



Response by ArtAML Limited to HM Treasury's Call for Evidence: Review of the UK's AML / CFT regulatory and supervisory regime

Glossary

AMPs: Art market participants

Background

We (Chris King & Susan J Mumford) are providing answers in our capacity as the founders of ArtAML. ArtAML is a software platform specifically designed to help the art market with its compliance obligations. We took part in the HM Treasury consultation regarding the transposition of 5MLD into UK law. We have been helping AMPs of all sizes and specialities with their obligations, and regularly meet with the HMRC sector lead for AMPs. The majority of our answers here relate specifically to what we are seeing from the industry in this newly regulated sector.

Chapter 2

(ii) High-impact activity

5. Activity required by the MLRs should be considered high impact?

Collection and validation of ID and screening for PEP and sanctions are high impact.

That said, many art buyers are not UK citizens, and AMPs struggle with proof of address from international customers. The guidance and all HMG documents presume that UK citizens are being checked. We have asked HMRC for guidelines on checking international customers, and they have not been able to provide any significant answers. Banks tend to deal with the risks arising from issues of international proof of address by simply refusing to operate in some countries (de-risking). AMPs do not have this luxury.

AML training is also high impact.

6. What examples can you share of how those high impact activities have contributed to the overarching objectives for the system?

ID verification: A gallery was given a fake passport which was an immediate red flag.

PEP / Sanctions screening: An auction house discovered that a potential customer had been involved in criminal activity.

AML Training: This has been seen to make a significant difference in AMPs' understanding of what it means to take a risk-based approach, the reason behind certain requirements (such as PEPs), what to do if suspicious activity is detected and more.

(iii) National strategic priorities

9. Would it improve effectiveness, by helping increase high impact, and reduce low impact, activity if the government published strategic national AML/CTF priorities for the system?

Not for AMPs.

11. What are the potential risks or downsides respondents see to publishing national priorities? How might firms and supervisors be required to respond to these priorities?

We feel that a list of strategic national priorities is likely to be defined at an extremely high level, and thus will only have significant influence upon supervisors and large firms.

AMPs are likely to be unaware of such priorities, or likely confused about the effect upon their day-to-day compliance obligations. This is in addition to already having multiple sets of Guidance which they are expected to know about and understand.

(iv) Extent of the regulated sector

12. What evidence should we consider as we evaluate whether the sectors or sub-sectors listed above should be considered for inclusion or exclusion from the regulated sector?

The items covered should be from the 1994 VAT section 21.5 A-C inclusive.

13. Are there any sectors or sub-sectors not listed above that should be considered for inclusion or exclusion from the regulated sector?

We are regularly asked by auctioneers why jewellery is not regulated. Auctioneers sell a wide variety of valuable items, and jewellery is easy to conceal, hard to carry out provenance for, and easy to break up while still maintaining value (in a way that art is not). Evidence to be considered might include SARs submitted by HVDs who deal in jewellery, in addition to other information available from HVDs in the regulated sector.

Several other categories of goods not covered include furniture and decorative art (which often falls outside the VAT definition by not being editioned or attributable to an individual maker).

If the above areas are to be regulated in the future, they might fall under the remit of AMPs, with the broadening of the definition of a 'work of art'.

The other area to consider is visual artists who sell works of art directly to patrons and institutions. This reflects a change in business model in recent decades, as many professional artists making a living with their work and transacting at 10K+ Euros sell both directly and indirectly (via dealers / agents). For clarity, artists selling via transactional marketplaces are directly transacting as such platforms (unless actively involved in making sales happen instead of just providing the facility) are not operating as AMPs.

14. What are the key factors that should be considered when amending the scope of the regulated sector?

AML obligations have a disproportionate effect upon very small businesses, both in operational and trading terms, and also in the levels of stress that business owners face.

What's important is identifying businesses that are high risk of being targeted by criminals, for example, those dealing in jewellery as mentioned in the answer to question 13 above.

(v) Enforcement

16. Is the current application of enforcement powers proportionate to the breaches they are used against?

It is too early to make any assessment of this for AMPs.

17. Is the current application of enforcement powers sufficiently dissuasive? If not, why?

It is too early to make any assessment of this for AMPs.

18. Are the relatively low number of criminal prosecutions a challenge to an effective enforcement regime? What would the impact of more prosecutions be? What are the barriers to pursuing criminal prosecutions?

In our view, the main aim of the MLRs should be to dissuade bad actors from attempting to target a particular sector.

Prosecution of AMPs for breaching the regulations is not a good measure of the enforcement regime, particularly when the sector has no overarching professional body/bodies.

Prosecutions of money launderers as a result of SARs submitted by AMPs is absolutely a measure of the success of the regime.

Chapter 3

(i) Barriers to the risk-based approach

19. What are the principal barriers to relevant persons in pursuing a risk based approach?

- Very easy to take a 'box-ticking' approach.
- Very tempting to take a "what is the least that I have to do?" approach.
- Taking a risk-based approach requires a proper understanding of the risks.
- It's very hard to get a proper view of what a 'risk-based approach' means in practice, when faced with a particular transaction. 'Take a risk based approach' is not a helpful answer for an art dealer taking part in a complicated transaction who more than anything wants to know "what must I do?".
- We recently saw an art dealer not using a technology solution, who collected photo id for a U.S. customer, and was told by HMRC that wasn't sufficient and that he should have done a video call, for example by WhatsApp. The requirements need to be clear and comprehensible.

20. What activity or reform could HMG undertake to better facilitate a risk based approach? Would strategic national priorities (discussed above) support this?

20.1 Give some clear examples relevant to the sectors.

20.2 No - such high level priorities are very unlikely to translate into practical advice.

(ii) Understanding of risk

22. Do relevant persons have an adequate understanding of ML/TF risk to pursue a risk based approach? If not, why?

AMPs understanding of the risks varies enormously. Older, and less technically capable people often struggle with even the basic steps required, which in addition to being technically challenging, fly in the face of decades of discreet and non-intrusive relationships with customers. The main risk they see is from the regulator, driven by the fear they have of not complying with regulations they don't understand.

23. What are the primary barriers to understanding of ML/TF risk?

The lack of clear and concrete examples of actual risks in their sector. Even with the risk guidance by HMRC published 28th June 2021, only a small percentage of AMPs will have seen the document and it doesn't cover common scenarios.

24. What are the most effective actions that the government can take to improve understanding of ML/TF risk?

(iii) Expectations of supervisors to the risk based approach

25. How do supervisors allow for businesses to demonstrate their risk based approach and take account of the discretion allowed by the MLRs in this regard?

It is too early to make any assessment of this for AMPs.

26. Do you have examples of supervisory authorities not taking account of the discretion allowed to relevant persons in the MLRs?

It is too early to make any assessment of this for AMPs.

(iv) Application of enhanced due diligence, simplified due diligence and reliance

30. Are the requirements for applying enhanced due diligence appropriate and proportionate? If not, why?

Yes

31. Are the measures required for enhanced due diligence appropriate and sufficient to counter the higher risk of ML/TF? If not, why?

Yes

32. Are the requirements for choosing to apply simplified due diligence appropriate and proportionate? If not, why?

Yes.

33. Are relevant persons able to apply simplified due diligence where appropriate? If not, why? Can you provide examples?

No. Whereas large art businesses (such as large auction houses) have compliance teams and medium art businesses (such as West End galleries) have team members with compliance as at least part of their roles for which they were recruited, the majority of small and micro art businesses have individuals who are in no way compliance professionals performing AML compliance duties. For the latter - despite undertaking AML training, they do not have much if any experience in taking a risk-based approach and nor do they have much practice reading or comprehending regulations or guidance with ease (noting that dyslexia is a common trait of art market professionals including dealers, who have proficiency with visual expertise). In some small AMP businesses, junior team members with no AML experience are given the task of conducting AML checks.

The result for small and micro AMP businesses is that on the one hand, it can be seen as an easy way to conduct an AML check, and on the other, the concern about doing what is necessary (and lack of understanding) can result in doing more than is necessary given the risk.

35. Are relevant persons able to utilise reliance where appropriate? If not, what are the principal barriers and what sort of activities or arrangements is this preventing? Can you provide examples?

No.

In relation to reliance, Paragraph 3.21 in the document states:

“This is particularly relevant in sectors where relevant persons often work closely together, for example solicitors and barristers. However, concerns are often raised about relevant persons feeling unable to utilise reliance to meet their obligations under the MLRs This may be due to difficulties in putting the required arrangements in place, or third parties being unwilling to allow their CDD measures to be relied upon”.

Reliance is THE “elephant in the room” for the art market. It has been widely misinterpreted and misused, terrifies AMPs whose entire livelihood depends upon keeping their closely held and carefully cultivated client list to themselves, and appears (to us) to be abused by more powerful parties in transactions.

In reading the following examples, it should be understood that many transactions for artworks involve multiple AMPs. These relationships are different from those between, for example, solicitors and barristers, whose work is distinct but complementary. AMPs need to be extremely competitive to survive. Thus in many cases they cooperate only as far as is necessary to make a deal.

Misinterpretation and misuse:

Prior to the art market being regulated, the identity of the ultimate beneficial owner of an art work would commonly only be known to the AMP dealing directly with them. The identity would be kept secret so that other AMPs could not “poach” the client, perhaps by cutting other AMPs out of a deal chain.

Reliance requires that the identity of the buyer is revealed to AMPs further down a deal chain. Some AMPs (and some advisers and service providers) have misinterpreted the guidance to the sector (either unintentionally or wilfully) in such a way that they maintain that they only need to provide the identity of the UBO if it is requested explicitly. In other words, business as usual, while still “complying”. HMRC has attempted to clarify this, but we still see significant misunderstanding.

Commercial fears:

There are a significant number of AMPs whose livelihood and business depend upon carefully established relationships with wealthy collectors. Even providing the identity of their customer to another AMP risks the other AMP from contacting that client directly.

We frequently point out that Regulation 41 prohibits information collected for AML purposes from being used for any other purpose. This is commonly met with laughter and a response such as “how would you prove it”?

Abuse of power:

The size of AMP business varies hugely - from single person businesses up to complex international multi-entity businesses. We are seeing a number of examples where the more powerful party in a transaction is acting in a way that they would not allow if the roles in the transactions were reversed.

For example:

Auction houses refusing to provide the identity of buyers to AMPs consigning work, but agreeing to provide that information (and CDD details) “if needed”. At the same time, some auction houses require the identity and other information of a potential customer being represented by an intermediary AMP prior to a successful bid being made.

Large galleries dealing with small AMPs insisting that the information that they must have include details such as the client’s phone number and email address.

(v) How the regulations affect the uptake of new technologies

37. As currently drafted, do you believe that the MLRs in any way inhibit the adoption of new technologies to tackle economic crime? If yes, what regulations do you think need amending and in what way?

The fundamental problem is that legislation moves slowly, and technological progress (particularly related to software) is extremely fast. Many many transactions are now carried out over the internet. Face-to-face has become much less common (and that’s before the effects of the SARS-Cov-2 pandemic). International transactions are common, and need to be considered.

38. Do you think the MLRs adequately make a provision for the safe and effective use of digital identity technology? If not, what regulations need amending and in what way?

As mentioned above, a significant portion of the transactions carried out by UK AMPs are with international customers. Digital identity schemes that cannot work across international boundaries will be of limited use to the art market.

Rather than digital identity per se, we and other AML market providers are making extensive use of digital identity verification services. These provide, by various means, both the ability to check the validity of an identity document, and mechanisms to try and ensure that the person presenting the document is the person in the document.

(vi) SARs reporting

41. What impact would there be from enhancing the role of supervisors to bring the consideration of SARs and assessment of the quality within the supervisor regime?

This would provide an understanding of reporting numbers and quality of submissions. The former could be viewed in context of what is expected, with possible pursuit of a communications campaign if not in alignment with expectations. The latter would be instructive for identifying training gaps in the sector.

42. If you have concerns about enhancing this role, what limitations and mitigation should be put in place?

The information provided should be of a general informational nature without specific details that identify individual businesses.

43. What else could be done to improve the quality of SARS submitted by reporters?

The NCA website is far from easy to use. In addition, no programmatic APIs are available, meaning that SARs have to be typed in by hand, re-entering information. Availability of an API would mean that platforms such as ours could help AMPs to submit SARs, potentially increasing the likelihood that reports are made.

44. Should the provision of high-value intelligence to law-enforcement be made an explicit objective of the regulatory regime and a requirement on firms that they are supervised against? If so, how might this be done in practice?

It's not clear to us how you could require AMPs to provide "high-value intelligence", or indeed what that would mean. As in an answer above, we consider that the primary purpose of the MLRs should be to dissuade bad actors from money laundering (although intelligence and enforcement are clearly vital).

(vii) Gatekeeping tests

45. Is it effective to have both regulation 26 and regulation 58 in place to support supervisors in their gatekeeper function, or would a single test support more effective gatekeeping?

Not answered

46. Our current requirements for information and effective basis from which to draw gatekeeper judgement, or should different or additional requirements, for all or some sectors, be considered?

Not answered

47. Do the current obligations and powers, for supervisors, and the current set of penalties for non-compliance support and effective gatekeeping system? If no, why?

It is too early to make any assessment of this for AMPs.

48. To what extent supervisors effectively monitor their supervised populations on an ongoing basis for meeting the requirements for continued participation in the profession? Is an additional requirement needed for when you individuals take up relevant positions in firms that are already registered?

It is too early to make any assessment of this for AMPs.

(viii) Guidance

49. In your view does the current guidance regime support relevant persons in meeting their obligations under the MLRs? If not, why?

Not completely. The international nature of the art market, internet and remote transactions, and often complex transactions are not effectively covered by the existing guidance.

50. What barriers are there to guidance being an effective tool for relevant persons?

The 2020 BAMF guidance is a good attempt to cover the complexities of the art market, but misses a number of significant areas, and is too long, very technical, and fails to address compliance challenges faced by many AMPs on a day-to-day basis.

51. What alternatives or ideas would you suggest to improve the guidance drafting and approval processes?

The rules around who is and is not an AMP need to be clarified. Artists appeared to be classified as AMP because they are selling art “by way of business”. This was a question that we raised in the original consultation prior to the 2019 amendments to the MLRs, and which has only recently been answered.

The standard refrain of “take a risk-based approach” is of little comfort to AMPs who are wanting to know what to do in a manner that both reduces their risk of being subject to money laundering and being sanctioned by the regulator.

Guidance needs to address all levels of the art market, and must be drafted with input from a wide variety of interested parties.

Given the complex nature of many art world transactions, it is important that there are clear rules that can be used to determine the differing roles in transactions. These rules should be drafted in such a way that they can be used by HMRC staff to assist AMPs, as well as by AMPs themselves.

Guidance should be given as to what to do when dealing with cross-jurisdictional problems - this is a problem that HMRC and HMT struggle with, so how AMPs are expected to understand is a challenge.

Chapter 4

(i) Structure of the supervisory regime

52. What are the strengths and weaknesses of the UK supervisory regime, in particular those offered by the structure of statutory and professional body supervisors?

It is too early to make any assessment of this for AMPs.

53. Are there any sectors or business areas which are subject to lower standards of supervision for equivalent risk?

Not answered

54. Which of the models highlighted, including maintaining the status quo, should the UK consider or discount?

Not answered

55. What in your view would be the arguments for and against the consolidation of supervision into fewer supervisor bodies? What factors should be considered in analysing the optimum number of bodies?

Fewer bodies will likely lead to less resources. Resourcing is already clearly a problem.

Currently, AMPs with questions are asked to email mlrcit@hmrc.gov.uk. When they do so, they receive a reply stating that the expected time for a reply is 15 days.

For AMPs with commercial deadlines and, commonly, demanding customers, delays like this could lead to AMPs being forced to make decisions between their best guess as to what will satisfy the regulator, and losing a sale.

(iv) Supervisory gaps

60. Are you aware of specific types of businesses who may offer regulated services under the MLRs if they do not have a designated supervisor?

Not answered

62. How should the government best ensure business cannot conduct regulated activity without supervision?

Not answered