



ARTICLE

Following the Treasure Trail: Luxury Goods and Financial Crime

What Are the Risks and Obligations, and How Should the Industry Adapt and Comply?

When looking at the USD\$312 billion luxury goods sector¹ – think fine art, superyachts, sports cars, watches, jewellery and high-end apparel – it could be assumed that the financial crime risk pales in comparison to the USD\$22.5 trillion financial services industry.² But is that really the case? And can industries outside of the highly regulated financial sector afford to rest on their laurels?

There is a lack of hard data on how financial crime compares across sectors of the economy, given its inherently illicit nature, but the risks within the luxury sector are self-evident. There are intrinsic characteristics that heighten its attractiveness for criminal activities including money laundering and tax evasion, such as:

- Portable goods like watches and other designer accessories are easily transportable across borders.
- High-value items such as superyachts and luxury cars are often associated with anonymous shell companies or intermediaries that purchase these.
- Assets; for example, through the use of virtual auctions, which can disguise true ownership.
- The international nature of markets such as art and whisky makes an attractive commodity for sanctions evaders and launderers looking to move illicit finance into or out of a country, especially coupled with highly subjective values and the potential for anonymity.
- Luxury brands, with their associated intangible social and psychological benefits and the aspirational lifestyles of their customers, can provide a veil of legitimacy.

Added to these risks are the long-standing, and often perfectly valid, industry customs of discretion and privacy, which are present across virtually all luxury sectors. This valuable commodity of beneficial owner anonymity will likely increase with the rise in popularity of metaverse-type platforms and virtual assets such as non-fungible tokens, which may also provide faster transfer of value.

How is the luxury sector being used to facilitate financial crime?

Recent high-profile cases of financial crime have often featured exploitation of the industry. In one example, the vice-president of Equatorial Guinea, Teodorin Obiang, was convicted of corruption and found in possession of luxury cars, Fabergé eggs and expensive wines, revealing spending habits comically in excess of his official salary.³ The so-called 1MDB scandal featured Malaysian officials and global associates using money stolen from the sovereign wealth fund to purchase diamonds and famous artwork.⁴ And, of course, organised crime groups have long been known for their taste in luxurious apartments, such as the Mafia's ownership of prime real estate in

London,⁵ financed through activities that cause significant harm to society.

To further complicate matters, the methods used by criminal groups to move money are becoming increasingly sophisticated. In 2020, a report issued by the US Office of Foreign Assets Control (“OFAC”) found several designated Russian oligarchs were linked to a network of shell companies that had anonymously purchased high-value artwork enabling the beneficiaries to evade US sanctions.⁶

Despite the clear connection between financial crime and the luxury sector, the evidence is not always easy to uncover. Luxury goods typically appear at the end-point or the integration stage of a money laundering operation and offer an ideal exit strategy for dirty money. Not only can the value be inflated to the benefit of the owner, but luxury goods are also saleable to exchange back to fiat currency, making them reliable and stable stores for illicit funds.

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The core challenge for firms in the sector is the ability to separate legitimate purchases from transactions potentially involving illicit funds. Compare this challenge, for example, to the scrutiny that banks and financial institutions have faced for decades to detect whether anomalous transactions are simply abnormal purchases or evidence of an underlying criminal network.

When considering this high-risk profile and the fact that traditional money laundering methods such as inter-bank money laundering and physical cash couriers are becoming harder to employ, it is no surprise that money laundering through luxury goods is increasing. Unsurprisingly, so is regulatory supervision.

Regulatory expectations and enforcement

The EU has been a trailblazer in this space, expanding its Anti-Money Laundering (“AML”) regulations to cover more of the luxury goods market. Currently, any high-value dealer accepting cash payments of €10,000 or more falls in the scope of the regulation. At an operational level, the requirements mean that many luxury brands operating in the EU are required to: register with the appropriate regulator; implement AML policies, controls, and procedures; undertake risk assessments; carry out due diligence; and report any suspicious activity to authorities.

One particular target of the increased EU regulation is the art market which, following implementation in 2020 of the 5th Money Laundering Directive, is now subject to official supervision and must abide by the AML rules. This brings the rest of the EU in line with countries such as France, where the art market has been subject to AML requirements for many years. An example of how these new laws are being actioned is visible in Ireland, where the Department of Justice has recently put 234 businesses trading in art, including dealers and galleries, in a database for monitoring compliance. There are 20 inspections planned for 2022 as part of a clampdown against organised crime groups and drug cartels using high-value art purchases to launder money and finance terrorism.⁷

In the UK, the Money Laundering Regulations align with changes made at EU level. However, the UK has a further tool at their disposal in the form of Unexplained Wealth Orders (“UWO”), which compel targets to explain and evidence how an asset was acquired. The first and most notable UWO to date involved the wife of an Azerbaijani banker of a state-owned company who spent £16 million in Harrods.⁸ This poses a new type of danger for non-compliant high-value dealers; a failure to check the source of a client’s wealth and funds could be uncovered years afterwards as a by-product of this novel court order.

It is not just Europe that is experiencing increased regulation. In the United Arab Emirates, the Central Bank has urged financial institutions to increase their due diligence and scrutiny of dealers in precious stones and metals. This follows the 2020 release of the country’s Financial Action Task Force (“FATF”) mutual evaluation report, identifying high-value goods dealers as a particularly risky area. Similar trends have also been observed in Israel, where the limit on cash transactions has recently been reduced to NIS 11,000 (around €3,100) and more stringent Know Your Client (“KYC”), AML policy, and suspicious transaction reporting requirements are being imposed on jewellers and other high-value dealers.

Luxury brands must also comply with sanctions laws and ensure that economic resources are not made available to designated individuals. Sanctions risk financial, regulatory and reputational repercussions, and they are evolving and complex. For example, in 2017, Richemont – the Swiss publicly listed holding company behind brands such as Cartier and Van Cleef & Arpels – was fined USD\$334,800 over a violation of OFAC sanctions.⁹ Critically, even if facilitation of sanctions violations is unintentional, participants can still be held liable and subject to civil penalties. Even if the

requirements may not directly impact the luxury sector, there may be pressure to respond to widescale sanctions, such as those seen recently against Russia following its invasion of Ukraine. Many luxury brands took the decision to suspend Russian operations due to moral — and reputational — concerns and operational difficulties; this led to losses estimated at an average of 2% of global revenue and significant disruption.¹⁰

For many firms, this changing regulatory landscape that differs across jurisdictions has sparked concern over whether they will be able to improve their compliance controls without negatively affecting their bottom line. This is hardly a sector-specific question; however, the luxury goods industry has some unique considerations.

With a high turnover of staff focussed on sales and generally with little compliance knowledge and experience, training is a significant burden. Additionally, by subjecting their customer base, which has taken years of hard work to build, to certain requests for information, brands are worried about the impact this might have on their position in the market. However, experience tells us that the bigger risk lies in not doing anything.

Reputational impact of non-compliance

For the luxury industry, brand is crucial. When reputation is your greatest asset, the risk of negative publicity can have a substantial impact on business. For example, significant market share has been lost to other jurisdictions since Antwerp's diamond industry has been embroiled in controversy ranging from links to deals with al-Qaeda to the smuggling of blood diamonds and a USD\$1 billion tax scandal. In the UK, Rolls-Royce has hit headlines for its role in enabling North Korea to defy US sanctions,¹¹ not so long after the company paid out £671 million to settle corruption cases with UK and US authorities. This news saw the flagship engineering giant post record losses, with shares sliding almost 15%.¹² Indicators of societal harm pose a significant risk to both reputation and bottom line; for example, online fashion giant Boohoo's shares crashed 33% in two days following claims of modern slavery within its UK supply chain.¹³

Given this material risk to brand reputation and financial health, luxury goods dealers must ensure that their control frameworks are fit for purpose.

Maturity of the compliance function

In theory, luxury goods organisations are well placed to prevent financial crime via effective due diligence. This is a reflection of their *modus operandi*, whereby critical importance is placed on “knowing the customer” through cultivating long-term relationships with big-spending clients. As well as high client retention rates, luxury brands also tend to maintain strict control over their distribution channels to ensure their exclusivity is not diluted.

However, unlike the financial sector, luxury brands have not been exposed to many years of close regulatory supervision. Not all organisations have established compliance functions; customer due diligence can be sparse and superficial; and there may not be sufficient knowledge within the business to spot money laundering concerns. Europol has explicitly noted that high-value goods dealers as a sector submit very few suspicious transaction reports.¹⁴ This was supported by recent National Crime Agency data in the UK, where high-value dealers accounted for a mere 0.06% of suspicious activity reports submitted between April 2019 and March 2020.¹⁵

The UK's National Risk Assessment for 2020 also concluded that high-value dealers lack understanding of their financial crime risks and have poor controls.¹⁶ This is aligned with the findings released by Transparency International in 2017 that criticised the seven largest markets for luxury — China, France, Germany, Japan, the UK and the US — on their AML performance,¹⁷ highlighting that a lack of maturity is a problem across the board.

While financial crime compliance is not expected to be the focus of a luxury brand or its boutique employees, it is no longer enough to rely on the financial sector to detect unusual activity. It is increasingly important to know where exposures lie and implementing mitigating controls is trending from a nice-to-have to a regulatory obligation.

What should luxury firms be focusing on?

While it is impossible to eliminate all risk, having a compliance framework that incorporates regulatory requirements and guidance helps to protect brand value.

Critically, there is a need to better understand jurisdiction and firm-specific risks, which requires assessing the firm's customer base, products, geographies and third-party network. This is particularly important for the luxury sector, where many firms have international supply and distribution chains and a global customer base spanning all levels of wealth.

The next phase is to implement proportionate controls to mitigate identified risks. This might involve establishment or enhancement of an AML policy, KYC procedures including source of wealth/source of funds checks, third-party due diligence processes, customer screening, governance and monitoring, and comprehensive financial crime training for relevant personnel.

However, while the underlying importance of these measures is the same as in the financial sector — i.e. to better spot and report suspicious patterns and money flows — luxury goods dealers are not banks. The execution needs to be tailored to the unique company-customer interactions that take place in the sector, rather than taking an off the shelf solution. It also needs to be proportionate to the identified risks, and not overly burdensome from a cost or employee time perspective.

By taking customised steps to close identified gaps, firms operating in the luxury industry are not only positioning themselves to deal with mounting regulatory pressure but are also mitigating against any potential reputational risk. And given that brand is paramount in the luxury sector, this makes investment in compliance a smart choice.



Boutique and other client-facing staff naturally focus on their core roles of selling and providing excellent service to clients; however, they are at the forefront of an organisation’s controls to combat financial crime. Training staff is fundamental to ensuring that they understand the risks and can help to meet regulatory obligations.



Third parties can also present both financial crime risk and reputational risk. Luxury goods organisations should perform appropriate due diligence on their supply and distribution chain to ensure that they select partners that will not facilitate financial crime or damage their brand.



Requirements can be complex, and they evolve. The development of simple workflows, systems and tools can greatly assist staff in following policies and procedures, and may also support the management of client records, transaction reporting and conducting screening.

Key Takeaways



Luxury goods have intrinsic characteristics that make them attractive to criminals laundering money. Organisations operating within this sector should perform a risk assessment in order to understand their inherent risk exposure.



Regulators are increasingly focussing on luxury goods organisations and expect them to meet certain requirements, which can vary across jurisdictions. Creating clear Anti-Money Laundering policies and procedures, including the risk classification of customers, will assist with meeting regulatory obligations.

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