



Art & Finance Report 2017

5th edition



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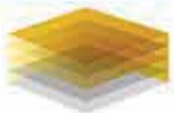
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Deloitte's services within the art market's ecosystem

01/

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- Finance
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- Tax
- Technology
- Risk Advisory
- Financial Advisory
- Statutory Audit

Deloitte Luxembourg contacts

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02/

Public sector, museum, cultural institutions strategy

- Strategic planning
- Impact analysis & feasibility study
- Finance
- Social & Cultural impact studies
- Building consultancy
- Statutory Audit

03/

Private wealth art-related services

- Strategy & operations
- Tax - Estate planning
- Art-secured lending - selection of third party service providers
- Strategy, operations and risks management
- AML and forensics
- Family Business

04/

Product development (i.e., art funds, art financing models)

- Art & collectible funds - set-up assistance, tax, statutory audit
- Selection of third party service providers
- Education

www.deloitte-artandfinance.com

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Foreword



Deloitte Luxembourg and ArtTactic are pleased to present the Art & Finance Report 2017, the fifth edition of the report.



Adriano Picinati di Torcello
Director - Global Art & Finance
Coordinator
Deloitte Luxembourg

Anders Petterson
Managing Director
ArtTactic
London

It is now six years since the first issue of the report was published and it has been exciting to follow and monitor how the Art & Finance industry has evolved over the years. In this anniversary report we have brought together and compared the findings and developments from the previous four editions with this year's findings.

Increasing competition in the wealth management industry has put emphasis on a more holistic wealth management model, which has become a key driver and motivation for incorporating art-related wealth into the service offering.

A lot has happened since we launched the inaugural issue in 2011. One major change over these years has been a shift in the primary focus on art investment toward issues around the management of art-related wealth, including art-secured lending, estate planning, art advisory, and risk management. What is particularly encouraging this year is that we are seeing both a confirmation of the increasing convergence between collectors, art professionals, and wealth managers on the role of art in a wealth management service offering, as well as a convergence of different stakeholder initiatives when it comes to improving art market transparency and the infrastructure around the management of art and collectible wealth. Many of these tools and services are mentioned in this report.

We are delighted to have 34 contributions this year from 42 experts within and outside of the Deloitte network representing different voices of the Art & Finance industry. We are also delighted to announce that what started as a local initiative in Luxembourg in 2011 has now become a truly global Deloitte initiative.

Once again, we would like to express our most sincere gratitude to all the individuals and institutions that have contributed to this report over the years, especially those who have taken part in interviews and surveys. Their collaboration and sharing of expertise and knowledge is truly what has made this report the benchmark for the Art & Finance industry today.



Aurélie Filippetti

French Minister of Culture
(2012–2014)

Associate Professor, Classical
Literature, Sciences Po, Paris

Art is the best part of our lives and the only way for two souls to deeply communicate. "Art is the shortest way from a man to a man" (André Malraux).

Nevertheless today ...

The economic impact of cultural investment is no longer limited to the traditional sphere of the art market and its evolution.

Cultural and artistic investment is an essential driver for the economic development of local communities as well as private companies. Additionally, it is a potential source of diversification of financial investments. But it doesn't stop there.

Today, cultural investment has a multiplier effect within organizations. In the eight main "capitals" selected by Deloitte for the purposes of evaluating the impact of cultural projects, we have observed that culture has a positive influence on the curiosity of teams and customers; the environment, through a new relationship with utility; brand identity; social capital, by creating and strengthening interpersonal relationships; economic capital, since investments are most effective when they receive adequate support; and social organization, as well as the capacity for innovation.

Cultural investment is thus a formidable source of change and even transformation within an organization; this is apparent in the medium term, but can even be evident in the short term provided that extensive preparation work is carried out. Moreover, cultural investment must be integrated within a company or community strategy, and not considered to be a luxury or a whim.

In France, economic studies have demonstrated that the economic weight of cultural activities accounts for 3.2 percent of national GDP and more than 800,000 direct jobs. It is therefore an important source of development.

But for individuals, the impact is also important: nowadays, investing in art has become an obligation. Investors entering this sphere must, however, be guided and informed, in particular with respect to the most innovative creators among the younger generations. It is a gamble, but it can be immensely gratifying from several points of view. It simply requires good knowledge of aesthetic (r)evolutions, and the legislative (r)evolutions in various countries.

Traditional banks are poorly equipped to assist those who wish to embark upon such a venture, and it is essential to develop financing and evaluation networks that are specific to the cultural sectors in question. These exist in the film and creative industries, but demand is outstripping supply. They must be expanded. While the art patrons of today are still obliged to fulfil their traditional role, their work has expanded in scope. This is why Italy adopted legislation on arts patronage inspired by the French law of 2003. However, a more dynamic and inventive view must be encouraged. For the cultural institutions, the challenge of developing strong links with families of art collectors is now of paramount importance, since the enrichment of collections occurs mainly through donations and inheritance. One clear example of this is the close bond between the Musée d'Orsay and Spencer and Marlène Hays that allowed one of the largest donations of impressionist and fauvist paintings in the world. This was only made possible by years of assistance and detailed knowledge, hand-in-hand, between the couple and the chairman of the Musée d'Orsay.

Such examples must be encouraged and increased in the future. This is the challenge of the work of developing studies on the relations between art and the economy. This report is an example of that.

Introduction

Is there a risk that collecting art is just another trend?

Need for better art risk management

While last year's report was published during the global art market slowdown, this year's report comes at a time where the art market has staged a significant recovery in the first six months of the year. However, while the art market seems to be on the mend, a new set of challenges and uncertainties have emerged in the last 18 months. Political uncertainty around the future of EU and Brexit, geo-political risk in many parts of the world, and the fear of conflict on the Korean peninsula are all macro factors that could weigh negatively on art market developments in the coming year. In addition, the art market is also increasingly feeling the pressure to change and adapt to a new environment shaped by changing consumer preferences, technological innovation, and new regulations. In a world of increasing uncertainty, the need to better understand, monitor, and measure risk is becoming increasingly obvious, which is a core theme running through this year's report.

Art and wealth management is now part of a longer term trend

When we launched the inaugural Art & Finance report six years ago, one third of the wealth managers surveyed said they were aware and followed the developments linked to art as an asset class and issues around art and wealth management. This year, close to 60 percent of the wealth managers said the same. However, it's not only awareness that has increased over the last years—we are also seeing real action, with 64 percent of wealth managers saying they were actively offering services related to art and collectibles. The most recent survey shows an increase from 78 percent in 2016 to 88 percent in 2017 of wealth managers saying that they think art and collectibles should be included as part of the wealth management offering, the highest registered reading since the launch of the survey in 2011.

So what are the key drivers behind the above trends? A combination of art market growth and higher valuation and prices have triggered more demand for art and more wealth allocated to art and collectibles. This in turn has forced wealth managers to take a more proactive approach with regards to their client's art-related assets. This trend has been further fueled by a shift in an increasingly competitive private banking industry toward a more holistic approach to wealth management.

Is there a risk that collecting art is just another trend? Although there are fashionable aspects about buying art, for an increasing number of HNWI's, art and collectibles are playing a more significant role in their lives and is accounting for a larger share of their overall wealth, a trend that is forecasted to continue in the next 10 years. In addition to its financial attributes, there are also strong emotional and social aspects associated with buying and owning art—motivations that wealth managers are realizing could be harnessed and cultivated more effectively, ultimately resulting in a stronger and more sustainable client relationship.

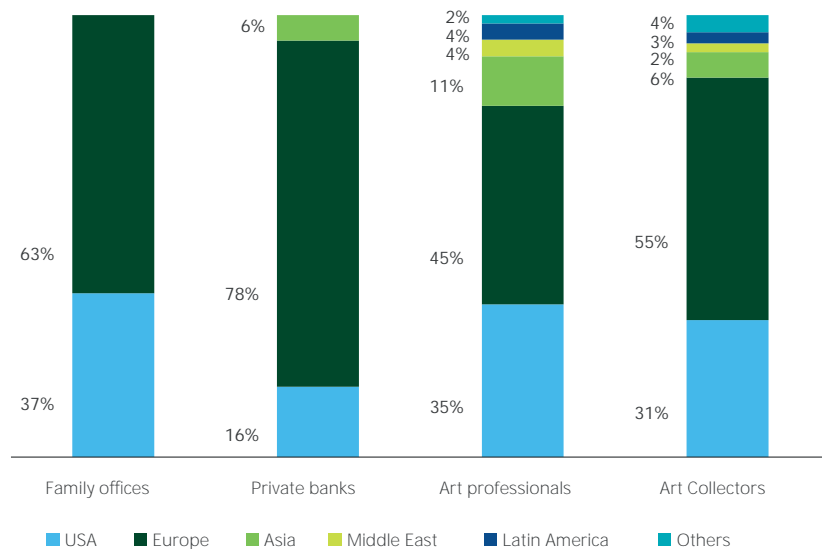
As illustrated throughout the report, the challenges are many, and the need for a coordinated response across the different industry stakeholders is more critical than ever. We hope that this year's edition of the Art & Finance Report continues to provide a forum for the Art & Finance industry to express their concerns and needs, but also provide ideas and possible solutions to how one can best address these issues. As before, the main aim is to build a platform to encourage and facilitate sustainable relationships between the Art & Finance world going forward.

Methodology and limitations

The first Art & Wealth Management Survey was conducted in 2011 and included 19 private banks from Luxembourg. In 2012 the sample was increased to 30 private banks from Europe. In 2014, the survey included 35 private banks from predominantly Europe & the USA and an additional 14 family offices from Europe and the USA. In 2016, the survey included 53 private banks from Europe, USA and Middle East and 14 family offices from Europe and the USA. This year, Deloitte Luxembourg and ArtTactic conducted the research for this report between May 2017 and August 2017. We surveyed 69 private banks among which 5 are art-secured lenders (specialized boutiques) and 27 family offices. Adding more private banks and family offices from different geographical regions could have an impact on the results from one year to another. However the increasing number of private banks and family offices is part of our ongoing effort to ensure that the report is increasingly representative of the perceptions and opinions of the global wealth management community, when it comes to issues around art as an asset class.

As for the previous report, we have again conducted research among other important stakeholders in the Art & Finance market, such as art collectors and art professionals (galleries, auction houses and art advisers, art lawyers, art insurers, art logistics, etc.). A total of 155 art professionals (up from 126 in 2016) and 107 major art collectors participated in the survey (up from 94 in 2016). These art collectors were from Europe, the US, Middle East, Latin America, and Asia, and were surveyed on a variety of topics relating to art as an asset class, their motivations, current and future involvement, challenges, and opportunities.

Sample by geography



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Section 1 of this report (market outlook for different art markets) includes findings based on qualitative Art Market Confidence Surveys that ArtTactic sent out to 310 international art collectors, art advisers, galleries, and auction houses in June 2017. This section also includes auction data analyses of different modern and contemporary art markets, and is predominantly based on data from Sotheby's and Christie's, but also includes other auction houses when they represent a major share of the market.

In order to provide a market context for the survey findings we have given a broad, international overview of recent developments across various regional modern and contemporary art collecting categories. Most of the data is collected from Sotheby's and Christie's, as they cover the majority of the modern and contemporary art collecting categories covered in this section, although certain regional markets such as China, India, Russia, and Africa also include auction data from other leading auction houses.

In the art investment section of the report (Section 4), we have estimated the size of

the global art fund industry, combining data and information from interviews with US and European art funds, as well as public records on art investment trusts and art funds in China. The Chinese art fund industry analysis is based on conservative estimates about the size and maturity of different art investment trusts. However, many Chinese trust companies are no longer marketing or publishing information about their art-related trust investment activities and it is not possible to know whether these funds have been wound up early or are still active. Our estimates are based on the publicly available information as of July 2017.

We have expanded the regulatory section (Section 6) this year to also include a strong focus on art and risk management, in addition to new issues around regulation in the art market. As in the previous editions, we are delighted to have many contributions from leading experts in this field to complement each section of the Art & Finance report.

We are delighted to be able to publish a series of interviews and opinions from key figures in the Art & Finance industry:

Aurelie Filippetti

French Ministry of Culture (2012-2014)
Associate Professor, Classical Literature,
Science Po, Paris

Nisha Dhaliwal

Account Manager, Deloitte Canada

Alan Mudie

Responsible for Société Général Private
Banking Investment, Société Générale

**Asia Institute of Art and Finance in
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China

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Senior Advisor, Faursschou Foundation

Rebecca Jennings

Art Researcher, The Fine Art Group

We also want to thank all the survey participants—without them this report would not be possible. Thank you to Claude Hermann from Fine Art Logistics Natural Le Coultre, Salma Shaheem, Head of Middle-Eastern Markets and Joint Venture Partner at the Fine Art Group in Dubai & Oscar N. Oneyma, CEO of the Nigerian Stock Exchange as well to Monica Carabajal Zamora, Capital Markets Manager, and her team, as well as Jean-Philippe Peters, Risk Advisory Partner at Deloitte Luxembourg, for their precious contributions. A special thank you also to Fabian Bocart and artnet for their support in supplying valuable annual art market performance data. We also express a special thank you to Mr. Yinka Shonibare who contributed to the quality and the originality of this report by allowing us to use a series of images from his own artistic creations. We wish you an inspiring reading.

Deloitte Luxembourg and ArtTactic recognize that the findings are indicative and see the limitations of these findings; however, we believe that the results reflect a broad representation of the perceptions and attitudes that exist in the global wealth management and art and art collector community.

Deloitte Canada



Nisha Dhaliwal
Account Manager
Deloitte Canada

At a time when countries are becoming increasingly economically and politically interdependent, promoting cultural expression through a cultural policy for the arts is a valuable way to emphasize and define what distinguishes one country from another. Canada continues to face significant challenges in the arts. Its vast geography and relatively small population make it difficult for the country to produce, exchange, disseminate, and communicate works of art. It is difficult—but not impossible.

The Canadian art market is relatively small in size, currently sitting at around US\$1.3 billion. However, the opportunity for growth is significant. Art hubs including Toronto, Montreal, Vancouver, and Calgary are steadily growing in size and attracting international interest.

In the last few months, Nisha Dhaliwal has been leveraging her passion for art in a professional context by promoting the Deloitte Art & Finance initiative, with the aim to develop this service line in Deloitte Canada. Nisha received her master's in Art and Business from Sotheby's Institute of Art. Her dissertation focused on how financial institutions invest in art, specifically in Canada. Nisha then began her own art consultancy, DART Consulting, which is currently in its sixth year of operation. Her work as an art consultant exposed her to clients and artists in New York, London, Los Angeles, Toronto, Vancouver, and Calgary. DART Consulting's mandate involves more than merely placing art on a wall. DART has delivered, and continues to successfully deliver, custom and strategic art-related advice to those inside and outside the art market. An example of a unique project Nisha led was Projects in Architecture. Through DART, she partnered with a prominent gallery in Los Angeles to develop Projects in Architecture: an initiative to make gallery-quality art available for new and upcoming developments (residential, educational, and commercial) in LA and surrounding areas.

Projects in Architecture's mandate was to strategically integrate art into the design of the particular space in question during the design conception stage. Nisha worked with each developer to meet specific needs and requirements, provided strategic input for special art pieces and special considerations, and provided traditional art consultancy services.

After returning to Toronto, Nisha's interaction with clients led her to notice that there was a gap in the market for professional services such as consulting and corporate strategy, specifically tailored to the arts. Today, Nisha is a strategic account manager in Canada's capital city of Ottawa. Nisha is motivated to bring the Art & Finance initiative to life in Canada, in an innovative and disruptive fashion. She has begun compiling research on the Canadian art market, by interviewing key players in both art and finance ecosystems. She continues to make business case presentations to promote the launch of the Art & Finance initiative in Toronto. Her placement in Ottawa currently positions her well, providing her with great exposure and access to art and cultural policy on a federal level. Nisha is working closely with the Luxembourg team throughout this process and is already engaged in some pre-work with a potential anchor client.

Please contact Nisha Dhaliwal if there is anything Canada-centric you wish to inquire about in regards to the Art & Finance initiative.

Key findings

SECTION 1 – The state of the global art market

- A new approach to art and wealth management needed:** With more wealth expected to be allocated to art and other passion assets in the next 10 years, coupled with a complex and uncertain global art market, a more sophisticated and dynamic approach to managing art-related wealth is required in the future.
- UHNWI population is expected to increase by 43 percent in the next decade:** The world's ultra-high-net-worth individual (UHNWI) population grew by 3.5 percent in 2016, a recovery from a sharp fall in 2015, according to a recent wealth report. The total number of ultra-wealthy individuals is predicted to rise 43 percent by 2026.
- Growing demand for luxury investments:** 37 percent of wealth managers surveyed in a recent report by Knight Frank said that their clients already had a number of luxury investments, such as art, wine, and classic cars. A total of 47 percent of these managers said that these types of investments had become more popular in recent years.
- Auction sales recovers in the first half of 2017 and the art market outlook for 2018 remains cautiously optimistic:** Total auction sales at Sotheby's, Christie's, and Phillips were up 18 percent in the first half of 2017 compared to the same period last year; the overall art market sentiment remains more cautious over the next 12 months. The increase in sales comes on the back of a global art market slowdown between the second half of 2015 and throughout 2016.
- Heightened geopolitical and economic risk:** A recent ArtTactic survey from June 2017 ranks political and economic uncertainty as the biggest risk to the development of the global art market in the coming 12 months. The ArtTactic art market speculation barometer is up 17.7 percent from January 2017, which suggests that experts feel the current art market recovery has reintroduced more speculative behavior.
- Positive outlook for the US contemporary art market:** Experts signal a more upbeat outlook for 2017–2018. Based on the responses of experts surveyed by ArtTactic in June 2017, 62 percent believe that the US contemporary art market will go up in the next 12 months (versus 47 percent in January 2016).
- Brexit could have a negative impact on the UK contemporary art market in 2018:** Much of London's relative success following the Brexit vote last year can be linked to the decline in sterling, motivating buyers from outside Europe to take advantage of the benefits of a lower exchange rate. However, 38 percent think that the market will come down in the next 12 months (up from nine percent in January 2016).
- European art market outlook looks positive:** 36 percent of the experts surveyed believe that the European contemporary art market will see a positive development in the next 12 months (up from only 14 percent in January 2016).
- Chinese contemporary art market outlook turns neutral-to-positive:** The direction of the Chinese contemporary art market in 2017/2018 signals that the market is getting more positive compared to 2016. 32 percent believe that the Chinese contemporary art market will go up in the next 12 months (versus 26 percent in January 2016).

- **China’s focus on building a regulated art market:** The Chinese government attaches great importance to the development of cultural projects, which are crucial to the soft power of China. In recent years, according to Asia Institute of Art & Finance (AIAF), the government has emphasized the healthy and regulated development of culture and the art market through the introduction of new policies.
- **Sentiment in the South Asian modern and contemporary art market turns from positive to neutral in the first half of 2017:** South Asian modern and contemporary auction sales in the first six months of 2017 were 14 percent lower than in the first half of 2016. Based on the responses of the experts surveyed in June 2017, only seven percent of the experts believe this market will go up in the next 12 months (versus 40 percent in January 2016).
- **Slowdown in the Southeast Asian art market:** Modern and contemporary Southeast Asian art saw a 29.7 percent year-on-year decrease in sales in 2016. The auction sales in the first half of 2017 suggest that the downward pressure on this market could continue into the second half of the year. Only 17 percent of the experts surveyed believe the market will go up in the next 12 months (down from 40 percent in January 2016).
- **Uncertain outlook for the Latin American art market:** Latin American auction sales in 2016 saw a year-on-year decrease of 27.2 percent following several years of steady growth. Based on the responses of the experts surveyed by ArtTactic in June 2017, 34 percent believe the market will go up, versus 37 percent who believe that the Latin American modern and contemporary art market will go down in the next 12 months.
- **The Middle-Eastern auction market bucks the trend last year:** Total auction sales of modern and contemporary Middle Eastern art rose by 11.9 percent in 2016. The first half of 2017 was also marked by solid performance. However, there are concerns about the next 12 months, with 41 percent (up from 24 percent in January 2016) predicting that the Middle Eastern art market will decline. Wars, terrorism, and geopolitical tension in the region were cited as the main reasons for this.
- **Art and Islamic finance:** Art has the potential to make a good underlying asset for a financing or investment structure under Sharia Law. With an increasing interest in the region around art as an asset class, there are opportunities for banks and investment houses to address the needs and opportunities associated with art financing and investment in the region.
- **The Russian art market sees a positive start to auction sales in 2017, but experts remain cautious about its outlook:** Despite a positive start to the year, only 19 percent of the experts surveyed by ArtTactic in June 2017 (up from 16 percent in January 2016) believed that the Russian art market would see a positive growth trend this year.
- **African art auction market sees significant growth in 2017:** The African modern and contemporary auction market has seen steady growth since 2014, but sales have accelerated this year as Sotheby’s launched its first African modern and contemporary art sale in May 2017 in London.
- **Art & Finance in Africa:** Rising global demand for African contemporary art and improved art market infrastructure is likely to increase the demand for Art & Finance related services and initiatives in the African art market, supported by investment in art education, awareness raising, and capacity-building.

SECTION 2 – Art and wealth management survey

- Art and wealth management industry converge:** This year's report confirms that art and wealth management is part of a long-term industry trend, particularly as the wealth management industry moves toward a more holistic asset management model.
- Stronger motivation to include art within wealth management:** 88 percent of wealth managers surveyed this year say that they think art and collectibles should be included as part of the array of wealth management solutions.
- A more holistic approach to wealth management drives interest in art and collectible wealth:** With an estimated US\$1.62 trillion of UHNWI wealth allocated to art and collectibles in 2016 and an estimated US\$2.7 trillion by 2026, wealth managers are forced to take a more holistic approach to the way they work with their clients' assets. This year's survey findings show that 85 percent of wealth managers believe that the move toward a holistic wealth management model is the strongest argument for including art and collectibles in a wealth management service range.
- A majority of wealth managers offer art-related services to their clients:** 64 percent of wealth managers surveyed said they were actively offering services related to art and collectibles, including entertainment and client hospitality.
- Client pressure on wealth managers:** 55 percent of wealth managers said that clients were increasingly asking their private bankers and wealth managers to help with art-related issues (up from 48 percent in 2016).
- More investment and resources allocated to art-related services:** An average of 44 percent of wealth managers reported that increasing focus and resources would be dedicated to art and wealth management services in the coming 12 months, up from 38 percent in 2016. This is the highest reading since the launch of the survey in 2011, and is supported by a positive trajectory for all art-related products and services.
- Art-related wealth to be included in wealth reporting:** Findings from this year's survey show that 69 percent of the wealth managers surveyed said they expected their clients to want to include art and other collectible assets in their wealth reports.
- Collecting art with a view to investment:** A large majority (86 percent) of art professionals said that their clients buy art and collectibles for emotional reasons (passionate about collecting), but also focus on investment value; this was up from 79 percent in 2016. 54 percent of wealth managers (up from 51 percent in 2016 and the highest reading since the survey was launched in 2011) increasingly see art as a way to safeguard value.
- Art is increasingly becoming a lifestyle product:** For the third time since the launch of the survey in 2011, the social value associated with buying art was the primary motivation among art collectors according to art professionals (85 percent of the art professionals surveyed said so, up from 80 percent in 2016 and 72 percent in 2014). This confirms the findings from previous years suggesting that art is increasingly viewed by art professionals and collectors as a "lifestyle" product and investment.
- Art and estate planning:** Estate planning is viewed as the most important art and wealth management service by wealth managers, art professionals, and collectors. With a massive transfer of wealth from baby boomers to millennials about to occur, art and estate planning is likely to become an increasingly important area for the wealth management industry.
- Almost half of collectors surveyed have yet to discuss their art-related estate with their heirs:** Although the majority of collectors surveyed have formal estate plans for their art collection, 46 percent of collectors have yet to discuss these plans with their heirs, although they intend to do so.
- Family offices, especially US family offices, seem better prepared to offer art wealth management services:** When a family office has to deal with an art collection, it usually provides the different services to protect the wealth of clients allocated to the art collection. The majority (61 percent) of family offices (all US family offices and half of the family offices from the rest of the world) stated that their clients maintain an updated inventory of their collection allowing them to administer the estate without the collector's input. Again, in stark contrast, only 13 percent of private banks said the same.
- More wealth managers are offering valuation services to their clients mainly through third party providers:** All of the family offices that responded to this year's survey said that they offered valuation services (73 percent said they were providing this through a third party). A high number (84 percent) of private banks also provided valuation services for their clients, with 67 percent providing this through a third party.

- **Private banks and family offices are focusing on art advisory services:**

83 percent of wealth managers said they offered art advisory services (this was up from 79 percent in 2016 and 67 percent in 2014), and 47 percent said the services were delivered in-house.

- **Collection management and wealth reporting are likely to converge:**

78 percent of wealth managers said that they offered art collection services; this was up from 59 percent in 2016. We are likely to see increasing demand for integration between art collection management software and banks' existing reporting systems. This would offer the wealth management sector an opportunity to be more proactive, to support estate planning, and to better monitor and protect art-related wealth.

- **More demand for services related to art and philanthropy:**

72 percent of the wealth managers surveyed this year said they offer services related to art philanthropy and individual giving to the arts (gifts, donations, help with setting up foundations, etc.). This was up from 64 percent in 2016, and suggests that art is now playing a bigger role in the spectrum of philanthropic activities that clients are seeking their wealth managers' advice and help on.

- **Lack of art market transparency remains a key hurdle:**

As the wealth management industry continues to grow and expand its investment in art-related wealth services, there is also a sense of heightened concern regarding the lack of transparency in the art market (75 percent of wealth managers expressed this view).

- **Unregulated nature of the art market remains a key hurdle:**

65 percent of the wealth managers surveyed this year said that the unregulated nature of the

art and collectibles market remains the biggest challenge for incorporating art into their service offering (up from 62 percent in 2016).

- **Lack of management support:**

51 percent of wealth managers said that lack of interest internally was a major challenge, up from 26 percent in 2016. This could suggest that as interest in art and wealth management is gaining momentum, there is a lack of leadership support for these types of initiatives.

- **Difficulties in finding and developing talent and expertise:**

55 percent of wealth managers said that finding the right expertise remains one of the key challenges in building an art-related service offering (up from 46 percent in 2016).

SECTION 3 – Art-secured lending

- **US art-secured lending market grows an estimated 13.3 percent:** The art-secured lending market in the US reached an estimated US\$17-20 billion in 2016, which represents a 13.3 percent growth from 2015.
- **Art-secured lending services stable:** In this year's survey, 67 percent of wealth managers said their institution now offered art-secured lending services.
- **Risk management a key challenge:** Issues around risk management, liquidity, valuation, and regulation remain key challenges for the future growth of this market.
- **New accounting requirements for art-secured lending:** New accounting requirements stipulate that provisions for credit losses will no longer have to be recorded with an incurred loss model, but rather with an expected loss model. This will have significant implications for risk models and risk management with regards to art-secured lending.
- **New developments in the European art-secured lending industry:** New offerings have recently come to the market, including the possibility of lending transactions using high-quality artworks transferred as collateral without taking physical possession of the artworks as collateral.
- **Art-secured lending providers call for more regulation:** Art lenders suggest that regulation would create new opportunities to expand and democratize the art market, as banks and wealth managers would be able to put their full weight into the market.

SECTION 4 – Art as an investment

- **Art market returns recover in the last 12 months:** Six out of seven Artnet art price indices see positive return between April 2016 and April 2017, with Impressionist Art and Contemporary Art accounting for the highest annual returns of 10.50 percent and 7.45 percent respectively.
- **The art fund market seems to struggle to gain momentum:** The lack of transparency around the actual number of active art funds makes the evaluation of the size of the market difficult. The overall art fund market in the first half of 2017 is conservatively estimated to be US\$834 million down from US\$1.03 billion in 2016 and US\$1.2 billion in 2015. However, with many art funds operating away from the scrutiny of the public eye, these numbers are likely to be higher.
- **Chinese art fund industry declines on the back of tougher regulation:** The estimated AUM for the Chinese art investment fund/trust business has fallen from US\$1.48 billion at the peak in 2012 to an estimated US\$483 million in 2016 and US\$373 million in first half of 2017.
- **Art investment fund products remains a niche service:** Only 11 percent of the wealth managers surveyed offer an art investment fund product as part of their in-house offering (down from 18 percent in 2016).
- **A small minority of banks are planning to offer art investment fund products to their clients in the coming 12 months:** The recent survey among wealth managers shows that only 13 percent of the wealth managers see it as likely that they will offer their clients art investment fund products in the next 12 months (this is up from 10 percent in 2016). However, 43 percent of art professionals stated that art investment

funds were a relevant/very relevant service for their clients and 37 percent of collectors said the same.

- **Challenges in the pre-investment process:** 79 percent of the wealth managers surveyed said that due diligence and assessing the viability and credibility of the art fund was one of the main obstacles (up from 77 percent in 2016). This challenge is linked to other aspects of the art fund industry and the art market, such as a lack of track record for art funds and the unregulated nature of the art market.
- **Challenges in the post-investment monitoring:** 85 percent of the wealth managers cited the lack of mark-to-market valuation as a major challenge for incorporating art into the wealth management offering (this was up from 77 percent in 2016).
- **New art investment products:** In recent years new art investment products are being developed trying to address many of the shortfalls associated with art investment funds, such as liquidity and price transparency.

SECTION 5 – Art and technology

- **Technology is increasingly playing a key role in the evolution of the art market.** Art-technology startups (ArtTechs) are building new digital business models aimed at enabling and supporting traditional art businesses, rather than replacing them. Technological innovations are aimed at increasing trust and transparency, but also supporting data-driven valuation methodology, building social capital and transforming the backbone of the art market ecosystem.
- **Online art sales continues to grow:** According to Hiscox Online Art Trade Report 2017, online art market sales reached an estimated US\$3.75 billion in 2016, up 15 percent from 2015. This gave the online art market an estimated 8.4 percent share of the overall art market, up from 7.4 percent in 2015.
- **Traditional art businesses take up the online challenge:** Growth in the last two years has picked up among the traditional auction houses. Sotheby's grew its online business (online bidding and online-only auctions) to US\$155 million—an increase of 19 percent in 2016—and Christie's increased its online activities (bidding and online-only auctions) by 34 percent from US\$162 million in 2015 to US\$217 million in 2016.
- **Auction and dealer markets converge online:** Increasing competition is already forcing online art platforms to embrace new strategies to expand their business and diversify their income streams.
- **Data and analytics infrastructure in the art market:** We are starting to see the emergence of new art market data and analytics addressing both risk and return in the art market. This is an important development and could contribute toward improving transparency, valuation accuracy, and risk management of art-related wealth.
- **New technology could transform parts of the art industry:** Blockchain could revolutionize the art industry by resolving questions of provenance, and improving transparency, copyright, and ownership issues. Seeing the potential, art startups are already building real-world applications based on blockchain.

SECTION 6 – Risk management and regulation

- **Call for modernization of the art market:** 73 percent of wealth managers, 74 percent of art professionals, and 64 percent of collectors said that the art market needed to modernize its business practices to meet the expected standards of a transparent, trustworthy, and developed marketplace.
- **Self regulation preferred over government intervention:** Over 77 percent of art professionals and 76 percent of collectors prefer a self-regulated approach to establish trust and credibility in the art market. However, wealth managers feel that more government regulation is required. A mixed approach seems recommended to support a sound growth of the art market.
- **Authenticity, lack of provenance, forgery, and attribution remains the greatest threat to the reputation of the art market:** 83 percent of wealth managers see authenticity, provenance, and attribution issues as the greatest risks in the art market. Art professionals are echoing this sentiment, with 81 percent saying these are major risks to the art market.
- **Undisclosed conflicts of interest:** 65 percent of wealth managers, 63 percent of collectors, and 69 percent of art professionals see issues around undisclosed conflicts of interest as a problematic issue in the art market. Increasing focus on due diligence in art transactions is called for.
- **Lack of standards around professional qualifications in the art market:** 65 percent of wealth managers feel that the lack of standards around professional qualifications in the art market is a major challenge, as it complicates the search and selection of individuals or firms with the appropriate knowledge and skills.
- **Price manipulation and other anti-competitive behavior:** One of the biggest perceived threats to the reputation of wealth managers, collectors, and art professionals are issues linked to price manipulation, insider trading, and other anti-competitive behavior.
- **Lack of market transparency:** 79 percent of wealth managers and 62 percent of collectors see the lack of transparency in the art market as one of the key challenges in the art market. Most of the problems outlined above boils down to the fact that the art market continues to operate opaquely.
- **Money laundering regulation will affect the art market:** 65 percent of the wealth managers (up from 56 percent) felt that money laundering is a serious threat to the credibility of the art market. With tighter anti-money laundering rules implemented around the world, the art world will be forced to comply with these new regulations.
- **Guidelines around money laundering launched to assist art businesses:** The Responsible Art Market Initiative (RAM) published its first set of guidelines to tackle the threats of money laundering and terrorist financing in the art market in January 2017. The guidelines are tailored to art transactions and focus on three areas of enquiry: the client, the artwork, and the transaction.
- **New regulations around the import of cultural goods in Europe:** The new rules could enter into force as early as 2019, and are part of a broader plan to fight terrorist financing. The new rules are aimed at bringing consistency and clarity on the types of restrictions and control measures proposed by the European Commission in tackling the illicit trade in cultural objects.
- **Reform of the Italian art market regulation:** In Italy, a new reform aimed at the existing Cultural Heritage Code is set to improve Italy's competitiveness in the international art market. On 29 June 2017, the Italian house of representatives (Camera dei Deputati) approved five amendments to a bill aimed at fostering competition.

Priorities

Since the inaugural issue of the “Art & Finance Report” in 2011, we have identified a number of key priorities we believe are important in relation to overcoming challenges and encouraging further investment in the development of the Art & Finance industry.

There have been a number of recurring themes over the last six years, which also will be addressed in this edition. They include the lack of transparency, the lack of valuation standards, the need for better understanding and quantification of risk, and the need for an improved risk management framework. Also, investment in better information infrastructure, improved knowledge-sharing between stakeholders in the art and finance industry, and education and professional development for wealth managers remain key priorities this year.

We also discuss how technology and innovation can enable further growth and have the potential to address many of the key challenges on the market, and while we have seen an increase in new ArtTech services and products, further investment and better coordination between industry needs and current solutions are required.

Last year, we launched a new section on regulation in the art market. This year we have broadened our exploration of this topic to include more of the key issues surrounding art and risk management. It is becoming evident that regulatory issues, particularly money laundering regulations, will increasingly have an impact on the development and evolution of the market, and it is important that stakeholders in the art and wealth management industries take a proactive role in creating and coordinating the efforts to shape a better regulatory framework for the Art & Finance industry. This involves striking the right balance between self-regulation and statutory regulation.

The fact that several of our priorities this year are related to those of previous reports does not mean that there have not been developments, or that these issues are not being addressed. Instead, this should serve as a reminder that the issues facing the Art & Finance industry revolve around a core set of challenges that require all stakeholders’ attention and focus going forward.

As in the previous four editions, the “Art & Finance Report 2017” aims to prioritize key considerations for the future development of the Art & Finance industry, and to encourage dialogue and collaboration between the three key stakeholder groups: wealth managers, art professionals, and art collectors.

We have structured this year’s priorities around three main areas:

- **regulation**
- **technology and risk management**
- **art and wealth management related issues**

Regulation—addressing the reputation of the art market

1. Improved transparency is essential for the art market: One of the key areas that may need to be addressed collectively by the wealth management industry and the art market is the issue of transparency. As the wealth management industry continues to grow and expand its investment in art-related wealth services, this year's findings show that there is a sense of heightened concern regarding the lack of transparency in the art market. There is an opportunity for the various art-market stakeholders, in both the private and the public sector, to drive this initiative forward in partnership with wealth managers, particularly when it comes to education, information and knowledge sharing, and data and research. There is a need for innovation, and for better standards and guidelines, which should be developed as a collaborative effort between the stakeholders in the Art & Finance industry. Technology will continue to play a role in enhancing transparency on the art market, but it is also about bringing in stakeholders who have kept a low profile in the evolution of the Art & Finance market thus far. One of these stakeholder groups is the non-commercial art sector (museums and non-for-profit institutions). This sector's deep knowledge and access to expertise, combined with its market neutrality, could ensure that it plays a very important role in bringing more trust and transparency to the art market through education, and the sharing of expertise, knowledge, and information with the wealth management sector.

2. The art and wealth management industries should develop common standards and guidelines to address reputational concerns: This year's survey findings show that the lack of art market regulation ranks as one of the top three concerns for wealth managers offering art-related services. The question is how best to move this forward, and earlier studies show that the art trade might not be prepared to

As the wealth management industry continues to grow and expand its investment in art-related wealth services, this year's findings show that there is a sense of heightened concern regarding the lack of transparency in the art market.

do this alone without external pressure. Instead of pressure coming directly from the government, there is an opportunity for the art industry to collaborate with the wealth management industry to influence and help shape new guidelines and standards covering art and collectibles in a wealth management context. With more wealth managers providing art-related services to their clients, there will be an increasing need for the art industry to adhere to certain guidelines and practices, and better communication and collaboration between these stakeholders will be required to ensure that these expectations are aligned. It is likely that guidelines produced in this way would be more nuanced and potentially less heavy-handed than government intervention, as wealth managers would have their clients' best interests in mind when developing a framework.

Technology will continue to play a role in enhancing transparency on the art market, but it is also about bringing in stakeholders who have kept a low profile in the evolution of the Art & Finance market thus far.

New technology and risk management

3. Using technology and innovation to support the growth of the Art & Finance industry: There is no doubt that technology will enable the evolution of the Art & Finance industry. ArtTech startups have raised increasing amounts of money in recent years: although the majority of the funding has gone toward art and e-commerce, there is a growing realization that investment also needs to go toward key enabling technologies, addressing issues such as transparency, valuation, authenticity, collection, and risk management. This is similar to how firms such as Schwab and Ameritrade revolutionized the financial investment arena by creating an online marketplace, and how crowdfunding continues to revolutionize real estate investment, investment in startups, and peer-to-peer lending. We believe that the same level of transparency, the democratization of information, and the improved access to investments that transformed the securities and real estate industry also have the potential to transform the Art & Finance industry in the years to come.

4. New specific models for art and risk management are required: Given the new regulations affecting art market operations (see Section 5), increasing wealth invested in art and collectibles, and the complex nature of the global art market, it is clear that a new risk management framework and standards are required. Again, this is an area that will become increasingly important to wealth managers, and greater emphasis should be placed on investing and developing better risk management, due diligence, and reporting tools. It is paramount that the art market industry and its expert providers (with their wealth of knowledge of object-specific risks), together with other existing third-party providers (offering services such as collection management, price databases, forecasting data, and market performance indices), and purveyors of fresh innovations (such as blockchain, tagging technology, and the development of title registers) start to combine their expertise. The challenge is to streamline the due-diligence and risk management process in a fragmented industry like the art market, although this could potentially be achieved through a credible third-party due-diligence platform, which would allow smaller, niche providers to “pipe-in” their knowledge, information, and data—to measure and form an aggregated, holistic view of various risk factors. See Section 4 for further discussion of this topic.

5. An increasing need for independent and unbiased valuation combining both expert and data-driven models: Valuation of art and collectibles is often considered to be subjective—an art rather than a science. Given the increasing levels of wealth invested in art and the financial risk associated with this, it is clear that greater standardization is required in terms of asset valuation and risk monitoring. This has become particularly relevant with the development of activities such as art-secured lending, art investment funds, financial auction guarantees, etc. This does not mean that we advocate reliance on a purely data-driven approach, but that a combination of independent expert opinions alongside more historic and forward-looking data would provide a more transparent and credible approach to valuing these non-traditional assets. The majority of art collectors and art professionals said in this year’s survey that valuation was a service that should be provided by the wealth management sector, and it is possible that this could lead to greater standardization and better guidelines with regards to valuations (i.e., in the context of art-secured lending and mark-to-market valuations for art investment funds). The existing industry of valuers, appraisers, and providers of data and analytics should work in collaboration with the wealth management sector to develop valuation standards and risk management tools that are better suited to the financial risk associated with art and collectibles.

6. Collection management and wealth reporting systems need to be combined: With a more holistic approach to art-related wealth, we are likely to see an increasing demand for integration between art collection management software and the banks’ existing reporting systems. Although there are a number of art collection management providers in the art market (ArtLogic, Collectrium, Artbinder, and Artbase to name a few), the strong focus on client discretion and confidentiality is hampering the integration of these tools with existing wealth reporting. There is a clear opportunity for art collection management systems to collaborate with existing wealth reporting software providers to see how passion-based assets, such as art and collectibles, could be integrated with overall wealth reporting, while simultaneously serving as a collection management system and facilitating the estate planning process—a service that has been rated by art professionals, art collectors, and wealth managers as one of the most vital art wealth management services. In addition to the financial aspect, it is also important not to forget the emotional and social side of collecting art. The opportunity to access your collection online, and enjoy and selectively share your art collection with others should be incorporated into this service. This is a service that the majority of existing collection management providers already offer, and the potential development of a hybrid collection/wealth management reporting system is likely to generate significant interest in the current market.

Art and wealth management related issues

7. Strong leadership support is required when integrating art and collectibles in a new holistic wealth management model:

Growing frustration is in evidence among wealth managers this year in response to the fact that there is not sufficient leadership support to strategically develop art-related services to meet the increasing level of demand from clients and embed these services within a more holistic wealth management model. According to a recent Deloitte report,¹ the wealth management industry is under pressure to increase profit and to adapt to changing client needs, as well as technology and innovation. The wealth management industry is facing a shift from mainly providing investment advice to a holistic wealth management model. This means looking at a client's total balance sheet rather than only the assets held with a wealth manager; in other words, clients are being offered services to boost their entire financial well-being. A holistic wealth management model has the potential to open up new sources of revenue and strengthen client relationships. However, this would involve the wealth industry going beyond the current core and building up expertise, new products and services related to art and collectible wealth, and other passion-based assets, which also requires leadership support and endorsement from senior management.

8. Moving from a reactive to a proactive art and wealth management approach:

This year's findings show that the trend toward incorporating art and collectible assets in wealth reporting will contribute to the drive toward a more holistic wealth management approach and a much more proactive approach to wealth invested in art and collectibles. This is because wealth managers will have access to information about art-related wealth. The ability to report on and monitor art and collectible wealth represents an opportunity and an effective way to provide value-added services to clients. By raising awareness of the financial value and risks associated with their clients' art and collectible wealth, wealth managers could develop a better understanding of their clients' total assets, which is a prerequisite for the development of a proactive and holistic wealth management strategy.

9. Education and professional development for wealth managers:

As the wealth management community realizes the potential of art as part of a holistic wealth management strategy, more focus and investment in staff training and professional development will be required. Better access to art market data, research, and information could stimulate wider appreciation and interest in art-related services in the future. In order for the wealth management industry to be able to properly service clients' art and collectible wealth, a significant investment in training, education, and access to market intelligence is required. As mentioned in Priority 1, we see the potential for a new type of relationship between the non-commercial art sector (museums and not-for-profit art institutions) and wealth managers. The non-commercial art sector could play a vital role in this education and knowledge-sharing process—and simultaneously add a new revenue source in addition to the more traditional corporate sponsorship model.

10. Estate planning, art philanthropy, and donations to public museums:

In this year's survey, only five percent of art collectors said that their collection would go to a public museum, versus 67 percent of art collectors, who had made formal arrangements for their collection to go to the family. At the same time, public funding for the museum and gallery sector has dwindled in recent years, making the public sector more dependent on private donations. Closer collaboration and communication between wealth managers (and their estate management services) and public museums' needs could enable a large portion of individual art-related wealth to end up in public museums, providing public access and the opportunity for millions of people to enjoy these cultural treasures.

¹ Deloitte Switzerland, "Innovation in Private Banking & Wealth Management - Embracing the Business Model Change" 2017

The wealth management industry is facing a shift from mainly providing investment advice to a holistic wealth management model.

The future of art & wealth management

How to bring passion into wealth management

Deloitte Art & Finance : Art & Finance is uniquely positioned at the intersection of three interconnected sectors

Finance

- Private bankers
- Wealth managers
- Family offices
- Private investors
- Art/collectibles fund promoters
- Art insurance companies
- Art trading companies
- Etc.

Culture

- Public museums
- Private museums
- Corporate collectors
- Private collectors
- Etc.



Business

- Companies selling art
- Digital art companies
- Art logistics companies
- Art & media companies
- Technological art companies
- Etc.

For the past six years*, we have been monitoring the development and evolution of the Art & Finance industry, and particularly the role of art and collectible wealth within wealth management.

* The "Art & Finance Report" was launched in December 2011 and is now in its fifth edition.

One of the key findings from this year's report is the growing body of evidence to suggest that wealth managers are taking a more proactive approach when it comes to addressing art and collectible wealth. Moreover, this year's survey results represent the highest overall reading to date for anticipated investment in art wealth management services over the next 12 months. These findings indicate that art wealth management services are slowly but surely moving into the mainstream.

These results are confirmed by the fact that 88 percent of wealth managers (up from 78 percent in 2016) said that they believed that art and collectibles should be included as part of a wealth management offering. In addition, 69 percent of the wealth managers surveyed said that they expected their clients to want to include art and other collectibles in their wealth reports to have a consolidated overview of their financial and passion-based assets.

With an estimated US\$1.62 trillion² in art and collectible wealth held by UHNWIs in 2016, and an estimated US\$2.7 trillion³ by 2026, wealth managers seem to realize both the financial and emotional value attached to art and collectibles, and to be starting to take a more strategic and holistic approach to these passion-based assets. Despite the auction market volatility seen in the last two years, the global auction market saw total sales growth⁴ of 319 percent between 2000 and 2016, and with more wealth⁵ allocated to art and collectibles, this positive trend is likely to continue. Offering art and collectible management alongside other wealth management services tailored to UHNWIs is an opportunity to better serve clients, but providers also have a responsibility to ensure that all client assets are monitored and protected.

² Based on an estimate from the "Knight Frank Wealth Report 2017," (six percent of global UHNWIs allocate assets to art and collectibles: pp. 63) and the fact that Wealth-X reported total UHNWI wealth of US\$27.035 trillion in 2017, which gives an estimated US\$1.62 trillion in art and collectible wealth.

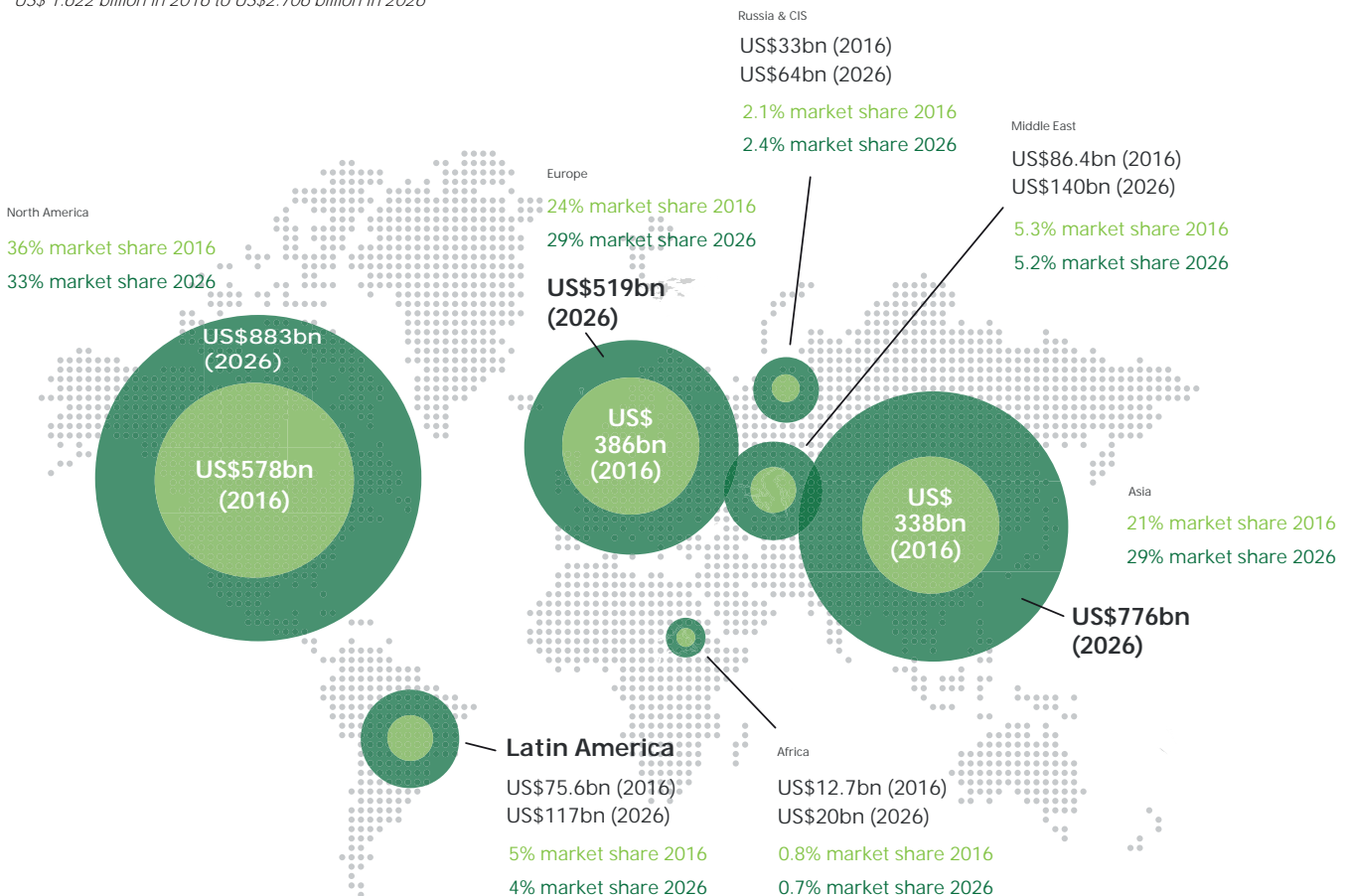
³ The ten-year estimate is based on the Wealth-X forecast of US\$27.035 trillion in UHNWI wealth in 2016. We have assumed that UHNWIs wealth (US\$) grows at the same growth rate as the expected growth in the UHNWI population according to Knight Frank Wealth Report 2017. Knight Frank Wealth Report 2017 reports that 47 percent of wealth managers having noted luxury investments increasing in popularity among their clients. Based on this, we assume that the allocation of wealth toward art and collectibles rises from six percent to seven percent as a global average, then an estimated US\$2.706 trillion would be allocated to art and collectibles by 2026.

⁴ These sales are based on Sotheby's and Christie's four main auction categories—Impressionist and Modern art, Post-War and Contemporary art, Old Masters art and Chinese works of art.

⁵ According to the "Knight Frank's Wealth Report 2017," a global average of 47 percent of wealth managers said that luxury investments had become more popular with their clients.

Global UHNWI Art & Collectibles Wealth 2016 to 2026 Estimates

US\$ 1.622 billion in 2016 to US\$2.706 billion in 2026

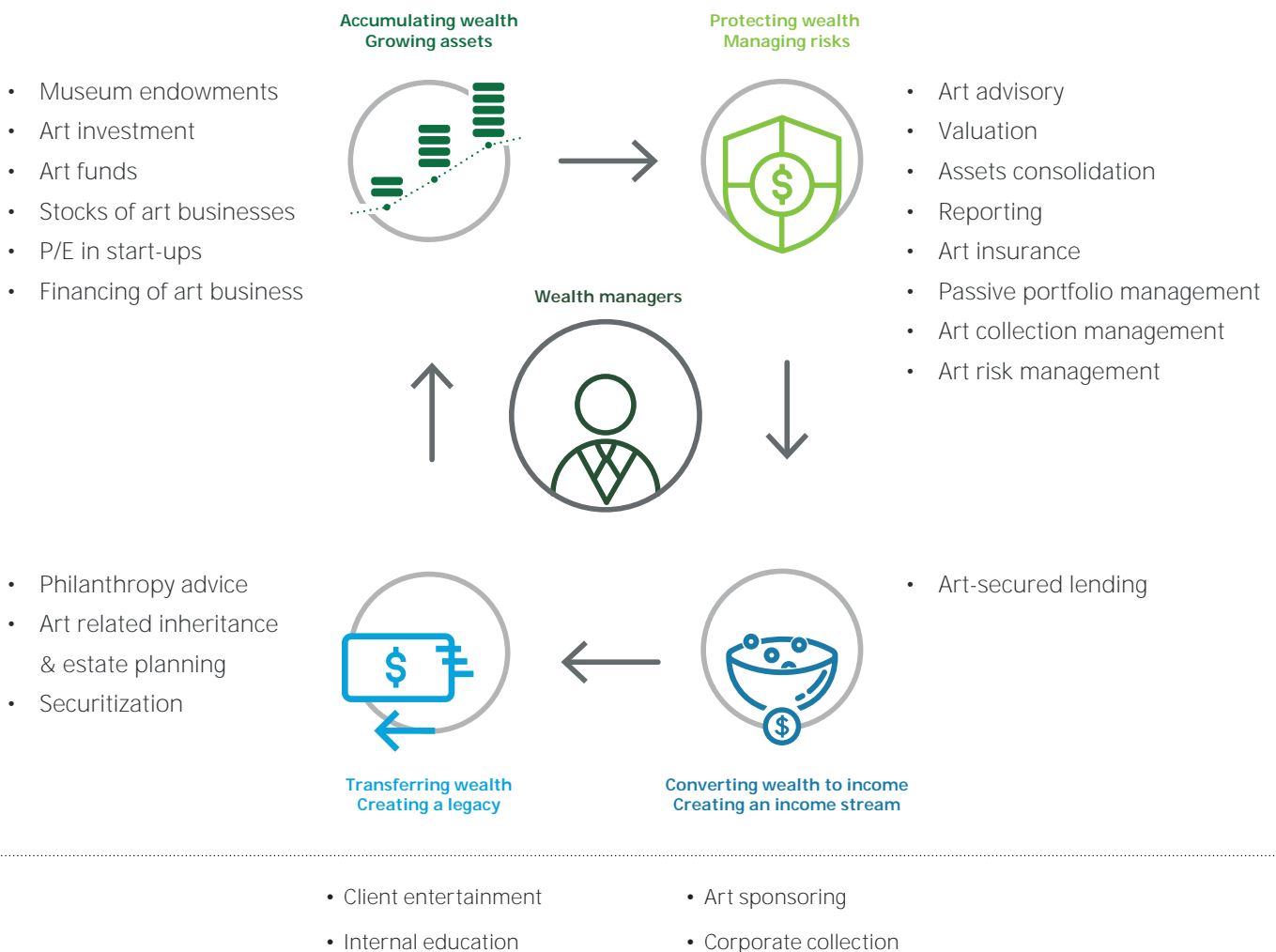


Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

One of the key findings from this year's report is the growing body of evidence to suggest that wealth managers are taking a more proactive approach when it comes to addressing art and collectible wealth.

Art and wealth management
Four core service areas

Typology of Art Wealth management services

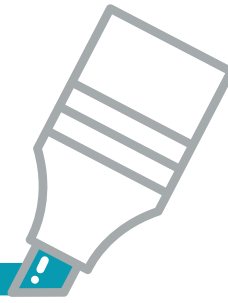


Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017



Section 1

The state of the global art market



HIGHLIGHTS

- **Art and wealth management services needed in an increasingly complex art market:** With more wealth allocated to art and other passion assets, a trend that is expected to continue in the coming 10 years, coupled with a more volatile and uncertain global art market, suggest that a more sophisticated and dynamic approach to managing art related wealth is required in the future.
- **Strong tailwind in the first half of 2017:** Total auction sales at Sotheby's, Christie's, and Phillips were up 18 percent in the first half of 2017 compared to the same period last year. This was primarily fueled by an increase in sales of impressionist, modern, and contemporary art, as well as a 21 percent increase in sales of Chinese and Asian works of art. The increase in sales comes on the back of a global art market slow down between the second half of 2015 and throughout 2016. Auction sales at Sotheby's and Christie's across four of the main auction categories⁶ were down 5.9 percent in 2015 and a further 35.7 percent in 2016.

- **Cautious outlook for 2018:** Despite the significant rebound in the first six months of 2017, the overall market sentiment remains more cautious about the next 12 months. The outlook regarding contemporary and modern art markets in the United States, China, Russia and Africa are looking more positive compared to 18 months ago, while art markets in the United Kingdom, Europe, South Asia, Southeast Asia, Latin America, and the Middle East have turned less optimistic.
- **London and New York strengthen their market share in the first half of 2017:** Despite the economic and political uncertainty around Brexit, London auction sales based on Sotheby's, Christie's, and Phillips saw a US\$404 million increase in the first half of 2017 compared to the same period last year. New York maintains its dominant position, with 45 percent market share (up from 41 percent in 2016), ahead of London with 30 percent market share (up from 27 percent in 2016).
- **Dealer market holding up better than the auction market in 2016:** The Art Basel Report 2017 reported an overall art market decline of 11 percent for 2016, while TEFAF's art market report documented a small two percent increase in global art market sales, primarily driven by an estimated 20 percent growth in dealer sales (offsetting an 18.75 percent fall in auction sales). Both reports highlight healthier growth in the private dealer market, and this could indicate that the overall volatility associated with the current auction market is having less impact on the private, non-auction art trade.

Despite the significant rebound in the first six months of 2017, the overall market sentiment remains more cautious about the next 12 months.

⁶ Contemporary art, Impressionist and modern art, Old Masters, and Chinese works of art

- **Political and economic uncertainty perceived as the biggest risks to the art market:** A recent ArtTactic survey from June 2017 ranks political and economic uncertainty as the biggest risk to the development of the global art market in the coming 12 months. Geo-political risks related to North Korea and Middle East, and Brexit-related uncertainties remain among the most important political sources of risk in the art market.
- **Speculation risks on the increase:** The ArtTactic art market speculation barometer⁷ is currently standing at 7.3, up 17.7 percent from January 2017. This suggests that experts feel the current art market recovery has reintroduced more speculative behavior, after a six-month market slowdown. The sharp reversal in expert perceptions of risk and speculation calls the health of the recovery process into question, and raises the question of whether the sharp auction market rebound in 2017 is an indication that we are entering a period of increasing volatility in the art market.
- **Wealth growth recovers after a sharp fall in 2015 and is expected to increase by 43 percent in the next decade:** The world's ultra-high-net-worth individual (UHNWI) population⁸ grew by 3.5 percent to 226,450 individuals in 2016, a recovery from a sharp fall in 2015, according to a recent wealth report.⁹ Their combined wealth also increased in 2016, expanding by 1.5 percent to US\$27 trillion. However, the average net worth of the ultra-wealthy declined for the first time since 2013. The total number of ultra-wealthy individuals is predicted to rise 43 percent¹⁰ to 275,740 by 2026. Predicted growth rates vary widely on a regional basis, with emerging economies still leading the way.

A recent ArtTactic survey from June 2017 ranks political and economic uncertainty as the biggest risk to the development of the global art market in the coming 12 months.

- **Growing popularity of luxury investments:** 37 percent of wealth managers surveyed by Knight Frank¹¹ said that their clients already had a number of luxury investments, such as art, wine, and classic cars. A total of 47 percent of these managers said that these luxuries had become more popular in recent years. Although personal enjoyment ranked as the most significant client motivation, the potential for increased capital gains came in second, which implies that the financial aspects of luxury investments are gaining in importance.
- **US contemporary art market outlook turns positive:** Experts signal a more upbeat outlook for 2017–2018. Based on the responses of experts surveyed by ArtTactic in June 2017, 62 percent believe that the US contemporary art market will go up in the next 12 months (versus 47 percent in January 2016).
- **Uncertainty around Brexit could have a negative impact on the UK contemporary art market in 2018:** Much of London's relative success following the Brexit vote last year can be linked to the decline in sterling, motivating buyers from outside Europe to take advantage of the benefits of a lower exchange rate. However, 34 percent of the experts surveyed in June 2017 believe that the UK's post-war and contemporary art market will go up in the next 12 months (down from 47 percent in January 2016) and 38 percent think that the market will come down in the next 12 months (up from 9 percent who expected the market to decline in January 2016).
- **European art market outlook looks positive:** 36 percent of the experts surveyed believe that the European contemporary art market will increase in the next 12 months (up from only 14 percent in January 2016). This indicates that there has been a shift toward a more positive stance on the European post-war and contemporary art market in 2017, despite the political and economic uncertainty.

⁷ The ArtTactic risk and speculation barometer is part of a six-monthly art market expert survey conducted by ArtTactic. Respondents are asked to rate their perception of current art market risk and speculation on a scale from 1 to 10, where 1 is a very low level of risk/speculation and 10 is a very high level of risk/speculation.

⁸ UHNWIs are defined as individuals with US\$30 million or more in net worth

⁹ Source: Wealth-X World Ultra Wealth Report 2017

¹⁰ The Wealth Report, 11th edition by Frank Knight, published in March 2017

¹¹ Source: World Wealth Report 2017 by Knight Frank



FLOWER POWER KIDS (DUELING) © YINKA SHONIBARE MBE (2014), PHOTOGRAPHER: STEPHEN WHITE

- **Chinese contemporary art market outlook turns neutral-to-positive:** Chinese contemporary art market direction in 2017/2018 signals that the market is getting more positive compared to 2016. Based on the responses of experts surveyed by ArtTactic, 32 percent believe that the Chinese contemporary art market will go up in the next 12 months (versus 26 percent in January 2016), and 22 percent believe that the market will come down (versus 45 percent in January 2016).
- **China's focus on cultural development and a regulated art market:** The Chinese government attaches great importance to the development of cultural projects, which are crucial to the soft power of China. In recent years, according to Asia Institute of Art & Finance (AIAF), the government has emphasized the healthy and regulated development of culture and the art market through the introduction of new policies.

- **Sentiment in the South Asian modern and contemporary art market turns from positive to neutral in the first half of 2017:** South Asian modern and contemporary auction sales in the first six months of 2017 was 14 percent lower than the first half of 2016. Based on the responses of the experts surveyed by ArtTactic in June 2017, only seven percent of the experts believe the market will go up in the next 12 months (versus 40 percent in January 2016) and 65 percent believe that the market will remain flat (versus 42 percent 12 months ago).
- **Slowdown in the Southeast Asian art market:** Modern and contemporary Southeast Asian art saw a 29.7 percent year-on-year decrease in sales in 2016. The auction sales in the first half of 2017 suggest that the downward pressure on this market could continue into the second half of the year. 17 percent of the experts surveyed believe the market will go up in the next 12 months (down from 40 percent in January 2016). A larger number of the experts (68 percent, up from 41 percent in January 2016), believe

Art has the potential to make a good underlying asset for a financing or investment structure under sharia law.

that the Southeast Asian art market will remain flat in the next six months. This indicates a shift toward a more negative stance on the modern and contemporary art market in the region for the coming 12 months.

- Latin American auction sales fall in 2016, and experts remain divided about its 12-month outlook:** Latin American auction sales in 2016 saw a year-on-year decrease of 27.2 percent following several years of steady growth. Based on the responses of the experts surveyed by ArtTactic in June 2017, 34 percent believe the market will go up (versus 25 percent in January 2016), 37 percent believe that the Latin American modern and contemporary art market will go down in the next 12 months (versus 14 percent in January 2016).
- Middle-Eastern auctions defy global art market downturn:** Total auction sales of modern and contemporary Middle-Eastern art rose by 11.9 percent in 2016. The first half of 2017 was also marked by solid performance with US\$23.4 million in sales, up 76.8 percent from the second half of 2016 and 1.7 percent from the first half of 2016. However, there are concerns about the next 12 months, with 41 percent (up from 24 percent in January 2016) predicting that the Middle-Eastern art market will decline. Wars, terrorism, and geopolitical tension in the region were cited as the main reasons for this.
- Art and Islamic finance:** Art has the potential to make a good underlying asset for a financing or investment structure under sharia law. It is equally possible that other Islamic financing structures can be used to fund art projects, such as the renovation of old mosques or Islamic cultural properties. With an increasing interest in the region around art as an asset class, there are opportunities for banks and investment houses to address the needs and opportunities associated with art financing and investment in the region.
- Russian modern and contemporary art market sees a positive start to auction sales in 2017, but experts remain cautious about its outlook:** Despite a positive start to the year, only 19 percent of the experts surveyed by ArtTactic in June 2017 (up from 16 percent in January 2016) believed that the Russian art market would see a positive growth trend this year. 46 percent of the respondents believe that the Russian art market could deteriorate in the coming 12 months (compared to 43 percent in January 2016).
- African art auction market sees significant growth in 2017:** The African modern and contemporary auction market has seen steady growth since 2014, but sales have accelerated this year as Sotheby's launched its first African modern and contemporary art sale in May 2017 in London. 46 percent of the experts surveyed in June 2017 believe the African modern and contemporary art market will go up in the next 12 months (up from 39 percent in January 2016), only 12 percent think that the market will come down in the next 12 months (versus 11 percent who expected the market to decline in January 2016).
- Art & Finance in Africa:** Rising global demand for African contemporary art and improved art market infrastructure is likely to increase the demand for Art & Finance-related services and initiatives in the African art market, supported by investment in art education, awareness raising, and capacity-building.

STILL HALF FULL



By Alan Mudie, Responsible for Société Générale Private Banking Investment, Société Générale

Within the UK government, some calls for a more pragmatic approach to Brexit negotiations have been voiced.



Investors experienced a bout of nerves in the aftermath of the Brexit referendum and US presidential election, fearing that Europe's elections in 2017 could yield similar shocks. These worries have proved unfounded so far and indeed the overall environment has been much more benign than expected.

Political mayhem was avoided in Europe...

Mariano Rajoy's minority center-right government has remained in power in Spain, far-right populists failed to create upsets in neither the Austrian presidential election nor the Dutch parliamentary poll, and recent surveys have credited Alternative für Deutschland with 10 percent of voting intentions in September's federal elections (well below the 15 percent registered in mid-2016). Perhaps most significantly, Emmanuel Macron won the French presidency with an explicitly reformist and pro-European Union platform. It now looks increasingly likely that Germany and France will be willing to forge ahead with much-needed reform of the economic and fiscal governance of the eurozone.

This rather benign backdrop can in large part be attributed to the ongoing improvement in Europe's economic performance. Unemployment continues its steady decline, business confidence has strengthened in both manufacturing and services, and consumer sentiment recently hit a 10-year high. This environment is bolstered by a powerful combination—the euro remains undervalued despite its rally this year, monetary policy is exceptionally easy, and governments have backed away from fiscal austerity. In addition, the recent rescue packages for banks in Spain and Italy suggest that a more pragmatic approach to solving the financial system's woes is gaining traction.

...but not in Washington and Westminster

Theresa May's inability to achieve an enhanced majority in June's snap election has added another level of uncertainty surrounding the Brexit negotiations. The initial rounds of talks have shown no real progress on major stumbling blocks such as the "divorce bill," and opposition is growing to the government's plan to achieve a clean break with the EU. In light of the murky outlook, businesses have begun to make plans to transfer activities to the EU in order to ensure long-term access to the single market and customs union.

The economic fallout is already becoming apparent. UK GDP growth in the first half of 2017 averaged an annual rate of around 1 percent, well below the 2.2 percent pace registered in the eurozone. Moreover, devaluation-induced inflation—hitting 2.9 percent in August—is eating into household confidence and disposable incomes.

In the US, the boost to small business confidence that followed Donald Trump's election has yet to be justified by progress on the president's flagship reforms to trade policy and taxation. The White House has seen rapid turnover among advisers, which has added to the perception of a lack of clear direction. And the economic surprise index calculated by Citi hit a six-year low in early summer.

However, we would not completely avoid the US and the UK...

First of all, with hope on Trump reforms at rock-bottom, any progress on healthcare reform, deregulation, or the tax code would come as a welcome surprise to investors. Second, the US economy continues to create numerous new jobs and with core inflation rising only gradually, it looks unlikely that the Fed will be forced to tighten policy to the point where growth potential would be choked. Finally, economic surprises tend to come in waves—after a long period of negative surprises, economists tone down their forecasts opening the way for a cycle of positive surprises. Indeed, the Citi index has staged a strong rally since mid-June.

Within the UK government, some calls for a more pragmatic approach to Brexit negotiations—most notably from Chancellor Hammond—have been voiced. It is possible that Mrs. May's poor electoral performance could encourage a leadership challenge, and any inkling of a "softer" Brexit might spark a reappraisal of the downside risks for sterling.

...while downside risks remain in the eurozone

In Italy, where there is still talk of a snap election, the populist Five Star movement has been leading the ruling Democratic Party in most polls since late February. In Spain, Prime Minister Rajoy's minority government could yet face a challenge from the upsurge in support for the left-wing PSOE. In addition, Catalonia has again begun to push for its independence from Spain, in a challenge to the government's refusal to sanction a referendum. Also, there remains a risk that Emmanuel Macron's labor market reforms could provoke widespread protest and strikes.

Furthermore, the improving outlook has been recognized by currency traders, pushing the euro up by over 13 percent against the dollar since early 2017. This has encouraged analysts to begin to revise their earnings forecasts downward, given the eurozone's significant reliance on international trade in some sectors.

So, one shouldn't extrapolate recent trends into the future. The outlook for the eurozone has improved but downside risks remain. And while the challenges faced by Prime Minister May and President Trump are daunting, they are not insurmountable.

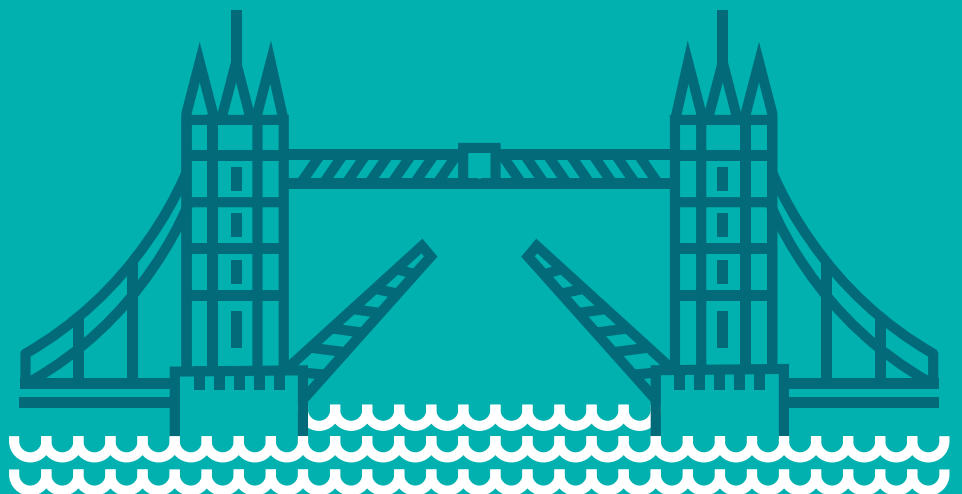
We still recommend a moderately risk-on stance

Fixed income markets face several challenges. The US Federal Reserve is continuing gradual normalization of its monetary policy, and is beginning to shrink its investment portfolio, which expanded dramatically during the three successive rounds of quantitative easing. Other central banks are likely to follow suit in coming quarters, most notably the European Central Bank, which we expect to reduce its asset purchase program next year. This will put downward pressure on fixed income markets, with yields—which move inversely to bond prices—rising over the next 12 months. In this context, we prefer inflation-linked

bonds whose coupons will be adjusted in line with any rise in inflation, and floating-rate notes where coupons are linked to base rates.

Regarding the corporate bond market, the yield differential with government bonds is currently at extremely low levels, meaning that investment-grade corporate bonds offer little protection against higher yields. Pockets of opportunity do exist—in particular, we highlight the attractions of the financial sector where credit quality has been vastly improved under the impulse of regulatory pressure. We also note the improved macro fundamentals in a number of emerging markets and the attractive pick-up in yields to be found in that segment.

The expansion currently underway in the global economy is above all supportive for equities, as are the pick-up in earnings and the improvement in fundamentals. Valuations are high on average, and investors should favor markets that have catch-up potential, such as the eurozone and Japan. Price momentum is strong across the board, but some sentiment indicators—such as implied volatility—show signs of complacency. Well-diversified holdings across asset classes and investment themes should enable investors to capture the upside potential without taking on undue risk.



An art market recovery?

+18 percent

auction sales growth in the first six months of 2017

Although it is too early to say whether the art market is on the path to a full recovery after a challenging 2016, the signs from the first six months of 2017 suggest that buyer and seller confidence is returning to the overall auction market. Total auction sales at Sotheby's, Christie's, and Phillips were up 18 percent, primarily fueled by an increase in sales of impressionist, modern, and contemporary art, as well as a 21 percent increase in sales of Chinese and Asian works of art. This means that the three auction houses generated US\$1.08 billion more in sales from these collecting categories in the first half of 2017, compared to the first half of 2016.



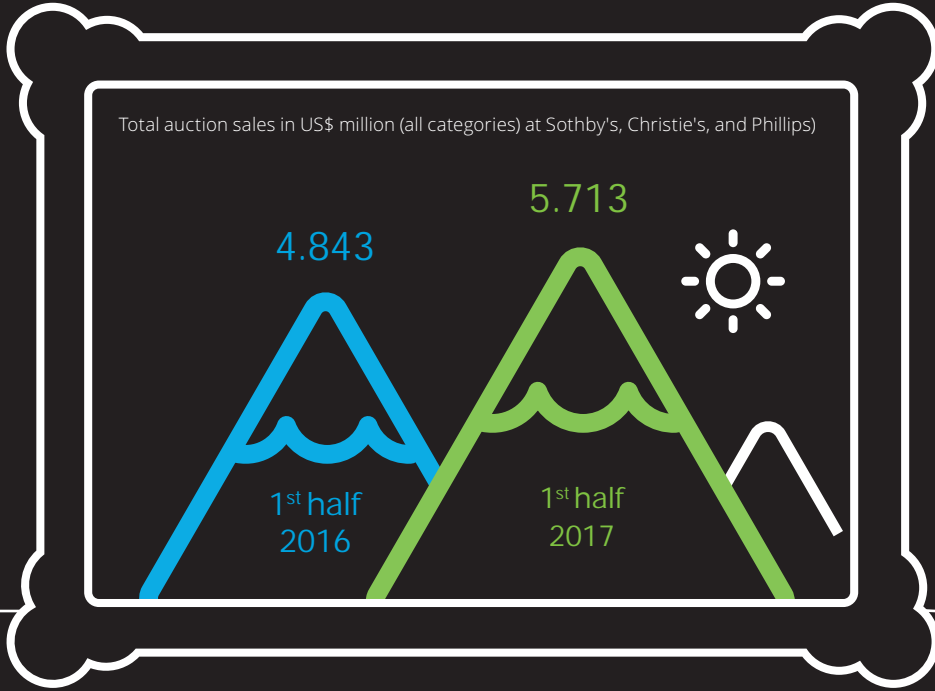
Total lots sold at auction (all categories) at Sotheby's, Christie's, and Phillips)



+US\$912 million

more sales generated by impressionist, modern, and contemporary art in the first half of 2017 compared to the same period in 2016.

Impressionist and modern art auction sales saw a 62 percent increase in the first six months of 2017 compared to the same period last year; this was followed by a 25 percent increase in sales of post-war and contemporary art. Post-war and contemporary art accounted for 30.2 percent market share of overall sales in the first six months of 2017.

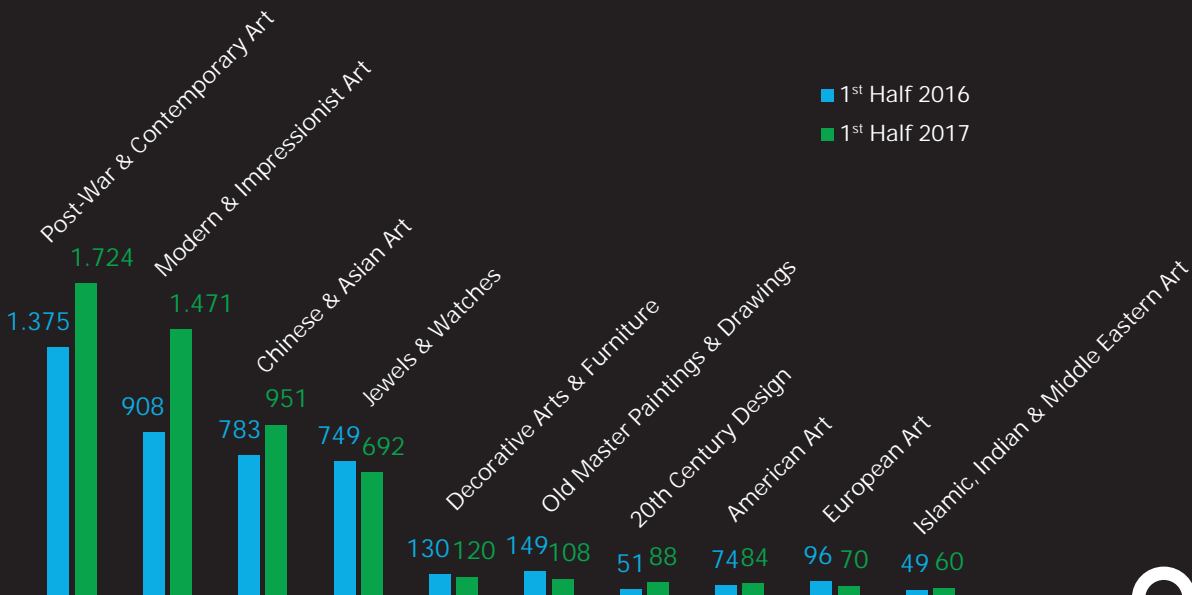


-10 percent

in the number of lots sold at auction in the first six months of 2017

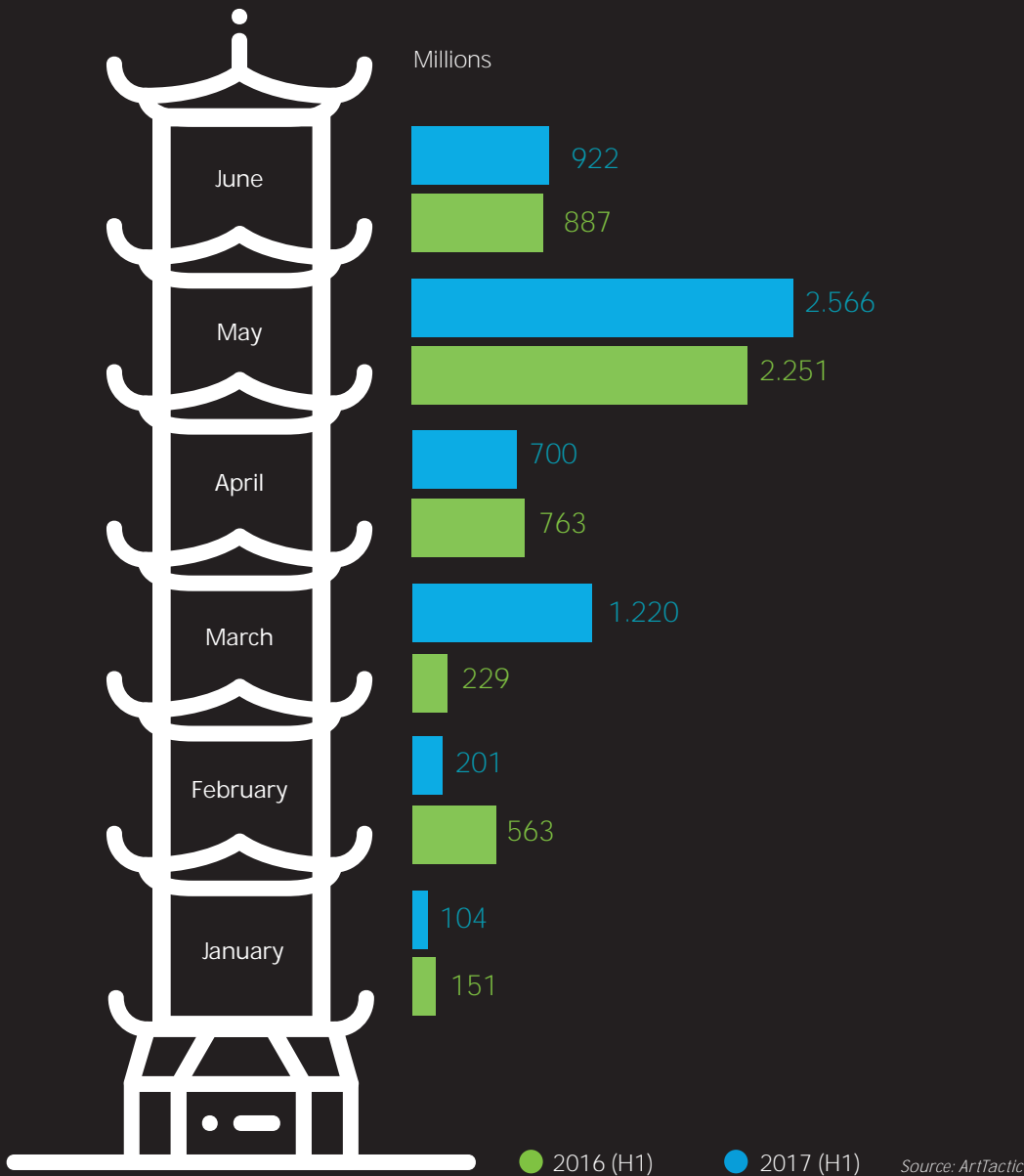
Despite the increase in overall sales, the number of lots sold in the first six months of 2017 decreased by 10 percent to 51,263 works of art and collectibles. This resulted in an overall increase in the average auction price across all categories at Sotheby's, Christie's, and Phillips of 31 percent, from US\$85,000 in the first half of 2016 to US\$111,400 in the first half of 2017.

Auction sales by category (n US\$ million) H1 2017 vs H1 2016 (Sotheby's, Christie's, Phillips)



+21 percent

growth in Chinese and Asian auction sales in the first six months of 2017



The significant jump in sales for March 2017 was due to a rescheduling of the major winter season, normally taking place in early February, to accommodate the Chinese New Year. This is a sign that Asian buyers are playing an increasingly important role in today's market. Contributing strongly to Asian growth in the first half of 2017 was the New York Asian Art Week in March, and in particular the sale entitled "Important Chinese Art from

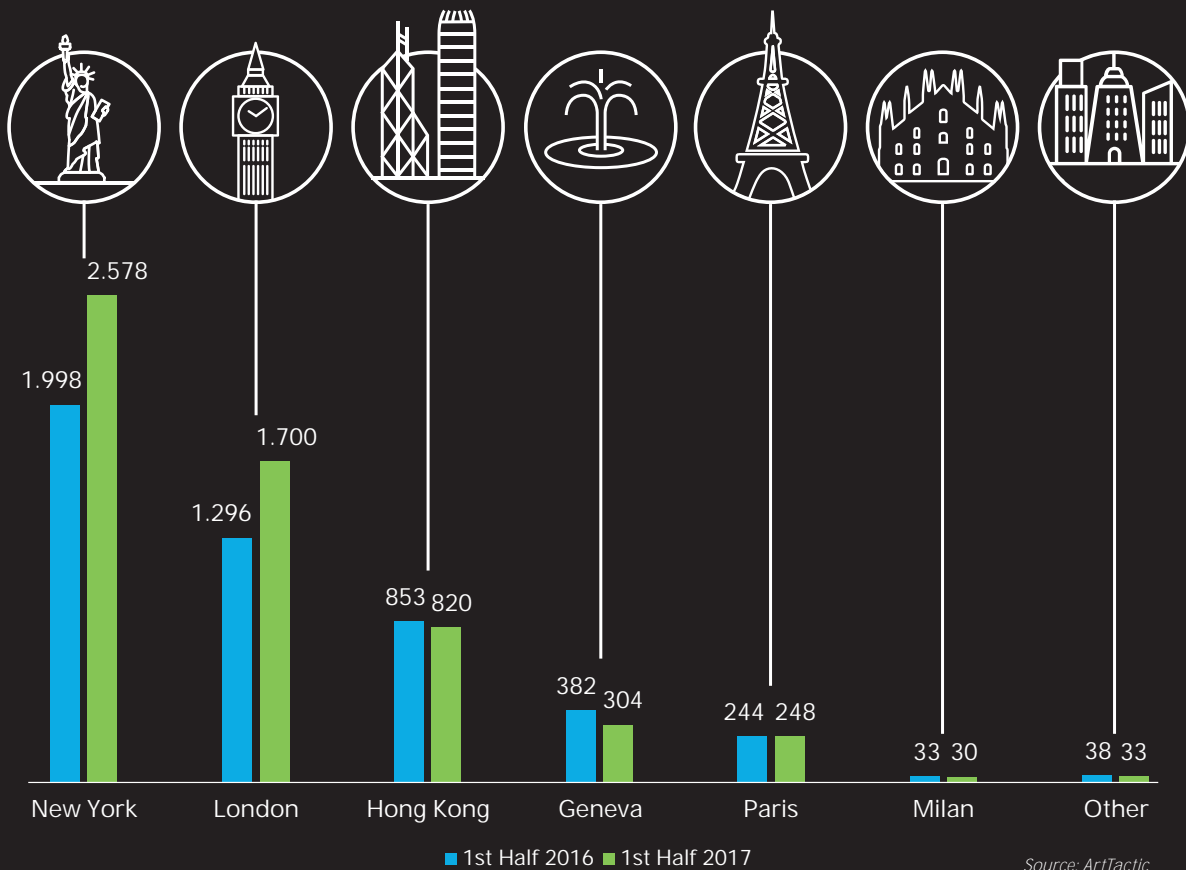
the Fujita Museum," which raised US\$262.8 million alone. While the first quarter of 2017 saw auction sales growth of 61.8 percent, Q2 growth fell back to a more modest +7.4 percent compared to the same quarter in 2016. This could signal that the speed of the recovery might be tapering off as we enter the second half of the year.

+31 percent

growth in auction sales in London in the first half of 2017, followed by 29 percent growth in New York auction sales.

All Auctions at Sotheby's, Christie's and Phillips - By Total Sales per Location


Millions



Despite the economic and political uncertainty around Brexit, London auction sales based on Sotheby's, Christie's, and Phillips saw a US\$404 million increase in the first half of 2017 compared to the same period last year. New York maintains its dominant position, with 45 percent market share (up from 41 percent in 2016), ahead

of London with 30 percent market share (up from 27 percent in 2016). European auction centers such as Paris, Milan, and Geneva ended up with a 10 percent market share after the first six months of 2017, down from 14 percent in 2016.

Figure 1. Christie's and Sotheby's: Auction Sales (in millions US\$) by category 2000 - 2017 (H1)

 CAGR (2000-2017) 9.3%



Should we expect more art market volatility in the future?

A strong tailwind has helped major global art auction segments such as post-war and contemporary art, impressionist and modern art, and Chinese and Asian works of art in the first six months of 2017, adding US\$1.08 billion¹² in additional sales compared to the same period last year.

After five years of uninterrupted growth between 2009 and 2014, the global art market started to slow down in the second half of 2015, a trend that deteriorated throughout last year. Auction sales at Sotheby's and Christie's across four of the main auction categories¹³ were down 5.9 percent in 2015 and a further 35.7 percent in 2016.

These auction market trends were also reflected in the wider global dealer and auction market reported in the "Art Basel Report 2017," which noted an overall art market decline of 11 percent for 2016, while auction sales saw a more severe 26 percent decline last year. However, TEFAF's recent

art market report documented a small two percent increase in global art market sales, primarily driven by an estimated 20 percent growth in dealer sales (offsetting an 18.75 percent fall in auction sales). Both reports highlight healthier growth in the private dealer market, and this could indicate that the overall volatility associated with the current auction market is having less impact on the private, non-auction art trade.

So, how sustainable is the latest auction recovery? Based on the findings of the ArtTactic art market confidence survey in June 2017, market confidence has not increased in-line with the jump in auction sales for the first six months of 2017. In fact, the six-monthly confidence indicator has declined by 13.4 percent from the level seen six months ago, raising questions about the speed and sustainability of the current art market recovery.

The confidence indicator has been affected by an increasingly negative outlook for the global economy in the next six

months, with the economic indicator component dropping 32.4 percent in the last six months. Geopolitical factors such as political instability in the UK and US, conflicts in the Middle East, the fear of terrorism, and heightened uncertainty around China's debt bubble were some of the key concerns mentioned by survey participants.

Does this mean we are facing an imminent reversal of the market recovery? Probably not—the share of market experts who believe the positive trend will continue for the remaining half of the year rose from 39 percent in January 2017 to 45 percent in June 2017. However, the overall decline in art market confidence does suggest that the pace of the recovery could be slowing down.

The bigger question is whether we are starting to experience a shift in the way that the global art market behaves. Are auction market cycles becoming shorter and are levels of sales volatility increasing? And is this caused by changing motivations

¹² Based on auction at Sotheby's, Christie's, and Phillips only.
¹³ Contemporary art, Impressionist and modern art, Old Masters, and Chinese works of art



Geopolitical factors such as political instability in the UK and US, conflicts in the Middle East, the fear of terrorism, and heightened uncertainty around China's debt bubble were some of the key concerns mentioned by survey participants

among art buyers and sellers? With the growing interest in art as an asset class identified by the findings of this report since we launched the first edition in 2011, is the art market starting to behave in a similar fashion to other asset classes and investments? And could art market volatility be set to increase as art buyers become more investment-oriented and increasingly amenable to short-term investment horizons? (see survey findings if investment/financial motivations are increasing) If this is the case, the art market and its participants need to start thinking about risk management in a different way. In Chapter 6, we discuss and address many of the issues related to the growing demand for art and risk management tools.

A new auction dynamic driven by financial guarantees

The divergence in sales trends between the auction market and the dealer market suggests that there are different dynamics and risks playing out in the two spheres. The nature of the fiercely competitive auction market, and particularly the rivalry between Sotheby's and Christie's, and increasingly Phillips at the high end of the market, has led to heavy reliance on financial guarantees to secure top-quality auction supply. With the value of art reaching astronomical levels, single lots can play a significant role in the overall

outcome of an auction season. The recent sale of Jean-Michel Basquiat's "Untitled" (1982) for US\$110.5 million (with a presale estimate of more than US\$60 million) at Sotheby's New York in May accounted for more than a third of the overall auction sale value at Sotheby's that evening. The lot carried both a financial guarantee and an irrevocable bid¹⁴.

The recent auction sales rebound among the top auction houses in the first half of 2017 could indicate that the art market was going through a supply adjustment rather than a price correction in 2016. This adjustment was largely caused by a reduction in the level of financial guarantees offered, making the process less attractive for potential sellers of top-quality art. The level of financial guarantees for the major auction sales by Christie's, Sotheby's, and Phillips (such as post-war and contemporary evening sales, dropped to around US\$220 million¹⁵ in May 2016 from US\$634 million in May 2015, but jumped up again to US\$425 million in May 2017.

¹⁴ Under an "irrevocable bid" arrangement, the auction house finds a person prepared to submit a bid for an undisclosed amount. Under normal circumstances, the financial guarantor do not bid on the lot, but offers the seller a guaranteed amount for the artwork. In this case, the combination of both a financial guarantee and an irrevocable bid could suggest that the auction houses felt the need to "hedge" the financial guarantee by finding a buyer prepared to commit to bid on this particular lot.

¹⁵ These values are calculated based on aggregating the value of lots that are flagged up as being guaranteed by the auction houses using the low presale estimate for each lot. While auction houses are required to disclose financial guarantees to bidders, their hazy wording prevents us from knowing if the guarantee is provided by a third party or by the auction house itself.

Although financial guarantee levels for post-war and contemporary evening sales in London have traditionally stood at a more modest level (between 15 percent and 20 percent of the total sales value based on the low estimate), there has been a significant shift in the level of guarantees offered this year, with 33 percent of the

March evening sale and 46 percent of the sales value guaranteed for the June sales this year being supported by guarantees. This shows how important and integral the financial guarantee market has become to the overall performance of the auction market today.

Figure 2. Financial Guarantees: New York Post-War & Contemporary Evening Sales (Sotheby's, Christie's and Phillips) (in millions US\$)

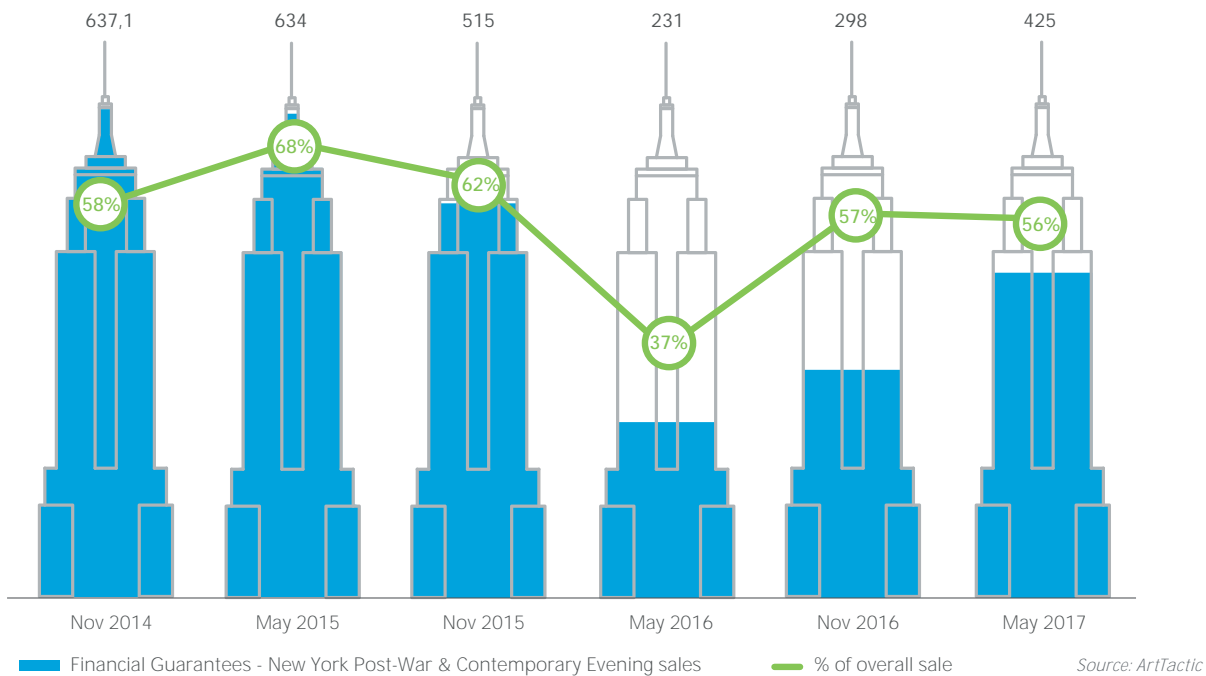
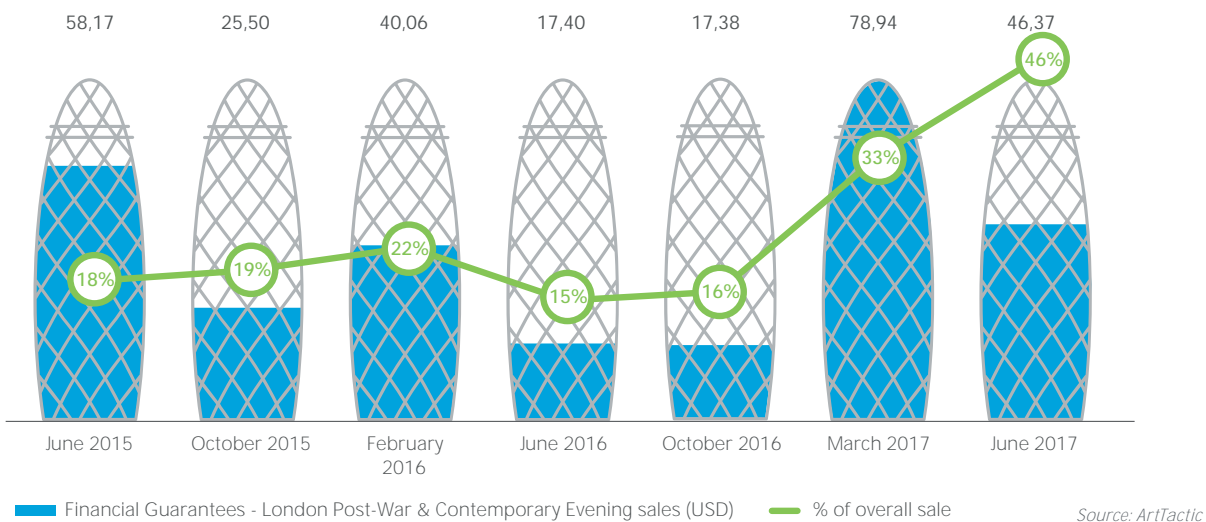


Figure 3. Financial Guarantees: London Post-War & Contemporary Evening Sales (Sotheby's, Christie's and Phillips) (in millions US\$)



The divergence in sales trends between the auction market and the dealer market suggests that there are different dynamics and risks playing out in the two spheres.

According to the “World Wealth Report 2017” by Knight Frank, 37 percent of wealth managers surveyed said that their clients already had a number of luxury investments, such as art, wine, and classic cars.

Art market risks: could speculation undermine the recovery process?

Since 2006, ArtTactic has monitored perceptions of art market risk and speculation, particularly focusing on the post-war and contemporary art market. The ArtTactic art market speculation barometer¹⁶ is currently standing at 7.3, up 17.7 percent from January 2017. This suggests that experts feel the current art market recovery has reintroduced more speculative behavior, after a six-month market slowdown.

The sharp reversal in expert perceptions of risk and speculation calls the health of the recovery process into question, and raises the question of whether the sharp auction market rebound in 2017 is an indication that we are entering a period of increasing volatility in the art market. So, what are the current risks in the market?

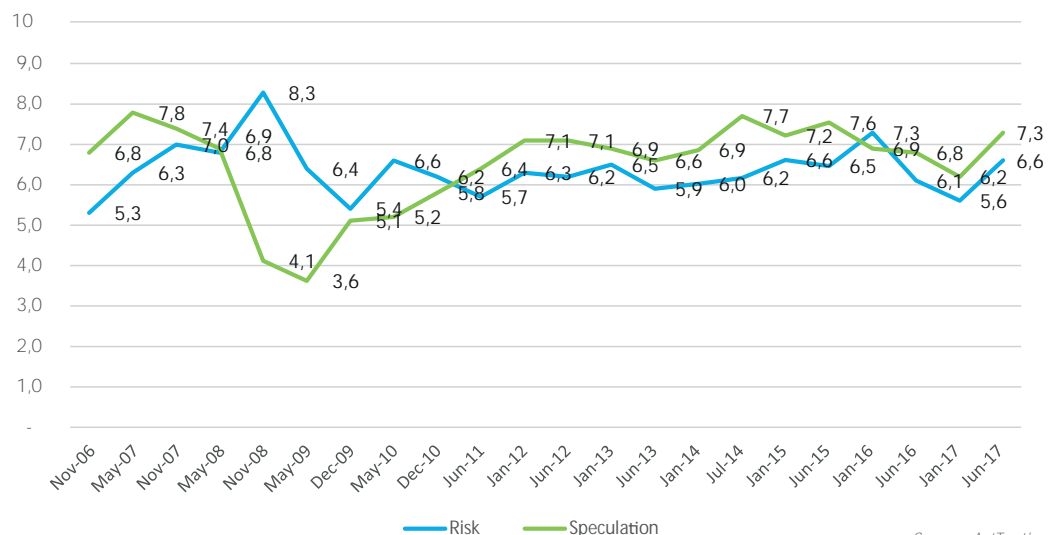
A recent ArtTactic survey from June 2017 ranks political and economic uncertainty as the biggest risk to the development of the global art market in the coming 12 months. With tricky Brexit negotiations under way, a new level of political and economic uncertainty is likely to dominate several of the world's largest art markets in the coming years.

Economic outlook: global economic activity is picking up pace

According to the latest report published by the World Bank in June 2017, global activity is picking up, and this is contributing to an improvement in confidence. A recovery in industrial activity has coincided with an increase in global trade, after two years of weakness. According to the World Bank, global growth is projected to strengthen to 2.7 percent in 2017 and 2.9 percent in 2018–19, in line with January 2017 forecasts. Activity in advanced economies is expected to gain momentum in 2017, supported by an upturn in the United States. Growth forecasts have been upgraded in the Eurozone and Japan, reflecting strengthening domestic demand and exports.

¹⁶ The ArtTactic risk and speculation barometer is part of a six-monthly art market expert survey conducted by ArtTactic. Respondents are asked to rate their perception of current art market risk and speculation on a scale from 1 to 10, where 1 is a very low level of risk/speculation and 10 is a very high level of risk/speculation.

Figure 4. ArtTactic Art Market Risk & Speculation Barometer 2006 - 1st Half 2017
Where 1 = Very low Risk/ Speculation and 10 = Very high Risk/ Speculation



Source: ArtTactic

In emerging markets and developing economies, growth is predicted to recover to 4.1 percent in 2017 and reach an average of 4.6 percent in 2018–19 as obstacles to growth for commodity exporters diminish, while activities for commodity importers continue to be robust. Risks to the global outlook remain on the downside, and include increased trade protectionism, economic policy uncertainty, the possibility of financial market disruptions, and, over the longer term, weaker potential growth, the report says.

Global wealth trends: UHNWI population and wealth grows in 2016

According to the "Wealth-X World Ultra Wealth Report 2017", the world's ultra-high-net-worth (UHNWI) population¹⁷ grew by 3.5 percent to 226,450 individuals in 2016, a recovery from a sharp fall in 2015. Their combined wealth also increased in 2016, expanding by 1.5 percent to US\$27 trillion. However, the average net worth of the ultra-wealthy declined for the first time since 2013.

Despite the overall increase in UHNWI population and wealth, there were significant regional differences in dollar-denominated wealth creation, with North America (+5.1 percent) and Asia (+3.5 percent) recording the only significant rises in wealth in 2016. However, Latin America and the Caribbean registered a significant fall and Africa also posted a decline. The Middle East remained largely unchanged, while Europe followed a gentler trajectory, with the UHNWI population and its total wealth coming in slightly lower than in 2015.

The stock of liquid assets (primarily cash) owned by the ultra-wealthy stood at US\$9.6 trillion in 2016, according to the "Wealth-X World Ultra Wealth Report 2017." These assets accounted for 35.4 percent of UHNWIs' holdings. One of the key findings of the report is that abundant liquidity also reflects a continuing search for yield and underlines the enormous spending potential of the world's ultra-wealthy.

According to the "World Wealth Report 2017" by Knight Frank, 37 percent of wealth managers surveyed said that their clients already had a number of luxury investments, such as art, wine, and classic cars. A total of 47 percent of these managers said that these luxuries had become more popular in recent years. Although personal enjoyment ranked as the most significant client motivation, the potential for increased capital gains came in second, which implies that the financial aspects of luxury investments are gaining in importance.

Growing client demand for luxury investments and rising philanthropic engagement will have implications for the wealth management sector in the coming years, and as the findings in this report confirm, we are already starting to see more wealth managers taking a proactive approach to these types of "personal investment."

Growing client demand for luxury investments and rising philanthropic engagement will have implications for the wealth management sector in the coming years, and as the findings in this report confirm, we are already starting to see more wealth managers taking a proactive approach to these types of "personal investment." This also dovetails with the ultra-wealthy's growing requirement for tailored solutions in today's increasingly commoditized world.

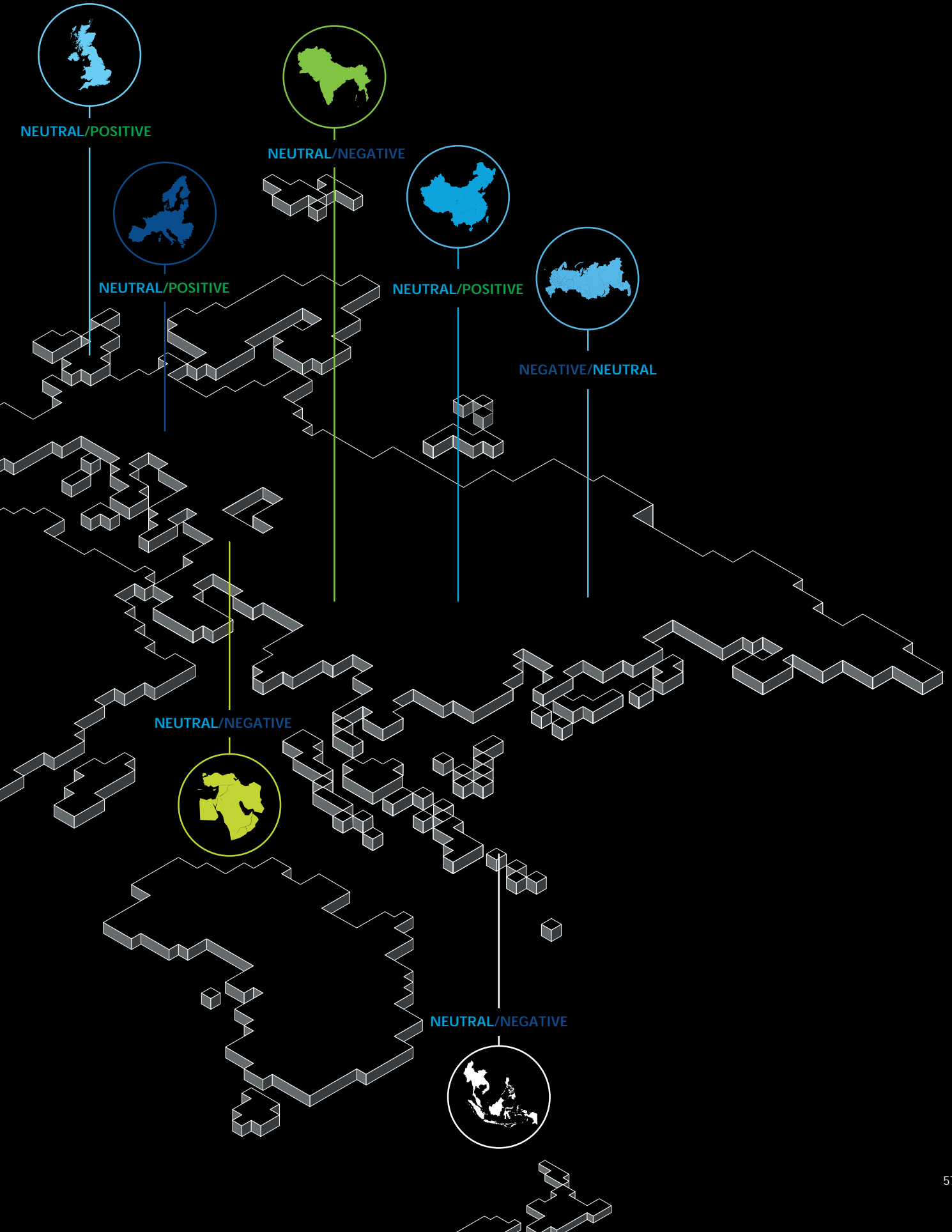
¹⁷ UHNWIs are defined as individuals with US\$30 million or more in net worth

Art market outlook 2017–2018

In a year of political shocks and economic uncertainty, the world's modern and contemporary art markets saw an annual contraction in auction sales of 32.2 percent, predominantly led by the fall in the US and the UK post-war and contemporary art market.

Mirroring the volatile global backdrop, there were marked regional differences in the modern and contemporary art markets. Among the 10 regional modern and contemporary art markets monitored in this report, two—the Middle-East and Africa—recorded an increase in auction sales in 2016. In contrast, 2016 was a difficult year for the US, UK, and European contemporary art markets, which suffered double-digit falls in auction sales, although these markets have been the fastest to rebound in the first six months of 2017. Elsewhere, the picture was muted, with auction sales edging lower in China, South Asia, Southeast Asia, and Latin America.





Where is the global art market heading in the next 12 months? Will the positive sales trends in the first half of 2017 continue into the second half of the year?

The global contemporary art market faced challenging conditions in 2016, but there are signs that buyer confidence is returning and that the global market is recovering from the 2016 downturn. In this section of the report, we will take a closer look at various regional modern and contemporary art markets and their outlook for the coming 12 months.

As in all previous editions of the Art & Finance report, our primary focus in the art market section is global trends in the modern and contemporary fine art market. We believe that the trends emerging in the modern and contemporary art sector across the different regions provide a reliable indication of nascent trends in these art markets more broadly. We have also aimed to link art market dynamics to overall wealth trends to hone our understanding of the potential connections between the global art market and the global wealth management industry. The following analysis focuses on modern and contemporary art by artist origin, focusing on the United States, Europe, China, India, the Middle East, Latin America, Southeast Asia, Russia, and Africa. Rather than providing a comparative analysis between the different regional markets, the analysis will focus on the art market and wealth trends within each region to see how the two elements might be linked, and what this may tell us about the potential for the Art & Finance industry.

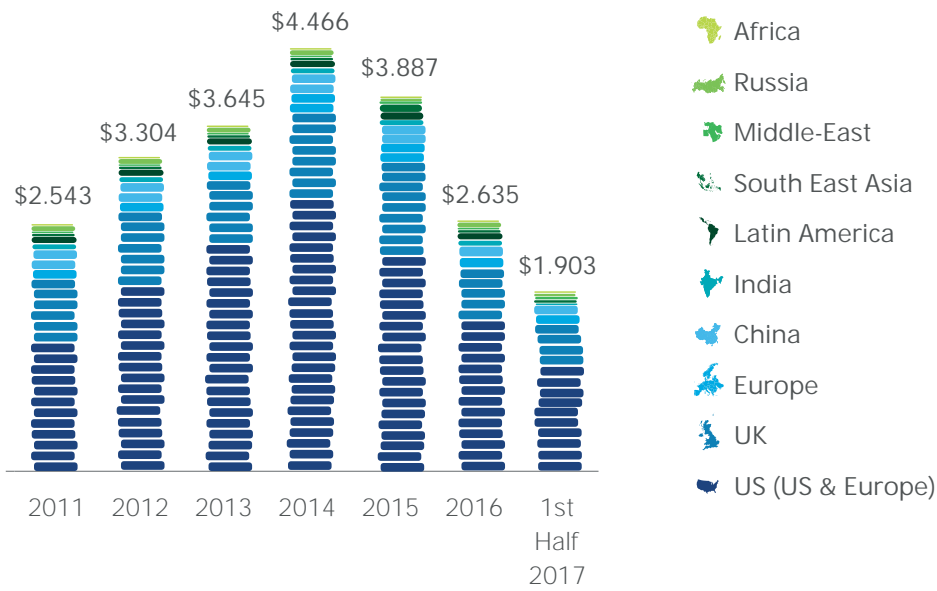
Our art market analysis is not necessarily limited to auction sales data generated within the country or region itself. For instance, our Latin American modern and contemporary art market analysis is based on sales at Sotheby's, Christie's, and Phillips in New York, but the majority of the buyers in these sales are of Latin American origin.

The same goes for the Russian art market, where sales take place in London but most buyers are from Russia or the CIS. Our analysis is predominantly based on auction sales by Christie's and Sotheby's, although other auction houses are included as they represent a major share of the overall market for that particular modern and contemporary art segment. This is highlighted in each individual section. For the United States and Europe, and China and Africa, we have used the contemporary art category to reflect broad market trends. However, in respect of the markets for artworks by Indian, Middle Eastern, Latin American and Southeast Asian artists, we have included the modern art segment based on the auction category classification used by the main auction houses such as Sotheby's and Christie's.

We have also added wealth trends for each of the geographical markets, when available, drawing on results from research reports produced by Wealth-X and Knight Frank in 2017.

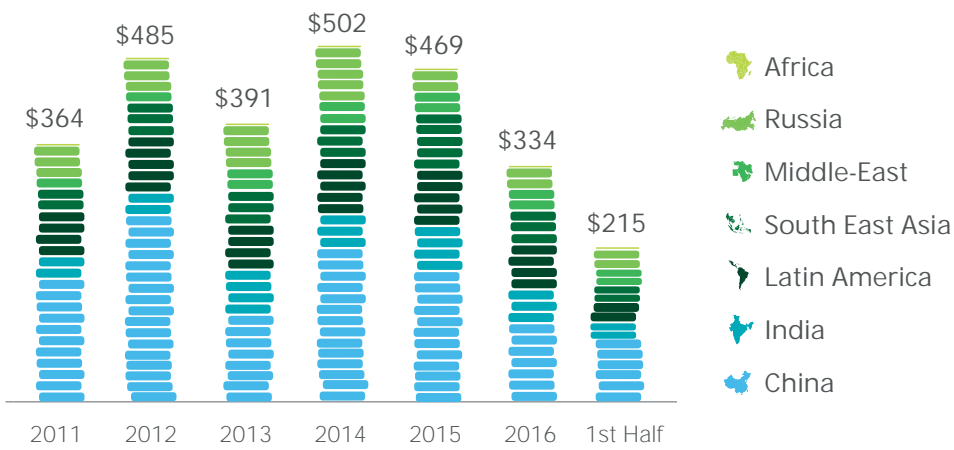
The global contemporary art market faced challenging conditions in 2016, but there are signs that buyer confidence is returning and that the global market is recovering from the 2016 downturn.

Figure 5. Market Share: Regional Modern & Contemporary Art Markets







Source: ArtTactic

Figure 6. Market Share: Regional Modern & Contemporary Art Market (Excluding US/European contemporary art market)



Source: ArtTactic

Table 1. Regional market trends in modern and contemporary art and 2018 outlook

 Geographical market	 Future wealth indicators: predicted growth in UHNWIs in the next 10 years ¹⁸	 Proportion of clients who have a number of luxury investments, such as art, wine, or classic cars ¹⁹	 Percent who believe luxury investments are becoming more popular ²⁰	 Modern and contemporary auction sales trend 2015-2016 ²¹
Global trends	+43%	37%	47%	Although there are some regional differences, 8 out of 10 modern and contemporary art markets were down in 2016.
 United States	+30%	44%	48%	-30%
 United Kingdom	+30%	39% ²⁴	49%	-41%
 Europe	+12%	39%	49%	-21%
 China	+140%	28% ²⁵	44%	-16%
 Middle East	+39%	32%	38%	+11.9%
 South Asia	+150% ²⁶	28%	44%	-24%
 Latin America	+37%	46%	64%	-27%
 Southeast Asia	+30 to +170% ²⁷	28%	44%	-30%
 Russia	+60%	33%	40%	-4%
 Africa	+19%	32%	55%	+12%

18 Knight Frank, "The Wealth Report 2017," 11th edition, page 67

19 Knight Frank, "The Wealth Report 2017," 11th edition, page 64

20 Knight Frank, "The Wealth Report 2017," 11th edition, page 64

21 These auction sales are predominantly based on sales by Sotheby's and Christie's, but will also include domestic auction houses for markets such as China, India, and Africa.

22 The art collector outlook for 2017-18 is based on an annual ArtTactic art collector survey conducted in June 2017. The percentage represents the change in the ArtTactic confidence indicator between 2016 and 2017.



Art market outlook trend
2017-2018²²



Art collector outlook 2016²³

Economic uncertainty has a dampening impact on confidence in the global art market. With all art markets (except India) expressing less positive development in the next 12 months.

The majority of art collectors have a neutral or positive outlook for the next 12 months. However, the outlooks for South Asia, the Middle East, and the UK modern and contemporary art markets are gloomier than they were 12 months ago.

+20% *Art collector poll: market direction*
 ⊕ **UP: 32%**
 ⊖ **FLAT: 52%**
 ⊖ **DOWN: 16%**

-30% *Art collector poll: market direction*
 ⊕ **UP: 32%**
 ⊖ **FLAT: 52%**
 ⊖ **DOWN: 16%**

-3% *Art collector poll: market direction*
 ⊕ **UP: 36%**
 ⊖ **FLAT: 44%**
 ⊖ **DOWN: 20%**

+60% *Art collector poll: market direction*
 ⊕ **UP: 32%**
 ⊖ **FLAT: 46%**
 ⊖ **DOWN: 22%**

-41% *Art collector poll: market direction*
 ⊕ **UP: 25%**
 ⊖ **FLAT: 34%**
 ⊖ **DOWN: 41%**

-78% *Art collector poll: market direction*
 ⊕ **UP: 7%**
 ⊖ **FLAT: 65%**
 ⊖ **DOWN: 28%**

-26% *Art collector poll: market direction*
 ⊕ **UP: 34%**
 ⊖ **FLAT: 29%**
 ⊖ **DOWN: 37%**

-35% *Art collector poll: market direction*
 ⊕ **UP: 17%**
 ⊖ **FLAT: 68%**
 ⊖ **DOWN: 28%**

+6% *Art collector poll: market direction*
 ⊕ **UP: 19%**
 ⊖ **FLAT: 35%**
 ⊖ **DOWN: 46%**

+0% *Art collector poll: market direction*
 ⊕ **UP: 46%**
 ⊖ **FLAT: 42%**
 ⊖ **DOWN: 12%**

Source: ArtTactic

²³ ArtTactic outlook survey among art collectors, art advisers, galleries, and auction houses in January 2016.

²⁴ There is no separate breakdown for the UK in *The Wealth Report 2017,* 11th edition, page 64 (Knight Frank), so we assumed the same rate as for Europe.

²⁵ There is no separate breakdown for China, South Asia, and Southeast Asia in *The Wealth Report 2017,* 11th edition, page 64 (Knight Frank), so we assumed the same rate for all of Asia.

²⁶ This figure is based on an estimate about India's UHNWI population growth between 2016 and 2026.

²⁷ Regional differences: Indonesia's UHNWI population is forecasted to grow 30 percent by 2026, Malaysia's UHNWI population estimated growth rate is 70 percent and Vietnam's UHNWI population is predicted to grow by 170 percent.



Market review 2016–2017

New York auctions bounce back in the first half of 2017 after a challenging 2016:

Christie's, Sotheby's, and Phillips post-war and contemporary (evening and day) sales in New York raised US\$1.57 billion in 2016, which was down 30 percent compared to 2015, when auction sales totaled US\$2.25 billion. However, the first half of 2017 shows that this market has recovered from its 2016 lows, with total sales in New York in May between Christie's, Sotheby's, and Phillips up 27.9 percent from May 2016, and 32 percent above the results from November last year. This result reinforces the global art market recovery that started during London auctions in March 2017.

New York market share up in 2016:

Auction market share of post-war and contemporary art in New York increased slightly to 68.3 percent in 2016, up from 65.7 percent in 2015. However, the first six months of 2017 show that New York's market share decreased to 65.6 percent as London took a larger share of auction sales (28.1 percent).

Auctions supported by strong demand at the top end of the art market:

New York's post-war and contemporary sales in May 2017 signaled strong interest in lots worth in excess of US\$5 million, which accounted for 71.1 percent of the total sales value (up from 64.3 percent in May 2016). The top 10 lots raised US\$352.1 million and accounted for 46.5 percent of the combined sales value (down from 48.8 percent in May 2016).

Increase in financial guarantees in 2017 lifts the market from its lows:

Almost half (47.7 percent) of the lots offered across the three post-war and contemporary evening sales in New York in May 2017 carried financial guarantees, compared to just 29.6 percent in May 2016.

This surge in the level of auction guarantees in the first half of 2017 comes on the back of a significant scale-back of these financial incentives in 2016.

Outlook 2017–2018

Experts signal a more upbeat outlook for 2017–2018:

Based on the responses of experts surveyed by ArtTactic in June 2017, 62 percent believe that the US contemporary art market will go up (versus 47 percent in January 2016), 15 percent believe that the market will go down in the next 12 months (versus 9 percent in January 2016) and the remaining 23 percent believe that the market will remain flat (versus 45 percent 12 months ago). This indicates a positive shift among art market experts for the coming 12 months.

Political risk on the art market: There is significant uncertainty regarding Donald Trump's longer-term impact on the art market. On the one hand, reduced tax rates combined with a business-oriented cabinet will likely be interpreted as generally positive; on the other hand, a protectionist stance on trade and borders could have a negative effect on the global art market.

Economic outlook in the US: Following a slowdown in 2016 that reflected investment and export weakness, growth is expected to recover in 2017 based on findings from a recent report by the World Bank.²⁸ The report forecasts US GDP growth of 2.2 percent in 2018, up from an estimated 2.1 percent in 2017.

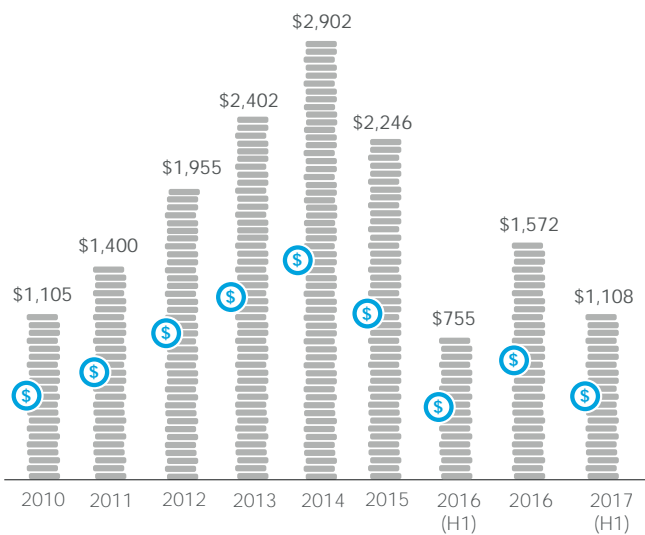
²⁸ Source: "World Bank - Global Economic Prospects - June 2017 - Global Outlook"

Wealth trends: Supported by a stronger currency and rising equity markets, the US consolidated its dominant position as the leading country for ultra-wealthy individuals in 2016. The United States saw a 6.7 percent increase in its UHNWI population in 2016 according to Wealth-X.²⁹ These individuals accounted for an estimated US\$8.719 trillion in wealth, up 6 percent in 2016. A recent wealth management survey by Knight Frank³⁰ reported that 44 percent of wealth managers said that their US clients had a number of luxury investments (art, wine, classic cars, etc.). Furthermore, 48 percent of the wealth managers surveyed said that luxury investments had become more popular in the last year.

Supported by a stronger currency and rising equity markets, the US consolidated its dominant position as the leading country for ultra-wealthy individuals in 2016.

Figure 7. US - Post War & Contemporary Art Auction Sales

Auction sales (in millions US\$) Sotheby's/Christie's



²⁹ Source: "Wealth-X World Ultra Wealth Report 2017,"

³⁰ Source: "Knight Frank Wealth Report 2017"



Market review 2016–2017

London sales drive the 2017 art market recovery: Auction sales for post-war and contemporary art in London experienced a substantial drop in value in 2016, returning to levels last seen in 2010–2011. Total auction sales (based on Sotheby's, Christie's, and Phillips) for 2016 were down 41 percent from the previous peak year in 2015. However, the sales total in March 2017 was 54.1 percent higher than in February 2016, and 66.7 percent above the July 2016 total. This positive trend continued into June 2017, in which both Sotheby's and Phillips increased their auction sales from last year. Christie's decided to focus on the October season instead and did not hold any post-war and contemporary art evening or day sales in June.

London's market share fell in 2016, but bounced back in the first half of 2017:

London's market share based on auction sales of post-war and contemporary art decreased from 28.8 percent in 2015 to 25.2 percent in 2016. However, data for the first six months of 2017 shows that London's market share has jumped back to 28.1 percent, clawing back most of last year's losses.

Sotheby's overtakes Christie's position as market leader in 2016 and Phillips gains further market share:

Sotheby's increased its market share in 2016 to 44.8 percent of the post-war and contemporary art market (up from 41.7 percent in 2015). This put it ahead of Christie's, which saw a drop in its market share to 39.4 percent (down from 45.4 percent in 2015). Phillips also saw its market share of London's post-war and contemporary art market rise to 15.8 percent in 2016 (up from 12.9 percent in 2015).

Outlook 2017–2018

Negative-to-neutral outlook for the London post-war and contemporary art market in the next 12 months: 34 percent of the experts surveyed in June 2017 believe that the UK post-war and contemporary art market will go up in the next 12 months (down from 47 percent in January 2016), 28 percent expect that the market will remain flat (down from 45 percent in January 2016) and 38 percent think that the market will come down in the next 12 months (up from 9 percent who expected the market to decline in January 2016).

Uncertainty around Brexit likely to have an impact on the UK art market in 2018:

Much of London's relative success following the Brexit vote last year can probably be linked to the decline in sterling, motivating buyers from outside Europe to take advantage of the benefits of a lower exchange rate. However, as the global art market is becoming increasingly competitive and cross-border trade and movement of talent is central to its growth, a potential exit from the customs union is likely to create uncertainty. Hence, questions remain with regards to how the global art market will look at the UK in the future.

Economic outlook in the UK: In June 2017, the World Bank³¹ upgraded its forecasts for UK GDP growth over the next three years against a stronger global backdrop that will boost the British economy, despite the uncertainty around Brexit and a weak start to 2017. Economists at the bank expect the UK economy to grow by 1.7 percent in 2017, and at the slightly lower rate of 1.5 percent in 2018.

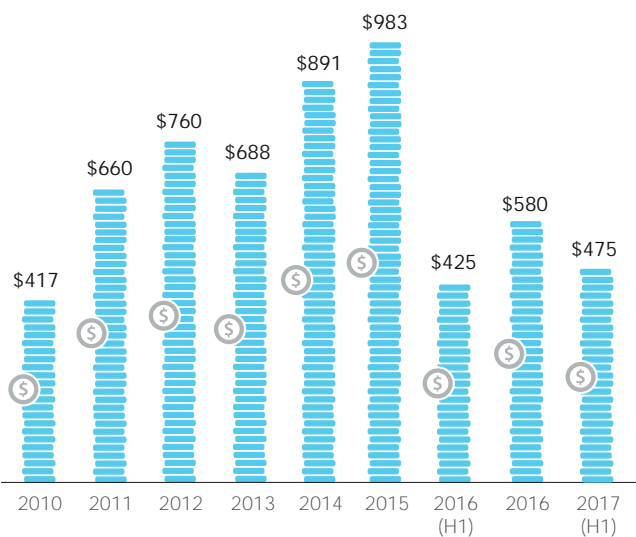
³¹ Source: World Bank - Global Economic Prospects - June 2017 - Global Outlook

Wealth trends: The United Kingdom saw a 14.2 percent drop in its UHNWI population in 2016 according to Wealth-X.³² These individuals accounted for an estimated US\$994 billion in wealth, which fell by 14.2 percent between 2015 and 2016. Despite the fall in the UHNWI population, a report by Knight Frank³³ forecasts that the UHNWI population will grow by 30 percent between 2016 and 2026.

Much of London's relative success following the Brexit vote last year can probably be linked to the decline in sterling, motivating buyers from outside Europe to take advantage of the benefits of a lower exchange rate.

Figure 8. UK - Post War & Contemporary Art Auction Sales

Auction sales (in millions US\$) Sotheby's/Christie's



Source: ArtTactic

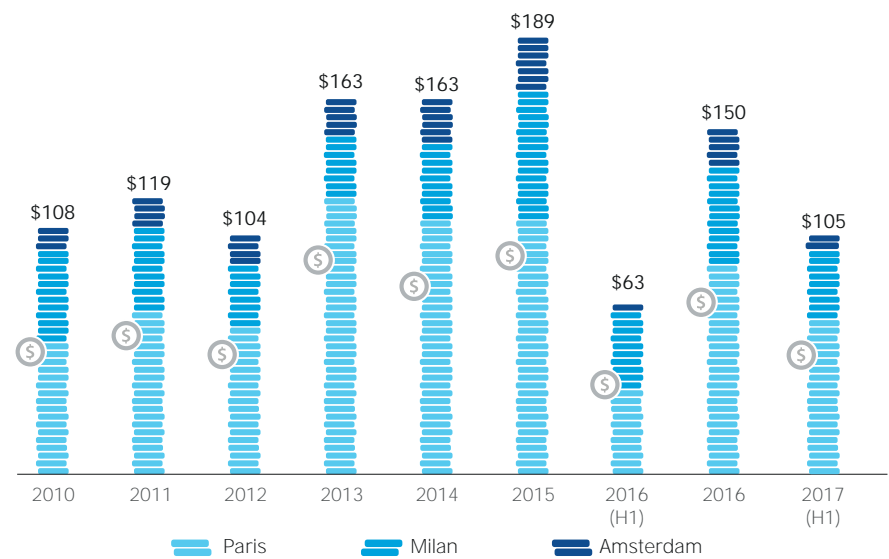
³² Wealth-X World Ultra Wealth Report 2017

³³ Source: Knight Frank Wealth Report 2017



EUROPE

Figure 9. Europe - Post War & Contemporary Art Auction Sales
 Auction sales (in millions US\$) Sotheby's/Christie's



Source: ArtTactic

Market review 2016–2017

Market resilience amid a global slowdown in contemporary auction sales in 2016: Christie's and Sotheby's post-war and contemporary art sales in Paris, Milan, and Amsterdam raised US\$149.7 million in 2016, representing a 20.9 percent decrease in sales from 2015. However, European sales fared better than those in New York and London, which suffered drops of 30 percent and 41 percent respectively. Contemporary art auction sales in Paris, Milan, and Amsterdam have seen a positive trend in the first six months of 2017, with a total of US\$105.3 million in sales, accounting for 70 percent of total sales in 2016. This shows that the market is on course to match the record year 2015.

Europe gains market share: Paris, Milan, and Amsterdam gained market share in the auction market for post-war and contemporary art (based on evening and day sales), up from 5.5 percent in 2015 to 6.5 percent in 2016. This increase in global market share was in evidence across all three locations. The market share in the first half of 2017 came in at 6.2 percent.

Paris increases its market share, further establishing its position as the main art market hub on the European continent: Paris increased its market share in 2016 to account for 62 percent of the continental European market (up from 58.6 percent in 2015), putting it ahead of both Milan, which saw a drop in its market share to 27.5 percent (down from 30.3 percent in 2015), and Amsterdam, which also saw its market share decrease to 10.5 percent (down from 11.1 percent in 2015).

Outlook 2017–2018**Experts are increasingly positive****regarding European market growth in**

2017: 36 percent of the experts surveyed believe that the market will increase in the next 12 months (up from only 14 percent in January 2016). A smaller number of the experts surveyed (44 percent, down from 61 percent in January 2016) believe that the contemporary art market will remain flat in the next six months. Meanwhile, 20 percent of the respondents believe that the market will fall in the next 12 months; only 11 percent believed so in January 2016. This indicates that there has been a shift toward a more positive stance on the European post-war and contemporary art market in 2017, despite the political and economic uncertainty.

Paris increases its market share, further establishing its position as the main art market hub on the European continent.

London could see increasing**competition from EU art markets in**

2017–2018: With uncertainty looming over the London art market in the wake of last year's Brexit vote, the city risks losing market share to the European continent. Although London will, for the time being, keep its position as Europe's main art market hub, Sotheby's and Christie's regional offices could pick up market share of the total EU-UK post-war and contemporary art market in the years to come.

Wealth trends: Europe saw a 0.2 percent decrease in its UHNWI population in 2016 according to Wealth-X.³⁵ These individuals accounted for an estimated US\$7.724 trillion in wealth, down 2.4 percent in 2016. A recent wealth management survey by Knight Frank³⁶ reported that 39 percent of wealth managers said that their European clients had a number of luxury investments (art, wine, classic cars, etc.). Furthermore, 49 percent of the wealth managers surveyed said that luxury investment had become more popular in the last year.

Economic outlook for Europe: In

June 2017, the World Bank³⁴ upgraded its forecasts for EU growth, reflecting strengthening domestic demand and exports. Economists at the bank expect Eurozone economies to grow by 1.7 percent in 2017, and at the slightly lower rate of 1.5 percent in 2018.

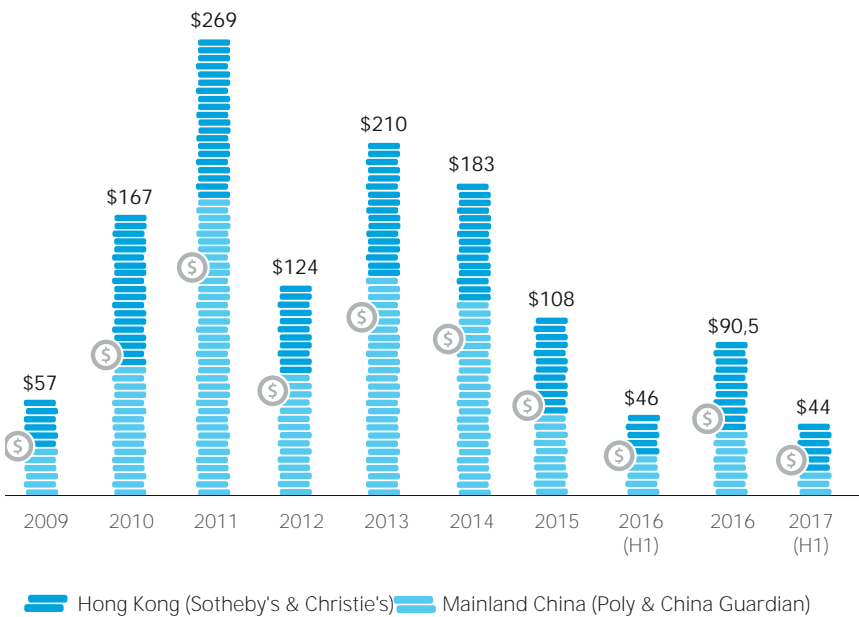
³⁴ Source: World Bank - Global Economic Prospects - June 2017 - Global Outlook

³⁵ Wealth-X World Ultra Wealth Report 2017

³⁶ Source: Knight Frank Wealth Report 2017

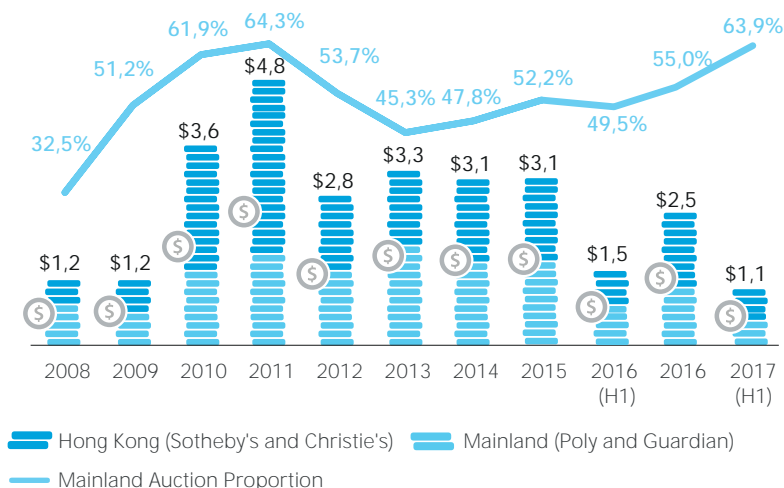


Figure 10. Chinese contemporary art sales
Auction sales (in millions US\$) in Hong Kong and Mainland China
(Sotheby's, Christie's, Poly, and Guardian)



Source: ArtTactic

Figure 11. Chinese Art Auction Sales (all Chinese collecting categories)
Auction sales (in billions US\$) in Hong Kong and Mainland China (Sotheby's, Christie's, Poly and Guardian) 2008-1st Half 2017)



Source: ArtTactic

Market review 2016

Contemporary Chinese art auction sales fall 15.9 percent in 2016: Following a substantial drop in sales in 2015, it looks like the Chinese contemporary art market reached its low-water mark in 2016. Overall sales from Christie's and Sotheby's fell by 13.1 percent in 2016, while the China Guardian and Poly Auction saw its contemporary art sales drop by 18.2 percent in 2016. However, the contemporary Chinese sales total across the four auction houses for the first half of 2017 came in at the same level as in the spring and autumn of 2016, suggesting that the contemporary Chinese art market is stabilizing.

Overall Chinese auction sales improve from the second half of 2016: The trend in the Chinese contemporary art market was similar to the overall trend in the Chinese market in 2016 (all categories) based on sales at Sotheby's and Christie's in Hong Kong and Poly and China Guardian's mainland sales, which saw an 18 percent decrease in sales during 2016. The overall sales result for the first six months of 2017 shows a 5.2 percent increase from the second half of 2016, but came in 29 percent lower than the first half of 2016.

Domestic Chinese auction houses hold a majority market share: Compared to Sotheby's and Christie's, Poly and China Guardian maintained the biggest market share in 2016, and accounted for 53.2 percent of contemporary art sales, compared to 54.6 percent in 2015. The market share of the domestic auction houses strengthened in the first six months of this year, with the two domestic auction houses accounting for 64.2 percent of the sales of Chinese contemporary art.

Outlook 2017–2018

China's art market trajectory for 2017–2018 suggests a neutral-to-positive outlook for Chinese contemporary art:

Based on the responses of experts surveyed by ArtTactic, 32 percent believe that the Chinese contemporary art market will go up in the next 12 months (versus 26 percent in January 2016), 22 percent believe that the market will come down (versus 45 percent in January 2016), and the remaining 46 percent believe that the market will remain flat (versus 29 percent 12 months ago).

Other Asian contemporary art markets take center stage:

In recent years, international auction houses have shifted their focus from Chinese contemporary artists toward artists from Japan, South Korea, and Southeast Asia. This shift is not only driven by auction houses; many of the biggest contemporary art dealers in the world have been championing Japanese and Korean art in the last year.

Economic outlook: GDP growth in China is expected to slow to 6.5 percent in 2017 and 6.3 percent in 2018.³⁷ China reported disappointing growth in industrial output, investment, and consumer spending in May 2017, increasing the uncertainty around the sustainability of GDP growth in the world's second-largest economy.

Wealth trends: China saw a 3.6 percent increase in its UHNWI population in 2016 according to Wealth-X.³⁸ These individuals accounted for an estimated US\$1,950 billion in wealth, representing a 2.2 percent rise in 2016. This makes China the third largest UHNWI nation after the United States and Japan. The projected growth forecast for China's UHNWI population is 140 percent between 2016 and 2026. A recent wealth management survey by Knight Frank³⁹ reported that 28 percent of wealth managers said that their Asian⁴⁰ clients had a number of luxury investments (art, wine, classic cars, etc.). Furthermore, 44 percent of the wealth managers surveyed said that luxury investment had become more popular in the last year among their Asian clients.

The contemporary Chinese sales total across the four auction houses for the first half of 2017 came in at the same level as in the spring and autumn of 2016, suggesting that the contemporary Chinese art market is stabilizing.

³⁷ Source: World Bank-Global Economic reports-June 2017-Global Outlook

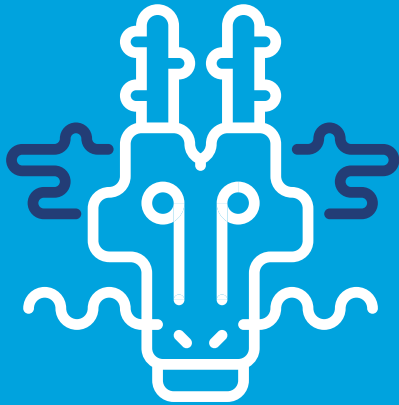
³⁸ Source: "Wealth-X World Ultra Wealth Report 2017"

³⁹ Source: "Knight Frank Wealth Report 2017"

⁴⁰ This includes other Asian countries besides China.

A VIEW ON ART & FINANCE IN CHINA

*By the Asia Institute of Art & Finance
based in Shanghai*



In the past, China's culture and art industry depended on government financial aid. This hindered the development of a market-oriented relationship between culture and capital, and posed significant challenges in the field of Art & Finance. In terms of the stock of artworks in China, the sheer volume of pieces was only rivaled by the volume of historical artifacts. However, the liquidity of these artistic assets required a considerable amount of capital. Thus, the relationship between these assets and financial demand was the key driver for the art market.

In light of this, the Asia Institute of Art and Finance business school was established to provide a strong talent platform for the development of China's Art & Finance market, to assist the government in creating infrastructure for the market, and to explore innovation in these fields with the goal to pass on China's national artistic and cultural heritage to future generations.

1. In the context of China, who are the main stakeholders, and what are the main products and services in the field of Art & Finance?

Many Chinese scholars have differing definitions with respect to Art & Finance. Although a vast number of scholars disagree with the opinion that it is a simple combination of "art" and "finance," this opinion is still the prevailing view among the majority of Chinese people. Some scholars regard Art & Finance as an industrial form and a financial service system aimed at formulating artistic values. Meanwhile, other scholars interpret it as certain financing and credit actions targeting major players in the art market, thereby accelerating the improvement of the art industry through exposure to modern ideas and operating methods. It is clear that while minor distinctions exist among the many interpretations of Art & Finance, the term itself still lacks a definition that is universally recognized by the public.

Art & Finance will serve the art industry and increase its size and strength. The purpose of art should not be regarded only as investment or financing. Art and finance covers a wide range of remits, including wealth management, price discovery, trans-temporal asset allocation, hedge funding and risk diversification, economic compensation, incentive mechanism, etc. As it is still considered a young industry in China, much more time should be taken to observe, reflect, and refine the definition.

2. What is the level of development of Art & Finance in China? Who are the main players and what are they doing?

Compared with the more mature markets in Europe and America, Chinese people have only recently developed clear aspirations in terms of cultural consumption and wealth management, as a result of China's rapid economic development and wealth accumulation. Therefore, China is currently seeing active innovations taking place in the Art & Finance market.

In recent years, capital in the Chinese auction market has risen from the billions of RMB to the hundreds of billions. For a vast number of people, it was the jaw-dropping prices at auctions that first brought the art market to their attention. On the one hand, the rapidly increasing scale and pricing of the art market have caught the attention of society at large; on the other hand, the positive economic benefits of owning particular pieces of fine art at an early stage have been clear-cut and prompted numerous business capital and art funds to dip a toe into the market. With revenue as their primary purchase motivation, some people view art purely as an investment product, which has led to a large amount of funds flooding into the art market. In the meantime, the composition of buyers in the art market has undergone profound changes: market entries made

by entrepreneurs have expanded the scale and boosted the price of the art market, which has made the art market shift from “collection alone” to “collection plus investment.” The entry of short-term funds seeking financial returns has enriched the bulk of the art market, heightening the economic value of art to a certain extent, while repositioning the primary purpose of art in terms of culture, history, emotion, and social contact. Recently, entrepreneurs such as Wang Jianlin and Liu Yiqian have become frequent callers in art market. Furthermore, enterprises such as China Taikang Life Insurance, China Minsheng Bank and more have dominated the Chinese high-end art market and made this a go-to resource for market actors.

In addition to the high-end auction market, other market players have also demonstrated great enthusiasm for art investment. It was reported by the media that, according to incomplete statistics, the sum of business transactions of post and coin cards on the platform of the Culture Assets and Equity Exchange Agencies reached RMB 3.9 trillion in 2016. Globally speaking, China's Art & Finance market ranked number one in terms of scale. However, in the last two years, the government has introduced regulation to curb speculation on the market.

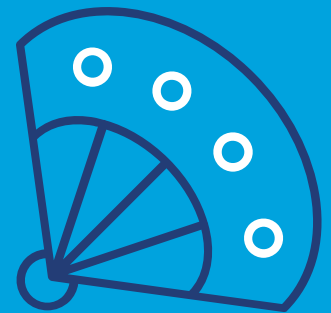
3. What are the drivers supporting the development of Art & Finance services in China?

On the one hand, the rapid economic development of China and wealth accumulation have meant that the public are eager to preserve the spirit of Chinese culture and seek wealth management. These impulses are the major driving forces behind the development of Art & Finance services in China. On the other hand, when the development of art in China reaches a certain stage, it is believed that the market will, in return, foster innovation in the service of Art & Finance.

4. What is the outlook for the Chinese government's position in relation to Art & Finance?

The Chinese government attaches great importance to the development of cultural projects, which are crucial to the soft power of China. In recent years, the government has emphasized the healthy and regulated development of culture and the art market through the introduction of new policies. For instance, the Ministry of Culture of the People's Republic of China issued Business Management Regulations of Art in March 2016. The State Administration of Cultural Heritage issued Some Suggestions to Utilize Cultural Relics Reasonably in December 2016, and the General Administration of Customs issued Adjustment Programs of Customs Duties in 2017 to reduce the import tariff attached to artwork.

With wealth accumulation and improved artistic appreciation, Art & Finance in China has a promising future ahead.

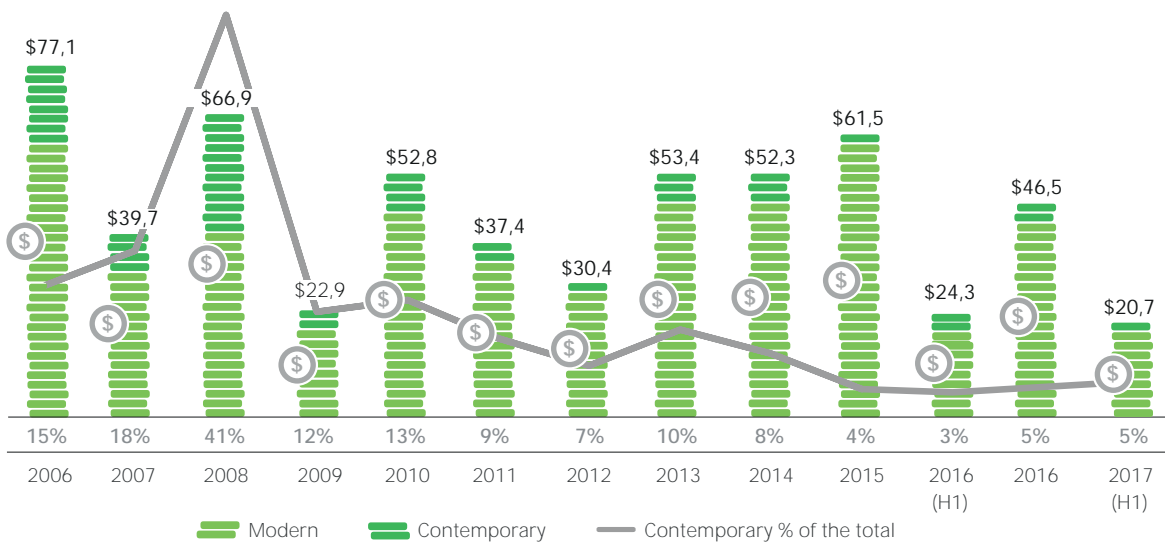




SOUTH ASIA

Figure 12. Indian modern and contemporary art market (2006–H1 2017)

Auction sales (in millions US\$) based on Christie's, Sotheby's, and Saffronart



Source: ArtTactic

Market review 2016

The South Asian art market was affected by the global downturn in 2016 and is struggling to gain momentum:

South Asian auction sales of modern and contemporary art decreased by 24.4 percent in 2016 compared to the previous year. The first half of 2017 raised US\$20.8 million in sales of modern and contemporary sales across Sotheby's, Christie's, and Saffronart. This was 14 percent lower than the US\$24.2 million raised in the first half of 2016.

Modern art dominates, but other South Asian collecting segments gain traction:

The top three auction houses (Christie's, Sotheby's, and Saffronart) saw a 24 percent decline in modern art auction sales in 2016. South Asian modern art dominated the sales in that period, accounting for 72 percent of total auction sales across all categories.

Classical Indian art gains traction in 2016:

Traditional, classical South Asian art categories accounted for 24 percent in 2016, which represented a 59 percent increase in sales for the year. This signals that art collectors and art buyers are widening their horizons when it comes to different collecting segments.

The modern art market broadens its focus in 2016:

Major museum exhibitions of Bhupen Khakhar at the Tate and Nasreen Mohamedi at the Met Breuer have fostered interest in schools other than the Progressive Group, which has dominated the auction market in the last 10 years. The support from major international institutions shined a spotlight on artists from the South Asian market in 2016.

Outlook 2017–2018

Sentiment in the South Asian modern and contemporary art market turns from positive to neutral in the first half of 2017:

Based on the responses of the experts surveyed by ArtTactic in June 2017, only 7 percent believe the market will go up (versus 40 percent in January 2016), 28 percent believe that the market will go down in the next 12 months (up from 5 percent in January 2016) and the remaining 65 percent believe that the market will remain flat (versus 42 percent 12 months ago).

South Asian biennial fever:

Since 2009, the South Asian art market has seen eight new biennials and festivals. These include the Kochi-Muziris Biennale, Dhaka Art Summit, Colombo Art Biennial, Pune Biennial, and the Serendipity Arts Festival. A further two biennials planned for Lahore and Karachi will open in 2017, which could inject even more energy into the regional art market.

Since 2009, the South Asian art market has seen eight new biennials and festivals.

Contemporary South Asian art will receive more museum exposure in 2017:

In March 2017, the Stedelijk Museum in Amsterdam will present the exhibition entitled "Nalini Malani: Transgressions." From October 2017 to January 2018, the Centre Pompidou in Paris will put on a retrospective of Nalini Malani, making her the first Indian artist to have a retrospective at the prestigious venue. The major institutional support through 2016, 2017, and 2018 is likely to increase the international focus on South Asian modern and contemporary art.

Economic outlook: The World Bank⁴¹ predicted that growth in the region would increase to 6.8 percent in 2017 and accelerate to 7.1 percent in 2018, reflecting a solid expansion of domestic demand and exports. Excluding India, regional growth is expected to remain at 5.7 percent, rising to 5.8 percent, with growth accelerating in Bhutan, Pakistan, and Sri Lanka but easing in Bangladesh and Nepal. India is expected to accelerate to 7.2 percent in the 2017 fiscal year (1 April 2017 to 31 March 2018) and 7.5 percent in the next fiscal year.

Wealth trends: India saw an 8.9 percent increase in its UHNWI population in 2016 according to Wealth-X.⁴² These individuals accounted for an estimated US\$604 billion in wealth, representing a 4.7 percent rise in 2016. This makes India the 11th largest UHNWI nation, but among the fastest growing. The projected growth in India's UHNWI population is forecast to grow by 150 percent between 2016 and 2026.

⁴¹ Source: World Bank-Global Economic reports-June 2017-Global Outlook

⁴² Source: "Wealth-X World Ultra Wealth Report 2017"

END OF EMPIRE © YINKA SHONIBARE MBE (2016), PHOTOGRAPHER: STEPHEN WHITE





SOUTHEAST ASIA

Market review 2016

Slowdown in the Southeast Asian art market: Since the global art market downturn in 2009, the Southeast Asian modern and contemporary art market has been on a steady climb, with an annual growth of 23.4 percent in sales between 2010 and 2015, based on auctions at Sotheby's and Christie's. However, in 2016 the Southeast Asian market finally succumbed to the forces driving the global art market slowdown. Modern and contemporary Southeast Asian art, which is primarily sold in Hong Kong, saw a 29.7 percent year-on-year decrease in sales last year. The auction sales in the first half of 2017 suggest that the downward pressure on this market could continue into the second half of the year.

Contemporary art from Southeast Asia increases its market share:

Modern Southeast Asian art accounted for 80.3 percent of the sales total in 2016 (down from 88.9 percent in 2015). This results in 19.7 percent market share for the contemporary art sector (up from 11.1 percent in 2015). The sector has experienced steady growth in market share in the last four years, with 2016 delivering the second highest total for contemporary art.

Indonesia is the strongest sector in 2016:

Indonesian art continues to dominate the region's art market with 48.8 percent market share based on total auction sales at Sotheby's and Christie's (down from 54 percent in 2015), followed by the Philippines, with 22.6 percent market share. Vietnamese art comes in third position with 16.2 percent market share.

Outlook 2017–2018

Neutral-to-negative outlook for the next 12 months:

17 percent of the experts surveyed believe the market will go up in the next 12 months (down from 40 percent in January 2016). A larger number of the experts (68 percent, up from 41 percent in January 2016), believe that the Southeast Asian art market will remain flat in the next six months. Moreover, 28 percent of the respondents believe that the market will fall in the next 12 months (up from 9 percent in January 2016). This indicates a shift toward a more negative stance on the modern and contemporary art market in the region for the coming 12 months.

Contemporary art from the Southeast Asian market is gaining attention:

In 2017, the National Art Center in Tokyo, the Mori Art Museum, and the Japan Foundation Asia Center will put on a major survey exhibition entitled "SUNSHOWER: Contemporary Art from Southeast Asia 1980s to Now," which will be the largest-ever exhibition of Southeast Asian contemporary art to be held in Japan.

Economic outlook:

The World Bank⁴³ reported in June 2017 that it expected Southeast Asia to grow at an estimated rate of 5.1 percent in 2017 and 5.2 percent in 2018. Indonesia is anticipated to pick up to 5.2 percent in 2017 and 5.3 percent in 2018. Growth in the Philippines is forecast to hold steady at 6.9 percent this year and the next, driven by an uptick in public and private investment. Thailand should similarly maintain 3.2 percent growth in 2017, accelerating to 3.3 percent next year, supported by greater public investment and recovering private consumption.

⁴³ Source: World Bank-Global Economic reports-June 2017-Global Outlook

Wealth trends: Despite a 0.5 percent decrease in the UHNWI population in Singapore in 2016, other Southeast Asian markets experienced significant growth. Indonesia saw a 9.6 percent increase in its UHNWI population in 2016, followed by 4.2 increase in Thailand. These three nations accounted for US\$677 billion in wealth held by UHNWIs according to Wealth-X.²⁹ Vietnam has also seen strong growth in the last 10 years, with a 320 percent increase in the country's UHNWI population, and with predictions that this population will continue to grow by 170 percent in the next decade according to Knight Frank.³⁰

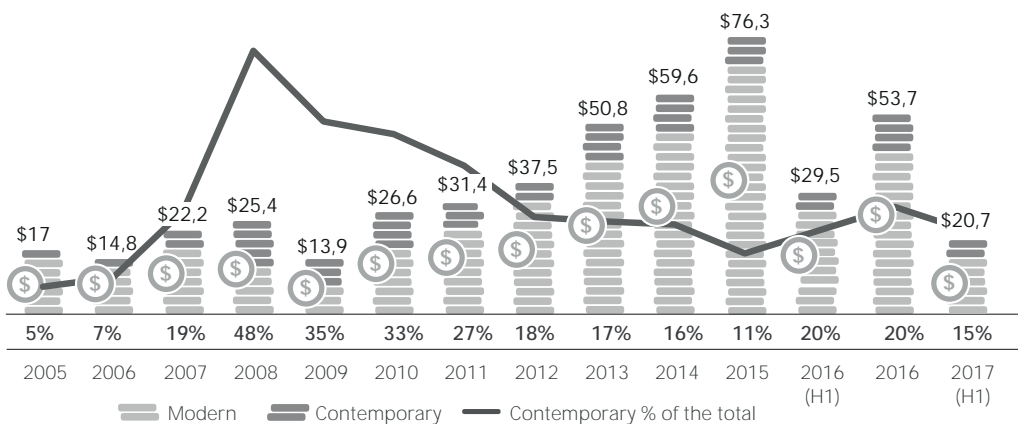
Since the global art market downturn in 2009, the Southeast Asian modern and contemporary art market has been on a steady climb.

44 Source: "Wealth-X World Ultra Wealth Report 2017"

45 Source: "Knight Frank Wealth Report 2017"

Figure 13. Southeast Asian Modern & Contemporary Art Market (2005-2017 1st Half)

Auction sales (in millions US\$) based on Christie's, Sotheby's and Phillips



Source: ArtTactic



LATIN AMERICA

Market review 2016

Latin American auction sales fall in 2016, but the decline seems to level out in the first half of 2017:

Latin American auction sales saw a year-on-year decrease of 27.2 percent in 2016 following several years of steady growth. The sector reported US\$62.2 million in modern and contemporary Latin American auction sales last year. These results are the lowest recorded for the sector since 2006. Data for the first half of 2017 shows that auction sales decreased by 13.4 percent from the second half of 2016, but were up 5.4 percent from the first half of 2016.

Contemporary Latin American art shows growth despite market downturn:

While the overall auction market for Latin American art fell in 2016, the contemporary art sector reported its strongest year to date. Contemporary art accounted for 12 percent market share of the Latin American market in 2016 (up from 8 percent in 2015) as sales hit US\$7.8 million (up from US\$6.8 million). However, auction sales from the first half of 2017 show the share of contemporary art falling back to only 3 percent of the overall total, indicating a more conservative attitude among buyers.

Mexican and Colombian artists gain market share in the first half of 2017:

During the Latin American auction sales in New York in May, artists from both Mexico and Colombia increased their share of overall sales. Mexican artists accounted for 31.8 percent (up from 23.3 percent in the second half of 2016) of the total sales value, followed by Colombian artists accounting for 24.4 percent of total sales (up from 15.3 percent in November 2016). Brazilian artists only accounted for 3.9 percent of the sales value in May 2017.

Outlook 2017–2018

Market experts take a polarized view on the Latin American art market:

Based on the responses of the experts surveyed by ArtTactic in June 2017, 34 percent believe the market will go up (versus 25 percent in January 2016), 37 percent believe that the Latin American modern and contemporary art market will go down in the next 12 months (versus 14 percent in January 2016) and the remaining 29 percent believe that the market will remain flat (versus 61 percent in January 2016).

Economic outlook:⁴⁶

According to a World Bank report, growth in Latin America and the Caribbean is projected to increase to 0.8 percent in 2017 as Brazil and Argentina emerge from recession and rising commodity prices support agricultural and energy exporters. Brazil is forecast to expand by 0.3 percent in 2017, with growth expected to pick up to a rate of 1.8 percent in 2018. Growth in Argentina is forecast to expand at a rate of 2.7 percent in 2017. Growth in Mexico is anticipated to average out at 1.8 percent in 2017 (principally as a result of a fall in investment stemming from uncertainty about US economic policy), before accelerating to 2.2 percent in 2018.

Wealth trends: Latin America saw a 3.4 percent decrease in its UHNWI population in 2016 according to Wealth-X.⁴⁷ These individuals accounted for an estimated US\$945 billion in wealth, down 10.2 percent from the previous year. Latin America's UHNWI population is forecast to grow by 37 percent between 2016 and 2026, with Mexico's UHNWI population predicted to grow by 40 percent, Brazil's by 20 percent and Colombia's by 30 percent over the next 10 years. A recent wealth management

⁴⁶ Source: World Bank-Global Economic reports-June 2017-Global Outlook

⁴⁷ Source: "Wealth-X World Ultra Wealth Report 2017"

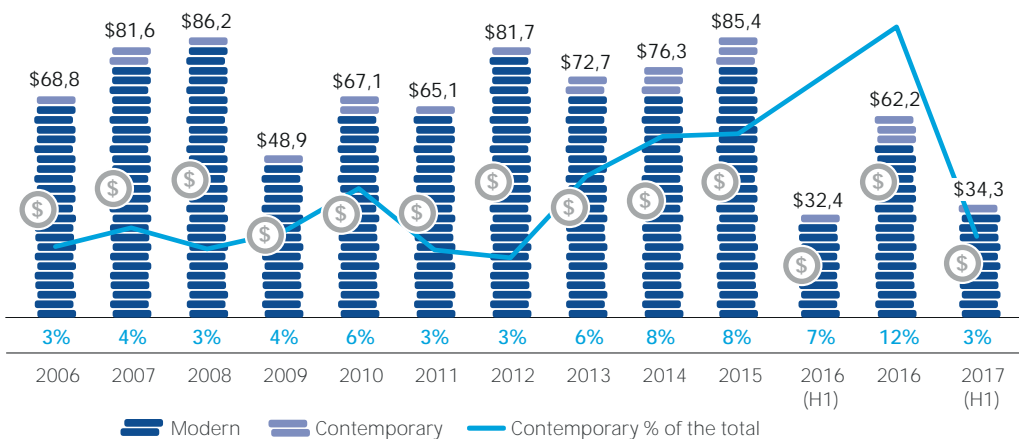
survey by Knight Frank⁴⁸ reported that 46 percent of wealth managers said that their Latin American clients had a number of luxury investments (art, wine, classic cars, etc.). Furthermore, 64 percent of the wealth managers said that luxury investment had become more popular in the last year among their Latin American clients, which was the highest percentage compared to other regions reported in the survey.

During the Latin American auction sales in New York in May, artists from both Mexico and Colombia increased their share of overall sales.

48 Source: "Knight Frank Wealth Report 2017"

Figure 14. Latin American Modern & Contemporary Art Market (2006-1st Half 2017)

Auction sales (in millions US\$) based on Christie's, Sotheby's and Phillips



Source: ArtTactic



MIDDLE EAST

Market review 2016

Middle-Eastern auctions defy the global art market downturn and expand by 11.9 percent in 2016: Total auction sales of modern and contemporary Middle-Eastern art rose by 11.9 percent in 2016, as more auction houses started offering sales of art from the region. The first half of 2017 raised \$20.5 million, down 11 percent from first half of 2016.

Outlook 2017–2018

Neutral-to-negative outlook for 2017–2018: a recent survey conducted by ArtTactic among international art collectors shows that 25 percent believe the Middle-Eastern modern and contemporary art market will see further growth in 2017–2018 (down from 45 percent in January 2016), with 34 percent believing the market will remain flat. However, there are concerns about the next 12 months, with 41 percent (up from 24 percent in January 2016) predicting that the Middle-Eastern art market will decline. Wars, terrorism, and geopolitical tension in the region were cited as the main reasons for this.

Total auction sales of modern and contemporary Middle-Eastern art rose by 11.9 percent in 2016, as more auction houses started offering sales of art from the region.

An Iranian auction house sees a 392 percent increase in sales from 2012:

Since Tehran Auction held its inaugural sale in 2012, sales have increased from US\$1.7 million to US\$8.4 million. The auction house's sales of modern and contemporary art accounted for nearly one quarter (24.9 percent market share) of the Middle-Eastern art market in 2016.

Christie's continues to be the leading player in the Middle-Eastern art market:

Christie's share of the Middle-Eastern market came in at 44.6 percent in 2016, putting it far ahead of its competitors: Tehran Auctions (24.9 percent market share), Sotheby's (15.7 percent market share), and Bonhams (14.8 percent market share).

Sotheby's opens a new office in Dubai:

Sotheby's, which up until now has held its Middle-Eastern auctions in Doha, opened a new office in nearby Dubai in March this year. In the UAE, the auction house has reportedly experienced a significant increase in sales and is now looking to cater for the local clientele. The move is likely to heighten the firm's competition with Christie's, which already holds its sales in Dubai.

Economic outlook: According to the World Bank⁴⁹, growth in the region is projected to fall from 3.2 percent to 2.1 percent in 2017 as the adverse impact of production cuts by the Organization of Petroleum Exporting Countries (OPEC) on oil exporters modestly outweighs improving conditions in oil importers. Growth is expected to accelerate to 2.9 percent in 2018, assuming an easing of geopolitical tensions and an increase in oil prices.

⁴⁹ Source: World Bank-Global Economic reports-June 2017-Global Outlook

Wealth trends: The Middle East saw a 0.1 percent decrease in its UHNWI population in 2016 according to Wealth-X.⁵⁰ These individuals accounted for an estimated US\$1.440 trillion in wealth, representing a 0.1 percent increase from the previous year. The Middle East's UHNWI population is forecast to grow by 39 percent between 2016 and 2026, with the UAE and Qatar's UHNWI population predicted to grow by 60 percent and

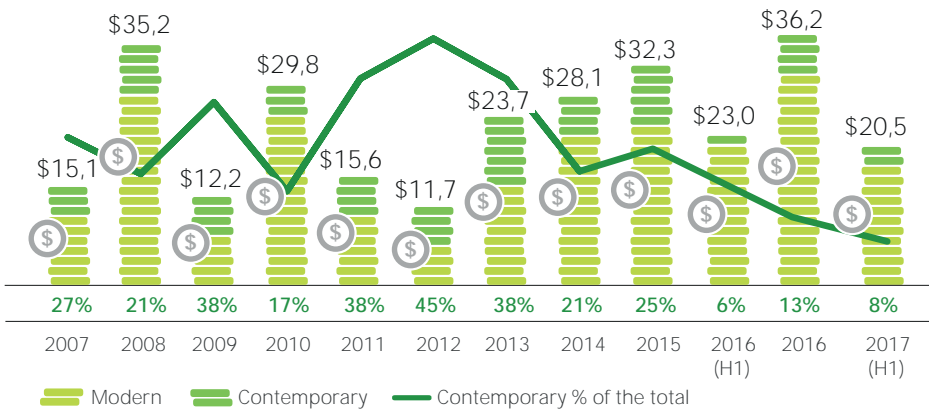
Saudi Arabia's by 20 percent over the next 10 years. A recent wealth management survey by Knight Frank⁵¹ reported that 32 percent of wealth managers said that their Middle-Eastern clients had a number of luxury investments (art, wine, classic cars, etc.). Furthermore, 38 percent of the wealth managers said that luxury investment had become more popular in the last year among their Middle-Eastern clients.

50 Source: "Wealth-X World Ultra Wealth Report 2017"

51 Source: "Knight Frank Wealth Report 2017"

Figure 15. Middle-East Modern & Contemporary art market (2007-1st Half of 2017)

Auction sales (in millions US\$) based on Christie's, Sotheby's and Bonhams



Source: ArtTactic

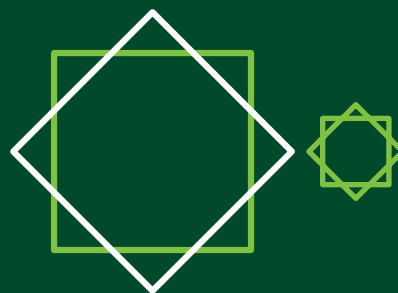
ART & FINANCE IN THE MIDDLE EAST AND GCC



*By Rosine Makhoul
Family Business Advisor
Deloitte Private (ME)*



Dr. Hatim Tahir leads the think-tank "Deloitte ME Islamic Finance Knowledge Center," where he advises clients across the globe on Islamic financial strategy and market development. He also works extensively with industry standard-setting bodies and other stakeholders to promote best practices in the industry and share experiences and insights in different jurisdictions. Hatim holds a PhD in Business Management, from the University of London, and was a Research Associate at the London School of Economics from 1995 to 2000. He is currently a visiting research fellow at the ICMA Centre, Henley Business School, University of Reading and Fellow of the British Chartered Institute for Securities & Investment (CISI).



The United Arab Emirates is among several of the GCC countries renowned for investing heavily in their cultural economy. With the development of the Sharjah Art Foundation, Mathaf Arab Museum of Modern Art, Art Abu Dhabi, Art Dubai, and the Sharjah Biennale, there has been significant growth in the regional art market.

This year marked the 11th edition of Art Dubai—the region's leading art fair—which featured works from 277 different artists from over 40 countries. These artists were represented by 94 international galleries that participated in a four-day exhibition and welcomed over 28,000 visitors, successfully bridging the gap between the Dubai art scene and the global contemporary art market.

A further testament to the development of the region was the opening of Sotheby's international auction house in Dubai. Its office and gallery space is located in Dubai's luxurious and modern international financial district alongside Christie's and several other art galleries. Despite all the growth we are witnessing, the Middle-Eastern art market is still considered to be an emerging market. In the 2016 Art & Finance Report, experts gave a neutral-to-positive outlook for the Middle-Eastern art market, with greater downside risk due to geo-political tensions. Identifying and profiling Middle-Eastern art collectors can be challenging owing to the opaque nature of the art market in general, although there is evidence of over 10 families across the region that actively buy or maintain their art collections. One private banker suggests that approximately 10 percent liquidity is allocated to art when dealing with a seasoned art collector. These individuals are often seeking unique ways to diversify their financial portfolios. According to Salma Shaheem, Head of Middle-Eastern Markets and Joint Venture Partner at the Fine Art Group in Dubai, a new generation of art collectors has begun to emerge. Typically in their

late 30s or early 40s, these individuals are seeking to acquire their first work of art with the knowledge that they are investing their money. Shaheem's primary research suggests that this market is increasingly learning about the value of art, and how acquiring the right piece at the right time evidently generates long-term value. The appetite is largely for regional artworks and the typical investment (per piece) starts in the range of US\$15,000–US\$30,000.

In 2008, the market saw a trend for the launching of various investment vehicles focusing on Middle-Eastern art. One was sponsored by the Bahraini bank Addax, which was a private fund, and another by Emirates National Bank of Dubai (ENBD), one of the largest banks in GCC. ENBD entered into a strategic partnership with an investment and advisory house (the Fine Art Group) to offer the bank's U/ HNWI clients the opportunity to acquire art and create their own art collection. With many great opportunities in this emerging market, one may pose the question of how this type of investment can be integrated into the ever-popular sharia-compliant system. Dr. Hatim Tahir, leader of the "Deloitte ME Islamic Finance Knowledge Center," shares his knowledge on this idea.

In 2008, the market saw a trend for the launching of various investment vehicles focusing on Middle-Eastern art.



Art usually exists as a tangible asset with an economic value and, when subject to sharia screening, it can certainly make a good underlying asset for a financing or investment structure.



What is the place of art in the Islamic tradition?

Islam has a great appreciation for art, especially when it comes to the preservation of our cultural heritage. The Islamic civilization has offered a valuable cultural legacy to the world, from the eras of the Umayyad caliphate, the Abbasid caliphate, and Al-Andalus civilization to the Ottoman Empire. This heritage includes, of course, mosque design and architecture, paintings, kufi and other Arabic calligraphy, souvenirs, and all sorts of art that trace the history of Islamic civilization. This heritage belongs to the Ummah and is a source of great pride. A large number of museums around the world exhibit artwork with Islamic heritage (in the Arabian Peninsula, Jordan, Turkey, Persia, Asia, Africa, Spain, etc.).



What is the definition of Islamic art?

Islamic art can be defined as the collections or repositories relating to Muslims' cultural and societal heritage. It might be embodied by any form or piece of work from architecture, design, paintings, and dresses to the weapons used during historic wars. Also, any creation or achievement that contributes to the social good or the history of Islam could be categorized under Islamic art. In saying this I am referring to science, medicine, and mathematics, and even handwritten historical agreements or treaties. Islamic art is the combination of all the above and the depository of Muslim culture and history.



What is the definition of a sharia-compliant investment?

A sharia-compliant investment is an investment of goods and services in accordance with Islamic principles and a code of commercial practice. For example, a sharia-compliant fund will only invest in products, assets, or services that do not conflict with Islamic principles in relation to investment and finance, and therefore cannot invest in what are largely viewed as "non-permissible" activities in the following proscribed sectors:

- Interest-bearing financial or investment products or services (Riba in Arabic)
- Weapons
- Alcohol
- Pork
- Gambling
- Investment, financing, services, or goods that are considered to involve a high level of uncertainty and speculation





Is it compliant with sharia to use art as an underlying asset for a financing instrument or fund?

Personally, I do not see any issues with accepting art as an asset. Art usually exists as a tangible asset with an economic value and, when subject to sharia screening, it can certainly make a good underlying asset for a financing or investment structure. It is equally possible that other Islamic financing structures can be used to fund art projects, such as the renovation of old mosques or Islamic cultural properties. It is a very interesting area and I believe there are several possible investment structures that banks and investment houses can develop to address the needs and opportunities associated with art financing and investment in the region. Investing in art is a recent phenomenon in the region, and art is a new asset class for MENA and GCC.



In your opinion, is there any appetite for art investment in the MENA and GCC regions?

I am confident that Islamic banks and other investment houses will be keen to tap into this niche market. This is particularly true for private banking and wealth management, where the interest from HNWI and family offices in art investment could be significant.



What could make art investment more popular and affordable as an alternative asset class for the MENA and GCC regions?

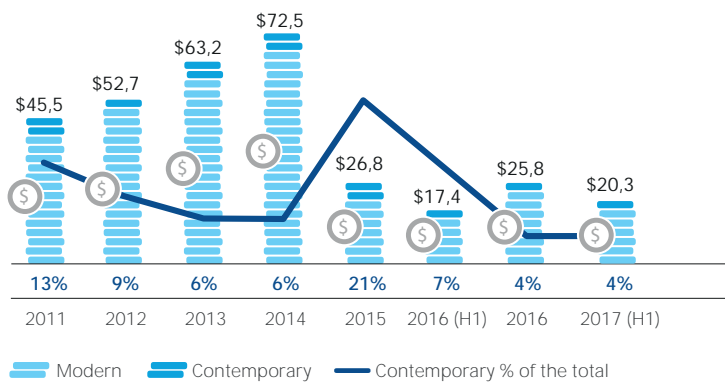
Key to the growth of this investment opportunity is creating the right products and services as well as making clients and potential investors aware of the economic benefits. Financial services firms can also play a key role in educating end-users and investors about the potential alternative sharia-compliant investment on offer. Generally, Islamic banks prefer financing "economic-related activities" (e.g., equipment for a factory, or a car for a particular use). For art investment, we need to see more effort on the part of bankers and investors to design products and services that will add value to societies and individuals. But, in my opinion, art is an asset with a defined economic value. Therefore, there are several possible ways of financing or linking investment products with Islamic art; for example, products such as the ijara or murabaha may be particularly suited to this purpose.





RUSSIA

Figure 16. Russian modern and contemporary art market 2011–2015
Auction sales (US\$) based on Christie's, Sotheby's, and MacDougall



Source: ArtTactic

Market review 2016

Russian modern and contemporary art sales decrease by 4 percent in 2016: In 2016, sales of modern and contemporary Russian art appear to have stabilized after the free-fall in 2015 when the market dropped 63 percent. Russian art sold at auctions in London at Christie's, Sotheby's, and MacDougall's totaled £25.8 million (including premiums) in 2016, a year-on-year decrease of 4 percent from 2015. However, auction sales in the first half of 2017 suggests that the negativity in the market might be lifting, as sales for the first six months of 2017 already stand at £20.3 million, accounting for 78 percent of the entire 2016 sales volume.

Sotheby's dominates the Russian art market:

Sotheby's retained its lead in the Russian modern and contemporary art market with 48.1 percent market share (down from 55 percent in 2015), versus Christie's reported market share of 17.5 percent (down from 20 percent in 2015). MacDougall's, the London-based auction house, saw a substantial increase in market share in 2016. Last year, MacDougall's reported a 34.4 percent market share; this should be compared to 2015, when its market share came in at 25 percent.

Outlook 2017–2018

Experts maintain a negative outlook for the Russian modern and contemporary art market in 2017–2018 despite a positive start to auction sales in 2017:

19 percent of the experts surveyed by ArtTactic in January 2017 (up from 16 percent in January 2016) believed that the Russian art market would see a positive growth trend this year, with 35 percent predicting that the market would remain flat. Furthermore, 46 percent of the respondents believe that the Russian art market could deteriorate in the coming 12 months (compared to 43 percent in January 2016).

Russia's economic outlook improves:

Russia is expected to grow at a rate of 1.3 percent in 2017 after a two-year recession and at a rate of 1.4 percent in 2018, with growth fueled by gains in consumption, according to a recent report by the World Bank.⁵²

Wealth trends: Russia saw a 6.2 percent decrease in its UHNWI population in 2016 according to Wealth-X.⁵³ These individuals accounted for an estimated US\$666 billion in wealth, down 7.2 percent from the previous year. Russia's UHNWI population is forecast to grow by 60 percent between 2016 and 2026.

A recent wealth management survey by Knight Frank⁵⁴ reported that 33 percent of wealth managers said that their Russian clients had a number of luxury investments (art, wine, classic cars, etc.). Furthermore, 40 percent of the wealth managers said that luxury investment had become more popular in the last year among their Russian clients.

⁵² Source: "World Bank - Global Economic Prospects - June 2017 - Global Outlook"

⁵³ Source: "Wealth-X World Ultra Wealth Report 2017"

⁵⁴ Source: "Knight Frank Wealth Report 2017"

Experts maintain a negative outlook for the Russian modern and contemporary art market in 2017–2018 despite a positive start to auction sales in 2017.

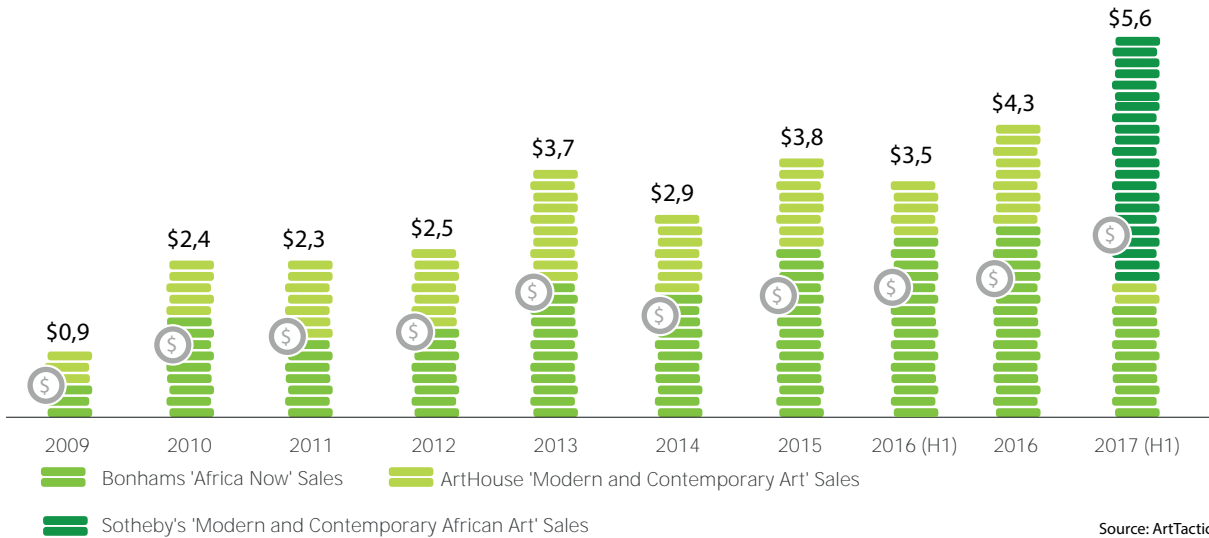
CAKE KID © YINKA SHONIBARE MBE (2014), PHOTOGRAPHER: STEPHEN WHITE





AFRICA

Figure 17. African Modern & Contemporary Art (2009 -2017 1st Half)
 Auction sales (US\$ millions) based on Sotheby's, Bonhams and ArtHouse



Market review 2016

Bonhams and Arthouse see increase in sales of contemporary African art: Bonhams organized two sales dedicated to African modern and contemporary art in 2016. Bonhams' Africa Now auctions raised a total of US\$2.8 million (£2.2 million) in 2016, up 11.6 percent from 2015. Also, the Nigerian auction house Arthouse Contemporary registered US\$1.5 million in overall auction sales in 2016 (up 14.1 percent from 2015).

London consolidates its position as the venue of choice for modern and contemporary African art: The total market in 2016 came in at US\$4.3 million compared to US\$3.8 million in 2015 (up 12.5 percent from 2015). Bonhams controlled 65 percent market share in 2016 with its two sales in London.

Balance in the market shifting as Sotheby's enters the market in 2017: Sotheby's launched its first African modern and contemporary art sale in May 2017 in London. The auction house raised US\$3.61 million in its inaugural sale, taking 64 percent market share in the first half of 2017. Based on this result, we could see both Christie's and Phillips following suit with their own dedicated sales for this region.

Outlook 2017-2018
Positive outlook for the next 12 months: 46 percent of the experts surveyed in January 2017 believe the African modern and contemporary art market will go up in the next 12 months (up from 39 percent in January 2016), 42 percent expect that the market will remain flat (down from 50 percent 12 months ago) and only 12 percent think that the market will come down in the next 12 months (versus 11 percent who expected the market to decline in January 2016).

Global initiatives setting the trend: With global initiatives such as the 1:54 Contemporary African Art Fair in London and New York, The African Art in Venice Forum organized for the first time this year, and Sotheby's new sale dedicated to African modern and contemporary art, the African art sector is enjoying an increasing global exposure. Also, the Armory Show in New York last year highlighted the African continent with its focus section entitled "African Perspectives."

Economic outlook: Growth in Sub-Saharan Africa is forecast to reach 2.6 percent in 2017 and 3.2 percent in 2018 according to the World Bank.⁵⁵ These forecasts are based on moderate rises in commodity prices and reforms to tackle macroeconomic imbalances. Nigeria is forecast to move from recession to a 1.2 percent growth rate in 2017, gaining speed to 2.4 percent in 2018, whereas growth in South Africa is projected to rise to 0.6 percent in 2017 and accelerate to 1.1 percent in 2018.

London consolidates its position as the venue of choice for modern and contemporary African art.

BALLERINA WITH VIOLIN (GISELLE) © YINKA SHONIBARE MBE (2013),
 PHOTOGRAPHER: STEPHEN WHITE



Wealth trends: Africa saw a 4.0 percent decrease in its UHNWI population in 2016 according to Wealth-X.⁵⁶ These individuals accounted for an estimated US\$212 billion in wealth, representing a 4.7 percent fall from the previous year. Africa's UHNWI population is forecast to grow by 33 percent between 2016 and 2026. A recent wealth management survey by Knight Frank⁵⁷ reported that 32 percent of wealth managers said that their African clients had a number of luxury investments (art, wine, classic cars, etc.). Furthermore, 55 percent of the wealth managers said that luxury investment had become more popular in the last year among their African clients, which was the second highest reading in the survey.

⁵⁶ Source: "Wealth-X World Ultra Wealth Report 2017"

⁵⁷ Source: "Knight Frank Wealth Report 2017"



ART & FINANCE 2017

THE AFRICAN PERSPECTIVE



Rising global demand for African contemporary art is changing the narrative at international auction houses, galleries, art fairs, and biennales.



Bola Asiru is the Deloitte West Africa Leader for Strategy & Operations. He also leads the consulting financial services industry business in Nigeria and is the Africa Art & Finance Coordinator. Bola has broad experience in delivering innovative solutions to complex business problems across multiple industries. He is also the Founder of Red Door Art Gallery—a leading gallery in Nigeria.

African art goes global

The international auction house Bonhams now holds its renowned "Africa Now" sale (focused on African contemporary art) twice a year. Sotheby's London joined the African art auction trend in 2017 with its first auction focused purely on African contemporary art. It achieved total sales of over US\$3.6 million and 79 of the 116 lots were sold.

Also in 2017, record-breaking hammer prices recorded at auction for contemporary art were achieved by Nigerian artist Njideka Akunyili Crosby, whose work sold for less than US\$100,000 at auction in 2016. However, less than a year later, the artist's piece "Drown" sold for a record-breaking US\$1.1 million at a Sotheby's auction and a few months after that, her 2012 painting "The Beautiful Ones" sold for US\$3.1 million at a Christie's London auction. In other words, Akunyili Crosby's sales prices grew by over 3,000 percent in a year.

This positive trend is also consistent with the growth of African art auctions in major markets such as London: the city experienced a 12.5 percent rise in African art auction sales between 2015 and 2016, with Bonhams controlling a 65 percent market share.

It is expected that other international auction houses will continue to focus on contemporary art of African origin in the near future.



International art fairs and biennales

The international "1:54 Contemporary African Art Fair" derives its name from the art of the 54 African countries it wishes to promote globally. The first fair was held in London in 2013, and by 2015, the event had inspired annual shows in New York with a Marrakech edition scheduled to debut in 2018.

Aside from annual contemporary art fairs, the narrative of the global art world is typically shaped by major events such as the Venice Biennale with its rich 122-year history. It is therefore interesting to note that eight out of the 54 African countries are represented at the 57th Venice Biennale in 2017, either at country-specific pavilions or through independent artists participating in the International Art Exhibition. The Nigeria pavillion also made its debut with a group show that the New York Times described as "excellent."

Who is collecting African contemporary art?

Within the African continent, the greatest demand comes from High-Net-Worth Individuals from the two largest economies on the continent—Nigeria and South Africa.

The increased demand is also being driven by large African corporations. The Nigerian Stock Exchange (NSE), for instance, owns an impressive collection of contemporary African art. The NSE CEO, Oscar N. Onyema, explained in an interview with Deloitte that the collection was inspired by the desire to create a first-class working environment for staff. Also, through the collection, the NSE encourages operators in the art industry to leverage opportunities offered by the capital market to promote growth and create durable wealth for stakeholders. He also notes that "quite a number of companies listed on our exchange have very impressive art collections."

Outside Africa, African contemporary art collections are also being fueled by museums and large corporations. Examples include the Standard Chartered collection in London and museum collections such as the San Francisco Museum of Modern Art and the Smithsonian.

Future trends—how sustainable is the African art growth story?

International dealers and auction houses like Bonhams and Sotheby's are seeing a gradual shift in the African contemporary art buyer base from mainly African art collectors to a more international and diverse group of art collectors. Giles Peppiat, Director of African Art at Bonhams, describes this transition to mainstream art collectors as "few and far between" but emphasizes that it is the "Holy Grail" that will enable African art to reach its full potential in terms of value on the global stage. Mainstream international art collector demand has a crucial role to play driving up the value of contemporary African art. In addition, the narrative of contemporary African art has not been adequately reflected across the entire art value chain. The genre is still in its infancy and growing fast, but is set to grow exponentially when strong supporting institutions are established to underpin the entire African art value chain.

Yinka Shonibare MBE, a renowned British artist of Nigerian descent, believes that the most important prerequisites to ensure that the sustainability of the African art market reaches Western levels are strong infrastructure and institutions. He says, "We need museums with trained curators, art critics, alternative art spaces, project spaces, national and commercial galleries, art fairs, and auction houses." He further explains that in order to support the growth of art as a viable asset class, the various institutions must be capable of informing and educating the general public on the intrinsic value of art. According to Shonibare, governments in Africa are yet to appreciate the transformative power of art on economies. He cites the example of how the former industrial city of Bilbao in northern Spain was transformed into a leading tourist destination with the opening of the Guggenheim Museum in 1997. The museum now generates over €400 million annually and has had a catalytic impact on the economy and GDP of the city. Shonibare believes that similar investments need to be made across the value chain by African governments and the corporate social responsibility (CSR) initiatives of large African corporations in order to truly optimize the value of contemporary African art.

This sentiment is in line with the thoughts of the CEO of the Nigerian Stock Exchange, who also believes that investment in art education, awareness, and capacity-building across the value chain is required in order to see continued value appreciation in the sector. He asserts that along with these enabling institutions will come more credibility, price discovery, and improved price transparency. He envisages a future where African contemporary art can be recognized as a viable security and alternative asset class. "Like every other investment vehicle, there is a need for regulatory input and for investors to understand the fundamentals of an art-based security," he notes.

It is clear from recent trends that the two key drivers for the continued growth of contemporary African art are (i) the establishment of strong infrastructure and supporting institutions (art schools, museums, galleries etc.) across the entire value chain and (ii) sustained, international, mainstream demand extending beyond the shores of the African continent and the diaspora of the African art collector base.

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REFUGEE ASTRONAUT II © YINKA SHONIBARE MBE (2016), PHOTOGRAPHER: STEPHEN WHITE

A fresh look at LE FREEPORT Luxembourg

Opened in September 2014,⁵⁸ the Luxembourg Freeport (LE FREEPORT)⁵⁹ located at Findel airport offers a high-secure and high-tech logistic hub within which high value goods may be handled, stored, conserved, traded, restored and exhibited. Exclusively dedicated to high-value goods—especially art, LE FREEPORT offers the perfect storage conditions in a tax-free environment.

The concept of a freeport is not new, but in our view LE FREEPORT Luxembourg is one of the most attractive ones.

An ecosystem exclusively dedicated to high-value goods

LE FREEPORT is an ultra-safe facility specialized in the conservation of high value goods with a total surface of 21.000 m². Valuable objects, both of a physical nature (e.g. fine art, fine wines, classic cars, precious metal, jewels, cigars, etc.) and of an electronic and digital nature can be stored.

As such, LE FREEPORT intends to attract to Luxembourg potential “investors” present in the globalized art world, notably financial professionals such as private bankers, insurance companies, family offices, banks and asset managers. It also constitutes a key center of interest for artists, high net-worth collectors, galleries, corporate collections and museums lacking space and allowing as such an exchange between museums and art collectors from all over the world.

LE FREEPORT offers long-term leases of larger dedicated storage areas who are managed by logistics and specialist forwarders companies. Those storage spaces are sublet to individuals and companies, which can benefit from its infrastructure and highly qualified staff and structure, and it also offers an ideal place for the management of said goods; for instance, these goods can be bought and sold between the different players operating on the art market.

This new state-of-the-art freeport is designed to function as a self-contained ecosystem offering a wide range of services including storage and warehousing activities, transport and logistics, packaging, framing, restoration, private exhibitions of artworks in one of eight showrooms, and a photography studio. A number of professionals based at the facility provide art valuation, art advisory, insurance brokerage, tax and customs advisory, and art monetization services. The facility also provides certain guarantees of quality to its clients, especially in terms of climate and temperature control, power supply, safety, and monitoring.



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⁵⁸ LE FREEPORT is in a free zone created by a ministerial decree dated 30 November 2012, pursuant to a law dated 28 July 2011, amending the Luxembourg VAT laws. More info: www.lefreeport.lu

⁵⁹ LE FREEPORT is part of the European Union customs union.

A world-class logistics and regulatory platform in the center of Europe

Located in the heart of Europe, next to the cargo center at Luxembourg's Findel airport, this impressive logistics hub is the epitome of Luxembourg savoir-faire and a member of the World Free Zones Organization. As such, it boasts direct air and land access. Valuable goods may be delivered straight from the tarmac to LE FREEPORT, without any road transport costs and risk, thanks to Cargolux's dedicated handling and logistics service for fine art and LuxairCARGO.

The Luxembourg customs authorities—*Administration des Douanes* (ADA)—which must be notified of the entry and exit of all goods, have a physical presence at LE FREEPORT as well as unlimited access and the right to inspect declared goods and storage rooms. The ADA supervises the facility and, as such, its operators: namely, prime logistics and specialist forwarding companies.⁶⁰

Such operators, direct customers of LE FREEPORT, must be duly licensed by the ADA. Once they have received their license, they are eligible to become long-term tenants of the facility and act as intermediaries between the ADA and the end users (i.e., family offices, banks, high net worth collectors, museums, etc.). The latter pay storage fees and other professional charges to the tenants for value-added services rendered.

LE FREEPORT, which is governed by the Luxembourg authorities, benefits from a legal framework compliant with international standards to ensure the total traceability of all goods stored and all activities carried out therein. Each operator is subject to Luxembourg anti money-laundering legislation.⁶¹ A meticulous and mandatory inventory is kept of all goods entrusted to LE FREEPORT for storage, through the Know Your Customer (KYC) form applicable to beneficial owners. Data on inbound, stored, and outbound goods is thereby exchanged electronically with the ADA. At the time of writing, this system of transparency is unparalleled anywhere in the world and unprecedented for logistics companies in general, and art logistics companies in particular.

⁶⁰ These operators are particularly, or even exclusively, active in transportation, handling, and storage of high-value goods.

⁶¹ Grand Ducal Regulation of 5 August 2015, which amended the Grand Ducal Regulation of 1 February 2010, providing details on certain provisions of the AML Laws dated 12 November 2004.

Case study 1

Private art collector—European Union goods

Private art collectors can use LE FREEPORT to store EU goods (e.g., family heirlooms, pieces acquired from an EU gallery, etc.) in free circulation. They benefit from the suspension of VAT on the services provided to them by the licensed operator for storage, handling, or presentation in one of the showrooms. The deferred VAT becomes due on EU goods returning to a European destination when leaving LE FREEPORT. If the owner decides to export the item outside Europe (e.g., to sell it at auction in New York), the suspension becomes permanent. Art collectors can save VAT costs and thereby increase their profits when the item is sold at auction outside of the EU. For EU goods in free circulation that return to the EU after storage at LE FREEPORT, VAT will only be due on the services, and not on the artwork itself. The artwork keeps its free circulation

advantages and can be removed from LE FREEPORT at any time.

For investment purposes, a private art collector may wish to benefit from a VAT suspension when purchasing an item from a European gallery. They can do so, provided the sale physically takes place at LE FREEPORT. Regarding VAT on the services, the VAT on the artwork will fall due should the art collector decide to bring the artwork into the EU on a permanent basis. If he or she decides to export the artwork outside of the EU, no VAT will be due in Luxembourg.



A favorable value-added tax ("VAT") and customs duties regime

LE FREEPORT offers a special VAT and customs duties suspension regime, which applies as long as high-value goods remain in the free zone. At the national level, Luxembourg has enacted legislation enabling the import of non-European Union goods into licensed free zones, such as LE FREEPORT, in a tax-suspension environment.⁶² Under this favorable regime (for which there is no time limit), VAT and customs duties are suspended⁶³ when the goods enter LE FREEPORT, and when any related transactions are carried out during the storage of the high-value goods in question. Only once they leave the facility to be marketed to end-users will said goods be subject to taxation. Import VAT will be due in the case of permanent import for both taxable persons and non-taxable persons. Taxable persons should be entitled to deduct all or part of the tax due.

For both taxable and non-taxable persons, import taxes are due in the country of import and not necessarily in their country of domicile or residence. This is particularly beneficial to non-taxable persons, as they may choose the lowest import VAT rate for import into the EU. Art collectors must pay particular attention to any indirect taxes that may be due on the import of the artwork into the destination country. We thus encourage all art collectors to work with their advisers when addressing potential tax issues.

Aside from these general rules, goods can be temporarily removed from the storage facility for up to an entire year under certain conditions (e.g., for an exhibition in a museum or an art fair), and the tax advantages applicable in the free zone will continue to apply. European Union goods also benefit from the favorable environment offered by LE FREEPORT. These goods are considered to be in free circulation and retain related advantages when leaving LE FREEPORT.

As such, the VAT suspension only applies to the services supplied inside LE FREEPORT. For other European goods, which are not in free circulation, customers may also benefit from the VAT suspension if they wish to do so.

Regardless of the situation, all services performed within LE FREEPORT on the goods stored will benefit from the VAT suspension and are only subject to the applicable tax when they exit. Postponing VAT payments enables LE FREEPORT clients to improve their cash flow. No guarantee is required by the tax authorities to secure the final tax liabilities due to the presence of the ADA on site. This is a major benefit in comparison with bonded warehouses. If customers of LE FREEPORT Luxembourg are neither established nor registered for VAT purposes in Luxembourg, pre-authorized operators can also act as tax representatives to facilitate administrative registration and clearance.

62 Act dated 29 July 2011, supplementing the amended act dated 12 February 1976 on VAT.

63 The suspension exclusively concerns VAT and customs duties. This regime cannot apply to any other taxes, such as capital gains, corporate income tax, municipal business tax, wealth tax etc.

Case study 2

Private art collector—Non-European Union goods

Non-EU goods, also commonly called "transit goods," benefit from a suspension of VAT and duties for as long as they are in storage at LE FREEPORT. They can also be removed temporarily for exhibitions or presented for sale without losing this advantage. These so-called "temporary admissions" place the artwork under the supervision of the Luxembourg customs authorities and are limited to a maximum length of one year⁶⁴ for a specific destination (museum, gallery, auction house, etc.). While the items are in storage at LE FREEPORT, the art collector benefits from a suspension of VAT on the services provided for the artwork in question (storage, handling, presentation, etc.).

This suspended VAT will fall due when the artwork is permanently imported into the EU. As long as the artwork remains "in transit," the art collector can permanently suspend any outstanding VAT by simply shipping the artwork to another country, inside or outside the EU.



64 It should be highlighted that each jurisdiction may have a specific regime applicable. This period of one year may be renewable.

Case study 3

European art galleries

European art galleries can use LE FREEPORT to meet their storage and logistics needs for all their activities in the European market. They can also use LE FREEPORT for presentations and sales to their clients. All European VAT principles also apply at LE FREEPORT, with the added advantage of a unique VAT suspension regime for goods and services supplied inside LE FREEPORT.

Galleries may choose LE FREEPORT to sell an artwork to a buyer who wishes to suspend VAT on the purchase, either because they are simply looking to invest in art or want to re-export the artwork at a later date. In order to benefit from the suspension regime at LE FREEPORT, the gallery must transfer the artwork to Luxembourg before finalizing the transaction so that the sale takes place in Luxembourg. The transfer can take place after the client has reserved and paid for the artwork; however, the final invoice needs to be issued in Luxembourg

with a specific notice to apply the VAT suspension.

The gallery does not need to have a physical presence in Luxembourg or have its own Luxembourg VAT number to apply the VAT suspension. The licensed operators can act as tax representatives for the gallery to file the required VAT returns with the Luxembourg tax authorities, both for the transfer of goods to Luxembourg and for their eventual sale.

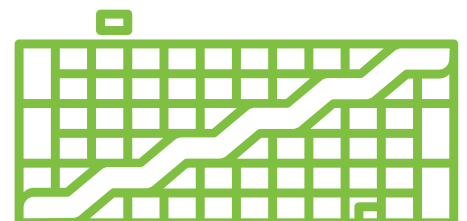


Case study 4

Private museums, corporate structures, and other holding vehicles

These types of vehicles benefit from the advantages LE FREEPORT provides in terms of asset preservation and logistics. Regarding taxation, their advantages are similar to those enjoyed by private art collectors. They can store both EU goods and non-EU goods and benefit from a VAT suspension on all services provided for their collection (storage, handling, presentation, etc.). Non-EU goods can be stored indefinitely subject to a suspension of VAT and duties and benefit from temporary admissions for exhibitions in galleries and museums. As with all other clients, VAT is settled when the artworks leave LE FREEPORT.

Structures that either have their own European VAT number or are established outside of the EU can purchase artworks subject to a VAT suspension by using the reverse charge mechanism. It is not necessary for the artwork to be transferred to LE FREEPORT prior to finalizing the sale. Licensed operators act as tax representatives for the structure to file the required VAT returns with the Luxembourg tax authorities for the purchase. The VAT is suspended for as long as the artwork remains in storage at LE FREEPORT.



As such, LE FREEPORT occupies a privileged position on the Art & Finance market by offering an interface and providing financial services for high-value collectible assets. It is no coincidence that LE FREEPORT is located in Luxembourg; with an extensive track record of art-sector knowledge and expertise, the Luxembourg market is perfectly positioned to become a hub for wealth management services associated with high-value goods. Moreover, High-Net-Worth Individuals ("HNWI") are increasingly viewing artworks and high-value goods as viable alternative assets to diversify their wealth while also enjoying the intangible benefits associated with owning such objects.

Legal and regulatory developments are supporting this trend. In particular, the Luxembourg parliament recently validated a law⁶⁵ allowing HNWIs wishing to invest their funds in companies or banks located in Luxembourg to benefit from a special visa, which is granted for three years.⁶⁶ This new measure is particularly favorable to HNWIs collecting artworks or other high-value goods, and seeks to encourage them to view Luxembourg as their gateway into the art world.

65 Law of 8 March 2017 amending the Law of 28 August 2008 on free movement and immigration.

66 Conditions notably include (i) an investment of at least €500,000 in a new company performing commercial, artisanal, or industrial activities with a commitment to hire at least five employees within the first three years, or (ii) an investment of at least €20,000,000 as deposit in a Luxembourg financial institution within five years.

LE FREEPORT intends to attract to Luxembourg potential "investors" present in the globalized art world, notably financial professionals such as private bankers, insurance companies, family offices, banks and asset managers. It also constitutes a key center of interest for artists, high net-worth collectors, galleries, corporate collections and museums lacking space and allowing as such an exchange between museums and art collectors from all over the world.



Section 2

Art and wealth management survey



HIGHLIGHTS

- **Art & Wealth management services starting to mature:** After six years of closely monitoring key market stakeholders, this year's report confirms that art and wealth management is part of a long-term industry trend. The combined effect of a global art market expansion and more wealth allocated to art and collectibles, together with the wealth management industry's move towards a more holistic asset management approach, is underpinning the long-term demand and sustainability for art & wealth management services.
- **Stronger motivation to include art within wealth management:** The most recent survey shows an increase from 78 percent in 2016 to 88 percent in 2017 of wealth managers saying that they think art and collectibles should be included as part of the array of wealth management solutions.
- **A move toward a holistic wealth management model driving interest in art and collectible wealth:** This year's survey findings show that 85 percent of wealth managers (86 percent of private bankers and 77 percent of family offices) believe that the move toward a holistic wealth management model is the strongest argument for including art and collectibles in a wealth management service range.
- **More wealth managers offer art-related services to their clients:** 64 percent of wealth managers (67 percent of private banks and 55 percent of family offices) said they were actively offering services related to art and collectibles including entertainment and client hospitality. This was slightly higher than the 63 percent seen in 2016.
- **Client pressure on wealth managers:** 55 percent of wealth managers (52 percent of private banks and 69 percent of family offices) said that clients were increasingly asking their private bankers and wealth managers to help with art-related issues (up from 48 percent in 2016). This was observed most frequently by the family offices surveyed, where 69 percent said that increasing client demand was the most important reason for including art and collectibles as part of a service range, compared to 52 percent for the private banks.
- **The increasing focus on "passion-based" investments:** An estimated US\$1.62 trillion of UHNWI wealth is allocated to art and collectibles, and an estimated US\$ 2.5 trillion by 2021, is a sign that wealth managers need to take a more emotional and holistic approach to the way they work with their clients' assets (which are often linked to their hobbies, such as classic cars, wine, race horses, paintings, etc.)

This year's survey findings show that 85 percent of wealth managers (86 percent of private bankers and 77 percent of family offices) believe that the move toward a holistic wealth management model is the strongest argument for including art and collectibles in a wealth management service range.

In accordance with the findings from last year's survey, a large majority (86 percent) of art professionals said that their clients buy art and collectibles for emotional reasons (passionate about collecting), but also focus on investment value.

- **More investment and resources to be dedicated to art-related services in the next 12 months:** An average of 44 percent of wealth managers reported that increasing focus and resources would be dedicated to art and wealth management services in the coming 12 months, up from 38 percent in 2016. This is the highest reading since the launch of the survey in 2011, and is supported by a positive trajectory for all art-related products and services.
- **An awareness of developments around art as an asset class:** Family offices seem to be more aware than their counterparts at private banks, with 63 percent of the family offices saying they are aware/very aware of the key developments related to art as an asset class, compared to 56 percent of wealth managers at private banks. Findings from this year's survey also show that 69 percent of the wealth managers surveyed (63 percent of family offices and 70 percent of private banks) said they expected their clients to want to include art and other collectible assets in their wealth reports.
- **Art as a way to safeguard value:** 54 percent of wealth managers (up from 51 percent in 2016 and the highest reading since the survey was launched in 2011), increasingly see art as a way to safeguard value.
- **Collecting art with a view to investment:** In accordance with the findings from last year's survey, a large majority (86 percent) of art professionals said that their clients buy art and collectibles for emotional reasons (passionate about collecting), but also focus on investment value; this was up from 79 percent in 2016. This implies that art as a pure investment/financial product is only attractive to a small minority of art buyers (three percent), and that it is the emotional and social aspects of collecting art combined with the potential to increase or safeguard value (i.e. value protection), that seems to be the driving motivation among most collectors on the art market (65 percent of collectors expressed this view).
- **Art is increasingly becoming a lifestyle product:** For the third time since the launch of the survey in 2011, the social value associated with buying art was the primary motivation among art collectors according to art professionals (85 percent of the art professionals surveyed said so, up from 80 percent in 2016 and 72 percent in 2014) and 63 percent of collectors said this was a key driver for their involvement in the art world (up from 61 percent in 2016). A further 54 percent of collectors said they viewed art as a luxury good (up from 51 percent in 2016), which confirms the findings from previous years suggesting that art is increasingly viewed by art professionals and collectors as a "lifestyle" product.

- **Art and estate planning services continue to gain traction in the wealth management sector:** Estate planning is viewed as the most important art and wealth management service by wealth managers, art professionals, and collectors. With a massive transfer of wealth from baby boomers to millennials about to occur, art and estate planning is likely to become an increasingly important area for the wealth management industry. It is also one that plays to its existing strengths. 89 percent of wealth managers said they were offering advice around art and estate planning; this is significantly higher than the 79 percent observed in 2016 and the 64 percent seen in 2014. Despite this, only 28 percent of private banks said that their clients had made adequate provisions for their art collections in their estate planning process. This stands in stark contrast to the family offices surveyed, where 72 percent said that their clients had adequately resolved the question of their art collection within the estate planning process.
- **Almost half of collectors surveyed have yet to discuss their art-related estate with their heirs:** Although the majority of collectors surveyed have formal estate plans for their art collection, 46 percent of collectors have yet to discuss these plans with their heirs, although they intend to do so. It is important for wealth managers to foster the development of family governance and intergenerational wealth management that also involves art and collectible wealth.
- **European family offices seem to be lagging behind their US counterparts in terms of collection management:** The majority (61 percent) of family offices (all US family offices and half of the family offices from the rest of the world) stated that their clients maintain an updated inventory of their collection allowing them to administer the estate without the art collector's input. Again, in stark contrast, only 13 percent of private banks said the same.
- **Valuation services are becoming increasingly important, but are predominantly delivered by third-party experts:** As art is increasingly considered to be an asset "class" and considerable financial risks are now tied to art, valuation services, which now seem to be a core component of this service range, with all of the family offices that responded to this year's survey saying that they offered valuation services (73 percent said they were providing this through a third party). A high number (84 percent) of private banks also provided valuation services for their clients, with 67 percent providing this through a third party.

As the wealth management industry continues to grow and expand its investment in art-related wealth services, there is also a sense of heightened concern regarding the lack of transparency in the art market (75 percent of wealth managers expressed this view).

- **Private banks and family offices are focusing on art advisory services:** 83 percent of wealth managers said they offered art advisory services (this was up from 79 percent in 2016 and 67 percent in 2014), and 47 percent of these were delivered in-house, which suggests an increasing number of private banks and family offices are adding art advisory services to their existing solutions.
- **Collection management and wealth reporting are likely to converge:** 78 percent of wealth managers said that they offered art collection services; this was up from 59 percent in 2016. 50 percent said that art collection services were delivered by third parties (the same as in 2016). With a more holistic approach to art-related wealth and with 69 percent of wealth managers saying that their clients are looking for art wealth to be integrated into their wealth reporting, we are likely to see increasing demand for integration between art collection management software and banks' existing reporting systems. This would offer the wealth management sector an opportunity to be more proactive, to support estate planning, and to better monitor and protect art-related wealth. Meanwhile, clients could enjoy both the financial aspects of the collection, and the ability to access and share their collection anytime and anywhere.
- **More wealth managers offer assistance on art and philanthropic topics:** 72 percent of the wealth managers surveyed this year said they offer services related to art philanthropy and individual giving to the arts (gifts, donations, help with setting up foundations, etc.). This was up from 64 percent in 2016, and suggests that art is now playing a bigger role in the spectrum of philanthropic activities that clients are seeking their wealth managers' advice and help on.

Estate planning is viewed as the most important art and wealth management service by wealth managers, art professionals, and collectors.

- **Lack of art market transparency remains a key hurdle to the future development of the Art & Finance industry:** As the wealth management industry continues to grow and expand its investment in art-related wealth services, there is also a sense of heightened concern regarding the lack of transparency in the art market (75 percent of wealth managers expressed this view).
- **Regulation remains an important challenge:** With financial institutions facing increasing regulatory scrutiny and pressure, 65 percent of the wealth managers surveyed this year said that the unregulated nature of the art and collectibles market remains the biggest challenge for incorporating art into their service offering (up from 62 percent in 2016).
- **Finding and developing talent and expertise:** 55 percent of wealth managers said that finding the right expertise remains one of the key challenges in building an art-related service offering (up from 46 percent in 2016).

Art and wealth management

Current situation

Art and wealth management is not a new concept. For many decades, private banks and wealth managers have helped their clients with their art and collectible wealth.

However, with the value of art increasing, and with an estimated US\$1.62 trillion¹⁰ in art and collectible wealth held by UHNWIs alone in 2016, and an estimated US\$2.7 trillion¹¹ by 2026, a more strategic and holistic approach to art and wealth management is required in order to fully meet clients' needs and expectations.

Holistic advisory relationships with clients as key for performance



¹⁰ Based on an estimate from the "Knight Frank Wealth Report 2017" (six percent of global UHNWIs invest in art and collectibles: pp. 63) and the fact that Wealth-X reported total UHNWI wealth of US\$27.035 trillion in 2017, this gives an estimated US\$1.62 trillion in art and collectible wealth.

¹¹ The ten-year estimate is based on the Wealth-X forecast of US\$27.035 trillion in UHNWI wealth in 2016. We have assumed that UHNWIs wealth (US\$) grows at the same growth rate as the expected growth in the UHNWI population according to Knight Frank Wealth Report 2017. Knight Frank Wealth Report 2017 reports that 47 percent of wealth managers having noted luxury investments increasing in popularity among their clients. Based on this, we assume that the allocation of wealth toward art and collectibles rises from six percent to seven percent as a global average, then an estimated US\$2.706 trillion would be allocated to art and collectibles by 2026.

Source: Deloitte Luxembourg & ArtTactic Art & Finance report 2017

According to a recent report entitled “Innovation in Private Banking & Wealth Management - Embracing the Business Model Change” by Deloitte in Switzerland, wealth management has now reached a point where a mental shift has become essential. The profitability of European wealth managers has declined steadily in recent years, with profit margins falling by 40 percent between 2000 and 2015. Over the same period, the size of the private banking industry, measured in terms of the bankable assets of European millionaire households, grew by more than 60 percent. This widening gap between profitability and market size shows that wealth managers are increasingly failing to serve clients successfully with their existing business models of an integrated value chain—either from a revenue or cost side, or, even worse, from both.

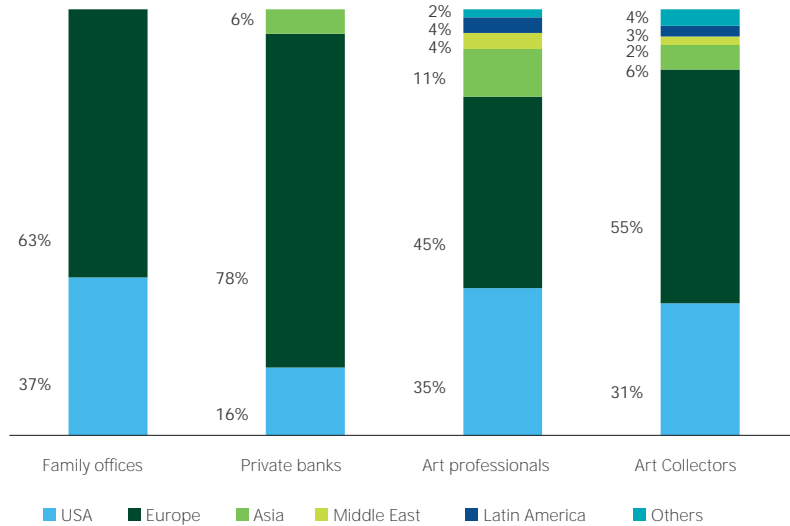
One of the primary drivers behind the push toward the holistic approach mentioned above is competitive pressure within traditional wealth management, as well as growing competition from the FinTech sector and its focus on digital wealth management aimed at disrupting three core areas: connecting, advising, and investing. However, according to the Deloitte Switzerland report’s findings, while digital wealth management is growing, face-to-face advice is not expected to become obsolete. For example, skilled financial advisers can create value for their clients and offer them tailored recommendations, particularly where decisions are more complex or involve higher value transactions. We believe that art and collectibles belong to this category.

According to the Deloitte Switzerland report’s findings, while digital wealth management is growing, face-to-face advice is not expected to become obsolete.

In this and the following section we will take a closer look at the opportunities and challenges facing the wealth management industry when it comes to developing the four core art and wealth management service areas (*see page 37*).

When we talk about art wealth management services, we are referring to a full range of services addressing the four core areas. According to our definition of art wealth management services, we consider art-related entertainment and corporate collections as peripheral activities to wealth management, but believe that they can play an important role in onboarding and promoting a broader spectrum of art wealth management services within an organization. Finally, developing an art wealth management offering can be naturally extended to cover other collectible assets.

Sample by geography



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Stakeholder analysis: bridging the wealth industry, art professionals, and art collectors

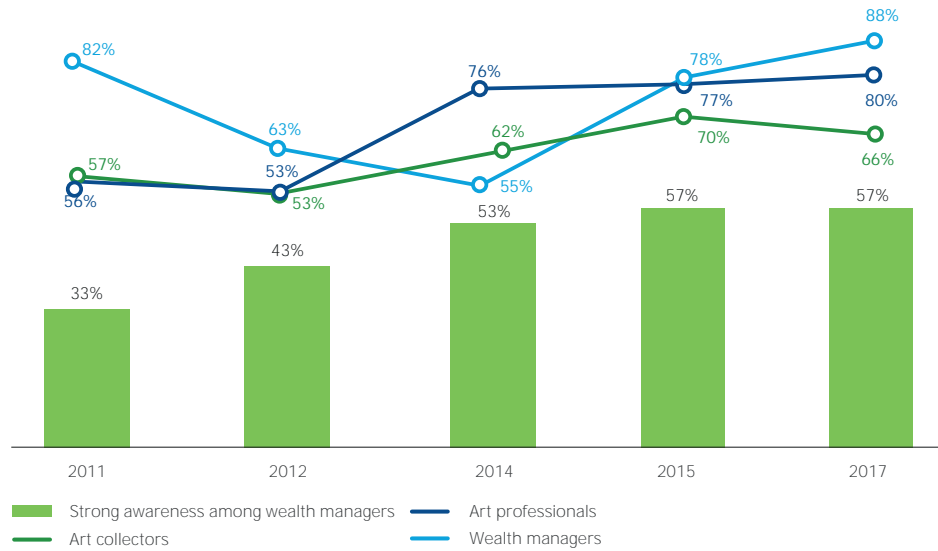
In this section of the report, we present the survey findings from 69 private banks, 27 family offices, 155 art professionals, and 107 art collectors, who were surveyed between May 2017 and July 2017 on a wide range of topics and issues related to art and wealth management. This section of the report focuses on the preservation, protection, and conversion of art-related wealth to income, as well as the issues related to estate planning and the transfer of wealth to the next generation.

As in previous editions of the Art & Finance Report, the aim is to gain a better understanding of the motivations, current involvement, and challenges facing each of the stakeholders, in order to be able to identify priority areas that will help the Art & Finance industry more effectively address existing challenges and fulfill its true potential. A new addition this year is that we will also highlight some of the differences between private banks and family offices in their attitudes toward and involvement in art and collectible wealth.

The wealth management industry is increasingly prepared to embrace art-related wealth

In the previous Art & Finance reports, the wealth management community appeared hesitant to embrace the role of art in a potential wealth management offering because of concerns about the complex nature of the art market, particularly regarding issues related to effective risk management and valuation, and also concerns about the business practices and the unregulated nature of certain segments of the art market. However, this year’s findings continue to build on the increasing confidence displayed among wealth managers in the 2016 results. After six years of closely monitoring key stakeholders in the market, we feel confident in confirming that the development of art wealth management services for UHNWIs is part of a long-term industry trend.

Figure 18. Do you think that art and collectibles should be part of a wealth management offering? (% answering Yes)



Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Sample	2011	2012	2014	2015	2017
Private banks	19	30	35	53	69 ⁶⁷
Family offices	0	0	14	14	27
Art collectors	48	81	90	94	107
Art professionals	140	112	122	126	155

The most recent survey shows an increase from 78 percent in 2016 to 88 percent in 2017⁶⁸ of wealth managers saying that they think art and collectibles should be included as part of the wealth management offering. On this point, both private banks and art professionals registered their highest reading since the launch of the survey in 2011. Private banks were significantly more positive about this development than family offices, with 94 percent saying there was a strong argument for including art in the wealth management offering, compared to 68 percent who said the same among the sample of family offices. As in 2016, wealth managers were more convinced about the value proposition around art and wealth management than both art professionals and collectors, where 80 percent of art professionals and 66 percent of collectors in 2017 stated the importance of including art as part of a wealth management strategy and offering.

⁶⁷ Among the 69 private banks, 5 are art-secured lenders players (specialized boutiques).

The aforementioned trend is underpinned by growing awareness⁶⁹ around issues and developments related to art as an asset class among wealth managers. This awareness has increased steadily since 2011, with 57 percent of wealth managers⁷⁰ stating that they are aware/very aware of developments in the Art & Finance industry (the same level as in 2016, but up from 53 percent in 2014 and 43 percent in 2012). Staff at family offices seem to be more aware than their counterparts at private banks, with 63 percent of family offices saying they are aware/very aware of key developments related to art as an asset class, compared to 56 percent of wealth managers at private banks.

The findings from this year's survey also indicate that 69 percent of the wealth managers surveyed (63 percent of family offices and 70 percent of private banks) said they expected their clients to want to include art and other collectible assets in their wealth reports in order to have a consolidated overview of their overall wealth and a better overview of their

⁶⁸ We cannot ignore the fact that the yearly trends could be a result of the changes and growth in the sample. The first art and wealth management survey was conducted in 2011 and included 17 private banks from Luxembourg. In 2012, the sample was increased to 30 private banks, including banks from Poland and Spain. In 2014, the survey included 35 banks predominantly from Europe, the US, and Asia (with no participation from Poland), and an additional 14 family offices from Europe and the US. In 2016, the sample included 53 private banks and 14 family offices, while the 2017 survey included 69 private banks and 27 family offices.

⁶⁹ This survey question aims to capture the level of awareness among wealth managers when it comes to developments and trends in the Art & Finance industry. The figures here are based on the percentage of individuals who answered "aware" and "very aware" (i.e., only option 4 and 5 on a Likert scale of 1 to 5).

⁷⁰ This is a weighted average: 56 percent of private banks (rated this question 4&5) and 63 percent of family offices rated it 4&5. The private bank figure is based on 69 responses and the family office figure is based on 27 responses.

exposure (slightly down from 73 percent in 2016, but still significantly up from 58 percent in 2014 and 40 percent in 2012). This shows that the wealth management industry is facing ongoing pressure from their clients to integrate art and collectible assets in their existing wealth reporting, which is a critical component in terms of how the industry thinks about and manages art-related wealth.

Integrating art into wealth reporting offers clear benefits for wealth managers, as it encourages a proactive rather than a reactive approach to art-related wealth. By having a proper overview of these types of assets, a more strategic plan with regards to monetization, wealth transfer, and asset protection can be put in place.

Issues related to the integration of art-related wealth in the wealth management offering will be further discussed throughout this report, supported by survey findings as well as opinions from key professionals operating within the worlds of Art & Finance.

Figure 19. GAP ANALYSIS: What 'Art & Wealth Management Services' that art professionals and collectors view as most relevant and what the wealth management industry is currently offering.

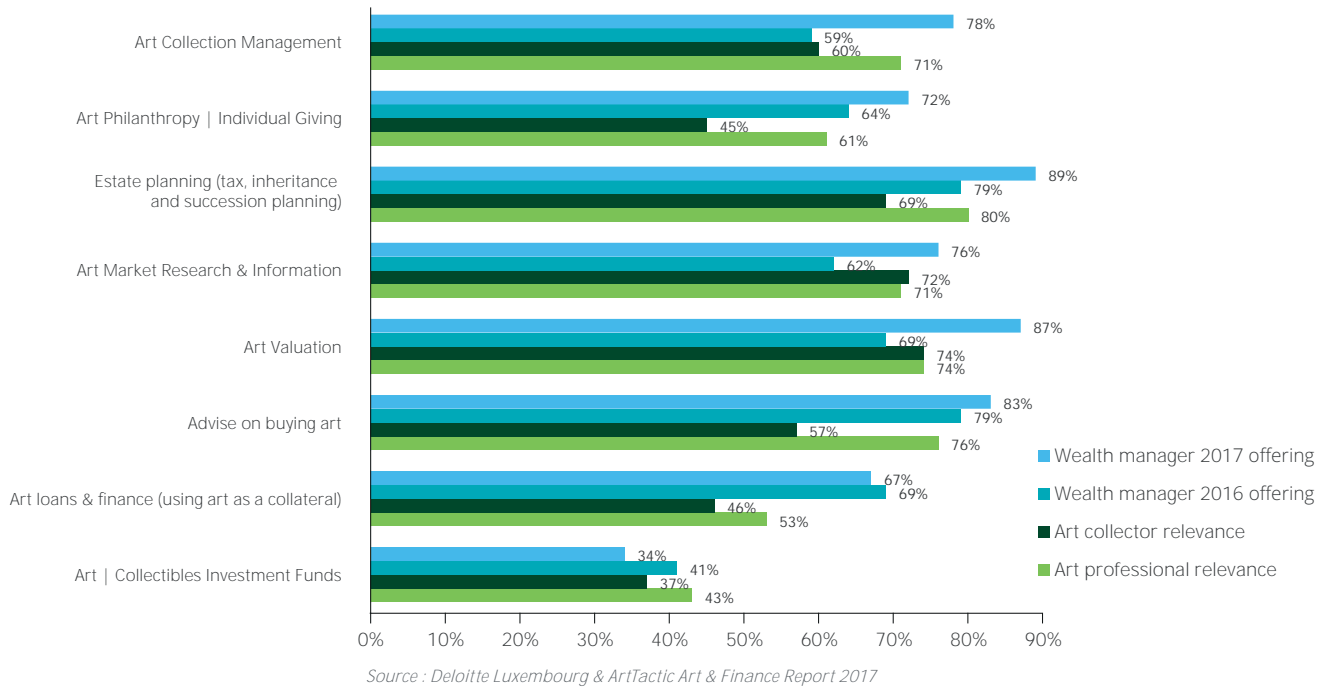
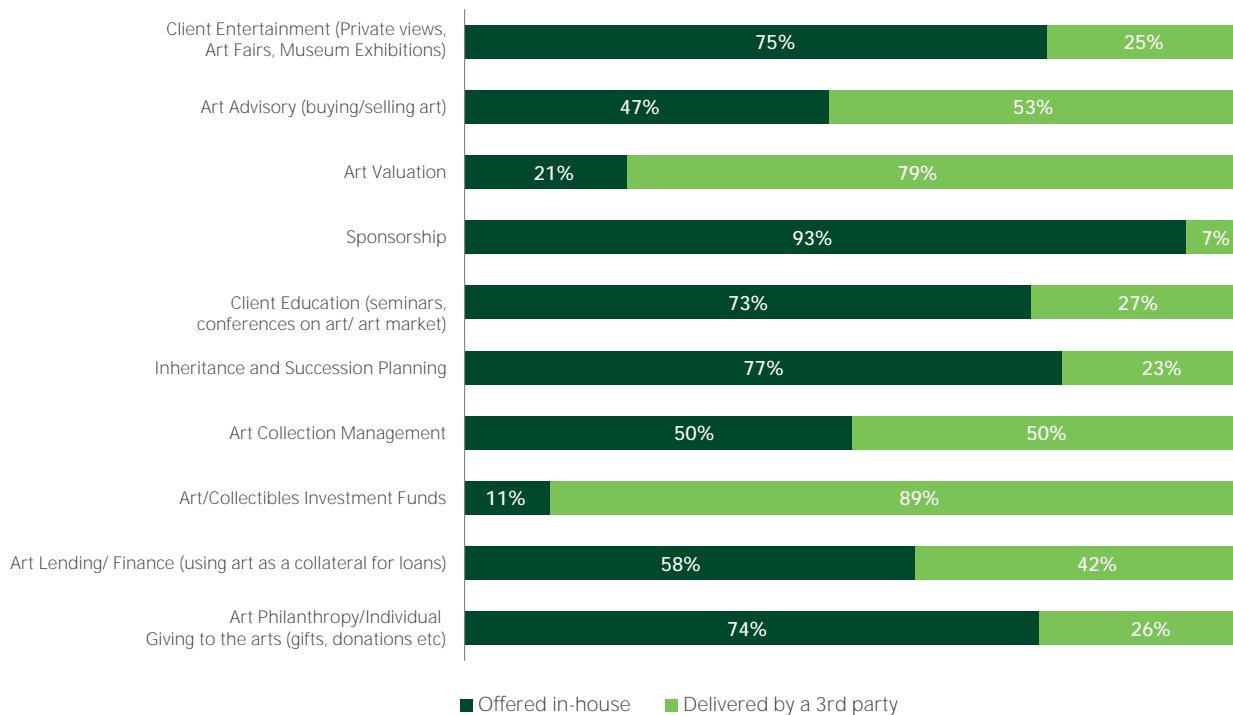


Figure 20. Wealth Managers: Which of the art related services do you offer in-house vs offered by a third party?



Both collectors and art professionals see collection management as an important remit of a wealth manager (60 percent and 71 percent said so respectively).

The wealth management industry is increasingly responding to clients' need for art-related services

In this year's survey, 64 percent of wealth managers (and 67 percent of private banks and 55 percent of family offices) said they were actively offering services related to art and collectibles including entertainment and client hospitality; this was slightly higher than the 63 percent reported in 2016. The fact that two-thirds of the private banks surveyed were already offering art-related services (including client entertainment and hospitality) is a strong testament to the importance that the wealth management industry now places on products and services linked to art-related wealth.

In last year's report, we identified a number of areas where there were visible gaps between client demand for specific art-related services and what the wealth management industry was offering at the time. There were signs that wealth managers predominantly focused on traditional wealth management services, while art collectors were looking to their wealth managers for specific art-related services such as art valuation and art collection management. This suggests that collectors also see their wealth managers as their trusted independent advisers for art-related activities. It is interesting to note in this year's findings that the percentage of wealth managers offering art collection management services has increased from 59 percent in 2016 to 78 percent in 2017 (72 percent of the private

banks and all of the family offices who offer art-related services). In her article, Maria de Peverelli from Stonehage Fleming (*page 110*) talks about the role of the collection manager within a family office setting, and how the management and administration of a collection fits within a wider family office strategy. Her article also discusses the role of the collection manager as an independent and neutral strategic adviser, not driven by their own agenda, and hence addresses some of the concerns around conflicts of interest, a lack of transparency, and secret commission—all issues discussed in more detail in Section 6.

A similar point is made by Melanie Damani from Edmond de Rothschild (*page 112*), who looks at the benefits for clients of working with their wealth manager rather than an independent art adviser.

Art valuations have also seen a significant increase in terms of the number of wealth managers offering these services (up from 69 percent in 2016 to 88 percent in 2017), predominantly through partnerships with third-party providers (79 percent expressed this view). *See Figure 20* for the breakdown between in-house and third-party services provided. The use of third-party services illustrates that we are already seeing closer collaboration between art professionals and the wealth management community.

- Collection management and wealth reporting:** Both collectors and art professionals see collection management as an important remit of a wealth manager (60 percent and 71 percent said so respectively). This specific client need has caught the attention of the wealth management community in the last 18 months, and this year's findings show that 78 percent of wealth managers are providing collection management (up from 59 percent in 2016). Half of the wealth managers use third-party services, while the rest have focused on developing these tools in-house. There are differences across the various categories of wealth manager, with 91 percent of family offices offering this in-house, versus only 35 percent of private banks saying the same. As highlighted earlier, the increasing focus on this area is likely to stem from the observation that 69 percent of wealth managers in 2017 said that their clients wanted to include art and other collectible assets in their wealth reports, in order to have a consolidated overview of their wealth. This is an important finding and it shows that the wealth management industry is acting, and increasingly recognizing the fact that wealth allocated to art needs to be managed and included in overall wealth reporting. This also offers the wealth management sector an opportunity to be more proactive, to support estate planning and to better monitor and protect art-related wealth, and for clients to enjoy both the financial aspects of the collection as well as the ability to access and share their collection anytime and anywhere.

- **Valuation, art market research, and information are priorities for collectors:** It is interesting to note that in this year's findings, 74 percent of collectors (up from 62 percent in 2016) and 74 percent of art professionals (up from 69 percent) said that valuation was important/very important. Art research and information services were also seen as important by 72 percent of collectors (down from 75 percent in 2016) and 71 percent of art professionals (up from 67 percent in 2016). It is likely that the wealth managers' perceived neutrality in the art market would give more credibility to both their art valuation and market research. That is not to say that wealth managers should offer valuation in-house, but they could play a key role in ensuring that the appropriate processes are in place when it comes to providing fair, unbiased, and accurate valuations. Again, this year's findings suggest that the wealth management industry has taken note, and 87 percent said they were currently offering valuation services (79 percent would offer this through a third party). All of the family offices that responded to this year's survey said they offered valuation services (73 percent said they were providing this through a third party). The highest ever number (84 percent) of private banks also provided valuation services for their clients, with 67 percent providing this through a third party. This is significantly higher than the 69 percent of wealth managers who said they were offering this service in 2016 (74 percent of these services were offered through a third party⁷¹).
- **Wealth management and art advisory:** This year's results show that 57 percent of collectors believe that art advisory services⁷² should be offered as part of a wealth management service (up from 52 percent in 2016). We are starting to see an increasing trend within the wealth management sector of incorporating art advisory services. A recent example of this is the acquisition of OmniArte by Stonehage Fleming, the largest Multi-Family Office in the EMEA region and one of the largest in the world. When client demand has reached a certain critical mass, there are clear advantages to bringing the advisory function in-house as opposed to outsourcing it to a third party. The most obvious benefits are client confidentiality, relationship management, and the ability to better integrate art-related wealth into the overall wealth management service offered to the client (see collection management above). This does mean that banks would not use third-party art-related services, however, but rather that these activities are often better coordinated through a dedicated resource within the bank or family office with access to a network of vetted art professionals and knowledge of the particularities of the art market.
- **Estate planning:** The wealth management industry is facing a US\$30 trillion⁷³ wealth transfer from baby boomers to millennials in the US alone. This is a process that is expected to occur over the next 30 years. With art-related wealth accounting for an estimated six percent of global UHNWI wealth,⁷⁴ it is clear that art and collectibles will naturally fall within the remit of traditional estate planning in the years to come. From this year's survey findings, it is evident from both art collectors (69 percent, up from 68 percent in 2016) and art professionals (80 percent, up from 65 percent in 2016) that issues related to estate planning are increasingly becoming a priority. Again, there is now heightened awareness of this demand among wealth managers, with 89 percent of wealth managers (88 percent of private banks and 91 percent of family offices) currently offering advice and services related to estate planning (up from 79 percent in 2016). This implies that more wealth managers are responding to their clients' growing estate planning needs in key areas related to art and collectibles, particularly with regards to valuation, taxation, inheritance, and succession planning. The growth in private museums in recent years (with a reported 317⁷⁵ privately funded contemporary art museums in the world, 70 percent of which were founded after 2000), suggests that there is an increasing demand for structuring and preserving art and collectible wealth for future generations.

71 Wealth managers who say they offer valuations in-house are likely to do this through an in-house expert/adviser, who either provide valuations themselves or know how to obtain a valuation (i.e., through a third party). When answering this question, it is possible that wealth managers might not know if the valuation is outsourced to a third party or carried out by someone in-house.

72 Art advisory covers a broad spectrum of services mainly related to buying and selling art and collectibles on behalf of clients. Although other services, such as collection management and valuation, could be defined as an art advisory service, for the purpose of this report we have separated this out as a stand-alone service.

73 <http://www.marketwatch.com/story/americas-trillion-dollar-wealth-transfer-how-to-prevent-a-generation-of-entitlement-2017-04-25>

74 Source: "Knight Frank Wealth Report 2017"

75 "Private Art Museum Report," Larry's List and AMMA (Art Market Monitor of Artron), 2015

All of the family offices that responded to this year's survey said they offered valuation services.

- **Art-secured lending:** With the US art-secured lending market estimated to be worth US\$17-20 billion in 2017—up 13.3 percent from 2016—it is clear that collectors and art professionals are increasingly looking to extract equity from their art collection or inventory. The survey of art collectors and art professionals shows that 46 percent of the collectors surveyed said they would be interested in using their art collection as collateral for a loan (this was down from 57% in 2016), and 53 percent of art professionals said the same (this was the same as in 2016). Again, the wealth management community seems to be responding, with 67 percent of wealth managers (70 percent of private banks and 55 percent of family offices) offering this service to their clients (42 percent say they use a third-party service). This was marginally lower than the 69 percent of wealth managers who said they offered art-secured lending products in 2016 (48 percent of these were through third-party providers).

- **Wealth managers remain reluctant to embrace art investment products:** 34 percent of the wealth managers who said that they offered art-related services said they offer or have access to art and collectible investment fund products (down from 41 percent in 2016). 30 percent of wealth managers said they had noticed an uptick in demand from clients for art investment products (up from 27 percent in 2016 and 20 percent in 2014); however, issues related to valuation (lack of mark-to-market valuation), difficulties in carrying out due diligence, and a general lack of experience in this asset class remain key obstacles.

However, perceptions among art professionals were more positive, with 43 percent (up from 34 percent in 2016) saying that their clients would potentially invest in art funds, while 37 percent of collectors (up from 35 percent in 2016) said they had noticed increasing demand for art investment products. With the art market generating significant wealth for many collectors in recent years, the desire to look for investment return in art continues to be a motivation. However, with only three percent looking to buy art as a pure investment, it is clear that the traditional art fund model should be reviewed, so that greater emphasis can be placed on the collecting aspect (social and emotional).

With a notable difference between what the wealth management industry is prepared to offer and the apparent demand for art investment products, the challenge is predicting how the art investment industry is likely to evolve. With the regulated financial industry shying away from investment products related to a much-less-regulated art market, the risk is that the art investment industry will increasingly move underground.



Maria de Peverelli
Executive Chairman -
Art Management
Stonehage Fleming

The fine art of managing an art collection within a family office

Collecting works of art can be a passion, a pleasure, or an addiction: each art collector has a unique perspective on this activity in which he or she chooses to invest time, money, knowledge, and expertise.

But owning a collection involves a wide array of practical concerns: initial due diligence, lending to museums, maintaining an inventory, transport, storage, insurance, valuations, the structure through which the collection is owned, scholarly cataloguing of the collection, strategic planning for the future (including inheritance planning), and more. All of these aspects require specialist knowledge and skills on the part of those who manage and oversee a collection.

It is inevitable that the time will come when the collection has become so vast, and the transactions so complex and numerous, that the art collector realizes that he or she needs assistance and guidance to address day-to-day matters as they arise, conduct necessary research, solve problems, provide and coordinate expert input, and (should he or she wish) even assist in planning for the future.

It is at this stage that collectors might consider what kind of expertise they require. Should they ask their personal assistant or their art adviser to help, or should they look instead for a collection manager? Or even a collection manager within a family office?

Owning and managing an art collection is a complex pursuit requiring frequent advice from a variety of experts.

Collectors' precise needs vary enormously, depending on the nature and number of artworks, their location, their value, the number of annual transactions, the objectives of the art collector in terms of making the collection available to the public, and the involvement of external advisors. They might wish to look primarily for administrative support, or they might decide that they also require assistance in terms of major decisions and long-term strategy.

The fiduciary obligations incumbent upon trustees have also increased, and careful management will help mitigate the many risks to which artworks are subject, from the most obvious (e.g., inadequate insurance, physical security, packing, and transport) to those inherent in the buying and selling process.

Owning and managing an art collection is a complex pursuit requiring frequent advice from a variety of experts. Many of these experts will have their own agendas, and, unlike investment management, the art world is much less regulated at an international level. Independent strategic advice is not easy to secure.

Art advisers tend to focus on the transaction itself. They may advise on the acquisition of specific artworks to fill gaps in the collection, expand the collection, or give it a specific focus (areas where their expertise may lie), and might also offer post-sale assistance with logistics and fee negotiations: areas in which they will often have limited experience. They will generally be focused on the now, rather than the lifecycle of the artwork after the transaction.

A collection manager, by definition, has broader knowledge and knows where to find the right expertise. Some aspects of managing the collection—such as specific art historical research, conservation, or legal and tax advice—will demand significant specialized professional input that a seasoned collection manager can easily draw upon.

He or she will therefore care for a collection in a holistic way, thinking about its past, present and future. He or she must be able to identify risks, offer suggestions, and bring a degree of knowledge, experience, and consideration: in other words, he or she is tasked with making the complex simple.

Thoughtfulness and sensitivity toward the works of art and the individual art collector's needs are paramount for an independent collection manager. A collection manager will often become indispensable, allowing the art collector to focus on his or her passion without having to continually worry about the details. Crucially, a collection manager will provide peace of mind and allow the art collector to own the collection, rather than the collection owning the art collector.

If the collection manager works within the context of a family office, where the focus is as much on the collection as on the art collector, a collection manager will also recognize that the long-term preservation of an art collection across multiple generations, and decisions about the future of the collection, are far more dependent on the art collector and his or her family than on the collection manager. He or she will also recognize that just as the art collector has an impact on the collection, so the collection has an impact on the art collector and his or her family: there is little point in passing down a collection if the beneficiaries do not share the same passion.

Part of the reason for choosing an experienced collection manager within a family office is to integrate a plan for the management and administration of the collection with a view to family inheritance into the wider family inheritance strategy.

Deciding on the need for a collection manager is, therefore, typically driven by the realization that the day-to-day management of a collection is a task that exceeds the capacity of the individual art collector. This discussion, however, often begins with the need to think about the future of the collection, and this also increases the need for a more formal decision-making process and administration of all assets.

The decision about what type of assistance is required must start with a thorough and honest appraisal of both the art collector and the collection's needs. A team working alongside the art collector to offer art management infrastructure as well as expertise, experience, and—crucially—continuity, might meet their needs most effectively.



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The role of wealth managers in managing art and collectibles and the transmission of a collection to the next generation

The banking industry is facing important challenges. The classic business model of private banks, focused on the allocation of liquidity to financial products, is therefore no longer sustainable.

These institutions now aim to move toward managing the broader wealth of their clients, which may include real estate, art, and collectibles, to differentiate themselves and excel in areas of expertise other than pure finance—just as a family office would. In addition, clients continue to express a desire to receive a consolidated overview of their assets in a bank report that includes art and collectibles. In that sense, private banks need to be capable of managing clients' broader portfolios, and the role of wealth managers is thus to expand their services to encompass these asset classes in order to generate benefits for collectors and the private bank alike.

The management of art and collectibles within private banks usually relies on collaboration between a relationship manager, in charge of the client/bank

With the transmission of an art collection from one generation to the next, the wealth manager's role is to assist the younger generation in viewing the collected items as assets rather than merely an art collection.

relationship, and in-house or external art specialists. Wealth managers usually focus on collection structuring and estate planning, art lending, art funds, logistics, etc., and request external advisers' assistance with valuation, authentication, and broader collection management. More specifically, the wealth manager advises clients at every stage in the life cycle of their art collection—i.e., acquisition, holding, and transmission. In the specific case of the transmission of a collection, one of the main issues is how it can be passed onto the next generation. The younger generation may often not appreciate the items collected by their parents or may simply have no interest in art. As a result, when it comes to bequeathing art collections, the process starts with a few simple questions for family members. Do the children like their parents' collections?

Would they be interested in keeping them? Are the parents willing to sell their collection while they are still alive? In the very few instances where both parents and children know the answers to these questions, the wealth manager's role is to provide the family with estate planning advice. However, the family has not usually discussed the future of the older generation's collection. In these cases, the family members should consider the following options for the art collection to make sure the transmission is planned successfully.

The usual pattern for an art enthusiast is to be passionate about a specific type of art, and then for this passion to turn into a collection. With the transmission of an art collection from one generation to the next, the wealth manager's role is to assist the younger generation in viewing the collected items as assets rather than merely an art collection. If the children perceive their parents' collection in this way, they will be more inclined to keep the collection and manage it rather than selling or simply ignoring it. To assist the family with this, the wealth manager can help implement a family governance plan for the art collection, whereby each family member has a role to play vis-à-vis the collection. As with the transmission of a family business, certain children would be actively involved in working in the business

while others would be happy simply to be shareholders. The wealth manager's role is also to educate the younger generation, provide curation advice on the collection, set up a dedicated vehicle to manage or hold the art, etc. The transmission arrangements for each collection need to be tailored, but, in many cases, the wealth manager's role, besides providing the aforementioned services, is to act as a mediator between the two generations. Art is an emotional asset and triggers a highly personal response. It is not always easy for collectors to open up to others on this topic—even to their own children. However, an empathetic wealth manager can serve as a bridge for communication between the two generations.

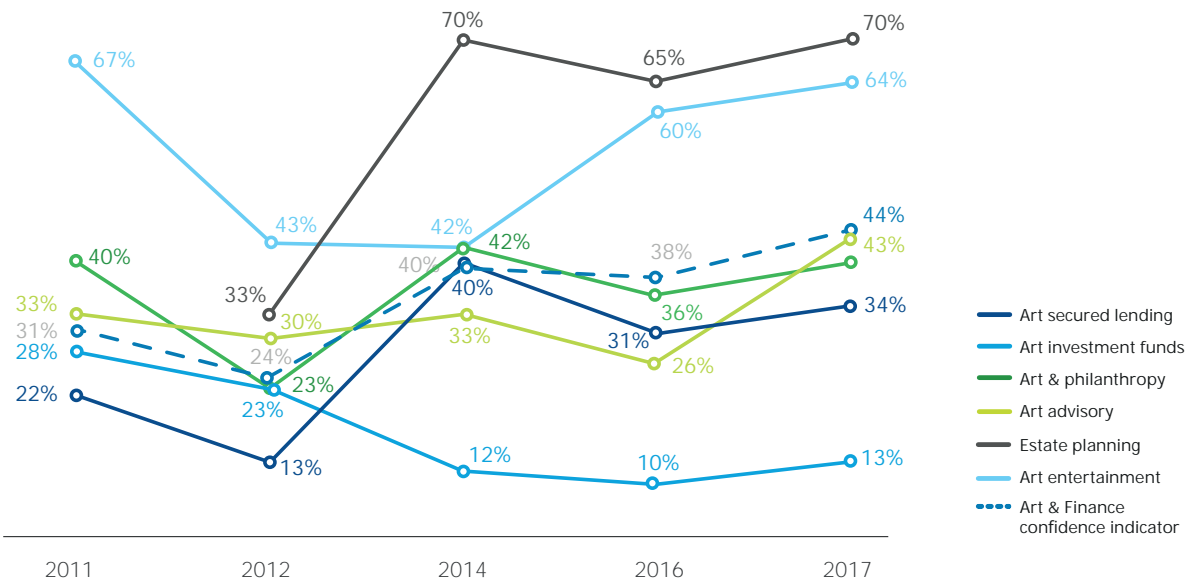
Reflecting on the role of wealth managers in the management of art and collectibles, it is legitimate to ask what the benefits are for clients of working with their wealth manager rather than an independent art adviser, for example. First, clients have established a strong trust-based relationship with their bank. Unlike other parties, such as a law firm, which clients only tend to contact when they are faced with problems, clients work with banks on positive topics such as generating returns on investment. Clients can also benefit from banks' risk culture, which can be extended to protect their art collection. In addition, the client-bank relationship is a long-term partnership—not just an association for a specific mandate. Moreover, the wealth manager is most likely best-placed to assist clients with the management of their collection within the broader context of their extended portfolio, because they can harmonize the funds allocated to their portfolio, implement cash flow logistics based upon their assets, and manage their collection appetite. Finally, it seems that clients tend to turn to their bank for advice on art and collectibles when the bank possesses certain specific attributes such as having a major network of collectors or in-house expertise rather than just a network of external experts. At such institutions, the bank remains the key point of reference, providing continuous support to its clients, and the wealth manager's role also benefits the bank by strengthening the institution's relationship with its clients.

Art & wealth management services

Future directions

General motivation and perception among wealth managers, art professionals, and collectors.

Figure 21. Future Services - Which services will you focus on in the next 12 months?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

A. Private bank and family office key survey findings 2017

Art & Finance Future Indicator – which services will wealth managers focus on in the near future?

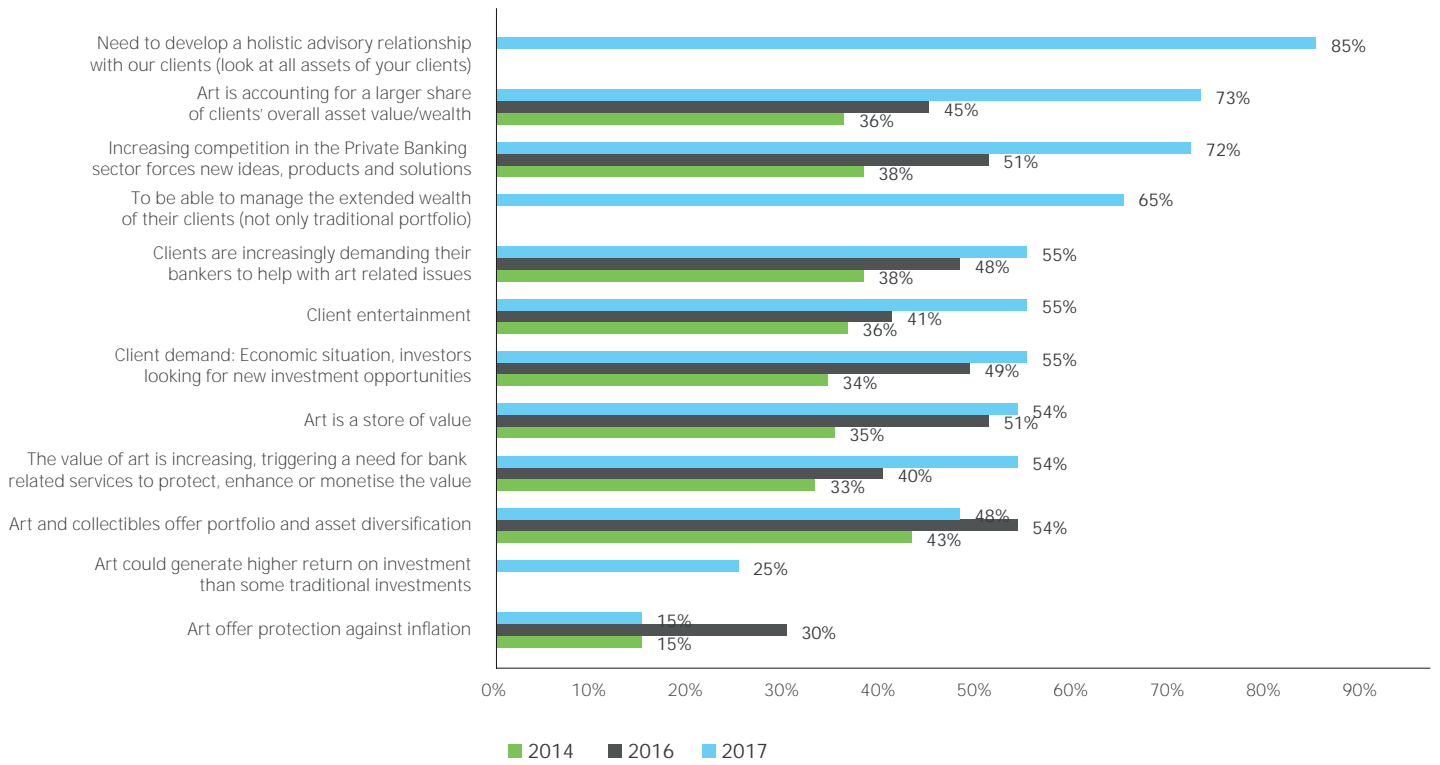
In the next 12 months, our survey findings reveal that wealth managers are likely to focus on and invest in a broader range of art-related services, paying particular attention to estate planning, client entertainment, art advisory, art and philanthropy, and art-secured lending. On average, 44 percent of wealth managers reported that increasing focus and resources

would be dedicated to art and wealth management services in the coming year, up from 38 percent in 2016. This is the highest reading since the launch of the survey in 2011, and is supported by a positive development for all activities. One particular focus area for the wealth management industry, besides estate planning, is offering an art advisory service; this is best understood as a competence or knowledge umbrella encompassing all other art-related services. The interest in client entertainment (often linked to art sponsorships) remains the second

most important area of focus for wealth managers in the coming year. Although this might be considered a “soft” service, it could be an effective education tool and a vehicle for raising awareness of current or future art-related services and initiatives, and bring attention to art and collectible wealth that has not been discussed in a wealth management setting before. It is also an opportunity to forge closer links with the non-commercial sector and to tap into the vast knowledge that these organizations have, as discussed in Priority 9 (page 32).

Figure 22. What do you consider the strongest arguments for including art and collectibles in traditional wealth management/private banking?

**Three new motivations were added to this year's survey*



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Among the most important motivations for including art in wealth management are the rising valuations seen on the art market and the fact that art is accounting for a larger share of the clients' overall wealth.

Motivations & rationale

A holistic approach to wealth management:

One of this year's primary motivations for including art and collectibles in traditional wealth management is a need to develop a holistic advisory relationship with clients (i.e., to consider all types of assets), which again is a consequence of fierce competition in the wealth management sector. This year's survey findings show that 85 percent of wealth managers (86 percent of private bankers and 77 percent of family offices) believe that the move toward a holistic wealth management model is the strongest argument for including art and collectibles in a wealth management service offering. This is linked to 65 percent of wealth managers saying that their primary motivation for including art and collectibles is to be able to manage the extended wealth of their clients (not only a traditional portfolios of assets), which demonstrates a broader trend toward a more holistic approach to wealth management (see the Priorities for further discussion on this point).

Art is accounting for a larger share of individual wealth:

Among the most important motivations for including art in wealth management are the rising valuations seen on the art market and the fact that art is accounting for a larger share of the clients' overall wealth. This view was expressed by 73 percent of wealth managers (72 percent of private banks and 77 percent of family offices), up from 45 percent in 2016. 54 percent of wealth managers feel that as the value of art is rising, the need for bank-related services to protect, enhance, or monetize these assets will increase in the future (up from 40 percent in 2016).

Increasing competition in the wealth management sector is fueling providers' desire to differentiate themselves from the competition:

One of the primary impulses behind the drive toward the holistic approach mentioned above is the competitive pressure within traditional wealth management. 72 percent of wealth managers (79 percent of private banks and 38 percent of family offices) see services around art and collectibles as a way of differentiating themselves from their competitors in an increasingly congested and competitive marketplace (this was up from 51 percent in 2016). The increasing focus on "passion-based" investments is a sign that wealth managers need to take a more emotional and—as mentioned earlier—a more holistic approach to the way they work with their clients' assets (which often are assets linked to their hobbies, such as classic cars, wine, race horses, paintings, etc.).

Asset diversification and inflation protection are losing importance as motivations:

48 percent of wealth managers (47 percent of private banks and 54 percent of family offices) said the strongest argument for including art and collectibles in a wealth management context was the opportunity for portfolio and asset diversification offered by art and collectibles (this was down from 54 percent in 2016). In the current low inflation environment, only 15 percent of wealth managers (15 percent of private banks and 16 percent of family offices) said that the strongest argument for including art was that it offers protection against inflation (this was down from 30 percent in 2016).

Art as a way to safeguard value:

More than half (54 percent of wealth managers, 57 percent of private banks, and 38 percent of family offices) increasingly see art as a means to safeguard value. This is up from 51 percent in 2016 and represents the highest reading since the survey was launched in 2011. The ability of the art market to weather economic and political turbulence during the financial crisis in 2009 and the uncertainty and tougher economic climate that followed provide some credence to the argument that art and collectible assets are worthwhile as a means to safeguard value.

Increasing demand for alternative investments:

In this year's survey, 55 percent of wealth managers (47 percent of private banks and 31 percent of family offices) said that their clients were looking for alternative investment opportunities and that this was a key motivating factor for considering art and collectibles (up from 49 percent in 2016). Geopolitical risk in the Middle East, uncertainty surrounding Brexit, and the uncertainty around the US presidency could increase volatility in financial markets in the coming years. It is likely that the appetite for art and collectible assets will have been strengthened by the track record of the global art market in the last years (*page 176*) for market analysis and trends).

Client pressure on wealth managers:

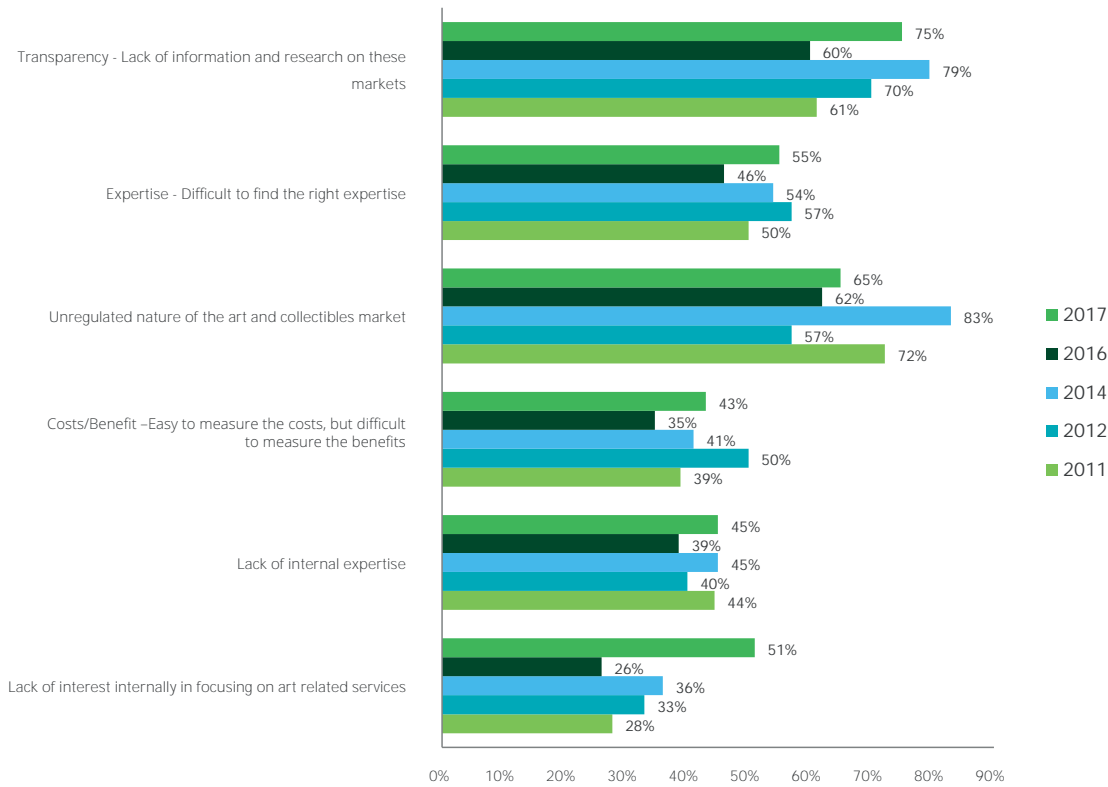
55 percent of wealth managers (52 percent of private banks and 69 percent of family offices) said that clients are increasingly asking their private bankers and wealth managers to help with art-related issues (up from 48 percent in 2016). This was felt more strongly among the family offices surveyed, where 69 percent said that increasing client demand was the most important reason for including art and collectibles as part of their service offering, compared to 52 percent of private banks.

Art offers an alternative client

entertainment tool: 55 percent of the wealth managers (60 percent of private banks and 31 percent of family offices) surveyed said that client entertainment was one of the most important motivations for including art and collectibles as part of a wealth management offering (up from 41 percent in 2016). This is also one of the key areas that wealth managers say they are likely to focus on in the next 12 months (*Figure 21*), reflecting the high emotional and social value that collectors place on being involved with art and the art world. This presents an opportunity for event-based art organizations, such as art fairs and museums, to develop innovative new collaborations that go beyond traditional sponsorships.

The ability of the art market to weather economic and political turbulence during the financial crisis in 2009 and the uncertainty and tougher economic climate that followed provide some credence to the argument that art and collectible assets are worthwhile as a means to safeguard value.

Figure 23. Wealth Managers: What do you see as the biggest challenge in offering art related services/products?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

1. Challenges

The ranking of the most important challenges facing wealth managers when incorporating art into their service offering remains largely the same as that reported in the first survey in 2011. However, as interest in art and wealth management grows, an apparent lack of senior management support for developing these initiatives seems to be creating a greater sense of frustration among the wealth managers surveyed this year.

Lack of art market transparency is a key obstacle to the future development of the Art & Finance industry: As the wealth management industry continues to grow and expand its investment in art-related wealth services, there is also a heightened sense of concern regarding the lack of transparency in the art market. This year, 75 percent of wealth managers (77 percent of private banks and 68

percent of family offices) see this issue as the biggest challenge when offering art-related services and products to their clients (up from 60 percent in 2016). Lack of transparency is also perceived to be one of the greatest threats to the overall reputation of the art market and is one of the areas that regulation could address.

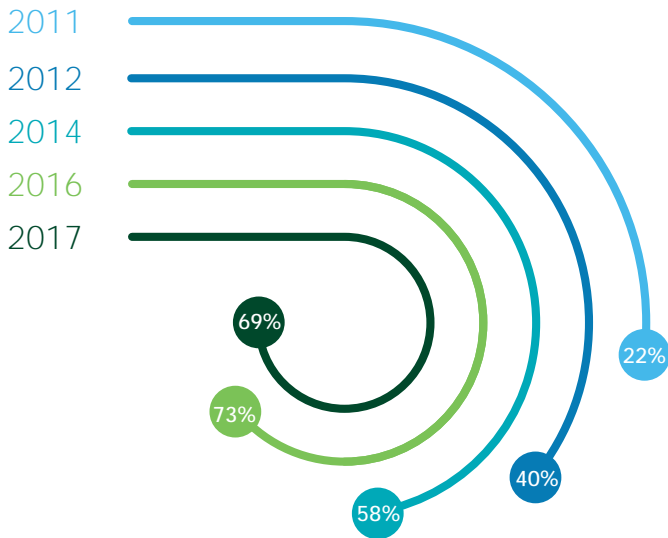
Regulation remains a major challenge: With financial institutions facing increasing regulatory scrutiny and pressure, 65 percent of the wealth managers surveyed this year said that the unregulated nature of the art and collectibles market remained the biggest challenge for incorporating art into their service offering (up from 62 percent in 2016). For a broader discussion of the issues surrounding regulation, see Section 5.

Finding and developing talent and expertise: 55 percent of wealth managers (59 percent of private banks

and 42 percent of family offices) said that finding the right expertise remains one of the key challenges in terms of building an art-related service offering (up from 46 percent in 2016). This pertinent issue is discussed in greater detail by Celine Fressart and Harvey Mendelson in the 1858 Ltd Art Advisory contribution entitled “Art wealth management: who can you trust?” (page 122). Another 45 percent of wealth managers (51 percent of private banks and 26 percent of family offices) said that the lack of internal expertise was a key hurdle (up from 39 percent in 2016).

Lack of management support: 51 percent of wealth managers said that lack of interest internally was a major challenge, up from 26 percent in 2016. This could suggest that as interest in art and wealth management is gaining momentum, there is a lack of leadership support for these types of initiative.

Figure 24. Do you expect your clients to want to include art and other collectible assets in their wealth reports to have a consolidated view on their client wealth and have a better view on the client exposure?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

2. Reporting

Better reporting on art and collectible assets could help the drive towards a more holistic wealth management approach: 69 percent of wealth managers (70 percent of private banks and 63 percent of family offices) expect their clients to want to include art and collectibles as part of their overall wealth reporting (slightly down from 73 percent in 2016, but still significantly higher than 58 percent in 2014 and 40 percent in 2012). This represents a continuation of the upward trend seen in the last five years. The ability to report on and monitor art and collectible wealth could present an opportunity and an effective way of providing value-added services to clients. By increasing awareness of the financial value and risks associated with their clients' art and collectible wealth, wealth managers could enhance their understanding of their clients' total assets, which is a prerequisite for developing a holistic wealth management strategy. This issue is also discussed further in the article by Celine Fressart and Harvey Mendelson from 1858 Ltd, who addresses the wealth managers' increasing need to obtain an overview of their clients' art assets and to consider the most appropriate collection management framework. The same argument is made in a broader context by Melanie Damani from Edmond de Rothchild, who states that private banks need to be capable of managing clients' broader portfolios, and stresses that the role of wealth managers is to expand their services to encompass these asset classes and generate benefits for collectors and the private bank alike.



Art wealth management Who can you trust?



Harvey Mendelson,
Managing Director
1858 Ltd Art Advisory



Celine Fressart
Head of Special Projects
1858 Ltd Art Advisory

The financial community is often at a loss when it comes to discussing art matters with clients. This is understandable, as the market is an unregulated and opaque industry, where there are more unwritten practices than there are written codes.

In almost two decades of providing art advisory services to the wealth management community, we have increasingly seen the successful union of art and wealth management. This is partly due to the fact that in recent years the art market has become a heavyweight industry on a global scale.

Top collectors are competing for bragging rights on pieces worth in excess of US\$100 million. Major auction houses have developed their financial services and art fairs have become highly skilled in the art of M&A. Even luxury brands have jumped on the bandwagon and are seeing the dollar signs with lucrative artist collaborations.

With all of this activity, it is not surprising to see that private banks are also trying to forge ever-closer bonds with the art world. This may take the form of art funds, art finance solutions, or establishing their own clubs of collectors and training their teams to identify prospective clients with an interest in art.

The main stumbling block for wealth managers remains the fact that the art industry continues to heavily rely on market expertise and trusted networks. So, who can they call upon?

Finding the right trusted partner is not always easy. Over the last two decades, we have witnessed a tremendous rise in the number of qualified and unqualified advisers. Today's market consists of many so called "advisers." Some market themselves as advisers but are actually gallerists/advisers or auctioneer/advisers. Of course, they can provide "advice," but their intrinsic business models render this advice biased.

A good question to ask when selecting the "right" adviser is this: does this person have a commercial interest in the work of art being offered for sale? As is the case with financial transactions, a trusted adviser who is truly independent and impartial will be able to provide market intelligence. This will enable the client to make informed decisions with complete transparency at all junctures of a transaction.

The financial community, traditionally skeptical of the art world, also seems to have shifted opinion. Whereas art was once seen as an expensive hobby, it is now viewed as a powerful tool to increase wealth, diversify into alternative investments, and pass assets on to the next generation.

As a result, it is now increasingly important for wealth managers to obtain an overview of their clients' art assets and consider the most appropriate collection management framework.

This should include protecting the assets by checking that the correct insurance coverage is in place, ensuring accurate valuations for the works are recorded, and making other arrangements regarding exhibitions, restoration, cataloguing, framing, crating, safe transportation of works, and so on. When managed correctly, a collection's value can be enhanced and holding costs minimized. Effective collection management also benefits heirs when the collection is passed on. Knowledgeable and effective wealth managers will be involved with the collection over time, ensuring they are at the center of all of their clients' activities.

The financial community is starting to appreciate that art is highly emotive and can potentially build or burn the bridge between intergenerational relationships and vested wealth. Most banks now provide educational programs for the next generation, aiming not only to prepare the next generation to handle financial matters relating to their inherited wealth, but also to create a relationship of trust with millennials and future generations. In an increasingly competitive financial market, it is vital for wealth managers to provide comprehensive solutions that will assist in retaining clientele across multiple generations.

Art is the cornerstone of well-conceived next generation programs. The best programs contain a module on the preservation of alternative assets and how to transform the burden of an

inherited collection into an opportunity for the future. What should be done with an inherited collection of old masters' paintings, when all one dreams about is street art? What is the relevance of numismatics to someone raised with bitcoins? These are the questions to be asked and the problems we endeavor to solve.

A good question to ask when selecting the "right" adviser is this: does this person have a commercial interest in the work of art being offered for sale?

Art and estate planning

In this year's survey, estate planning was the art and wealth management service viewed by art professionals, collectors, and wealth managers as the most relevant. Wealth planning with respect to a future art legacy can be complex. The issues that need to be confronted are often far easier to avoid than to address. But effective planning can reduce the likelihood of family conflict as well as the possible tax burden associated with the passing of a loved one.

Regardless of the size of an art-related estate, a basic estate plan is an essential step toward addressing fundamental issues such as the disposal of assets, charitable bequests, and responsibilities for carrying out the express wishes of the deceased. For wealthy individuals with large art collections, the estate plan becomes the roadmap from which a legacy will be established and implemented. The article by Micaela Saviano, Mark Stokes, and Cyrielle Gauvin on *page 128* aims to raise awareness of the risks to a collection during estate settlement and highlight the need for specialized planning tailored to an art collection. Emilie Villette from Christie's (*page 146*) discusses the need for wealth managers to seek a 360 degree overview of their clients' assets to provide them with a tailored service, inform and assist collectors in managing their collections as patrimonial assets, and provide a framework for how this can be done.

Private banks and family offices—survey findings

Significant growth potential with regards to art and estate planning: Art and estate planning has been one of the growing areas of art-related services within the wealth management industry, and this will remain a core focus for private banks and family offices in the next 12 months according to this year's survey. Despite the fact that 89 percent of private banks said they offered art and estate planning services, only 28 percent said that their clients had made adequate provisions for their art collections in their estate plans, and 31 percent said that their clients had not addressed their art collections in their estate plans at all. A further 41 percent of private bankers said they are unsure about their clients' level of preparedness when it comes to their art collection and estate planning. This stands in stark contrast to the family offices surveyed, where 72 percent said their clients had made adequate provisions for their art and estate planning needs. These findings could signal that art and estate planning is more of a token service at the moment, but that there is significant untapped potential for the private banking industry to take a more proactive approach to art-related wealth and estate planning in the future.

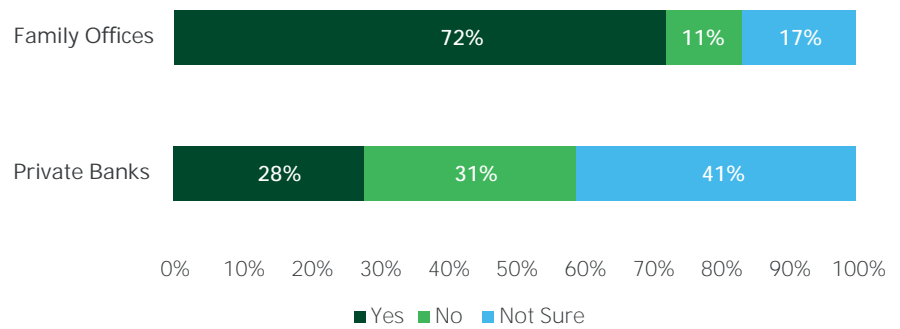
The aforementioned findings could also be a sign that art-related wealth has some distance to go in terms of being fully understood and integrated into overall wealth management, and that there is still a certain amount of complacency within the wealth management industry when it comes to art and collectible wealth. However, this provides a significant opportunity for the private banking industry to initiate a broader and more holistic discussion around art and wealth management with their clients.

When it comes to collection management and estate planning, it is once again the clients of family offices that seem to have their house in order. The majority, i.e., 61 percent, of family offices (all of the US family offices and half of the offices from the rest of the world) stated that their

clients maintain an updated inventory of their collection (a description of the object, its location, and its minimum) allowing them to administer the estate without the art collector's input. Again, in stark contrast, only 13 percent of the private banks said the same, with 21 percent saying that their clients had such a system in place, but that it was likely to be outdated.

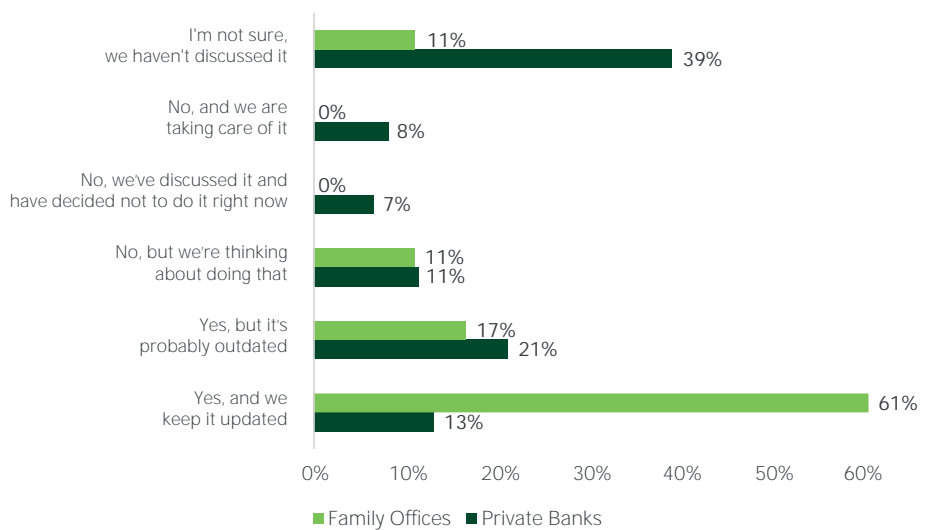
Again, a high number (39 percent) of private banks had not had this discussion with their clients. However, there are signs that some private banks are acting, with eight percent saying that they were actively working with their clients to establish a collection management system, and 11 percent considering implementing one in the future.

Figure 25. Wealth managers: Do my clients have estate plans that sufficiently address their art collection?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Figure 26. Wealth managers: Do my clients maintain an inventory of their collection that at a minimum identifies each piece, its present location and its approximate value so that we could help to administer the estate without the art collector's input?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Art collectors survey findings

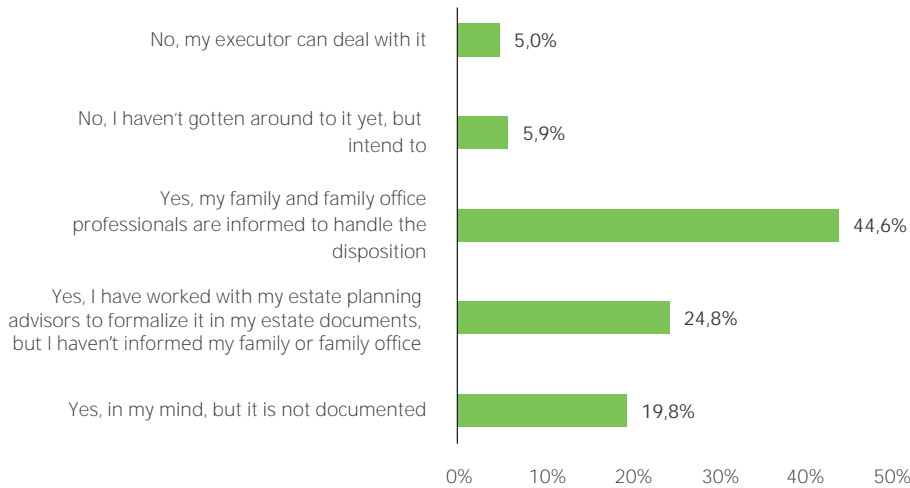
While the majority of private banks have yet to discuss or address their clients' needs in respect to art and estate planning, the survey findings for collectors indicate that the majority (69.4 percent) have already taken steps to formalize the long-term plan for the collection (44.6 percent through their family office, and 24.8 percent through their estate planning adviser, although they have yet to involve the family office). A further 19.8 percent of collectors say they are thinking about formalizing the plan for their art collection, but it is not yet documented. Only 10.9 percent of collectors surveyed have no plans or see no purpose in planning for such an event.

67 percent of the collectors who have made formal arrangements for their collection in their estate plan say that the art will primarily go to the family, 14 percent said that the art would be sold and that the proceeds would go to the family, and 13 percent said it would go to their private foundation. On *page 132*, Javier Lumbreras talks about the innovative Charitable Museum Endowment Fund, focusing particularly on artistic patronage and how to harmonize finance and culture.

When it comes to public donations, only five percent said that their collection would go to a public museum and only one percent said it would be sold and go primarily to charity. The risks associated with private donations to public museums are discussed in greater detail in Section 6 (*page 239*), which explores the role wealth managers can play in the development of best practices. Donations to museums and charities are also discussed by Micaela Saviano, Mark Stokes, and Cyrielle Gauvin in their article on *page 128*.

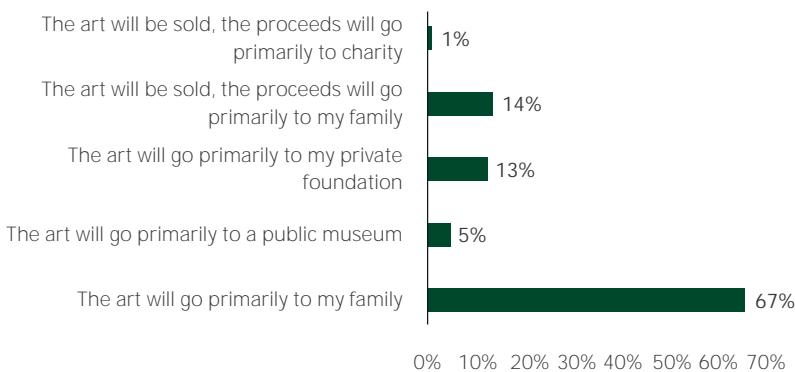
When it comes to public donations, only five percent said that their collection would go to a public museum and only one percent said it would be sold and go primarily to charity.

Figure 27. Art collectors: Do you have a long-term plan for your collection?



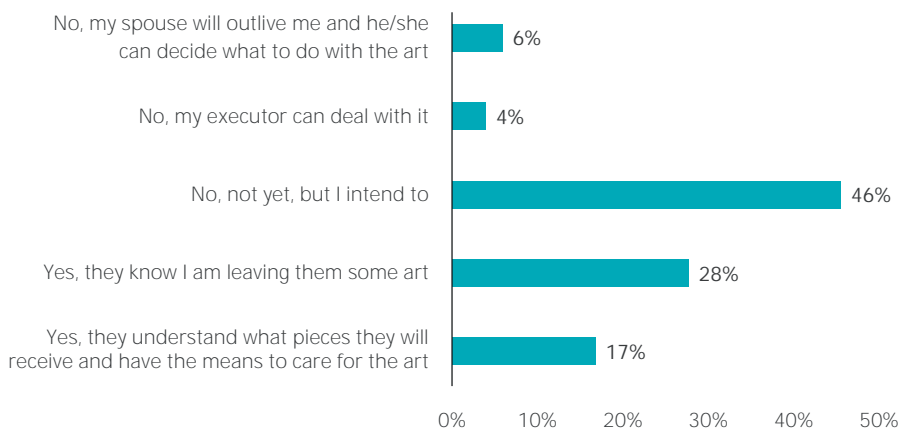
Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Figure 28. Art collectors: If you have made formal arrangements for your collection in your estate plan where will the art go?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Figure 29. Art collectors: If you intend to leave some or all of the collection to your heirs, have you discussed it with them?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017



Micaela Saviano

US Tax Private Wealth
and US Art & Finance
Deloitte US

Mark Stokes

UK Private Client and
Family Office Tax
Deloitte UK

Cyrielle Gauvin

Luxembourg Tax and
Art & Finance
Deloitte Luxembourg

Leaving a legacy that lasts

A high-level look at the risks of estate planning (or lack thereof) to your collection

An art collector's motivations for starting and growing a collection are likely to be as unique as the pieces that they own. And yet, what everyone comes to learn is that care and maintenance are required to preserve the collection. Most collectors work carefully with art advisers and other specialists to address the many risks linked with the preservation of the collection—risks such as provenance, restoration, conservation, transportation, and valuation. While the 2017 survey found that more than half of the collectors surveyed have taken steps to address the disposition of their collection within their estate, many collectors have yet to address this profound risk to the collection.

In the event of an art collector's death, one of three things can occur to a collection: it can pass to heirs, be transferred to charity, or be sold. Most collectors have a preference, but there are many who have not formally addressed the matter and written this into a tailored estate plan. Several characteristics differentiate art and collectibles from other assets in an estate.

Most obvious is the fact that collectibles are (almost always) physical items and one-of-a-kind objects to which collectors generally have a strong emotional attachment. Additionally, within a complete collection, each individual piece may have a vastly different, and ever-changing value. This generates a multitude of challenges.

Estate planning is ultimately a legal matter and there are issues that are unique to each jurisdiction depending on where the art collector is resident and domiciled. Because this publication is tailored to a global audience, we will cover only high-level issues associated with planning in relation to tangible assets with significant financial value. What we hope to accomplish is to raise awareness of the risks to a collection during estate settlement and highlight the need for specialized planning tailored to a collection. We encourage all collectors to work with their advisers when addressing the tax and legal issues of their estate.



Bequeath to family/friends

Passing the collection to family or friends may be perceived as a way of preserving the collection for the future, but there are common pitfalls that require careful consideration.

First, many individuals' estate plans include very generic provisions for tangible personal property; it often transfers first to the surviving spouse and if none, to the deceased's children. While this is generally reasonable for household furnishings and other chattels, it may not be the intended result for a valuable collection.

The art collector may have assumed that the collection would be passed on in accordance with the more extensive terms of his or her estate plan, but failed to discuss the collection with his or her estate planning adviser. Even worse, the art collector may be living with an outdated estate plan, drafted before the collection ballooned in value.

Perhaps the art collector did intend to leave the collection to his or her surviving spouse or children, in which case this kind of general provision for tangible property would be fit for purpose. However, as noted earlier, it is important to remember that an art collection often consists of one-of-a-kind items and that these items, in many cases, are significantly more valuable when held as a single collection that may have taken years to curate. Defaulting to the tangible property provisions could result in the unintended division of the collection.

In the context of a family, there are any number of situations that could create issues. For example, if the collection is to be divided up among the family, could this result in conflict between the beneficiaries? Unique pieces that may be comparable in value now could have significantly different values in the future—is the family comfortable with that possibility?

Do the beneficiaries want the collection, have enough interest in it, or have the resources available to properly maintain and care for the works?

Alternatively, an art collector may choose to transfer unique pieces of interests in the collection to the desired beneficiary or to a trust during their lifetime. In a jurisdiction with an estate or inheritance tax, proactive lifetime planning can significantly reduce the tax burden on a collection. A transfer also removes the asset from the art collector's taxable estate, shifting future appreciation in the art to the trust or individual(s) receiving it. Equally, the art collector can control and monitor that the transfers are completed according to his or her wishes. The art collector may also value seeing family members enjoying the artwork and/or reconsider future gifts if the family is less engaged or appreciative than expected.



Leave to charity

Some collectors wish to donate their collection to a museum or charity upon their death. In some jurisdictions, this will result in tax relief for their estate. While many collectors assume that their prized possessions will be highly coveted by their favorite museum, this is often not the case, as modern museums have storage rooms full of high-quality artwork, more and more gifts are being turned away. Meanwhile, many alternative museums or other charitable institutions may be quite

pleased to have a specific piece, if the opportunity were presented. Collectors would be wise to have initial discussions with the museum(s) to confirm that the collection will ultimately find a suitable home.

Another alternative may be to leave a collection to a private foundation. However, this brings its own challenges in terms of the maintenance of the collection, funding for the organization, and specific tax and legal considerations in the relevant jurisdiction.

Similar to lifetime transfers to family or trusts, lifetime transfers to charity may yield tax and personal benefits. Some jurisdictions, such as the US, offer income tax deductions for lifetime charitable gifts of artwork. Collectors may enjoy seeing their prized collection in a public institution where their legacy can be enjoyed by the public.



Sell the collection

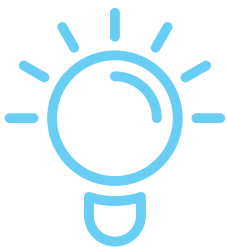
The third approach is to sell the collection. One might assume this is the easiest option, yet many people fail to realize that selling a collection is a daunting and time-consuming task for the average executor. The executor may not be familiar with the collection or the nuances of selling collectible assets. It can be challenging for executors to maximize the value of the collection for the estate, given the specialist nature of an art collection.

Executors may not be aware of what they have or how to realize its true value. Accordingly, some collectors chose to

name an art adviser in their documents or preemptively appoint an auction house to sell the collection. More fundamentally, the executor or family may not know what the collection encompasses. Most collectors are now aware that they should have an inventory system for their collection, but the process is often postponed due to the complexity. In many cases, an inventory may exist, but is not effectively maintained with current asset value estimates, locations or other critical information.

It is also important to be attentive to the residence and domicile of the art collector when planning for a sale. It should be

highlighted that each jurisdiction may have a specific regime applicable to sales of artworks, and art advisers and executors must be aware of those details if they are to manage collectors' estate planning most efficiently. For example, some countries such as France offer preferred tax treatment on the sale of artworks by a French tax resident.



SOLUTION

Building a collection is a lifelong pursuit for many people. The care and attention that goes into building a collection should also be applied to planning for a collection upon the art collector's death. A collection can ultimately go to family, charity or the auction block. Each art collector must decide for himself or herself what is best for the family and the collection. As noted above, pitfalls abound, but with some careful planning, regular review of the plan and collection details and the assistance of specialist advisers, an art collector can develop a legacy that lasts.

Artists face unique challenges when it comes to ensuring their legacy. Unlike collectors, artists own a set of various intellectual property rights, which exist separately from the ownership of the physical artwork. Far too often, artists actively deal with the transfer of their physical goods, but completely ignore the transfer of the intellectual property rights attached to such artwork. Developing an estate plan can help preserve and develop the legacy of an artist. Specialized attorneys, accountants, and valuation experts can work together with the artist to address the appropriate

breakdown between the various ownership elements, according to the prospective heirs, the artist's wishes and goals, and the local laws. Any estate planning measures should also focus on the preservation of the artist's reputation.



Descendant

- Does your current estate plan (or local law) accomplish your wishes for your collection?
- Have you evaluated it under different family and economic scenarios?



Family

- Have you discussed your collection with your family? Are you sure that they want *all* of it?
- If you're leaving it to your spouse, what happens to the collection upon his/her death?
- Would your plans change if you determined that your family did not intend to keep the art after your death?
- Is there a plan in place for your family to divide the artwork if multiple people will inherit it?



Charity

- If you will leave the collection to charity, have you already discussed it with the charitable organization and are sure that they want it? *All* of it?
- Do you have a gift agreement in place?
- If your first choice organization doesn't want some or any of the art, is there an alternative organization you want to support?
- Will you leave a cash gift to help support operations to sustain the collection?



Sell

- If the collection will be sold, does your executor know what to do?
- Does your executor know where all the assets are located and what they are worth?
- Have you named an art adviser in your estate plan?
- Have you coordinated with an auction house to sell the collection?

An art collector's motivations for starting and growing a collection are likely as unique as the pieces that they own. Yet, what all will learn is that care and maintenance are required to preserve the collection.



Javier Lumbreras
CEO
The Charitable
Museum Endowment
Fund, L.P.

The Charitable Museum Endowment Fund

Artistic patronage harmonizing finance and culture

Javier and Lorena Lumbreras had a dream; rescuing a splendid 16th -century Jesuit school, Saint Nicholas Church and other adjacent buildings in a state of ruin and disrepair, along archaeological medieval and Roman findings, located in Arévalo, Spain.

The key motivation behind is the creation of COLLEGIUM, a place destined to generate social change, sustainable intellectual stimulation, the perpetuation of community well-being while building a legacy for their family. The ambitious scope of the project led to the creation of The Charitable Museum Endowment Fund, an open-ended hedge fund that aims to reduce or permanently eliminate a museum's dependency on its founder's resources, while also creating a network through which museums can share resources and innovations. The following case study explores the creation of Spain's most ambitious private museographic project of the 21st century since the Thyssen-Bornemisza Museum in Madrid, along with the investment vehicle that will render this endeavor financially stable.

Scheduled to open in 2020, COLLEGIUM will be one of the first museums to integrate the cultural and economic structures of its locality with its values and operative system. This project will not only become the permanent home of the Adrastus Collection—which comprises over 600 artworks by 150 artists from five continents curated by Patrick Charpenel—but will also create an exchange platform with the region's public museums as announced by the government and summarized in a protocol signed last June. The guiding principle behind COLLEGIUM is critical museology where the aim is to capture the radical nature of the most important manifestations of 21st century art and the history of the site.



Render of COLLEGIUM © Tatiana Bilbao Studio



© Fundación Lumbreras-Colección Adrastus

The following case study explores the creation of Spain's most ambitious private museographic project of the 21st century since the Thyssen-Bornemisza Museum in Madrid, along with the investment vehicle that will render this endeavor financially stable.

As a laboratory of experiences, and research center, COLLEGIUM depicts a society of revitalized communities where all people—local residents and visitors alike—are inspired by the transformative power of art to shape our understanding of ourselves and improve our collective quality of life.

A total surface area of 12,020m² will house COLLEGIUM's ambitious program, comprising 4,000m² of exhibition space, 3,300m² of public space, 1,300m² of archive and research areas, 750m² for workshops and artists' residencies, 2,000m² for other facilities (including a specialized conservation center), and 250m² for the foundation's hub. The project will create a connected space in which the thread of history is woven into the reality of modern culture. This experimental museographic concept projects itself into the 21st century breaking away from the traditional white-cube appearance by blurring the boundaries between the exhibition, production, conservation, and research areas and creating a dynamic relationship among them.

Designed by the acclaimed Mexican architect Tatiana Bilbao, the museum aspires to be part of a multicultural and plural experience in which the city of Arévalo is the jewel in the crown.

The Fundación Lumbreras—Colección Adrastus soon realized that this undertaking would be highly challenging. Not only because it involves the laborious restoration of 16th century ruins – amongst the new building additions– but also because the time and financial resources available could not be forever capable of subsidizing the operational expenses and financing the ambitious program planned for COLLEGIUM in the absence of its founders. Museums are becoming more than mere places to exhibit objects. Nowadays, they act as agents of change and development in the community through the creation of

innovative programs, stimulating projects and educational events that encourage social well-being. With the creation of over 317 contemporary art museums in the last 15 years, the competition for grants from governments and private foundations has never been tougher, and this has now become a serious concern among most private and public museum endowments around the world. Some performance-limiting factors in fundraising are: (i) a lack of governmental and private donors, (ii) aging boards, (iii) rising operational costs associated with recruiting and retaining top talent, and (iv) the escalating price of ambitious art programming. That is why Javier Lumbreras created The Charitable Museum Endowment Fund.

The Master Fund is expected to run into the billions of dollars and will maintain a diversified portfolio of wholly and partially owned art investments with varying holding periods.

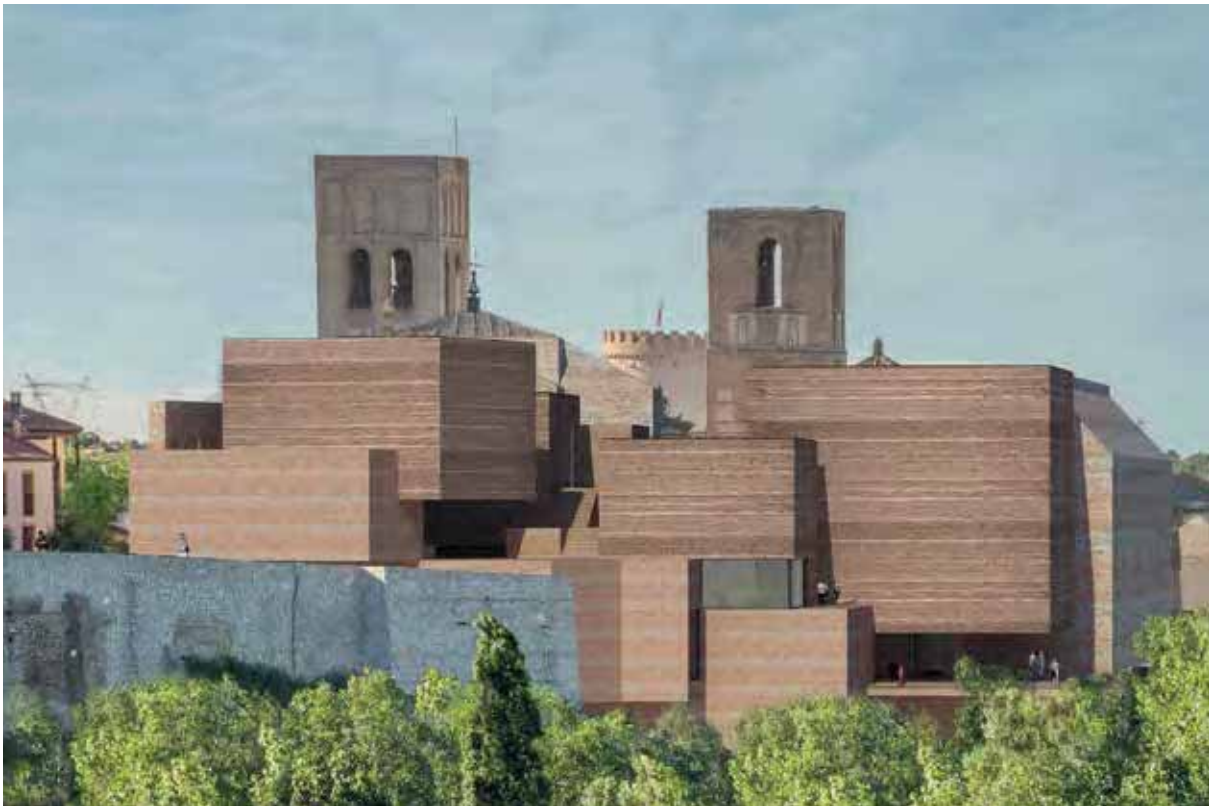
With a strong background in art and finance, and a deep concern to build a self-sustaining mechanism for his own foundation's sake, Lumbreras decided to create a charitable investment vehicle to assist collections, foundations and existing museums in the creation and funding of their respective permanent endowments.

With over 30 years of experience in the art market, and having successfully launched and closed the Artemundi Global Fund (17.02 percent average return per annum), Lumbreras realized that it was time for the art market to give something back to the art world. The Charitable Museum Endowment Fund's main objective is to produce investment returns to fund non-profit endowments for museums and other cultural institutions. The uses of resources include, but are not limited to, creating and

maintaining programs and acquisitions for permanent collections, expansion, or renovation schemes; improving visitor services; and even balancing budget deficits.

The Charitable Museum Endowment Fund's assets are being invested in a well-diversified portfolio of fine art pieces by universally recognized artists. The main investment objective of the partnership is to earn an attractive rate of return and seek capital appreciation for socially responsible, community-minded members. The Master Fund is expected to run into the billions of dollars and will maintain a diversified portfolio of wholly and partially owned art investments with varying holding periods.

The Master Fund's capital is being invested in artworks from artists with proven track records from the late 19th and early 20th centuries, including artistic categories such as Impressionism, Post-Impressionism, and Modernism. In addition, a significant percentage of the Master Fund's portfolio also comprises blue-chip Post War and Contemporary art with a solid secondary market. The Charitable Museum Endowment Fund provides a much-needed collaboration to artistic patronage aiming to increase social welfare.



Render of COLLEGIUM © Tatiana Bilbao Studio



Render of COLLEGIUM © Tatiana Bilbao Studio

Private banks vs. family offices **Comparative trends 2017**

As more family offices contributed to this year's report, we have added a new comparison between private banks and family offices with regards to their attitudes, actions, and expectations when it comes to the role of art and collectibles in a traditional wealth management offering.

It is important to keep in mind when looking at the results that more private banks (69) participated in the survey than family offices (27). Overall, family offices and private banks not surprisingly have quite a similar approach to art wealth management services.

The main highlights are:

01

Private banks and family offices recognize the need to develop a holistic range of wealth management services, as art can represent a sizeable portion of the total wealth of their clients.

02

Family offices seem better prepared to offer art wealth management services. When a family office has to deal with an art collection, it provides the services to protect the wealth allocated to the art collection.

03

Family offices typically seem to have greater room for maneuver when developing art wealth management service offerings.

04

Although private banks and family offices can be in direct competition when it comes to managing wealth, there are areas highlighted below that suggest there is also scope for collaboration, particularly in areas such as leverage and risk management.



05

Family offices seem a bit more aware of the financial dimension of art collection as part of portfolio management.

06

Client entertainment and sponsoring are less of a priority for family offices.

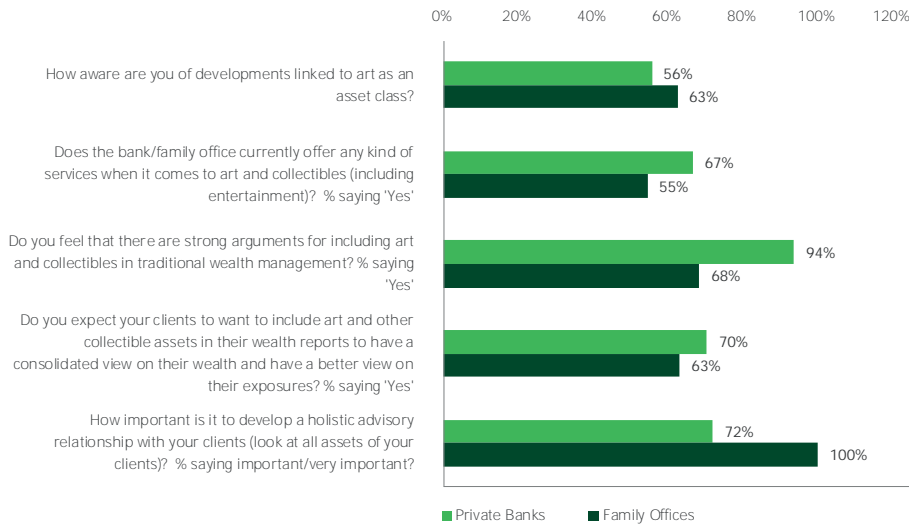
07

Estate planning is the primary service that private banks and family offices will focus on in the next 12 months.

08

Private banks are much more involved in sponsorship and client entertainment:

Figure 30. Private Banks vs Family Offices: Awareness, Adaption and Expectations



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Industry competition and a move toward a holistic wealth management model encourage private banks to take a more proactive approach when it comes to offering art-related services:

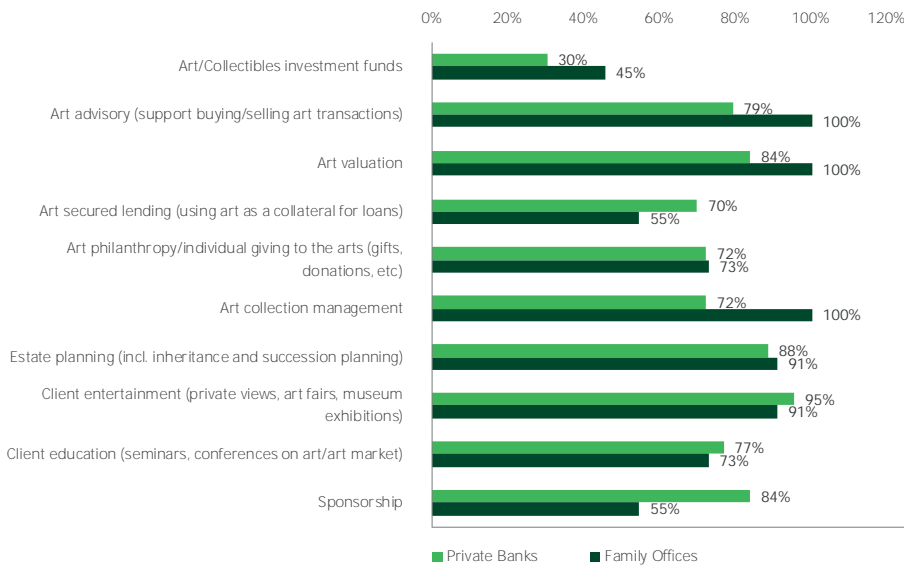
67 percent of the private banks surveyed (compared to 55 percent of family offices) said they offered art-related services. Also, 94 percent of private banks stated that they felt there were strong arguments for incorporating art and collectibles in their wealth management offering, compared to 68 percent of family offices. This could imply that the private banking community is taking a more proactive approach as the industry starts to move toward a more holistic wealth management model (72 percent of private banks said having a holistic advisory relationship with clients was very important, compared to 100 percent of the family offices who expressed this view).

When family offices have to deal with art, they are 100 percent committed to art advisory, valuation services, and collection management to protect the familial wealth invested in art:

Among the family offices surveyed that provide art-related services, all provided art advisory services (compared to 79 percent of private banks), valuation services (compared to 84 percent of private banks), and art collection management (compared to 72 percent of private banks). Despite comparatively lower readings from private banks, this year's readings show a significant increase in private banks offering these services compared to 2016, which suggests that private banks are starting to act.

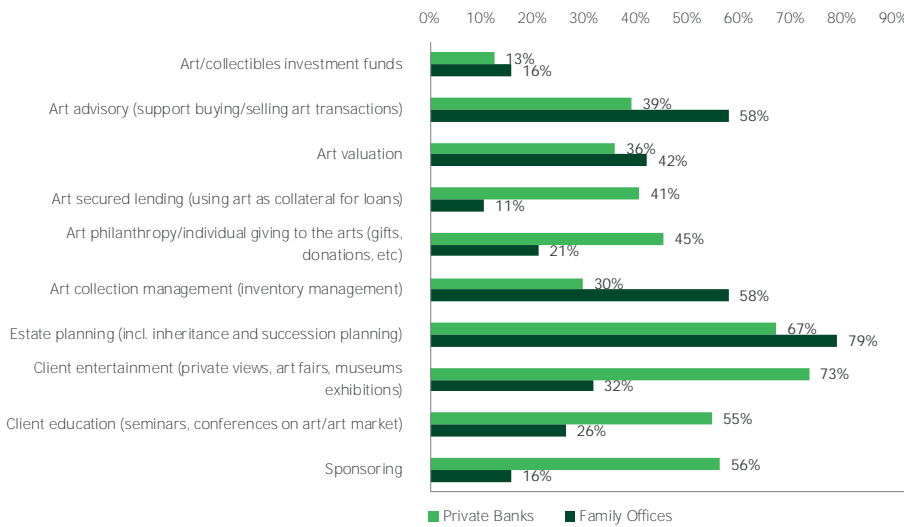
The private banking community is taking a more proactive approach as the industry starts to move toward a more holistic wealth management model.

Figure 31. Private Banks vs Family Offices: What art related services do you offer?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

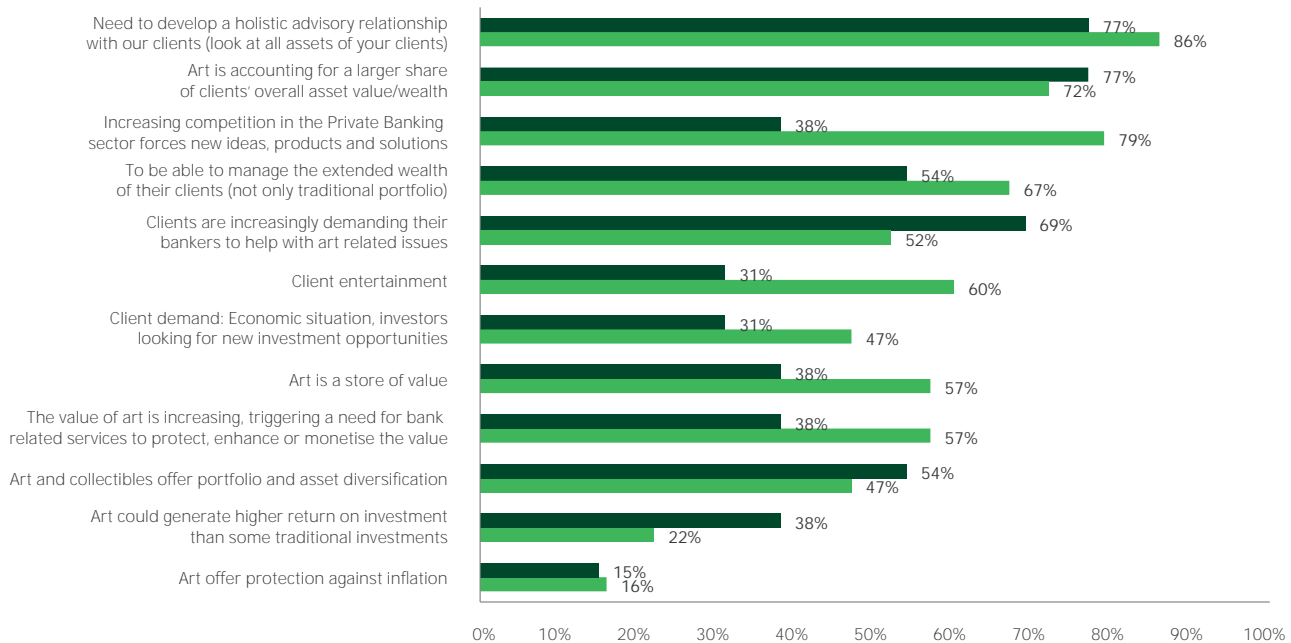
Figure 32. Private Banks vs Family Offices: How likely is the bank/ family office to get involved in the following services in the next 12 months? (likely/very likely)



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

The increasing value of art-related wealth is motivating private banks to take a proactive approach.

Figure 33. What do you consider the strongest arguments for including Art and Collectibles in traditional Wealth Management?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Art and estate planning remains a strong focus for both private banks and family offices:

88 percent of private banks and 91 percent of family offices said they offered estate planning services. 67 percent of private banks and 79 percent of family offices said they would focus on this service in the next 12 months. This suggests that one of the key battle grounds in the wealth management industry is and will continue to be around estate planning.

Private banks are taking the lead on art-secured lending:

70 percent of the private banks who stated they offered art-related services said that they offer their clients the opportunity to use their art collection as collateral for a loan, compared to 55 percent of family offices who said they offered their clients art-secured lending services. There is significant scope for collaboration between private banks and family offices when it comes to offering art-secured lending services.

Private banks are much more involved in sponsorship and client entertainment:

95 percent of private banks and 91 percent of family offices offer client entertainment services (exhibitions, private viewing, etc.), and 84 percent of private banks offer art-related sponsorship, compared to 55 percent of family offices. Significantly more private banks than family offices said that they would invest in these areas in the next 12 months.

A holistic wealth management model is a key driver: Both private banks (86 percent) and family offices (77 percent) see the need to develop a holistic advisory relationship with their clients as the strongest argument for including art and collectibles within traditional wealth

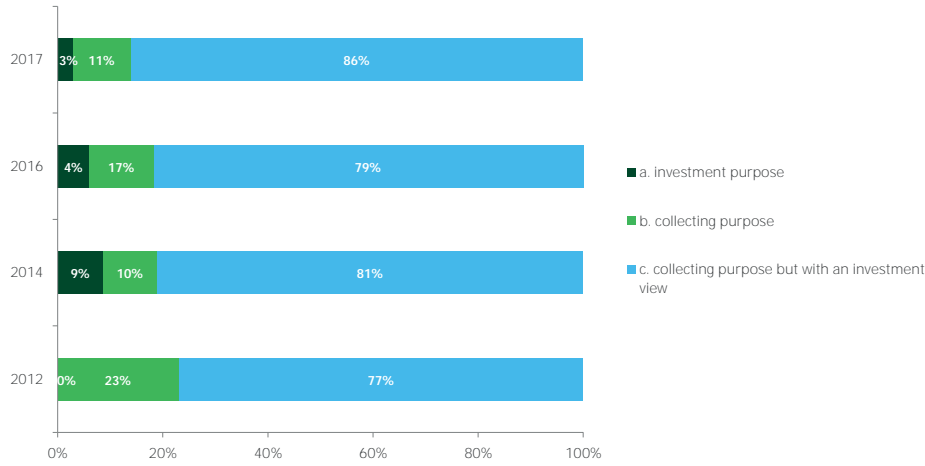
management. There is a stronger sense among family offices (69 percent of those surveyed) that their clients expect wealth managers to assist with art-related issues, compared to 52 percent of private banks that said the same.

Private banks are experiencing competitive pressure: 79 percent of private banks said that increasing competition in the wealth management sector was a key driver for offering clients new and innovative products and solutions, including art and collectibles. Only 38 percent of family offices felt this was a key argument. Another driver for private banks is client demand for new investment opportunities: 47 percent of private banks expressed this view, compared to 31 percent of family offices.

The increasing value of art-related wealth is motivating private banks to take a proactive approach: 57 percent of the private banks surveyed felt a more acute need to address the increasing value of art and the need to offer services to protect, enhance, and monetize this value. Only 38 percent of the family offices felt that this was a key argument for including art and collectibles as part of their wealth management offering. 57 percent of private banks also viewed art as a means of safeguarding value, compared to 38 percent of family offices who said the same.

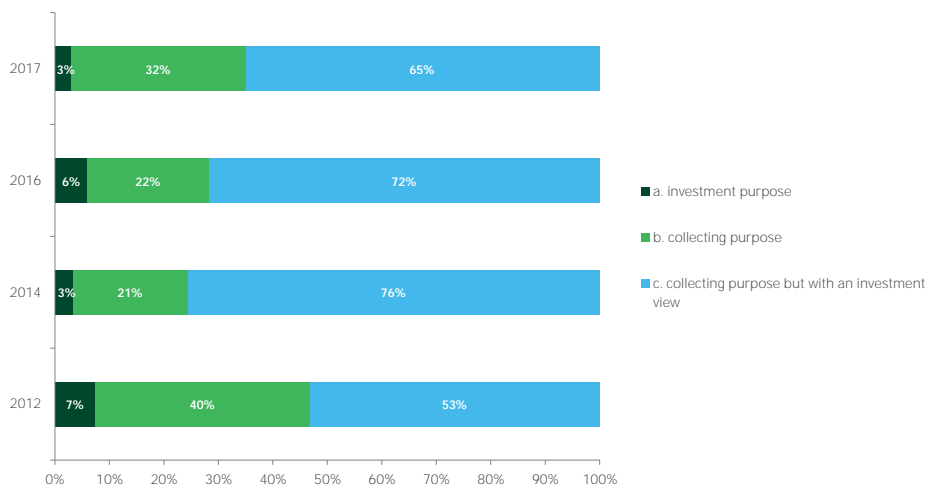
Emotions vs. investment

Figure 34. Why do your clients buy art ? (art professionals)



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Figure 35. Why do you buy art ? (art collectors)



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

It is the emotional and social aspects of collecting art combined with the potential for increasing or safeguarding value, i.e., value protection, that seems to be the driving motivation among most art collectors in the art market

B. Art professional and Art collector key survey findings 2017

Collecting art with a view to investment:

As per last year’s survey findings, a large majority (86 percent) of art professionals said their clients buy art and collectibles for emotional reasons (i.e., because of a passion for collecting), but with a view to investment value (not only investment return, but also art as a means of safeguarding value); this was up from 79 percent in 2016. Only three percent of the art professionals surveyed said that their clients buy art purely for investment reasons (down from four percent in 2016 and nine percent in 2014), and 11 percent said their clients bought art for collecting purposes only (down from 17 percent in 2016). Although the hierarchy of motivations remains the same for art collectors, a higher portion (32 percent) of art collectors say that they are driven by “pure” collecting, where the investment aspect is not a concern (up from 22 percent in 2016 and 21 percent in 2014).

65 percent of art collectors (down from 72 percent in 2016 and 76 percent in 2014) said that they bought art for collecting purposes with a view to investment. This trend could suggest that the financial aspect of buying art is now slightly less important to many art collectors than it was in previous years, although the majority of art collectors still buy art with financial considerations in mind. It is worth noting that 42 percent of US art collectors said that they bought art for “collecting” purposes only, versus 28 percent of art collectors from the rest of the world. It is interesting to note the difference between what art professionals say are their clients’ motivations for buying art versus what the art collectors themselves say.

This implies that art as a pure investment or financial product is only attractive to a small minority of art buyers (three percent), and that it is the emotional and social aspects of collecting art combined with the potential for increasing or safeguarding value, i.e., value protection, that seems to be the driving motivation among most art collectors on the art market (65 percent of art collectors expressed this view).

Art is increasingly becoming a lifestyle product:

This year's survey findings indicate that a large majority of art professionals believe that "social value" is becoming the dominant motivation when their clients buy art (85 percent said so in 2017, up from 80 percent in 2016 and 72 percent in 2014). This was followed by 75 percent who said that "emotional value" was a key factor in their buying decisions (down from 79 percent in 2016). In terms of the financial aspects of art collecting, art professionals were generally slightly less convinced about these motivations this year, with 44 percent of art professionals saying their clients were driven by "investment returns" (the same as in 2016). Meanwhile, 39 percent saw it as a diversification tool (down from 47 percent) and 27 percent said they saw art as a "safe haven" (down from 33 percent).

This year's survey findings indicate that a large majority of art professionals believe that "social value" is becoming the dominant motivation when their clients buy art.

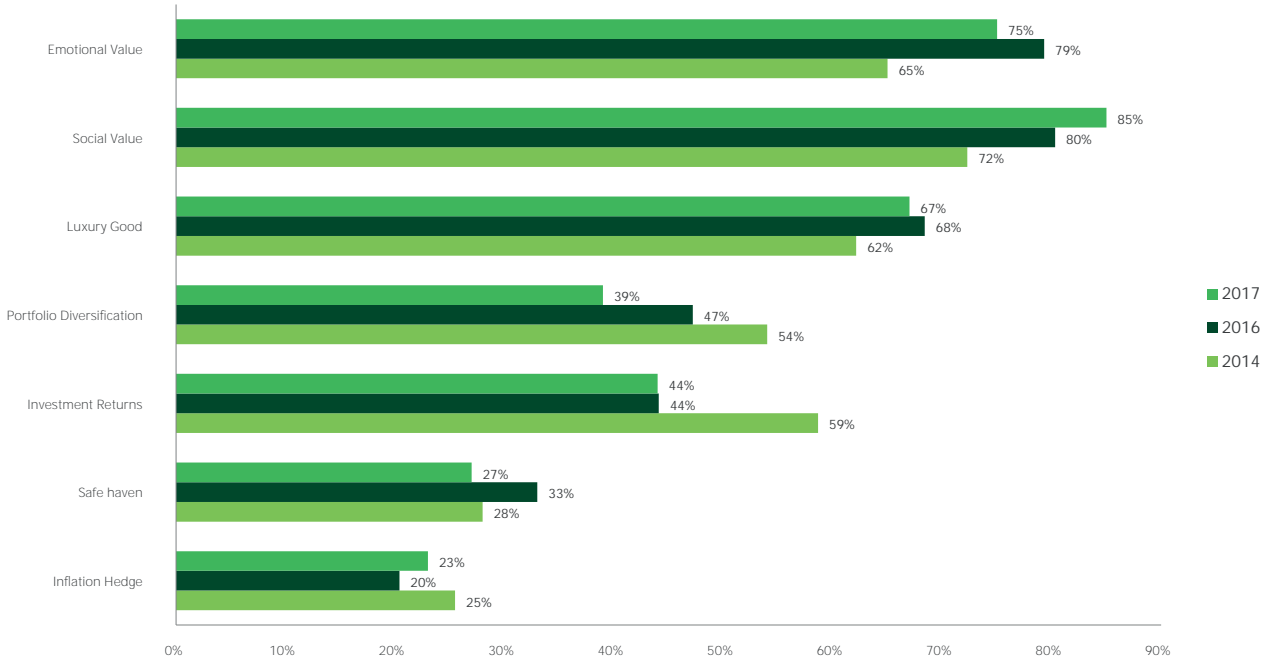
Art collectors are focusing on the "soft" value of art:

79 percent of art collectors (up from 71 percent in 2016) still feel that emotional value remains the primary reason for buying art, followed by social value, with 63 percent of art collectors saying this was a key driver for their involvement in the art world (up from 61 percent in 2016). A further 54 percent said they viewed art as a luxury good (up from 51 percent in 2016), which confirms the finding from previous years that art is predominantly viewed by art professionals and art collectors as a "lifestyle" product. However, this does not mean that the financial aspect of buying art is not important, just that it is not the driving factor. This is an important finding and needs to be considered when wealth managers design their art and wealth management products.

Investment value motivations are reverting to historic trends among art collectors:

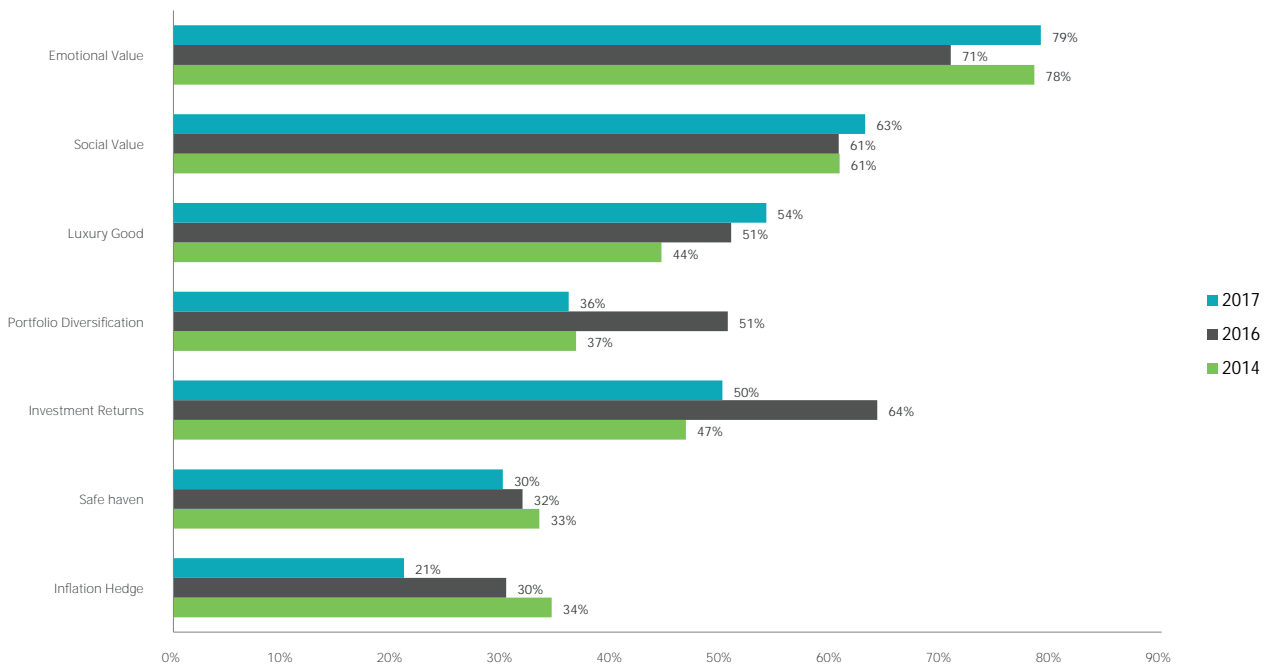
After seeing an increase in motivations involving "investment returns" in 2016, this has dropped back to 2014 levels according to art collectors surveyed this year. Half of the art collectors said investment returns were a key motivation in 2017 (down from 64 percent in 2016). It is likely that tougher art market conditions in 2016 have muted art collectors' expectations about investment returns this year, combined with improved performances for other financial asset classes in the last 18 months.

Figure 36. Art professionals: Which of the following motivations are most important in buying art?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Figure 37. Art collectors: Which of the following motivations are most important in buying art?



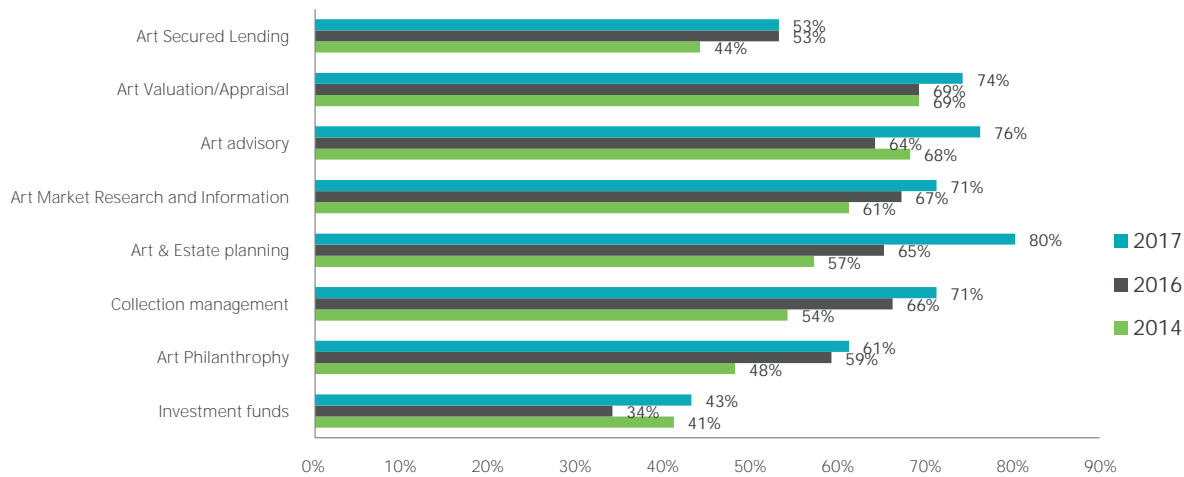
Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Portfolio diversification and art as a “safe haven” remain important motivations this year:

36 percent of the art collectors surveyed said that portfolio diversification was an important motivation when buying art this year, down from 51 percent in 2016. In terms of art as a “safe haven,” 30 percent said this was an important motivation this year (about the same as the 32 percent seen in 2016). Although not the primary reason for buying art, the fact that more than a third of art collectors see portfolio diversification benefits from owning and holding art as important, is another reason why integrating art-related wealth into traditional wealth reporting continues to be a key priority for the Art & Finance industry.

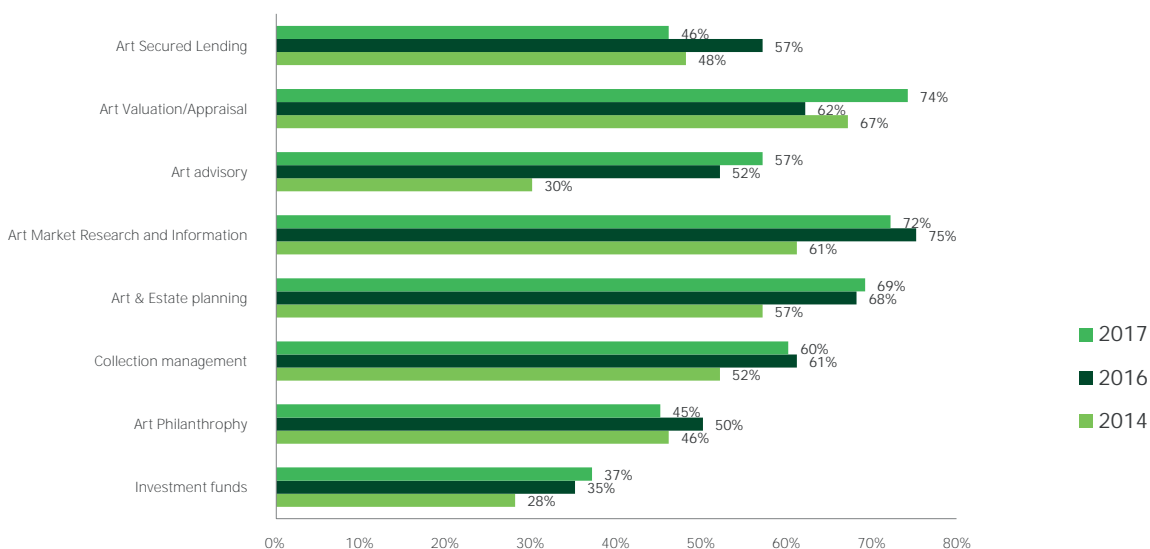
There is an overall consensus between art professionals and art collectors in terms of the art wealth management services that they would like to be offered by their wealth managers.

Figure 38. Art Professionals: Which of the art wealth management services are most relevant to your clients?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Figure 39. Art collectors: Which of the art wealth management services are most relevant to you?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Art valuation and value appraisal are perceived as a core art and wealth management service:

74 percent of the art professionals surveyed stated that art valuation was the most important art wealth management service for their clients (up from 69 percent in 2016). 74 percent of art collectors also said that valuation services were the most important services (up from 62 percent in 2016), and these ranked at the top of art collectors' priorities ahead of art market research and art and estate planning for the first time. As noted earlier in Section 2, wealth managers have responded to this need, with 88 percent of wealth managers offering valuation services this year (up from 69 percent in 2016). The vast majority (79 percent) of wealth managers said valuation services were outsourced to a third party. This could signal that art collectors and art professionals now see the wealth management industry as a neutral party when it comes to providing valuation services.

Art market research and information is an area for further investment and growth:

71 percent of the art professionals (up from 67 percent in 2016) and 72 percent of the art collectors surveyed (down slightly from 75 percent in 2016) said that market research and information is a product they would like to see included in a wealth management offering. This is an area that most wealth managers have yet to explore, and it could be combined both with valuation services as well as internal education and efforts aimed at increasing in-house art-market knowledge.

Art advisory⁷⁶:

57 percent of art collectors believe that wealth managers should offer art advisory services (up from 52 percent in 2016 and 30 percent in 2014). This trend suggests that art collectors see art advisory services as an integral part of any art and wealth management offering. It is clear that the largely unregulated art advisory profession is of concern to art collectors, since 48 percent of art collectors said that a "Lack of standards around professional qualifications in the art market" was of major concern (See also Section 6: Regulation & Risk Management). Moving art advisory services under the umbrella of a regulated financial entity is likely to improve the credibility of these services in the eyes of the art collector. 76 percent of art professionals (up from 64 percent in 2016) said that their clients would like to see art advisory services as part of a wealth management offering—an opportunity for increasing collaboration between art professionals and wealth managers.

Increasing potential for software development companies and collection management systems to be integrated with wealth reporting:

60 percent of art collectors and 71 percent of art professionals believe collection management is a service that should be offered by the wealth management industry, and this corresponds with the wealth managers' view that more clients want to see their art integrated into overall wealth reporting.

Art and estate planning:

69 percent of art collectors said that art and estate planning was a sought-after and necessary service (up from 68 percent in 2016). 80 percent of art professionals agreed with this (up from 65 percent in 2016). 45 percent of art collectors said that wealth management services around art and philanthropy would be important to them (down from 50 percent in 2016). This trend was supported by 61 percent of the art professionals surveyed (up from 59 percent in 2016). This implies that art is increasingly becoming important in legacy planning for HNWIs. Wealth managers are actively responding to the demand for art and estate planning, and 70 percent of the wealth managers surveyed said this was going to be a focus area in the next 12 months.

Art collectors' interest in art investment products remains around the same level as in 2016:

37 percent of art collectors said that art investment fund products would be useful to them (up from 35 percent in 2016), although only 14 percent of wealth managers said they would offer access to such a product. Despite the reluctance for the wealth management industry to offer art investment products, this does signal interest among art collectors in the opportunity to gain financial exposure to art through an investment vehicle. The same view was echoed among 43 percent of art professionals (up from 35 percent in 2016) who said they believed their clients would be interested in art investment products.

With 50 percent of art collectors motivated by financial returns when buying art, there is clear potential for the right type of art investment product or service—particularly as art collectors are looking for services that can combine art market access, improved valuation, expertise, and a more regulated investment environment.

⁷⁶ Art advisory covers a broad spectrum of services mainly related to buying and selling art and collectibles on behalf of clients. Although other services such as collection management and valuation could be defined as an art advisory service, for the purposes of this report we have separated this as a stand-alone service.

Moving art advisory services under the umbrella of a regulated financial entity is likely to improve the credibility of these services in the eyes of the art collector.



Emilie Villette
Business Development
Director
Christie's France

Art & wealth management **A win-win combination**

Over the past 15 years, the art market has entered a new era. It has undergone radical transformations. Among these can first be mentioned the unprecedented globalization of the art market players, as well as a new market's geography initiated by the rapid rise of China. The emergence of new fortunes worldwide (in particular in Asia, India, Latin America, and the Gulf countries) is significant, so as the expansion of the market for modern and contemporary art and the number of multi-million auction record prices for masterpieces.

Moreover, the safe-haven status, attributed to works of art and collectibles (including wine, jewelry, watches, etc.), their inclusion in wealth investment and diversification strategies, or also the development of the online art market, highlight the nature of these structural changes. The accumulative effects of these drivers of growth have allowed the art market to rapidly recover from the 2008–2009 financial crisis and reach, in the intervening years, both historically unprecedented global sales totals and price levels.

Art and collectibles have a unique role to play in the increasingly precise and complex structures used to organize the asset portfolio of wealthy individuals.

Art as an asset class: a self-evident diagnosis?

As artworks have increased their value, so have financial stakes inherent to art ownership. The so-called “investments of passion” represent a rising proportion of the asset portfolio of HNWI/UHNWI. This demonstrates, as if it were still necessary, that art has become an entirely distinct asset class, all the more attractive as it epitomizes the kind of tangible “investments” that have been so highly prized by individuals since the crisis.

Art as an asset class, however, has a very specific profile. The risk, liquidity, as well as the tangibility and the pleasure linked to the possession/sale/transmission of artworks make them atypical assets. Buying a work of art is and must be first and foremost a matter of desire and pleasure, and thus also a question of choice.

MAGIC LADDER KID IV © YINKA SHONIBARE MBE (2014), PHOTOGRAPHER: STEPHEN WHITE





Undoubtedly, the encounter between an art collector and a work of art—this moment out of time—is the first “revenue” that art can offer: an emotional revenue! In some cases, it may remain the buyer’s only reward.

However, artistic assets are not always included in families’ overall wealth management strategies. Whether a collection stems from personal passion or is the result of an inheritance, it is an area that often remains “outside the scope” of advice. Art and collectibles have a unique role to play in the increasingly precise and complex structures used to organize the asset portfolio of wealthy individuals. More than ever, wealth managers must seek a 360° view of their clients’ assets to provide them with complete and relevant advice as part of a truly tailored service. They will thus be able to inform and assist art owners in dynamically managing their collections as patrimonial assets to:

- Anticipate and plan for certain problems related to family matters, such as inheritance planning, divorce, moving, change of country of residence, etc.;
- Conduct arbitrage, with a view on tax planning, project financing, or “good governance”, taking advantage of any market opportunities, changing trends or price fluctuations;
- Protect and, in certain cases, monetize these assets;
- Ensure the preservation of all or part of the collections across generations, where necessary.

This rather rational and economic approach of art as part of a family wealth does not diminish the initial quest for pleasure and meaning that inspires many art collectors. It is, on the contrary, a complementary approach, as many countries have specific tax laws in relation to art, which may prove beneficial.

More than ever, wealth managers must seek a 360° view of their clients' assets to provide them with complete and relevant advice as part of a truly tailored service.

From why to how

If the answer to the question "why" include art in a family wealth management strategy seems obvious, then the question "how" has no single solution.

What is the objective value of the artworks owned? Answering to this first issue is a necessary step to begin with in any wealth management plan, putting numbers to models and thus enabling possible arbitrage. Listing, appraising, and estimating are the fundamental prerequisites involved in managing an art collection from a patrimonial perspective. The frequent valuations of artistic assets made by established art professionals, as the valuation of a stock portfolio, are necessary in order to have a consolidated and dynamic assessment of their value.

Moreover, collectors have different practices, tastes, and ways of research. They also have diverse objectives, and these undoubtedly change over the lifetime of a collection as it takes time and practice to develop what can be called a "good eye." It is therefore just as important for wealth management professionals to identify their clients' or prospects' motivations and their objectives relating to art.

Here are several typical questions that could help wealth managers to understand, in the first instance, the history and the characteristics of a specific art collection:

- **How and when was this art collection amassed?**

- Is it through personal purchases (artworks acquired proactively), or from a legacy (artworks inherited/ owned passively)? In the latter case: does the client have a strong emotional connection to the artworks? Does the client have precise/approximate/non-existent knowledge of the value of the works and their history?
- Is the client a new or a seasoned art collector?
- Has there already been any resale of particular works? Is the collection still growing or is it stable?

- **What are the objectives and expectations in relation to the art collection?**

- Is personal enjoyment paramount, or do financial considerations or a desire for asset diversification come into play? And to what extent?
- Collection versus decoration: does the collection contain a limited number of target acquisitions, e.g., to decorate an indoor space (the notion of lifestyle and works of art to mark success and social status), or is it the result of a process befitting a passionate art collector?
- Does the client have any aspiration regarding the preservation of the art collection and, if so, should this be achieved through inheritance or patronage or through philanthropic activities (donations to museums or charitable organizations, the creation of a family foundation, etc.)?

- **What are the objectives of the next generation concerning these artworks?**

- What is the level of interest, attachment, and involvement of the next generation?

Each of these questions can rise more or less significant and often complex legal and tax considerations regarding the art collector's country of residence. Take the example of the tax considerations involved in the resale of a work of art. For many art collectors, it is often necessary to resell artworks in order to continue to make further purchases. In other cases, reselling works is motivated by changes in the art collector's taste or a direction change in his collection focus. Gains on the resale of artworks are exempt from tax when achieved in a private wealth management context in Belgium, Italy, Singapore, and Hong Kong. In Luxembourg and Germany, however, the exemption only applies at the end of a short holding time, from six months to one year. A French tax resident may either be charged to a flat rate of 6.5 percent on the full resale price for any artworks sold in excess of €5,000, or alternatively, opt for the standard form of capital gains tax (34.5 percent on a basis equal to the difference between the resale price and the acquisition price with a 5% discount per year of holding beyond the second year). There is therefore a full exemption after 22 years of ownership. This two-option system is still advantageous, nevertheless, compared to Spanish, US, or UK taxation schemes. A case-by-case analysis is therefore necessary.⁷⁷

⁷⁷ For a complete analysis of comparative law on the international taxation of art, please see the feature article appearing in the *Journal des Arts*, n°479, pages 36 to 39

The desire to collect art is not necessarily passed down from generation to generation. It may sometimes be effectively transmitted but only crystallize in a single inheritor or within a different artistic discipline.

Ars longa, vita brevis

However, the pivotal moment in the life of any art collection is undoubtedly the time of its transmission. Anticipating this transition is fundamental.

Contrary to popular wisdom, the creation of a collection is often an adventure started by an individual, sometimes a couple and more rarely a full family. The desire to collect art is not necessarily passed down from generation to generation. It may sometimes be effectively transmitted but only crystallize in a single inheritor or within a different artistic discipline. Nonetheless, tastes and lifestyles change, not to mention the growing international dispersion of children and potential unequal levels of wealth.

For families, art and collectibles are often a very emotional asset class. It might be that an art collection requires more time and a psychological understanding, that the other assets categories may not need.

The very structure of certain art collections may also complicate their transmission. This is the case, for example, of collections made of a very large number of items, especially when the inheritors are unable or unwilling to keep such a volume of pieces. It is also the case for art collections that are imbalanced in value: for example, when a single painting accounts for a large proportion of the total value of the whole collection, making any credible sharing impossible or awkward.

Finally, there are significant differences in inheritance taxes from country to country. In many cases, a combination of solutions will ultimately be chosen: some artworks may be kept by the heirs, while others will be sold and others donated. Estate planning relating to art is thus becoming increasingly relevant. On one side, appropriate legal and tax assistance is needed. On the other side, art market professionals can advise on the value and level of liquidity of the works, and design an appropriate sale strategy tailored to their typology, answering to the family's constraints and objectives. All of this must be carried out meticulously, without rushing, in order not to make decisions in haste.

When it comes to the transmission of an art collection, if wealth managers/advisors and art-market specialists work hand in hand, it will undoubtedly provide added value to the art collector and his family, creating the conditions of true legal security, optimal tax management, and maximized economic results, while preserving a degree of serenity in decision making and familial peace as much as possible.

Building bridges and strengthening the collaboration between the wealth management and the art market communities seems more necessary than ever, with the legal, tax, and financial expertise of the former complementing the artistic knowledge and the command of the market, its prices and trends of the latter, for the greatest final benefit of art collectors. This is surely a win-win combination.

Contrary to popular wisdom, the creation of a collection is often an adventure started by an individual, sometimes a couple and more rarely a full family.



Section 3

Art-secured lending



HIGHLIGHTS

- **US art-secured lending market grows an estimated 13.3 percent:** The art-secured lending market in the US reached an estimated US\$17-20 billion in 2017, which represents a 13.3 percent growth from 2016.
- **Two thirds of wealth managers surveyed say their institutions offer art-secured lending services:** The art-secured lending market in the US has grown at a relatively consistent rate, attributable to a persistently attractive market, and increasing comfort from art collectors and lenders alike. In this year's survey, 67 percent of wealth managers said their institution now offered art-secured lending services (slightly lower than the 69 percent seen in 2016, but up from 48 percent in 2014).
- **New accounting requirements for art-secured lending:** New accounting requirements stipulate that provisions for credit losses will no longer have to be recorded with an incurred loss model, but rather with an expected loss model. This will have significant implications for risk models and risk management with regards to art-secured lending.
- **Risk management a key challenge:** Issues around risk management, liquidity, valuation, and regulation remain key challenges for the future growth of this market.
- **New developments in the European art-secured lending industry:** New products have recently come to the market, permitting lending transactions using high-quality artworks transferred as collateral without taking physical possession of the artworks. These new art financing methods could be a game-changer for the European art-secured lending market.
- **Art-secured lending providers call for more regulation:** The lack of a regulated framework around the way art is bought and sold, the lack of central title registry, and issues regarding provenance are currently restricting the art-secured lending market, according to Borro. They suggest that regulation would create new opportunities to expand and democratize the art market—and banks and wealth managers would be able to put their full weight into the market, which is something they are simply unable to do now.

Art-secured lending may be viewed as an effective way to enable art collectors to access the equity value in their artworks without having to sell them.

Art-secured lending may be viewed as an effective way to enable art collectors to access the equity value in their artworks without having to sell them. Art-secured lending makes it possible to reinvest their capital in the form of new art acquisitions or attractive business opportunities, or to refinance existing loans.

The US has taken the lead in the international development of art-secured lending, taking advantage of the favorable legal environment provided by the Uniform Commercial Code (UCC), tax provisions, and also a different attitude toward the financial aspect of collecting art. The UCC allows the art collector to keep possession of the artworks while the loan is still outstanding—a strong attraction for most borrowers. However, as outlined in the 2016 edition of the Art & Finance Report, the situation in Europe is quite different, where banks and specialist lenders often have no choice but to take possession of the collateral in order to perfect their security interest. With several European countries⁷⁸ having introduced a register of charges against chattels,⁷⁹ and with new insurance products⁸⁰ entering the market, one would anticipate the European art-secured lending industry to start catching up with its US counterpart. In this section, we continue to monitor the wealth management community, art professionals, and collectors in terms of their attitudes and actions toward art-secured lending.

The US has taken the lead in the international development of art-secured lending, taking advantage of the favorable legal environment provided by the Uniform Commercial Code (UCC), tax provisions, and also a different attitude towards the financial aspect of collecting art.

⁷⁸ France introduced a register of pledges over chattels in 2006, and Belgium has followed a similar model. Spain allows pledges without dispossession but these must be registered in the Spanish register for moveable property (Registro de bienes muebles)

⁷⁹ The word "chattel" is a legal term meaning an item of tangible, movable property—something you can both touch and move. Your personal possessions will normally be chattels, such as household furniture, paintings, antiques, items of crockery and china, plate and silverware, motor cars and motorcycles, etc.

⁸⁰ These products are variously known as collateralized art lenders' insurance or art-lending fidelity insurance. Insurers and insurance brokers who have announced products include Hiscox, Willis, and RT WP Longreach in the UK. US-based company Aris specializes in defective title insurance for artworks.



Phillip Ashley Klein
U.S Art & Finance
Coordinator
Deloitte Consulting
LLP

Art-secured lending

A U.S. market update

We currently estimate the overall outstanding value of art-secured loans to be US\$17 – US\$20 billion, which represents a 13.3 percent growth from 2016. We have seen consistent growth over the past year, and the market’s size now well exceeds the lower end of our revised 2016 estimate. Persistently attractive conditions have aided this expansion, making this an opportune time to highlight important industry developments on both the demand and supply sides of the equation.

Lenders are more comfortable lending against art. Private banks traditionally provided the service as an accommodation for wealthy clients, but they have rapidly moved up the experience curve in art market understanding, underwriting, and risk management. Although private banks dominate the market, boutique lenders—both existing players and new market entrants—are growing at an increasing rate. Many of these boutiques are applying data methodologies in the lending process to better understand and manage risk. Interestingly, since our 2016 analysis where loan-to-value (LTV) rarely surpassed 50 percent, we now observe a set of private banks offering up to 55 percent, with one boutique lender offering as much as 70 percent LTV. As lenders become increasingly comfortable, with monetary defaults few and far between, higher LTV has become an important competitive attraction for collectors who seek to maximize the capital they can

unlock for other investments. Additionally, an important growth driver is the provision of credit facilities by lenders to those collectors (including third party guarantors) seeking the big ticket items at auction. These collectors range from purely profit-driven hedge funds to avid collectors emulating those hedge funds through application of this available capital.

Art collectors are increasingly sophisticated in employing their art. Our Deloitte Art & Finance Survey has shown over the years that collectors increasingly view their art with an eye on investment. This cultural shift is congruent with the rapid expansion and professionalization of the art market more broadly. We see collectors increasingly using structured credit vehicles as a component of overall estate planning strategy. Evan Beard, National Art Executive with US Trust Bank of America Private Wealth Management noted, “Structured

credit is commonly used to unlock capital from this tangible trove and pay down draconian estate taxes.” Applying these strategies is a mixture of: 1) those who did not buy their art for financial benefits, but who now suddenly see it as an estate planning arbitrage play, and 2) a more market-driven segment, many of whom are career finance professionals that see art as a natural progression in investment. When there is a need for liquidity, we often see collectors favor unlocking capital through credit versus sale, driven by the perceived complexities of the consignment process and the uncertainty of auction results.



BALLERINA WITH VIOLIN (GISELLE) © YINKA SHONIBARE MBE (2013), PHOTOGRAPHER: STEPHEN WHITE

Recent non-US initiatives

Fine Art Group: In October 2016, the Fine Art Group (UK) launched a new art loan operation called Fine Art Financial Services (FAFS). It will be using its own invested equity capital, and rely on its in-house team of art experts. The company offers up to 50 percent of the value of the assets on a single artwork or group of artworks valued from US\$250,000 to US\$20 million. Loans are available with maturities ranging from three months to three years. The type of collateral considered for a loan includes artworks dating from 1400 to present day from all major auction categories, and high-value jewelry. The collateral will be stored in one of the specialist storage facilities in London, Geneva, New York, Hong Kong, or Singapore.

Griffin Art Partners: In June 2017, Griffin Art Partners, a Luxembourg-based securitization platform designed to provide non-recourse loans collateralized by works of fine art, announced its new lending platform. Griffin has appointed LINK Management as its investment and collateral adviser and REYL Private Office (Luxembourg) as its administrative agent. Griffin Art Partners is based in Luxembourg and aims to become one of the leading independent art lenders in Europe by offering a competitive and flexible non-recourse financing solution.

PassionProtect®: PassionProtect® positions itself as a privileged partner to wealth managers, family offices, and private banks, enabling them to offer innovative and differentiating solutions using their clients' passion assets.

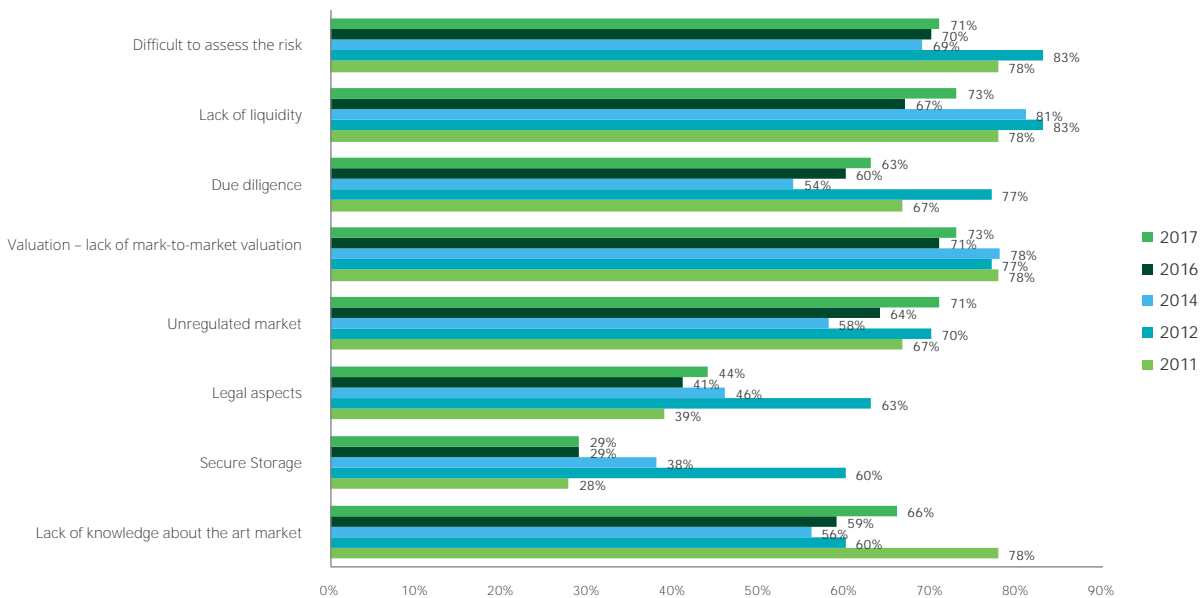
Based on a Luxembourg securitization platform, PassionProtect® enhances collectors' liquidity through Art Secured Financing while providing investors with a new standardized alternative asset class: PassionBonds. This new asset class allows qualified and institutional investors to diversify their investments, using an asset backed fixed-income instrument in a standard bond format with limited risk while offering a competitive return.

Privatbank Berlin 1929 AG has developed an insurance and legal solution that permits lending transactions using high-quality artworks transferred by way of collateral without taking physical possession of the artworks as a pledge. See *page 162* to read an article on recent developments in this regard.

In China, Bank of Weifang established its art finance department in 2013. Since its inception, the pledge financing business in respect of art has progressed on a regular basis with standardization and scale development. The types of art they accepted range from calligraphy and painting to jewelry, jade, and porcelain. Meanwhile, Bank of Weifang has its own warehouse through which it provides an optimal art storage service and contributes to the development of art storage across the whole society. Besides this, they also provide art curation and artist recommendations, thereby extending the service chain of art finance. A Chinese art finance database has been established based on China's Art & Finance magazine. Most recently, the bank has established a chain of services, including art financing, art storage, artist recommendations and curation, and research studies covering Art & Finance among other topics. According to the latest update in 2017, the Bank of Weifang has provided more than 300 clients with art lending worth over CNY 6 billion.

Survey findings

Figure 40. What do you feel is the main hurdle for providing Art Lending/Art as collateral to the bank's current clients?



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Private banks are building up in-house art-secured lending capabilities:

Among the wealth managers who actively offer art-related services, 67 percent said they provided art-lending and art-financing services (slightly down from 69 percent in 2016). By type of wealth manager, 70 percent of private banks and 55 percent of family offices said they offered art-secured lending services. In the case of family offices, 67 percent of these services were provided through third parties, while 63 percent of private banks said they offered this service in-house (up from 52 percent in 2016).

This trend could imply that private banks have increased their capacity and willingness to provide art-secured lending services in the last 18 months.

Challenges related to art-secured lending

In the six years since this report was first produced, we have noticed a small improvement in the perception

of the risks associated with particular aspects of art-secured lending. However, three quarters of the stakeholders surveyed still rank valuation, difficulties in assessing risk, and liquidity in the art market as the main challenges for providing art-secured lending.

Increasing concern about liquidity risk:

The issue of liquidity remains an increasing concern among 73 percent of wealth managers (up from 67 percent in 2016). A more challenging art market climate in 2016, with a significant drop in global auction sales, could have contributed to this concern.

Risk management and a lack of mark-to-market valuation are worrying wealth managers:

As in 2016, valuation and risk assessment issues remain among the biggest hurdles standing in the way of art-secured lending. 73 percent of wealth managers in 2017 (up from 71 percent in 2016) considered valuation and the lack of mark-to-market valuations to be the

biggest hurdle. A further 71 percent said that the challenges around assessing risk was among the biggest hurdles when it came to offering this service (up slightly from 70 percent in 2016). In an interview with Ben Williams from JP Morgan (page 160), he highlights that the biggest risk in art-secured lending is valuation variability, as valuation transparency and consistency are key factors when providing loans. Claire Hillier from Borro also indicates the need for more regulation to support the development of the art-secured lending market (page 168). Further issues around valuation and risk management, and also new accounting requirements where provisions for credit losses will no longer have to be recorded with an incurred loss model, but rather with an expected loss model, will be discussed by Adrien Chiarello (page 164).



Art-secured lending



*By Victoria Kisseleva
Assistant Director Financial Advisory
Deloitte UK Art & Finance Coordinator
Deloitte LLP (UK)*



INTERVIEW WITH Ben Williams

Managing Director, Head of Lending Solutions in the UK & Nordics for J.P. Morgan Private Bank

How long has J.P. Morgan been lending against art?

We have been providing art-secured lending to clients for more than 10 years.

Have you noticed increased demand for liquidity using art as collateral among your clients in the last few years?

There is no question that as our clients' financing needs have grown in sophistication, we have developed our product range accordingly. We endeavor to understand our clients' balance sheet holistically to better manage and grow their wealth. Art-secured lending has steadily gained in importance as a solution to help meet clients' needs. The professionalization of art-market support services has helped improve transparency, which is beneficial for art-secured lending.

Are you happy to hold the debt on your balance sheet or do you prefer to use third-party providers to meet your clients' needs?

Given the overall strength of our balance sheet, we do not syndicate the debts of private clients. Instead, we hold debt on our balance sheet with no internal cap allocated for art-secured lending and no maximum loan size. Our clients' appetite typically reaches a cap before we encounter budget restrictions. As long as the art collateral is diversified and high quality, the client has a strong balance sheet, and the loan complies with our risk policy, we are in a position to lend.

What do you see as the biggest risk when providing art-secured lending to your clients?

The biggest risk in art-secured lending is valuation variability. Since valuation transparency and consistency are key factors when providing loans, we rely on the knowledge of experts to assess the value of a client's art. However, even the best experts are frequently obliged to value individual artworks within a range. Additionally, while price certainty is a function of liquidity, we do not control the liquidity of the art market. On the other hand, transparency and provenance are less of a concern when pieces can be associated with a clear history and central registers. There has recently been a series of high-profile cases in which auction houses have had to refund buyers for fraudulent pieces. The fact that more instances of this are entering the public arena suggests we are moving toward a healthier, more transparent art market.

Have you ever had to take possession of a client's collection?

Never to date. We structure our loans very conservatively—not because we have to, but because we choose to. Our conservative risk appetite typically matches the risk appetite of our clients and their needs. Our holistic approach to managing client relationships means we have a fiduciary responsibility to care for the health of our clients' overall balance sheets, even when providing loan financing.

Are there any particular art periods you feel most comfortable lending against?

We lend against a variety of periods and have no particular affinity for any single era or style. The key variables when providing a loan include the number of pieces, their value, and diversification. One of our largest loans was against an Old Masters collection. Some contemporary artists have good characteristics (Gerhard Richter, for example) and we will happily lend against them.

How has J.P. Morgan's corporate art collection evolved?

David Rockefeller initially amassed the collection in the late 1950s, 1960s, and 1970s, during a time of corporate extravagance when such practices were becoming increasingly common. Firms can now sometimes see amassing a corporate art collection as indulgent in these times of austerity, and some have sold their art collections since the financial crisis. We are proud to have been able to continuously build our art collection over nearly 60 years with interesting, up-and-coming artists, and to have filled the gaps in the current collection. American folk art and photography, for example, are more relevant to us today than Old Masters.





Shirin Kranz
Head of Art Lending
Privatbank Berlin
v. 1929 AG

The ease of art lending

European borrowers can now retain possession of collateralized works

A pledged Dan Flavin in the hallway, a pledged Lisa Genzken in the dressing room, a pledged Andy Warhol in the gallery—until now, this was only possible in the USA; in Europe, the beautiful collateralized artworks had to languish in storage.

In response to overwhelming client demand, Privatbank Berlin v. 1929 AG has taken on the challenge of bringing art-secured lending up to its full potential in Europe. Artworks loaned as collateral can now remain in the borrower's possession, and as a result there is greater flexibility for art collectors and gallerists who reap the many benefits this kind of financing brings.

Art lending allows art collectors and gallerists to realize liquidity without having to make unfavorable sales to satisfy short-term cash-flow concerns. Through this form of bridge financing, collections can be expanded and investment returns can be optimized through leverage effects. The loans are non-recourse, exclusively secured by high-quality artworks; the borrower does not assume liability other than legal title in the artworks and their authenticity. Possible risks such as embezzlement, theft or damage are covered by insurance.

Two leading art lending markets have prevailed over the last few years: firstly, the US market, which is dominated by major banks and auction houses, and secondly the European market, primarily served by specialized providers of art financing. The basic principle is the same. However, the difference so far has been that the US art lending market can use the artworks as security regardless of where they are located so that the works may remain in the possession of the borrowers.

Not so in Europe: owing to the different legislative regimes, gallerists or art collectors have needed to relinquish physical possession of the artworks that served as collateral and the lender would then store them in the warehouse of a fine art shipper and packer. There were some exceptions to this, for example in the UK artworks could at least be displayed at loan exhibitions in a non-commercial context. Art lenders have been working on a solution for a long time to create a balance between competitive advantage and risk management.

Privatbank Berlin v. 1929 AG has taken up this challenge and has developed an insurance and legal solution that permits lending transactions using high-quality artworks transferred by way of collateral without taking physical possession of the artworks as a pledge. In contrast to the UCC Filing in the USA and the chattel mortgage in the UK, this set-up does not require entry into a public register for transactions outside of the United States and the United Kingdom. Based on thorough legal processes, the offering can

Art lending allows art collectors and gallerists to realize liquidity without having to make unfavorable sales to satisfy short-term cash-flow concerns.

be made available to clients worldwide; initial international client cases have proven to be a success.

This new art financing method will be a game changer for the European art lending market and will surely lead to considerable growth.

The advantages are obvious: borrowers do not have to part with any artworks from their collection, gallery owners can still choose collateralized items from their inventory for art fairs and investors can showcase their works of art in international exhibitions, which will increase the value of the pieces. Furthermore, fragile works and bulky sculptures are no longer exposed to risky transportation and can remain in situ.

Art-secured lending will never be a mass market product. The individual financing needs of each borrower will always be different, and of course their collections will all be unique; art lending is therefore not a standardized process. Each transaction

must be treated individually with a tailored solution considering customer requirements and the respective legal situation.

Expert knowledge in all areas is essential, along with trustworthy and long-term client relationships and balanced risk management. The offering of Privatbank Berlin includes fixed and variable loans and credit facilities, from €500,000 to more than €20 million. Loans are secured by high-quality works of renowned contemporary artists. The loan to value ratio is usually around 40 percent and the terms range from six months to five years.

In summary, the nascent market for art-secured lending is growing steadily and meeting the demands of the art market for professional financing. Clients can now use this leverage and are still able to enjoy their Dan Flavin or Andy Warhol at home or in the gallery.



Adrien Chiariello
Senior Consultant
Deloitte Luxembourg

The relevance of risk assessment in art-secured lending

Why assess risk in the context of art-secured lending

Recent data has shown that art-secured lending has been gaining in prominence in the art world. In fact, it is safe to say that it offers synergies with common lending activities that could lead to economies of scale. In this context, newcomers (even those without clear links to the art industry) can attempt to enter this niche market and win over UHNWI clients seeking to use their artwork as collateral when borrowing funds, provided that such companies have the right amount of expertise. While the activity is becoming increasingly attractive, 71 percent of wealth managers in 2017 considered the difficulty inherent in assessing risk as a hurdle to providing art-secured lending to their clients.

When it comes to risks, art-secured lending essentially entails a wide array of risks that may be categorized into financial risks, in common with any other regular lending activity; and operational risks associated with the underlying collateral, in common with any other transaction on the art market. With this observation in mind, it is essential for art-secured lenders to have access to the data they need in order to monitor their risks. For instance, the level of concentration in a specific style of art or artist may be a key factor in the decision-making process.

Recently issued standards all stress the need for lenders to assess future credit risk, rather than focus exclusively on a specific past fact pattern.

When best practices meet accounting requirements

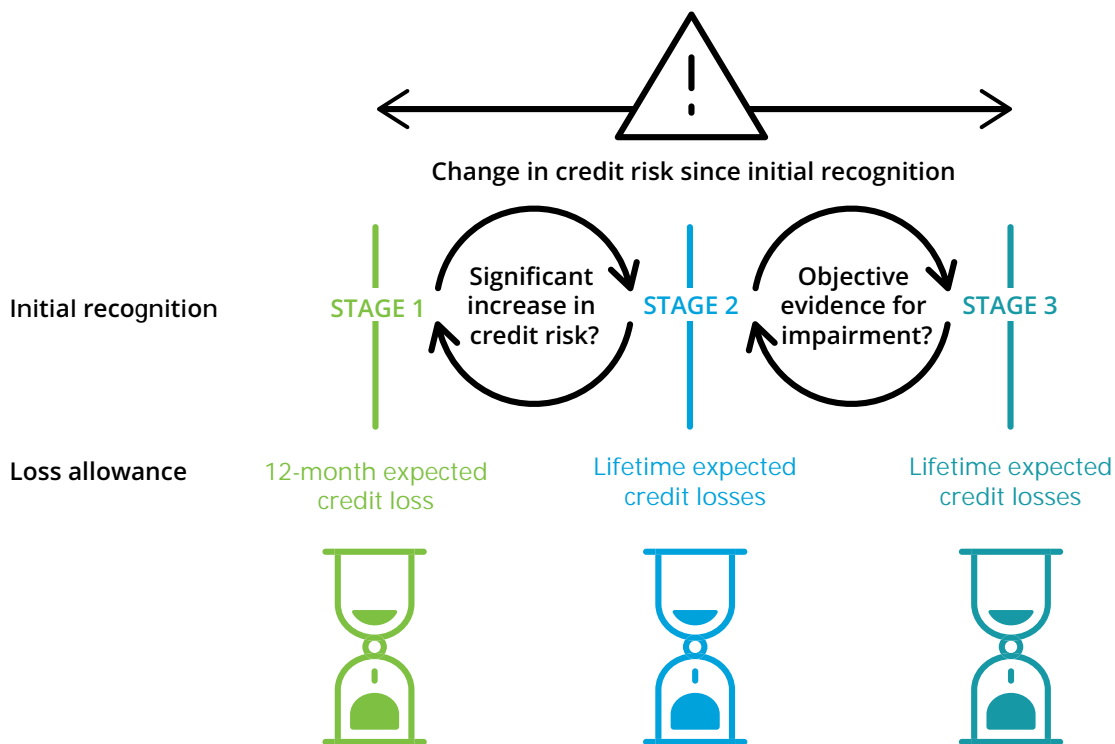
Recently issued standards all stress the need for lenders to assess future credit risk, rather than focus exclusively on a specific past fact pattern.

On one hand, the Financial Accounting Standards Board (FASB) issued the "Accounting Standards Update (ASU) 2016-13, Financial Instruments – Credit Losses (Topic 326)," on 16 June 2016, which will be effective for all entities reporting in US GAAP issuing after 15 December 2021 (application for public entities will be effective from 15 December 2019). On the other hand, the International Accounting Standards Board (IASB) issued "IFRS 9 Financial Instruments," on 24 July 2014, which will enter into force for annual periods beginning on or after 1 January 2018.

These two accounting standards essentially share the same philosophy: provisions for credit losses will no longer have to be recorded with an incurred loss model, but rather with an expected loss model. In other words, the prominence of what is likely to happen to the borrower will be as important, if not more important than what has happened. As the standards are applied in future, lenders will have to book a provision for expected credit loss (ECL) right from the loan inception, based on loss expectations for the coming 12 months (stage 1). This period extends to the lifetime of the loan if a significant increase in credit risk arises (stage 2); see *Figure 41*.⁸¹ This concept is key, as the profit and loss impact of a 12-month ECL, versus a contract-lifetime-ECL could be dramatically different.

Figure 41. Impairment-staging

Change in credit risk and impact on the loss allowance



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

⁸¹ The last stage (3) will occur in the event of a greater increase in credit risk and will imply interest revenue to be calculated on the net carrying amount of the asset (i.e., the value of the asset, less the ECL).

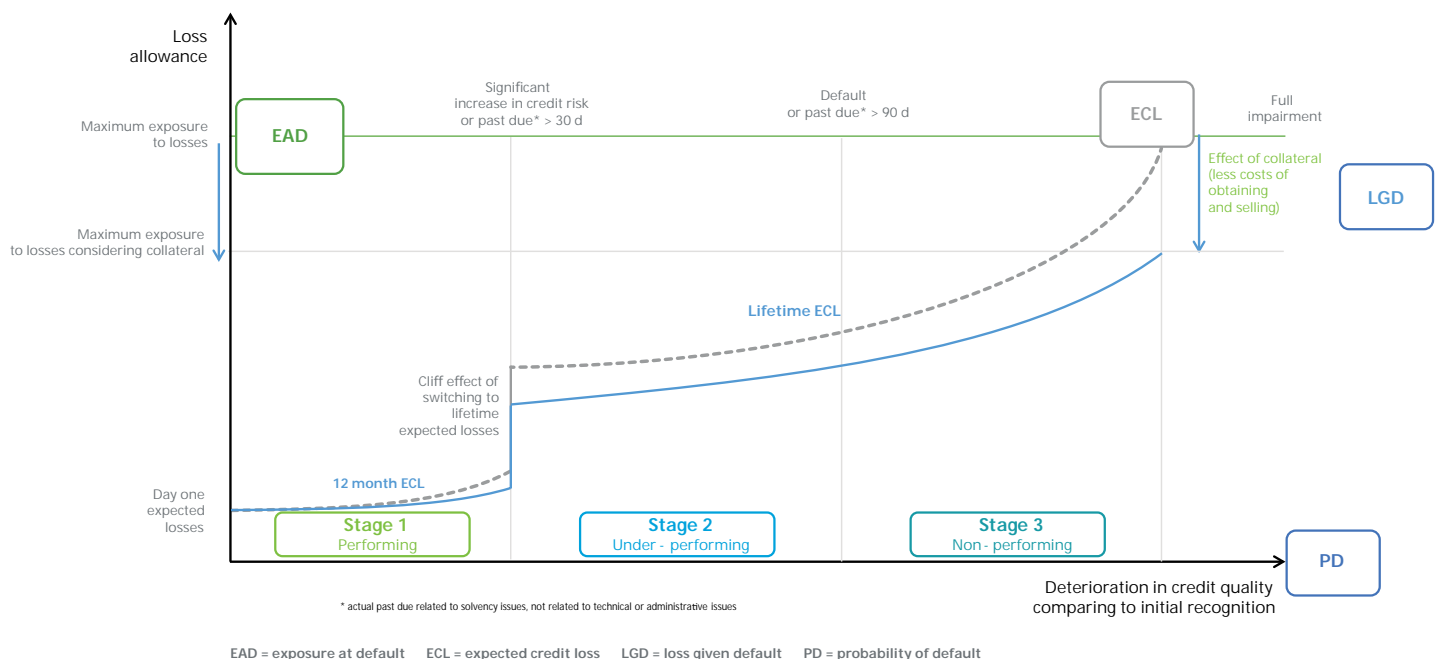
Challenges and applications

The application of these standards brings its own set of challenges:

- The ECL calculation must account for forward-looking information about both the borrower and the collateral, which is not always easily available on the art market.
- The concept of a significant increase in credit risk, which triggers the extension of the length used for the ECL calculation, implies not only setting a threshold measuring its significance, but also careful monitoring of forward-looking information to foresee this increase. Therefore, to achieve consistency between ECL measurement and the assessment of significant increases in credit risks, the same reasonable and supportable forward-looking information should be taken into consideration, where relevant.
- Under both standards, when determining the ECL, the fair value of the collateral reducing the projected loss needs to reflect the future value of the collateral but also consider the impact of the cost of sales of the collateral (if used for repayment); see **Figure 42**. Additionally, the standards will also affect full-recourse and non-recourse loans. In the context of a full-recourse loan, this implies a much more complex and diverse forward-looking valuation.
- The standards also allow for the determination of the parameters of the ECL model and the thresholds for significant credit risk increases, for a pool of loans sharing the same risk characteristics. In essence, a portfolio could then be split between homogenous populations, for the ECL to then be calibrated using internal or market data pertaining to such a homogenous population only. In some cases, such tasks could become a tedious datamining process.

Figure 42. The Impairment model–staging

The introduction of three ‘stages’ in creditworthiness of the various positions has an impact on the modelling and related ECL provisioning



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

In this journey toward risk assessment, Deloitte has designed an art-secured lending dashboard, providing useful analytics regarding the content of the loan portfolio. Wisely used, it could ease the process of classifying loans into homogenous buckets. Such a tool could fully leverage market data on specific artists or artworks in the form of forward-looking information. Hence, this dashboard could outline the following interesting characteristics:



When aiming for the standardization of risk assessment, this proof-of-concept, along with other techniques deployed on a transactional level, and leveraging algorithms⁸² could be valuable to decision makers in the art world, but also to newcomers seeking guidance. Major players in the art market have already recognized the rising appeal of big data in the art market, and thus, such concepts, coupled with the right set of data, could make it an even more powerful tool from a risk management and industry development standpoint.

Special thanks to Monica Carabajal Zamora, Capital Markets Manager, and her team, as well as Jean-Philippe Peters, Risk Advisory Partner at Deloitte Luxembourg, for their dedicated work and advice on this project.

In this journey toward risk assessment, Deloitte has designed an art-secured lending dashboard, providing useful analytics regarding the content of the loan portfolio.

⁸² Mitigating risk in the art market – Laura Patten and Borna Emami (page 260).



Claire Hillier
Managing Director -
Global Originations
Borro

Risk in the art market

Art valuation methods at Borro

Borro has valued over 60,000 assets overall since launching in 2009. While we always aim to lend as much as possible to our clients, as a company we must ensure that individual assets can be sold on the secondary market if clients cannot repay their loans. Therefore, the correct valuation is critical and there is significant risk around provenance as well as pricing.

Each asset we value must have the appropriate provenance to protect us against forgery or ownership disputes. Without this, the asset almost becomes worthless—we would be unable to sell it and recover what is owed.

To mitigate this risk, we value assets using a combination of personal knowledge and data insight—a method that offers 88 percent accuracy based on asset sale prices, a percentage that compares favorably to auction houses.

Our data insight draws upon a historical view of liquidity and price trends from millions of auction sale records. This data is then considered by our expert valuers, who

have over 100 years' collective experience with the likes of Bonham's across a variety of assets. Their tailored expertise and opinions on likely movements for specific artists, genres, media, and the art market overall, together with the data, ultimately help to determine pricing and the adequate provenance for each particular asset.

Our valuers perform rigorous online and offline processes to identify fraudulent or stolen paintings, including online registry checks, examining provenance, and, of course, examining the piece itself. These practical inspections are critical—our specialists in New York once realized a piece was a forgery after analyzing the materials used. The materials were found to include newspapers dated after the year the piece was said to have been produced.

It is important to remember that provenance will not be similar for all artists. It could take the form of certification from a foundation (e.g., the Warhol foundation), inclusion in a catalogue raisonnée, or purchase receipts from an auction house. All help trace the piece from the artist to the current owner.



The art market needs to adapt to show true valuations

Although we are pleased to see that the days of price fixing are over, problems with art auctions persist. Two particular difficulties driving mistrust, both among buyers and artists themselves, are private deals made on works sold at auction and estimates that are made for the sole purpose of driving prices up and encouraging bidding activity. For the buyer especially, it is difficult to recognize a good deal, or whether, in fact, the artwork has achieved its true value.

Looking at private sales specifically, there is confusion due to a lack of transparency and regulation. The Alfred Taubman sale demonstrated this perfectly, whereby Sotheby's sales figures were below the guarantee, although this was not overtly mentioned. Subsequent private sales for other pieces achieved the expected value, but this means there are a number of pieces without a public record of their sales price.

A classic example of the lack of true value in the art market is Damien Hirst's *For the Love of God*—a piece that was put up for sale at £50 million. With a lack of buyers willing to buy at that price, the artist bought it himself, claiming that a third of the work had been sold to private investors. This raises the question—can a piece truly be worth £50 million if the artist bought it himself?

In addition to valuation discrepancies, private sales make tracing provenance more complicated, and high-value pieces, such as those by Jackson Pollock, are often the subject of disputes. Art foundations can also refute or refuse to recognize sales as the sale of authentic works by an artist. An clear example is the 2014 case against the Calder Foundation brought by Patrick Cramer, which centered around a piece his father bought privately from the artist that the foundation said was only a fragment of a larger work.

Many of these issues are rooted in a lack of regulation

Currently, there is no regulated, structured way to buy or sell art, or declare ownership or transfer of ownership, and provenance remains a highly subjective matter. There is still no set definition or standard for what makes up "good provenance" and this is often assessed through a random assortment of documents, photographs, and other source materials that collectively allow the history of an artwork to be pieced together. It is therefore easy to understand how those who are not heavily involved in the market have difficulty understanding a piece's true value.

At Borro, we strongly believe that defining "good provenance" and introducing additional regulation in this area is key to mitigating the risk of forgery. The current lack of regulation is restricting the market and maximizing the need for specialists who can truly appraise value. Even at Borro, where our in-house valuers have considerable experience in auction houses, we have a supplementary network of 300 appraisers to help supplement and cross-check our valuations.

Regulation would create new opportunities to expand and democratize the art market—banks and wealth managers would be able to put their full weight into the market, something they are simply unable to do now.

In addition to tighter controls and definitions, we need to allow the market to expand technologically. There are significant opportunities to use new innovations in technology to provide more standardized procedures for valuations. The success of Artnet in digitizing art sales and knowledge is a step in the right direction and yet, even then, correctly interpreting the data they make available requires significant knowledge.

In order to grow and thrive, it is imperative the market becomes more accessible for those without an Art degree or years of experience in the market. To really do this, regulation needs to come from outside; self-regulation is likely not going to be enough unless the whole market can come together and agree on stringent standards.

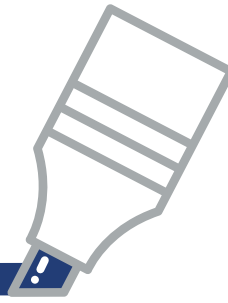
The current lack of regulation is restricting the market.

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Section 4

Art as an investment



HIGHLIGHTS

- **Art market returns have recovered in the last 12 months:** Six out of seven artnet art price indices recorded positive returns between April 2016 and April 2017, with impressionist art and contemporary art accounting for the highest annual returns of 10.50 percent and 7.45 percent respectively.

In terms of correlation across all asset classes, it is clear that safe haven art categories (impressionism and old masters) are highly correlated with safe haven asset types (bonds, real estate), whereas riskier movements (contemporary, Chinese art etc.) exhibit greater correlation with riskier asset types (stocks, commodities).

- **The art fund market is struggling to gain momentum:** The overall art fund market⁸³ in the first half of 2017 was conservatively estimated to be worth US\$834 million,⁸⁴ down from US\$1.03 billion in 2016 and US\$1.2 billion in 2015. However, there are signs, particularly in Europe and the US, that new art investment funds are seeking to enter the market.

- **The Chinese art fund industry is declining because of tougher regulations:** The decrease in the overall AUM in the art fund market since 2012 is largely due to the Chinese art fund and art trust business winding down over the last four years. The estimated AUM for the Chinese art investment fund/trust business has fallen from US\$1.48 billion at the peak in 2012 to an estimated US\$483 million⁸⁵ in 2016, and US\$373 million in the first half of 2017.
- **Art investment fund products remain a niche service:** Only 11 percent of the wealth managers surveyed offer an art investment fund product as part of their in-house offering⁸⁶ (down from 18 percent in 2016), however more banks are able to offer art investment funds through a limited number of third-party providers. However, in terms of art-related services, art fund products remain niche and this corresponds with the limited growth in the number of public art fund providers in recent years.

83 Measured in terms of assets under management (AUM).

84 A conservative estimate of US\$461 million of this total is based on art investment funds in Europe and the US that reported their AUM. US\$420 million of this is accounted for by the Fine Art Group. The Chinese art fund and art investment trust market was worth an estimated US\$483 million in 2016, and an estimated \$373 million in the first half of 2017 based on publicly available information.

85 This figure is based on conservative estimates about the size and maturity of different art investment trusts, drawing on information that was publicly available in July 2017. However, many Chinese trust companies are no longer marketing or publishing information about their art-related trust investment activities and it is not possible to know whether these funds have been wound up early or are still active. Our estimates are based on the limited publicly available information as of July 2017, and it is likely that our numbers are underestimated as many art investment vehicles are not official investment vehicles.

86 We believe this finding could be a matter of definition of what is considered in-house vs. third party services. Very few banks to our knowledge offer art investment products that are originated in-house, and we believe these findings also reflect the fact that several wealth managers offer the opportunity for their clients to invest in art through partnerships with existing art fund providers. We do believe respondents may consider these products as an in-house offering, although they are delivered by external third-party providers.

Although art funds have struggled to gain a proper foothold among investors, few new art investment products are being developed to address many of the shortfalls associated with art investment funds, such as liquidity and price transparency.

- **Challenges around the art fund market remain the same:** After tracking wealth managers' attitudes toward art investment funds for six years, the obstacles preventing the incorporation of these products in a wealth management offering remain the same.
- **Pre-investment process:** 79 percent of the wealth managers surveyed said that due diligence and assessing art funds' viability and credibility were among the main obstacles (up from 77 percent in 2016). This challenge is linked to other aspects of the art fund industry and the art market, such as the lack of track record for art funds, and the unregulated nature of the art market.
- **Post-investment monitoring:** 85 percent of wealth managers cited the lack of mark-to-market valuation as a major challenge preventing the incorporation of art into the wealth management offering (this was up from 77 percent in 2016). Securing an improved valuation framework using both historic and forward-looking price and valuation data combined with expert opinions should therefore be a priority.
- **Art funds remain a low priority for wealth managers:** Only 13 percent of wealth managers said they were likely to offer their clients such a service in the coming 12 months, which makes this the art-related service wealth managers viewed as the lowest priority. The global art investment fund industry's lack of critical mass and track record continues to undermine the credibility of art investment products from the perspective of wealth managers.
- **New art investment products:** Although art funds have struggled to gain a proper foothold among investors, few new art investment products are being developed to address many of the shortfalls associated with art investment funds, such as liquidity and price transparency. Most of these efforts are driven by technological innovation, and the adaptation of existing technology, such as blockchain.



Fabian Bocart

Vice President of
Analytics
artnet

Yoage Wang

Business Analyst
artnet

The performance of the art market as a whole and among collecting categories⁸⁷

In the global auction market, scarce supply—18 percent fewer lots were consigned year-over-year globally—led to a drop in the quantity of works sold at auction, despite an increase in prices. The first half of 2017 saw the global auction market increase in value to US\$5.1 billion, compared to US\$4.7 billion in the first half of 2016. In the United States and Europe, sales increased by 26 percent and 7 percent, respectively, thanks to significantly higher prices at auction fueled by strong demand and weak supply. In Asia, however, the total sales value decreased by 18 percent in the first half of 2017 as compared to the same period last year, as prices could not compensate for the 12 percent drop in supply. As a result, the United States now has more than twice the global market share of Asia.

Contemporary art remained bullish around the world as prices increased by 20 percent year-over-year. In the first half of 2017, 47,052 lots sold out of the 70,473 offered at auction in this category, down from 88,986 lots offered in the first half of 2016.

Meanwhile, the sell-through rate increased to 66.8 percent in the first half of 2017 from 63.9 percent last year. The total sales volume in the first half of 2017 amounted to US\$2.7 billion, experiencing a 4.7 percent increase as the contemporary market pivoted towards higher-value lots.

Other collecting categories were not affected by the same trends. According to artnet indices, the Modern Art market was the only market to experience deflation in the first quarter of 2017—a global downward trend that began in 2015. As in previous years, prices for European Old Masters remained stable across the board.

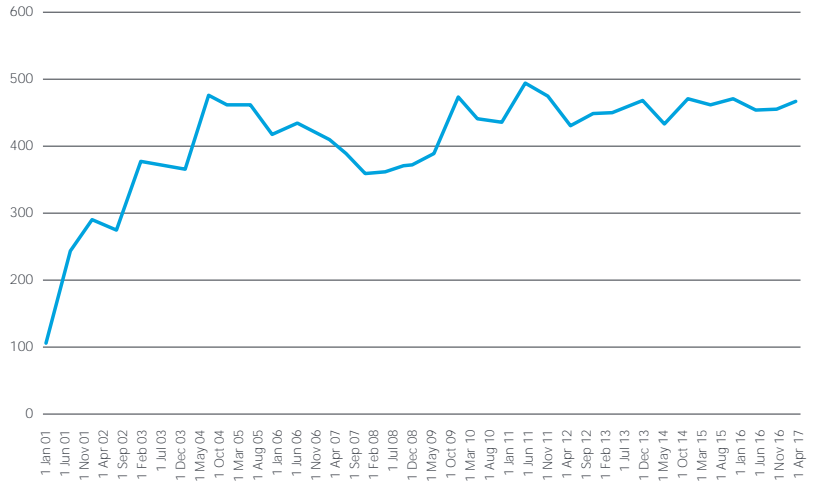
Future growth in the art market will largely depend on macroeconomic conditions. The first quarter of 2017 saw sluggish consumer spending in the United States, while the Federal Reserve scaled back its quantitative easing program and pursued rate hikes to meet its inflation target. As a result, this may negatively affect asset prices in the future, including those of art.

87 Previous editions of the Art & Finance Report have used data and indices from Mei Moses. However, Mei Moses was acquired by Sotheby's in October 2016. This year we have collaborated with artnet, and analyzed their new set of indices, developed by a team headed up by Fabian Bocart, who was previously with Tutela Capital. More about the index methodology can be found in this paper: onlinelibrary.wiley.com/doi/10.1002/

According to artnet indices, the Modern Art market was the only market to experience deflation in the first quarter of 2017—a global downward trend that began in 2015.

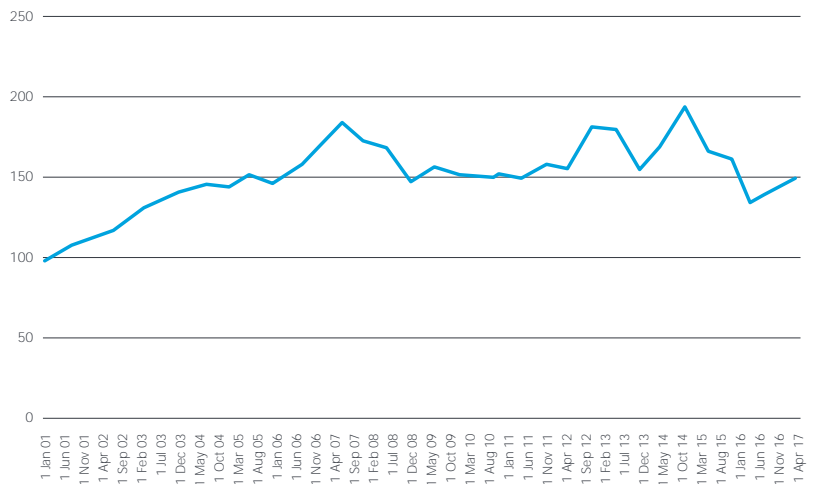
Economic growth in Europe continues to improve with GDP growth of 1.5 percent forecast for Germany. The political climate has largely recovered after the shock of Brexit in 2016, and this rebound is an important factor for stability in the art market as continental Europe is a net exporter of art. In Asia, China's National Bureau of Statistics declared that the economy had maintained momentum from the second half of last year, saying it was “getting off to a good start in 2017, and laying a solid foundation for accomplishing the whole year growth target” of 6.5 percent.

Figure 43. artnet Price Index: European Old Masters



Source : artnet

Figure 44. artnet Price Index: Global Impressionist Art



Source : artnet

Figure 45. artnet Price Indices: Modern Art

Global vs. European vs. American



Source : artnet

Although this analysis documents some variations in performance across the various fine art collecting segments in the short term, the long-term performance over a period of 15 years indicates positive annual returns for all art price indices monitored in this report.

Figure 46. artnet Price Indices: Post-War Art

Global vs. European vs. American



Source : artnet

Figure 47. artnet Price Indices: Contemporary Art

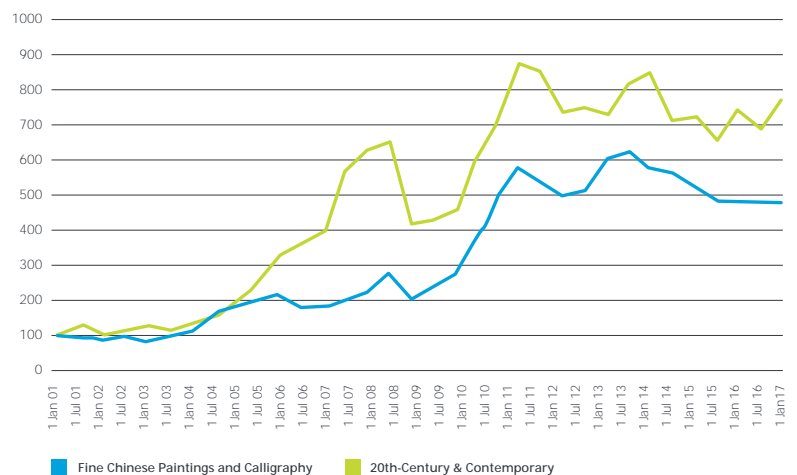
Global vs. European vs. American



Source : artnet

Figure 48. artnet Price Indices: Chinese Art

Fine Chinese Paintings and Calligraphy vs. 20th-Century and Contemporary



Source : artnet

Table 2. Art market returns by time periodArt market price index returns—1, 5, 10, and 15 years based on artnet indices¹

	Last 12-month return	5-year CAGR	10-year CAGR	15-year CAGR
European Old Masters	2.21%	1.72%	1.72%	3.69%
Global Impressionist Art	10.50%	-0.78%	-2.07%	1.54%
Global Modern Art	3.62%	-2.50%	-2.43%	4.05%
Global Post-War Art	-0.98%	1.29%	-1.26%	7.12%
Global Contemporary Art	7.45%	4.09%	2.04%	8.54%
Fine Chinese Paintings & Calligraphy	0.67%	-0.59%	9.17%	11.50%
20th-Century & Contemporary Chinese Art	3.74%	1.10%	3.19%	14.10%

Source : artnet

The returns are nominal and do not include transaction fees. The 12-month return is from April 2016 to April 2017.

Although this analysis documents some variations in performance across the various fine art collecting segments in the short term, the long-term performance over a period of 15 years indicates positive annual returns for all art price indices monitored in this report. Previous analysis shows year-over-year changes in the performance of the art market as a whole, as well as the various fine art collecting segments in the first half of 2016 as compared to the same period of 2017. This suggests that, in addition to the diversification benefits of including art in an overall portfolio (as outlined below), investors also enjoy positive returns over a long investment horizon.

1-year period: Six out of seven art markets monitored by artnet for this report saw a positive compound annual return (CAGR) during the 12-month period from August 2016 to August 2017. Impressionist Art saw the strongest annual return of 10.5 percent, followed by Contemporary Art with a 7.45 percent annual return, 20th-Century and Contemporary Chinese Art with a 3.74 percent annual return, and Modern Art with a 3.62 percent annual return. The Post-War Art category was the only category that registered a negative return of -0.98 percent over the last 12 months.

5-year period: Over a five-year period from August 2012 to August 2017, Contemporary Art saw the highest CAGR of 4.09 percent, followed by Old Masters with a 1.72 percent annual return over the last five years. Impressionist Art, Modern Art, and 20th-Century and Contemporary Chinese Art all recorded a negative annual return in this period, according to analysis by artnet.

10-year period: Despite an overall weak performance during the last five years, the highest annual return for the last decade was achieved by Fine Chinese Paintings and Calligraphy, which saw a 9.17 percent CAGR in this period. This was followed by Chinese Modern Art along with 20th-Century and Contemporary Chinese Art, which registered an annual return of 3.19 percent during the same period. According to a recent report by artnet, increasing demand from Chinese buyers, coupled with a 14 percent increase in overseas sales of Chinese art and antiques in 2015, are driving this trend. Although the total sales of Chinese art and antiques overseas declined in 2016, it still accounted for 14 percent of all art sales outside of mainland China—a much larger share than in 2009 (8 percent). Contemporary Art, which saw the strongest return over the last five

years, had the third highest CAGR with 2.04 percent measured over a 10-year period. Impressionist Art, Modern Art, and Post-War Art all experienced negative annual returns over the last decade.

15-year period: Between 2002 and 2017, artnet art market indices show positive annual returns of between 1.54 percent and 14.1 percent. The three best-performing art categories for this period were 20th-Century and Contemporary Chinese Art with a 14.1 percent CAGR, Fine Chinese Paintings and Calligraphy with an 11.5 percent CAGR, and Contemporary Art with an 8.54 percent CAGR.

Table 3. Risk and Correlation

Based on artnet indices¹

	Volatility	Correlation with US Equities (S&P 500 between 2002–2016)	Correlation with Global Equities (MSCI World Index between 2003–2016)	Correlation with Equities in Developed and Emerging Markets (MSCI ACWI IMI between 2003–2016)
European Old Masters	14.06%	-17.16%	21.00%	13.53%
Global Impressionist Art	12.28%	20.75%	23.77%	35.85%
Global Modern Art	15.66%	32.02%	25.36%	42.13%
Global Post-War Art	15.54%	31.27%	49.05%	59.57%
Global Contemporary Art	19.80%	16.73%	14.51%	29.60%
Fine Chinese Paintings & Calligraphy	29.01%	41.33%	39.50%	42.48%
20th-Century & Contemporary Chinese Art	29.31%	21.68%	15.96%	38.85%

	Correlation with Real Estate (MSCI World REITs 2007–2016)	Correlation with Commodities (S&P GSCI between 2008–2016)	Correlation with Fixed Income (S&P 500 Bond Index between 2008–2016)
European Old Masters	20.69%	16.52%	24.45%
Global Impressionist Art	57.44%	7.08%	69.01%
Global Modern Art	36.13%	30.83%	36.61%
Global Post-War Art	52.03%	16.55%	28.95%
Global Contemporary Art	-4.23%	25.66%	5.48%
Fine Chinese Paintings & Calligraphy	29.91%	61.72%	27.78%
20th-Century & Contemporary Chinese Art	21.93%	71.68%	27.93%

Source: artnet

In addition to return, relative risk is another important measure of financial performance. The risk associated with traditional assets is enhancing the appeal of using art to ensure optimal portfolio allocation. The correlation matrix here above outlines the diversification opportunities between the various collecting categories and other asset classes.

The Old Masters price index does not have a clear correlation with any of the financial indices listed in the chart. The

Impressionist Art index and Modern Art index, however, have relatively low volatility and are correlated with the S&P 500 bond index, due to the fact that both bonds and Impressionist and Modern Art are widely perceived as low-risk investments with stable returns.

The Post-War Art index also has low volatility among all art price indices. This index is correlated with MSCI World REITs, indicating that investing in Post-War Art is to some extent treated as an investment vehicle similar to REITs.

Interestingly, the Contemporary Art index has a loose negative correlation with MSCI World REITs, demonstrating that Contemporary Art is treated less like REITs and more like other liquid commodities. By contrast, Chinese art indices have higher volatility than the other art price indices. They show strong correlation with the S&P GSCI, suggesting that investing in Chinese art shares some similar features with investing in the most liquid commodities.

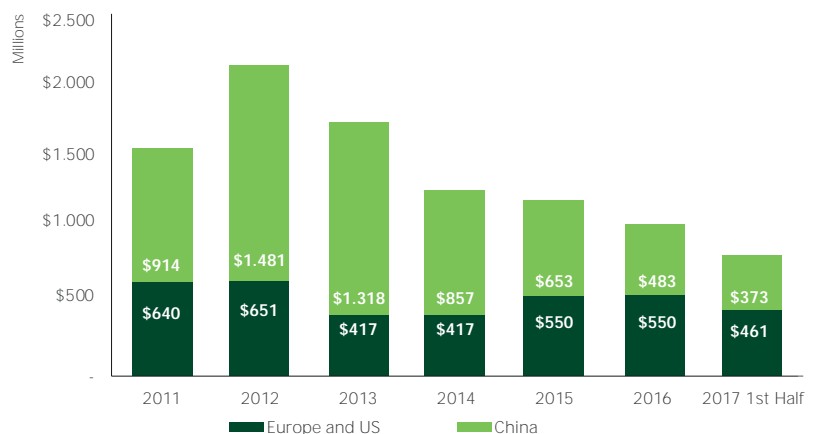
The risk associated with traditional assets is enhancing the appeal of using art to ensure optimal portfolio allocation.

Art investment funds

The global art investment fund market is struggling to gain momentum after five years of decline

The overall art fund market⁸⁸ in the first half of 2017 was conservatively estimated to be worth US\$834 million,⁸⁹ down from US\$1.03 billion in 2016 and US\$1.2 billion in 2015. The US and European art fund market continues to decline, and fundraising has taken place predominantly among existing art funds. The decrease in the overall AUM in the art fund market over the last five years is largely due to the Chinese art fund and art trust business winding down since 2013.

Figure 49. Global Art Investment Fund Market (AUM) 2011 – H1 2017
Estimated assets under management (AUM) in US\$



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

⁸⁸ Measured in terms of assets under management (AUM).

⁸⁹ A conservative estimate of US\$461 of this total is based on art investment funds in Europe and the US that reported their AUM. The Chinese art fund and art investment trust market was worth an estimated US\$483 million in 2016, and an estimated US\$373 million in the first half of 2017 based on publicly available information.

⁹⁰ This figure is based on conservative estimates about size and maturity of different art investment trusts, drawing on information that was publicly available in July 2017. However, many Chinese trust companies are no longer marketing or publishing information about their art-related trust investment activities and it is not possible to know whether these funds have been wound up early or are still active. Our estimates are based on the publicly available information as of July 2017.

⁹¹ This is a conservative estimate and is based on art investment funds in Europe and the US that reported their AUM and are operating with a public profile. The Fine Art Group accounted for the lion's share of the European and US total with a reported US\$420 million in AUM. A number of art fund providers included in last year's figures did not submit their AUM and are therefore not included in the above total. Fine wine and collectibles funds are also excluded, as are private, family wealth-oriented art funds that do not raise funds from external investors. Also, it is highly likely that the actual size of the art investment fund industry is considerably larger, if one were to consider art investment products, vehicles, and companies without any public profile. However, with no transparency in this part of the market, an estimated figure would be hard to establish.

⁹² In 2016, we learned that The Art Agency, Partners, which was acquired by Sotheby's in January 2016, established an art fund that held about US\$52 million in capital. This was an art fund that was only known to a small number of insiders and investors, and there are likely to be many more of these private, under-the-radar investment structures.

Lack of industry transparency a major hurdle for the art investment fund market.

The estimated AUM for the Chinese art investment fund/trust business has fallen from US\$1.48 billion at the peak in 2012 to an estimated US\$483 million⁹⁰ in 2016, and US\$373 million in the first half of 2017. It is very difficult to ascertain the level of art investment fund or trust activity in China at the moment, as very few trust companies are currently marketing these products openly. This could indicate that art investment fund activity is increasingly taking place under the radar, and away from public and government scrutiny.

The US and European art fund market also saw a decline between 2016 and 2017, with an estimated US\$461 million⁹¹ of assets under management in July 2017, down from US\$550 million in January 2016. However, there are signs, particularly in Europe, that new art investment funds continue to enter the market. One of the recent additions to the art fund landscape is the IN ART FUND, based in Luxembourg. The fund aims to secure long-term uncorrelated returns through investments in collections of original artwork by post-war and contemporary artists. What makes the concept behind the IN ART FUND different is that it acquires the entire collection of an artist selected with the approval of an academic council. The fund's strategy is

characterized by a conviction that past valuations of such works can be restored by implementing a precise, specific strategy in terms of museum exhibitions and catalogue publications. This is likely to be the first regulated art fund under the European Alternative Investment Fund Directive, and it could pave the way for more art funds to follow a similar path. For more information, see the interview on *page 186*.

Lack of industry transparency a major hurdle for the art investment fund market

As noted in previous editions of this report, the actual size of the art investment fund market is likely to be considerably larger than the publicly available data⁹² suggests. The high costs associated with regulatory compliance and the complexity associated with setting up art investment funds is increasingly forcing the industry to consider "lighter," more cost-efficient structures. The risk associated with this trend is that it seems to move art investment underground and away from the scrutiny of the public eye. Although this may have certain advantages in terms of anonymity and discretion, it heightens what most stakeholders view as the greatest risk associated with the

art market: a lack of transparency. As art collector demand for art investment products exists (37 percent of art collectors this year said they would be interested in art investment funds), there is an opportunity for wealth managers to play a bigger role in bringing greater transparency to the art fund industry. By implementing certain industry standards, such as an art fund industry rating system or guidelines on how to carry out due diligence, such developments could encourage more investors to consider these products, while forcing the art fund industry to emerge from the shadows. One thing is clear: the art fund industry is unlikely to evolve until transparency, credibility, and trust are restored in this market. This requires further collaboration between the main stakeholder groups, such as wealth managers, financial regulators, art professionals, and art collectors, to develop an industry framework and standards to govern this investment product category.



Art investment funds: historic net asset value (NAV) for the Fine Art Invest Fund and the Tiroche DeLeon Collection

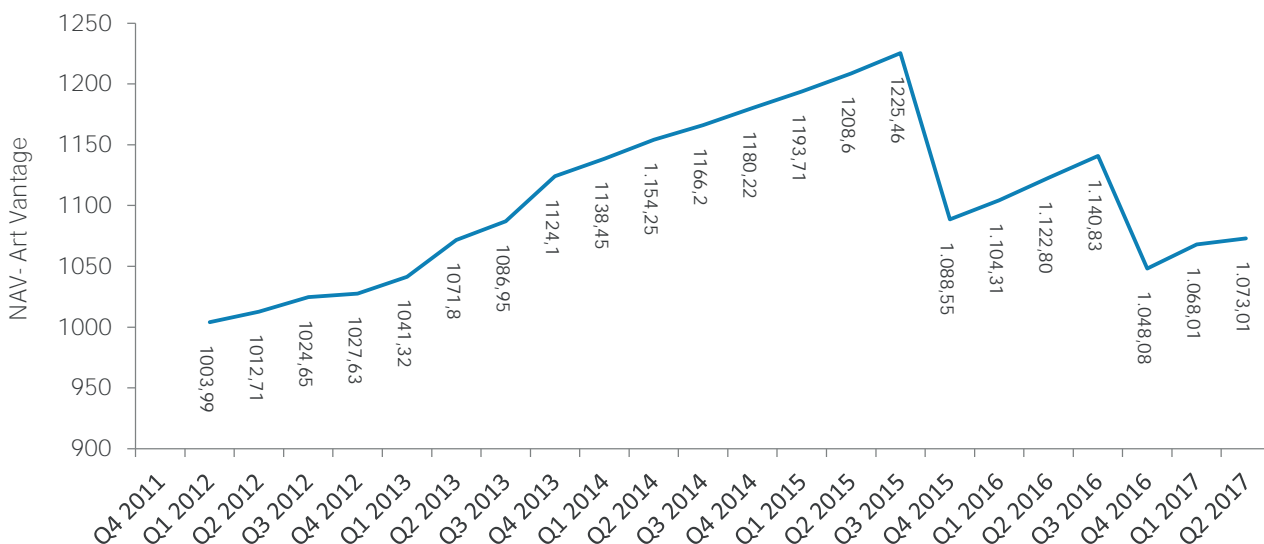
Below is one example of an art investment fund that is actively focusing on market transparency by making performance figures available to the public.

Table 4. Example of an art investment fund's structure and performance

Tiroche DeLeon Collection (Art Vantage PCC Limited)	
Launch year	2012
Term	10 years
Investment objective	Contemporary art from developing markets.
Total return	21.70 percent (since Jan. 2011)
Minimum subscription	US\$500,000
AUM	US\$20.17 million (June 2017)
Website	www.tirochedeleon.com
Domicile of fund	Gibraltar

93 Q4 2015 and Q4 2016 are reductions in mark-to-market valuations provided by external parties on 31 December of each year. The biggest single contributor to these drops has been Ai Weiwei who was also a major contributor to rises in value in the early years of the fund. The fund holds two major works and the value has fluctuated significantly in the last two years.

Figure 50. Tiroche DeLeon Collection (Art Vantage PCC Limited) - Historical Net Asset Value⁹³



Source: <http://www.tirochedeleon.com/about/investors/>



IN ART FUND



INTERVIEW WITH

Violaine Remacle, IN ART Managing Partner, Alain Balanzategui & Miguel A. Muñoz



You recently launched an art fund. Could you briefly describe the structure of the company and the motivation behind it?

In terms of legal structure, the ART FUND was set up as a limited partnership (*société en commandite simple*), qualifying as an Alternative Investment Fund (AIF) within the meaning of article 1(39) of the 2013 Act on Alternative Investment Fund Managers (AIFM Act). The fund is managed by the general partner (INVICTAS S.A.), which is registered with the Commission de Surveillance du Secteur Financier (CSSF) as an AIFM. The IN ART FUND was created by INVICTAS, an AIFM company. The IN ART FUND relies upon the experience and knowledge of IN ART S.A., which is the fund's adviser entity.

IN ART S.A. manages museum collections, for example a collection of Picasso's photography, and works with museums from Barcelona to Beijing. The main benefits of this legal structure are the competitive cost structure and fast set-up process. It offers a flexible and effective framework combined with general contractual freedom, paving the way for the development of specific strategies in tangible assets and in particular in innovative art strategies.

INVICTAS's board
(Alain Balanzategui, Violaine S.
Remacle & Miguel A. Muñoz),
2017 (Photographer J. Verhoef)

The company is lightly regulated as an AIFM—what does that mean in practice? What is the nature of the CSSF supervision to which it is subject? AIFMD (the Alternative Investment Fund Manager Directive), introduced in 2013, provides a freer regime for AIFMs of funds with less than €100 million in assets under management. This threshold rises to €500 million in cases where the AIFM is unleveraged or does not allow redemptions for five years, the period that is usually required for the development of the specific strategies in private equity or alternative investment strategies in tangible assets. AIFMs are required to register to access this freer regime as opposed to the stricter authorization criteria that usually apply to retail investors.

Thus, the general partner of the limited partnership (INVICTAS S.A.) is exempt from strict requirements other than its reporting obligations to the CSSF. The IN ART FUND, domiciled in Luxembourg and audited by an external auditor (*réviseur d'entreprises*), may be subscribed by well-informed/professional investors (in kind or cash) and marketed in the EU in accordance with applicable national private investment rules.

Could you briefly introduce the art fund, its performance objective, and the strategy used to achieve this performance?

The IN ART FUND, based in Luxembourg, is a pioneer in innovative art strategies, focused on securing long-term uncorrelated returns through investments in collections of original artwork by post-war and contemporary artists. The selected artists are of exceptional quality and are generally deceased.

What makes the concept behind the IN ART FUND unique is that it acquires the entire collection of an artist selected with the academic council's approval. Moreover, the fund is characterized by a conviction that past valuations of such works can be restored by implementing a precise, specific strategy in terms of museum exhibitions and catalogue publications.

In practice, this means for example that the artwork of Matt Lamb (an IN ART FUND artist) will regain the attractive art-market valuation it had 15 years ago. This will be achieved through the implementation of profile-boosting strategies including holding exhibitions, producing monographies, and managing the artist's image through media and print campaigns.

Value will be created promoting and marketing the collection in the world's finest galleries and museums. Our target is for the artwork to reach its former value after three years and we expect performance to double between year three and five.

The target is to continue to boost the attractiveness and performance of the artist's global collection by working with leading auction houses such as Christie's, Sotheby's, and others. Interest in art as an alternative asset class has grown in recent years, in tandem with the emergence of new art investment strategies and opportunities created by new art portfolio structures. Art is increasingly prevalent in the portfolios of investors searching for alternative assets that offer risk-adjusted returns uncorrelated with more traditional investments.

IN ART S.A. manages museum collections, for example a collection of Picasso's photography, and works with museums from Barcelona to Beijing.

Do you have any specific experience in the investment management of art collections?

Our capabilities and experience guarantee a successful outcome.

IN ART S.A., an adviser entity for the fund, has an extensive global network of contacts and works closely with the best players in the art market including experts and members of the academic council (all of whom have an excellent amazing track record), and scholars at the world's best universities.

These include, for example:

- Prof. Serena Baccaglini, Arte ed Economia, Università Cattolica del Sacro Cuore di Milano
- Mrs. Ana Chilova, Curator of International Art Projects, Cologne, Germany
- Dr. Joan Abello Juanperre, Director of Reial Cercle Artistic, Barcelona, Spain
- Prof. Patricia Pellegrini, President of the Museo Escuela de Arte, Buenos Aires, Argentina
- Prof. Deborah Bell, artist and international auction expert, New York, USA.

Annual valuation of the art has been outsourced to a prestigious independent company that has been monitoring major international auctions for many years. This company uses scientific algorithms and methods for optimal price estimation and to ascertain fair market values based on a prudent approach.

The initial pictorial work appraisal of the IN ART FUND collections is based on both the artwork replacement prices and valuations, and on the artworks held within the collection.



A practical example of IN ART's activity is the promotion of a major photography collection by Picasso over the past two years. We have achieved value growth of nearly 80 percent and outstanding performance over an 18-month period. This is mainly due to our successful exhibitions across China (from Shanghai to Beijing) accompanied by national press campaigns, museum catalogue publications, and hundreds of thousands of paying visitors.

www.inartfund.lu

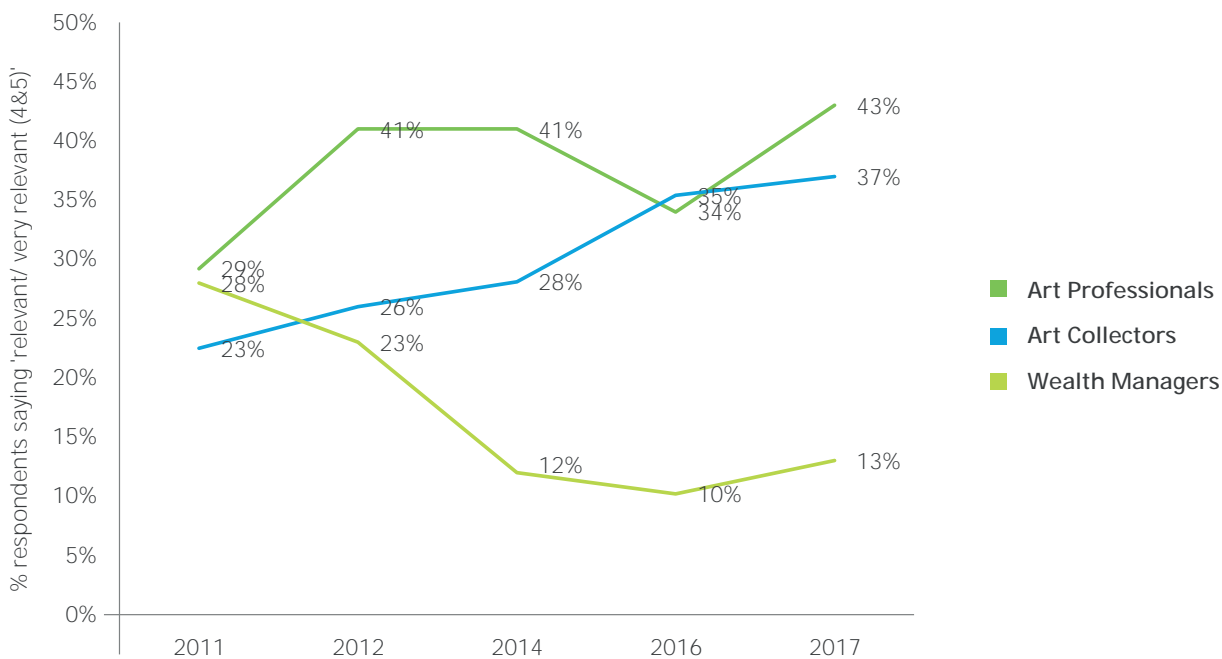


What makes the concept behind the IN ART FUND unique is that it acquires the entire collection of an artist selected with the academic council's approval.

The IN ART FUND collection at the Luxembourg Freeport showroom, 2017 (Photographer J. Verhoeft)

Survey findings

Figure 51. How relevant is Art Investment vs. % of wealth managers focusing on this service in the next 12 months



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Only a small minority of banks are planning to offer art investment fund products to their clients in the coming 12 months:

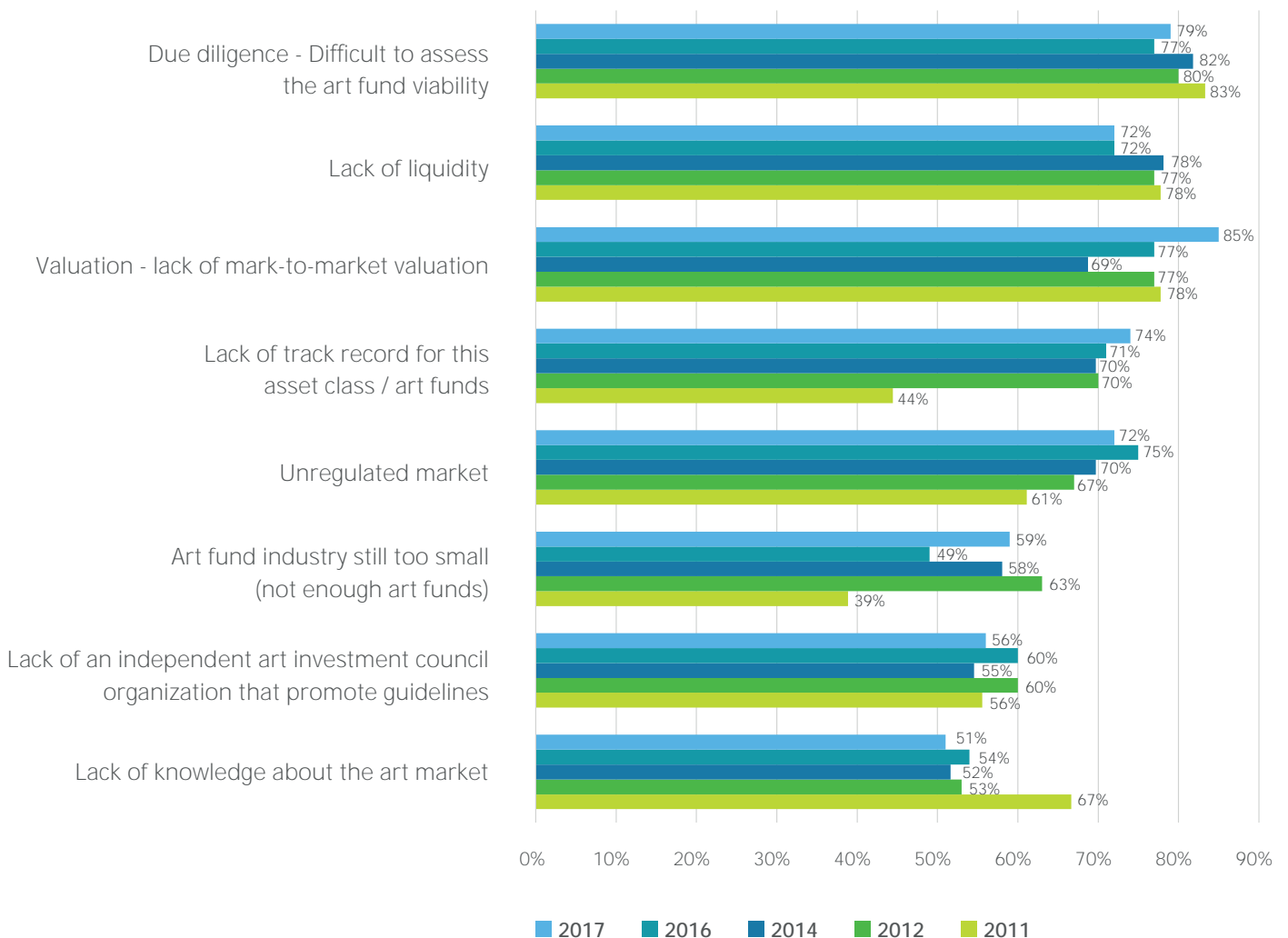
the recent survey of wealth managers shows that only 13 percent (13 percent of private banks and 16 percent of family offices) see it as likely that they will offer their clients art investment fund products over the next 12 months (this is up from 10 percent in 2016). The limited appetite among wealth managers for offering art and collectible investment products stands in contrast to the current demand among art professionals and their clients, as 43 percent of art professionals stated that art investment funds were a relevant/very relevant service for their clients. In addition, 37 percent of art collectors said that these types of art

investment products would be relevant/very relevant. Almost half (48 percent) of art collectors would be interested to know more about existing art and collectible investment products, while 68 percent of art professionals said the same. This is a clear signal that there is market demand and curiosity for these types for alternative investment, but that current vehicles and art investment products might not be appropriate for generating wider consumer and investor interest. New innovations in the art investment space have emerged at regular intervals for some time, and Marcelo Garcia Casil, CEO of Maecenas, who is building a global art blockchain market where assets are traded quickly and fairly on a liquid exchange, discusses this in greater depth on *page 194*.

Neutral outlook for the art fund industry: 30 percent of the wealth managers surveyed said they have noticed an increase in demand for such investment products from their clients (up from 27 percent in 2016 and 20 percent in 2014). This increase corresponds to the art collector trend outlined in *Figure 51*, where 37 percent of art collectors see art funds as a relevant art and wealth management service.

Wealth managers are increasingly keen to know more about the existing art fund industry: 49 percent of wealth managers wanted to know more about existing art funds (up from 44 percent in 2016). The interest was greater among the private banking community, where 54 percent said they were interested in knowing more about collectible investment products. This could signal an opportunity for the art fund industry to start working more closely with the wealth management industry, in particular with regards to how to address the challenges outlined in the section below.

Figure 52. What do you feel are the main hurdles for incorporating Art Investment Funds as part of the bank's current client offering



Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Despite several attempts to create associations and self-regulated bodies to promote and provide guidelines for the art fund industry, it is yet again the small size of this market (i.e., the small number of art funds currently in the market) that makes these organizations hard to sustain.

Challenges

After tracking wealth managers' attitudes toward art investment funds for six years, the challenges preventing the incorporation of these products in a wealth management offering remain the same.

Existing art funds have failed to create an industry: 59 percent of wealth managers said that the small size of the art fund industry meant that there was insufficient depth to this investment market (up from 49 percent in 2016) to make it a viable investment alternative. The small art fund industry is clearly in a catch-22 situation: the lack of track record and transparency regarding the performance of existing art investment funds makes it harder for new art funds to enter the market, preventing the industry from growing, learning, and building on other funds' success and failures. Despite several attempts to create associations and self-regulated bodies to promote and provide guidelines for the art fund industry, it is yet again the small size of this market (i.e., the small number of art funds currently in the market) that makes these organizations hard to sustain. This does not mean that they are not needed, and 56 percent of wealth managers this year said that such an independent organization could help to foster trust and transparency in this market.

Pre-investment process: 79 percent of the wealth managers surveyed said that due diligence and the effort required to ascertain the viability and credibility of an art fund were among the main obstacles (up from 77 percent in 2016). This challenge is linked to other aspects of the art fund industry and the art market such as: 1) lack of track record for art funds (74 percent said this was important, up from 71 percent in 2016), and 2) the unregulated nature of the art market (72 percent said this was an important aspect, down from 75 percent in 2016).

Post-investment monitoring: 85 percent of wealth managers cited the lack of market-to-market valuations as a major challenge preventing the incorporation of art into the wealth management offering (this was up from 77 percent in 2016). The importance of securing an improved valuation framework using both historic and forward-looking price and valuation data combined with expert opinions is discussed in greater depth in the Priorities section on *page 28*. As in the art-secured lending market, art market liquidity was cited as a major risk factor, with 72 percent of wealth managers describing this as a major challenge (the same percentage as in 2016).

Unregulated market: 72 percent of wealth managers cited the unregulated nature of the art market as the main hurdle preventing the incorporation of art investment funds into their wealth service offering (down slightly from 75 percent in 2016). As we have seen earlier, regulation is increasingly becoming an issue and concern in the art market and among the wealth management community (see section 6 on Risk management and regulation).



Maecenas: A new art investment platform

INTERVIEW WITH



Marcelo García Casil Founder & CEO of Maecenas



Could you please outline who is behind the Maecenas project and describe their background?

Maecenas is a young company, but it is growing fast. At the time of writing, we have 15 people in our team and have offices in London, Geneva, Singapore and Buenos Aires. This is our founding team:

I am the CEO and founding partner of Maecenas. I come from an investment banking background, having designed and built mission-critical systems for a number of large multinational banks including Crédit Suisse and Barclays Capital. For the last four years, since founding the company, I have specialized in blockchain technology.

Jérôme Croisier is our Chief Art Officer, who has been instrumental in terms of shaping Maecenas to truly address the key problems within the Art & Finance industry. Jérôme is a renowned art adviser and art historian, and has 20 years of art market experience. His art history research has been published in a variety of books and publications.

Miguel Neumann is a founding partner of Maecenas. He is a business manager specializing in financial innovation and he has a background in branding and marketing. He has over 15 years of experience leading international projects and teams, and has been involved in fine art for over eight years, including several exhibitions and successful sales.

Federico Cardoso is our CTO and co-founder. He is highly regarded as a blockchain and security expert and is a strong supporter of the open source movement. He actively contributes to projects related to blockchain and cryptography. His experience working for large corporations like IBM and Telecom Argentina has equipped Federico with the skills required to build and support a global platform like Maecenas.

Please tell us briefly about the vision behind Maecenas, and the market needs it sets out to address.

Our goal is to create the largest and most trusted art investment platform in the world. We love art and we want to address the fundamental issues that have plagued this industry for years. A lack of transparency is probably the biggest one in people's minds, but equally important are a lack of access to this market due to inefficiencies, and high fees that prevent a large number of players from participating. We believe that an open and global platform like Maecenas can create the necessary liquidity and transparency to completely transform the art market and trigger an investment revolution.

Ultimately, Maecenas is about the emergence of a new asset class—a liquid and efficient vehicle that offers investors controlled exposure to fine art in their portfolios. We leverage blockchain technology to create tamper-proof provenance records for every piece of art, and use smart contracts to remove intermediaries and run financially sensitive processes in a trustworthy way. Through a process called asset tokenization, Maecenas creates shares in artworks that can be traded in real-time on our art exchange platform.

In addition, our platform aims to become an efficient source of financing for art collectors, galleries, and museums alike looking to raise cash against their existing collections at a lower rate than those offered by traditional lenders.

Can you please describe the current state of play with the project? What has already been done? What still has to be addressed? Do you already have a launch date planned?

We embarked upon this venture more than three years ago and, in that time, we have made a tremendous amount of progress. Maecenas is a very ambitious project that involves cutting-edge technology, financial structuring, and cross-jurisdictional legal frameworks that make it quite sophisticated in nature.

At this point, we have an alpha version of our platform that we are testing internally and privately with some potential partners and clients. We have made strides in terms of designing the financial and legal structures required for Maecenas to operate.

We believe that we are about six months away from completing the outstanding work and therefore we aim to launch our beta version to a select audience in the first quarter of 2018.

Transparency and liquidity are two factors that are cited among the most significant challenges when it comes to art as an asset class. How does Maecenas plan to improve these?

Our ultimate goal is to eliminate art-market intermediaries that add no value to the process and take advantage of information asymmetry to charge exorbitant fees or unnecessarily mark prices up, or even worse to deal with pieces that are either not authentic or have unverifiable origins.

Using a cryptographic and decentralized platform like blockchain enables us to run our financial processes in a fully transparent manner, where all participants can independently verify transactions and where trust is achieved through an unbreakable computational process and does not depend solely on the counterparty's trustworthiness. Comprehensive information about

Through a process called asset tokenization, Maecenas creates shares in artworks that can be traded in real-time on our art exchange platform.

the listed artworks will be put into the blockchain, including their provenance record, condition report, authenticity certificate, past exhibitions, literature references, and insurance certificate; and these will be available to the investors at all times. Once in the blockchain, the information can be trusted as reliable as it cannot be altered by anyone, even Maecenas itself. This ensures transparency for the investor.

Using the same technology, Maecenas creates digital units or shares for each work of art listed on the platform. This process creates liquidity thanks to our art exchange where investors can instantly buy and sell their holdings with each other.

Issues around price manipulation are also a major concern on the art market—what are Maecenas' solutions to this problem?

Two factors that enable price manipulation are privileged access and poor transparency over the investment process. Maecenas implements a Dutch

auction process via smart contracts to provide a fair and transparent price discovery mechanism that gives investors greater control and visibility over the investment process.

As blockchain transactions are cryptographically protected and cannot be amended, each bid submitted into the system can be audited and trusted, therefore this greatly reduces the opportunity for bad actors to manipulate prices.

Maecenas is building a global art blockchain market, but why was blockchain chosen?

Blockchain is often called the “internet of trust” because it enables parties to execute and settle financial transactions without having to rely on a trusted intermediary. In addition, because blockchain records are tamper-proof, it also makes an ideal secure repository for certificates, which Maecenas uses to keep track of provenance records. This makes blockchain technology the perfect solution for the art market problems that we are trying to solve.

Ultimately, Maecenas is about the emergence of a new asset class—a liquid and efficient vehicle that offers investors controlled exposure to fine art in their portfolios.

What are the signs that the market is ready for a platform like Maecenas?

There are a number of trends that validate and reaffirm our business model:

- **The shared economy:** Crowdfunding platforms have seen exponential growth worldwide since they launched. Maecenas allows investors to syndicate and jointly own a piece of art. We also issue collateralized loans that draw upon the uptick in P2P lending platforms.
- **Cryptocurrencies:** Investment in cryptocurrencies and crypto-assets has seen meteoric growth this year. The market is now worth US\$160 billion and it continues to rise. Maecenas offers cryptocurrency investors a great way to divest their portfolio.
- **Investment in art finance innovation:** Investment in art-related startups is at an all-time high and new deals are now struck worth nearly US\$1 billion annually.
- **Art as collateral:** Art & Finance is expected to grow significantly. The US art-secured lending market has grown an estimated 15 to 20 percent annually for the last five years.
- **Self-investment:** Over the coming years, more and more money will be passed on to younger generations, who are actively looking to participate in the process of making decisions regarding their investments. The behavior of this digital-native generation favors digital-first platforms and the ability to self-invest. Millennials will be the largest adult segment by as soon as 2020.
- **Alternative investments:** The younger generation of investors favours tangible assets over traditional capital market products, such as government bonds and stocks. These products are currently offering negative or very low interest rates, making alternative assets even more attractive.

What are the key factors that will ensure that the platform is successful,

i.e., how do you aim to encourage and incentivize people to use the platform?

At its very core, Maecenas is a marketplace. The lifeblood of a marketplace is its liquidity, and therefore that is one of our top priorities. We have a significant number of qualified artworks in the pipeline that will be listed on our platform when we launch. Likewise, we have a growing number of investors who are signing up to take part in our beta phase early next year. This will ensure that our marketplace is the right size and has enough players and assets when we start; two key aspects that will increase our chances of success.

As we secure more artworks and register more investors, we will continue to expand to new markets and to establish strategic partnerships with existing key players.

We anticipate having to subsidize market makers to operate in our secondary market. In addition, we will run revenue-sharing schemes with selected partners that will help us reach out to our target audience in key segments.

Survey findings show that people's motivations for buying art extend far beyond financial considerations, with the emotional and social aspects of collecting art ranking as the most significant. What is Maecenas doing to address these key non-financial motivations?

We like to think of Maecenas as a decentralized art gallery. To realize that vision, we will set up viewing facilities within art vaults worldwide that are purposely tailored to exhibitions, with the aim scheduling events to let our clients view and enjoy the artworks they own. They could even arrange for their family and friends to join them. We see this as a great way to add value by helping art investors to emotionally connect with their collections.

Who do you see as your main competitors on this market? Are your rivals other technology companies or traditional art-market players?

Even though Maecenas is the first of

its kind, we know that we will face competition from copycats and other existing startups sitting at the junction of ArtTech and FinTech.

The initial feedback we have received from traditional art-market players has been very positive and we see them more as collaborators than as competitors. Maecenas brings net positive value to the art market as a whole and existing players seem to recognize that. We look forward to building fruitful partnerships with many of them.

The idea of dematerializing art objects into tradeable certificates or units has been tried before (e.g., SplitArt, which we covered in our first Art & Finance Report in 2011)—what are you offering that is different? Why do you think you will succeed where others have failed? What are the lessons learned?

The market today is very different from what it was back in 2011. When launching new ventures, timing is absolutely key. There are countless examples of companies that executed an idea too early and failed.

There are many advantages that we have now that did not exist back in 2011 when SplitArt started. The most significant boost we have is definitely the regulatory landscape.

With the advent of FinTech, financial regulators today are much more open and flexible with regard to enforcing regulation on startups. They have come to the realization that innovation is very positive for their industry and therefore they have demonstrated that they are willing to bend some rules and accommodate some others to allow innovative startups to operate without regulation being a huge burden on them. A prime example of this is the myriad of crowdfunding licenses that have been issued in many large financial centers globally. These licenses have much lower capital requirements and reporting duties are simplified and definitely more lightweight than those applied to traditional players.



Applying data to art funds



INTERVIEW WITH

Madelaine D'Angelo Founder & CEO of Arthena

Arthena builds investment funds backed by art assets using quantitative strategies. Through modeling and simulation, Arthena provides financial analysis comparable to mainstream investment opportunities. Our models are able to impose tight statistical bounds on the performance and volatility of the art market.

We use data science to evaluate investment opportunities. By combining our quantitative model with human intelligence to analyze the art market, we identify works with strong growth potential and a low rate of volatility in order to deliver returns to our investors. Ultimately, we consider and evaluate our products in the same rigorous and data-driven way as a fund manager of any other alternative financial product.

What makes art an attractive alternative asset?

In many cases, investors seeking uncorrelated returns, portfolio diversification, or alpha compromise too easily on the expected returns of those investments, given the benefits they bring in offsetting the risk of the broader portfolio.

At an aggregate level, the art market does not move closely in step with mainstream financial markets, and thus serves to diversify an investor's portfolio. Artnet's latest estimates of correlation with the S&P 500 range from -17 percent for old masters, to 32 percent for modern art—all well below other alternative asset choices like REITs or hedge funds. The figures for art can be broken down one stage further to reveal the individual artists and types of

Fine art is a centuries-old asset class that has long offered solid returns and portfolio diversification, but the high barriers to entry have deterred many from participating.

work with sales values demonstrating low correlation even at the most granular level. In focusing on this latter group, it is possible to construct portfolios with correlations as near to zero as possible.

In terms of returns, investments in post-war and contemporary art, for example, have generated 10.7 percent annualized returns over the past 20 years⁹⁴, with a standard deviation of 12.9 percent, while art funds have returned 8.8-12.5 percent on average. The S&P 500 returned 8.3 percent in the same period, with 19.3 percent standard deviation.

Why invest in a fund instead of buying art directly?

Fine art is a centuries-old asset class that has long offered solid returns and portfolio diversification, but the high barriers to entry have deterred many

from participating. Art funds enable a broader spectrum of investors to engage, which ultimately means more money entering the art market as a whole, benefiting artists and other existing stakeholders.

Art funds offer a variety of benefits that address the historical barriers to entry to the asset class. Not least, they solve the apparent conflict between conventional art market wisdom encouraging investors to “buy the best they can afford,” versus the financial maxim that you should not “hold all your eggs in one basket.” By pooling capital across multiple positions, art funds are able to diversify a portfolio of assets across genres, artists, rates of return, and volatilities.

Personal collections rarely end up truly diversified, as they are skewed by the personal tastes of the investor, or the areas in which the art adviser has the greatest expertise, the desire for a collection that can be viewed and enjoyed as a coherent whole. Funds can only be truly diversified and agnostic to the extent to which they are liberated from aesthetic or emotional considerations.

Investment via an art fund structure also alleviates the need to develop in-house expertise, build trust with a team of advisers and dealers, and navigate the operational requirements for handling, storing, and placing works for divestment. In combination this reduces investor overhead and maximizes returns.

⁹⁴ Mei Moses® *World and Collecting category indexes*®

What led us to develop a quantitative strategy?

If art is ever to be considered a true financial investment option, there needs to be the same level of analysis of art assets as there is for any other investment opportunity. Our quantitative strategy and methodology enable us to offer this.

Data science has enabled substantial advancement across a spectrum of industries—from baseball to retail—and the same is true for art.

Data-backed methodologies make it possible to identify and evaluate trends on a wider number of dimensions, and across a broader body of works than could readily be tracked by a team of human advisers or analysts.

How can data be applied to the art market?

There are two major obstacles to applying data science to art. The first is the availability of data, as art sales happen less frequently than financial trades and often take place behind closed doors. The other is that each work of art is different, making it difficult to compare one piece with another.

The effective use of data science requires a dataset which is: 1) large enough to draw statistically significant conclusions, and 2) sufficiently representative of trends occurring across the market, including areas where data is unavailable.

In art, there is an abundance of public auction data spanning multiple decades, but fewer than 15 percent of these data points represent repeat sales where

it is possible to view previous public transactions for the same work. In real estate, the comparable figure is 90 percent.⁹⁵ This renders conventional “repeat sales” estimates of value growth unreliable: 85 percent of data points would have to be omitted, and the remaining 15 percent are unlikely to be representative, since works that are particularly good or bad are more likely to be resold.⁹⁶

Our answer to this at Arthena is the application of hedonic regression, which breaks down the individual attributes of each work (artist, medium, style, material, size, and so on) and evaluates how each influences artwork values and volatilities over time. On this basis, the historic dataset is rich enough to draw statistically significant conclusions. While no method is free from error or risk, we can identify and focus on the attributes that provide the greatest reliability and predictive potential, and avoid attributes that prove less reliable. These findings can then be used to extrapolate into the future, to assess the expected future value of a work available for sale.

Effective analysis requires the application of mathematical regressions as well as an expert understanding of the value drivers of the asset class, allowing Arthena to view investments through a lens comparable to that used for more standard financial instruments.

As to whether auction data is representative of the overall market, the worlds of auctions and private sales are intertwined: since auction data is publicly available, it is hard for dealers to justify valuations that do not align

with their values. Similarly, auction houses keep their ear to the ground on private sales when generating estimates for a lot. The interplay of these dynamics creates a market that remains relatively in step, across both the auction and private sale spheres.

While it may sound complex, at a fundamental level the application of data science simply replicates the conventional assessments of art advisers in evaluating works. But beyond this mathematical rigor, the key difference is in speed and scale: it allows near-instant evaluation across the entire field of available works.



⁹⁵ *artnet*—See *What Experts Have to Say About Sotheby's Acquisition of the Mei Moses Art Indices*

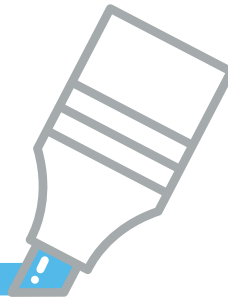
⁹⁶ Chanel, Olivier, Louis-André Gérard-Varet, and Victor Ginsburgh. “The Relevance of Hedonic Price Indices.” *Journal of Cultural Economics* 20, no. 1 (03, 1996): 1–24. doi: <http://dx.doi.org/10.1007/s10824-005-1024-3>.

If art is ever to be considered a true financial investment option, there needs to be the same level of analysis of art assets as there is for any other investment opportunity.



Section 5

Art and technology



HIGHLIGHTS

- **Technology is increasingly playing a key role in the evolution of the art market:** Art-technology startups (ArtTechs) are building new digital business models aimed at enabling and supporting traditional art businesses, rather than replacing them. Technological innovations are aimed at increasing trust and transparency, but also supporting data-driven valuation methodology, building social capital, and transforming the backbone of the art market ecosystem.
- **Online art sales continue to grow:** Despite a challenging year for the global art market in 2016, with global auction sales falling by 19 percent⁹⁷ in 2016, the online art market continued to show resilience and further growth. According to the "Hiscox Online Art Trade Report 2017," online art market sales reached an estimated US\$3.75 billion in 2016, up 15 percent from 2015. This gave the online art market an estimated 8.4 percent share of the overall art market, up from 7.4 percent in 2015.
- **Traditional art businesses responding to the online challenge:** The lion's share of online art market growth between 2011 and 2014 was recorded by online-only platforms, boosted by significant venture capital funding and first-to-market advantages. However, growth has picked up among the traditional auction houses in the last two years. Sotheby's expanded its online business (online bidding and online-only auctions) to US\$155 million, an increase of 19 percent in 2016, and Christie's increased its online activities (bidding and online-only auctions) by 34 percent from US\$162 million in 2015 to US\$217 million in 2016.
- **Auction and dealer markets converging online:** Increasing competition is already forcing online art platforms to embrace new strategies to expand their business and diversify their income streams. Among the auction aggregators, Invaluable has ventured into the gallery and dealer space by allowing visitors to buy directly from galleries through fixed-price offers. Artsy, a platform predominantly targeting galleries, has held several online auctions in partnership with Phillips and Heritage over the last 12 months, and it raised a further US\$50 million in July 2017 to expand its auction business.
- **Improved data and analytics infrastructure in the art market:** A number of existing and new players are pushing for further developments, new data, and new analytical tools for the art market, and we are starting to see the emergence of a new and improved industry as it relates to data and analytics. This is an important development and it could contribute toward improving the transparency, valuation accuracy, and risk management of art-related wealth.
- **Blockchain could revolutionize the art industry:** The art industry is one of the world's most opaque business sectors, with a multitude of middlemen between the creator and the consumers of art. Blockchain could revolutionize the art industry by resolving questions of provenance, and improving transparency, copyright, and ownership issues. Seeing the potential, art startups are already building real-world applications based on blockchain.



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A digital art world

The intersection of art, wealth, and technology

While the fine art industry is often viewed as old-guard and slow to change, technology is quickly taking a front seat in its evolution. Today's consumers expect convenience, personalization, and contextual transparency, and the industry is looking to technology to deliver that experience. From art-technology startups (ArtTechs) to traditional incumbents, players are starting to look toward digital business models as a way to win in the contemporary art world.

In a series of recent discussions with industry luminaries, they provided their perspectives on the intersection of art, wealth and technology. From auction houses to startups to wealth managers, numerous leaders representing different aspects of the industry expressed their thoughts: how is technology evolving in the art market? What technologies are changing how art is viewed, purchased, and analyzed? What will the future hold?

Transparent valuation methodologies are increasing transaction comfort and investment opportunities

Traditionally, valuation has been considered more of an art than a science. While historical data points and comparatives are employed, much of the final result lies in the experience of professional appraisers and advisers. The influencing factors (and how they drive an artwork's value) are not always obvious or made clear to art collectors, and this can create friction and market inefficiencies.

A handful of industry pioneers are seeking to improve the valuation process through a more structured and transparent methodology. Christopher E. Vroom, CEO of CollectorIQ, Inc. is one of those spearheading the charge. He explains that “by aggregating nearly 100 million distinct attributes covering over \$100 billion in art sales, we’re able to assess the value impact of a wide range of selling choices such as auction house or location, time of year and the like while assessing the contribution to value of both primary and secondary object characteristics. Ultimately, structuring data is the key to understanding value.” The immediate goal is not necessarily to create a pin-perfect algorithm-based valuation, as this challenge may be too great given the subjective nature of art and the social capital element that drives the underlying value. However, increased transparency into the different components and weighting that determine value could instill more trust in the process, bringing increased comfort to buyers and sellers alike.

The development of more quantitative, transparent methods for valuations has a positive impact for financial services, particularly wealth managers. A key obstacle that high-net-worth clients face is the lack of sophisticated data and sufficient reporting that enables an investment-oriented evaluation. Art collectors are more commonly seeking the same level of sophistication from their auction house as from their investment bank. As pricing becomes more transparent and high-net-worth consumers get more comfortable with transactions, demand for art-related wealth management services should grow. As it relates to art-secured lending and financing, these algorithmic valuation methodologies could remove human bias / error and enable banks / financial

institutions to better evaluate and monitor their risk pools, driving increased loan volume on more favorable terms.

The establishment and adoption of these valuation methods can also open the door for advanced financial instruments, increasing exposure to art market economics and serving as a barometer for investment choices. Although art indices currently exist, they are not without their criticisms; they are often limited by the quality and availability of data.

Real-time algorithmic valuations could enable a more sophisticated, accurate, and timely index that satisfies the needs of investors. These same algorithms could also potentially drive the development of art exchange traded funds (ETFs), which would provide a financial instrument through which investors can gain exposure to market economics.

Social media as a builder of social capital and platform for art industry professionals

Social media is influencing the creation of art, serving as both subject matter and marketing channel. With exhibits such as *Rain Room*⁹⁸ and *Infinity Mirrors*⁹⁹ drawing massive crowds seeking that perfect photo to post online, the social media “friendliness” of a piece can make a considerable difference to the branding and performance of an artist, gallery, or museum.

Beyond just influencing the types of works created, social media is also serving as a low cost distribution channel for artists. In many ways, it is disintermediating the artist-gallery paradigm by allowing these creatives to showcase their work directly to millions of potential buyers. Joshua Campbell, a Sotheby’s Institute of Art alumnus and co-founder of Canvas

The development of more quantitative, transparent methods for valuations has a positive impact for financial services, particularly wealth managers.

Collective—a social art-recognition platform and marketing tool for art venues—believes that galleries are realizing social media is the best way to target the middle market, and a lot of the focus is now shifting toward these buyers. “Middle market transactions might not have headliner prices, but the sheer scale and quantity of this market is starting to have a lot of appeal for sellers,” said Campbell. Perhaps the most popular platform currently used is Instagram, often viewed as the social media of choice for the art community.

⁹⁸ *Rain Room* is an immersive environment piece created by Hannes Koch and Florian Ortkrass of Random International in 2012

⁹⁹ *Infinity Mirrors* refers to a number of Yayoi Kusama’s infinity mirror installations that have been made available to the public throughout the course of her artistic career

While it may be surprising to those who believe that the profile of an “insider” would suggest a slow or reluctant adoption of social media (due to their typical demographic), current observations suggest the opposite, with a significant number of active art collectors using the app on a consistent basis.

Dan Desmond, of Morgan Stanley’s Blue Rider Group, emphasizes the criticality of this development and its importance for wealth managers and financial services professionals who are looking to be well informed on what is happening in contemporary art. To truly develop deep and meaningful relationships with art collectors, it is not enough to merely understand the financial metrics and data of art, but to share an interest in the work itself and the community of artists, curators, scholars, and dealers that are the core of the community. Social media can provide a convenient and valuable channel for advisers to do just that, offering a window into shows happening all over the world.

Technology is transforming “the backbone” of the art ecosystem

From collection management to security to transportation, these ancillary services act as the backbone of the industry, ensuring art is exactly where it needs to be, when it needs to be there, and arriving in the same condition in which it left. While these services are acknowledged as crucial, how they are evolving through technology can frequently be overshadowed by more high-profile industry developments.

Adam Fields, CEO of ARTA, highlights that while the industry is often generalized as antiquated and resistant to change, logistics and other ancillary services that enable the daily operations for fine art can be considered even more old-fashioned. For example, electronic payment processing and currency conversion, capabilities that are taken for granted in most other industries, can be considered relatively new developments that many art shippers and service-providers are starting to adopt. Having found success with

directly connecting high quality shippers with customers, ARTA is now turning to APIs that can connect seller and buyer systems directly, bypassing the manual pen-and-paper processes that are typically required to complete a transaction.

Technology is also starting to address the challenges of provenance, tracking, and security, all of which are major risks and concerns. For example, the idea of a unique, reliable, and tamper-proof tracker for artwork can have many positive applications: simplified collection management, enhanced security monitoring, improved provenance accuracy, and monitored condition management. With technology like this, institutions and buyers can eliminate many steps that are currently being used to establish provenance and authenticity, and these benefits can ultimately translate into cost savings and improved confidence in the shipping and storage process.

A handful of firms are working on solutions to this problem, including Steven and Anne Halliwell (founders of ID4Arts and managing directors of the Art collectors Fund), who believe that technology using RFID transponders could be the solution. These developments will also likely have important implications for wealth management services as the issues of provenance, tracking, and security are solved.

The next frontier in trust and transparency: primary market data

It is widely regarded that one of the most impactful industry developments has been data transparency. While negotiating power and access to art have traditionally been reserved for insiders, improved access and analysis of data has made it easier for a variety of stakeholders to venture into the art world. Secondary market data is readily available, and the understanding of fine art movements and financials has improved drastically as a result, giving art collectors more confidence to engage in transactions.

Conversely, a significant percentage of the global market value lies in the primary market, and the data on these transactions is not readily available or understood. Shedding light on this data could have enormous implications, as it provides the last major piece for a complete picture. As Pip Deely of Wolfram Ventures suggests, "What it's going to take to see this change happen is for the holders of primary market data to understand the value of sharing their data." Art insiders inherently want to amass as much primary sales data as possible because they understand the value that this information asymmetry has in both influence and negotiating power. However, Deely believes dealers are starting to understand that their data is not going to stay private forever and it's in their best interest to tell richer stories and better justify their prices.

Although the issue of primary market data opacity is very much alive, the need for transparency is becoming more and more compelling. There is no doubt that technology will play a critical role in unlocking this part of the market, and it will be exciting to see what the future holds.

Technology is here to enable and support businesses, not replace them

While technology may invariably change how business is done, it does not necessarily mean that traditional jobs are at risk. Instead, incumbents will likely have to evolve to adapt to the technology. Those who are willing to transform can learn to engage the market in more compelling ways. For example, an art appraiser can embrace data-driven algorithms and marry them with the traditional appraisal process to provide a more compelling value proposition for a specific price point. They can also play a role in the development and fine-tuning of the algorithms.

The major role of technology within the industry will likely be to reduce friction, improve access, and instill confidence in the underlying processes. Margins for certain businesses and players may suffer as technology eliminates information

asymmetries and lowers the barriers for market entry; however, it is important to recognize that the same technology provides opportunity, as it enables more accessibility and comfort in transactions. As Hugo Liu of Artsy articulates: "You shouldn't look at 'ArtTech' as threatening your slice of the pie. You should see it as a way to grow the entire pie overall." The firms that can adopt and adapt will likely be able to tap into a more expansive market than they have ever seen before.

The nucleus of the market adopting technology innovation will continue to expand as prices become more transparent and demand better matches supply. However, there is broad agreement that the art industry has an intangible quality that can never be replaced or co-opted by technology. Much of the personal satisfaction and appeal can be derived from the "romance" of the in-person experience, and it's not expected that any of these elements will ever be phased out entirely. Technology can go far in improving the access and convenience of art, but the nuances surrounding the experience of art may never vanish.

While technology may invariably change how business is done, it does not necessarily mean that traditional jobs are at risk. Instead, incumbents will likely have to evolve to adapt to the technology.

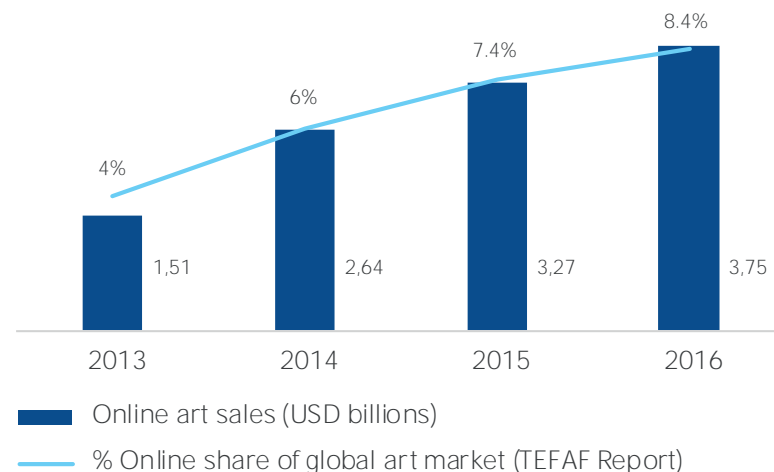
Trends

Online art market continues to grow, but competition intensifies

Despite a challenging year for the global art market in 2016, with global auction sales falling by 19 percent¹⁰⁰ in 2016, the online art market continued to show resilience and further growth.

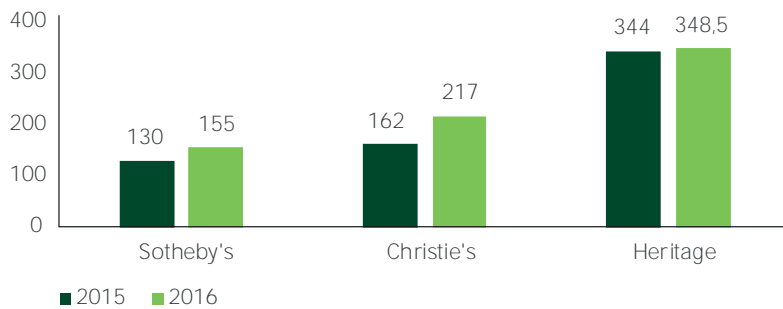
According to the “Hiscox Online Art Trade Report 2017,” online art market sales reached an estimated US\$3.75 billion in 2016, up 15 percent from 2015. This gave the online art market an estimated 8.4 percent share of the overall art market, up from 7.4 percent¹ in 2015. Tefaf reported in 2017 that more than US\$1 billion of art and antique dealer sales in 2016 were taking place online, which accounted for approximately 4 percent of the overall dealer market.

Figure 53. Online Sales 2013 - 2016 (\$US billion)



Source: “Hiscox Online Art Trade Report 2017”

¹⁰⁰ Source: “TEFAF Art Market Report 2017”

Figure 54. Traditional Art Auction Houses: Online Sales in \$US Million

Source: "Hiscox Online Art Trade Report 2017"

Despite the global decline in auction sales, Sotheby's expanded its online business (online bidding and online-only auctions) to US\$155 million, i.e., an increase of 19 percent in 2016, and Christie's increased its online activities (bidding and online-only auctions) by 34 percent from US\$162 million in 2015 to US\$217 million in 2016. Online-only auctions saw particularly strong growth at Christie's, with an 84 percent jump in sales last year. Heritage Auction reported that 41 percent of its auction sales were now conducted online, with US\$348.5 million in sales reported in 2016 (up 1.3 percent).

While the lion's share of online art market growth between 2011 and 2014 was recorded by online-only platforms, boosted by significant venture capital funding and first-to-market advantages, growth has picked up in the last two years among the traditional auction houses, which are rapidly investing and adapting to the digital age.

The failure of the high-profile online auction house Auctionata (announced in January 2017), casts doubt upon the ability of new online-only players to grow fast enough and become profitable in an increasingly congested marketplace. On the other hand, the growth in online-only auction sales from traditional auction houses such as Christie's suggests that the power balance might be shifting back to the incumbent art-market players.

The "Hiscox Online Art Trade Report 2017" reported that the majority of online art platforms expected to see more industry consolidation. Among the online art platforms surveyed, 71 percent said they expected more consolidation to occur. 48 percent of companies surveyed felt that "horizontal mergers" (companies operating in the same space such as Paddle8 and Auctionata) will be the most common, while 53 percent believe "vertical mergers" are more likely, i.e., companies operating in different parts of the value chain. There is also evidence that online art business models are converging toward a one-stop shop template. Increasing competition is already forcing online art platforms to embrace new strategies to expand their business and diversify their income streams. Among the auction aggregators, Invaluable has ventured into the gallery and dealer space by allowing visitors to buy directly from galleries through fixed-price offers. Artsy, a platform predominantly targeting galleries, has held several online auctions in partnership with Phillips and Heritage over the last 12 months, and raised a further US\$50 million¹⁰¹ to expand the auction business. These trends suggest we could see more consolidation in the industry over the coming years.

¹⁰¹ The round of financing was raised in July 2017 from 56 investors led by Avenir Growth Capital

The "Hiscox Online Art Trade Report 2017" reported that the majority of online art platforms expected to see more industry consolidation.

Art data & analytics providers

Table 5.

Products	AMA/Art Analytics	Artfacts.net	artnet	Artprice
Art price database	Art Analytics do not own any price database itself.	ArtFacts.Net compares exhibition careers and auction trends using data provided by Mutualart.com	artnet has a database of auction records dating back to 1985. The database contains over 11 million color-illustrated fine art, design, and decorative art auction results with complete lot descriptions.	Artprice.com covers 30 million prices and indices for 630,000 artists. The data comes from 6,300 partner auction houses and covers auctions from 1962 to the present day.
Art price indices			A new family of art price indices launched in autumn 2017, showing the representative prices of art market sectors and artists. These indices help users to track the evolution of prices.	Artprice produces price indices per artists as part of their artist analytics service.
Primary art market analysis	AMA covers extensively all art market news including fairs, biennials, events, museum and gallery exhibitions.	ArtFacts.Net is the leading provider of data and analytics related to exhibition information. ArtFacts.Net produces a set of rankings for artists, galleries and art fairs. The Artist Ranking is an indicator of the cultural value of an artist career. It is calculated by quantifying the exhibition success of an artist, acting as an important counterbalance to the formation of prices in the art market.		

Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Although the majority of the financing has gone into e-commerce-related art businesses, we are also seeing more activity in the art services and art infrastructure space. In this section, we have highlighted a number of new and recently launched initiatives in the art and technology space, which may have a real impact on the Art & Finance market in the future, and many of the key issues discussed in this report.

Art market data, research, and new analytical tools

Many of the art data analytics companies have existed for more than 15 years and have developed analytical tools to offer both quantitative and qualitative analysis aimed at improving the understanding of risk and performance in the art market. The following table illustrates some of these companies:

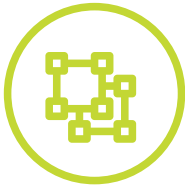
ArtTactic	Mutualart	Pi-eX
<p>ArtTactic has developed a proprietary auction price and price forecasting database for around 1,300 modern and contemporary artists. This data can be accessed via bespoke projects and reports.</p>	<p>With price analysis, auction results and event listings for over 300,000 artists, the MutualArt database offers an objective and extensive view of the global art market.</p>	<p>"Pi-eX has a clean and exhaustive database of fine art auction sales results since 2007 from the top three auction houses. The data includes withdrawn, unsold and guarantee information."</p>
<p>ArtTactic artist reports map the characteristics and structure of the primary market for an artist using a mix of gallery, exhibition, museum, media, social media and collector sentiment data.</p>	<p>MutualArt does not offer an index based on auction prices, however they do offer their subscribers the MutualArt Index, which uses a comprehensive proprietary algorithm to rank artists. MutualArt's extensive primary market data is featured in their subscriber newsletter, where they highlight key exhibitions, and is a primary source for their mobile app, which uses geo-location to alert users to nearby exhibitions of their favourite artists. This data is also used in the MutualArt Index (as described above).</p>	<p>Pi-eX believes that the disparate nature of fine art and the relatively low level of transactions do not allow for the construction of accurate price indices. To obtain better benchmarking, Pi-eX developed a buyer/seller behavioral analysis, switching the focus from the artwork to the collectors.</p>



Products	AMA/Art Analytics	Artfacts.net	artnet	Artprice
Risk analysis		ArtFacts.Net offers dynamic career charts for over 500,000 artists. This unique career trend analysis can be used to make informed decisions about the likelihood of an artist to become historical and offers vital information when estimating risk value.	artnet can use its new art indices to calculate market volatility and correlation with other asset classes.	Artprice regular market reports inform about historic trends and market risks. Artprice artist analytics allows users to compare the performance of the market with other asset classes.
Valuation / Analysis of single art works	Art Analytics produces on-demand artwork valuation and analyses. These very detailed (up to 50+ pages) reports focuses only on the valuation and market research. Art Analytics does not provide any type of forensic or artistic analyse.			Artprice offers an estimate service called Artpricing. This is not an appraisal, but will provide an estimated range of the work's current value based on the detailed auction results for at least two comparable artworks.
Artist reports	Art Analytics produces numerous artist reports for AMA's readership as well as for third-party medias. It also produces on-demand artists reports for art market professionals.	"ArtFacts.Net provides reports on individual artists breaking down their exhibition and primary art market performance data over time. This includes global and local artist rankings, peer artist comparisons, exhibition type and location. ArtFacts.Net also creates customised ranks on artists according to gender, artistic movement, country and fair participation, among others. "	Reports to track an artist's auction market performance and trends over time, or against any other from artnet's database of over 130,000 artists.	Analytics to track an artist's auction market performance and trends.
Art market & sector reports	AMA produces specific event-related reports (auction, fairs, etc.). Art Analytics produces macro-level reports for specific sectors: tribal art, bought ins, etc.	ArtFacts.Net has been contributing data to the Art Basel Art Market Report since 2017.	Art market analysis on various collecting categories and regional sectors based on its comprehensive database. The in-depth analysis shows the evolution of market and includes experts' insights into the rational behind changes. artnet publishes yearly auction reports on the Chinese art market and in partnership with art fairs.	Artprice publishes the annual global auction report, as well as half-year reports on the global auction market. It also publishes special reports on the contemporary art auction market, as well as regional reports on Asia.

Source : Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

ArtTactic	Mutualart	Pi-eX
<p>ArtTactic produces bespoke risk analysis and due-diligence reports on individual artist markets. ArtTactic is also using its Artforecaster platform to crowd-source for forward looking data, which is then imbedded in market risk analysis and expected loss scenarios.</p>		<p>Pi-eX standard methodology provides clear indicators of liquidity, performance and volatility for specific artists, locations, auction houses, price ranges, etc.</p>
<p>ArtTactic offers this as a bespoke service and sits within the family of artist research reports. These reports would analyse the value of a single art work in the context of the overall market for the artist, and analysis around current value and future (12-months) value are provided.</p>	<p>MutualArt's art experts have over 30 years of experience in art appraisal and authentication, assisting private collectors, corporations, insurance companies and legal professionals to value artworks. Their experts are members of International Fine Art Appraisers (IFAA) and have worked for leading art auction houses including Sotheby's and Christie's.</p>	<p>The performance of single artworks can be viewed in comparison to other relevant artworks sold or bought by collectors of the same artist, at the same auction, in the same location, etc.</p>
<p>ArtTactic produces monthly artists reports on important Post-War and Contemporary artists. It also offers bespoke artist reports on any artist, and provides a holistic look at the market using a mix of primary market, auction market, media/social media and collector sentiment data.</p>	<p>MutualArt provides subscribers with detailed auction performance analyses including: value and volume of lots offered and sold, performance against estimate, relative value compared to related artists and price band comparisons. They also provide links to exhibitions (past and upcoming), articles and other information about the artist.</p>	<p>Pi-eX artist reports focus on analyzing the behavioral trends of art buyers and sellers for that particular artist. Data standardization and visualization allow for easy understanding and comparison.</p>
<p>ArtTactic produces weekly, monthly, quarterly and annual market reports on different developed and emerging art markets, with specific focus on Modern and Contemporary Art. In 2017, ArtTactic launched a new set of market reports on Old Masters and Impressionist & Modern Art. ArtTactic is also partner in several research projects such as the annual Hiscox Online Art Trade Report, Deloitte Art & Finance Report and the South Asian Art Market Report.</p>	<p>MutualArt produces seasonal auction summaries: sale week summaries (i.e. post-Frieze week sales); individual artist spotlights and collecting guides.</p>	<p>Pi-eX market and sector reports focus on analyzing the behavioral trends of art buyers and sellers for that particular market or sector. Data standardization and visualization allow for easy understanding and comparison.</p>



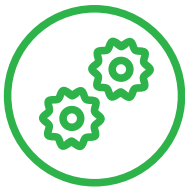
artnet's new Insights platform

Based on artnet's database of auction results, the newly launched artnet Insights platform allows users to understand an artist's market performance, with reports that can be filtered by medium, artwork series, and more. The platform makes use of artificial intelligence powered by a new virtual device (please see the contribution on *page 220*).



Pi-eX develops analytical and financial tools

Over the past four years, Pi-eX has focused on building analytical and financial tools that help fine art collectors better understand and manage risk and volatility in the fine art market. While developing the first derivative instrument based on fine art, Pi-eX built a proprietary database of auction sales results and developed a systematic methodology for analyzing liquidity, performance, volatility, and hedges against volatility. Please see the contribution on *page 226*.



A new initiative to foster the role of science in the world of the art market and cultural heritage: The Seracini Foundation

Award winning scientist and art diagnostician, Maurizio Seracini, has secured funding and is expected to open in 2018 in Luxembourg the Seracini Foundation, a non-profit organization dedicated to furthering the role of applied science and technology to conservation, preservation, discovery and dissemination of Cultural Heritage and to authentication for the art market.

The Foundation will set-up a world class lab and will use its findings to educate the general public as well as train the next generation of art researchers and scientists. Additionally, it will develop an online database of over 3,500 scientific studies making it available to scholars and art professionals worldwide and further develop the "Clinical Chart for Art", establishing international certified standards for the scientific study and authentication of art.



ArtTactic launches new art market tracking and market confidence tools

Over the last 12 months, ArtTactic has expanded its in-depth art market coverage and market tracking tools. This includes a weekly, monthly, and quarterly auction tracking barometer (RawFacts), as well as regular in-depth analyses and reports on specific artists and collecting segments such as the old masters, modern and impressionist art, and post-war and contemporary art. Data and analysis covering regional art markets in Africa, the Middle East, and South Asia are also provided. Furthermore, ArtTactic continues to monitor the role of financial guarantees at auction, and with more than 5,000 individuals surveyed on a weekly basis, and constant monitoring of changes in buyers' taste, preferences, and sentiment. Please see the contribution on *page 222*.

New infrastructure developments

1. Art valuation

ValueMyStuff: having been acquired by the now-defunct Auctionata in 2015, but subsequently bought back by the founder Patrick van der Vorst in 2017, ValueMyStuff (VMS) will now exclusively focus on expanding its valuation business and capabilities. With mobile traffic accounting for 38 percent of its business dealings, fresh efforts to redevelop the website and launch a new app at the end of the year are aimed at increasing mobile conversions. ValueMyStuff has also been developing software for their website over the last five years, amassing over 500,000 clients and performing over 1.2 million valuations to date. From October this year, this software will be ready to be shared with third-party businesses as a white-label service. This would, for example, allow auction houses to outsource their online valuations, and focus their valuation efforts only on objects that they would consider for a sale. VMS is moving from simply providing valuations to integrating their valuation expertise and software platform into existing art-related businesses. In doing so, it hopes to increase effectiveness, reduce costs, and allow these businesses to focus on their strengths.

ArtForecaster: the market prediction and valuation gamification platform launched by ArtTactic in 2014, has tested its first crowd-based valuation, risk, and market analysis service with a number of art-secured lenders and insurance companies over the last 12 months. ArtForecaster is unique in that it offers users the opportunity to identify specific groups of forecasters with particular skills based on their past forecaster performance. This unique data has been

used to generate crowd-based market valuations (current and expected value in 12 months), as well as developing scenarios to assess the probability of downside risk over a 12-month period. The current shift in accounting regulations around art-secured lending (*discussed on page 164*), in which forward-looking data is prioritized over historical data for risk management purposes, means that new types of data and models will be required, and this is an area that Artforecaster is currently addressing.

2. Blockchain

smArtchain: smArtchain is a recently launched not-for-profit initiative at blockchainhub.net, which showcases art projects and art startups using blockchain technology. The aim is to draw attention to case studies involving the use of blockchain, smart contracts, DAOs, and ICOs by artists and the art industry alike. Please see the contribution on *page 232*.

ArtTracktive: Deloitte Luxembourg has developed a technological alternative to the paper trail that normally proves the provenance and movements of an artwork. The firm's blockchain development team revealed the application during the ICT spring summit in Luxembourg in May 2016. The Deloitte ArtTracktive proof-of-concept provides a distributed ledger for tracking the provenance and whereabouts of works of fine art. The blockchain-based application manages the interactions between all parties involved, from the artist or the owner of the piece of art, through freight forwarders, customs, art galleries, museums, and all the way to potential buyers.

3. Tagging and authenticity

Tagsmart: Tagsmart uses DNA tagging technology to identify artworks alongside a unique system for issuing secure certificates of authenticity. These services are fully integrated with a provenance record that enables artists to verify the authenticity of their artworks and create an accredited ownership history over time. With over 15,000 artwork records stored on its platform, Tagsmart has tagged more than 5,000 artworks in its first year. It is now also providing its API to online platforms including ArtRepublic (launched in August 2017), enabling end-users to instantly request secure certificates of authenticity, and establish provenance records for works sold via their website. Tagsmart recently announced its next-generation range of products and services, including location security for artist studios and a new method for establishing proof of ownership. Tagsmart is also working with leading material scientists at the University of Surrey in the development of highly secure, uncopyable materials to work alongside their existing synthetic DNA solutions, as well as exploring other forms of tagging, including limited-edition books.

4. Art collection management: new vs. incumbent providers

The last 10 years have seen significant activity in the art collection management industry. Artbinder raised US\$3.17 million in Series A funding in July 2014, and other new providers, such as Collectrium (founded in 2009) and ArtCloud (founded in 2012), joined the traditional market of existing providers such as Artsystems (1989), ArtLogic (formally incorporated in 1999), and Artbase (set up in 1993). Christie's reported the US\$16 million purchase^[1] of Collectrium in 2015, signaling that the art industry was increasingly seeing art collection management as an attractive customer service tool, and a potential platform on which to integrate other services (such as valuation, insurance, and shipping, as well as a potential platform for buying and selling). It is clear from this year's survey findings that consolidated wealth reporting incorporating art and collectible wealth is a key priority for both clients and wealth managers, particularly as the wealth management industry is increasingly moving toward a holistic wealth

management model. This represents an opportunity for existing art collection management providers to collaborate more closely with the wealth management industry in developing solutions that addresses their concerns regarding client confidentiality and discretion. However, with the landscape currently fragmented between new and incumbent providers with different legacy systems and solutions, it is still not clear whether technology will be the dominant competitive factor, or whether the ability to provide tailored solutions will suit the wealth industry better.

ArtTracktive:
Deloitte
Luxembourg
has developed
a technological
alternative to the
paper trail that
normally proves the
provenance and
movements of an
artwork.

5. Technology and logistics

Arta: the company connects high-quality shippers with customers, and seeks to address the inefficient, fragmented and opaque high-end art shipping and logistics market. The service aims to streamline the process by creating a one-stop shop for fine art shipping. ARTA allows customers to find the best shipping option by tapping into a network of selected art transporters, compare pricing, transact and pay online (which streamlines the invoicing process), and manage an entire logistics operation. It is essentially a Kayak or Expedia for fine art shipping. The company is also working on developing APIs to connect seller and buyer systems directly, bypassing the manual pen-and-paper processes that are typically required to complete a transaction.

Artrunners: this is an online comparison and contracting service striving to be the new benchmark in specialized art logistics services such as crating, packing, transport, and installation, anywhere in the world. The service is currently in a live beta version, and aims to give other art lovers, collectors, and art professionals a simple and efficient solution, enabling them to choose from a diversity of service providers and make informed decisions. Artrunners tackles the complexity of art logistics using its proprietary technology so that users can save time. It has developed a proprietary algorithm that matches your shipping requirements with the specific capabilities of each of its service providers. There is also a strong community element, whereby community member reviews enhance transparency and satisfaction for customers and service providers alike.



Fabian Bocart
Vice President of
Analytics
artnet

artnet Insights

case study

Pablo Picasso

Established in 1989, artnet is dedicated to bringing transparency to the art world with a range of products that ensure easy access to the latest art market information and news online. More than ever, the world of Art & Finance would benefit considerably from an accurate, quantifiable, and reliable metric to assess art as an asset. **artnet Insights** comes as the latest development in the field of analytics for Art & Finance.

Pablo Picasso is one of the most liquid artists at auction, and thus a prime candidate for any serious art investor. Over the last 12 months, global auction sales for Picasso works totaled US\$401 million—2,675 lots were offered, with 77 percent successfully sold. According to the trend of the artnet Picasso price index, the sale price of his paintings saw a decrease in 2016, but increased by 38 percent during the first half of 2017. The total sales volume in 2016 had dropped sharply from its peak level of US\$572.5 million in 2015. Picasso works are now back on the rise again, and look set to make a strong recovery in 2017.

Market-wise, Christie's New York has had the largest market share of Picasso's auction market history over the last three years, totaling US\$610.5 million and accounting for 38.36 percent of the total sales value—followed by Sotheby's London (23.98 percent), and Sotheby's New York (19.08 percent). With the data pulled from artnet Insights, prospective investors can either choose the right partner for an auction sale or select from a list of over 200 galleries for a private sale.

artnet Insights

These types of analyses are highly sought-after on the art market. Based on artnet's database of auction results, the newly launched artnet Insights platform allows users to understand an artist's market performance, with reports that enable them to filter by medium, artwork series, and more. Covering a total of over 103,000 artists, it provides an up-to-date price index for any given artist, which can be used to compute the estimated potential return on investment.

The tool also allows for data to be downloaded directly in CSV—a format that is compatible with most data analysis software packages, including Microsoft Excel. This new approach allows dealers, money managers, hedge fund managers, and private bankers to use artnet's indices to easily obtain an indicative update on the value of their stock or their client's collection without the risk of sharing confidential information. Naturally, all other traditional metrics are readily available as well, including total auction sales, number of lots offered, sell-through rate, and volume. Auction volumes can be filtered by medium, such as paintings, works on paper, photographs, sculpture, and design, allowing users to directly focus on the medium of interest to them.

artnet has also employed another new development in the field of art data analysis: artificial intelligence powered by a new virtual device—a groundbreaking addition to the field of art data analysis. This tool will analyze a set of works produced by an artist: an algorithmically generated group of works that are variations on a theme or otherwise resemble one another. For each series, a price index is generated to identify different trends among the various groupings by the same artist. For example, the algorithm automatically differentiates and analyzes Pablo Picasso's male portraits and then indicates the performance of that specific series.

artnet Insights has also introduced a much-needed metric in the art world: market shares of auction houses per artist. At a glance, users can identify which auction houses occupy the top positions in consigning works by a given artist, which can help determine the right partner for an auction sale. Similarly, this option gives auction houses the capability to identify their strengths and weaknesses in the market for any artist.

Figure 55. artnet Insights





Anders Petterson
Founder
ArtTactic Ltd

ArtTactic: Market sentiment analysis— understanding the risk associated with market fashions and tastes in the contemporary art market

The ArtTactic Art Market Confidence Survey was launched in May 2005, and covers a range of art markets and specific artists. This unique dataset covers changes in market sentiment and confidence among key experts and stakeholders in the market. The survey findings are made available every six months and are based on a sample of 120-130 key international collectors, curators, auction houses, dealers, and art advisers. The relationship between the short-term and long-term confidence indicators tell us something about how fashion, one of the greatest risks in the contemporary art market, can be better monitored, analyzed, and understood.

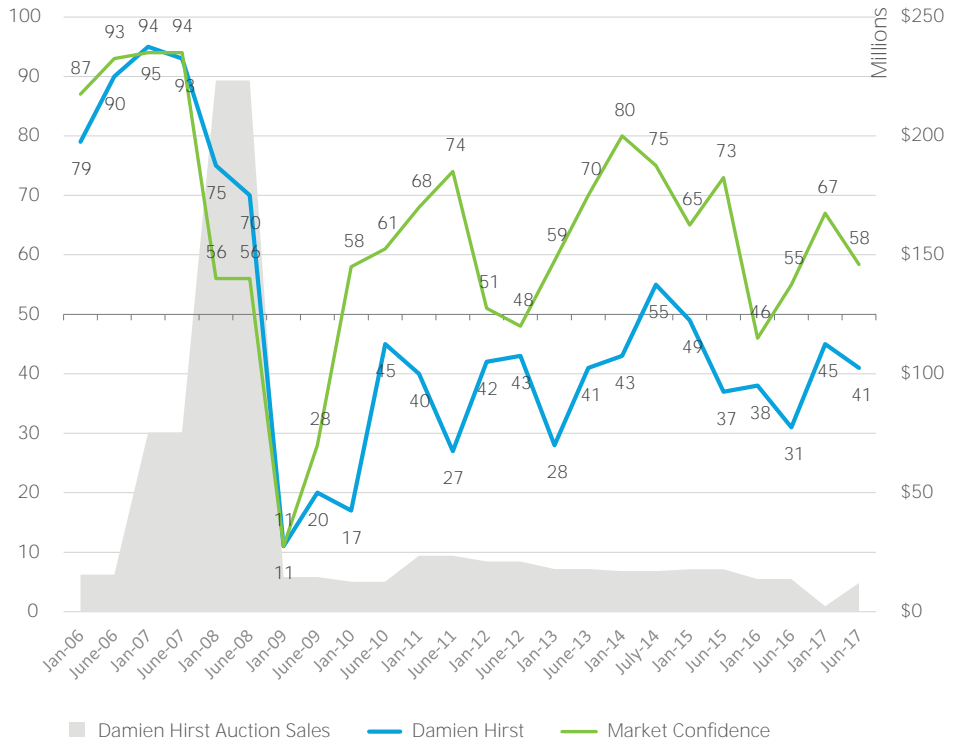
In the following brief example, we take a closer look at how this data has been utilized in the context of the market for a specific artist: namely, Damien Hirst.

Short-term market confidence

Short-term confidence in the Damien Hirst market experienced a substantial drop in 2008, ahead of and after the ground-breaking single-artist auction at Sotheby's in September 2008. This sale raised £111 million over two days, in the midst of the outbreak of the financial crisis. Although the auctions were a financial success, the market's interpretation of the events was very different, with confidence falling 25 percent leading up to the event, and a further 85 percent after the auction had happened. Although confidence has recovered from its lowest ebbs, the market has remained in limbo since 2010, with a lack of consensus as to where the market will be heading next. In the most recent reading from June 2017, the confidence indicator came in at 41 (a reading below 50 signals that there is more negative than positive sentiment in the market), down from 45 in January 2017. This could imply that Hirst's long-anticipated and highly publicized exhibition in Venice has had little positive short-term impact on the market's perception of where the market is going next.

Figure 56. ArtTactic Damien Hirst Confidence Indicator 2006 - June 2017

Damien Hirst Market vs. Overall Market Confidence



Source: ArtTactic

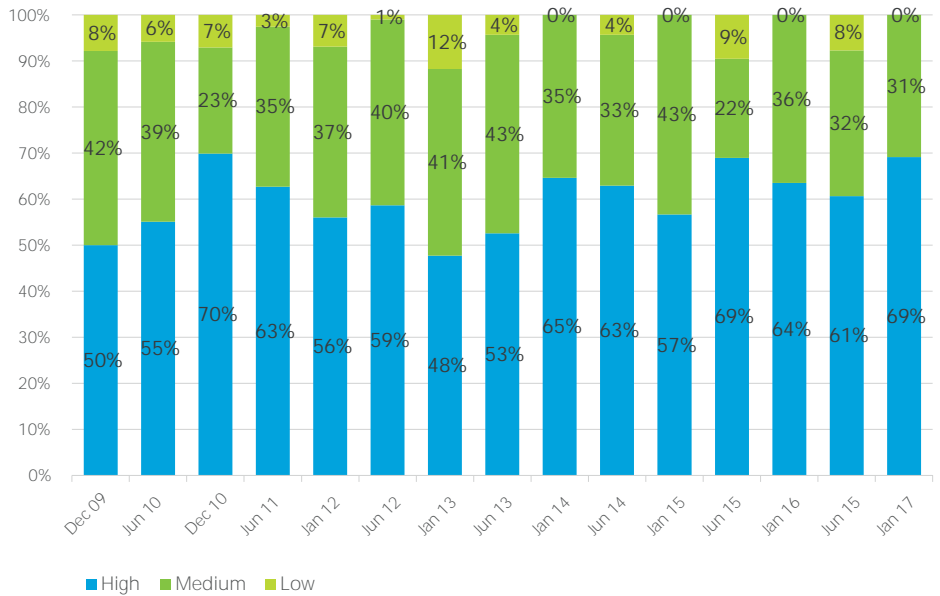
Although confidence has recovered from its lowest ebbs, the market has remained in limbo since 2010, with a lack of consensus as to where the market will be heading next.

Long-term market confidence

In addition to measuring experts' perceptions regarding short-term confidence (next six months), the confidence survey also looks at respondents' perceptions about their long-term outlook. Despite negative short-term sentiment, the market has remained more confident about Damien Hirst's long-term importance. Based on the recent survey findings, 40 percent of market experts believe the artist will be of high importance and a further 43 percent believe the artist will be of medium importance in ten years' time, which suggests that the majority think the artist's market will survive and play an important role in the future. Accordingly, only 17 percent believe that the market will be of low importance.

Figure 57. ArtTactic Hirst Market Survey March 2017

Question: How important do you believe Damien Hirst's Market will be in 10 years' time?



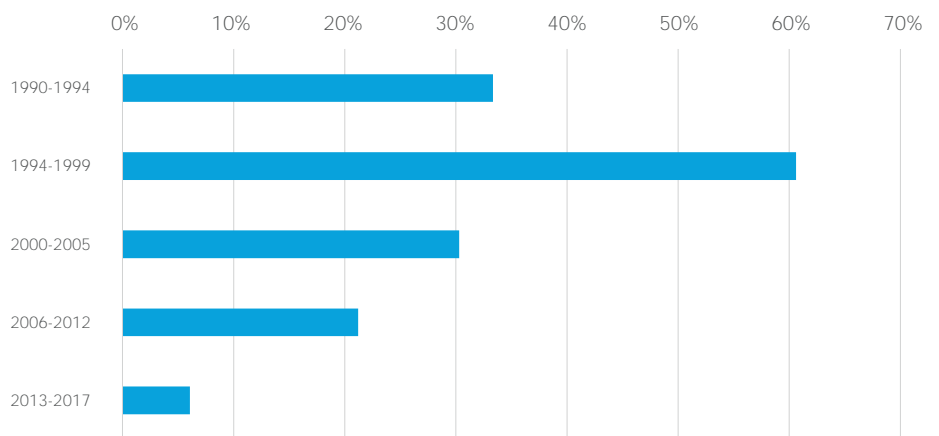
Source: ArtTactic

Confidence in object-specific characteristics

Overall short-term and long-term confidence can help us to understand the market's perception of a particular artist in broad terms. This, in turn, may give an indication as to where the market and prices could be heading next, and to what extent this trend is sustainable. However, the confidence survey also aims to extract more granular details regarding perceptions of the artist's specific oeuvre. The analytical tools, see **Figures 58 & 59**, depict the market's perception of the period and series of works believed to be of the greatest importance at the time of the survey.

Figure 58. ArtTactic Hirst Market Survey March 2017

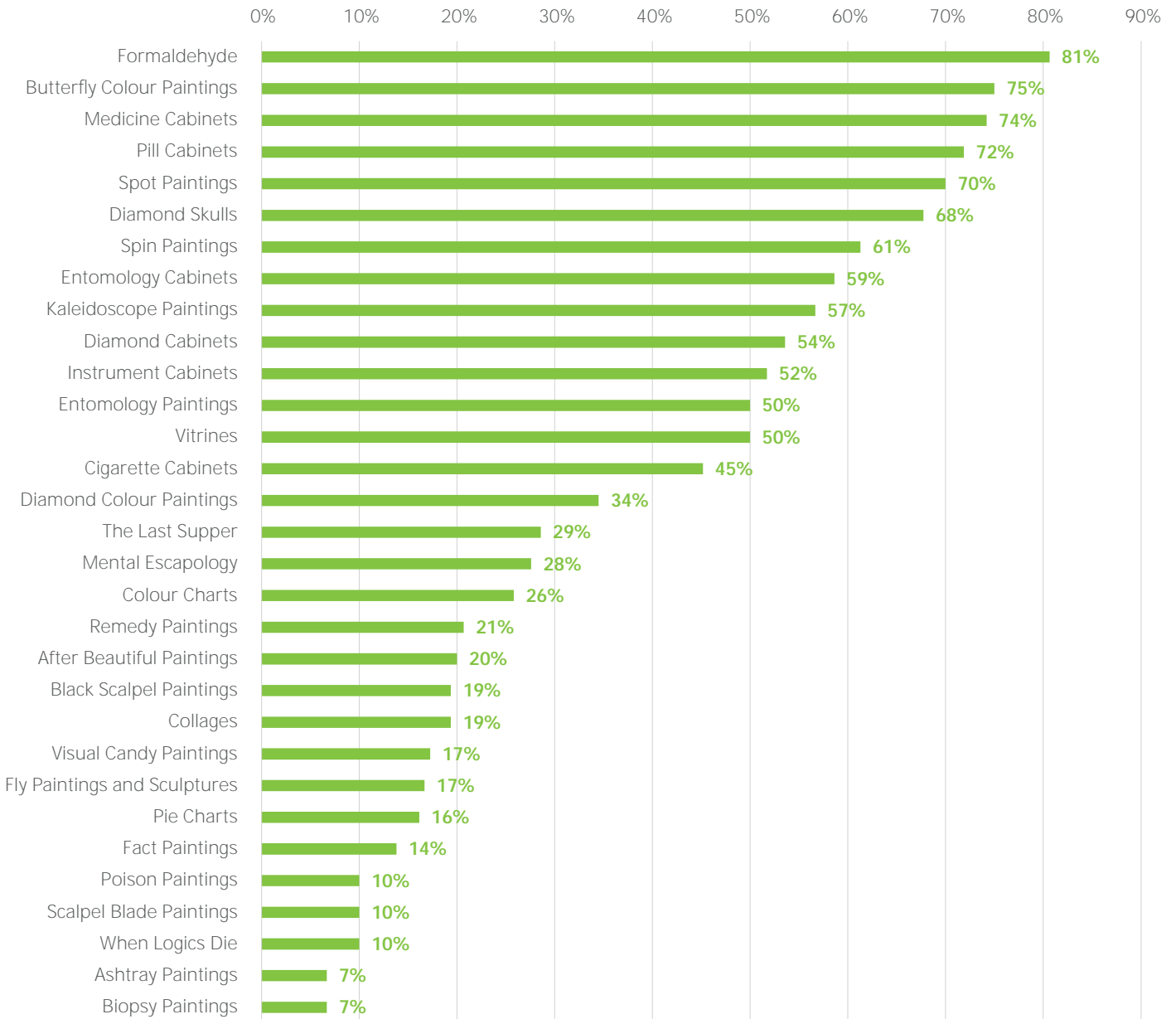
Question: Which period(s) do you consider to be his most important?



Source: ArtTactic

Figure 59. ArtTactic Hirst Market Survey March 2017

Question: Which series do you consider the most important?



Source: ArtTactic

Despite negative short-term sentiment, the market has remained more confident about Damien Hirst's long-term importance.



Christine Bourron
CEO
Pi-eX Ltd

Pi-eX: A new approach to art data analysis

Shifting the focus from the artwork to the collectors

At a time when Big Data has become a buzz phrase for many industries, providing new opportunities to analyze data and understand market trends, the art market continues to struggle with data. This was clearly demonstrated earlier this year when simply sizing the art market proved a challenge, as shown by the wide discrepancies between the 2017 TEFAF report and the 2017 Art Basel report.

The discrepancies not only highlighted the lack of transparency in the fine art market, but also the absence of widely established methodologies and analytical standards on the research side of the fine art industry.

Does this mean that the art market should remain forever a world where all that matters is emotions and feelings as opposed to quantitative, objective data and rational analysis? Not necessarily, but it clearly shows that art is a unique asset class that requires a new approach to data analysis and communication.

Over the past four years, Pi-eX has focused on building analytical and financial tools that help fine art collectors better understand and manage risk and volatility in the fine art market. In the process of developing the first derivative instrument

based on fine art, Pi-eX built a proprietary database of auction sales results and developed a systematic methodology for analyzing liquidity, performance, volatility, and volatility hedges. As in the traditional finance world, especially when dealing with risk assessment and management, Pi-eX uses a behavioral analysis approach to gain insightful information on the dynamics of the fine art market. By focusing on the behavioral trends of art buyers and sellers rather than specific artworks or styles, Pi-eX strives to provide valuable market-focused information to those interested in better understanding liquidity, performance and volatility in the fine art market.

Here is some of the rationale behind Pi-eX's new approach to art data analysis.

Why, in the era of Big Data, is the fine art market still struggling with data?

Various elements contribute to this struggle: a lack of trade transparency, lack of industry standards, the multiple distribution channels, and—of course—the unique nature of the trade of fine art in which each item is unique and non fungible, making it extremely difficult to truly compare like for like. Even the same exact item sold at different times after belonging to different collectors can hardly be used as a point of comparison.

Is Big Data analytics the solution for the fine art market?

While it would be easy today to browse through millions of art sales records, the reality of analyzing art data is often very similar to comparing apples to oranges. In fact, when looking at the historical trends for a particular artwork, the researcher rarely finds more than three or four relevant data points. We can therefore forget any correlation or regression analysis, variance calculation, Sharpe Ratio, etc. With only three dots, it is often challenging to discern any historical trends. As for predictions of the future based on these historical trends, one might as well resort to Paul Klee's creative definition that "a line is a dot that went on a walk."

Recognizing and accepting that art is a particular asset class, for which standard analytical solutions do not perfectly apply, is an important step. In this regard, we at Pi-eX strongly believe that the solution for fine art does not reside in Big Data, but rather in Smart Data.

What is Smart Data?

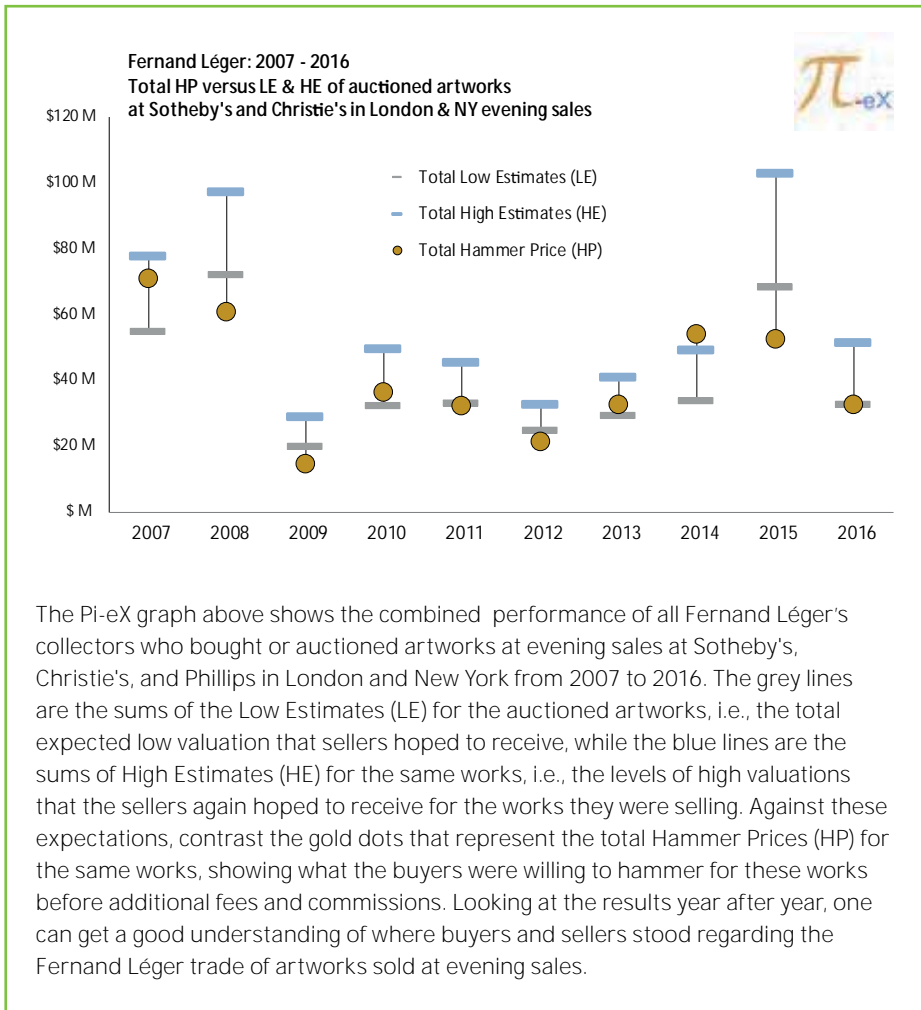
Smart Data is about finding creative ways to deal with the unique challenges presented by the fine art market. A Smart Data analysis starts by recognizing that any analysis can only be based on a small dataset. Consequently, it is not meaningful to look at the data exclusively through averages or indices, as any type of aggregation could be disproportionately influenced by the fate of just a single artwork and thereby minimize the importance of others. The other important thing to recognize is that the small dataset cannot easily be extended by adding

multiple comparable items. By mixing too many loosely related items, one may lose track of the particularities of the original analysis. Does this mean that no data analysis can be done? Not at all, but it certainly means that the analysis should always link back to specific works of art to allow the reader to see and understand the impact of every single artwork involved in the analysis.

While it would be easy today to browse through millions of art sales records, the reality of analyzing art data is often very similar to comparing apples to oranges.

Shifting from an artwork-focused analysis to a collector-focused analysis

In a Smart Data analysis, one way to overcome the challenge of a small data set at the artwork level is to switch the focus from the artwork to the collectors. Specifically, rather than trying to analyze repeat sales for one particular artwork, the focus should be on the collectors of artworks, thus analyzing behavioral trends between sellers and buyers. While data for collectors' behaviors is not available across all art distribution channels, there is one channel where there is a profusion of data: public auction sales. In fact, this channel offers all the prerequisites for systematic behavioral analysis of art buyers and sellers.



The Pi-eX graph above shows the combined performance of all Fernand Léger's collectors who bought or auctioned artworks at evening sales at Sotheby's, Christie's, and Phillips in London and New York from 2007 to 2016. The grey lines are the sums of the Low Estimates (LE) for the auctioned artworks, i.e., the total expected low valuation that sellers hoped to receive, while the blue lines are the sums of High Estimates (HE) for the same works, i.e., the levels of high valuations that the sellers again hoped to receive for the works they were selling. Against these expectations, contrast the gold dots that represent the total Hammer Prices (HP) for the same works, showing what the buyers were willing to hammer for these works before additional fees and commissions. Looking at the results year after year, one can get a good understanding of where buyers and sellers stood regarding the Fernand Léger trade of artworks sold at evening sales.

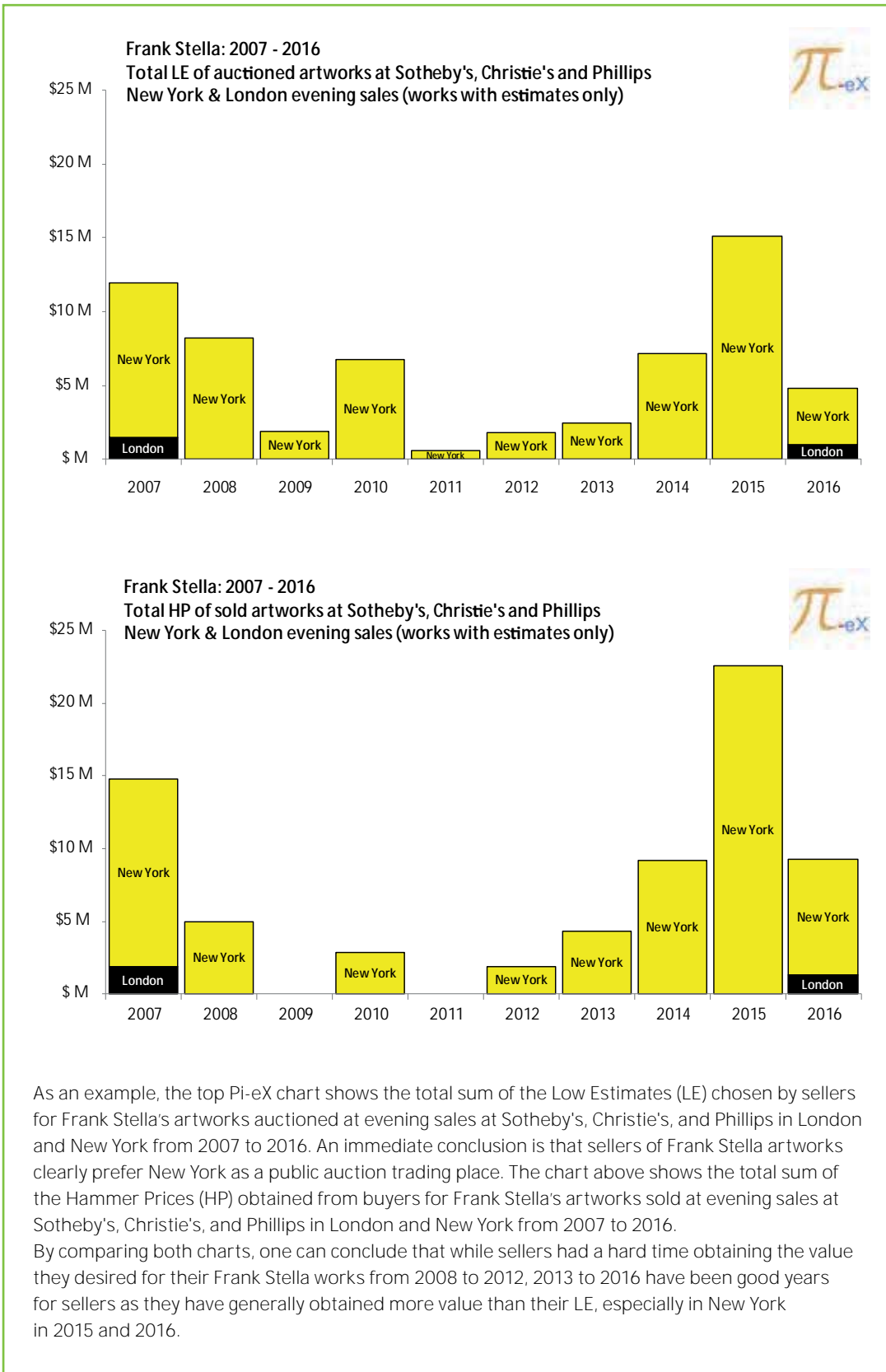
Source: Pi-eX Ltd

Why is behavioral analysis relevant to the fine art market?

The value of a work of fine art goes far beyond its intrinsic value: the cost of the canvas, the oil, or the time spent by the artist creating the artwork represent a mere fraction of the price eventually paid. What mostly drives the value of an artwork is at which price sellers are willing to sell their works and buyers are willing to pay. In the end, the sale price of an artwork is a fragile equilibrium between the expectations of both sides. If no common ground is found between the two sides, the artwork does not reach the reserve price and it is unsold or "bought-in". Behavioral analysis of buyers and sellers deals with understanding this critical price point at which sellers and buyers may or may not meet. It is the analysis of where this price point has been historically and where it could be in the future.

How does behavioral analysis help with the small dataset challenge?

While historical sales for a particular artwork generate very little data, behavioral analysis of buyers and sellers can be based on abundant data across many years, different locations, and numerous artworks, especially when dealing with collectors buying at public auctions. Thanks to the annual regularity of public auction sales, one can systematically analyze year after year what collectors like to buy or sell, where they prefer to do so, how their tastes evolve, what their critical price points are, which artists they are confident in or not, etc.



As an example, the top Pi-eX chart shows the total sum of the Low Estimates (LE) chosen by sellers for Frank Stella's artworks auctioned at evening sales at Sotheby's, Christie's, and Phillips in London and New York from 2007 to 2016. An immediate conclusion is that sellers of Frank Stella artworks clearly prefer New York as a public auction trading place. The chart above shows the total sum of the Hammer Prices (HP) obtained from buyers for Frank Stella's artworks sold at evening sales at Sotheby's, Christie's, and Phillips in London and New York from 2007 to 2016. By comparing both charts, one can conclude that while sellers had a hard time obtaining the value they desired for their Frank Stella works from 2008 to 2012, 2013 to 2016 have been good years for sellers as they have generally obtained more value than their LE, especially in New York in 2015 and 2016.

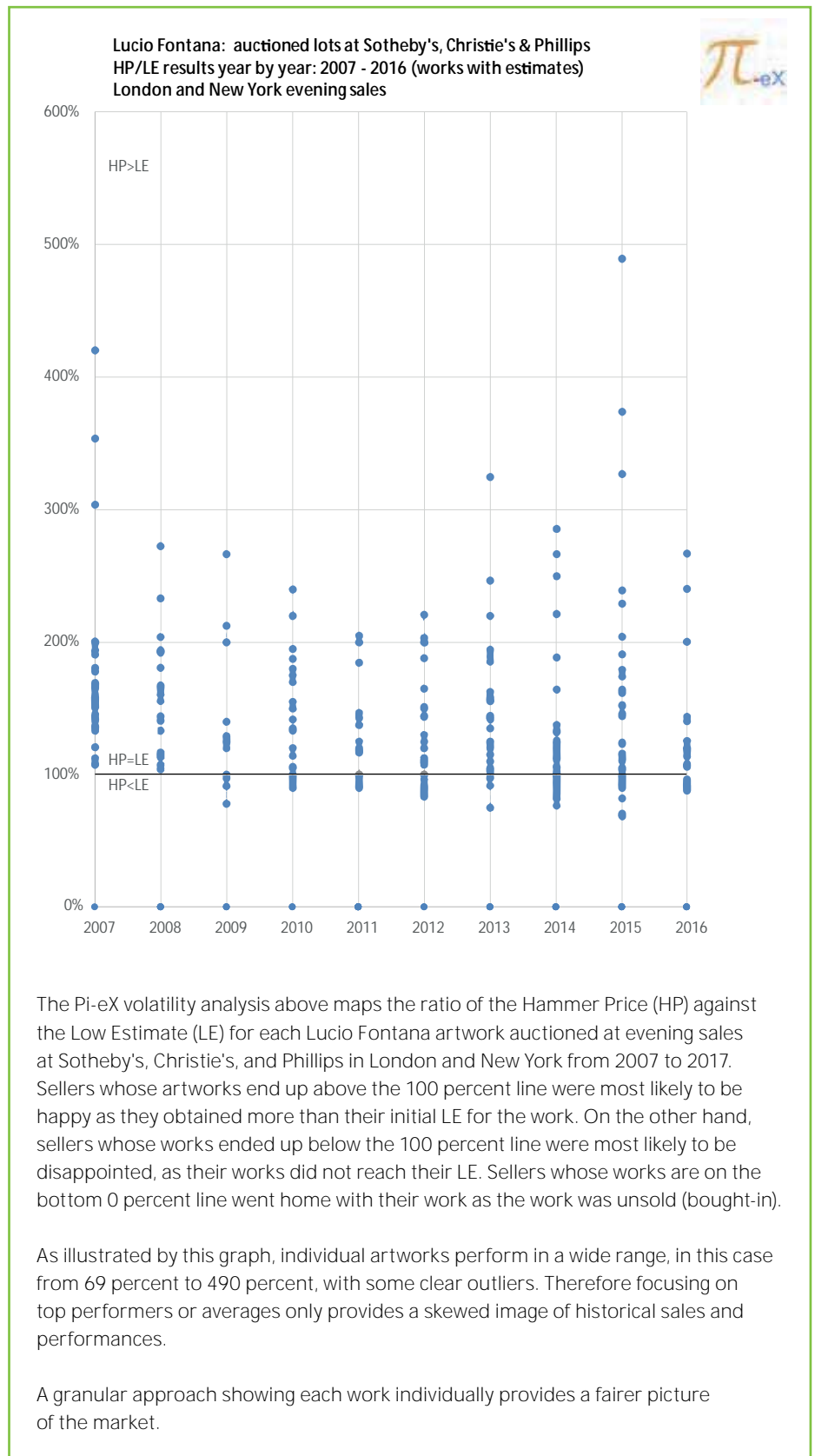
Source: Pi-eX Ltd

What else can be done to make data more relevant to the fine art market?

When looking at the behavioral analysis of art collectors, one should never forget that these collectors are buying unique artworks. Therefore, while there certainly are some trends that can be identified, there will always be a few outliers that will not and cannot fit the trends because they are so unique. How to identify and showcase these outliers is critical in a Smart Data analysis. A successful way to do so is through granularity and visuals.

1. Granularity

Instead of just producing indices or averages, a granular approach makes sure to always represent the various components of the market. Specifically, for art, the analysis should map specific artworks according to the criteria chosen for the analysis.



Source: Pi-eX Ltd

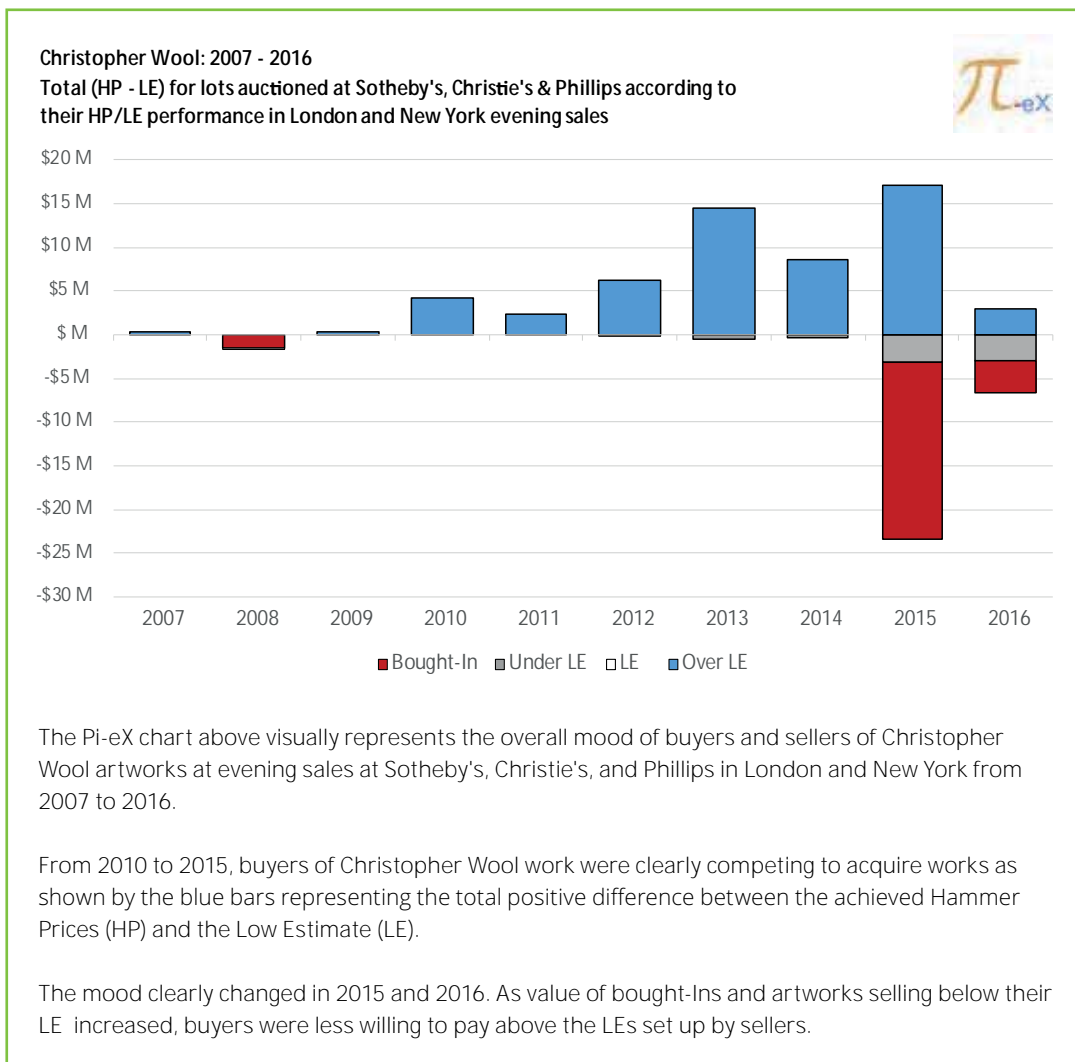
2. Visuals

While art is considered by many as an alternative investment opportunity, it certainly cannot be reduced to a number or an index. Along the same line, art analysis could not just be a ratio. It requires its own visual representation that talks both to the left and right parts of our brain.

Pi-eX was shortlisted for the Best Innovation in the Data category for the 2017 UK Financial Innovation Awards. The company was selected for the work it has done developing a new methodology to analyze trends and opportunities in fine art as described here.

Conclusion

Traditional analytical tools available to fine art collectors usually offer limited value-add to the risk assessment and investment decision process when buying art. As interest in art as an asset class has grown recently, a new analytical approach to the fine art market based on a Smart Data approach and the behavioral analysis of art buyers and sellers not only makes sense, but also offers a completely new perspective on the market, especially in regards to risk analysis and assessment during the investment decision process.



Source: Pi-eX Ltd



Dr. Shermin Voshmgir
Founder
blockchainhub.net

blockchainhub.net is an information hub and think tank advocating blockchain, smart contracts and the decentralized web.

Blockchain

Case studies in the art industry and beyond

We recently launched the smArtchain¹⁰² initiative at blockchainhub.net, where we showcase art projects and art startups using blockchain technology. Our aim is to draw attention to case studies involving the use of blockchain, smart contracts, DAOs, and ICOs by artists and the art industry alike. Furthermore, we have forged a partnership with Lensbased—Hito Steyerl’s class at Berlin University of the Arts—where we critically examine the role of blockchain in society. As blockchainhub.net, we are also collaborating with Propellor Film Tech Hub—a joint venture between the Berlinale Film Market and Rotterdam Film Festival.

Art-industry case studies

The art industry is one of the world’s most opaque business sectors, with a multitude of middlemen between the creators and the consumers of art. Each of these middlemen takes a cut of the revenue and passes along the rest, with the leftovers typically reaching the artists themselves months, if not years, later. Blockchain could help keep track of an artwork’s movements

without relying on cloudy and sometimes still paper-based systems of recording provenance. Blockchain could revolutionize the art industry by resolving questions of provenance, and improving transparency, copyright, and ownership issues. Seeing the potential, art startups are already building real-world applications based on blockchain.

Ascribe.io, for example, offers artists a platform for uploading their digital works, securing their attribution, and selling them. In 2015, the Museum of Applied Arts (MAK) in Vienna acquired several editions by the artist Harm van den Dorpel that had been authenticated by Ascribe. MAK also showcased an exhibition of the work of Valentin Ruhry, an artist and the cofounder of Cointemporary,¹⁰³ a scheme that exhibits works online that are available for purchase in bitcoin.

Blockai is a startup that seeks to democratize access to copyright protection, allowing artists to claim copyright on their work instantaneously and see where it is being used. Blockai also acts as a fraud deterrent. If someone tries to claim somebody else's work, there will be a permanent record of this on the blockchain.

Chainmark, on the other hand, is a startup that seeks to bridge the gap between physical art and blockchain. Combined with tagging technology, chainmark is a mixture of materials of varying colors that can be placed on the side of a painting. This produces a unique fingerprint that can then be hashed onto a blockchain. A missing chainmark could reveal that a work has been tampered with.

Grammy-award winning singer-songwriter Imogen Heap¹⁰⁴ has pioneered Mycelia, a think tank to empower a fair, sustainable, and vibrant music industry ecosystem. The startup Artlery¹⁰⁵ is attempting the same thing for physical art such as sculptures and paintings.

Earlier this year, music streaming company Spotify acquired blockchain startup Mediachain Labs,¹⁰⁶ an open-source platform that seeks to enable creators to attach information to projects and create a record on the bitcoin blockchain stored on the distributed file system, IPFS.

In the entertainment industry, SingularDTV¹⁰⁷ is working on a blockchain-based digital content management and distribution platform. The vision is to decentralize the entertainment industry so that creative individuals can profit from the films, videos, games, and art they help to make.

Blockchain as a creative tool

Blockchain is much more than a tool to make the art industry more efficient. Blockchain technology could also serve as a new creative medium for artists to use to push the boundaries of creation and society, as we can see with Plantoid and Terra0.

Terra0¹⁰⁸ is a self-owned forest. It is an ongoing art project by two students of Berlin University of the Arts, who are seeking to set up a prototype of a self-utilizing piece of land. A smart contract on the blockchain allows the forest to become an autonomous piece of land that manages itself in accordance with the rules established in the smart contract. With Terra0, the forest is able to sell licenses to log trees through automated processes. The forest thereby accumulates capital. A shift from valuation through third parties to self-utilization makes it possible for the forest to procure its real exchange value, and eventually buy and own itself. The augmented autonomous forest is then in a position to buy more ground and therefore to expand.

Another art project using smart contracts is Plantoid¹⁰⁹—the plant equivalent of an android. It is an autonomous blockchain-based lifeform that is able to reproduce itself through a smart contract. Plantoid is a hybrid creature that lives both in the physical world, as a mechanical contraption made up of recycled steel and electronics, and in the digital world, as a piece of software deployed on top of a blockchain-based network.

It is autonomous, self-sustainable, and capable of reproducing itself through a combination of blockchain-based code and human interactions. Contributions are made through the bitcoin blockchain, by simply sending funds to the Plantoid's bitcoin wallet. Once a Plantoid has proven its worth by accumulating a sufficient quantity of bitcoins, it will enter into the reproductive phase, initiating a procedure whereby the Plantoid will look for humans willing to help it in the process of reproducing itself—physically building another Plantoid in exchange for bitcoins.

ICOs, artist tokens, and crowd funding

Blockchain and smart contracts can also be used by artists to fund their projects through token sales, creating their own artist coins or using it as a crowdfunding or crowd-investing tool.

Tatiana Moroz pioneered this field in 2014 by issuing the first artist currency, Tatiana Coin, long before ICOs and token sales became a mainstream application. Owners of TCs could redeem them for members-only rewards including autographed memorabilia, advanced copies of music, merchandise, and access to exclusive events, and also custom music, house concerts or sponsorship opportunities. With Ethereum, token issuance and sales have become easier, and we are likely to see more artist coins emerge in the future.

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¹⁰⁴ <http://myceliaformusic.org/2016/05/14/imogen-heap-decentralising-the-music-industry-with-blockchain/>

¹⁰⁵ <https://artlery.com/>

¹⁰⁶ <http://www.coindesk.com/mediachain-blockchain-tech-next-spotify/> and <http://www.coindesk.com/spotify-acquires-blockchain-startup-mediachain/>

¹⁰⁷ <https://medium.com/@SingularDTV/anatomy-of-singulardvs-code-centrally-organized-distributed-entity-cd7285d63549>

¹⁰⁸ <http://digital.udk-berlin.de/?/students/kolling-paul/projects/ss16.terra0/>

¹⁰⁹ <http://okhaos.com/plantoids/>



Section 6

Risk management and regulation



- **Strong calls for modernization:**
As the art industry continues to grow, and art values climb to record levels, expectations will emerge in respect of market conduct. In this year's survey, 73 percent of wealth managers, 74 percent of art professionals, and 64 percent of collectors said that the art market needed to modernize its business practices to meet the expected standards of a transparent, trustworthy, and developed marketplace. As in other markets and business sectors, different forms of regulation could play an important role in achieving this.
- **Self-regulation preferred over government intervention.**
Over 77 percent of art professionals and 76 percent of collectors prefer a self-regulated approach to establish trust and credibility in the art market. However, wealth managers feel that more government regulation is required. However a mixed approach seems recommended to support a sound growth of the art market.
- **Wealth managers see authenticity issues, lack of provenance, forgery, and attribution as the greatest threats to the reputation of the art market:**
83 percent of wealth managers see authenticity, provenance, and attribution issues as the greatest risks in the art market. Art professionals are echoing this sentiment, with 81 percent saying that these are major risks to the art market.

Some of the biggest threats to the reputation of the art market from the perspective of wealth managers, collectors, and art professionals are issues linked to price manipulation, insider trading, and other anti-competitive behaviors.

The Responsible Art Market Initiative (RAM) published its first set of guidelines to tackle the threats of money laundering and terrorist financing in the art market in January 2017.

- Undisclosed conflicts of interest:** 65 percent of wealth managers, 63 percent of collectors, and 69 percent of art professionals see issues around undisclosed conflicts of interest as a problematic topic in the art market. Increasing focus must be placed on due diligence in art transactions.
- Lack of standardization regarding professional qualifications in the art market:** 65 percent of the wealth managers surveyed (up from 52 percent in 2016) feel that the lack of standardized professional qualifications in the art market is a real issue, as it complicates the search and selection of individuals or firms with the appropriate knowledge and skills.
- Price manipulation and other anti-competitive behavior:** Some of the biggest threats to the reputation of the art market from the perspective of wealth managers, collectors, and art professionals are issues linked to price manipulation, insider trading, and other anti-competitive behaviors.
- Lack of market transparency:** 79 percent of wealth managers and 62 percent of collectors see this issue as one of the key issues within the art market. Most of the problems outlined above boil down to the fact that the art market continues to operate as an opaque and non-transparent market, and the duty and obligation to be transparent have largely been circumvented. However, high-profile court cases and legal disputes have pushed this issue to the top of the agenda.
- Money laundering regulations will affect the art market:** 65 percent of the wealth managers surveyed (up from 56 percent) felt that money laundering is a serious threat to the credibility of the art market. With tighter anti-money laundering rules currently entering into force around the world, the art world will be forced to comply with these new regulations.
- Guidelines around money laundering launched to assist art businesses:** The Responsible Art Market Initiative (RAM) published its first set of guidelines to tackle the threats of money laundering and terrorist financing in the art market in January 2017. The guidelines are tailored to art transactions and focus on three areas of enquiry: the client, the artwork, and the transaction. RAM sees this practical, self-regulatory approach as complementing existing regulations imposed by states.
- New regulations around the import of cultural goods in Europe:** In July 2017, a new European Commission proposal on the import of cultural goods¹¹⁰ was published. The new rules could enter into force as early as 2019, and they are part of a broader plan to fight terrorist financing. The new rules are aimed at ensuring consistency and clarity as regards the types of restrictions and control measures proposed by the European Commission to tackle the illicit trade in cultural objects.
- Approved reform to the existing regulations governing the Italian art market:** In Italy, a new reform aimed at the existing Cultural Heritage Code is set to improve Italy's competitiveness in the international art market. On 29 June 2017, the Italian house of representatives (*Camera dei Deputati*) approved five amendments to a bill aimed at fostering competition

¹¹⁰ Proposal for a Regulation of the European Parliament and of the Council on the Import of Cultural Goods. Publication. Vol. SWD (2017) 263 Final. Brussels: European Commission, 2017.

In last year's report, we launched a new section on regulation in response to a number of issues threatening the reputation of the art market and hence also the development of the Art & Finance industry. The report initiated a debate on the best way forward in terms of regulating certain practices and aspects of the art market, and regarding the extent to which the art market should move toward greater self-regulation or pursue a path of government intervention.



Transparency around object-specific risks

- Authenticity
- Lack of provenance
- Forgery and attribution



Transparency in valuation and pricing

- Price manipulation
- Undisclosed interest
- Insider trading
- Auction guarantees



Transparency around skills and knowledge

- Lack of international standards around professional qualifications in the art market



Transparency in transactions

- Money laundering
- Lack of title register
- Secret commissions
- Confidentiality around the buyer's and seller's identity

In this year's edition, we continue the debate by inviting a number of key stakeholders to express their opinions and experiences on the theme of regulation and we have also added a closely related theme of risk management in the art world.

One of the key initiatives this year, covered in greater depth in this report, was the launch of the Responsible Art Market Initiative (RAM), which was formally launched on 26 January 2017 in Geneva. The aim of the initiative is to issue a set of guidelines aimed at rebuilding trust and credibility without undermining the commercial interests of the art industry. Its guidelines are designed to be accessible to the entire art market, including small art businesses, and individual dealers and collectors. RAM's first set of guidelines tackle the threats of money laundering and terrorist financing in the art market.

Like the majority of the stakeholders surveyed this year, RAM argues strongly for a self-regulated approach in the art market (*page 246*). As the threats and challenges to the art market and Art & Finance industry evolve, initiatives such as RAM offer a forum and collaborative model to address and tackle these issues, and thereby increase transparency, public trust, and confidence in the market. As mentioned by the founders of RAM, international collaboration and engagement on the issues faced by the art market, not just within the art market itself but also with other stakeholders, such as law enforcement and state authorities, will be very important for the future success and development of the Art & Finance market.

In this regards, it is interesting to mention that Art Basel, owned by Basel-based MCH Group, has issued new exhibitor regulations that will go into effect with Art Basel Miami Beach in December 2018. Changes are aimed at improving professionalism and shoring up buyer confidence in the wake of growing litigation in the art world¹¹¹.

However, it is not only the art market that is affected by a lack of regulation and challenges in relation to risk management. A recent report by the National Audit Office in the UK¹¹² on the risks associated with private donations to public museums shows that this is a much broader cause for concern.

This report states that private donations present different risks to other sources of revenue for the museums and cannot be managed in the same way as commercial transactions. The report highlights a number of risks:

- **Legal risk**—if accepting a donation were to breach legislation such as the Proceeds of Crime Act 2002 (for example, where the donor has generated the underlying fund through illegal activity). This could expose a charity to legal or regulatory challenges
- **Financial risk**—if the donor cannot honor the donation in full or in part. This would be most damaging where the receiving institution was heavily reliant on the anticipated donation to fund key strategic expenditure
- **Reputational risk**—if accepting the donation were to create an association with an individual or entity that is perceived to be inappropriate or unethical by other stakeholders. This would include the perception of the public, employees, and other significant donors
- **Dependency risk**—if accepting the donation were to give the donor an undue level of influence over a charity and its trustees

All of the aforementioned risks present an opportunity for wealth managers to work with the public museum sector in areas of best practice to consider when responding to the risks associated with private donations.

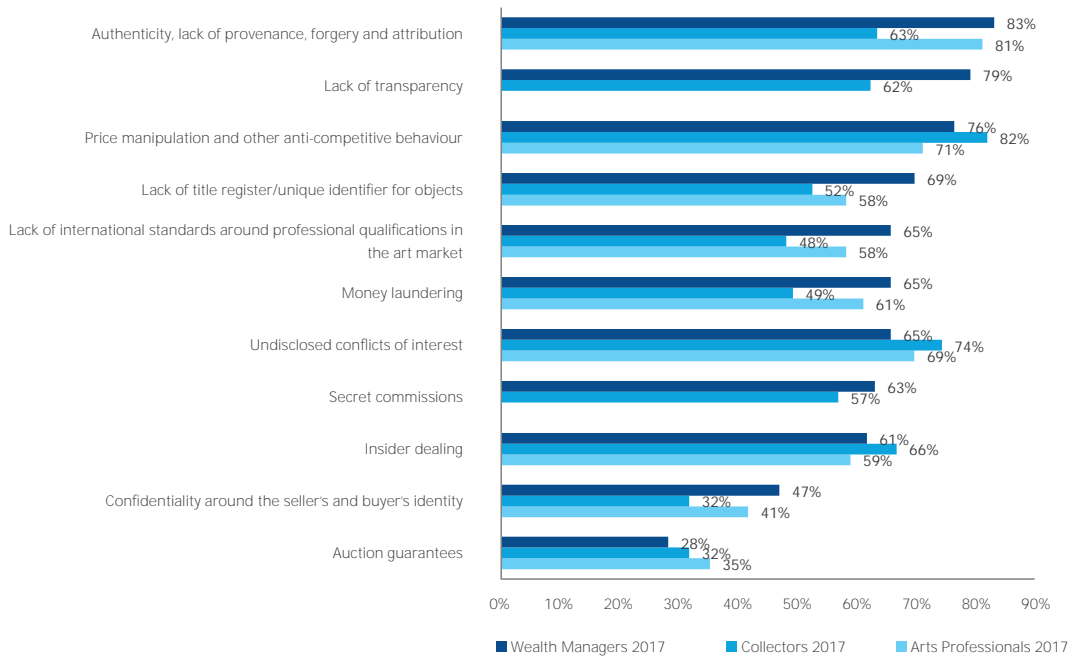
The following section is based on the findings from surveys conducted among legal professionals, wealth managers, art professionals, and art collectors. The purpose was to identify a set of priorities among these stakeholders when it comes to issues that pose the greatest threat to the reputation and functioning of the global art market. These findings are provided alongside opinions and comments from experts working closely with the art market today.

111 *The Art Newspaper* 29 September 2017

112 "Due diligence processes for potential donations" by the National Audit Office, July 2017.

Survey findings

Figure 60. Which of the following issues do you feel are the most threatening/damaging to the reputation of the art market?



Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

There is consensus across different stakeholders (collectors, art professionals, and wealth managers) when it comes to the issues that constitute a real threat to the reputation and the functioning of the art market.

These concerns notably include authentication and provenance issues, price manipulation, conflicts of interest, lack of transparency, and secret commissions, where nearly three quarters of wealth managers, collectors, and art professionals share these views.

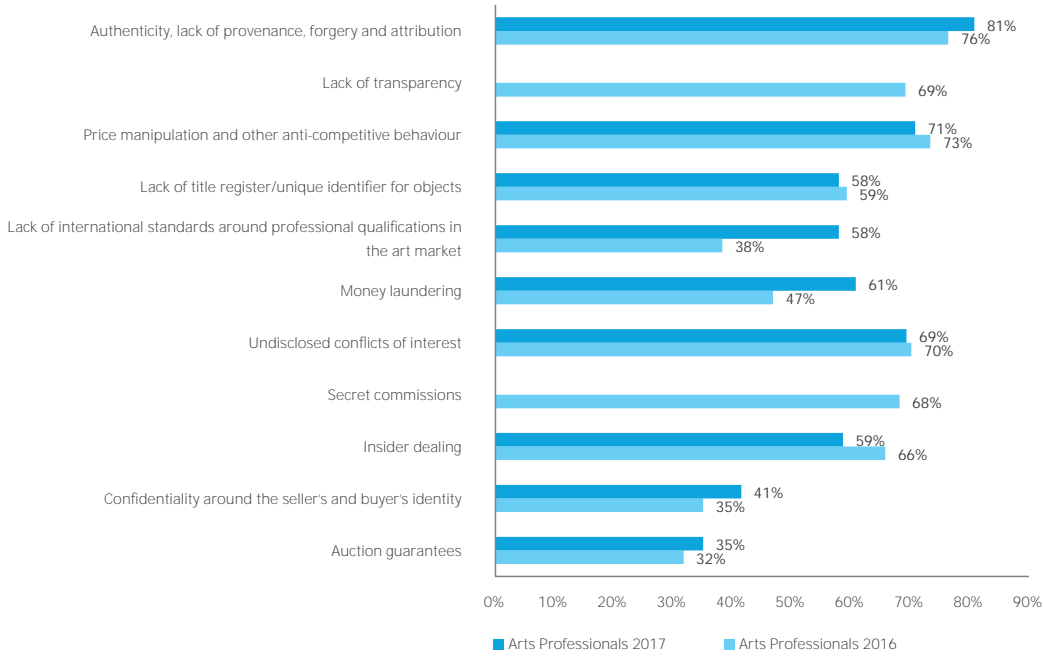
Price manipulation and other anti-competitive behaviors: 76 percent of wealth managers (up from 73 percent in 2016), 82 percent of collectors (the

same as in 2016), and 71 percent of art professionals (down from 73 percent in 2016) see price manipulation and other anti-competitive behaviors as a major damaging factor to the reputation of the global art market.

This view was also supported by 66 percent of collectors who said that insider dealing was a major threat to the reputation of the art market (up from 64 percent in 2016). The majority (59 percent) of art professionals (down from 66 percent in 2016) and 61 percent of wealth managers (down from 62 percent in 2016) said the same this year. These are critical factors and they have the potential to undermine confidence in and the credibility of any given price (and hence also the data being used to assess risk and performance in the art market). All stakeholders continue to feel strongly about this particular aspect of the market.

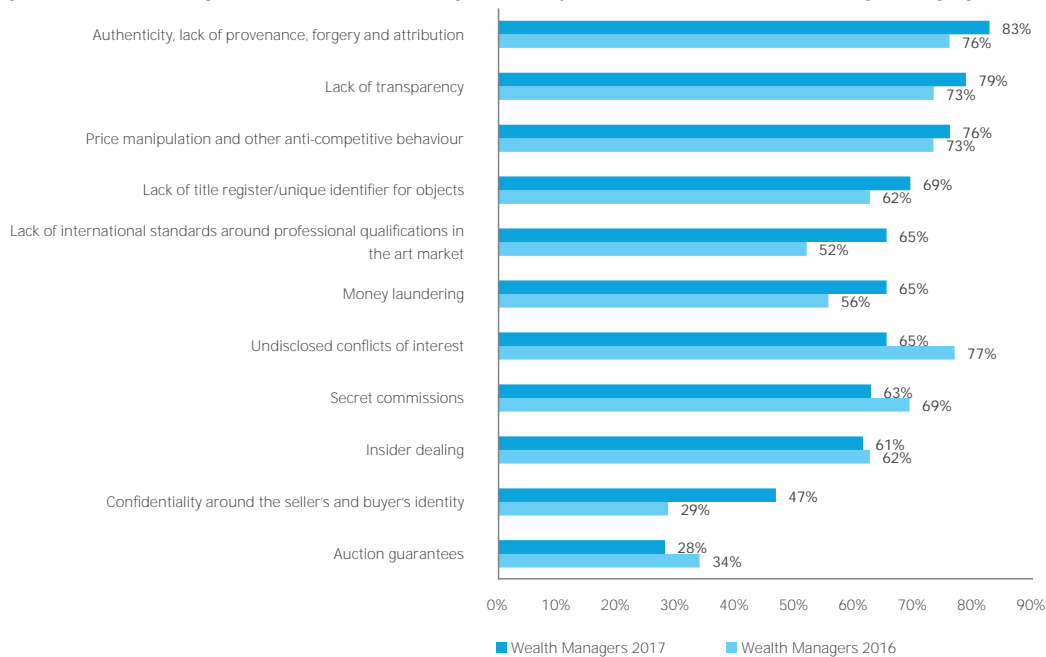
Undisclosed conflicts of interest: 65 percent of wealth managers (down from 77 percent in 2016), 63 percent of collectors (down from 72 percent in 2016), and 69 percent of art professionals (down from 70 percent in 2016) see issues around undisclosed conflicts of interest as a problematic issue in the art market. The role of intermediaries in the art market remains a gray and unregulated area. The relationship between intermediaries and the seller/buyer is often fraught with a lack of transparency and potential conflicts of interest. As long as the art market is wedded to a commission-based revenue model, the problem of conflicts of interest is unlikely to go away. These issues around conflicts of interest and how to manage this risk is discussed by Deborah Gunn, Senior Adviser, Faursschou Foundation on page 264.

Figure 61. Art Professionals: Which of the following issues do you feel are the most threatening/damaging to the reputation of the art market?



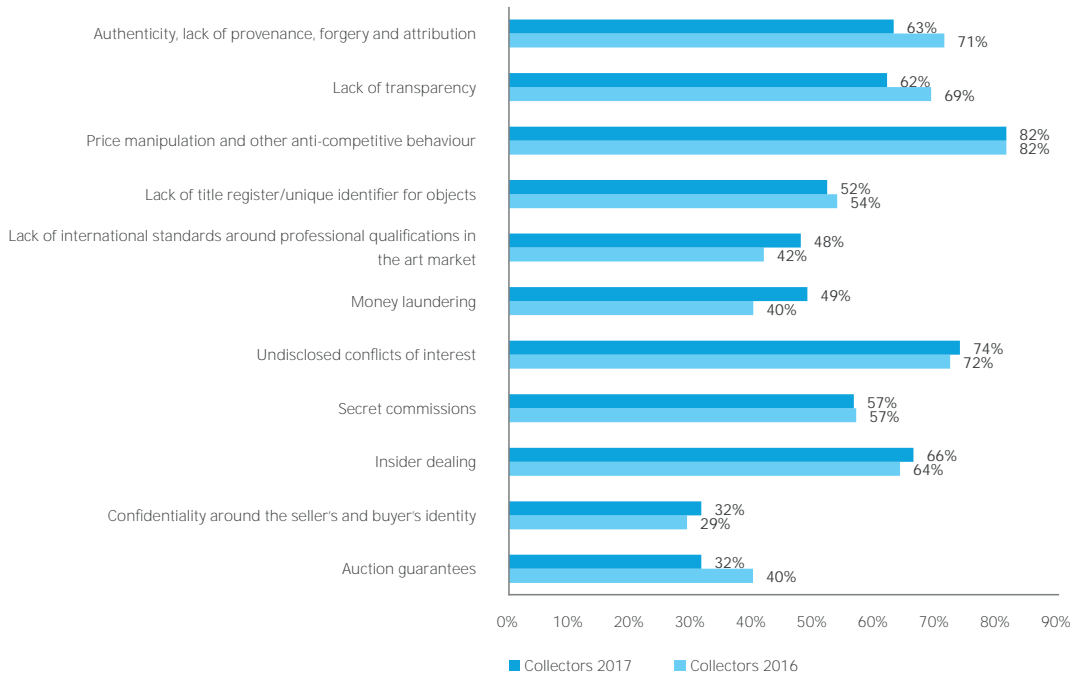
Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Figure 62. Wealth Managers: Which of the following issues do you feel are the most threatening/damaging to the reputation of the art market?



Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Figure 63. Art collectors: Which of the following issues do you feel are the most threatening/damaging to the reputation of the art market?



Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Lack of market transparency: Linked to the above is the issue of a lack of transparency in the art market. 79 percent of wealth managers (up from 76 percent in 2016) and 62 percent of collectors (down from 69 percent in 2016) see this issue as one of the key issues within the art market. Most of the problems outlined above boil down to the fact that the art market continues to operate as an opaque and non-transparent market, and the duty and obligation to be transparent have largely been circumvented. However, high-profile court cases and legal disputes have pushed this issue to the top of the agenda.

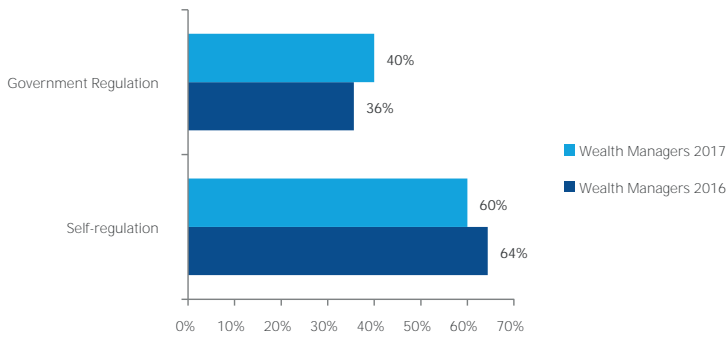
Wealth managers see authenticity issues, lack of provenance, forgery, and attribution as the greatest threats to the reputation of the art market: 83 percent of wealth managers (up from 76 percent in 2016) see authenticity, provenance, and attribution issues as the greatest risks in the art market. Art professionals are echoing this sentiment, with 81 percent (up from 76 percent in 2016) saying this is a major risk to the art market.

Lack of standardization regarding professional qualifications in the art market: 65 percent of the wealth managers surveyed (up from 52 percent in 2016) feel that the lack of standardized professional qualifications in the art market is a real issue, as it complicates the search and selection of individuals or firms with the appropriate knowledge and skills. However, different art industry associations, such as the Association of Professional Art Advisors (APAA), the Association of Art & Antique Dealers (LAPADA), Le Comité Professionnel des Galeries d'Art, and the Appraisers Association of America, have all been set up to raise standards and promote adherence to a code of ethics among its members. It is important that these associations improve the dialogue with the wealth management community to ensure that their members are part of the process to create a common platform for the Art & Finance industry.

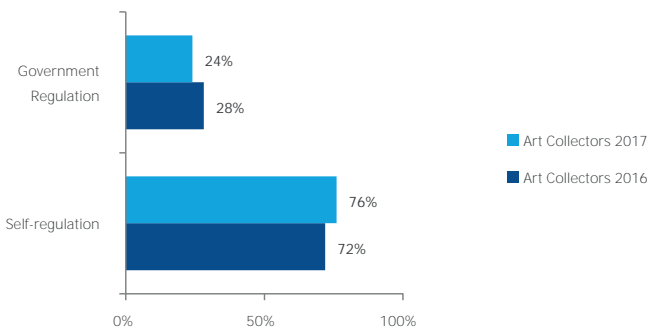
Money laundering: 65 percent of the wealth managers surveyed (up from 56 percent) felt that money laundering was a serious threat to the credibility of the art market, and 61 percent of the art professionals surveyed (up from 47 percent in 2016) and 49 percent of the collectors surveyed (up from 40 percent in 2016) felt the same. However, with tighter anti-money laundering rules currently entering into force around the world, the art world will be forced to comply with these new regulations.¹¹³ This issue is discussed in more detail by Mathilde Heaton and Sandrine Giroud from RAM (page 246), David Heurtevent and Adrien Chiariello from Deloitte Luxembourg (page 256), and by Rebecca Jennings from The Fine Art Group (page 268).

¹¹³ "As of 1 January 2016, the Anti Money Laundering law of Switzerland (AMLA) will also apply to traders, i.e., individuals and legal entities that commercially trade in movable goods and in this context, accept payment of cash (source: <http://www.caplax.ch/2015/anti-money-laundering-implementation-of-the-revised-fatf-recommendations/>).

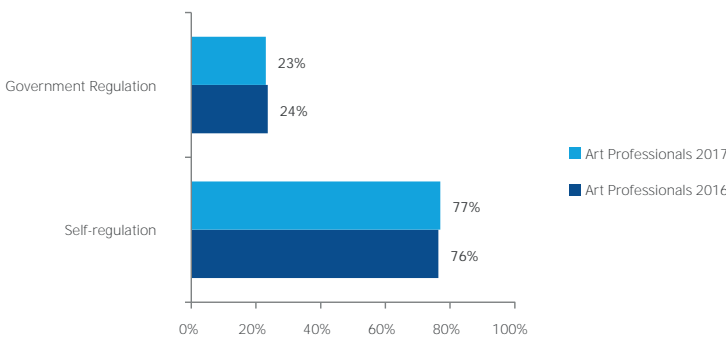
Figure 64. Arts Professionals: Which regulatory approach do you favor when it comes to establishing trust and credibility in the art market?



Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017



Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017



Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2017

Government intervention or self-regulation?

Over 77 percent of art professionals and 76 percent of collectors prefer a self-regulated approach to establish trust and credibility in the art market, i.e., they believe that the threats to the art market are best addressed from within the art industry itself rather than through government intervention. However, wealth managers feel that more government regulation is required, with 40 percent of the wealth managers surveyed this year feeling strongly about more government intervention (up from 36 percent in 2016). This is one aspect of the Art & Finance industry that could pit the two industries against one another.

As this year's findings suggest, there is strong consensus among the different stakeholders (wealth managers, collectors, and art professionals) on what the problems are, although there is less agreement about the best tools to address these risks. While 40 percent of wealth managers call for more government regulation, many question the effectiveness of such regulations and whether the government is sufficiently equipped to deal with the complexities of the art market. Such doubts were magnified when participants considered the global nature of the art market. The risk is that this type of regulation could impose higher costs on companies, forcing them to shift resources toward meeting compliance requirements, arguably at the expense of other activities. This might not be a problem for the biggest and most financially powerful operators in the art market, but for the thousands of smaller companies and individuals, increased government regulation could make their businesses unviable.

However, government regulation can support the development of the art market such as in Italy with the reform on the circulation of artworks discussed by Giuseppe Calabi (page 248), or to tackle illicit trafficking of artworks through new European Commission rules discussed by Famke Schaap (page 252).

The majority of respondents (including wealth managers) see self-regulation as a more appropriate framework to address the threats facing the art market.

The majority of respondents (including wealth managers) see self-regulation as a more appropriate framework to address the threats facing the art market. Self-regulation is an essential part of today's global economy, and widely adopted across a range of industries, such as health care, fashion, advertising, and professional sports, as well as the art market. These industries rely on self-regulation to address a range of issues, from establishing industry standards, to developing and applying codes of professional ethics, to ensuring consumer confidence. However, the fragmented nature of the art market and art industry means that there is no one body at the moment that could speak on behalf of the industry as a whole, as each self-regulatory body defends and promotes the interest of its members, which means that getting the art industry to adhere to a set of common guidelines and principles could be difficult to practically implement and enforce.

Does the art market need to modernize its business practices?

In this year's survey, we extended our research around issues linked to how well-equipped the art market is to meet the demands of a rapidly changing market place. The responses have been clear: 73 percent of wealth managers, 74 percent of art professionals, and 64 percent of collectors said that the art market needed to modernize its business practices.

Some of the key reasons why modernization is required are listed below:



Art transactions must adhere to KYC and anti-money laundering regulations:

The increasing burden of anti-money laundering (AML) regulation is likely to have an effect on the global art market, with high-value dealers already falling under AML regulation. If these powers were widened to a broader segment of the art market, there would be a need for new skills and services to bring the art market into compliance with the regulatory requirements.



The art market has become an industry and participants expect professionalism:

As the global art market is generating more than US\$50 billion in annual turnover, like in other industries, the highest level of professionalism is expected in all areas of the art market. The issues highlighted in this report suggest that the art market still has some distance to go before it can define itself as a fully modern and professional industry.



Lack of transparency threatens the integrity of the art market:

The issue around transparency has come up throughout the report, and is clearly a key priority across the different stakeholder groups.

The increasing burden of anti-money laundering (AML) regulation is likely to have an effect on the global art market.



Taking the initiative

The Responsible Art Market Initiative

Mathilde Heaton¹¹⁴

Lawyer and art law consultant
Researcher at the University of Geneva's Art-Law Centre and RAM's task force coordinator

Sandrine Giroud¹¹⁵

Partner with LALIVE, Switzerland
Board member of the Art Law Foundation and member of RAM's task force

Self-regulation or external regulation? This question has been hotly debated in art-market circles in recent years.

Previous editions of this report have highlighted that a lack of transparency and issues of authenticity are undermining trust and credibility in the art market. At the same time, the legal and regulatory framework within which art businesses are required to operate is becoming increasingly complex. Several countries have imposed anti-money laundering requirements on art dealers as part of ongoing efforts to protect the market from abuse. Globalized and complex, the art market is also evolving. Art is increasingly being sold online and collected as an investment as well as for its intrinsic aesthetic, cultural, or historical value.

To contribute to the discussion on best practices and compliance in the art market, the **Responsible Art Market Initiative (RAM)**, together with its online platform,¹¹⁶ was launched on 26 January 2017.

Supporting responsible art-market players

Rebuilding trust and credibility without undermining the commercial interests of the industry in a way that promotes fair and efficient competition for future growth—this is the challenge the art market faces today.

RAM is a direct response to this challenge. Formed in Geneva in November 2015¹¹⁷ under the auspices of the Geneva-based Art Law Foundation (ALF) and the University of Geneva's Art-Law Centre (ALC), this non-profit initiative is the first of its kind.

It exists to support art-market players by providing them with a practical and ethical compass to navigate an increasingly complex and fragmented legal framework.

It aims to do this by:

- Raising awareness among art-market players of the risks they face as they do business
- Consolidating and sharing existing industry best practices
- Providing practical guidelines and tools that can be easily understood and implemented

RAM sees this practical, self-regulatory approach as complementing existing regulation imposed by states. Its guidelines are designed to be accessible to the entire market, including small art businesses, individual dealers and collectors who do not have the financial resources to spend on large compliance departments or expensive lawyers.

By adopting a cooperative approach to sharing and implementing best practices throughout the industry, RAM aims to have a greater impact when it comes to reducing risks for art businesses and collectors alike, thereby increasing public trust and confidence in the market and combatting the negative public perceptions that have arisen in recent years.

What makes RAM unique is its collaborative, interdisciplinary, and cross-industry approach. RAM's founding members span the entire spectrum of the art market, from international auction houses (Christie's) to individual dealers (Seydoux & Associés) and service providers (the Geneva Freeports and SGS art services). These players have joined forces with specialist art lawyers and academics from the Geneva based Art Law Foundation and the University of Geneva's Art-Law Centre as well as law enforcement to ensure issues are addressed holistically from various perspectives.

Guidelines

RAM's first set of guidelines tackle the threats of money laundering and terrorist financing in the art market.¹¹⁸ They adopt a risk-based approach and emphasize the importance of art businesses identifying risks, knowing their clients, and being alert to red flags. The guidelines are tailored to art transactions and focus on three areas of enquiry: the client, the artwork, and the transaction.

Remaining close to the market, RAM submitted its first draft for public consultation and reached out to key art-market stakeholders to improve, simplify, and enrich the set of principles laid down in the guidelines.

The guidelines are supplemented by a Quick Reference Guide and Red Flag Lists, catering for art professionals who are on-the-move attending an art fair or visiting a client, and Country Guides giving an overview of the anti-money laundering regimes that apply in different jurisdictions.

Can self-regulation in the art market make a difference?

For a market as complex, diverse, and constantly evolving as the art market, a self-regulatory approach is widely recognized as having several advantages over externally imposed state regulation. These include:

- **Flexibility and speed**—Industry guidelines can be developed and updated more quickly than state-imposed legislation, which takes time to be approved and adopted. This results in greater operating efficiencies for art businesses in turn minimizing compliance costs
- **Better adaptation**—Greater technical and industry expertise can be achieved through industry-developed guidelines striking that critical balance between achieving the desired goal whilst not stifling the market so that it cannot operate
- **Increased collaboration**—Conflicts of interest are mitigated through the participatory design process
- **Global scope**—Unlike territorial legislation, guidelines and codes of conduct can transcend national boundaries, resulting in a more flexible approach better adapted to serving a global market such as the art market

The future

The response to RAM's launch has been positive and has generated global interest. More work remains to be done in raising awareness among art-market players of the risks they face and actions they can take to protect themselves and the reputation of the art market. As the threats to the global economy and art market evolve, initiatives such as RAM aim to offer a means of tackling them, reducing risk for art businesses and collectors alike and thereby increasing public trust and confidence in the market. International collaboration and engagement on issues faced by the art market, not just within the art market itself but also with other stakeholders, such as law enforcement and state authorities, are important for success.

In keeping with its unerring goal of identifying and sharing responsible practices in the art market, RAM will be organising annual conferences and publishing further materials on topics of specific concern to the art industry and collectors.

For its latest project RAM is preparing a comprehensive due diligence toolkit for art transactions, focussing on the client, the artwork and the transaction as a whole, including source of funds.

The toolkit will be launched at RAM's next annual conference which will be held in Geneva, Switzerland on 2 February 2018.

For more information:

<http://responsibleartmarket.org>

¹¹⁴ mathilde@artlawadvisory.com

¹¹⁵ sgiroud@lalive.ch

¹¹⁶ RAM's website is available at: <http://responsibleartmarket.org/>

¹¹⁷ RAM is the outcome of a conference organized by the Art-Law Centre of the University of Geneva and the Geneva based Art Law Foundation entitled "Money Laundering in the art market. A reality?", available at: <http://artlawfoundation.com/fda-events/blanchiment/>

¹¹⁸ The full guidelines can be downloaded from RAM's website available at <http://responsibleartmarket.org>.



Avv. Giuseppe Calabi
Studio Legale
CBM & Partners

International circulation of artworks: An important reform approved by the Italian parliament

The Italian legal framework

The Italian art market is characterized by a regulatory system that dates back to 1909.¹¹⁹

Today, the main legal framework is the *Decreto Legislativo 22 gennaio 2004, n. 42* (Cultural Heritage Code). The provisions of the Cultural Heritage Code concerning the art market are, by the same token, anachronistic and highly protectionist. The Cultural Heritage Code sets forth several limits to the circulation of artworks, including:

01. The "declaration of cultural interest"¹²⁰ preventing the owners of "classified" artworks from exporting them on a permanent basis. Furthermore, the state is entitled to exercise a preemption right when such artworks are sold.
02. The requirement of a license (*attestato di libera circolazione*) to export any artworks of cultural interest, with the sole exemption covering works created by living artists or created fewer than 50 years ago. There is no monetary threshold exempting items with a market value below a certain amount from state control.¹²¹

Hence, the export control does not reflect the actual monetary value of the artwork, while Export Offices (*Uffici Esportazione*) follow subjective criteria and decide with utmost discretion whether an artwork is "rare" or whether its "quality" prevents the owner from exporting it. Furthermore, private collectors frequently do not receive adequate explanations of the grounds for export denials, in particular in relation to why a certain artwork is of interest in terms of national cultural heritage.

The general criteria upon which export licenses are granted are set forth in a circular issued by the Public Education Ministry in 1974.¹²² The criteria give rise to a very high level of uncertainty and discretion, insofar as they focus on factors such as the "aesthetic importance" or "rarity" of a particular artifact, without specifying when an artwork is to be deemed "important" or "rare."

How the market is affected by the current legal framework

The current Italian regulations lead to market uncertainty and limited sales. The ban on exporting artworks declared to be of cultural interest represents a huge deterrent for the sales of such artworks. Studies on the economic effects of the “declaration of cultural interest” demonstrate that such a declaration decreases the commercial value of an artwork by about 40 percent. Furthermore, if an unclassified artwork is sold and the buyer wishes to export it, there is always the risk that the export license will be denied, with the consequent automatic declaration of public interest. This situation creates uncertainty in the market and is a strong deterrent for foreign collectors from purchasing art in Italy. Consequently, both Italian and foreign collectors prefer to buy and sell art in other countries, where they are sure that the artworks they buy can be moved without restrictions.

The regulation also leads to administrative congestion. Any artwork created more than 50 years ago by a nonliving artist—for which an export license is requested—has to be physically inspected by a commission at the local *soprintendenza*.¹²³ Notwithstanding the independence of the local authority in the final decision, the file must be submitted for advice to a central administrative body, which must reply within a 10-day term. However, this obligation is rarely fulfilled: certain intermediaries have reported that they have had to wait for several months before obtaining an export license. This procedure is applied across the board, whether the artwork in question is a Lucio Fontana masterpiece or a piece by an unknown artist, and regardless of the commercial value of the artwork and its final destination, whether in the EU or outside the EU.

In the first eight months of 2016, there were 75 denials of export licenses out of 9,816 requests.¹²⁴ This ratio shows that the administrative system is overloaded by an unjustified number of export applications, with two negative effects: (i) the public officers in charge of export controls (whose number has decreased in recent years as a result of the public spending review carried out by the government) need to process hundreds of files with an inevitable impact on the quality of their assessment; (ii) the Italian art market cannot compete with more efficient foreign markets, not only with respect to high-value artworks, but also with respect to those with medium or low value.

Furthermore, local *soprintendenze* across Italy adopt different criteria, which makes the management of ordinary matters (such as imports and exports) extremely difficult for art professionals.

As a result of these differences, Italian collectors and shipping agencies frequently choose Export Offices that they believe are more “liberal” than others (known as “forum shopping”) and this creates further uncertainty as to the interpretation of Italian export law.

Both Italian and foreign collectors prefer to buy and sell art in other countries, where they are sure that the artworks they buy can be moved without restrictions.

¹¹⁹ Legge Rosadi, 20 June 1909, no. 364.

¹²⁰ Art. 13

¹²¹ Art. 65 paragraph 3 (a) and (b) and Art. 68 Cultural Heritage Code

¹²² Circolare del Ministero della Pubblica Istruzione, prot. n. 2718

¹²³ Local authority acting on behalf of the Cultural Heritage Ministry.

¹²⁴ Sole 24 Ore, Plus 24, 17 September 2016.

The international circulation reform project¹²⁵

On 29 June 2017, the Italian house of representatives (Camera dei Deputati) approved five amendments to a bill aimed at fostering competition (Disegno legge concorrenza: hereafter called DDL), which had already been approved by the senate. Once approved by the Senate, the bill will be published in the official gazette and enter into force.

The DDL includes relevant provisions that may have a positive effect on the international circulation of artworks. The reform was advocated by the major art market stakeholders, including Sotheby's and Christie's, the Italian Association of Antique Dealers, the Italian Association of Auctioneers, and the Italian Association of Modern and Contemporary Art Dealers. Here is an outline of the reform:

- An export license will be required for all artworks made more than 70 years prior to the export date by nonliving artists. As mentioned above, since 1909 the relevant timeframe is 50 years from creation of the relevant artwork (in Germany this is 70 years and in Spain it is 100 years.) The differences in the relevant timeframes for heritage protection in European jurisdictions is a critical factor that hinders the free circulation of cultural property in Europe.
- For older works (excluding archaeological items), a minimum monetary threshold of €13,500 applies for all cultural property. Regarding circulation within the EU, the Italian ministry did not accept the value thresholds specified in Council Regulation (EC) 116/2009 for export of objects from the territory of the EU (e.g., i.e., €15,000 for photographs and drawings, €30,000 for watercolors, and €150,000 for paintings).

- Works of art made less than 70 years ago or with a declared value below the minimum monetary threshold may be exported on the basis of the owner's unilateral declaration certified by the ministry.
- However, for works of art whose age falls within the 50 to 70-year bracket, the ministry shall be entitled to ascertain whether they have an exceptional artistic, historical, archaeological, or ethnoanthropological interest for the integrity of the national cultural heritage. If this is the case, within 60 days of the date of the filing of the unilateral declaration, the state can officially classify the work, which will be ineligible for export as a result. Should the 60-day timeframe expire, the state will have no right to block the export of the relevant item.

Within 60 days of the date of the entry into force of the DDL, a decree of the Ministry of Cultural Heritage will:

- Review the Export License Guidelines for Export Offices (the Italian equivalent of the UK Waverly Criteria)
- Introduce a "passport" for works of art, facilitating their import and export and with a validity term of five years

125 On 4 August 2017 the Italian senate approved the law 124/2017, whose provisions are outlined in this section and have become effective as of 29 August 2017.



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Tackling illicit trafficking of artworks through new European Commission rules

On 13 July 2017, a new European Commission proposal on the import of cultural goods¹²⁶ was published. The new rules are part of a broader EU action-plan to fight terrorist financing, and could enter into force as early as 2019, subsequent to discussion in and approval by the European Parliament and the Council of the EU.

For the art market and its various stakeholders, the new rules would bring consistency and clarity on the types of restrictions and control measures proposed by the European Commission in tackling the illicit trade in cultural objects. Imports of cultural objects made over 250 years ago into the EU will be forbidden if they are illegally exported from the source country.

The Global Trade Advisory team, together with the Legal practice in Deloitte Belgium, were requested by the European Commission to prepare the 'Study on Fighting illicit trafficking of cultural goods: analysis of customs issues in the EU' (forthcoming), which served as inputs into the EU's own Impact Assessment for this proposal.

Background

Antique trading has been thriving since the 1970s. Europe is the continent with the largest volumes of art exports, totaling US\$14.59 billion, and the second largest volume of imports after the Americas, with US\$11.5 billion of art and antique imports into and between European countries. The European market for classical antiques and ancient art represented a total value of US\$66.7 million in 2016, whereas the auction market for other antiques generated US\$807.5 million in sales. The average price of lots consigned in continental Europe surged to US\$43,109 in 2016 from US\$13,168 in 2015, according to the 2017 TEFAF Art Market report.¹²⁷

Imports of artworks, collectibles, and antiques to Europe account for around 54 percent of global trade in the sector. Eurostat data¹²⁸ indicates that the legitimate import of antiques into the EU generated €11.8 million in 2015.

In parallel, illicit trafficking of cultural artifacts (sometimes referred to as “blood antiques”) has also grown. Despite increased awareness around the issue, the looting of historic sites and illegal excavations currently continue in Iraq, Syria, areas stretching the Mediterranean basin, Africa, and beyond. This activity is currently playing a crucial role in the financing of terrorism.

Similarly, illegally exported cultural objects continue to be offered and sold on the European art market through traditional channels and e-commerce platforms. High-profile cases involving illegally traded antiquities, such as the *Becchina* and *Symes* cases, continue to plague the art industry. In the United States, the recent discovery¹²⁹ of illegal artifact imports by the arts and crafts chain Hobby Lobby brought the matter back to the fore once again.

Customs administrations' seizures of goods illegally imported into the EU have been frequent of late. One recent example is the French customs' 2016 seizure¹³⁰ of two bas-relief pieces obtained from the looting of Syrian cultural heritage sites.

The lack of artwork provenance and origin certification continues to complicate the daily business of legitimate art dealers, auction houses, and buyers.

What regulations are in place for cultural good imports at the national and international level?

In its current form, regulation on cultural good imports consists of different and fragmented instruments across the international, EU, and national levels. The year 2017 has so far seen a patchwork of measures covering the movement of cultural property (i.e., import, transfer, and export).

At the international level, the 1970 UNESCO Convention remains the most widely used instrument for international cooperation in this area. This convention has brought the international community's much needed attention to the ongoing looting of cultural artifacts, consequently leading to an increase in policies at the national level.

Since 1995, the UNIDROIT Convention has built and expanded upon the UNESCO Convention, regulating the restitution of stolen cultural artifacts and the return of illegally exported ones.

In aiming to combat illicit trafficking of cultural goods in the EU, the UNIDROIT Convention is somewhat hindered by the absence of three EU member state signatories (Ireland, Malta, and Lithuania), among 131 signatory states across the world.

At the EU level, there have so far been two ad hoc measures in place for Iraq (since 2003 - Regulation No. 1210/2003) and Syria (since 2012 - Regulation No. 36/2012), placing specific restrictions on the movement of cultural property from these areas—with some exceptions. In practice however, only a limited number of seizures under these ad hoc measures have been detailed by British, German, French, and Dutch tax authorities and other pending cases. For example, the German criminal police seized a Sumerian clay cuneiform tablet¹³¹ of Iraqi origin, dating from 2049 BC

and which was put up for public auction. The artifact was returned to Iraq in 2012.

Given the impact of the ad hoc measures currently in place, it is clear that customs administrations are currently facing a challenging task. They often find themselves going beyond the resources available to establish provenance, age, and legitimate owner after seizing artifacts.

¹²⁶ Proposal for a Regulation of the European Parliament and of the Council on the Import of Cultural Goods. *Publication. Vol. SWD(2017) 263 Final. Brussels: European Commission, 2017.*

¹²⁷ Pownall, Rachel A.J., comp. TEFAF Art Market Report 2017. *Rep. Helvoirt: European Fine Art Foundation, 2017.*

¹²⁸ http://ec.europa.eu/eurostat/statistics-explained/images/3/39/Imports_of_cultural_goods_by_group_of_products%2C_2015.png

¹²⁹ Kinsella, Eileen. “Did Hobby Lobby Buy Up Iraqi War Loot in Its Quest to Amass Biblical Artifacts?” *Artnet News. Artnet News, 06 July 2017.*

¹³⁰ “Patrimoine Culturel - Saisie De Deux Bas-reliefs Par Les Douanes Françaises.” *France Diplomatie : Ministère De L'Europe Et Des Affaires étrangères. 29 Sept. 2016.*

¹³¹ Kami, Aseel. “Sumerian Gold Jar, Other Relics Returned to Iraq.” *Reuters. Thomson Reuters, 30 Jan. 2012.*

While the same legislative framework will apply to the import of cultural goods in all EU member states, it is important to recognize that penalties resulting from infringements are likely to differ across EU member states, as these remain a national competency.

At the national level, the past three years have brought new legislation to combat the illicit trade of cultural goods across various countries, both inside the EU (Germany, France, Austria, and the Netherlands) or outside it (the United States and Switzerland in particular). Consequently, an export certificate from the source country is required to allow entry of cultural goods into France and Germany, with additional due diligence obligations on buyers of these goods (attesting legitimate provenance). In Austria and the Netherlands, the import of cultural goods that have been illegally exported out of their country of origin is forbidden.

Since 2005, Switzerland required persons importing or placing cultural property in transit to provide information on the customs declaration about the object type, a description of its place of origin and a declaration that the export of cultural property from the source country is not subject to a permit under local laws. Additional measures were introduced in 2016 for all imports into Swiss freeports, requiring an official audit for every archaeological object offered for storage.

Together, these measures have shown to lack consistency, efficiency, and effectiveness, especially within the context of needed harmonized action within the EU customs union.

Under the currently disjointed regulatory framework, the risk that cultural good imports will receive inconsistent treatment in different EU member states is all too real. This can potentially harm the protection of cultural goods in source countries and allow continued terrorist financing through illegally-traded cultural goods.

What does the EU propose in the new regulation on cultural good imports?

The European Commission's 13 July 2017 proposal acknowledges the importance of protecting cultural goods from two different angles.

From a national perspective, the EU has proposed new rules acknowledging the importance of cultural goods to national heritage, as well as the artistic, historical, and archaeological value to their country of origin.

From an international perspective, the EU proposal emphasizes the negative effects and risks of illegal trading in the art market, where valuable artworks, sculptures, and archaeological artifacts are often illegally obtained, sold, and imported into the EU from conflict zones. This illicit trafficking is believed to be linked to terrorism finance, tax avoidance, and money laundering.

The proposed rules on the import of cultural goods provide a strong incentive for the art market to exercise due diligence regarding the legality of cultural goods imported into the EU.

While the new rules would add an additional burden on the side of EU importers of antiquities, they seem relatively straight-forward in terms of proposed scope and control mechanisms. Whereas the rules remain pending for approval, their content includes the following.

The **geographical coverage** is global. In contrast to the ad hoc measures for Syria and Iraq, the new regulation applies to all source countries. The laws of the exporting country (whether source or intermediate) will prevail in determining the legality of import into the EU.

In terms of **product coverage**, the proposed regulation only applies to artworks listed in the UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects. The annex to the EU proposal provides a list of all categories in scope. Unlike UNIDROIT, an additional age threshold is added, meaning that from the listed categories, only objects older than

250 years upon their import are in scope. To prevent artifact seizure, importers of antiquities are therefore pushed toward additional prudence, specifically with regards to age determination.

In terms of **documentary requirements**, the EU proposal introduces a new licensing mechanism. The proposed regulation requires the importer to prove that the item was legally exported from the source country. The proposal distinguishes between two categories of cultural goods, imposing different documentary requirements on the person planning to import them:

- An import license would be required for archaeological objects, parts of monuments, rare manuscripts, and incunabula, providing proof of the goods' legal export from the source country
- A signed importer statement together with an Object ID (in a standardized format), certifying that the goods were legally exported out of the source country, would be required for all other goods falling within the proposed regulation's scope

While the same legislative framework will apply to the import of cultural goods in all EU member states, it is important to recognize that penalties resulting from infringements are likely to differ across EU member states, as these remain a national competency.

What does it mean for you?

While the entry into force of the proposed EU regulation on the import of cultural goods is pending European Parliament and Council approval, the proposal's text paves the way for improved monitoring and combat against illicit trafficking of cultural goods. A first discussion on the proposed regulation is scheduled in the Council of the EU committees at the end of September 2017.

For the art market, the proposed EU regulation promises greater consistency, additional clarity, and transparency in a regulatory landscape that was already moving toward increased (national) regulation, with tightened import

requirements on cultural goods. Generally, the regulation and the control mechanism compliance it introduces may improve the European art market's reputation and credibility.

Looking at the ongoing Brexit negotiations, the question is whether the new rules would apply in the United Kingdom, which currently stands as the primary importer of antiques into the EU (over half of EU imports arrive in the United Kingdom, which according to the 2017 TEFAF Art Market Report, imports US\$6.275 billion in art, collectibles, and antiques). As it currently stands, the rules will likely become applicable in the UK until the exit agreement enters into force. It remains uncertain whether the UK government will thereafter decide to transpose these EU rules to the new post-Brexit legislative framework.

Looking at the ongoing Brexit negotiations, the question is whether the new rules would apply in the United Kingdom, which currently stands as the primary importer of antiques into the EU.

The actual implementation and enforcement of the new rules on the import of cultural goods will depend, to a large extent, on the competent authorities in EU member states. Controls will require specific expertise and sanctions will need to be determined. In the meantime, the proposal incentivizes both buyers and sellers to exercise due diligence and act prudently with respect to the provenance of any cultural object.



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Addressing Money Laundering and Terrorism Financing vulnerabilities in art and collectibles

The fight against Islamic State of Iraq and the Levant may be a turning point in the history of regulations in the Art and Collectibles market. On 13 July 2017, the European Commission presented measures to crack down on the traffic of cultural goods in an effort to cut funding to terrorist groups. The EU tax commissioner Pierre Moscovici stated at a press conference that "terrorists are well and truly artwork traffickers"¹³².

The EU commission wants the measures including a new licensing system for imports to enter into force in 2019. These measures follow a call of the UN to stop illicit trade of cultural goods from Iraq and Syria. It also follows a call of G20 leaders on 7 July 2017 on all countries to "address all alternative sources of financing of terrorism, including dismantling connections, where they exist, between terrorism and transnational organized crime, such as the diversion of weapons including weapons of mass destruction, looting and smuggling of antiquities, kidnapping for ransom, drugs and human trafficking."¹³³

In May 2016, the "G7 Action Plan on Combatting the Financing of Terrorism"¹³⁴ already asked countries to "consider the extent to which art dealers in cultural artifacts are vulnerable to terrorist financing".

The statement identified several vulnerabilities such as "the lack of transparency in transactions, the use of Freeports and Free Trade Zones to transfer and store antiquities, highly mobile goods that can be easily converted into cash, and limited knowledge of the threat among some market participants"¹³⁵. It urged countries to take coordinated and targeted action, to increase awareness of the risk, to share information and to strengthen regulatory requirements.

Thus, governments, law enforcement and businesses are searching for the best strategy to address Money Laundering¹³⁶ and Terrorism Financing¹³⁷ vulnerabilities when dealing with cultural goods. In Luxembourg, the licensed operators of the Luxembourg Freeport already are subject to Anti-Money Laundering provisions since the law of 24 July 2015. In Switzerland, the Responsible Art Market initiative and the appointment of service providers to monitor antiquities entering the Geneva Freeport¹³⁸ from September 2016 are part of the response. This article¹³⁹ draws on recent enforcement cases to feature some issues and approaches to address the vulnerabilities at the private sector level.

Looted antiquities from Syria

The recent "Hobby Lobby" case highlights the vulnerability of arts and collectibles to terrorism financing. Hobby Lobby, an American arts and craft chain of retail stores, agreed in July 2017 to forfeit thousands of artefacts from Iraq and pay a \$3 million fine to settle a civil action brought by the U.S. Department of Justice (DoJ) against the company following a four year-investigation¹⁴⁰. Hobby Lobby purchased cuneiform tablets and clay

bullae from a supplier in the UAE despite the warning of an expert on cultural property law retained by the company that "such objects may have been looted from archaeological sites in Iraq". Some shipments were without proper customs declaration and bore "shipping labels that falsely and misleadingly described their contents" and false origins. The DoJ went so far as to describe these acquisitions as "fraught with red flags". Vanity Fair had raised the question "Did Hobby Lobby's CEO unknowingly sponsor terrorism?"¹⁴¹

In September 2016, Reuters also questioned the potential storage of looted goods in storage sites following seizure of Turkish and Italian antiquities¹⁴². In 2015, the FBI had already warned dealers and collectors about terrorist loot and cultural property being removed from Syria and Iraq and hitting the U.S. market¹⁴³.

The "Hobby Lobby" case shows a failure in deal due-diligence:

- The artwork's provenance was lightly or falsely documented whereas the source country had been a recent conflict zone
- The dealers did not pay attention to law enforcement warnings

Yet, deal due-diligence processes could have been set up to identify the parties involved in the transaction. Searches through public records, including advanced web searches, could have been used to be aware of law enforcement concerns and detect the potential involvement of the parties in criminal activities, Money Laundering or Terrorism Financing. The results of such analysis may have helped raising questions whether the transactions were lawful or not.

Governments, law enforcement and businesses are searching for the best strategy to address Money Laundering and Terrorism Financing vulnerabilities when dealing with cultural goods.

132 <https://euobserver.com/justice/138522>

133 http://europa.eu/rapid/press-release_STATEMENT-17-1955_en.htm

134 The plan was adopted at the G7 Finance Ministers and Central Bank Governors' Meeting.

135 <http://www.fsa.go.jp/inter/etc/20161011-1/01.pdf>

136 Money Laundering is the concealment of the origin of illicit funds and their integration in the licit economy.

137 Terrorism Financing is the funding of terrorism activities.

138 <https://www.arts-franc.ch/copie-de-procedure-pfeg-fr>

139 Special thanks to Edouard Delfosse (Senior Consultant) and Guillaume Jacquot (Consultant) for their contribution to researches.

140 <https://www.justice.gov/usao-edny/pr/unit-ed-states-files-civil-action-for-felt-thousands-ancient-iraqi-artifacts-imported>

141 <http://www.vanityfair.com/news/2015/10/hobby-lobby-ceo-antiquities-terrorism>

142 <http://www.reuters.com/article/us-swiss-freeports-idUSKCN11S10L>

143 <https://www.fbi.gov/news/stories/isil-and-antiquities-trafficking>

Money laundering conspiracy in Pennsylvania

The "Isen" case in Philadelphia highlights the vulnerability of arts and collectibles to money laundering.

In August 2015, the Philadelphia magazine reported that Nathan "Nicky" Isen, "one of Philadelphia's most prominent gallery owners"¹⁴⁴ and a museum curator¹⁴⁵ had received three years' probation and a US\$25,000 sentence from a Judge at the U.S. Federal Court in Pennsylvania on money laundering charges. This sentence followed an indictment by the Eastern District of Pennsylvania in January 2015¹⁴⁶ after an investigation by the U.S. Immigration and Customs Enforcement's (ICE) Homeland Security Investigations (HSI). ICE sent an undercover officer and Mr. Isen "allegedly sold 12 pieces of art work in exchange for US\$20,000 in cash for the purpose of laundering cash he believed to be drug proceeds".¹⁴⁷

The Philadelphia magazine reported that prior to this sentence, Mr. Isen, a dealer with over 30 years of experience on the Philadelphia market, had questionable reputation regarding the authenticity of the artwork sold and had ties to a man who had received 5-year in federal prison on drug charges.¹⁴⁸ He had sold over US\$1 million in art to the drug dealer, including a fake Picasso.¹⁴⁹ The artworks were sold at a low value. Most were print series of blue-chip artists.

This case shows a failure of the dealer to avoid money laundering due to the lack of identification of the origin of the funds used to buy the artworks. This case reminds us that:

- Money Laundering can be perpetrated over a long time span even in a series of low value transactions
- Acquaintance is not a proper form of Due Diligence

Depending upon the extent of regulatory changes, the strengthening of regulations on actors in the art and collectible markets envisioned by the EU, the G7 and the G20 may have a direct or indirect impact on other type of businesses handling high value goods, whether financial institutions, DNFBPs or other entities.

The risks arising from the lack of traceability

The international investigations into 1Malaysia Development Berhad (1MDB) highlight the risks arising from the lack of traceability particularly when dealing with Politically Exposed Persons (PEP) and gifts. The 1MDB case focuses on "up to US\$6bn that was allegedly skimmed from the sovereign fund and allegedly used to support the lavish lifestyles of several men connected to the Malaysian Prime Minister, Najib Razak".¹⁵⁰ Authorities in Switzerland, the United States, Malaysia, Hong Kong, Thailand, Singapore, Australia and Luxembourg have been investigating suspected corruption and money laundering related to this case.

In July 2016, the U.S. DoJ filed a complaint in a federal court "seeking to seize US\$1 billion that they say was diverted from 1MDB into luxury real estate in New York, Beverly Hills and London; valuable paintings; and a private jet".¹⁵¹ A Van Gogh painting and two Monet paintings were seized at a European Freeport.¹⁵²

In June 2017, a famous movie actor returned a US\$3.2 million Picasso and a US\$9 Million Basquiat to the U.S. Government that he had received as gifts after cooperating with the U.S. DoJ.¹⁵³ These gifts were allegedly received to include them in an annual charity auction to benefit his eponymous foundation.¹⁵⁴

The global 1MDB case highlights the reputational and litigation risks faced by any player involved in buying, selling, donating, receiving, storing or benefiting from assets derived from illegal proceeds:

- Collectors (i.e. private foundations, family trust and estates) and non-profit organizations (i.e. museums, foundations, estates) are at direct risk of being sued to recover such assets. Working for the general interest is insufficient to protect them from being sued or facing public scrutiny
- Storage facilities and financial professionals dealing with high net worth individuals (i.e. private banks and family offices) can end up with an indirect reputational damages from dealing with such client

The online art market's exposure to money laundering

The impact is not limited to the physical world. Online art sales are increasing rapidly (US\$3.75 billion in 2016 versus US\$1.51 billion in 2013) and these business models exhibit specific money laundering vulnerabilities.

According to the 2017 Hiscox report,¹⁵⁵ 40 percent of the online galleries surveyed have reported that they do not see their individual clients purchasing repeatedly, i.e. they are rather seeking one-off deals, and that half their clients were located in other jurisdictions. Two-third of the online galleries' customers were new to purchasing art online.

Yet, past experience in the financial industry emphasizes the importance of effective Know Your Customer (KYC) and Know Your Transactions (KYT) procedures and controls, particularly when facing the situation of remote entry into business relationship and new clients with insufficient product knowledge.

The case for preparedness

These enforcement cases, among others, could be seen as the foretelling signs of an increased scrutiny by law enforcement agencies and regulators in the near future for players in the art and collectible markets.

Enforcement actions prove the need for any business dealing with these markets to act upon law enforcement warnings, monitor regulatory changes, identify risks and address vulnerabilities in these markets.

Professionals should pay particular attention to the recommendations, risk assessments and results of country evaluations issued by the FATF/GAFI, the inter-governmental body aimed at developing Money Laundering and Terrorism Financing policies. Until now, only dealers in precious metals and stones have been categorized by FATF as "designated non-financial businesses and professions" (DNFBP), the broader category of non-financial players subject to its recommendations.¹⁵⁶ The FATF already issued guidance on risks and vulnerabilities in Gold¹⁵⁷ and Diamonds¹⁵⁸ and included these sectors in its methodology of mutual evaluation.¹⁵⁹ So far, art and antiquities dealers, auction houses, pawnshops and other dealers and traders in high value goods have been listed as "other entities"¹⁶⁰ whose vulnerabilities could be exploited in regulated entities.¹⁶¹

Depending upon the extent of regulatory changes, the strengthening of regulations on players in the art and collectible markets envisioned by the EU, the G7 and the G20 may have a direct or indirect impact on other type of businesses handling high value goods, whether financial institutions, DNFBPs or other entities.

Therefore, businesses should identify their specific vulnerabilities to Money Laundering and Terrorism Financing from the art and collectibles markets, implement an adequate internal organization, monitor these business relationships and question the effectiveness of their cooperation with authorities. Operationally, business should

design, implement, evaluate or review their customer and transaction due-diligence procedures for these markets.

A wealth of experience in managing proper lines of defence could be borrowed from the historical experience and expertise of the financial industry in combatting Money Laundering and Terrorism Financing.

144 <http://www.phillymag.com/articles/nathan-nicky-isen-art-philadelphia/>

145 He self identifies as curator of the Louis Icart Museum in Philadelphia (<https://www.linkedin.com/in/nathanisen>).

146 <https://www.justice.gov/usao-edpa/pr/villanova-man-charged-money-laundering>

147 <https://www.ice.gov/news/releases/philadelphia-art-dealer-charged-money-laundering-after-ice-investigation>

148 http://www.mainlinemedianews.com/mainlinetimes/news/former-villanova-resident-gets--plus-years-in-prison-for/article_825f204e-4233-5703-9d78-6d3052550eee.html

149 <http://www.phillymag.com/articles/nathan-nicky-isen-art-philadelphia/>

150 <https://www.theguardian.com/world/2016/jul/20/us-justice-department-1mdb-fund-seizure-fraud-investigation>

151 <http://www.cncb.com/2016/07/21/us-1mdb-lawsuits-link-malaysian-pm-najib-razak-to-stolen-money.html>

152 <http://www.finews.com/news/english-news/23804-van-gogh-monet-1mdb-seized-in-switzerland-freeport>

153 <https://news.artnet.com/art-world/leonardo-dicaprio-gives-pack-jho-low-picasso-basquiat-996377>

154 <https://www.theguardian.com/film/2016/aug/31/leonardo-dicaprio-wolf-of-wall-street-rainforest-charity-malaysia>

155 <https://www.hiscox.co.uk/sites/uk/files/documents/2017-05/hiscox-online-art-trade-report-2017.pdf>

156 Particularly in terms of customer due diligence (recommendation 22.1.c) and suspicious activity reports (recommendation 23.1.b).

157 "Money laundering and terrorist financing risks and vulnerabilities associated with gold", 20 Jul 2015, FATF. <http://www.fatf-gafi.org/media/fatf/documents/reports/ML-TF-risks-vulnerabilities-associated-with-gold.pdf>

158 "Money Laundering and Terrorist Financing through Trade in Diamonds", October 2013, FATF.

<http://www.fatf-gafi.org/media/fatf/documents/reports/ML-TF-through-trade-in-diamonds.pdf>

159 "Methodology for assessing technical compliance with the FATF recommendations and the effectiveness of AML/CFT systems", February 2013, FATF.

160 <http://www.fatf-gafi.org/media/fatf/documents/methodology/FATF%20Methodology%2022%20Feb%202013.pdf>

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Modernizing risk management in the art market:

the art market:

Applying a holistic approach across artwork, counterparties, and business practices

An esteemed New York gallery closes after tracking millions of dollars in forged pictures, including a fake US\$8.3 million “Mark Rothko” sold to a sophisticated auction house chairman for his private collection.¹⁶² A Washington museum forfeits to the U.S. Department of Justice looted antiquities that are consistent with the types of cultural property that Syrian-and Iraqi-based terrorists loot and monetize.¹⁶³ Each year, the FBI receives enough credible complaints about multimillion dollar fraud in the art market that it has to triage for response the most egregious.¹⁶⁴

Welcome to the 21st century art market. While the bullish market presents opportunities, it also poses significant risks. Threats across artwork, counterparties, and business practices—coupled with an expanding marketplace and complex regulatory regimes—converge to create a formidable terrain.

To thrive in this high-stakes and rapidly changing international art market, Deloitte urges businesses to modernize risk management strategies and capabilities. Art market stakeholders should apply forensic due diligence to significant transactions, and view all business activities through a lens of strategic risk and reputation. This brief article suggests an approach to managing risk in the art market that will increase enterprise resilience and client confidence, as well as differentiate organizations from competitors who don't proactively mitigate risk.

Modernizing risk management is especially important at the high end of the market, where financing, acquiring, managing, insuring, or selling artwork represents not just aesthetic or social capital, but financial, reputational, and operational capital. Imagine the consequences of loaning against a masterpiece, only to learn, when the borrower defaults, that the collateral is fake. Or imagine the reputational impact of mistakenly auctioning an antiquity that U.S. forces discovered amid inventory recovered from the Islamic State's late financial chief, Abu Sayyaf.¹⁶⁵ These hypothetical scenarios reflect real risks in the art market, and should spur a review of acquisition and other relevant policies across the art world.

Historically, the art market protected itself primarily through engaging only a relatively small group of people, most of whom knew each other if not directly then by referral. This approach might have served the market well during art dealer Bernard Berenson's reign in the first part of the 20th century, but not so today: Art world "insiders" perpetrated approximately 87 percent of all art authenticity frauds investigated by the FBI during the last three decades.¹⁶⁶ In most of these frauds, such as the one that closed the formerly venerable Knoedler Gallery in New York City, victims conducted little if any independent or technical due diligence.

Gone are the days when visually inspecting artwork, engaging accredited experts, and transacting with known counterparties could adequately ensure a positive business outcome. Today art businesses must adopt a more holistic, data-driven approach to risk management that considers artwork, counterparties, and business practices; draws on diverse sources of information (e.g., catalogue raisonné, OFAC Sanction lists, and Lexis-Nexis); and uses modern analytical methods that leverage the power of technology. Doing so won't eliminate all risk (i.e., risk will never be zero), but will help mitigate risk to acceptable and achievable levels.

¹⁶² <https://www.nytimes.com/2016/02/11/arts/design/knoedler-gallery-and-collectors-settle-case-over-fake-rothko.html>

¹⁶³ <https://www.nytimes.com/2017/07/06/opinion/hobby-lobby-iraq-artifacts.html>

¹⁶⁴ The author served as the FBI's chief intelligence officer for art crime from 2013-2016.

¹⁶⁵ https://eca.state.gov/files/bureau/final_presentation_to_met_on_isil_antiquities_trafficking_for_daskeller_9.29.2015_.pdf

¹⁶⁶ Patten, Laura S. "Painting Red Flags: A Typology of Art Fraud and Risk Indicators." Sotheby's Institute of Art. New York City, 2016.

Art market stakeholders should apply forensic due diligence to significant transactions, and view all business activities through a lens of strategic risk and reputation.

Consider artwork itself. It's important to know which types of objects merit extra vetting, so that businesses can adjust risk management resources accordingly. As a commodity, an artwork's value depends upon its authenticity, provenance, condition, rarity, and market variables such as taste and context. The late Metropolitan Museum of Art Director Thomas Hoving estimated that 40 percent of the artwork he handled (and presumably did not acquire) was fake or otherwise "wrong," to use the trade parlance for artwork of suspect origin or quality.¹⁶⁷ As a result of vulnerabilities associated with artwork, the trade routinely employ specialists who are charged with extensively researching and assessing artwork. The market has long recognized that certain artworks are more problematic than others, e.g. a European painting whose chain-of-ownership vanishes during the Nazi era is a riskier object than a unique contemporary sculpture created by a living artist. Toward that end, therefore trustworthy art business typically vet artwork, not just for physical and historic traits, but also against commercial and government stolen art databases, ICOM Red Lists, import/ export regulations, and other legal/policy regimes governing cultural property. For certain particularly risky or high value pieces, stakeholders should consider adding forensic investigators to the battery of art historians, connoisseurs, and other subject matter experts who normally assess the

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physicality and history of artwork. Just as scientific innovations help advance the creation of new art forms (think Jeff Koons' balloon sculptures), technology can help advance the authentication or repudiation of existing artwork. Signaling that such technical inspection is no longer an afterthought, in late 2016 Sotheby's acquired Orion Analytical to start an in-house scientific research department.¹⁶⁸

Next, **consider counterparties.**

Counterparties are particularly tricky to vet in the largely self-regulated, opaque, and clubby art world. Key stakeholders—especially the ultra-high-net-worth individuals and businesses that drive the market—want and maintain privacy, mostly for legitimate reasons. Unfortunately, nefarious players have repeatedly exploited the trade's "handshake" culture to infuse onto the market illegally-generated monies, or fake, stolen, or otherwise undesirable material. Therefore, after verifying a counterparty's identity and assets, art businesses should explore a host of cascading questions based on a typology of art frauds identified that rose to criminal prosecution in the United States. For example: Are there any indications that the counterparties committed Foreign Corrupt Practices Act violations? Do any of the counterparties cohabitate with a person previously convicted of art fraud? Does a counterparty require request anomalous payment structures? Does a counterparty profess access to a large cache of masterpieces artwork previously unknown to those experts who regularly track such collections? These questions might seem

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pedestrian, but con-artists succeeded in large part because they build rapport and trust with their targets, and often operate long-term schemes; i.e., a mugging victim knows he's being mugged, while a victim in the art market usually doesn't discover he's been victimized until a long time after the moment of exploitation, be it a sale, loan, or other deal.

Moreover, a review of more than three dozen convicted or self-professed white-collar criminals in the art market indicates that most present themselves as well-educated art aficionados, superficially indistinguishable from the honest brokers they emulate. It is easy to overlook a human threat from people who resonate with one's own interests, appearances and social-behavioral norms. For example, a counterparty might appear benign in all respects until arranging payment methods. U.S. court documents show that in many art-related frauds, con-artists requested multiple tranche payments, just under legal reporting thresholds; wired funds to off-shore accounts that do not align with places-of-residence; and made other unusual transactions that might serve as red flags. Collectors, dealers, bankers – really anyone who has access to, or a stake in – the art market, is a potential target for these charlatans who hide in plain sight. Thus, to reinforce defenses, stakeholders must (a) understand their own vulnerabilities to con-artists and (b) acquire an understanding of swindlers' *modus operandi*.

Finally, **consider overarching business practices.** For reasons noted above, the art market is moving away from its traditional handshake culture to one that, while valuing and encouraging freedom in artistic creation on the creative side of the house, values risk mitigation and assurance on the business side of the house. As the art world becomes more complex, and

threats become more difficult to detect, so business tools and techniques must become smarter and capable of adjusting to evolving environments. From Deloitte's point of view, the most important step an art enterprise can take in this regard is to design and implement a business-wide risk management methodology. Adopting commonsense procedures such as those advocated by the Geneva-based Responsible Art Market Initiative¹⁶⁹, the New York-based International Foundation for Art Research¹⁷⁰, and other nonprofit organizations, will certainly help enterprises identify and manage obvious risks. Introducing computer-enabled algorithms and analytics, process robotics, artificial intelligence, and other cutting-edge enablers could will help identify and manage less obvious risks—many of which only become apparent through the correlation of multiple, discrete pieces of information.

Quick responses, real-time data feeds, and analysis of Potential Risk Indicators (PRIs) across object, people and transactions, are imperative to staying in front of fake artwork, exploitative counterparties, and other business problems. Detecting, investigating, and triaging anomalies as early as possible will help businesses halt the forward motion of threats before assets, financials, and reputations, are compromised. Failure to take such a risk-based approach can increase vulnerabilities and leave the organization enterprise exposed to untenable risk. Some forward-leaning art businesses already are taking adopting best practices and lessons learned from criminologists and the post-9/11 financial industry; . As in other international cross-border trades, these more trusted art business firms will adhere to rigorous anti-money laundering (AML) and know-your-client (KYC) standards. Staff will conduct, or outsource to objective third-parties, due

diligence that combines best commercial intelligence and investigative techniques. This involves extensive analogue and cyber due diligencereserch, including scouring a wide range of open source and subscriber data for alerting associations, patterns, and behavior. Assessing these specific risk-factors with a wide aperture of information and mitigating actions, – such as subjecting an object to forensic testing to withdrawing from deal, – provides the holistic approach we believe is needed in today's art world.

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168 <http://www.prnewswire.com/news-releases/sothebys-announces-the-acquisition-of-orion-analytical-and-the-appointment-of-james-martin-as-director-of-scientific-research-300372670.html>

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Reducing risk in art transactions

Most collectors are familiar with the transaction risks associated with pricing, authenticity, condition, provenance, and title. But there are two underlying, interrelated issues that can cause or increase the probability of these risks: conflicts of interest and a lack of unbiased expert advice.

In the art world, free advice may be worse than no advice and failing to seek independent expert opinions may result in costly mistakes. Without transparency in relationship and transaction advice, it can be difficult to safeguard against influences or conflicts that run counter to the art collector's interests.

Collectors often seek information and advice from a variety of sources, including dealers/galleries, auction house personnel, art advisers, scholars/curators, appraisers, and conservators. The overwhelming majority of these professionals are knowledgeable and trustworthy, and when issues arise they are usually the result of misunderstandings, rather than nefarious intentions. But collectors can protect themselves from potential problems in three ways: by seeking independent, third-party advice from appropriate professionals, clearly defining expectations and compensation in adviser relationships, and insisting on transparent transactions backed by comprehensive written contracts.

Choosing the right professional

In the case of appraisals and research for significant artworks, collectors should consider hiring their own experts rather than relying on the information provided by parties who may have a vested interest in the outcome. For example, a gallery may tend to overestimate market value or overlook the defects of works they have sold to an art collector, and an auction house may under or overvalue works to gain favor with an art collector. In a recent case, the US Tax Court rejected an auction house's valuations of two paintings, finding, among other things, that the auction house specialist's appraisals were tainted by a conflict of interest because the specialist was hoping to secure the consignment to auction the artworks.

It is also essential to engage appraisers specializing in the specific type of artwork in question to avoid issues relating to misattribution and undervaluation. For one museum, failing to obtain an expert third-party appraisal led to a loss of over US\$1 million when its rare Chinese vase was sold by a regional auction house for US\$23,000; the vase was quickly resold in Hong Kong for over US\$1.5 million. When seeking valuations, it is important to look for certified appraisers who are members of accrediting organizations; in the US, the relevant bodies are the International Society of Appraisers (ISA), the American Society of Appraisers (ASA), and the Appraisers Association of America (AAA).

The same principle holds for condition reports. When considering a significant art purchase, it is prudent to commission an independent report rather than relying on those provided by the seller, gallery, or auction house. Not all condition reports are equal in quality, reports can become obsolete quickly, are done for a variety of reasons, and are not always prepared by trained conservators. Indeed, terms and conditions for auctions warn that buyers should not rely on auction house condition reports and should consult their own experts. Collectors should look for conservators with solid training and credentials who are accredited by professional groups such as the American Institute for Conservation of Historic and Artistic Works (AIC).

Scholars and curators can also be essential resources when researching potential acquisitions. Mr. and Mrs. De Sole's recent dispute with the Knoedler gallery illustrates how important it is to obtain independent expert advice. Because of its reputation, the De Soles relied on documentation provided by the gallery and did not seek third-party expertise when purchasing what turned out to be a fake Rothko.

Collectors often develop long-term relationships with individuals who advise on transactions and collection development. These advisers may be dealers, auction house personnel, independent art advisers, or other art professionals. In these relationships, divided loyalties can sometimes arise due to the adviser's fiduciary responsibilities to other parties, such as artists or consignors. Collectors should evaluate all advice in light of potential conflicts of interest, and may want to consider hiring an independent art adviser who is a member of a professional organization such as the Association of Professional Art Advisors (APAA). Members of this group agree to adhere to standards that put the art collector's interests first and forbid practices that can lead to conflicts of interest.

Transparency versus conflicts of interest

Conflicts of interest in the art world often arise from undisclosed commissions or payments. These are common in the art market; for example, in the De Sole case, media accounts of the testimony suggest that the De Soles may not have been aware that their adviser had added a commission for himself on top of the US\$8.3 million price for the forged Rothko.

In addition to commissions incorporated in purchase prices, undisclosed payments can take a variety of forms, including introductory commissions, kickbacks, or double commissions—when an adviser receives payment from both sides of a transaction. Kickbacks paid to influence an adviser's recommendations are obviously problematic; however, double commissions and introductory commissions paid by dealers and auction houses to advisers who bring in clients or business are not intrinsically detrimental. But, if hidden, they may affect the quality of advice or seriously affect the art collector's net profit or purchase costs; for this reason, these commissions should always be disclosed.

In the art world, free advice may be worse than no advice and failing to seek independent expert opinions may result in costly mistakes.

One of the myths of the art world is that confidentiality is always the best policy.

One of the myths of the art world is that confidentiality is always the best policy. In fact, confidentiality can work to the art collector's detriment by hindering adequate due diligence for authenticity, title, and money laundering. The desire for confidentiality is often cited as the justification for intermediary contracts and net-to-seller agreements, but unfortunately these agreements can also result in conflicts of interest with serious consequences.

Intermediary contracts in which the adviser purchases the work from the seller and then resells to the buyer create opportunities for price mark-ups and fraud; as shown by two recent examples: Dmitry Rybolovlev's allegation that he was overcharged by as much as US\$1 billion by his adviser, and the case of Lisa Jacobs who defrauded her art collector out of US\$1 million on a US\$6.5 million sale.

In net-to-seller or net-return agreements, the art collector agrees to a net price and allows the dealer or adviser to pocket any difference above that amount. This can create an incentive for dealers and advisers to undervalue artworks to increase their own profits and may also result in huge transaction costs when artworks are offered through successive dealers with undisclosed commissions added at each step. The Accidia Foundation experienced this first hand when it received only US\$5 million on a US\$7 million sale after several adviser/dealer commissions were deducted.

To avoid these issues and promote transparency in a long-term art advisory relationship, it is helpful to create a written agreement that defines the adviser's responsibilities and compensation and requires disclosure of, or possibly limits, related payments the adviser may collect. For transactions, especially those for which there is no preexisting advisory agreement, collectors can protect themselves with written purchase and sale agreements between the ultimate buyers and sellers, which include protective warranties and language regarding commissions.

Conflicts of interest in the art world often arise from undisclosed commissions or payments.

It bears repeating that most collectors never experience serious problems and most art professionals are ethical and professional. But by hiring the appropriate independent experts, avoiding conflicts of interest, and requiring transparency, collectors can avoid or reduce the most common art transaction risks.



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Unlocking the art world: Navigating the peaks and troughs of a mystifying market

Entering an art fair for the first time is a disorientating experience. Everything you see is vying for your attention, imagination, and inevitably, money. The daunting task of the new buyer is to negotiate this maelstrom, often with only the faintest inkling that perhaps what is on display is not necessarily all that is on offer, not knowing that seeming bargains are not necessarily sound investments nor that there can often be a discrepancy between the monetary and artistic value of an artwork.

A new buyer at his or her very first art fair may stop at a certain booth and behold a brightly colored abstract canvas. This work has caught his or her eye for the simple reason that he or she “likes it,” without any reference to the artist’s background or artistic context. From an outsider’s perspective, it may seem that there is neither harm nor foul in purchasing said

work to satisfy one’s aesthetic impulse, just as one might purchase any other decorative item to adorn one’s household. The knowledge required to know whether this canvas, so coveted by the new buyer, has long-term market and artistic value beyond its decorative qualities may not be of any interest to the buyer. As with novices in any new industry, budding collectors are endowed with beginners’ luck that may enable them to maintain objectivity and lead them to become a trailblazer of taste and fosterer of new talent. Unfortunately, more often than not, this innocence is likely to make them vulnerable. Even extremely experienced buyers have suffered from the pitfalls of a bad deal and a changeable market. Many collectors have been taken in by a work in bad condition, or with a questionable provenance or—worse still—trusted implicitly in the hype surrounding the latest artist at the vanguard of contemporary style.

It is undeniable that art has set itself apart as an asset class from other investment opportunities. The market, though subject to downturns, is a stable, durable and long-lasting alternative to investing in property, gold, or stocks. This, inevitably, brings a certain type of buyer to the market—one whose interest is purely financial—and this buyer will require different advice from the high-end art collector whose investment in art is both for pleasure and to turn a profit. There is, therefore, above and beyond the competition between dealers, galleries, and auction houses to sell their works, a drive to find the best advice money can buy to secure the most lucrative investment or the most distinguished collection.

However, regardless of the new buyer's approach to purchasing artwork, the best advice will always remain the same and is perhaps the direct opposite of what one might suppose. The best advice to give a new buyer is, in fact, not to buy but instead to look, to cultivate the perfect eyes, nose, and ears for appreciating artworks and the art market. Investors and collectors must be patient and begin by looking, taking note of what is on offer, and where and when certain artists make the biggest impact. They should become familiar with the names and styles around them and when they feel satisfied with their knowledge of movement, taste, art history, gallery history, and primary and secondary markets, they should go back and look again. It is essential to foster an obsessive drive for research when sourcing and acquiring a desired piece.

There is no great secret to success in the art world; if anything, the greatest pitfall is that people are often so busy looking for a nonexistent catch they end up ignoring the obvious factors that are constant obstacles to making a worthwhile purchase. These obvious factors are what any good adviser would thoroughly assess as part of the due

diligence process. Provenance, exhibition history, price compared to comparable works and the rarity of the piece within the artist's oeuvre are just a fraction of the type of precise questions that must all be thoroughly resolved before a purchase can be completed. The longer one looks, the more knowledge one accumulates, and the easier it becomes to answer these obvious but indispensable questions.

However simple this process may seem, new buyers tend to be impatient, wanting to act on their own ideas and harbor suspicions about hiring an adviser. Investors who have found success in alternate asset classes may fancy themselves capable of navigating the art market without the need for such a slow and calculated approach. While there is an element of speed that must be observed, buying from up-and-coming artists while you can still afford them is the cornerstone of starting any good art collection and time spent fostering relationships with people in the artworld is key. This is perhaps the greatest and most long-term investment you can make, honing one's senses to appreciate the art market is always best done collaboratively with an art adviser whose connections, experience, and expertise are the most valuable assets on the market.

If new buyers follow these steps—time and patience, advice and due diligence—their chances of success are manifold, likely not only to produce high-end results, but also to nurture a passion for art that truly enriches their lives.



Recommendation to buyers before completing a purchase

Check :

1. Provenance
2. Exhibition History
3. Price Compared to Comparable Works
4. Rarity of the Piece within the Artist's Oeuvre
5. Condition of the Work

It is undeniable that art has set itself apart as an asset class from other investment opportunities.

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