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AML and the Art Market: BAMF Guidance addresses key issues

On 24 January 2020, the British Art Market Federation ("**BAMF**") published its keenly anticipated "*Guidance on Anti-Money Laundering for UK Art Market Participants*" ("**the Guidance**"), providing welcome clarity on a number of questions on how newly regulated dealers, galleries and auction houses should apply the Money Laundering Regulations ("**the ML Regulations**") in the course of business.

In our previous e-alerts on the ML Regulations and the art market (available here and here) we set out how regulated "Art Market Participants" ("**AMPs**") should prepare for the ML Regulations, by conducting risk assessments and drafting policy documents.

In this third e-alert we consider what the Guidance says about the effect of ML Regulations in the course of day to day business. In particular we consider three pressing questions: (a) when Customer Due Diligence ("**CDD**") measures need to be applied; (b) to whom they need to be applied and (c) the extent to which they need to be applied.

When to apply CDD

The Guidance clarifies a number of points around the question of when to apply CDD:

- As was expected, the Guidance makes clear that, "*For those AMPs which engage in a mixture of regulated and unregulated transactions, the ML Regulations apply to the regulated transactions only*". Simply because an AMP falls within the ML Regulations for some, or even the majority, of the transactions it conducts does not mean that CDD is necessary in respect of every transaction that is conducted (i.e. it is not necessary in respect of transactions at a value of below €10,000).
- The €10,000 threshold for the application of CDD is to be calculated with reference to, "*the final invoiced price for the work of art including taxes, commission and ancillary costs*". Therefore the sale of a work for (the sterling equivalent of) €9,500, with €500 of shipping costs, crosses the threshold and CDD must be applied.
- The Guidance notes that, "*HMRC considers multiple payments against a single invoice, which together exceed the 10,000 euros threshold, to be linked, regardless of how long it takes to make payment*."
- The Guidance does **not** explicitly state that multiple sales to the same customer, with a cumulative total over €10,000 are "linked sales". This is a contrast with the HMRC Guidance for High Value Dealers, which provides that: "*Linked operations may be several transactions by the same customer for goods such as purchasing £5,000 of [goods] several times over a short period*" (available here, see para 4.18).
- However, multiple sales to the same customer may amount to a "business relationship" for the purposes of the ML Regulations, and thus the requirement to apply CDD will be engaged.

In respect of the precise point in the course of a transaction at which CDD measures must be applied the Guidance states that:

> *"In general, CDD must be completed prior to the completion of a transaction and this would normally be the case in relation to the sale of an artwork. This means, for example, where a dealer at an art fair makes a sale to a new customer, a transaction may be agreed ahead of carrying out all required CDD measures, but CDD measures are to be completed before release of the work of art to the customer."*

Compliance with the ML Regulations is thus achieved so long as CDD is complete before the "completion" (the ML Regulations use the phrase "*carrying out*") of the transaction.

Two important points arise from the question of timing of CDD, in relation to Terms of Business and "third party payments":

- To ensure that the dealer is not put in a position where a contract is formed, without CDD having been completed, it may be prudent to amend Terms of Business to make sales conditional on the completion of CDD checks.
- As regards "third party payments": at numerous points, the Guidance highlights that payments made by a party other than the customer may be a "red flag"; that staff should be trained to spot third party payments; and that an unknown payee may be a trigger for Enhanced Due Diligence ("**EDD**"). Additionally, an unexpected or unknown payment arriving in a dealer's account may amount to "*reasonable grounds to suspect*" money laundering, such as to require a Suspicious Activity Report to be made to the National Crime Agency. For these reasons, AMPs may wish to conduct CDD on the customer, and achieve clarity as how payment will be made, at an early stage in the transaction, before funds are transferred.

To whom must CDD be applied?

The Guidance offers helpful clarification on the question: "Who is the customer?" for CDD purposes, and on CDD obligations where there are multiple parties to a transaction, including agents and intermediaries.

On the question of "who is the customer?" the Guidance states:

- *"It will be the purchaser of a work of art, and any broker or agent acting for them";* and
- *"It will be the seller, where the AMP provides a service to, and receives financial value from, them".*

The following results follow from these definitions of the customer:

"Double" CDD obligations where an AMP acts for a seller

Where an AMP is offering a work for sale on behalf of someone else (e.g. an artist or owner), and is receiving a commission from that person ("the seller"), the AMP must treat both the buyer of the work **and** the seller as its "customer" and conduct risk-based CDD on both.

"Double" CDD obligations where a buyer acts through an agent

The Guidance states that:

> *"Where a customer is acting as an agent, the AMP conducting the transaction has an obligation under the ML Regulations to carry out CDD on the agent and also on the ultimate customer, as the AMP must know the identity of the person who is ultimately paying for the work of art. The AMP must also verify that the agent is authorised to act on behalf of the customer."*

It follows that, where a sale is conducted with an agent, CDD must be carried out, on a risk sensitive basis, on both the agent and on the "ultimate customer".

The Guidance suggests that the position is more complex where an AMP is selling a work to someone who it "suspects" to be "pa*ying with money from an underlying client*. This situation would arise where the AMP is not explicitly told, but rather has a "suspicion", that the "buyer" with whom it is dealing is in fact acting as a "buying agent" for someone else.

By way of answer in this situation, the Guidance states that, in such circumstances, the AMP's obligation is to "*consider whether EDD is appropriate*". However, this is always the case, in respect of all transactions to which the ML Regulations apply.

Paragraph 5.11 of the Guidance also helpfully adds that, "*There is no requirement on AMPs to make proactive searches for beneficial owners in respect of private individuals (who might be assumed to be buying for themselves), unless it appears that the customer is not acting on his own behalf*".

As a starting point, in circumstances where one dealer ("A") sells to another ("B"), and B informs A that B is purchasing the work in question as principal, unless one of the triggers for EDD in the ML Regulations applies, A will likely fulfil his or her obligations by applying CDD checks in respect of B, on a risk sensitive basis. In such a scenario, A will need to consider factors such as where B is established, whether B is himself or herself subject to the ML Regulations, and B's reputation and standing in the art market.

By way of illustration of a situation where EDD would be required: the AML Regulations (as amended) now require EDD where a transaction is "*complex or unusually large*" (Reg.33(1)(f)). In a situation where a dealer is making a sale, where s/he knows or suspects that the buyer would not be able to make the purchase using their own funds, it may be that enquiry as to the identity of the "ultimate buyer", and CDD / EDD on that person, as required, is necessary.

It is important to note that the test is "unusually large". A "large" transaction, which is not "unusual", does not, of itself, automatically trigger a requirement for EDD.

CDD at arts fairs

In respect of sales at art fairs, paragraphs 54 (p.13), 5.60 and 5.61 (p.68) of the Guidance provide some assistance:

Paragraph 5.61 states that:

> *"for face to face verification, production of a valid passport of photo card driving licence (so long as the photograph is in date) should enable most individuals to meet the identification requirement for AML / FCFT purposes".*

It therefore follows that, for "most individuals" (which must be taken to mean lower-risk individuals), there are two approaches that might be taken to meet CDD obligations in respect of sales at an art fair:

1. If the customer, on the day, is able to present a passport or valid and in-date photo card driving licence (or other government ID, with a photograph), a copy should be taken, the copy should be certified by the member of staff conducting the sale (to confirm the original has been seen) and the copy should be saved and stored on file; or
2. If the customer is not able to produce photographic identification document at the fair, as envisioned in paragraph 54 (p.13), a sale may be *agreed*, but the work of art should not be released before CDD measures are complete.

In practical terms, customers who may wish to purchase work valued above €10,000 at an art fair should be advised to bring a passport or other photo ID, should they wish to take the work home on the same day. In time, as the AML regulations become embedded in the art market, taking photographic ID to an art fair will likely become common practice.

The ML Regulations are complex, and the Guidance lengthy. This e-alert is not intended to represent a comprehensive summary of either, does not represent advice, and must not be relied upon as such.

We have advised a number of art dealerships, galleries and auction houses on implementing the ML Regulations. If we can be of assistance in this regard please do not hesitate to get in touch.

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