

Fools go Russian in: why the art world needs to consider sanctions carefully

An expert view on how post-Ukraine invasion restrictions are giving the art market plenty to think about

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The art and antiques sector has taken on board the basics of the sanctions imposed on Russia but their complexity and wider implications need to be fully understood.

What do sanctions do?

Sanctions restrict trade with countries or ban dealings with persons that behave in ways that threaten peace, security, or economic stability. They can be aimed not only at governments that violate international treaties, support terrorism or arms proliferation, but also at individuals who commit serious crimes such as terrorists, terrorist financiers, drug traffickers and money launderers.

Sanctions are administered and enforced by the Office of Financial Sanctions Implementation (OFSI) in the UK and the Office of Foreign Assets Control (OFAC) in the US. In the European Union, Sanctions Resolutions are passed by the Council of the European Union and enforced by appropriate regulators within each member state.

Arguably, the most effective type of sanction is an 'asset freeze' which involves the blocking of property and financial assets of an individual or entity. The aim is to deny access to finances, making it as difficult as possible for them to go about their day-to-day activities.

What are the sanctions on Russia?

The sanctions that have been levelled at Russia since its invasion of Ukraine on February 24 are unprecedented in scale, scope and immediacy.

While causing the Russian economy immeasurable harm - which is what they were designed to do - they have also placed a significant compliance workload on the rest of the world.

Understanding and complying with sanctions is complicated; so much so, that where the stakes of getting it wrong are too high, banks are known to adopt 'de-risking' policies to limit their exposures. These policies slow down the movement of funds to and from a targeted country and quickly cause

businesses to decide for practical reasons to stop doing business with an impacted country and its citizens for the simple reason that it becomes so difficult to get paid.

Penalties

There is increasing co-ordination between the UK, EU and US in sanctions implementation and enforcement, particularly where the individuals or entities in question are resident in or operate on a trans-continental level.

While banks have historically borne the brunt of penalties for breaching sanctions, any person, private company or organisation can be found liable for dealing with or making economic resources available to a sanctioned person or for enabling the circumvention of sanctions.

In the UK, rapidly passed legislation in March 2022 introduced a strict liability civil offence for breaching sanctions, punishable by a fine of up to £1m or 50% of the estimated value of the economic resources made available, whichever is greater. Strict liability takes away the requirement to prove intention to breach sanctions and therefore significantly eases the path for enforcement. A breach of sanctions may also be a criminal offence, punishable by up to seven years in prison in the UK. OFSI may also choose to publish the names of persons involved in a breach of sanctions along with case summaries, even where no monetary penalty is imposed.

Practical takeaways

Dealers, auction houses, advisers and other participants in the art market should follow these practical steps to

ensure they do not unwittingly end up involved in activities that could breach sanctions:

1. Sanctions screening is essential

As a minimum, art market professionals should use the free and easy to use search tools provided by OFSI, OFAC and the EU[1]. All results (matching or not) should be saved to demonstrate compliance. For those businesses that wish to invest in professional screening solutions, a plethora of programmes exist on the market, many of which offer the added comfort of continuous sanctions monitoring.

2. Consider sanctions from a global perspective

Although the UK, EU and US sanctions regimes implement similar and overlapping measures, there are also points of departure. It is often the case that a person sanctioned by one regime is not simultaneously sanctioned by another. While there may be an opportunity for that person to transact in a country where they are not sanctioned, it should be noted that global banks implement enterprise-wide sanctions policies which effectively block transactions with a person or entity wherever they may occur.

3. Scrutinise ownership and control

When dealing with companies, take great care to identify not just ultimate beneficial owners, but also those in control - if a person with de facto control of an entity is sanctioned, the company could also be deemed to be sanctioned.

Again, beware of interpretative divergences in sanctions determinations by different regimes. The EU and US apply an aggregate shareholding threshold of 50% or more when determining whether a company owned by a sanctioned person should be treated as sanctioned. The UK and EU use a broader 'ownership and control test' which means that shareholders and directors who exercise control can



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be the determining factor. As the element of control is an important part of the assessment for UK and EU sanctions, other due diligence around the corporate structure can be just as important as share ownership at any level.

4. Know your ultimate transactor

As highlighted in a report published by the United States Senate's Permanent Subcommittee on Investigations in 2019, the bypassing of sanctions via the use of intermediaries and shell companies is a serious risk. When dealing with intermediaries who are known to act for, among others, Russian collectors, enhanced due diligence is essential - no stone should be left unturned when conducting customer and, where appropriate, artwork due diligence in such cases.

5. Know your shipper

It goes without saying that shippers play an all-important role in delivering goods to buyers and must be held to the highest standards of compliance. Make sure you are satisfied that your shippers and their agents have appropriate sanctions compliance policies and procedures in place.

6. Know your sanctions reporting obligations

'Relevant firms', including antique dealers who sell items of jewellery made of precious metals, stones or pearls, have an obligation to report to OFSI (the Office of Sanctions Implementation) in the UK if in the course of conducting their business, they know or suspect: (i) that a breach of financial sanctions has occurred; or (ii) that a person involved is a designated person or (iii) that they are holding frozen assets.

If a relevant firm fails to report, this is a criminal offence. Although the legal requirement to report currently only applies to a small subset of art dealers in the UK, it is prudent for all art market participants to give due consideration to voluntarily reporting sanctions concerns to OFSI in appropriate situations.



Left: Rakhi Talwar of RTalwar Compliance, and, right, Zia Ullah of Eversheds Sutherland.



A quick guide on what the bans now entail

Russian sanctions and restrictions

The US, UK, EU and other countries have directed a slew of sanctions and restrictive measures at Russia which have seen the closure, suspension or quietening down of operations in Russia by international banks and companies, including some major international auction houses.

The measures include:

- A ban on new investment in the country
- Sanctions on major Russian banks and critical state-owned enterprises
- Sanctions against President Putin and other Russian government officials and their family members
- A ban on all Russian flights over US, Canadian, UK and EU airspace
- The removal of various Russian banks from the Swift payment system which is used by banks worldwide to transfer funds between themselves
- Targeted sanctions against more than 1000 Russian individuals, including so-called 'inner circle' oligarchs such as Roman Abramovich, Mikhail Fridman, Oleg Deripaska, Alisher Usmanov and Pyotr Aven
- A ban on the export of luxury goods to Russia

The luxury goods export ban

The UK, US and EU have placed differing and complementary bans on luxury goods. The EU has imposed a general export ban on luxury goods, whereas the US has more specifically prohibited the export/re-export, transfer, sale, or supply, directly or indirectly, from the United States or by a US person (even if outside of the US), of luxury goods to Russia, as well as to designated Russian oligarchs and 'malign actors'.

The UK sanctions regime has prohibited the direct or indirect:

- supply or delivery of luxury goods to a place in Russia;
- making luxury goods available to **a person connected with Russia**; and
- making luxury goods available for use in Russia

A person connected with Russia is defined in UK legislation as including:

- an individual or combination of individuals who are, ordinarily resident in Russia
- an individual or combination of individuals who are, located in Russia
- organisations incorporated or constituted under the law of Russia, or
- organisations domiciled in Russia

Luxury goods, as defined in UK legislation includes jewellery, wine, handbags, works of art, collectors' pieces, antiques and vehicles.

This means that art and antiques dealers and auction houses are effectively prevented from selling any works to persons connected with Russia. Shippers, too, are prevented from delivering or making luxury goods available for use in Russia.

While art market participants are still able to sell works of art on behalf of non-sanctioned Russians, most will have decided that this is not an activity they are willing to be involved in.

Quite apart from the moral argument, they would have to take extreme care to ensure that if the sale involves or is going through a corporate entity it is not beneficially owned by a sanctioned person. This may be difficult to prove.

The breadth of the 'connected person' definition also impacts jewellers, high-end retailers and online selling platforms listing luxury goods from dealers.

Harrods has reportedly written to advise customers whom they have identified as being ordinarily resident in Russia that they will no longer be able to supply them with restricted luxury goods.

This type of initiative-taking can be helpful, not only for compliance, but also reputation and customer relationship management.



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