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Money Laundering in the Global Art Market

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Abstract

It is no secret that money laundering has seeped into the art market for years, but veils of anonymity and lack of regulation have kept many of those who foster the illegal operations immune from justice. As criminal operations permeate the art market on a regular basis, what can be done? This thesis will approach this question through an examination of qualitative data and studies, including investigating applicable recent cases, to understand four unique vulnerabilities of the art market and how these weaknesses are exploited. Additionally, the major groups who use the art market as a means of money laundering will be identified. I will be analyzing how each of these factors perpetuates the problem of money laundering in the art market, and I will propose solutions on two fronts: government regulation and internal self-regulation. These proposed actions, both external and internal, directly correspond to the vulnerabilities identified. These actions are intended to build upon current regulation imposed by the European Union and United States, as this governmental group comprises much of the art market's total value. Recommendations to bolster the art market's self-regulatory culture, however, are not restrained to national borders, but reflect national policies. Despite being frequently portrayed as a "victimless crime," money laundering on this scale is fraught with danger to not only national and global economies through the effects of tax evasion, but also the safety of people around the world through the finance of terror organizations.

Keywords: art market, money laundering, art market regulation, tax evasion, terror finance

I. Introduction

When purchasing high-value fine art through galleries and auction houses, anonymity is common practice and veiling transactions and using third-party bidders is expected. Security measures intended to protect clients, while in place to reduce crime and bolster privacy, also creates a curtain of obscurity that allows the 65-billion-dollar global fine art market to be ripe for money laundering. While this is a subject that has only recently gained traction in mainstream knowledge and is seemingly distant to the average citizen who doesn't participate in high-stakes art bidding, the consequences of money laundering in the art market ripple beyond the immediate layer of individuals who can consider collecting, selling, and trading fine art created by the likes of Leonardo da Vinci, Rembrandt, and Picasso. Money laundering schemes stemming in the art market is frequented by both the ultra-wealthy and terrorist organizations, making this not only an economic issue, but also a public safety issue—problems that can affect all levels of society.

Since the illicit nature of money laundering will make uncovering new cases an unreasonable goal for this research, government documents, independent reports, peer-reviewed articles, and statistics will be the primary methods of obtaining relevant information. Using these, the goal of this thesis is to shed light on money laundering within the global fine art market, making the issues currently surrounding the market common knowledge and proposing regulations to mitigate vulnerabilities in the market. This thesis will use a qualitative research approach of money laundering within the global fine art market by reviewing the current state of the market, illuminating who uses this market for money laundering, investigate how money laundering in the art market occurs, highlighting primary current market regulations, and finally proposing recommendations to both government regulation and internal self-regulation. Without change to the regulations surrounding the art market in the United States and European Union, the ultra-wealthy will continue to destabilize social structure through tax evasion, and terrorist organizations will bolster their sources of income, funding the purchase of weapons and deadly materials that endanger the public.

Terminology

Before beginning this research, I will define common terminology surrounding money laundering and the art market to create a foundation to understand research presented later. First, the global art market is the system of private dealers, auction houses, physical galleries, online galleries, appraisers, and art collectors, including their transactions both nationally and internationally. Additionally, the distinction between the art market and the underground art market must be made: the art market includes all legal transactions of artwork, while the underground art market is comprised of illegally imported artwork, stolen artwork, and fake or reproduced artwork—items that could not be sold at, for example, a legitimate auction. Both markets have high potential for money laundering, however, I will be examining the relationship between money laundering and the legitimate art market. For the purpose of this study, I have defined art itself as illustrations, photographs, and non-textual material intended to be published. Additionally, art and fine art can be easily confused, and this distinction should be noted. Art includes many categories such as of fine arts, performing arts, visual arts, video arts, and architecture. Fine art, however, is creative art, and especially visual art where the products are to be appreciated primarily or solely for their imaginative, aesthetic, or intellectual content (Oxford 2023). Paintings from Picasso and Rembrandt, for example, are often the first type of fine art to come to mind but can encompass sculptures, drawings, and printmaking as well. Paintings, being the medium primarily explored in this research, can divided into four subcategories: Old Masters, Impressionist and Modern, Postwar, and Contemporary (Vincent). Antiquities, while sometimes included in the global art market, are a separate category of art: these are items that have survived from ancient civilizations, such as statues, sculptures, or coins (Collins 2018). For example, the U.S. State Department recognizes ancient coins as being the most stolen and sold antiquity (Pineda 2018). Because of their comparative scarcity in legal art trade, however, antiquities are not a statistically significant portion of art that is speculated to be used in money laundering operations and will only be briefly mentioned in this research. When it comes to large scale money laundering, fine art is the most common means compared to the other categories of art stated above and is what I will primarily focus on in this research.

Money laundering, according to the U.S. treasury Department, is the process of transactions where criminals and terrorist organizations conceal the source and nature of their funds and illegal operations (Treasury Department). The objective of money laundering is to turn illicitly gained "dirty" money into legal, useable cash, or "clean" money, there, laundering the funds. More methods of money laundering will be explained later in this research. Layering, which is a crucial step in money laundering, is the series of movement of cash between owners making dirty money as difficult to track to the source as possible, adding layers of transactions that make money appear to be legally gained, adding financial legitimacy (Comply Advantage). The layers of laundering within the market occurs by buying and selling pieces of valuable artwork many times until the original cash has been dispersed. Additionally, the use of the online banking systems and cryptocurrency has made tracking money through layers even more difficult, as criminals can not only transfer funds between financial institutions, but also between currencies. Cryptocurrency includes any digital currency that is a substitute for cash and is not maintained by a central authority like a government or bank (Oxford 2023). Cryptocurrencies have no physical form and records are stored in anonymous, decentralized systems, which can make identifying the owner of funds very difficult. Common cryptocurrencies include Bitcoin, Ethereum, and Tether. Using Blockchain, which is a public ledger of cryptocurrency transactions, the use of cryptocurrency can easily be tracked and has the potential to be valuable tool for financial institutions (Cousins 2021). Shell companies, which are not illegal, will also be mentioned in this research; these are companies used to launder money that only exist on paper in low-regulation jurisdictions such as the British Virgin Islands and Cayman Islands and have no physical office or employees, and can protect the identity their Ultimate Beneficial Owner (UBO) (Comply Advantage). The Panama Papers leak in 2016 illuminated the extent of these and cost the United States alone over $70 billion each year (Comply Advantage). Shell companies may, however, have their own bank accounts and own both financial assets and physical property—including fine art.

Within this research, many regulatory terms will be used, and anti-money laundering (AML) regulations will be cited. These are the set of regulations, policies, and legislation that are in place to prevent money laundering. Additionally, the Financial Action Task Force, or FTAF, is the watchdog organization created by 16 G7 nations (and now includes 39 members) to recommend AML laws, determine which countries have below-standard AML laws, and to create recommendations to mitigate future threats (FTAF 2023). There are various software systems used to help prevent money laundering, in addition to the laws themselves: name screening, currency transaction reporting (CTR), and transaction monitoring, along with regularly updating AML regulation compliances. Name screening is used to flag sanctioned accounts or individuals that have conducted suspicious activity in the past. CTR is a software that identifies transactions of excessive amounts of cash, as well as one account transacting in many small amounts—traditional banks, for example, are required by the IRS to flag deposits of

$10,000 or more. CTR software completes this, as well as noticing someone attempting to evade this by depositing $9000 ten times (FDIC 2021). Transaction monitoring is similar—it identifies patterns of transactions that are suspicious using historical data, like if someone who never deposited more than $100 over their membership at a bank suddenly deposits $8,000 in cash (Napier). Lastly, financial institutions can use compliance software that keeps FTAF regulations updated, trains employees on changing technology, and tracks data, reports, and flagged transactions.

II. Current State of the Art Market

Next, the current state of the global art market will be established to understand the impact of money laundering on the art market in the present and in the future. First, global trade is growing in this market, despite a small setback at the beginning of the COVID-19 pandemic as dealers and buyers were forced to abruptly adapt to fully remote business. A survey by Dr. Clare Andrews of Art Economics found that worldwide imports fine art, as well as antiques, increased 41% in 2021, and exports increased 38% (UBS 2022). This level of increase is impressive after the pandemic, and if this trend continues, record highs could be reached by the end of 2023. These increases can partly be attributed to the resumption of in-person art fairs. Of 2,700 collectors from 11 art markets surveyed by Dr. Andrews, 65% purchased art at fairs in person, while just 37% did in 2021 (UBS 2022). Similarly, purchasing art online remains strong—95% of Andrew's participants bought art through the internet, half of which did so on a regular basis; online art sales are here to stay, even after the pandemic (UBS 2022). As online sales increase, the use of cryptocurrency will increase also—a factor to seriously consider when examining potential for anti-money laundering regulations. Overall, median expenditures by collectors increased in 2021 and 2022. In the first half of 2022 alone, the average collector spent $180,000, which surpassed the average of the entire previous year, which was $164,000, and was almost double from the pre-pandemic median of $100,000 (UBS 2022). This data indicates a strengthening art market—collectors are confident and spending more, which has helped create the $65.1 billion-dollar final market at the end of 2022, just $2.1 billion shy of pre-pandemic highs, and 29% higher than pandemic lows.

This increase in the value of the art market and the expenditures of collectors isn't, however, a fluke or impulse after the world was in isolation for a year. In 2020, a low year for the art market, one of every ten fine art sales were still valued at over $50,000 each, and these transactions accounted for 85% of the entire value of the art market (Napier 2022). The value of the market reached $50 billion, and despite being uncharacteristically low due to the pandemic, global sales of art, numbers of participating artists, and auction houses in operation have trended upwards for the last 30 years. In a study by ArtNet Art Business editor Tim Schneider, between 1988 and 2018 the number of artists in the ArtNet price database increased by 650% and the number of auction houses, including physical locations and those solely online, in operation increased by 5,550% (Schneider 2019). Additionally, in Hong Kong alone, which is becoming a hotspot for art sales globally, the total number of art sales between 1991 and 2018 increased from almost no sales to $1.25 billion (Schneider 2019). As the art market is expands both financially and in physical size, so does the potential for money laundering.

Vulnerabilities of the Art Market

So, what makes the global art market so vulnerable to money laundering? The answer can be broken into four areas that are considerably weaker compared to other financial institutions. First, individual pieces of art can have extremely high value when compared to other individual retail items—with prices of high value art pieces regularly fetching thousands and even millions each at auction, they make prime real estate for money laundering—the more money that can be laundered in a single transaction, the better. Despite the existence of CTR technology being an obstacle in large bank deposits, fewer transactions of items both decreases the chance of suspicion—art regularly sells for luxury prices—and makes layering the item easier. A company that regularly purchases one hundred $10,000 paintings is significantly more complicated and suspicious to banks and AML task forces than a single $1 million dollar art piece by a wealthy individual. Secondly, the pricing itself of the art is extremely easy to manipulate and is subjective. For example, if someone has $1 million to launder, they can use shell companies to artificially inflate the price of a piece of fine art in auction to the amount they need to launder. With the high opacity of the market, which will be mentioned shortly, and subjective value, this can be a simple process. The saying "something is only worth what someone will pay for it" truly comes to life in art auctions—who is to say if a buyer just really likes a piece of art, or is using its high price as a tool of laundering cash? In addition to subjective pricing, the art market is very opaque, meaning that is not difficult for third-party buyers to purchase artwork on behalf of separate individual supplying funds, which veils the true buyer and where the funds came from, as well as where the artwork will go if it is sold again later. Lastly, fine art is easy to move across borders and warehouse. Most artwork doesn't attract the attention of authorities because of its small, unsuspecting nature, and even if it is noticed, most border and port agents cannot identify or appraise the value of artwork on the spot. This, paired with the ability of individuals or companies to store artwork cheaply and anonymously in international freeports, which I will go into more detail later, makes moving and selling artwork far easier than other luxury goods that are more heavily regulated.

These vulnerabilities of the art market are targeted by three primary groups: the ultra-wealthy, those funding terrorist organizations, and drug cartels. These groups also highlight why hindering money laundering is an both important and urgent. It may seem like it is more necessary to focus on the funding of terror organizations like Al Qaeda, the Islamic State, and the Taliban, however, Adriana Baranello, writing for the Seton Hall Legislative Journal, states, "Preventing tax evasion is equally, if not more important, because tax evasion facilitates and funds terrorism and organized crime. Furthermore, the techniques used to launder the proceeds of both are substantially similar" (Baranello 2021). While the urgency of halting funding for terror organizations is the cornerstone of this problem's urgency, the speculatively low volume of income makes it the secondary issue—the ultra-wealthy who launder billions each year, which will be explained shortly, is a more pressing matter. Cracking down on the ultra-wealthy not only mitigates the individuals looking to pay less tax for personal or business reasons, but also can identify and stop the wealthy families funding terror groups; Osama bin Laden, for example became a prominent leader from his access to his family's construction company wealth, despite the family disagreeing with his use of the funds. This research and regulatory suggestions will be applicable for both groups, however, this will focus more closely on the methods of laundering money used by ultra-wealthy and with legitimate sales, rather than stolen antiquities sold illegally. The ultra-wealthy individuals that launder money with are often legitimate participants; hindering sales of stolen art and antiquities presents another concern altogether. Judge Fausto Martin De Sanctis states that "Investigations in the United States, for instance, show that most (80–90%) of the crimes committed in this field are perpetrated by participants in the market, which includes curators, collectors, volunteers, dealers, appraisers and even professors" (De Sanctis 2013). To launder money, individuals require an entrance within the art market—either they themselves are active, or they have connections willing to be an accomplice in their schemes for a cut of the money laundered. Later in this research, I will review a case where exactly this happens. This is one reason that soft self-regulation within the art market has done little to stop money laundering: the criminals aren't trying to get into the market, they are the market and can easily bypass most recommended self-regulation.

First, the ultra-wealthy, often with the help of businesses, are primarily laundering money to increase profits through tax evasion. Tax evasion is frequently titled a "victimless crime," not because there are not victims, but because it is often nearly impossible to determine specific individuals affected and laws surrounding it are not enforced as strongly, they could be, leaving room for the wealthy to exploit the art market's relaxed regulatory environment. Tax evasion, however, is not a victimless crime. As the world's richest avoid paying millions in taxes, they withhold funds are essential to the operation of society, reducing the budget for essential salaries, maintenance, infrastructure, and social programs (Matthews 2019). While tax evasion may not have a single, identifiable victim as a home robbery would, it destabilizes national economies, affecting all citizens—especially developing nations and those in the lowest tax brackets who depend on government assistance. While there is little data on tax evasion per tax bracket, a look at some statistics will be helpful to understand the severity of the tax evasion by the ultra-wealthy and the importance of reducing money laundering in the art market.

First, one in five individuals with a net worth over $1 million dollars are presumed to collect art (Artwork Archive 2016). These individuals with more than $1 million dollars in net worth comprised the 0.8% of the world population, holding 44.9% of global wealth, meaning 8.4 million people collect high-value fine art (Matthews 2019). Additionally, a 2001 study "Indicates that the top 10 percent of earners were responsible for 28 percent of tax evasion, meaning overall rates of tax evasion are likely much higher for higher income individuals" (Baranello 2021). But how do these figures relate to the victims of crime? In a 2013 IRS report, $381 billion of taxes went unpaid that were owed by citizens, which is 56% of the federal budget deficit of that year (Baranello 2021). Globally, however, this number increases massively; the United Nations reported that over $1.6 trillion is lost annually due to financial crimes (Barefoot 2019). Oxfam International, an organization of charities, believes that this number is even larger, stating that the fifty largest US companies alone have $1.6 trillion in offshore accounts, and that the twenty largest banks in Europe put 25% of their profits into accounts hidden beyond the borders of their own countries (Oxfam). Tax evasion on this level only widens the already growing economic disparity and social inequality between socioeconomic classes. Oxfam International states that Africa loses out on $14 billion due to ultra-wealthy individuals and businesses avoiding taxes—enough money to provide healthcare and education for 4 million children (Oxfam). The continent of Africa holds nine of the ten countries who receive the most financial aid from the United States alone in 2017, and $14 billion of extra funds would create a 41% increase in financial aid each year.

The second and third groups exploiting art for financial gain are terrorist organizations and drug cartels, using money laundering as a means of cleaning cash that is intertwined with violent acts. Unlike the white-collar crime of tax evasion, where victims are difficult to identify, the crimes stemming from the funding terror organizations and organized crime is much more obvious. Now, there is only little evidence that terror organizations such as Al Qaeda or the Islamic State specifically use the legal global art market to launder money in traditional ways such as layering, however, the methods of obtaining funds are similar when selling and moving art illegally—which is a separate issue that also must be stopped. Hans-Jakob Schindler and

Frederique Gautier of the International Journal of Cultural Property, use evidence from the United Nations Security Council, writing “In recent years, the Islamic State in Iraq and the Levant (ISIL) as well as several Al-Qaida affiliates have used the systematic and large-scale looting of antiquities as one of their income streams” (Gautier 2019). While this isn’t money laundering per-se, the paths and connections creating when moving, storing, and selling stolen artifacts and antiquities are not dissimilar from those used when laundering money by layering art purchases (Baranello 2021). Additionally, the same means of moving stolen artifacts can be used for moving weapons and various contraband, which have specific consequences to the targets of terror organizations. Since most looted antiques and artifacts can be identified as stolen if brought to the legitimate art market, terror groups sell these through underground channels (Gauiter 2019). Despite the specific stolen artifacts themselves not being circulated to launder money, the funds gained from illegally selling them must be cleaned to some degree, by terrorist organizations or by future buyers; even if no stolen artwork is ever seen in the art market, the funds gained can still use the art market as a means of cleaning it, or art as collateral, thus entering legitimate banks.

Additionally, drug cartel leaders, and most notably Pablo Escobar and Joaquín Guzman Loera, better known as “El Chapo” have been recorded using fine art to laundering proceeds from illegal drug sales. Since the cartels often own Mexican banks, it is difficult to track the true amount of cash laundering, but Escobar, laundering approximately $10 billion each year, was known to collect paintings by Salvador Dali and Pablo Picasso to laundering proceeds from the drug trade (Roth 2016). Additionally, evidence of the drug cartels using art to launder money can be extrapolated from a 2012 regulation change in Mexico. In this regulation, the Mexican government began requiring galleries and auction houses to disclose client information and reduce cash sales—something that legitimate buyers would have nothing to worry about, but buyers looking to hide their identity would stray away from. After the regulation began, art sales in Mexico fell by 70% (Roth 2016). In 2012 alone, the Mexican art market was valued at $645 million (Romero 2012). With client disclosure regulation, it would fall to $194 million. Drug cartels rely on their billions to continue to hold power in Mexico, and even small increases in AML regulation can have significant effects.

Money Laundering Tactics

Now that the "who" of money laundering within the art market has been established, how exactly do these individuals and groups launder the money using fine art? There are three primary instruments of laundering money within the art market: layering, freeports, and market manipulation. The first method, which was mentioned earlier, is the most traditional and widespread form of money laundering and can be found not only within the art market, but also in other financial systems. Laundering money has three steps: placement, layering, and integration. In the placement stage, criminals simply move funds from their origin into a financial system by, in this case, buying a piece or multiple pieces of art. To layer these funds, the criminal then sells the artworks to one or multiple intermediaries, which can be accomplices or buying more pieces of art, to spread the illegal funds around and make the original illegal transaction difficult to track, creating the possibility for an infinite number of transactions (FCA). Often, these sales are at a loss for the original buyer; for example, it is better to have $75 of legal tender you can spend than $100 you can't spend. The goal of money laundering isn't to make money, it is to convert unusable cash into useable funds. Lastly, in integration, the criminal intends be reunited with the laundered money through various investments such as selling the art to a completely innocent buyer—this way, it is difficult for authorities to distinguish legal and illegal funds (FCA). The art market is a prime location for laundering money in this way because it is commonplace for ultra-wealthy buyers to use third parties to purchase a high-value art for them in the name of security; no one questions those attempting to launder money when anonymous names are present. Additionally, this accepted veil of secrecy allows perpetrators to use shell companies to both artificially inflate the price of art and to "own" pieces of art until the funds are ready to be fully integrated. Shell companies, whose UBO is naturally hidden, can use freeports to hide and store art used for laundering.

Freeports, as defined by the congressman Emmanuel Cellar (D-NY) who pioneered their establishment in the United States, are "A neutral, stockaded area where a shipper can put down his load, catch his breath, and decide what to do next" (Tiefenbrun 2012). Additionally, freeports are economically separate from traditional ports, as well as the taxation that comes with importing and exporting goods; the goods within a freeport are still technically in transit, despite not actually moving. Freeports are meant to foster economic growth for countries by incentivizing companies to import to locations, as they would pay fewer taxes, have their goods securely stored, and can even finish the packaging and labeling process of goods within the freeport before shipping domestically (Tiefenbrun 2012). While these benefits are certainly helpful for those importing and exporting goods, they also help those operating money laundering schemes evade detection. Since freeports regularly receive goods that cost tens of millions of dollars, security is a key factor. For those laundering money, this means they can securely and anonymously store artwork within freeport warehouses without paying taxes that would otherwise be associated with a multi-million-dollar painting or the prying eyes of customs officers and government agents. A 2016 UNESCO (The United Nations Educational, Scientific, and Cultural Organization) report stated that "Recent embarrassments have confirmed that some art dealers are closely involved in the illegal trafficking of cultural property through free ports" (UNESCO 2016). The report details that Swiss freeports were a "haven for looted antiquities" including pieces owned by the Getty Museum in Los Angeles, over 200 ancient Egyptian artifacts, and a stockpile of artifacts from the Roman and Etruscan era (UNESCO 2016). While even this may be shocking, the owner, once caught, admitted that he had stored his collection across 29 freeports globally with the treasures in crates marked with the name of a shell company—all of which had gone completely unnoticed and unreported. The lack of oversight on the global freeport system allowed this, as well as many other similar cases, to go unnoticed for decades. Despite freeports being monitored by several global organizations, a 2010 FTAF concluded that the current state of freeports is a "money laundering and terror financing threat" (FTAF 2010).

Market manipulation is the third method of money laundering that occurs through the global art market. Market manipulation is "When someone artificially affects the supply or demand for a security (for example, causing stock prices to rise or to fall dramatically)" (Investor.gov). Examples of securities are stock certificates, debts, bonds, and debentures. This can be best illustrated through a recent example of using Picasso's "Personage's, Painted 11 April 1965" to launder money gained through market manipulation. Over the period of several years, Beaufort Securities, a now-defunct investment firm, gained over $50 million by selling valueless securities and layering them into various markets so they wouldn't be noticed and through real estate turnovers (Baranello 2021). In 2017, Matthew Green, owner of Mayfair Fine Art Limited, and Beaufort Securities, schemed to clean the money with the help of an undercover federal agent who posed as a client. The undercover agent would purchase the $9 million Picasso painting with illicit funds from Beaufort Securities, then Green would transfer the funds back to the undercover agent (Gerlis 2018). The painting, however, would never actually leave Green's possession; he would keep it hidden for some time to not raise suspicion, then would buy the painting back at a lower price. For participation in the scheme, Green asked for 5% of the sale as payment: $450,000. After being caught, Green was recorded stating that "the art trade is the only market that is unregulated" and that one "could even buy the art under a false name with no repercussions" (Baranello 2021). While this case was fortunately busted, it leaves much to speculation, considering it is a miniscule drop in the $65 billion dollar art market; the United Nations Office on Drugs and Crime, however, report billions of the dollars circulating the art market are involved in crime and money laundering schemes in 2019 (Boulder Group). The Green-Beaufort case also sheds light on a separate problem in the art market—priceless art works, especially those from the Old Masters, are regularly bought and sold with no regard to their value in the public eye—Picasso's "Personages", for example, only had records of being owned by several private collections and galleries—these could have been previous instances of money laundering, and the opacity of the market makes it impossible to know.

Two more cases showcase the range of art being used for money laundering and tax evasion. In 2014, the case *U.S. v. Ronald Belciano et al* was made after U.S. police found and seized "$4 million in cash, 125 pounds of marijuana, and 33 paintings worth more than $619,000" (Mashberg 2018). While a small drop in the bucket of the art market, prosecutors stated that Belciano received the artwork instead of cash for drugs under the promise that the artwork could be used as vehicles of money laundering over time. In the second case, a Brazilian financier Edemar Cid Ferreira was convicted of embezzling millions of dollars and laundering the stolen money by buying expensive artwork—he attempted to bring over ninety pieces of high value art into the United States, while only listing their value at $100 each

(Mashberg 2018). The most prominent of the pieces was Jean-Michel Basquiat's *Hannibal*, which previously sold for $79,500 in 1993. The Belciano and Ferreira cases, along with Matthew Green's incidence, all showcase different reasons for laundering art. Green laundered money for a firm as a means of making extra cash (a lot of it at that), Belciano laundered money to hide proceeds from drugs, and Ferreira laundered money to hide embezzlement. The issue of money laundering is not one that stems from a certain country, business, or person—art is a vehicle for the crime for all kinds of people and businesses. Thus, it would be ineffective to attempt to mitigate money laundering for a single source, such as only for wealthy business owners. Instead, encompassing regulation must be passed that effects both governmental legislation as well as market self-regulation and addresses vulnerabilities in the entire market.

Current Regulations

Now that the current state of the art market has been discussed and how money laundering within the market has been established, I will examine the current regulations and legislation in place to prevent money laundering. The discussion of regulations will be focused on the United States and the European Union. Although this research does include global perspectives on the art market and freeports, the U.S. and E.U. alone comprise 72% of global market share and provide market environments where significant change and cooperation can most easily be achieved (Statista 2022). In the future, however, other nations should be encouraged to model regulation in these two markets, which, despite many weaknesses to money laundering, already have many regulations in place. Once I have established current money laundering regulations and the recent history of changes made to the regulations of the U.S. and E.U. nations, I will present recommendations to AML regulations that could be beneficial in reducing money laundering through a variety of avenues.

European Union

First, I will examine AML laws in the European Union and United Kingdom over the last five years. In 2017, the E.U. implemented the 4th Money Laundering Directive (4MLD), and at this time, the U.K. was a member of the E.U. While not the most recent directive of money laundering regulation, the 4MLD added vital updates to the E.U.'s ability to hinder money laundering and is a cornerstone to the most recent iteration of E.U. money laundering regulation. The 4MLD consisted of three major components that were updated from the outdated 3MLD of 2005. These changes were risk-based approach verification, beneficial owner identification, and expansion of the Politically Exposed Persons (PEPs) list. Implementing a risk-based approach required market entities, like art galleries and auction houses, to prove they have taken appropriate steps to understand and reduce the hazards of money laundering and financial manipulation between client and business. Verifying that entities are up to date on their AML regulation knowledge and have implemented AML mitigation such as using CTR software is a helpful step in preventing money laundering at a key transaction point. The second major change in the 4MLD was requiring organizations to know who the beneficial owners of companies, accounts, and trusts are when a third-party was fronting a transaction. A beneficial owner is an individual whose property is legally owned by someone else. Additionally, all beneficial owners recorded in transactions must be added to a master list of beneficial owners contributed to by all countries in the E.U. Lastly, the 4MLD expanded its list of Politically Exposed Persons—individuals who hold political power in their respective countries and are susceptible to corruption by political leverage both during their time in office, as well as when not currently in elected or appointed positions. E.U. countries were required to monitor PEPs for a least a year after leaving their position (Harris).

In January of 2020, the E.U. implemented the 5th Money Laundering Directive (5MLD), and the United Kingdom adopted it. Like the 4MLD, the 5MLD requires all E.U. nations to be compliant in enacting new minimum AML regulations through domestic legislation. The 5MLD is not as significant of a move to mitigate money laundering risks as the 4MLD was, however, it does add some crucial requirements for E.U. nations, and was motivated by four factors: Change in terror attack methods, Panama Papers and FinCen leaks ($2 trillion in suspicious activity uncovered), the increase in cryptocurrency use, and the U.K.'s desire to regularly update legislation to reflect FATF recommendations (Harris). To combat these modern issues, the 5MLD increased regulations on five fronts. First, the 5MLD updated the PEP requirements from the 4MLD, requiring E.U. nations to match FTAF literature and constantly update their qualifications for PEPs. Additionally, the E.U. began creating a comprehensive list of all public functions that are considered politically prominent (Harris). Secondly, the 5MLD updated regulation on reporting beneficial owners by requiring nations to report discrepancies in beneficial owner lists. The 5MLD also recognized the use of prepaid debit cards as a means of crime and terror attacks and required Customer Due Diligence (CDD) to be conducted on purchases of prepaid cards over £150 (reduced from £250) (Laven 2021). Next, the 5MLD gave Financial Intelligence Units (FIUs) the authority to access information from central bank account registers at any time, even without reports of suspicious activity being filed (Harris). This includes cryptocurrency transaction oversight, cryptocurrency marketplace oversight, removing anonymity surrounding safe deposit boxes, and adding CTR regulations to art market transactions, where collectors, for example, must report any transaction over £10,000 and must answer in-depth questions about the buyers and the property's provenance. (Povey 2022). Finally, the 5MLD increased CDD to include checking Electronic Identity Verification (EIV) through secure, third-party channels, and increasing diligence on firms that open branches in high-risk countries, where AML regulations don't follow FTAF guidelines, but business is still conducted.

The 5MLD also added "Know Your Client" (KYC) rules, which include protocols such as ID verification, proof of address verification, and biometric verification. This is extremely helpful, as it helps mitigate one of the art market's greatest problems that the 4MLD failed to fully address: opacity of buyers and sellers. With KYC regulations in place, third parties and shell companies would be more obsolete, as the actual identity of the sales participants would be required, not just stand in names. Forging utility bills, home addresses, and biometrics, which would all be verified by trained AML officers, is significantly more difficult than simply putting a fake name or shell company title on a sales sheet. Instead of the provenance of artwork being listed as owned by an offshore shell company or behind layers of beneficial owners, a real person would have to be tied to the physical art. Additionally, this new directive by the EU continues to implement previous regulations participants within the art market, such as the use of staff training and hiring money laundering reporting officers.

United States

Prior to 2021, the United States AML regulations were primarily created within the Bank Secrecy Act (BSA) of 1970, however, with improvements in technology and a greater understanding of money laundering, the U.S. has made massive expansions to regulation in recent years. In 1996, the BSA was altered to include suspicious activity reporting (SAR), which is the predecessor for modern CTR technology. After 1996, several proposed changes to AML regulations were made, but it was only in 2001 that the Patriot Act, spurred by the 9/11 attacks, implemented identity verification and information sharing—a controversial step towards increased regulation and decreased transaction privacy in the name of public security. In 2004, the Intelligence Reform & Terrorism Prevention Act was instituted, which amended the BSA by mandating international transfers of funds from some financial institutions to be reported. During this time, transactions in the U.S. were only regulated by the Uniform Commercial Code, which had major vulnerabilities in its lack of transaction amount reporting. As mentioned earlier, all U.S. financial institutions are required to report transactions over $10,000 or more to FTAF member nations (U.S., EU, UK); under the UCC, the art market was surprisingly subject to no such reporting regulations.

In 2021, the U.S. implemented the Anti Money Laundering Act 2020 (AMLA). This is the most recent AML legislation passed in the U.S. and aims to renovate the outdated BSA. The AMLA does this on five key fronts. First, beneficial ownership disclosure regulations were strengthened (Comply 2022). Like in the 5MLD, this helps prevent money laundering operations from occurring under the shroud shell companies and third parties. Additionally, while AMLA doesn’t include many SEC registered businesses and FDIC institutions in their updated beneficial ownership reporting requirements, it upholds all CDD requirements from the BSA. Secondly, the AMLA increased penalties for those laundering money including PEP’s violating compliance violations and repeat offenders. Next, the AMLA introduces compliance laws for cryptocurrency, which includes bringing both cryptocurrency wallets and exchange servicers within the BSA AML laws. Lastly, the AMLA updated whistleblower rewards and protections from the BSA, creating more incentive to report suspicious activity.

AML initiatives like the AMLA, as well as their European counterparts, provide security in financial systems, but are still not fully effective. The Basel Institute on Governance reports that organizations and jurisdictions are still failing to meet the FTAF’s baseline of effectiveness for the prevention and enforcement of money laundering (Basel 2021). In North America, average prevention of money laundering and terror finance was highest, at 53% effective prevention and 56% effective enforcement. Europe trailed second, at 37% effective at prevention and 41% effective at enforcement. The U.K., however, achieved 67% in prevention and enforcement, which was the highest of any single country or region (Basel 2021). Globally, however, 2021 saw a much lower average score with regions preventing 27% of money laundering and terrorist finance, and 31% effective enforcement of AML regulations. The lowest of the regions were Sub-Saharan Africa and South Asia, preventing an average of just 5% and 6% of money laundering and terror finance and enforcing 8% and 13% of their regulations (Basel). While this disparity may be due to lack of available resources diverted towards AML action, there no doubt that the global regions with the greatest regulatory measures—the AMLA 2020 and 5MLD—are vastly superior at hindering money laundering. Additionally, only being three years removed the AMLA's implementation date, there is not much concrete data on the effectiveness of it specifically. In the coming years, I believe both the U.S. and E.U. will see increases in the prevention and enforcement averages.

III. Proposed Actions

In the final section of this research, I will make recommendations for AML regulation within the U.S. government and the E.U., including the U.K., as well as recommendations for self-regulation within the global art market. Increased regulation is needed within the art market because although the market fully operates in every capacity as other financial institution, it is missing key regulations on reporting transactions, UBO identification, and transparency, allowing money laundering schemes to go unnoticed. The expansion of government regulation specifically is necessary as it enforces all regulations, prevents widespread loopholes for fraud, and bolsters the market's reputation as a legitimate and safe market for trade. Internal regulation, however, is equally as important. Regular participants in the art market have long wished for self-regulation without heavy governmental interference for ease of trade, but self-regulation alone in a market fraught with tax evasion and money laundering schemes without increased government regulation is unlikely to be effective, as criminals can easily skirt soft laws and suggestions as they already avoid regulations in place today (Deloitte 2018). But this doesn't make internal regulation any less necessary—with proper self-regulation, the art market will gain credibility through transparency and authenticity and reduce money laundering schemes. The more successful self-regulation is, the more credibility the market will gain.

The following recommendations are meant to bolster the security of the art market's financial sector and prevent money laundering schemes in the future that correspond to the vulnerabilities discussed earlier: the naturally high value of art, the opacity of the art market, the subjective nature of the value of art, and the ease of transport of artworks. These recommendations are not necessarily limited to any single nation, agency, or governing body—they are suggestions that could be incorporated into any set of regulations to mitigate money laundering operations, much like FTAF guidelines. They aim to not only strengthen specific regulations and legislation already in place in the United States' AMLA 2021 and European Union's 5MLD, but also to strengthen actions beyond government control. Additionally, these recommendations will address the three primary groups taking advantage of the market's vulnerabilities: the ultra-wealthy, terrorist organizations, and drug cartels.

First, I will propose action to mitigate the vulnerability of the naturally high pricing of art in galleries, auctions, and all public sales. This is a foundational trait of the market that makes trading art for both legitimate collections and money laundering operations a lucrative vehicle;

without high prices, the market would not be the haven for money launderers that it is today. It would be futile to attempt to mandate price caps on art sales in galleries and auctions through governmental mandates and price caps provide no incentive for those self-regulating. So, if we cannot change the nature of the vulnerability, what can be done? This is perhaps the most difficult vulnerability to combat, however, I believe that legislation allowing AML agencies to share certain identifying information with auction houses and galleries could be effective. For example, if an auction house could know the beneficial owners in all bidders—but not release this information publicly, and not allow an individual to fund more than one bid, it would be much more difficult to artificially raise the price of fine art at auction, thus more difficult to have a price high enough to launder money.

One might suggest that auction houses would have no reason to do this, as they would make less money from sales that were not inflated. This may be true, but auction houses not participating would lose some amount of credibility, which is invaluable in the business of authentication and selling of priceless artworks and cultural objects. Information sharing goes beyond UBO identification, however. Sharing financial transactions of individuals with suspicious activity in the art market with both auction houses and between nations could help add previously unseen pieces to the puzzle when uncovering money laundering operations. While it is true that profits would be lower, auction houses refusing to participate or attempting to sidestep this legislation would lose this credibility as an art dealer making legitimate sales. Art trading institutions holding legitimate auctions with intent to create a more secure art market would be more likely embrace UBO identification in auctions, and bidders without ill-intention shouldn't take issue with this—their information is protected regardless.

The variability of the price itself is the second vulnerability I will address, which includes third parties artificially inflating the price of a piece of artwork, perhaps an amount sufficient for laundering a set of illicitly gained cash. I believe a solution to this can be found in blockchain technology. Blockchain provides a record of cryptocurrency transactions that allows immutable information to be recorded and distributed to the public. Additionally, using blockchain with unique identifiers, like NFT's, with art sales allows individual pieces of artwork to have proven provenance and ownership, which can increase the value of art without raising questions of legitimacy (Deloitte 2018). Additionally, this could create opportunities for artists to receive royalties from all sales of a piece. While not all art sales are made with cryptocurrency today, implementing government regulations requiring art sales above $10,000 to match CTR reporting standards updated in the 2020 AMLA and 5MLD, would make for legitimate sales to be more easily tracked and remove one of the layers of obscurity that come with variable prices. For example, if an art piece has a record of selling for $80,000, with increases of $5,000 at each auction, and then, for no apparent reason, the price jumps to $300,000, SAR software coupled with the previous transaction history would be able to flag the transaction for authorities to investigate.

This change would mostly affect the ultra-wealthy's use of the art as a mean for laundering money, however, it would also create never before seen connections between sales of art at all levels. A public register of transaction history, along with unique identifiers for art pieces, however, can help provide legitimacy to the end destination of the sale, as well as where pieces of art are sold in the future. In 2019, 106 million cryptocurrency users transacted an estimated $21.4 billion globally, 2.1% of which was suspected to be criminal activity (Chainanalysis 2021). The true number of transactions, however, is difficult determine and could certainty be higher (Basel). The Basel Institute on Governance reported that cryptocurrency provided many positive and unique characteristics and is a necessary aspect of AML regulation globally (Basel). Whether the art market likes it or not, cryptocurrency use will only become more prevalent in transactions, and leaning into its best features, like public price history, that traditional transactions have not provided, is a method not only to help combat suspicious prices changes, but also further the conversation on cryptocurrency regulation and reporting.

The opacity of the art market is equally as commonplace in the fine art market as is its luxury pricing; this does not, however, mean that it should simply be accepted as necessary. We have all heard of lottery winners, for example, going to extreme lengths to conceal their identity when receiving checks for millions of dollars while being interviewed and broadcasted on national television—who wouldn't be wary of theft after such a win? Similarly, a wealthy individual buying a Picasso painting for millions of dollars would not necessarily want to flaunt their identity to the world and become a potential target of burglary. This level of opacity makes sense, as individuals should not be forced to put their safety at risk to buy art. However, regulation can be put in place that allows anonymity from the public, but transparency to relevant government and international AML agencies.

To combat this vulnerability, I believe a sister program to the Kimberley Certification Scheme would effective. This recommendation is unique in that it reflects a feature of the international gemstone market. The Kimberly Process is a commitment involving 85 nations to remove conflict diamonds, which are rough diamonds used to finance war, and especially violence against legitimate governments, from circulation in the global gemstone market. According to the Kimberly Process officials, the implemented measures prevent 99.8% of conflict diamonds from entering the supply chain (Kimberly Process). Assuming their success rate is accurate, implementing a similar process in tracking artwork could be extremely useful in hindering money laundering and terror financing. The Kimberly Process achieves success in reducing conflict diamonds circulating in the gemstone market through four primary methods. Members of the Kimberly Process must satisfy minimum requirements of national legislation of import and export controls, commit to transparent practices and exchange of information, trade only with other members, and certify shipments as conflict-free. While the gemstone and art markets are not identical, modeling regulations after a the highly successful Kimberly Process is a promising method of reducing money laundering.

Creating an international, unaffiliated group of galleries, museums, auction houses, dealers, and appraisers can begin to bolster the vulnerabilities of the art market I have already identified. The same way that the Kimberly Process keeps conflict diamonds out of global gemstone trade, a process where galleries, for example, can opt-in at their own will (not a government regulation) can help keep artwork from being used to launder money. Earlier, I discussed a basic step in money laundering: layering. With enough art market parties signed into a Kimberly Process-esque organization, money laundering can be hindered at the first step in the process of layering—the instance of purchasing artwork for a large sum of money. Auctions, galleries, and dealers would only trade with others that are members, who have committed to certain regulations in transparency during transport, sale, and purchase. Additionally, this would give more legitimacy to the art appraisers devoted to correctly valuing art—not over or under valuing it to meet the needs of a money laundering scheme for a cut of the proceeds. The same way that the gemstone market self-regulates with the Kimberly Process and reduces funding for international criminals mining conflict diamonds and using them to fund war, this would be effective in not only hindering money launder schemes for ultra-wealthy individuals, but also terrorist organizations and drug cartels. Earlier in this research, it was established that around 80-90% of criminals are already participants; it would be more difficult for those within the market to continue participating in the market with suspicious and illegal activity with membership being necessary to, for example, participate in a high-profile auction. Parties in accordance with the organization's regulations would have a completely transparent transaction where third party buyers and bidders would have far more difficulty in inflating the price of a piece of art at auction or using a shell company to "own" the art.

The final recommended action I will propose addresses the vulnerability of the ease of transport, import, and export of fine art. Individuals and businesses use means such as anonymous freeports to conceal the transport of illicit goods and conceal the true value of their shipments. Participation in a Kimberley Process-esque NGO would be helpful in mitigating this, but I've found that there hard and fast government regulation within freeports is necessary. As mentioned before, the 5MLD cracked down on market opacity by increasing KYC processes and expanding beneficial owner identification regulations. The United States' weakest link in AML framework, as seen in the 2022 Basel AML Index Report, is beneficial ownership disclosure (Basel Index 2022). Compared to the E.U. and U.K., the U.S. has less legislation aimed at disclosing who exactly is buying art, and in many cases, who is funding another entity to buy it.

Increases in the KYC regulation in the AMLA 2020 could be a major step in identifying suspicious activity during transport for both money laundering and terror funding. If client's identity and client history were disclosed at a freeport, it would be more difficult for those laundering money to go unnoticed. Additionally, regulation at freeports requiring individuals to disclose the contents of their shipment would be included. KYC regulation would also be beneficial in catching individuals involved in other crimes, as they would be watch listed within the art market, even if they come from a country will more relaxed laws than the U.S. or E.U. This would have the possibility of reducing the illicit use of freeports for tax evasion. While there would need to be additional regulations that increase taxation on "in-transit" goods stored in freeports, allowing government organizations to know who owns storage in a freeport would reduce their use as safe havens for art used for money laundering. Despite the need for anonymity when purchasing multi-million-dollar paintings, the use of freeports, shell companies, and unquestioned anonymity that surrounds the trade and transport of art is not necessary to the extent that they are currently opaque.

IV. Conclusion

Without increased government regulation and self-regulation, the global fine art market will continue to serve as a vessel of the destabilizing national social structures and a means of funding terrorist operations and drug cartels. The market does this by allowing money laundering operations to continue because of regulatory loopholes and relaxed action by regulatory agencies. In this research, I identified four major vulnerabilities within the art market that create unacceptable susceptibility to money laundering schemes: the price of art, the manipulation of the price, the opacity of the art market, and the ease of transporting art. Unlike other financial institutions subject to heavy regulation, these vulnerabilities plague the art market, unlike other financial institutions, because of the lack of regulation implemented by governments and the reluctance of the market itself to self-regulate. The combination of almost nonexistent regulation in the past and gaping vulnerabilities unmitigated today leave the art market prime ground for money laundering. To attempt to mitigate these issues, I proposed four regulatory changes: publicized transactions with blockchain, required beneficial owner transparency, increased Know Your Client self-regulations, and a sister program to the Kimberly

Process. The implementation of these actions will not see immediate results; however, I believe any steps forward in preventing money laundering are needed. As in-person auctions return and online sales build from the structure created during the COVID-19 pandemic, the global art market will continue to grow, creating more opportunity for money laundering operations and more need for regulation.

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