

DUE DILIGENCE TOOLKIT

EXPLANATORY NOTES

INTRODUCTION

Context and background

Due diligence forms an essential part of art transactions. Investigating and obtaining as much information as possible about the parties to the proposed transaction, the artwork and the transaction itself protects art businesses and collectors and helps art businesses manage their reputational and financial risks. Increasingly, legislators and regulators are emphasising the importance of “due diligence”.

What is Due Diligence?

Due diligence is defined as “*action that is considered reasonable for people to be expected to take to keep themselves or others and their property safe*”. In practice, it is about asking the right questions, obtaining and verifying information and applying common sense.

Why is Due Diligence important?

For anyone involved in art transactions, due diligence is important for managing reputational and financial risks. Situations where due diligence plays a key role include:

- Acquisitions, sales, donations and loans of artworks;
- Managing art collections as a trustee or in an advisory capacity;
- Financial transactions and loans secured against artworks;
- Curating exhibitions and art fairs;
- Insuring, storing and transporting artworks.

Who should use the checklist?

Whilst the checklist is specifically aimed at art businesses and collectors involved in selling or acquiring art, anyone engaging in the activities described above may find the checklist helpful.

How should the checklist be used?

As with any good risk management tool, judgement should be applied as to the level of due diligence required and the enquiries tailored according to the risk factors (red flags), if any, which are present. The checklist is designed as an “aide-memoire” of the key areas of enquiry. It does not purport to be completely comprehensive. Depending on the circumstances and the nature of the artworks involved, fewer or additional checks and measures may be required.

1. CLIENT DUE DILIGENCE

1.1. Individual

Identity should be verified based on official identity papers (e.g. passport or national ID card) together with other reliable, independent source documents, data, or information as may be appropriate under the circumstances (e.g. copy of a bank statement or utility bill for proof of address).

The documents used to verify the client's identity must be current at the time of undertaking the due diligence and the Art Business should keep copies of the documents in line with any legal time periods or standard practice applying in the jurisdiction where it is carrying out business. Please refer to Guideline 6 of the AML /CFT Guidelines for further guidance.

1.2 Company, Trust, Association, Foundation, other legal entity

Identity should be verified based on official documents proving these entities were properly formed and exist (e.g. certificate issued by the relevant company registry including details of directors and shareholders, or partners as the case may be, and for trusts, the trust deed including details of the trustees, settlor(s) and beneficiaries).

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Companies – Controlling owner

The Art Business should verify who has management control over the company or who is the company's controlling owner, i.e. who is the company's majority shareholder, or who is the single largest or the largest shareholders of the company. Some countries' commercial registers list the shareholders of registered companies. These registry excerpts may be useful in identifying controlling owners.

Trusts – Settlor, Trustees, Beneficiaries, Protector

The settlor is a person or entity that establishes a trust for one or more beneficiaries. Each trust is controlled and managed by trustees. The protector is a person appointed under the trust instrument to direct or restrain the trustees in relation to their administration of the trust. It is important to identify who the trustee is and whether he/she has the power to sell the Artwork.

Offshore companies - Beneficial Owner

If the client is a company, trust or other corporate vehicle, in addition to establishing if the corporate vehicle carries out any trading activities or simply exists to hold assets, the Art Business will also want to identify the natural person(s) who control that entity (“**Beneficial Owner(s)**”).

The “**Beneficial Owner**” refers to the natural person who enjoys the ultimate benefit of ownership of an artwork, asset, legal entity, bank account or wealth.

If the Art Business knows, or has reason to suspect that the client they are transacting with is acting on behalf of another individual or entity, the Art Business must use best efforts to establish:

- the identity of that other individual or entity, i.e. the Beneficial Owner; and
- the capacity in which the contracting client is representing the Beneficial Owner.

If the Beneficial Owner is a company or other form of legal entity, Art Businesses should make further enquiries to establish the individual with ultimate ownership or control of that entity.

Best efforts should be made to identify the Beneficial Owner even if the contracting client raises confidentiality concerns because of the reputational and other risks entailed if the Art Business is found to be involved in Money Laundering or Terrorist Financing schemes.

Art Businesses may also choose to include appropriate warranties and representations in their agreements with their clients to emphasise the importance of this point¹.

The laws in certain countries may require Art Businesses (principally when the Art Business is acting as financial intermediary) to identify the beneficial owners of certain corporate entities (see the Country Profile guides for further details).

1.3	Client’s role in the transaction checked
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Intermediaries: If the transaction involves one or more intermediaries (for example an art advisor or agent), the Art Business should check in what capacity that intermediary is acting and that they have authority to act (see section 1.5 below).

¹ European Member States are now required to hold beneficial ownership information for certain companies and trusts in central registers. Not all of these registers are accessible to the public so Art Businesses may not be able to use them for verification purposes.

1.4	Client's authority to act checked
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Jointly owned artworks: An Artwork may be owned jointly by two or more individuals (e.g. married couples, siblings following the death of a parent etc.). In such cases, the sale of the Artwork requires the approval of all joint owners. Art Businesses should obtain confirmation that all joint owners consent to the sale. A signed letter or power of attorney from the other joint owner(s) or their legal representatives can be used to confirm this authority.

Executor of a deceased person's estate: If an Artwork is being offered for sale by the Executor of a deceased person's estate, the Art Business should confirm that the executor has authority to sell the Artwork by asking for copies of the relevant documentation confirming their authority to act in this capacity.

Agent acting on behalf of a principal owner: If an Artwork is sold by an agent on behalf of a principal, the Art Business should verify whether the agent has authority to conduct such a sale, such as according to a signed letter from the principal or his/her legal representative including a signed Power of Attorney.

1.5	Client red flags checked
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Please refer to the Client red flag list.

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2. ARTWORK DUE DILIGENCE

2.1. Identification

A physical examination of the artwork as well as quality high resolution images (front and back for two dimensional artworks and of multiple facets for three dimensional artworks) is particularly important at the identification stage.

Inscriptions, dates and other distinctive marks can provide important information and clues about the authenticity of the artwork and its ownership history (see 2.2 and 2.5 below).

Information can also be gleaned from exhibition stickers, seals, dealers' and collectors' marks and transport and customs stamps which are often found on the reverse of artworks.

Identifying the country of origin or find spot of an archaeological object can help flag cultural property and/or trade restriction issues.

Comprehensive identification information is needed to undertake the database searches referenced below (see 2.3).

Endangered species material

Does the artwork contain endangered species material? Examples include ivory, tortoiseshell and certain species of crocodile. You can check the lists of endangered species at <https://www.cites.org/>. You may need to ask an expert to help you identify the species. You will need the species information to obtain relevant export and import licences and any sale permits which may be required.

Archaeological objects

See section 2.4.

2.2 Trade restrictions

Is the artwork subject to trade sanctions in any of the jurisdictions covered by the transaction? Following a UN Security Council resolution, at the time of writing many countries have imposed bans on the handling, importation, exportation, sale, supply and transfer of Syrian and Iraqi cultural property.

Trade restriction and sanction information is published on official state and government websites.

2.3 Ownership

The person who presents the artwork for sale may not be the legal owner or the sole legal owner. In these situations:

- obtain details of the legal owner and all other persons who have a legal interest in the artwork; and
- confirm that the people you are dealing with have authority to act on behalf of the legal owner of the artwork.

Situations where heightened due diligence over ownership may be required include:

- divorcing couples;
- family disputes and sales following inheritance;
- artworks subject to charges, liens and other security interests;
- legal proceedings involving the seller of the artwork;
- insurer interests in the artwork following a loss or theft.

2.4 Provenance & exhibition history

Establishing the **provenance** (historical record of ownership) and if applicable, exhibition history of an artwork can:

- (1) help establish the work's authenticity;
- (2) add to the work's value if it has a complete or distinguished ownership and exhibition history; and
- (3) help prove ownership if legal title to the artwork is later contested.

Conversely, the absence or lack of a credible provenance can raise "red flags" regarding the artwork's attribution or authenticity. In the case of archaeological objects and cultural goods, the absence of a verifiable recent provenance could indicate that the item has been illegally removed from its source country.

Lost and stolen items

If there are provenance doubts or gaps, it is advisable to check the artwork against databases of lost and stolen art. Examples include:

- Interpol's "Works of Art" database <https://www.interpol.int>
- The Art Loss Register <http://www.artloss.com/en>

Enhanced due diligence is advised in the following situations:

Archaeological objects

The looting and illicit trafficking of archaeological objects and other cultural goods from conflict zones such as Iraq and Syria is of increasing concern.

ICOM's "red lists" database <http://www.icom.museum> provides a useful resource and should be checked before handling or acquiring archaeological objects and cultural goods.

Spoliation & looting

Art professionals and collectors should be alive to the looting and spoliation of artworks that occurred:

- at the hands of the Nazis in Europe between 1933 and 1948;
- in Eastern Europe and in the Soviet Union during the Communist era between 1949 and 1990; and
- in Cuba during the revolution between 1953 and 1959.

If an artwork was located in these areas during the sensitive periods, enhanced due diligence should be carried out to ensure the artwork is not looted or stolen. Specialist databases which can be searched include:

- Lost Art <http://www.lostart.de>
- The Getty Research Institute <http://www.getty.edu>

Some countries have published guidance on conducting due diligence for artworks suspected as having been spoliated or looted. For example:

- Swiss Culture Ministry <http://www.bak.admin.ch>

2.5 Artwork location & recent movement

The location and tax status of the artwork and if applicable its last country of export should be identified and verified. This ensures relevant tax requirements can be complied with and any necessary import and export licences and permits can be obtained².

Copies of export and import paperwork should be obtained ideally before taking possession of the artwork to ensure the artwork has entered the country legally.

² If the proposed European regulation on the import of cultural goods is adopted, art businesses and collectors will need to provide this information to import cultural goods into the EU, whether bringing them into free circulation or storing them in a bonded warehouse or Freeport

If the artwork is an archaeological object, a fragment of an ancient building or a statue or other cultural good, written evidence confirming the artwork left its source country legally, should be obtained. Extra vigilance is required if the cultural goods have transited through countries neighbouring a conflict zone or which have been identified as being used in illicit trafficking routes³.

2.6 Authenticity

Fakes, forgeries and misattributions are perceived as a major risk for buyers in art transactions. A fake artwork or one whose authenticity is difficult or impossible to establish with a high degree of certainty, will lose its commercial value and could represent a total loss for its buyer.

With the professionalization of the art market higher standards of due diligence are expected of art market actors. The reputational and financial consequences for art businesses are also extremely high.

Determining authenticity is a complex task and the checks undertaken will depend on the artwork. Where there is doubt, typically the following three areas will be explored in conjunction to give an overall picture on authenticity:

- expert opinion (including artist foundations, authentication boards and committees where they exist) and catalogues raisonnés;
- provenance and art historical research; and
- scientific testing.

It is best practice to gather information from all three areas of enquiry and not to rely on one source alone.

Expert opinions and scholarship

There can be differences of opinion between experts, authors of catalogue raisonné and authentication boards and committees. Also, for some artists, the body of scholarship is constantly evolving. It is essential to record all expert opinions provided, even if those opinions differ. To avoid conflicts of interests, experts should not have a financial interest in the transaction for which their opinion is sought. Where several reliable catalogues raisonnés exist on an artist, they should all be checked.

Provenance and art historical research

The provenance of an artwork should be supported and verified wherever possible with factual, written or photographic evidence. If any part of the provenance is hypothetical or cannot be verified, this should be indicated clearly. Caution is required when verifying provenance information as forgers

³ At the time of writing, examples of transit countries for Syrian objects include Turkey, Lebanon and Jordan

or traffickers often falsify provenance information. For this reason, it is not advisable to rely on it as the only proof of authenticity.

Scientific testing

Scientific testing is increasingly used in art due diligence as it can provide independent and reliable information on materials and techniques used and the dating of materials and pigments. Scientific analyses can be helpful in detecting fakes and forgeries by revealing inconsistencies and anachronisms. These tests cannot however positively prove the authenticity of an artwork or its attribution to a particular artist. Any scientific report which makes such claims should be considered biased and unreliable. Scientific testing provides a complementary source of information to be used in conjunction with the other sources (i.e. expert opinion and art historical research) to provide an overall conclusion on authenticity.

In keeping with best practices, scientific testing should be performed by laboratories and conservation scientists with the relevant qualifications. Scientific reports should clearly describe the analytical process followed (including the type and calibration of the equipment) such that other professional laboratories could repeat the tests and verify the results. The reports should clearly indicate which part of the results is factual and which part represents the author's interpretation of the results. As with any academic publication, scientific reports should reference their sources.

2.7	Condition
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It is advisable to gather and share as much information as possible on the artwork's composition, condition and recommended conservation.

The materials used in an artwork as well as the artwork's condition and the presence of any restoration can impact the artwork's present and future value. An original artwork which has been highly or improperly restored can lose an important part of its value.

Sales are regularly contested based on what the buyer perceives as a lack of information (or incorrect information) regarding the state of conservation of the artwork. These factors will also dictate how the artwork should be transported and conserved and the associated costs. If incomplete information about the condition or fragility of an artwork is communicated to people taking custody of the artwork for shipping or exhibition purposes for example, damage can occur.

An artwork composed of materials which are bound to react chemically or which are organic and could decompose in the short term, should be considered a risky investment and a buyer should be informed of the risks related to the artwork's conservation. Seeking the advice of a professional and independent art conservator, specialising in the type of artwork in question (work on paper, oil paintings, ceramic, bronze sculpture, contemporary installation, etc.) is recommended.

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Restoration is sometimes used to forge an artwork and/or modify its attribution (for example making it look older, adding a signature or an inscription, adding details typical of a particular artist or period, etc.)

A condition report prepared by an independent art conservator, with the proper level of expertise and specialisation can be an essential document in an art transaction or during a key stage of a logistical operation.

2.8	Artwork red flags checked
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Please refer to the Artwork red flag list.

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3.

TRANSACTION DUE DILIGENCE

Understanding the background and purpose of the transaction is helpful to establish the risk profile of the transaction and to inform on the level of diligence the Art Business should carry out.

Art Businesses should examine in particular:

- The purpose of the transaction;
- The form and structure of the transaction (fair price, structure of the payment, involvement of intermediaries, conflicts of interests);
- The source of funds; and
- The documentation supporting the transaction.

Any activity relating to a proposed transaction that is not consistent with what is known about the client and the client’s risk profile or which otherwise raises “red flags” should be the subject of enhanced due diligence by the Art Business. Such enhanced due diligence could include asking for additional information or documentation on the key elements of the transaction such as the context of the transaction, the source of funds or the structure of the transaction.

3.1	Purpose of the transaction
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The Art Business should examine the client’s background and purpose behind the contemplated transaction to identify if there is anything which raises suspicions as to the legitimate purpose of the transaction. For example:

- Are the artworks being sold by the client consistent with what is known about the client’s collection?
- Is the level at which the client is selling or buying consistent with their past transactions and what is known about their professional activities and personal wealth?
- If not, the Art Business may want to ask the client for further information.

3.2	Form of the transaction
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Art Businesses should also consider the form and structure of the transaction, such as:

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The use of intermediaries and other non-face to face methods

If the transaction is taking place through intermediaries, face to face, entirely via the Internet, over the phone, or by any other similar non-face to face means, there is a risk that the information provided cannot be properly verified and that the transaction is used in the context of an illegal scheme;

The use of unusually complex structures

If the client operates through multiple private investment companies or offshore structures whose ownership, control and/or beneficiary structure is opaque, legal rights arising from the transaction may be difficult to ascertain Art Businesses should exercise caution to ensure the transaction is not part of an illegal scheme;

Artificially low or inflated prices

If the client is willing to sell or buy at an artificially low or inflated price, and there are no logical business reasons justifying the price difference, there is a risk that the transaction may be part of a money laundering scheme and art businesses should exercise caution

Unusual payment structures

If the client proposes making multiple low value cash payments for a single or series of connected transactions or proposes using a loan from a lender whose background cannot be verified or who is otherwise unreliable and the terms of the loan are unusual (non-existent interest rates, lack of collateral, excessive loan maturity dates), Art Businesses should exercise caution and obtain additional comfort that the transaction is not part of an illegal scheme before proceeding.

Conflicts of interests

Art Businesses should be alert to actual or potential conflicts of interest arising and take steps to avoid them and any situations of potential bribery. Examples of situations requiring scrutiny include where the seller and buyer (or their intermediaries) are connected. For those involved in the transaction, conflicts of interests create a potential exposure to liability for breach of contract or breach of other duties and the transaction could be rendered void.

3.3	Source of funds
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Art Businesses should pay particular attention to the source of funds used in a transaction and be particularly alert to risks of money laundering or terrorist financing.

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Cash payments

Art Businesses should generally discourage cash payments wherever possible. The source of cash cannot be traced in the way that payments made through established banking systems can. Accordingly, there can be no guarantee that the cash source is legitimate and clean.

Where Art Businesses accept cash they should keep the amounts small. Some countries have imposed limits on cash transactions per transaction or series of related transactions. Art Businesses should check the limits (if any) applying in the jurisdictions where they operate. See the Country Guides for further details.

Art Businesses should not accept single or multiple cash payments for an artwork in excess of the legally imposed threshold. If there is no legal threshold, Art Businesses are advised to conduct enhanced due diligence on the buyer and the source of funds so that they are satisfied that no money laundering risk exists.

Third party payments

Art Businesses are discouraged from accepting payments from a third party who is not their client and buyer of record. If there are legitimate reasons why it is justified for the Art Business to accept payment from a third party, before doing so the Art Business should conduct enhanced due diligence on both their buyer of record and the third-party payer and only proceed with accepting the payment if satisfied that no money laundering or terrorist financing risk exists.

Payments from bank accounts located in non-AML regulated jurisdictions

The preference for all transactions should be for the Art Business only to accept payments from reputable banks in jurisdictions subject to AML regulation and supervision. Such reputable banks and financial institutions are generally subject to a high degree of AML regulation. That said Art Businesses should remain vigilant and not rely entirely on the fact that banks and financial institutions will have carried out the necessary checks and verification to be satisfied that the source of funds is clean.

Art Businesses should be wary about accepting payments from bank accounts located in high risk or non-cooperative AML jurisdictions. To identify such jurisdictions Art Businesses are encouraged to consult the list of "High Risk and Non-Cooperative Jurisdictions" published by the Financial Action Task Force (FATF) <http://www.fatf-gafi.org>.

Digital currencies

Digital currencies are currencies with no physical form that are not controlled by a central bank. Examples of digital currencies include Bitcoins, Litecoins and Namecoins.

At the time of writing the use of digital currencies in art transactions is not common. Art Businesses are advised to act cautiously before accepting payments in the form of digital currencies which are not controlled or regulated. It is an area which regulators continue to monitor.

3.4 Documentation

It is important to document transactions fully and correctly. This puts Art Businesses in a better position if they are later required to provide information in the context of an investigation or if a dispute subsequently arises. Art Businesses minimise their legal, reputational and financial risks by being able to demonstrate and prove the circumstances of the transaction and the due diligence measures they carried out at the time. It is advisable to gather and retain written proof of the transaction and the due diligence measures carried out, particularly for transactions presenting increased risks or which involved artworks of significant value.

Documentation relating to the identification and movement of the artwork are particularly important. Relevant aspects to check include: correctly entered dates, statements of origin and destination, vehicle numbers, details of the consignor, consignee and transporter and the description of artwork on bills of lading and delivery notes and other transport documentation, authenticity certificates and invoices. Having correct and complete transport documents is important to prove legal import and export of an artwork.

3.5 Transaction Red Flags checked

Please refer to the Transaction red flag list.

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