

# Ready or Not, New UK Anti-Money Laundering (AML) Regulations Hit UK Art Sector from 10 January 2020

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## Introduction

1. On the UK Parliament's last working day before Christmas, new regulations (The Money Laundering and Terrorist Finance Amendments Regulations 2019) (Regulations) were passed with almost no warning to implement the European Union's 5<sup>th</sup> Money Laundering Directive (Directive). The new Regulations now take effect from **10 January 2020** and have major consequences for art market practices.
2. Although a Government Consultation Paper was issued in April 2019 (Consultation) inviting views from the UK art sector regarding how intermediaries would be brought into the scope of the new rules, and official guidance was expected by many at the end of last year, it now seems that the views of industry will not be taken on board to help refine the rules before implementation.
3. The UK Regulations take a 'principles based approach', appearing to have re-used many of the EU Directive's provisions without providing further detail on their scope and application.

## Who do these AML Regulations Cover?

4. The Regulations amend the current UK Money Laundering etc. Regulations 2017. Crucially, '**art market participants**' doing business in the UK (along with letting agents, crypto asset exchange providers and custodian wallet providers) now become a '**regulated sector**' for AML compliance purposes when participating in transactions with values over 10,000 EUR (currently around £8,500 GBP or \$11,000 USD).
5. As a regulated businesses, art market participants must follow certain mandatory procedures to verify ultimate client identity and veracity of a transaction to minimise the risk of being caught-up in money laundering when taking on new business.
6. An 'art market participant' is a firm or sole practitioner who by way of business trades in, or acts as an 'intermediary' in the sale or purchase of, works of art; or is the operator of a 'freeport' (designated as such by the UK Treasury) when it, or any other firm or sole practitioner, by way of business stores works of art in that freeport.
7. Despite the Consultation indicating that further clarification would be provided, the Regulations do not give guidance on whether an 'intermediary' includes dealers and others involved in a transaction who provide advice to owners and collectors, but who don't actually send or receive any of the actual sale proceeds. Subject to further guidance, any professional taking a substantive role in the planning or execution of a transaction should assume that the Regulations apply.

8. The Regulations also apply regardless of the size of the art intermediary business, so sole traders and small galleries will be subject to the same rules as the large international auction houses.
9. Under the Regulations, 'works of art' are as defined under current UK VAT legislation which includes artist created pictures, collages and similar decorative plaques; paintings and drawings; original engravings, prints and lithographs; original sculptures; tapestries and wall textiles from original designs; individual signed ceramics; enamels on copper; and photographs taken or printed by the artist. This definition appears however to exclude collectors' items and antiques, so transactions involving these ostensibly remain outside the scope of the Regulations.

### Key Features

10. Key features of the Regulations to note are:
  - (a) Regulated entities now need to register with the relevant regulatory authority. In the UK, art sector participants who are now regulated, will need to register with HM Revenue & Customs (HMRC) – see <https://www.gov.uk/guidance/register-or-renew-your-money-laundering-supervision-with-hmrc>. At the moment, the HMRC website has not been updated to take account of the new Regulations. Newly regulated art market participants (and their owners, officers and managers) will need to apply to the HMRC for registration within 12 months of the Regulations taking effect (i.e. **10 January 2021**).
  - (b) Conducting 'client due diligence' (**CDD**) is now compulsory for art market participants who are participating in a transaction (or linked series of transactions) whose value exceeds 10,000 EUR.
  - (c) There's no specific list of documents to obtain for conducting CDD, but current UK guidance on CDD refers to at least the following: full name of the client; photographic ID and date of birth on an official document (e.g. a passport); recent proof of a client's residential address. These should be originals or copies certified by a legal professional.
  - (d) If acting for a company, trust or partnership or a consignor/counterparty representing an underlying client, participants will need to establish the relevant ownership structure and then identify/conduct CDD on the 'ultimate beneficial owner' (**UBO**) or client. For UK limited companies, beneficial owners' registers such as that held at UK Companies House can be used.
  - (e) Once identified, participants need to establish the relationship between the UBO and the consignor/counterparty they are acting for. They should also make enquiries about the purpose of the planned transaction and source of transaction funds. A client's authority to act if they are acting in an agency capacity for someone else or as one of the joint owners of a work, also needs to be verified.
  - (f) Individual clients or UBOs, once identified, need to be checked against 'watch lists' for sanctioned individuals (e.g. the HM Treasury's Office of Financial Sanctions Implementation (OFSI) list in the UK or Office of Financial Asset Control (OFAC) in the US) and 'politically exposed persons' (known as PEPs). There are a number of third party service providers who offer verification and screening services.
  - (g) AML compliance requires regulated art intermediaries to take a 'risk-based approach' to determine the level of risk they may be exposed to by acting for a particular client or participating in a particular transaction.

- (h) The level of due diligence to conduct may be 'standard' as noted above or 'enhanced' or 'simple'.
  - (i) 'Enhanced due diligence' (**EDD**) will be needed if the basic client diligence signals a potential red-flag issue that makes a transaction potentially high risk such as:
    - (1) A client in a 'high-risk' country – the EU publishes a list here: [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_19\\_781](https://ec.europa.eu/commission/presscorner/detail/en/IP_19_781).
    - (2) A client who is a PEP (see above);
    - (3) No face to face interaction with the client; and/or
    - (4) Anything raising doubt about the nature of the transaction, such as gaps in provenance of the work, a refusal to identify the buyer or seller, an artificially inflated price or apparent rush to complete a sale without legitimate reason.

Where there is a need for EDD, further reasonable enquiries need to be made. Generally, as well as obtaining evidence of the client/UBO identity and source of funds, you will need to seek further background information on the transaction to reasonably satisfy yourself of its legitimacy.
  - (ii) On the other hand, intermediaries may be able to apply 'simplified due diligence' (**SDD**) where acting for a 'low risk' party. The main examples of this are when acting for: a bank or financial institution regulated in a reputable territory; a corporation/company whose stock is listed on a recognised stock exchange or a government/public authority in a low risk country. Where you are satisfied that a client falls within the SDD category, then the only requirement is to identify them, for example, by checking a regulatory listing.
    - (i) **Note:** Just because a client is an existing or long-standing client, this does not mean they are exempt or automatically qualify for SDD. If you are a regulated party, you will need to assess whether you have sufficient information to satisfy yourself of the client's identity and that they have been recently checked against relevant watch or sanctions lists (see above).
    - (j) If a client (or prospect) does not provide satisfactory CDD documents or information, AML Regulations require that you should not act for them.
    - (k) Regulated entities need to keep records of the CDD checks they have carried out. In the UK, such records usually need to be retained for up to 5 years. These records may need to be shown to HMRC to demonstrate compliance with the Regulations or to a law enforcement agency if there is an investigation about a particular client or transaction at a later date.
    - (l) Counterparties to a transaction (such as a buyer or seller) who are subject to AML regulation may request sight of documents you have obtained as part of your CDD. Although you are not necessarily legally obligated to provide these, refusal to do so could mean that those counterparties cannot transact with you or your client.
- 11. There are other requirements for regulated entities to implement AML policies, train staff and appoint a nominated money laundering reporting officer (**MLRO**) and a deputy to act as that regulated entity's principal contact point for AML compliance.
- 12. Where necessary, a regulated entity (through its MLRO) will need to submit a 'suspicious activity report' (**SAR**) to the relevant law enforcement authority where any information they have obtained gives them 'reasonable grounds' for knowledge or suspicion of money laundering. In the UK, the relevant authority is the UK National Crime Agency (NCA) (see <https://www.nationalcrimeagency.gov.uk/>).

13. In circumstances where an SAR is being or has been submitted, the regulated intermediary/MLRO is prohibited from and must **not** inform the relevant client (or their representative/agent) of the fact it has made an SAR unless expressly allowed to do so by the NCA. (**Note:** Informing such a party is called 'tipping off' and can be a criminal offence if it prejudices a criminal investigation).

#### **What to do?**

14. We expect that, aside from some of the largest international galleries and auction houses, many art sector participants are either only in early stages of planning or are unprepared for the Regulations taking effect, given there has been very little opportunity to see the rules in their final form. It's also not entirely clear how far the views of the UK art sector were considered in the final Regulations. There is a reference to considering stakeholders' views in the accompanying Explanatory Memorandum, but no specific mention of the art sector response.
15. However, the Regulations are now with us and we recommend that any intermediaries doing business or that are likely to do business in the UK (and/or other parts of the EU) take immediate action to review their current internal procedures and put into place measures to ensure that relevant CDD is conducted on any new clients (with transactions that are likely to meet the threshold) from the 10 January 2020.
16. You should draw up a checklist of documents and procedures you need to verify client identity. The Responsible Art Market (RAM) initiative due diligence toolkit: <http://responsibleartmarket.org/guidelines/art-transaction-due-diligence-toolkit/> has further guidance on this which you may find helpful. You should determine whether there are technology solutions that can assist with some of this process such as access to PEP databases.
17. A chain of responsibility should be set up for AML compliance internally and staff who take on new client business should be made aware of the new requirements and appropriate training should be given to make sure that relevant parts of the business are aware of the requirements on them. Money should **not** be accepted from new clients before conducting appropriate CDD as referred to above. Records should also be kept of the CDD documentation that has been obtained and these should be kept secure.
18. You should undertake a risk assessment of any existing clients as you will need to consider whether the information you hold on their identity is sufficient and up to date, based on your risk assessment of the client. This is needed so that you are able to demonstrate that you have taken appropriate steps to verify the identity of your client. If anything has changed in the period since you have taken the client on that renders the information you have about them out of date, then you may need to conduct CDD on them.
19. You should also ensure that any parties with whom you contract also need to understand the new requirements. The requirement to obtain relevant CDD documents and any other information required to comply with the Regulations (and other applicable AML laws) should be written into your invoices and contractual documentation.
20. Also, you should consider the GDPR/data protection implications of having to conduct background checks on individual clients, and review/amend your client facing privacy notices to set out the checks that you are likely to undertake in order to meet GDPR fairness and transparency principles.
21. You should prepare for registration with the HMRC and appoint a responsible MLRO in order to be your main point of contact with regulatory authorities and law enforcement. You should ensure that procedures are in place so that any questions around particular clients or transactions are reported through the MLRO and that no one else in your business does this.
22. If a client or potential client (or their representative) refuses to provide relevant CDD documentation when asked or delays in providing information without good reason (or sees compliance as an obstruction and threatens to take their business away), then you should not act for them. UK banks,

financial instructions, lawyers and accountants have had to conduct CDD checks when taking on new business for a number of years and legitimate clients should be prepared to provide relevant documents, when asked, in the same manner that they currently have to with these organisations.

23. If you do business in other EU member states you should also take advice on the national implementing AML legislation in these countries. For example, we understand that Germany has passed similar legislation to meet the 10 January 2020 implementation date.

Check any relevant industry guidance when it comes out. The Explanatory Memorandum for the Regulations states that the British Art Market Federation will be providing guidance for the art sector.

24. Take advice, where necessary.

Please note that the above is only a summary of the new requirements. We will be providing further updates in due course and if there are any further regulatory developments in the UK or elsewhere.

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