

November 5, 2020

OFAC Advisory on Sanctions Risks Arising From Transacting in High-Value Artwork

Advisory Highlights Risks Relating to the Involvement of “Blocked Persons” in Transactions in the High-Value Art Market

SUMMARY

On October 30, 2020, the U.S. Department of the Treasury’s Office of Foreign Assets Control (“OFAC”) issued an advisory and guidance (“Advisory”) relating to the potential sanctions risks inherent in the market for high-value artwork, with emphasis on the risk that “blocked persons” on OFAC’s List of Specialty Designated Nationals and Blocked Persons (“SDN List”) engage in high-value artwork transactions in order to access the U.S. market and financial system in violation of OFAC regulations.¹ The Advisory notes that the lack of transparency and the high degree of anonymity and confidentiality in the high-value art market make the market attractive to individuals engaged in sanctions evasion or other illegal financial activity, and notes that over the past year, OFAC and other authorities have identified several instances of blocked persons utilizing the high-value art market to evade U.S. sanctions and launder money. The Advisory emphasizes to art galleries, museums, private art collectors, auction companies, agents, brokers and other participants in the art market the importance of maintaining a risk-based compliance program to mitigate the risk of transacting with blocked persons. As the Advisory notes, violations are subject to strict liability, and a risk-based compliance program is important to OFAC in considering whether civil penalties should be imposed.² Finally, the Advisory highlights OFAC’s view that the Berman Amendment to the International Emergency Economic Powers Act (“IEEPA”) and Trading with the Enemy Act (“TWEA”) (which provides an exemption for certain transactions involving “information and informational materials,” including artworks, from sanctions regulations) does not categorically exempt all dealings in artwork from OFAC regulation and enforcement.

BACKGROUND

As part of its enforcement efforts, OFAC publishes a list of individuals, groups, and entities, such as terrorists and narcotics traffickers designated under sanctions programs that are not country-specific, and certain individuals and companies owned or controlled by, or acting for or on behalf of, sanctions-targeted countries. Collectively, such individuals and companies are called “Specially Designated Nationals” or “SDNs.” Their assets are blocked and U.S. persons are generally prohibited from dealing with them.³ In addition, under OFAC’s “fifty percent rule,” any entity “owned in the aggregate, directly or indirectly, 50 percent or more by one or more blocked persons is itself considered to be a blocked person.”⁴ As the Advisory notes, OFAC may impose civil penalties for sanctions violations based on strict liability, meaning that a person may be held civilly liable even if it did not know or have reason to know it was engaging in prohibited conduct.

The Advisory describes certain characteristics inherent in the market for high-value artwork which render the market attractive for SDNs, or blocked persons, seeking to mitigate the effect of sanctions, as well as for others engaged in illegal financial activity. In particular, the Advisory notes that there is often a lack of transparency and a high degree of anonymity and confidentiality in the sale and purchase of high-value artworks, and that shell companies and intermediaries are frequently used to purchase, hold or sell artworks and to make and receive payments for such artwork. These characteristics allow illicit actors to conceal their identities from other participants in the market and evade detection by law enforcement and regulators, activities which are further aided by the mobility, concealability and subjective value of artwork.

Beyond the characteristics identified by OFAC, a July 2020 report issued by the Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs (“PSI Report”) highlights additional vulnerabilities in the market for high-value artwork that make it attractive for blocked persons and others engaged in illicit financial activity. In particular, the PSI Report notes that the art market is not subject to the Bank Secrecy Act, and participants are not required to maintain AML and anti-terrorism financing controls for transactions.⁵ The PSI Report further notes that although many major auction houses voluntarily impose AML practices, the majority of art transactions occur between private art dealers, who are not subject to AML requirements.⁶ Moreover, auction houses routinely treat agents and dealers as the principal purchasers of art, and are not always required to identify and evaluate an undisclosed client.⁷

The Advisory highlights multiple instances recently identified by OFAC and other agencies of blocked persons transacting in the high-value artwork market. For example, in December 2019, OFAC took action against Nazem Said Ahmad, a Lebanon-based art collector and diamond dealer who has provided substantial financial assistance to Hizballah, designating Ahmad as a Specially Designated Global Terrorist pursuant to Executive Order 13224.⁸ Said, who owns an extensive art collection worth tens of millions of dollars, including works by Pablo Picasso and Andy Warhol, was found to have stored personal funds in high-value art to preemptively mitigate the effect of U.S. sanctions, and to have laundered money through

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his art gallery in Beirut.⁹ OFAC's press release describing its action against Ahmad included a list of 11 entities owned, controlled or directed by Ahmad,¹⁰ cautioning that this list of entities should not be viewed as exhaustive and that market participants must conduct necessary due diligence to ensure compliance with OFAC regulations, including the fifty percent rule.

More recently, the PSI Report set forth findings regarding two Russian oligarchs, Arkady and Boris Rotenberg.¹¹ In 2014, President Obama issued a series of Executive Orders authorizing the Treasury to sanction individuals, assets and companies in Russia, including persons "contributing to the situation in the Ukraine," in reference to Russia's annexation of Crimea.¹² Pursuant to one of these Executive Orders, OFAC designated the Rotenbergs as SDNs. The committee's investigation found that the Rotenbergs used shell companies to conceal their identities in transactions for high-value art both before and after being sanctioned by OFAC.¹³ Similarly, in March 2020, the United Nations North Korea Panel of Experts issued a report describing galleries and exhibitions in China and Hong Kong showing artworks from the Mansudae Art Studio, a UN-designated entity in North Korea.¹⁴ The Advisory notes that press reports suggest North Korea has earned tens of millions of dollars from producing and exporting statues to foreign nations.

In issuing the Advisory, OFAC anticipated that concerns could be raised under the Berman Amendment to the IEEPA and TWEA, two laws pursuant to which the economic sanctions programs is administered by OFAC, and OFAC clarifies its view of the Berman Amendment in this context. The Berman Amendment generally exempts from regulation "the importation from any country, or the exportation to any country . . . of any information or informational materials, including but not limited to . . . artworks."¹⁵ The Advisory states explicitly that OFAC does not interpret this exemption to allow blocked persons or their facilitators to evade sanctions by exchanging financial assets for high-value artwork, or vice-versa. The Advisory makes clear that OFAC will apply IEEPA- and TWEA-based sanctions to transactions involving artwork in which a blocked person has an interest, to the extent the artwork functions primarily as an investment asset or medium of exchange. This directive is consistent with the view the Treasury expressed to the Senate Subcommittee on Investigations in July 2020, stating it does not view the Berman Amendment as "a categorical bar to the application of IEEPA-based sanctions to transactions involving artwork."¹⁶ The Advisory recommends that persons considering a transaction with a blocked person involving high-value artwork seek guidance or a license from OFAC before engaging in the proposed transaction.

IMPLICATIONS

OFAC's Advisory sends a clear signal that OFAC is attuned to the risk that blocked persons may seek to transact in high-value artwork, and intends to scrutinize even unintentional violations of its regulations in this regard. The Advisory's emphasis on the strict liability standard, which enables OFAC to assess civil penalties even if the person or entity did not know or have reason to believe it was engaging in prohibited conduct, should serve as a warning to market participants to remain equally attuned to the sanctions risks

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OFAC has identified, and should prompt evaluation of due diligence and other compliance policies by market participants.

Market participants should be mindful that the risks of participating in the high-value art market are not limited to sanctions concerns, but also extend to risks related to money laundering, as made clear by recent legislation in the United Kingdom and European Union and the recommendations of the PSI Report. Earlier this year, the United Kingdom implemented the European Union's Fifth Anti-Money Laundering Directive, requiring participants in the art market to comply with more stringent AML obligations in connection with transactions in art valued at more than €10,000.¹⁷ Similarly, the PSI Report recommends that Congress amend the Bank Secrecy Act to impose its AML requirements on businesses handling transactions involving high-value art, referencing the recent changes in the European Union.¹⁸

As suggested by the Advisory, market participants including art galleries, museums, private collectors, auction companies, agents, brokers and others should, in consultation with counsel, implement or enhance AML and sanctions compliance measures. OFAC has established a Framework for OFAC Compliance Commitments that provides guidance on establishing an adequate risk-based sanctions compliance program.¹⁹ Among other things, the Framework advises companies to adhere to at least five essential components of compliance, including: (i) ensuring the strong commitment of senior management to the sanctions-based compliance program; (ii) conducting risk assessments to identify potential OFAC issues the organization is likely to encounter; (iii) the implementation of internal controls, including policies and procedures, relating to OFAC compliance; (iv) comprehensive and objective testing and auditing of the organization to identify any weaknesses and deficiencies; and (v) an effective training program.

In light of the recent legislation in the European Union and the PSI Report's recommendations, market participants may also want to consider implementing AML measures similar to those required of financial institutions. Hallmarks of an effective AML program include: (i) a system of internal controls to assure ongoing compliance; (ii) independent testing for compliance conducted by either personnel or an outside party; (iii) designation of an individual or individuals responsible for coordinating and monitoring day-to-day compliance (in other words, designation of an AML compliance officer); (iv) training for appropriate personnel; and (v) a customer identification program with risk-based procedures that enable the institution to form a reasonable belief that it knows the true identity of its customers.²⁰

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ENDNOTES

- 1 U.S. Dep't of Treasury, Office of Foreign Assets Control, "Advisory and Guidance on Potential Sanctions Risks Arising from Dealings in High-Value Artwork," (October 30, 2020), available at https://home.treasury.gov/system/files/126/ofac_art_advisory_10302020.pdf.
- 2 See 31 C.F.R. § Pt. 501, App. A.
- 3 See U.S. Dep't of Treasury, Office of Foreign Assets Control, "Specially Designated Nationals And Blocked Persons List (SDN) Human Readable Lists," available at <https://home.treasury.gov/policy-issues/financial-sanctions/specially-designated-nationals-and-blocked-persons-list-sdn-human-readable-lists>.
- 4 U.S. Dep't of Treasury, Office of Foreign Assets Control, "Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property are Blocked," (Aug. 13, 2014), available at https://home.treasury.gov/system/files/126/licensing_guidance.pdf.
- 5 Staff of S. Permanent Subcommittee on Investigations, "The Art Industry and U.S. Policies That Undermine Sanctions, Staff Report," (July 29, 2020) ("PSI Report"), at 10, available at <https://www.hsgac.senate.gov/imo/media/doc/2020-07-29%20PSI%20Staff%20Report%20-%20The%20Art%20Industry%20and%20U.S.%20Policies%20that%20Undermine%20Sanctions.pdf>.
- 6 *Id.*
- 7 *Id.*
- 8 U.S. Dep't of Treasury, Office of Foreign Assets Control, Press Release, "Treasury Designates Prominent Lebanon and DRC Based Hizballah Money Launderers," (Dec. 13, 2019), available at <https://home.treasury.gov/news/press-releases/sm856>.
- 9 *Id.*
- 10 Beirut Diam Sal, Beirut Gem Sal, Montecarlo Beach Sal, Debbiye 143 Sal, Nour Holding Sal, Aramoun 1506 Sal, Damour 850 Sal, Gebaa 2480 Sal, Noumayriye 1057 Sal, Beirut Trade Sal, and Blue Star Diamond Sal – Offshore.
- 11 PSI Report.
- 12 *Id.* at 20.
- 13 *Id.* at 63.
- 14 Letter dated 26 February from the Panel of Experts established pursuant to resolution 1874 (2009) to the President of the Security Council, S/2020/151 (March 2, 2020), available at <https://undocs.org/S/2020/151>.
- 15 50 U.S.C. § 1702.
- 16 PSI Report, at 39.
- 17 Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU; see also Kenneth Mullen, "Tough UK anti-money laundering law comes into force tomorrow – here's what you need to know," The Art Newspaper (Jan. 9, 2019), available at <https://www.theartnewspaper.com/news/new-eu-law-calls-for-tough-action-on-dirty-money>.
- 18 PSI Report, at 14.
- 19 U.S. Dep't of Treasury, Office of Foreign Assets Control, "A Framework for OFAC Compliance Commitments," available at https://home.treasury.gov/system/files/126/framework_ofac_cc.pdf. See also U.S. Dep't of Treasury, Office of Foreign Assets Control, "FAQ #812-814," available at <https://home.treasury.gov/policy-issues/financial-sanctions/faqs/topic/2396>.
- 20 31 CFR § 1020.210.

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