%20Undermine%20Sanctions.pdf>.

² *Id.* at 10.

³ *Id.* at 2.

Specifically, the investigation found that:

- Arkady and Boris Rotenberg purchased over \$18 million worth of art in transactions implicating the U.S. financial system, in the months after they became subject to sanctions administered by the Office of Foreign Assets Control (“OFAC”).
- High-value art transactions, including the Rotenbergs’, often occur through anonymous shell companies and involve agents or “art advisors” acting on behalf of undisclosed principals. For example, the Rotenbergs employed a Moscow-based art agent, Gregory Baltser, to bid on specific artworks at auction, purchase them in his own name, and then assign title to various Rotenberg-linked shell companies. Mr. Baltser, a U.S. citizen and subject to U.S. sanctions, did all this while the Rotenbergs were subject to OFAC sanctions that prevented them from engaging in such transactions. During this time, Mr. Baltser also transferred title to art purchased at auction to a Belize company Steamort Limited (“Steamort”), the beneficial ownership of which remains unknown.
- Although all U.S. persons are prohibited from transacting with sanctioned individuals or entities, only the larger auction houses have adopted OFAC compliance programs, and these vary in quality and sophistication. As a whole, the art industry is not subject to regulation under the Bank Secrecy Act (“BSA”), which requires financial institutions to implement anti-money laundering (“AML”) programs.
- Notwithstanding that certain auction houses have adopted voluntarily OFAC and AML compliance procedures, the majority of high-value art transactions occur through private market transactions lacking such controls. In 2019, transactions at auction houses made up approximately 42% of total art sales; the remaining 58% occurred through private dealers.
- Auction houses ordinarily treat art agents or dealers as the principal purchaser of art, even when acting on behalf of an undisclosed client. This practice enables auction houses to perform due diligence on the art agent or dealer instead of identifying and evaluating the undisclosed client, which may create an AML vulnerability.
- Overall, “[s]ecrecy, anonymity, and a lack of regulation [in the art market] create an environment ripe for laundering money and evading sanctions.”⁴

⁴ *Id.* at 6.

In light of these findings, the PSI recommends sweeping changes to the art industry and to AML and sanctions enforcement measures more generally. These include:

- Amending the BSA to impose AML compliance obligations on auction houses and art dealers in the United States, similar to those imposed on financial institutions. For example, require art sellers to confirm the identity of the buyer or that the buyer is not laundering money through the purchase.
- Improving corporate transparency, including by requiring the Treasury Department to collect and make available to law enforcement beneficial ownership information for companies formed or registered to do business in the United States.
- Making broader changes to OFAC regulation and enforcement, such as:
 - Providing comprehensive OFAC guidance on steps that auction houses and art dealers should take to: (i) ensure they are not doing business with sanctioned individuals or entities; (ii) determine whether a person is the principal seller or purchaser of art, or is acting on behalf of an undisclosed client; and (iii) determine which person should be subject to due diligence;
 - Lowering or removing the ownership threshold for blocking companies owned by sanctioned individuals;
 - Clarifying that the “Informational Materials” exemption (the so-called “Berman Amendment”) under sanctions programs issued pursuant to the International Emergency Economic Powers Act is narrowly drawn and does not cover works of art, such as paintings, etchings and sculpture; and
 - Implementing and announcing sanctions concurrently to prevent a time lag that may enable sanctioned individuals and entities to continue using the U.S. financial system for transactions in the period before the relevant restrictions take effect.

We note this report is not the first or only time that Congress recently has addressed corporate transparency regarding ultimate beneficial owners. On October 22, 2019, the House passed the Corporate Transparency Act of 2019, a bill that would also require certain entities that apply to form a corporation or limited liability company and certain existing companies to file ultimate beneficial ownership information with the Financial Crimes Enforcement Network.⁵ On June 26, 2019, the Senate also introduced the

⁵ H.R. 2513, 116th Cong. (2019).

Corporate Transparency Act of 2019, but its ultimate fate remains uncertain.⁶ The provisions in these bills mirror in many respects recommendations made in the PSI report.

Implications for Industry

The PSI report calls for unprecedented regulatory scrutiny, specifically amending the BSA to impose AML compliance obligations on auction houses and art dealers in the United States, which, if enacted, would change the United States art industry, and it signals congressional concerns about the effectiveness of current sanctions regulation and enforcement. In light of the PSI report, it may be prudent for auction houses and private dealers to begin considering how BSA/AML and sanctions programs could be implemented or enhanced in their business models. We make recommendations for AML and sanctions compliance in turn below.

Industry Recommendations: AML Compliance

Art industry leaders can create effective AML compliance programs by utilizing guidance provided to financial institutions in their compliance requirements. For example, these programs generally require: (i) a system of internal controls to assure ongoing compliance; (ii) independent testing for compliance; (iii) designation of an individual or individuals responsible for coordinating and monitoring day-to-day compliance (e.g. BSA compliance officer); (iv) training for appropriate personnel; (v) a customer identification program with risk-based procedures that enable the institution to form a reasonable belief that it knows the true identity of its customers; and (vi) risk-based procedures for conducting ongoing customer due diligence and complying with sanctions programs administered by OFAC (as discussed below).⁷ Generally, a financial institution's compliance system and internal controls should be commensurate with the institution's size or complexity and organizational structure.⁸ Specifically, they must provide for timely updates in response to changes in regulations, mechanisms to identify and inform the board of directors and senior management of compliance deficiencies and the corrective action taken by the institution.⁹

Although all of these requirements may not ultimately be imposed on participants in the art industry, they could help to serve as a guidepost for developing appropriate AML

⁶ S.1978, 116th Cong. (2019).

⁷ Federal Financial Institutions Examination Council, Bank Secrecy Act/ Anti-Money Laundering Examination Manual, 18 (April 2020) <https://www.ncu.gov/files/press-releases-news/bsa-aml-examination-manual-april-2020.pdf>.

⁸ *Id.* at 21.

⁹ *Id.*

policies. In particular, the standard that an organization should have procedures “that enable the institution to form a reasonable belief that it knows the true identity of its customers” may be especially important. There is no one-size-fits-all solution; an effective BSA/AML compliance program will be tailored to an organization’s risk profile, including the types of customers it serves and the markets in which it operates. Key components of effective compliance that the art industry can incorporate immediately is monitoring regulatory changes and ensuring their boards of directors and senior management are informed of any AML deficiencies. All organizations operating in the art industry will benefit from familiarizing themselves with the goals and principles of BSA/AML compliance and documenting their efforts.

Industry Recommendations: Sanctions Compliance

Although all U.S. persons are required to comply with OFAC regulations, there is no legal requirement to adopt a sanctions compliance program (“SCP”). But OFAC has signaled that it views such programs favorably and laid out in the 2019 guidance the components it believes should be included within such programs, including a sanctions risk assessment, internal controls, independent testing and training.¹⁰ In that guidance, OFAC also provides information regarding how it will assess the adequacy of a firm’s SCP in the context of an enforcement action.¹¹ Similarly to the BSA/AML guidance above, OFAC expects senior management to have reviewed and approved the organization’s SCP and conduct its risk assessment “in a manner, and with a frequency,” that adequately accounts for the institution’s potential risks.¹²

Beyond the BSA/AML goals above, it may be useful for art dealers, including auction houses, to consider OFAC’s SCP guidance and, specifically, how they review OFAC’s list of Specially Designated Nationals and Blocked Entities and document their history of searching the list for each buyer. In addition to preventing legal violations, these types of compliance measures also could prove useful in the context of potential future enforcement actions or scrutiny by OFAC.

In light of the PSI report, it is an opportune time for auction houses and private dealers to begin considering how BSA/AML and sanctions programs could be implemented or enhanced in their business models and ensure that their board of directors is up to date on the most recent regulatory guidance.

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¹⁰ Department of the Treasury, A Framework for OFAC Compliance Commitments, 1 (May 2, 2019) https://www.treasury.gov/resource-center/sanctions/Documents/framework_ofac_cc.pdf. Additional information regarding OFAC’s expectations for SCP programs can be found in our Debevoise Update, [here](#).

¹¹ Department of the Treasury, A Framework for OFAC Compliance Commitments, at 1.

¹² *Id.* at 2-3.

Please do not hesitate to contact us with any questions.

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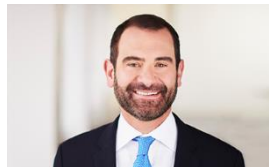
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