

## Senate Report Exposes the U.S. Art Market as a Hotbed for Money-Laundering and U.S. Sanctions Evasion

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A congressional report released on July 29, 2020, by the Senate’s Permanent Subcommittee on Investigations, exposes how Russian oligarchs looking to evade U.S. sanctions are able to exploit loopholes in the art industry. *The Art Industry and U.S. Policies that Undermine Sanctions*, a 150-page bipartisan report, spearheaded by senators Rob Portman (R – Ohio) and Tom Carper (D – Delaware), calls for more regulation in a notoriously opaque industry which, according to the report’s findings, undermines one of the most fundamental tools that U.S. administrations use to pressure foreign governments against “bad behavior.”

The Senate report focuses on a case study of activities by one sanctioned Russian family, the Rotenbergs, and details how the art industry’s frequent use of shell companies and intermediaries – and an overall lack of accountability among art auction houses and private galleries – helps conceal the identities of buyers and sellers and fuels a culture of turning a blind eye to dirty money.

### Sanction Authority and the Art Industry

The Treasury Department’s Office of Terrorism and Financial Intelligence (“TFI”) is responsible for enforcing economic sanctions as well as developing policy, strategies, and guidance to combat terrorist funding.<sup>1</sup> Sanction authority rests with the Office of Foreign Assets Control (“OFAC”), a division of TFI, and stems from presidential national emergency powers, as well as authority granted by specific legislation to impose controls on transactions and freeze assets under U.S. jurisdiction. These statutes include the Trading with the Enemy Act (“TWEA”), the Global Magnitsky Human Rights Accountability Act (“Magnitsky Act”), and the International Emergency Economic Powers Act (“IEEPA”).

IEEPA has been amended several times since its enactment in 1977. Significantly, the “Berman Amendment,” passed by Congress in 1988, has been interpreted to exempt artwork from presidential sanction authority under both IEEPA and TWEA. The Berman Amendment, as amended and expanded by the Free Trade in Ideas Act in 1994, specifies that OFAC does not have the statutory authority to regulate “directly or indirectly” transactions concerning the import or export of “information and informational materials” to or from sanctioned countries, “regardless of format or medium of transmission.” “Informational materials” has been interpreted to include most books, magazines, eBooks, and other publications; pre-recorded video and audio tapes and CDs; and paintings, sculptures, and other works of art.

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<sup>1</sup> 31 U.S.C. § 312

## The Rotenbergs Case Study

The Obama administration imposed sanctions on the Rotenbergs in 2014 under IEEPA, as part of a larger response to Russia's annexation of Ukraine's Crimean peninsula. However, the sanctions against Russian government officials, financial entities, and members of President Vladimir Putin's inner circle did not have the intended effect of pressuring Russia to withdraw from Crimea. Senate subcommittee investigators began to consider where holes might exist in the sanctions program and initiated an investigation after reviewing a number of suspicious transactions involving high-value art.

In the spring of 2016, investigators found an important tip in the leaked Panama Papers – millions of documents released by the International Consortium of Investigative Journalists ("ICIJ"), originating from the Panama-based law firm of Mossack Fonseca & Co. ("Mossack"), referred to as the "one of the world's top creators of shell companies."<sup>2</sup> The papers included an email chain identifying at least nine shell companies formed in the British Virgin Islands, which were involved in high-value art purchases for the Rotenbergs.

That discovery led investigators to a naturalized American art advisor, Gregory Baltser, who operated through the network of offshore shell companies buying and selling art for the Rotenbergs. The shell companies themselves were set up and managed by an attorney named Mark Omelnitski, a British citizen born in Moscow, and his company, the Markom Group.

Investigators were able to piece together that Baltser had purchased roughly \$18 million in art for the Rotenbergs during the months just after sanctions were announced and that shell companies linked to the Rotenbergs participated in nearly \$91 million in transactions from 2014 onward. Only two months after sanctions were imposed, Baltser purchased roughly \$6.8 million in art on behalf of the Rotenberg family during an auction at Sotheby's, including a \$1.2 million painting by Marc Chagall, *Femme et Enfant*, and a nearly \$3 million painting by Georges Braque, *Pichet et Journal*.<sup>3</sup>

## Lack of Transparency in the Art Industry

As the Senate report notes, the art industry is considered "the largest, legal unregulated industry in the United States." Unlike financial institutions, the art industry is not subject to the Bank Secrecy Act ("BSA"), which requires detailed procedures to verify customer identity and combat money laundering.

Art sales are often conducted through intermediaries such as art advisors, who frequently represent anonymous purchasers and sellers. Indeed, in a typical transaction, a purchaser may never know the ultimate identity of the seller of the art they are purchasing, and the seller may not know the identity of the purchaser or the origin of the funds used for the purchase. Because the industry is not currently subject to the BSA, no legal requirement forces the seller to confirm the identity of the purchaser or that the funds are not laundered money. Finally, it would be considered "taboo" for an art advisor to reveal

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<sup>2</sup> *The Panama Papers: Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption*, INT'L CONSORTIUM OF INVESTIGATIVE JOURNALISTS (Apr. 3, 2016), <https://www.icij.org/investigations/panama-papers/20160403-panama-papers-global-overview>.

<sup>3</sup> *The Art Industry and U.S. Policies That Undermine Sanctions*, Staff Report, Permanent Subcommittee on Investigations, U.S. Senate (July 29, 2020), <https://www.hsgac.senate.gov/subcommittees/investigations/hearings/majority-and-minority-staff-report-the-art-industry-and-us-policies-that-undermine-sanctions> at 9.

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the identity of the seller or ultimate beneficiary – one that would surely result in a loss of trust among all parties concerned, as well as any future business for the art advisor.

The majority of art sales are also private transactions where anti-money-laundering (“AML”) policies are virtually nonexistent. A private dealer interviewed in the Senate report confessed that she had no formal AML policies and that she merely tries to work with people she knows and trusts, and “relies on her gut.”<sup>4</sup>

By contrast, the four largest auction houses identified in the report – Sotheby’s, Christie’s, Phillips and Bonhams — all have voluntary AML programs despite no current U.S. legal requirement to do so. Yet, the auction house employees who facilitated the art purchases in the case study apparently never asked the art advisor to the Rotenbergs for the identity of the purchaser.<sup>5</sup> Baltser was able to take advantage of rules and practices that allowed him to be presented as the “principal buyer,” and thus avoid naming his clients.

In the case of Sotheby’s, because Baltser took title to the purchases he made in his name, with funds coming from an account in his name<sup>6</sup>, Sotheby’s did not view Mr. Baltser as an agent, but rather as the principal buyer. Counsel for Bonhams similarly stated that the auction house did not consider Baltser to be an agent, given that he was transacting in his own name and with his own funds, thereby assuming all contractual risks such as representing that a third-party is not on a Specially Designated National (“SDN”) or other sanctions list. Whereas Bonhams understood that Baltser often resold purchased items, the identity of a third-party buyer was not of importance to the auction house because Bonhams viewed Baltser as the principal buyer.<sup>7</sup>

An eventual partnership established between Baltser and Christie’s in 2014 provided a newly-created Baltser entity (“BALTZER LLP”) with a number of bidding paddles under one account, thereby allowing Baltser to bid on behalf of “a whole class of contemporaneous collectors” at his new private club in Moscow.<sup>8</sup> The agreement stipulated that BALTZER would conduct AML and sanctions checks on its own clients and would certify at the end of each trading year that it had no reason to suspect that any of its clients were engaged in money laundering activities.<sup>9</sup> It is worth noting that Mark Omelnitski – the same man who set up and managed the Rotenberg shell companies – served as the Money Laundering Reporting Officer (“MLRO”) for BALTZER LLP.<sup>10</sup>

## Recommendations

The Senate report makes eight principal recommendations to enforce policies designed to crack down on sanctions evasion. In sum, the recommendations call for amendments to the BSA to include regulations for the art industry, as well as increased oversight of the industry by the Treasury Department.

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<sup>4</sup> *Id.* at 3

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at 82

<sup>7</sup> *Id.* at 83

<sup>8</sup> *Id.* at 90

<sup>9</sup> *Id.* at 94

<sup>10</sup> *Id.* at 93

1. *Congress should amend the BSA to add businesses handling transactions involving high-value art.*

As the art industry is not currently subject to AML requirements under the BSA, this change would bring the United States more in line with the European Union. The EU's 5<sup>th</sup> Anti-Money Laundering Directive ("5AMLD") now requires businesses handling art transactions valued at €10,000 or more to comply with AML laws, including verifying the identity of the buyer, seller, and ultimate beneficial owner of the art.<sup>11</sup>

2. *Congress should require the Treasury Department to collect beneficial ownership information for companies formed or registered to do business in the United States.*

This recommendation is intended to improve corporate transparency and allow the Treasury not only to collect this beneficial ownership information, but also make it available to law enforcement.

3. *When imposing sanctions on an individual, the Treasury Department should consider routinely imposing sanctions on the individual's immediate family members.*

While the U.S. sanctioned the Rotenberg brothers in March 2014, for example, it did not sanction the brothers' children until later dates, which allowed the brothers to evade sanctions by transferring their interests in companies to their children despite maintaining effective control of the companies.

4. *The Treasury Department should implement and announce sanctions concurrently.*

A four-day window existed between the date when President Obama announced sanctions for Russia's annexation of Crimea on March 16, 2014, and when the Treasury Department officially imposed sanctions on specific individuals and entities – March 20, 2014. This time lapse between the announcement of the policy and its implementation allowed millions of dollars to be transferred through the United States and back to Russia.

5. *The Treasury Department should lower or remove the ownership threshold for blocking companies owned by sanctioned individuals.*

According to Treasury Department guidance, a company is blocked if it is majority-owned by a sanctioned individual – otherwise known as OFAC's "50 Percent Rule." If the sanctioned individual has a minority ownership in a company, that company is not blocked or placed on an SDN list, even if a sanctioned individual owns 49 percent of the company.<sup>12</sup>

6. *The Treasury Department should maximize its use of suspicious activity reports ("SARs") filed by financial institutions.*

Under the BSA, financial institutions are required to file SARs with the Treasury Department's Financial Crimes Enforcement Network ("FINCEN"). These reports to FINCEN document financial transactions that appear to involve money laundering or terrorist financing. The report suggests that the Treasury Department should establish more effective mining of SARs for information related to SDNs.

<sup>11</sup> See *The New UK Anti-Money Laundering Regulations: How Will the Art World be Impacted?* <https://www.cohengresser.com/app/uploads/2020/02/CG-Client-Alert-1.pdf>.

<sup>12</sup> U.S. DEP'T OF TREASURY, REVISED GUIDANCE ON ENTITIES OWNED BY PERSONS WHOSE PROPERTY AND INTERESTS IN PROPERTY ARE BLOCKED (2014), [https://www.treasury.gov/resourcecenter/sanctions/Documents/licensing\\_guidance.pdf](https://www.treasury.gov/resourcecenter/sanctions/Documents/licensing_guidance.pdf).

7. *OFAC should issue comprehensive guidance on the steps auction houses and art dealers should take to ensure they are not doing business with sanctioned individuals or entities.*

This guidance should include steps that auction houses and art dealers should take regarding determining whether an individual is the principal buyer or seller of art, or is acting on behalf of an undisclosed client, as well as determining whether an individual should be subject to increased due diligence.

8. *OFAC should issue guidance interpreting the informational exception to the International Emergency Economic Powers Act related to “artworks.”*

The Senate report suggests that OFAC guidance should interpret the Berman Amendment narrowly and not exclude artwork from sanction authority. We may expect such guidance from OFAC relatively soon. In response to the Subcommittee’s requests for clarification from the Treasury Department regarding how high-value art is treated under IEEPA, given its apparent exemption under the “informational materials” exception in the Berman Amendment, the Treasury provided a telling update on July 22, 2020, stating that “Treasury does not believe the Berman Amendment is a categorical bar to the application of IEEPA-based sanctions involving artwork... OFAC intends to issue additional public guidance on this issue in the near term.”<sup>13</sup>

### **Conclusion – What’s Next?**

Because there are no strict laws in place requiring auction houses and dealers to do background checks on buyers, it has been relatively easy for individuals like the Rotenbergs to move money around within the art world. Especially after the recent implementation of 5AMLD in Europe, it is difficult to imagine the U.S. art industry with a long life ahead as an unregulated market; the Senate report may well be the last nail in that coffin.

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<sup>13</sup> *The Art Industry and U.S. Policies That Undermine Sanctions*, Staff Report, Permanent Subcommittee on Investigations, U.S. Senate (July 29, 2020), <https://www.hsgac.senate.gov/subcommittees/investigations/hearings/majority-and-minority-staff-report-the-art-industry-and-us-policies-that-undermine-sanctions> at 39, citing *Letter from Frederick W. Vaughan, U.S. Dep’t of Treasury, Principal Deputy Assistant Secretary Office of Legislative Affairs to Chairman Rob Portman* (Jul. 22, 2020).

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