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ILLICIT FINANCE SPOTLIGHT SERIES

In Plain Sight: Illicit Funds Concealed in Artwork

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February 2018

Introduction

In 2007, US federal investigators found someone attempting to smuggle a painting, titled *Hannibal*, at New York's Kennedy Airport. Although the painting by American artist Jean-Michel Basquiat was appraised at \$8 million, it was accompanied with a bill of lading listing the value as \$100. The painting was part of a 12,000-piece art collection purchased by Brazilian financier Edmar Cid Ferreira using embezzled funds.ⁱ Similarly, in a high-profile money laundering case that helped finance the movie, "Wolf of Wall Street," Malaysian Prime Minister, Najib Razak, siphoned part of a \$1 billion fortune from the Malaysian sovereign wealth fund into American assets, such as real estate in California and, most notably, works of paintings by Basquiat, Rothko, and Van Gogh.ⁱⁱ Both Ferreira and Razak gained recognition, not because of the amassed wealth they laundered, nor because they were renowned art enthusiasts, but because of the manner in which it was performed.



Ferreira and Razak were caught by authorities, but there are many other examples of individuals purchasing art to launder funds. According to Fausto Martin De Sanctis, author of *Money Laundering Through Art: A Criminal Justice Perspective*, "The more tightly the international financial sector is regulated, the more funds flow into the art world."ⁱⁱⁱ In an effort to move away from traditional money laundering vehicles such as real estate, money service businesses (MSBs), and cash-intensive businesses (CIBs), financial criminals are learning that the art market is a viable alternative. So, it begs the question: what makes art so attractive to financial criminals? What is the role of financial institutions (FIs) in countering this emerging threat?

Advantages of the Art Market

Using art to conceal illicit funds appeals to financial criminals for a number of reasons. First, the logistics of transporting art is more appealing than other methods. Transporting \$8 million dollars transnationally in \$100 bills would equate to about 176 pounds, and transporting \$1 billion would equate to approximately 20,000 pounds. Financial criminals are unlikely to use such a method to transport funds. Gold does not prove to be a better option. Transporting the same value through gold would equate to approximately 3,600 pounds, but fluctuations in gold prices would affect the amount of metal that needs to be transported. Other methods, including real estate and business transactions, leave a traceable paper trail for investigators. Although wire transfers offer the advantage of moving large amounts of money quickly, they, too, are scrutinized. As our examples above demonstrate, traditional methods used to conceal illicit funds are too risky and too transparent. In contrast to the examples, paintings and other types of artwork are easy to transport or conceal from authorities in conducting illicit cross-border activities.

In addition to the transportation logistics, the art market offers two primary benefits to financial criminals: (1) minimal regulation and (2) anonymity. Unlike precious metals or futures trading, art does not carry a universal standard in which all other art is measured. There is no single market or index to measure the value of art, which causes people to wonder, "What determines the value of art?" Fine art generates high equity based on its own intrinsic dynamics. The value of art is subjective, based on multiple factors, such as fashions, trends, cultures, expectations of increased valuation, limited editions, and supply and demand.ⁱⁱⁱ There is no government agency or industry organization that provides oversight over the price of art when pieces are on the market. It is this dynamic that reveals the first benefit to financial criminals—the art industry is not regulated.

The lack of regulation and the subjective nature of the art function together to provide freedom to determine the value of the artwork. Artwork appraised at excessively high values carries the almost certainty of even higher returns sometimes based on what is popular at the time.^{iv} On the art market, the value of a piece of art can be manipulated, making it difficult for authorities to know whether it was overpriced. To be sure, artists with notoriety, such as Michelangelo, Renoirs, and Caravaggio, are only a few masters in which the artist's name by itself provides equity. Art created by artists without the same level of fame must be associated with certain events or other factors to create value.

One case study of how societal trends and current events influence the value of a piece is Norman Rockwell. Norman Rockwell is the celebrated artist who provided illustrations for the American publication, *The Saturday Evening Post*. Rockwell's images (including the famous and iconic, "Rosie the Riveter") depict American society during the first half of the 20th century. Following the terrorist attacks of 9/11, there was a rise in Americana and patriotism. Rockwell's art was an unexpected beneficiary of the resurgence in patriotism, becoming more popular. Increased demand resulted in inflated prices for his images. In 2006, some of Rockwell's paintings sold for \$15 million, but a mere seven years later, some of his paintings sold for \$45 million.^{v,iv,vi} Without a regulatory body authorized to oversee the value of art, it is difficult to determine when a person has overpaid for art. Discerning financial criminals may use a societal trend to manipulate a piece of artwork and sell it for an exorbitant price. Without regulation of the art market, financial criminals use it to disguise the origin of illicit funds.

Moreover, tighter regulations in other areas, such as real estate, have pushed criminals to the art market. When China implemented regulations to restrict the flow of capital out of the country, wealthy individuals turned to the art market to evade the restrictions.^{vii} Chinese laws prohibit individuals from moving more than \$50,000 out of China in one calendar year.^{viii} Individuals are able to use two primary methods to evade the restriction.^{ix} First, individuals can sell art in another country at a higher price and retain the profits in the foreign currency.^x The second method involves an associate who sells the work at an inflated price, retaining a portion of the proceeds, and depositing the remaining amount in an offshore bank account.^{xi} Either method lends legitimacy to the funds, which forms the ultimate intent of the transactions.



Efforts to address the minimal regulation of the art market have had little impact, but there is hope that the tide is starting to turn. Industry experts are starting to recognize that the lack of regulation encourages financial criminals to use art purchases for illicit transactions. At the World Economic Forum in Davos in 2015, American economist, Nouriel Roubini, recommended additional oversight over the art market.^{xii} He stated that art may be used as a tool for tax avoidance and tax evasion.^{xiii} In response to the rising threat, the European Commission passed transaction reporting requirements on art galleries and established a suspicious transaction reporting mechanism. Additional regulation and oversight of the art market may discourage financial criminals who attempt to abuse it.

The second key advantage art offers to financial criminals is anonymity. When it comes to the art market, secrecy carries a mark of distinction. Typically, multiple parties have a role in the sale of art. The Basel Institute on Governance uses the term "art market operators" to refer to all the persons, entities, and intermediaries operating between the buyer and seller to engage in the trade of art objects.^{xiv} These parties include the artists themselves, auction houses and clearinghouses, investment companies, art insurance companies, museums, trusts, and offshore accounts in tax havens. During the previous two decades, art market operators have become parties to illicit activity. In addition to the secrecy offered by

offshore entities, art market operators generally refuse to disclose the identities of their clients to protect the confidence and integrity of the transaction.

Often, art market operators serve wealthy clientele who prefer to remain anonymous. As a result, art market operators privatize the personal identifying information of their clientele during the course of art transactions. These transactions are not subject to public scrutiny because there is little information available to the public about who purchased or sold the art. However, as we have seen with the promulgation of the Customer Due Diligence (CDD) Beneficial Ownership Rule and similar measures established across the world, transparency is being demanded by governing bodies, because anonymity becomes subject to abuse. The methods used to disguise funds in art transactions are not limited to shell companies. A closer examination of two case studies provides us with insight into the Tactics, Techniques, and Procedures (TTPs) financial criminals use to achieve their criminal endeavors.

Tactics, Techniques, and Procedures Used to Launder Funds through Artwork

Some of the schemes used to conduct illicit transactions involving art are quite sophisticated. Multiple individuals and entities are usually involved in order to layer the funds and disguise the source of funds. The tactics used to make the funds appear legitimate involve art, but may include other money laundering vehicles, such as real estate and jewelry. Case studies conducted by Edmar Cid Ferreira and Najib Razak provide some insight into the nature of the methods used.

Ferreira built a financial empire in Brazil around his control of Banco Santos. Before his arrest, Ferreira and his wife smuggled more than \$30 million of art out of Brazil.^{xv} A Panamanian company named Broadening-Info Enterprises purchased Jean-Michel Basquiat's *Hannibal* for \$1 million in 2004.^{xvi} The painting was sold for \$5 million.^{xvii} On its way to New York in 2007, the painting moved through four shipping agents in two countries.^{xviii} The value of the merchandise was listed as \$100, thus eliminating the need to enter the US with customs documents.^{xix} Despite the inaccurate valuation of the painting, Broadening-Info Enterprises claimed there was no intent to smuggle the painting and that the painting was purchased legally from a corporate entity owned by Ferreira's wife.^{xx}

The second case study provides additional insight into the layering of transactions criminals use. The scheme involved 10 countries. Razak oversaw 1Malaysia Development Bhd. (1MDB), a government investment fund with the mission of encouraging economic development and investment in Malaysia.^{xxi} However, as early as 2015, allegations arose relating to the use of funds. Investigations revealed billions of dollars were missing from the fund.^{xxii} Investigators focused on more than \$700 million in deposits to Razak's personal accounts using agencies, banks, and companies linked to 1MDB.^{xxiii}



Like many schemes, Razak's associates helped disguise the true nature of the funds. The primary individual responsible for laundering the embezzled funds was Jho Low. Jho Low is a financier who established offshore shell companies, mislabeled transactions as gifts, and purchased art and real estate to disguise the origins of the funds.^{xxiv} The offshore shell companies established by Low had misleading names, such as Good Star Ltd.^{xxv} Notably, many of these offshore shell companies were incorporated in traditional secrecy havens such as the British Virgin Islands and the Seychelles.^{xxvi} Low also used his connections with bankers at FIs to conduct the transactions and ensure the funds would not be traced back to Razak.^{xxvii} Low drafted letters which purported to identify the source of funds as gifts.^{xxviii} One letter stated that a transfer of \$800 million from a Saudi prince was a donation to

Razak.^{xxx} Low also used correspondent banks to transfer the funds in dollars.^{xxx} This case generated publicity because it reached celebrities and Hollywood. Low used some of the funds to produce the “Wolf of Wall Street” film.

Multiple FIs across the world were responsible for facilitating the illicit transactions. The consequences of their involvement included criminal proceedings for one institution in Switzerland and revocation of another’s banking license in Singapore. In response to these consequences, FIs are left wondering how they can mitigate the potential reputational, legal, and operational risks associated with becoming embroiled in a similar scandal.

AML Professionals and Tools

AML professionals have several tools at their disposal to combat these emerging threats. The first step is to develop and implement a strong KYC program. To be sure, the focus is *not* to prove guilt. Rather, the focus is to ensure the art market operators provide transparency in their transactions. The balance between the transparency needed to stop illicit funding and privacy concerns is delicate. A failure to maintain clients’ privacy may cause operators to lose business and valued client relationships. FIs may shift some of the burden by requiring art auction houses to have a KYC program in place, thus shifting the burden to the art auction house to perform due diligence on the buyers and sellers of the artwork. Some international auction houses, such as Sotheby’s and Christie’s already perform due diligence on their clients, as part of a comprehensive compliance program.^{xxxii} Specifically, Christie’s reviews documentation identifying the beneficial owners of its corporate clients.^{xxxii}

One of the critical components of an effective KYC program is due diligence. However, the secrecy surrounding the art industry combined with art market operators’ reluctance to reveal their clients’ data makes due diligence difficult. Open source databases and negative news may not always reveal key pieces of information. While there may not be any reference to the individual buyers and sellers, an investigator may analyze the geographic area or the person’s occupation to determine whether the transaction is reasonable. Some geographic regions may be more susceptible to the potential of art being used to launder funds. As we saw, China has experienced an increase in this type of activity. Areas of unrest such as Syria may be subject to similar types of transactions with stolen antiquities being smuggled out of the country.



Clients’ occupations should also be carefully analyzed to determine whether the art transactions are reasonable. As seen in the Razak case study, Political Exposed Persons (PEPs) are more susceptible to the potential of money laundering because they have greater authority over the allocation of funds and the opportunity to abuse the funds. Fausto Martin De Sanctis, author of *Money Laundering Through Art: A Criminal Justice Perspective*, states that criminal law has concerned itself with protecting basic government and citizens’ interest.^{xxxiii} The AML professional should remember that PEPs have knowledge of social and economic interests and the changes these interests impose on a financial landscape. This would be the likely place where that susceptibility begins. FIs should closely scrutinize relationships with PEPs and the source of their funds/wealth.

In addition, AML professionals may investigate whether the price of the artwork is reasonable. Even if the bank requests an invoice for the transaction to verify the purpose of the transaction, the financial criminal may provide a fake invoice. The investigator should closely scrutinize the invoice for any apparent

inconsistencies that may indicate potential misconduct. Resources such as art databases and the Art Loss Registry can assist with these efforts. Ultimately, the gathering, processing, and evaluation of all the information should answer the question: “Does the transaction make economic sense?”

A second component of a methodical approach to combating art exploitation is training. The Basel Institute recommends that FIs educate their staff on how to appropriately detect illicit activity. Most FIs have red flags programs, which are used to identify certain patterns of transactions or behaviors that may require additional investigation. In addition to developing a red flags program that includes the TTPs discussed above, it may be beneficial for AML professionals to learn about the art market and how social trends may impact the monetary value of art.

Conclusion

The art market provides an attractive venue to perpetuate crime in light of increased regulation in other sectors. Artwork is easy to conceal and can be moved with relative ease compared to paper money or other assets. The transfer of art also does not incur the same paper trail as traditional bank transactions. Additionally, art transactions provide a heightened level of anonymity. Moreover, there is minimal regulation of the art industry in comparison to other sectors, and the subjective and changeable value of art pieces can be leveraged for money laundering practices, such as over- or undervaluation. Undervaluation and false invoicing allows paintings to cross borders without the requisite customs documents that would certainly be required if the true value of the item was known. Thus, the art market can be utilized to evade taxes, circumvent regulations regarding the movement of funds into or out of certain countries, disguise the origin of illicit funds, and layer transactions.

To safeguard themselves, FIs can proactively take several measures to limit their risk exposure with regard to art industry customers. FIs should ensure that a robust KYC program is in place in order to fully understand the occupations and business practices of customers involved in buying and selling art. Art auction houses should be required to develop their own KYC programs in order to ensure proper due diligence is being performed on their clients. FIs should utilize a risk-based approach by focusing on certain higher risk jurisdictions for potential art related crimes, such as China and Syria. Customers designated as PEPs, especially those engaging in art transactions, should receive heightened scrutiny. A critical review of all art related invoices should be performed to determine whether the transactions are reasonable and make economic sense. Finally, targeted training on the art market and various TTPs used by art criminals should be offered to AML professionals so they are in a better position to recognize inconsistencies and suspicious activity.



The buying and selling of art and the international movement of artwork provides a unique vehicle through which financial crimes can be facilitated, but with the right combination of education and preparation, the risks associated with the industry can be combatted and minimized, allowing the art industry to retain its beautiful and profitable aspects, without the stain of criminality.

Have you been paying attention to criminal exploitation through the art market? Does your AML program have implemented the appropriate tools and training required to identify financial art crimes? At AML RightSource, our Financial Crimes Advisory professionals can introduce targeted investigative techniques and research tools to ensure your institution is not being misused by the art industry. Please visit <http://amlrightsource.com/financial-crimes-advisory-services/> to find out more information about the services we provide.

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ⁱⁱⁱ Neuendorf, H. (2016, July 14). Art Demystified: What Determines Artworks' Value? <https://news.artnet.com/market/art-demystified-artworks-value-533990>.

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^{vii} Yan, S. (2014, Feb. 21). Chinese Snap Up Fine Art for Use in Laundering Schemes. *CNN* <http://money.cnn.com/2014/02/20/news/economy/china-art-laundering/>.

^{viii} *Id.*

^{ix} *Id.*

^x *Id.*

^{xi} *Id.*

^{xii} Little, H. (2016, February 25). Does the art market need more regulation? <https://www.apollo-magazine.com/does-the-art-market-need-more-regulation/>.

^{xiii} Cascone, S. (2015, Jan. 26). Dr. Doom Warns of Art-World Money Laundering in Davos. *Artnet News* <https://news.artnet.com/market/dr-doom-warns-of-art-world-money-laundering-in-davos-232958>.

^{xiv} Basel Art Trade Principles on Anti-Money Laundering Green Paper for Public Consultation. (2016, June 17). Basel Institute of Governance. <https://www.baselgovernance.org/sites/biog/art-trade/Green%20Paper%2017%2006%202016.pdf>.

^{xv} Cohen, *supra*.

^{xvi} *Id.*

^{xvii} *Id.*

^{xviii} *Id.*

^{xix} *Id.*

^{xx} *Id.*

^{xxi} Wright, T. and Hope, B. (2015, Oct. 15). Malaysia's Najib Razak Played Key Role at Troubled 1MDB Investment Fund. *The Wall Street Journal Online* <https://www.wsj.com/articles/malysias-leader-at-center-of-a-storm-1444963838>.

^{xxii} *Id.*

^{xxiii} *Id.*

^{xxiv} Wright, T. and Hope, B. (2016, Sept. 6). Behind the 1MDB Scandal: Banks that Missed Clues and Bowed to Pressure. *The Wall Street Journal Online* <https://www.wsj.com/articles/behind-the-1mdb-scandal-banks-that-missed-clues-and-bowed-to-pressure-1473109548>.

xxv *Id.*

xxvi *Id.*

xxvii *Id.*

xxviii *Id.*

xxix *Id.*

xxx *Id.*

xxxi Rubinfeld, S. (2017, Mar. 3). Art World's Response to Money-Laundering Concerns Draws Critics. *Dow Jones* <https://www.dowjones.com/insights/art-worlds-response-money-laundering-concerns-draws-critics/>.

xxxii *Id.*

xxxiii Sanctis, *supra*.