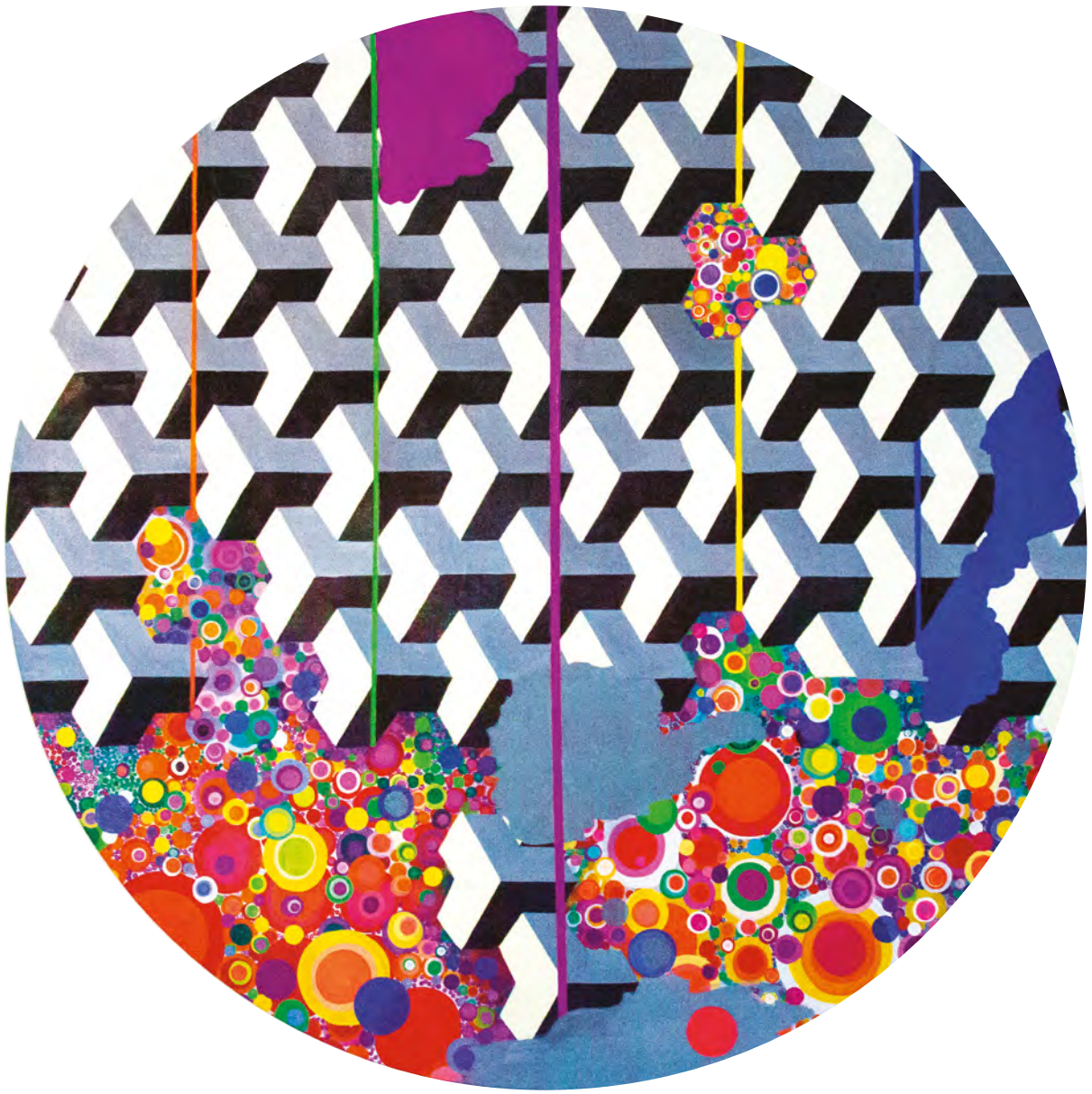
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Art & Finance Report 2019

6th edition

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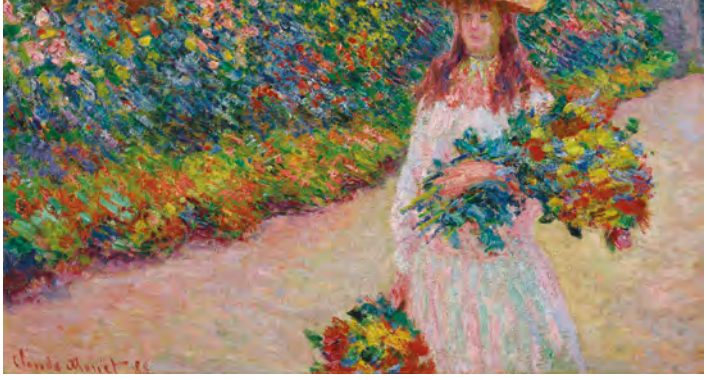
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Foreword





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

Anders Petterson
Managing Director
ArtTactic
London

We are delighted to present the sixth edition of the *Deloitte Art & Finance Report*.

Since launching the initiative in 2011, we have seen the global art market ebb and flow: from the aftermath of the financial crisis to the peak of the market in 2016. In parallel, we have also monitored how the wealth management sector is increasingly responding to competitive pressures in its own industry, and the role art and collectible wealth are playing in the transition to a more holistic wealth management model.

Since our last report in 2017, external factors such as increasing political and economic uncertainty, rapid technological progress, climate change, and social inequality have dominated the headlines on a daily basis. We live in a changing world, fraught with uncertainty. This is the context in which we should view the global art and finance industry—the crucial intersection between culture and wealth.

With the advent of the millennial collector and an immense transfer of wealth on the horizon, new ideas and models in the art and finance industry are required. This year we have covered trends in social impact investing, and taken a closer look at how these models are currently working within the art and cultural sectors. We have focused on the opportunities these models offer and how they could be adapted to a broader wealth management strategy. We have also explored the strong interdependencies that exist between the art and finance ecosystem and the cultural and creative industries. Finally, we have examined the fifth EU anti-money

laundering directive and its implications for the art market. We are proud to see that the art and finance topic is slowly but surely gaining traction within the broader Deloitte network and we welcome contributions to the report from more and more Deloitte offices. We thank Deloitte Russia, Japan, Netherlands, Germany, Monaco, China, Hong Kong, Italy, Canada, United States of America, Belgium, France, United Kingdom, and Switzerland for their input in this edition.

This report identifies the need for more education and stresses that more information and research are required if we are to make the case for change. This year's findings show that fewer collectors and art professionals feel they are aware of developments in relation to art as an asset class this year compared with 2017. The wealth managers surveyed said the same, with just under half (54 percent) describing themselves as "aware" or "very aware" of what is happening compared with 57 percent who said the same in 2017. This could reflect that there have been fewer developments in the areas of art investment (such as art investment funds) and art-secured lending (fewer operators and more consolidation). Conversely, however, we have seen rapid progress in technology (blockchain and AI) and art-related regulations (such as anti-money laundering legislation).

These new trends are fundamental to the future well-being of the art and finance industry and the evolution of art as an asset class.
This suggests that the art and finance industry needs to do more to raise awareness and educate its stakeholders about key developments and broader issues in relation to art-related wealth and how they will shape the future trajectory of the sector.

We hope that this report will help to raise awareness of the developments and initiatives that have emerged within the art and finance industry over the past couple of years. Transparency, regulation, and technology trends will play an important role in the future of the art and finance industry. However, a collaborative approach between all stakeholders (art professionals, collectors (young and old), and wealth managers) is essential if we are to address the pressing issues and challenges we face, particularly as regards increasing trust in the art market today and in the years to come.



We are honoured to feature the dazzling works of visual artist **Lina Sinisterra** in this edition of The Art & Finance Report. An award-winning artist from Colombia, she has enchanted fellow artists, collectors, and gallery curators from all over the world.

The vibrancy and colour of her pieces mirror the dedication and passion for what we at Deloitte create on the canvas of our industry. In light of this collaboration, we would like to thank Sinisterra for providing the ideal palette to our survey.

Above:
Big Bang - Excéntrica © Lina Sinisterra (2014)

Below:
Comer del Arte Quiero © Lina Sinisterra (2010)



Introduction

Since the last edition of the *Deloitte Art & Finance Report* in 2017, the art market has experienced 18 months of positive growth.

The recent results from the major auction houses show that auction sales slowed by 20 percent in the first six months of 2019 (based on results from Sotheby's, Christie's and Phillips). This could signal that the art market is heading for a period of weaker growth, as both the uncertainty surrounding Brexit and the US trade war with China take their toll on the global art market.

Growth trends in the art market in recent years are also a cause for concern because they have failed to keep pace with the growth in global wealth (see p.48 for analysis). Why are we not seeing a higher correlation between wealth generation and the size and growth of the art market?[1] What is holding wealthy individuals back from investing more of their wealth in art as an asset class?

We will attempt to explore and answer these questions in this report, but one critical challenge when it comes to broadening the appeal of the art market is a lack of transparency. In this year's report, 75 percent of collectors said that a lack of transparency was the biggest threat to the reputation of the art market, up from 62 percent in 2017. This is the highest reading we have observed since we first asked this question in 2016. If seasoned and established collectors say this is their main concern, one can clearly see why potential new art buyers and collectors might shy away from the art market and thereby fail to take advantage of the rapid growth in wealth.

This report covers two main trends that could drive the art market towards greater transparency. In section 5, we look at how technology has the potential to effect change in the art market and how many of the new ArtTech start ups aim to enhance transparency and trust, whether through the use of blockchain technology or by looking at ways to improve transparency through more data, better data analytics, and artificial intelligence. The other major development that will compel the art market to become more transparent is regulation, which we cover extensively in section 6. The main focus of this section is the implications of the fifth EU anti-money laundering directive, which will enter into force in January 2020 and is likely to have a significant impact on the art market and how it does business. Despite the challenges that this regulation will present, findings from other sectors and industries that have gone through similar transition periods (the diamond industry is discussed on p.241) suggest that the reputational benefits of a more transparent and professionally compliant environment ultimately create more trust and favor the expansion of the market beyond its current boundaries.

So maybe regulations and the rapid pace of technological changes are exactly the ingredients the art market needs to grow and expand beyond its existing client base. Maybe a more regulated, professional, and transparent art industry will generate more trust and interest among wealth managers who, in turn, will develop new art and wealth management services and become stronger advocates for art as a viable asset class. There is strong evidence of this in the US where, for example, the legal framework (e.g., the *Uniform Commercial Code (UCC)*) has supported the growth and development of the world's largest art-secured lending market.

1 We have defined growth in the art market by using figures published by Art Basel and UBS in their Global Art Market Report 2019. The report publishes sales figures based on auction results as well as estimated dealer and gallery sales.

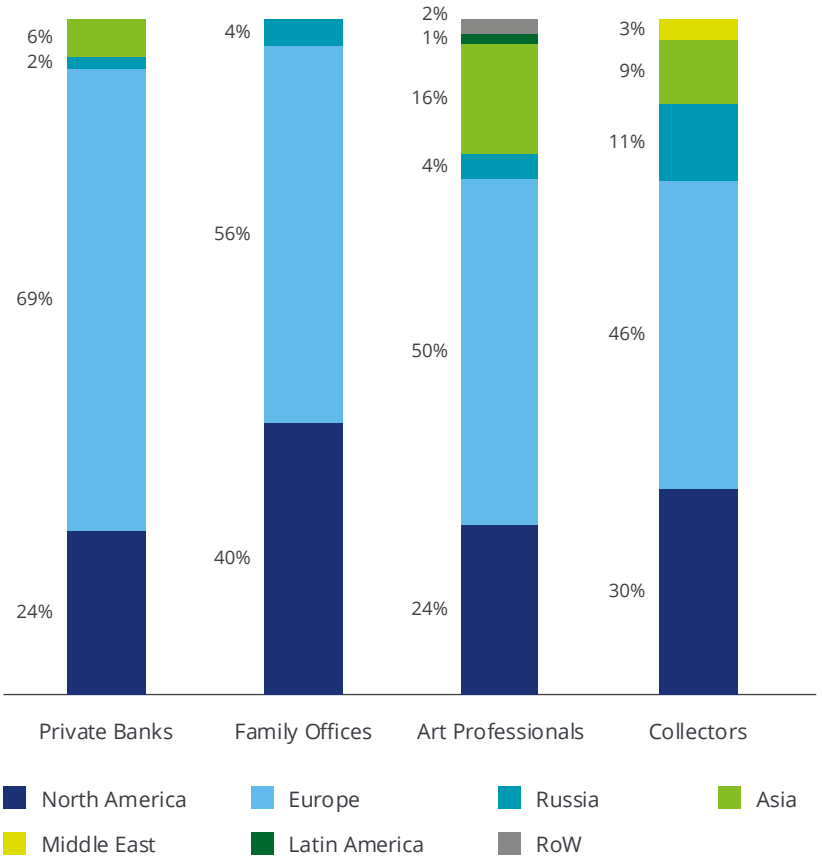
We would also like to highlight the growing interest and opportunities associated with social impact investment in the cultural and creative sectors. As we show in this report, these are likely to play a more important role in the development of the art and finance industry in the future.

We hope that this year's edition of the *Deloitte Art & Finance Report* follows in the footsteps of its predecessors by providing a forum in which art and finance industry professionals can express their concerns and needs, in addition to suggesting ideas and possible solutions as to how these issues are best approached. As ever, the main aim is to forge and foster long-lasting relationships within the Art & Finance world.

Methodology and limitations

Deloitte Luxembourg and ArtTactic conducted the research for this report between April 2019 and June 2019. We surveyed 54 private banks (down from 69 in 2017), and 25 family offices (down from 27 in 2017).

As in previous years, we conducted research among other important stakeholders in the Art & Finance market, such as art collectors and art professionals (galleries, auction houses, art advisors, art lawyers, art insurers, art logistics specialists, etc.). A total of 138 art professionals (down from 155 in 2017) and 105 major art collectors participated in the survey (down from 107 in 2017). These stakeholders from Europe, the US, the Middle East, Latin America, and Asia were surveyed on a variety of topics relating to art as an asset class, their motivations, current and future involvement, challenges, and opportunities.



Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

Sample	2011	2012	2014	2016	2017	2019
Private banks	19	30	35	53	69	54
Family offices	0	0	14	14	27	25
Art collectors	48	81	90	94	107	105
Art professionals	140	112	122	126	155	138

SAMPLE DIFFERENCES: We are aware that each year's results may be affected by variations in the sample size and the geographical location of the wealth managers responding to the survey. 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 survey included 53 private banks (38 from Europe, nine from the US, and six new banks from Dubai) and 14 family offices (with eight new family offices from the US). In 2017, Deloitte Luxembourg and ArtTactic surveyed 69 private banks (of which five were art-secured lenders) and 27

family offices. In this year's survey, our sample included 54 private banks (69 percent from Europe, 24 percent from the US, 6 percent from Asia, and 2 percent from Russia). We also included 25 family offices (40 percent based in the US, 56 percent in Europe, and 4 percent in Russia).

We would like to take this opportunity to express our heartfelt thanks to all the survey participants: without their enthusiasm and support, this report would not have been possible.

Section 1 of the report sets out our findings in relation to the outlook for the various art markets. These were based on qualitative Art Market Confidence Surveys that ArtTactic sent out to 365 international art collectors, art advisors, galleries, and auction houses in May 2019. This section also includes auction data analysis of various modern and contemporary art markets. It 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 present the survey findings within the wider market context, we have given a broad, international overview of recent developments across various regional modern and contemporary art collecting categories. Most of the data was collected from Sotheby's and Christie's, as they cover the majority of the modern and contemporary art collecting categories discussed in this section, although auction data from other leading auction houses is included for certain regional markets such as those in China, India, Russia, and Africa.

In the art investment section of the report (section 4), we present analysis from artnet and Sotheby's; for more information on the methodology used, please refer to p.140.

We have expanded the regulatory section (section 6) this year to shine a spotlight on the new EU anti-money laundering regulation entering into force in January 2020.

Deloitte Luxembourg and ArtTactic recognize that the findings are indicative and understand their limitations. However, we believe that the results broadly reflect the perceptions and attitudes that exist in the global wealth management and art professional and collector communities.

External contributions
We are delighted to be able to present contributions from leading experts in this field in this report.

Like its predecessors, this report features a wide array of interviews and contributions from leading figures in the art and finance industry. We are extremely grateful to them for the following 48 contributions:

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Kate Vasilieva, Co-founder/president, F.A.R.E Consulting GmbH; Kate Vass Galerie GmbH (Founder, Creative Director); Tom Rieder, Co-founder and Vice President, CEO dloop, Founder NOOW.ART

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Bernadine Bröcker Wieder, CEO/Co-founder, Vastari Group

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Claude Herrmann, Executive Manager at Fine Art Logistics, Le Coultre S.A.; and Carole Schmitz, Commercial & Events Director at Le Freeport Luxembourg

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In November 2018, Deloitte CIS announced the launch of the Deloitte Art & Finance service line, which would provide Russian art-market players—collectors, museums, art galleries, art dealers, and artists, as well as our existing clients from family offices and private banks—with professional legal, tax, customs, and other services. This service line would operate under the umbrella of Deloitte Private, CIS, and be run by Svetlana Meyer, managing partner of Tax & Legal, CIS.



Svetlana Meyer
Managing Partner, Tax & Legal
Deloitte CIS

Drawing on Deloitte's vast experience in legal, tax, and customs services, the team offers end-to-end services for the Russian art market, such as blockchain-based solutions, market research, fine art logistics (in partnership), forensic services, etc.

Among the tax and legal services that Deloitte CIS offers to art market players are general business and labor law advisory services, legal due diligence, drafting of sale and purchase contracts and agreements with artists, restorers, and art dealers (agency and licensing agreements, etc.), comprehensive tax assistance for businesses supporting the art market, and the preparation of individual statements reflecting income from the sale or use of artworks. We also provide legal and tax advice on patronage, donation, grant and investment raising; assist with dispute resolution and help to develop special loyalty programs.

Our forensic services include business partner due diligence (reputation, assets, beneficiaries, relevant expertise, relationships, and contacts), affiliation checks for transaction parties, and due diligence on previous owners of artworks. Our specialists review art transactions for AML purposes as well as sanction and corruption risks and offer recommendations on effective anti-corruption and bribery controls, professional accountancy support, and other related services.

Part 1

Deloitte CIS Russian Art market analysis

The Deloitte CIS research approach is to provide extensive support to businesses in sectors that lack transparency, including the art industry in Russia. We use unique data collection and analysis techniques



Yuliya Bolshakova
Senior Consultant
Global Employer Services/PCS Department/Art & Finance Coordinator
Deloitte CIS

The rise of online auctions represents an outstanding opportunity to drive up turnover in the low-cost segment (up to ₽100,000 per artwork).

that guarantee high data quality and help to identify trends and profile diverse target audiences and business sectors. The data we gather is guaranteed to remain relevant for at least two years. On top of that, we provide updates and supplement the findings, if necessary.

The Russian art market has its own peculiarities. Before the official launch of Art & Finance in Russia, our specialists did some fieldwork and interviewed market players. Here are some of our key findings:

- Confidence in how prices are set on the Russian art market is dampened by limited market analytics and low transparency (especially for non-auction transactions).
- Low-priced and fast-selling works dominate in the Russian contemporary art segment. Local market players tend to have a more short-term outlook, looking to make quick returns in a fast-moving market.
- Market growth is held back by muted middle-class activity. The art market is very sensitive to macroeconomic shocks, which are a key concern for Russia's emerging middle class. The average art spend in Russia, at approximately ₽100,000 (roughly €1,340), is currently insufficient to support a large, professional, and investment-oriented market.
- Russian buyers are generally more emotional than rational, with contemporary art purchases often guided by personal taste. However, there are tentative signs that they are moving towards a "collector" mentality, i.e., buying art based on its historical value or the reputation of the artist (big names, exhibitors at international art fairs, etc.).
- Sellers sometimes overestimate the resale value of their works or hold off selling indefinitely due to the emotional nature of the initial purchase.
- Lax legal protections undermine trust among stakeholders on the art market: galleries are sometimes reluctant to invest in artists as, unlike the situation in the West, contractual violations are rarely punished in Russia (e.g., for selling artworks without a gallery's consent).
- A home-grown network of professional art critics is still maturing.

Encouraging trends on the Russian art market:

- Transparent communication is opening up among market players, which increases efficiency and trust.
- Professional art criticism is continuing to develop and mature, driving up quality and interest.
- Local galleries are making positive strides towards boosting their appeal with up-and-coming young artists, recognizing the need to compete with the opportunities and support offered by their European rivals.
- After years of mistrust, all players are coming to a consensus that market relations need tighter regulation and are taking tentative steps towards tackling key issues.
- The rise of online auctions represents an outstanding opportunity to drive up turnover in the low-cost segment (up to ₽100,000 per artwork); this sector has huge potential in Russia's current economic climate.
- Artists are becoming increasingly aware of the commercial aspects of the art world.

The official launch of the Art & Finance service line in March 2019 and the public discussion that Deloitte CIS organized brought together many Russian art-market players and clients of Deloitte CIS. To name just a few, our guests included representatives of *The Art Newspaper Russia*, Gazprombank, Mercury Group, VAC Foundation, Russian State Tretyakov Gallery, MMOMA, PHILLIPS, Cosmoscow, InArt, top Russian galleries such as pop/off/art, Osnova, and Fragment Art Club. The discussion we had at the event and later findings confirmed that providing quantitative estimates of the contemporary Russian art market is no easy task due to the lack of transparency and the reticence of most stakeholders. The market capacity is estimated to fall within the range from €5.9 million in 2018 (based solely on the public reports of Russian auction sales at www.artinvestment.ru—this figure has met with some criticism, as it only covers about 10 percent of the market) to €22.4 million (based on the InArt report mentioned below).

For the time being, Deloitte CIS will not attempt to estimate the size of the market; instead, the team is focusing on getting to know art-market players better, understanding their needs, and determining how Deloitte can draw on its professional services expertise to reinforce our position in the market.

Part 2

Russian art-market players on their initiatives

Inna Bazhenova grew up in Nizhny Novgorod, where she graduated from the Lobachevsky State University of Nizhny Novgorod (UNN).
In 2014, she acquired the English version of *The Art Newspaper*, as well as the entire international licensed network of its editions in the UK, Greece, Italy,



Inna Bazhenova
Publisher of *The Art Newspaper* international network, founder of the IN ARTIBUS cultural foundation, co-publisher of *The Russian Art Focus*, art collector

China, Russia, the USA, and France (the newspaper is distributed in over 60 countries in total). *The Art Newspaper Russia* is the only international art periodical in the country. The purpose of the publication is to spark Russian-speaking readers' interest in the international art world and to carve a niche for Russian art in the broader global context.

The IN ARTIBUS foundation is a non-profit organization whose mission is to research and promote classic and modern art. The foundation organizes art exhibitions in collaboration with museums, cultural foundations, and private collections in Russia and abroad. It also publishes art books. The foundation's exhibition space was opened in 2014 at Prechistenskaya embankment in Moscow.

The exhibitions organized by the IN ARTIBUS foundation include "Mikhail Roginsky. Beyond the 'Red door'", held as part of the 14th Venice architecture biennale's main program in 2014; "I wished to work in the manner of Callot"; "Vladimir Weisberg"; "Boris Kasatkin" and "Late Mashkov". All of these formed part of a project dedicated to the Moscow school of painting (in collaboration with The State Tretyakov Gallery, The State Russian Museum, and regional museums of the Russian Federation). Among other major shows organized by the foundation are "Mikhail Roginsky. Farewell to the 'Pink fence'"; "Yuri Palmin. Winterreise"; "Inspired by Rome. For the 400th anniversary of Salvator Rosa and Gaspard Dughet" (in cooperation with The State Hermitage Museum, Pushkin State Museum of Fine Arts, and The Russian State Library); "Enlightenment Gothic. Vasily Bazhenov—Anniversary Year" (in cooperation with the Shchusev State Museum of Architecture); "Khardzhiev's Archive. Unique archive materials on Russian avant-garde and works from private collections"; "Sculptors' Drawings. Rodin. Maillol. Despiau"; and a few others. In January 2019, IN ARTIBUS foundation and The Pushkin State Museum of Fine Arts brought together their large collections of one of the most prominent Russian painters of the 20th century (Vladimir Weisberg) to present his monographic exhibition "Nothing but harmony" to the public.

Inna Bazhenova says: "IN ARTIBUS foundation is constantly engaged in the research and popularization of the world's classical art. We consider Russian art to be global art. We organize exhibitions of European and Russian

art and publish research and catalogues in cooperation with the major Russian state museums (the State Hermitage Museum, The Pushkin State Museum of Fine Arts, The State Tretyakov Gallery, etc.), as well as private collectors.

Together with respected institutions like Ca'Foscari University of Venice, the Art History Department at the University of Cambridge, and the Cambridge Courtauld Russian Art Centre (CCRAC), we hold scientific conferences and invite world-famous art experts. As a collector, I am pleased to provide items from my own collection to museum exhibitions anywhere in the world."



Denis Belkevich
Co-founder at FUELARTS, art analyst and economist, professional manager of cultural projects, art investment & collection management consultant

Previously, Denis served as managing director of the Contemporary Asian Art Fair at GAAB (Warsaw) and project manager of the Peter Konchalovsky Foundation (Moscow).
He currently serves as the international development advisor to Cube.Moscow, which is a non-commercial platform under the patronage of Dr. Uli Sigg (Switzerland). He is a regular participant at international conferences and forums on marketing, economics, and technology in art. Denis is also the author of educational programs and articles on museum marketing, art banking, ArtTech, career management for artists, and asset management.

As a program director, Denis has supervised several international art conferences, such as Art & Reality (2010-2012, St. Petersburg and Moscow), GAAB Collectors Summit (2017, Warsaw), and Cube.Collectors Summit (2019, Moscow). He founded the art and finance blog ARTFINEX and sits on the Board of the International Association of Asian Art Collectors. In 2017, he co-founded the Artherium startup: a collection management system based on blockchain technology. In 2019, Denis joined FUELARTS, the first ArtTech accelerator based in New York, as a co-founder along with Roxanna Zarnegar.

Cube.Moscow is a newly launched platform in Moscow, Russia (in 2019). It was designed as a response to the international art market's need for new sales channels. As the traditional gallery format gradually becomes obsolete, the attention of galleries is switching to sales at art fairs and online commerce. "Cube.Moscow is a special space, where galleries function like a year-round art fair. It is also an exhibition area and a place where educational programs are held. This platform type is attractive for emerging markets, where gallery businesses need open and daily communication. Besides, a new generation of collectors is being brought up and educated thanks to various educational projects.

The Cube.Collectors summit—the platform's anchor event held in April 2019—confirmed that the project was moving in the right direction. It gathered world-renowned international art functionaries and market strategists, who were among the speakers.

Today, the fastest and most effective way to attract international attention to local art is participating in international fairs. Cube.Moscow does this by gathering a pool of artists from the platform's resident galleries several times a year and exhibiting at fairs under a common brand. The next step for Cube.Moscow is launching educational programs and our own art market index," says Denis Belkevich.



Ksenia Podoynitsyna
Russian contemporary art-market expert and founder of InArt—a project that provides Russian contemporary art analytics

Ksenia founded Gallery 21 in Moscow in 2010. Since its inception, the gallery has collaborated with established and emerging Russian artists, such as Vladimir Dubossarsky, Sergey Shutov, Vladimir Arkhipov, Natasha Dahnberg, and Sergey Katran.

In 2015, Ksenia launched an educational course on how to price artworks at the Plekhanov University of Economics. In 2016, Ksenia presented the first analytical report on the market for contemporary Russian art in Moscow, Vienna, and London. In 2017, she released the first InArt ratings and launched the online platform in-art.ru. InArt provides information on contemporary Russian artists and Russian art-market developments, generates annual analytical reports, and maintains a market database, which includes top contemporary artists and art organizations working with Russian artists internationally.

Before taking up contemporary art dealership and research, Ksenia worked at Fleming Family and Partners, VTB Capital, and Deutsche Bank.

Ksenia earned her master's degree from ESCP Europe in 2009, majoring in Marketing and European Business. She earned her two bachelor's degrees in Economics, majoring in Finance and Credit, at the Russian Plekhanov Academy of Economics, and the University of Applied Sciences in Dresden.

> "The current crisis has shown that contemporary art is not a key priority for investors who are diversifying their assets or pursuing alternative investments."

Ksenia launched InArt in 2016 to help people navigate the contemporary art market, identify contemporary artists, and understand how much artworks cost and why, price trends, market size, and main drivers. The insights accumulated by InArt from 2009 onwards show that the right infrastructure and a high degree of transparency, delivered through reliable data, are essential if the Russian art market is to be brought into line with the international market more broadly.

Ksenia believes that data collection and analysis are important milestones on the road to setting high standards for the art business and elevating it to a global level. "The current crisis has shown that contemporary art is not a key priority for investors who are diversifying their assets or pursuing alternative investments. The crisis has served as a litmus test for the level of trust and loyalty among potential investors and is determining the future direction of the Russian art industry", says Ms. Podoynitsyna. That is why her team are working on systematizing quantitative data on the domestic contemporary art market, as it promotes higher transparency and a better understanding of pricing models and key trends. Ms. Podoynitsyna believes that this data also provides insights into investor loyalty and creates a positive trajectory for the market as a whole.

The data used by InArt to measure the size of the domestic market is public information on auction and gallery sales, and the revenue from the Cosmoscow Art Fair. At present, the InArt database contains records on around 1,500 contemporary Russian artists (including the publicly available auction sale

prices for 594 artists). InArt gathers data from 322 auction houses, including international giants such as Sotheby's, Christie's, and Phillips; MacDougall's (an auction house specializing in Russian art); Russian auction houses Vladey and Sovcom; and auction houses in Germany, France, Belgium, Italy, Switzerland, Austria, the United States, and other countries.

The platform provides data on domestic sales of Russian contemporary artworks. InArt believe that sales abroad are less impressive for several reasons, including the weak profile of Russian artists internationally. However, InArt is working hard to find a niche for Russian art within the global market. Although the results have been rather disappointing so far, InArt is making every effort to integrate Russian contemporary art into the global industry.

According to InArt, the main market drivers that influence the Russian contemporary art market are the following:

Here is how InArt pictures the evolution of the auction market for Russian contemporary art, based on their findings:

The national market has gone through three stages since the early 2000s:

- Emergence (2000–2005). Small market volume (max. €2 million per year).
- Explosive growth (2006–2008). The market grew more than tenfold over three years, followed by a sharp 85 percent decline to €4.21 million in 2009 due to the global financial crisis.
- Gradual recovery (2010 onwards).

The period from 2012 through 2014 saw short-term declines in sales, mainly due to the political and economic environment. There has been a steady increase in the number of lots sold since 2015, with a peak in 2018 (993 artworks sold representing an increase of 63 percent compared with 2017).
Based on an analysis of the auctions and Cosmoscow sales in 2018, as well as surveys of gallery owners and experts, InArt estimates that the Russian contemporary art market generated revenues of €22.41 million in 2018.

As for the auction sales forecast, InArt has developed two scenarios for the period between 2017 and 2024—one moderate and one optimistic—both suggesting gradual market growth.

- According to the moderate scenario, annual auction sales will reach €11.44 million by 2024 (i.e., the market will grow by 18 percent between 2017 and 2024).
- According to the optimistic scenario, annual auction sales will reach €14.29 million in 2024 (i.e., the market will grow by 47.5 percent over seven years).



- **Growth of Russian GDP, %**
- **Average annual RUB/EUR rate**
- **Annual inflation in Russia, %**
- **Purchasing power parity (RUB/USD)**
- **Average annual Brent crude price, USD**

- **Overall growth of the art market**
- **Growth in auction sales of post-WWII art**

- **Auctions**
  Number of auctions selling contemporary Russian artworks
  Number of lots exhibited
- **Art fairs**
- **Museums**
- **Galleries**
- **Media and insights**
  InArt uses media statistics to analyze media coverage statistics

SALES OF CONTEMPORARY RUSSIAN ART AT AUCTION

Key report findings 2019

Section 1

Wealth and the global art market

- **Anemic global art market growth in the past 10 years stands in stark contrast to growth in wealth:** Whilst HNWI financial wealth more than doubled between 2008 and 2018, from an estimated US$32.8 trillion in 2008 to US$68.1 trillion in 2018, global art market sales only saw a nominal increase of 9 percent over the same period[2]. This report looks at the challenges facing the art industry and how a lack of transparency is preventing the market from reaching a broader audience.
- **Is the art market heading for a slowdown?** The first half of 2019 has demonstrated that the art market is facing tougher conditions on the back of heightened political and economic uncertainty. Global auction sales from Christie's, Sotheby's, and Phillips were down 20.3 percent year-on-year in the first half of 2019.
- **Art and collectible wealth is estimated to be worth US$1.74 trillion:** In this year's report, we report that UHNWI wealth associated with art and collectibles was worth an estimated US$1.742 trillion in 2018, up from US$1.622 trillion in 2016. The projection for 2023 is that this will grow to an estimated US$2.125 trillion (see footnotes p.49).
- **Risk perception rose by 10 percent over the last 12 months:** The overall perception of risk in the art market increased by 10 percent by September 2019 from the previous reading in September 2018, with the ArtTactic Risk Barometer coming in at 7.0 (which was above its 10-year average of 6.4).
- **Record level of guaranteed sales in 2018**
  The use of auction guarantees has increased steadily, with the total value of guarantees in Post-War & Contemporary evening sales increasing from US$988 million in 2017 to US$1.29 billion in 2018. Guarantees have now become an "invisible hand" in the art market; on the one hand, they are a key indicator of investor sentiment and art market confidence, and, on the other hand, they represent a new source of art market risk (see section 1 p.56 for more information).

Section 2

Art and wealth management

- **Wealth managers forced to rethink the client experience:** Recent wealth management research[3] suggests that wealth industry stakeholders will have to change their business models and the relationships they have with clients. Value propositions focused on personal and emotional connections will become increasingly important as a way to stand out from the competition.
- **Holistic wealth management is a key driver behind the focus on art-related services:** The benefits of developing a holistic wealth management advisory service remain the key argument for service providers to include art and collectibles in their service offering. A large majority (83 percent) of wealth managers said that a desire to offer more holistic services to their clients was a vital motivating factor.
- **In general, stakeholders agree on the value of art as one aspect of a wealth management offering:** This year's findings show the highest reading since the launch of the survey in 2011, and a strong consensus among

2 The Art Market Report 2019 by Art Basel and UBS
3 World Wealth Report 2019, Capgemini

wealth managers, art professionals, and art collectors on the importance of art as one aspect of a wealth management service offering.

- **The wealth management community has introduced more art-related services for clients in recent years:** This year, 72 percent of wealth managers said they offered art-related services to their clients. This was up from 64 percent of wealth managers in 2017. This shows that more private banks and family offices are responding to client demand for more services.
- **Collectors increasingly see their art as an integral part of their total wealth:** 81 percent of collectors surveyed said they wanted wealth managers to incorporate art and collectibles into their service offering, which was up from 66 percent in 2017 and the highest reading since the report was launched in 2011. This suggests that collectors are increasingly seeing art and collectibles as part of their overall wealth.
- **Consolidated reporting is needed:** With a large majority (84 percent) of art collectors surveyed this year saying that they wanted to include art and other collectible assets in their wealth reports, there is strong demand for consolidated reporting. This could be an effective way for wealth managers to introduce an art-related wealth management offering and to be in a position to offer a proactive and meaningful value proposition to their clients.
- **Wealth transfer is boosting demand for art and estate planning services:** Most collectors (76 percent) said that estate planning would be the most relevant service for them (up from 69 percent in 2017). This indicates that collectors' top priorities are estate planning and generational wealth transfer, and art professionals strongly agreed with collectors on this point.
- **Art philanthropy and social impact investment are attracting more attention:** Another area in which the collectors surveyed this year said that they believed wealth managers could play a more significant role is art philanthropy. 65 percent of collectors said this would be a helpful service, up from 45 percent in 2017.
- **Urgent need to address art and estate planning issues:** With new transparency requirements due to enter into force, wealth managers must anticipate and adapt to upcoming changes. With more than a third of the private banks surveyed yet to discuss art-related wealth with their clients, addressing how art assets should be organized is now an urgent matter.

Section 3

Art-secured lending

- **Collector finance dominates the art-secured lending market:** The market for art-secured lending has grown over the past ten years, with the market size in 2019 estimated to be between US$21 billion and US$24 billion in outstanding loans against art. Based on existing research and interviews with art finance providers, we estimate the value of loans underwritten to collectors and private individuals to be between US$18 billion and US$20 billion, which represents around 90-92 percent of the overall art-secured lending market.
- **Art-secured lending ranks among the most popular art and wealth management services in 2019:** There seems to be a greater degree of interest

in art-secured lending among collectors this year, with 60 percent stating that this is one of the most relevant wealth management services, compared with 46 percent in 2017.

- **Collector demand for art-secured lending is on the rise:** 69 percent of collectors said they would be interested in using their art collection (or parts of it) as collateral (versus 57 percent in 2017).
- **European private banks are reluctant to offer art-secured lending services:** Despite significant demand for art-secured lending services among collectors and art professionals, only 26 percent of the wealth managers (32 percent of private banks and 13 percent of family offices) surveyed this year said that this would be an area of focus in the next 12 months. However, 80 percent of US private banks said they will focus on art-secured lending services in the next 12 months, compared with only 16 percent of European banks.
- **The lack of a legal framework is holding European art lending back:** The European art lending market has been affected by the fact that the notion of art as an asset class is less widely understood in Europe than it is in the US and that there is no uniform system of registering charges over chattels such as the US Uniform Commercial Code (UCC). Each European country has its own system and many of these systems are unsuited to the art-secured lending market as constituted in the 21st century. This has resulted in the US accounting for an estimated 90 percent of the global art-secured lending market.
- **The art-secured lending business has yet to reach the mainstream:** However, there is the potential for future growth in this area thanks to the development of regulations and new technology aimed at reducing risk and standardizing processes.

Section 4

Art as an investment

- **Positive returns in the art market between 2000 and 2018**: artnet's Index for Top 100 Artists produced an 8 percent Compound Annual Growth Rate (CAGR) between 2000 and 2018, compared with 3 percent for the S&P 500[4].
- **Art is thought of as an asset class that holds its value:** Across all collecting categories, art has a stronger positive correlation with the price of gold than with other asset classes reviewed in this study, indicating investors' perception of art as a value-preserving asset class rather than an investment vehicle[5].
- **Long holding periods:** Analysis of repeat auction sale data from Sotheby's Mei Moses suggests that works of art held off the auction market for at least ten years benefitted from the "holding period effect", in which works were more likely to be sold for a profit and had less volatile Compound Annual Returns (CARs).
- **With the visible global art fund industry not developing, new art investment models are emerging:** Fractional art ownership models/projects have emerged in recent years aimed at democratizing the art investment market.
- **Tokenization could become a catalyst for new art & finance initiatives:** While the existence of tokens in general, and digital tokens in particular, is not new, the speed with which these cryptographic tokens are being deployed and issued is an indicator that they could be the killer blockchain application many people have been waiting for. As such, tokens could become a catalyst for new developments in the art and finance industry.
- **Shift towards impact investing as the world faces ever-greater challenges:** Investors are increasingly calling for their money to have a positive impact on society and the world at large, and there is a global shift in investment trends towards a focus on more than the financial returns of a given investment.
- **Socially responsible investment products in art and culture rank highly among private banks:** In this year's survey, 28 percent of wealth managers said that socially responsible investment products in art and culture would be most relevant to their clients.
- **Technology is driving changes in impact investing:** With the advent of blockchain technology and tokenization, the next generation of art and cultural impact investment models, combining fractional ownership with social impact investment, could emerge.
- **Investment in art and cultural infrastructure:** The past three years have seen annual investment in art and cultural infrastructure projects hovering at between US$8 billion and US$9 billion based on an average of 115 completed projects according to AEA Consulting.
- **Impact investment in art and culture is gaining momentum internationally:** Organizations such as Nesta and their Arts Impact Fund have attracted significant international attention, with funders, policymakers, and national agencies across many countries looking at how to replicate the fund in their own jurisdictions.

4 Source: artnet
5 Source: artnet

- **Could private-public partnerships pave the way for new social impact investment models in the cultural sector?** In the future, could we see partnerships between the public and the private sector redefine the notion of 'public' assets (i.e. collections) and maybe turn collections into investable assets, which could form part of a public institution's funding strategy?

Section 5

Art and technology

- **ArtTech startups have raised US$600 million over the past eight years[6]:** The first generation of ArtTech startups have received nearly US$600 million in investment, with 50 percent of this investment going towards transaction-related businesses, 25 percent to discovery and social, 15 percent to logistics and collection management, and 10 percent to data-related ArtTech startups.
- **The next generation of ArtTech startups are focusing more on peripheral business segments:** The next generation of startups are likely to focus on several key areas: logistics, insurance, contracts, legal, storage, data, standardization, education, and new artist discovery.
- **Technology will drive change in the art market:** Collectors, art professionals, and wealth managers believe that technology could have a profound impact on a number of aspects of the art market, including transparency and regulation.

Section 6

Risk management and regulation

- **More wealth managers in Europe believe the art market needs government regulation:** In 2017, 60 percent of the wealth managers surveyed said that they thought self-regulation would be the best way to regulate the art market. The past two years have seen a change in sentiment among European wealth managers: 54 percent of those surveyed said that they thought the art market should face more government regulation and only 46 percent said that self-regulation would be the right approach. US wealth managers showed a preference for self-regulation, with 73 percent of respondents advocating this view.
- **There are mounting calls for art market business practices to be modernized:** In this year's survey, the majority of all stakeholders felt that current business practices needed to be modernized, with 80 percent of art professionals (up from 74 percent in 2017), 81 percent of collectors (up from 64 percent in 2017), and 76 percent of wealth managers (up from 73 percent in 2017) expressing this view. It is possible that the entry into force of the fifth anti-money laundering directive in January 2020 will act as a driver of this much-needed change.
- **The fight against money-laundering has widened to encompass the art trade:** The scope of EU anti-money laundering regulations is being extended to include the art trade from January 2020. The global trend has been to broaden the scope of industries required to help in the fight against financial crime, on the back of innovative money laundering schemes and the increasing threat of terrorism. This means that under the new regulation, dealers, auction houses, and other artwork traders fall under the same regulation as other "gatekeepers", such as banks, accountants, and lawyers.
- **Identifying beneficial owners:** Art professionals (notably auction houses, dealers, and galleries) must perform due diligence checks and identify the beneficial owner of each transaction under the new EU anti-money laundering regulation.
- **Museums need to know their patrons:** In light of the controversy around certain patrons and their support of the art world, there is likely to be increasing scrutiny of corporate and private financial support and donations to museums. In the context of greater reliance on funds from the private sector, institutions should adopt an up-to-date policy on donations. Such policies are aimed at enforcing pre-emptive behaviors to ensure that the source of funds and their use are scrutinized. This is similar to the approach required under the fifth EU anti-money laundering directive.

6 Source: Fuelarts

Priorities

Since the inaugural issue of the *Deloitte 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 art and finance industry.

Like the previous five editions, this year's report aims to prioritize key considerations for the future of the art and finance industry and to encourage dialogue and collaboration among the three key stakeholder groups: wealth managers, art professionals, and art collectors.

We have structured this year's priorities into five main areas:

01. Wealth managers need to rethink the client experience and take a new strategic approach to art and wealth management

The wealth management industry faces significant challenges linked to a need to adapt to a new generation of younger clients. Changing behaviors, motivations, and requirements will force the industry to innovate and focus on new client services and experiences. An interesting finding from a recent Capgemini report suggested that the next generation of investors seek connections—particularly emotional and personal connections. We believe that this is a domain in which art and wealth management can develop a mutually beneficial partnership.

Developing a client relationship model based on clients' interests and passions could deliver tangible benefits and play an important role in creating these personal connections. There are also valuable opportunities to leverage existing services and areas of expertise, as collectors are increasingly shifting towards more finance-driven art ownership models.

This year's survey findings point to an increasing emphasis on wealth reporting, estate planning, art-secured lending, social impact investing, and philanthropy: all areas in which the wealth management sector is already active.

With collectors increasingly seeing their art as an integral part of their total wealth, and with a strong consensus among stakeholders (wealth managers, art professionals, and collectors) on the importance of art as part of a wealth management offering, it seems that we have arrived at a point where stakeholders' interests are aligned.

New transparency requirements (see article by Pascal Noel p.100 in section 2, and section 6) also mean that there is a need for wealth managers to have better knowledge about their clients' art and collectible assets in order to ensure adequate protection. Now is the time to develop a new strategic and holistic approach to art and wealth management incorporating the emotional and financial factors associated with wealth preservation and management.

02. Collaboration between Art & Finance stakeholders is essential in order to develop common guidelines and standards to address deteriorating trust in the art market

Many of the issues and challenges raised in this report cannot be addressed by a single stakeholder group or a single country. They would require a cross-disciplinary approach involving all stakeholders (national and international) in the art and finance industry, including potentially governments, coming together to develop a common vision, and to promote standards and guidelines to achieve this collective aim. This is becoming increasingly pressing as trust among the stakeholders in the current art market is deteriorating. This poses a significant threat to the future development of the art and finance industry.

So, what role should the wide array of existing art-related associations (representing various stakeholders from art dealers to authenticators, appraisers, museum registrars, art logistics providers, art lawyers, and other art-related professionals) play in this development? Their firm commitment to acting in their members' best interests often means that clashing agendas and conflicting motivations are obstacles to finding optimal solutions for the industry as a whole. We believe that the expertise and knowledge are there, but that a new collaborative model is required to address many of the issues and challenges facing the development of the art and finance industry over the coming decade.

The art and finance industry needs a more unified voice. Without this common voice, the art market risks falling under additional government regulation, which could increase the industry opacity, meaning less transparency rather than more. One way to achieve this is by setting up a shared platform where all stakeholders (art dealers, art professionals, and wealth managers) can discuss ideas, put forward arguments, and offer advice and guidance on best practice. The aim would be to establish a strategy for the future around how to best regulate/self-regulate the art market.

The aim would be to establish a strategy for the future around how to best regulate/self-regulate the art market.

A collaboration between existing art industry associations and representatives from the wealth management community would be a possible outcome. The goals would be:

- **Awareness raising and advocacy**
  To promote awareness around specific Art & Finance issues. The industry needs to become collectively better at coordinating initiatives and campaigns around Art & Finance issues, but this will not be possible without increased cooperation/involvement from the wealth management community.

- **Promotion of industry standards**
  Challenges regarding the valuation of art and collectibles, coupled with the perceived threat of price manipulation, have been highlighted as key areas of concern by the majority of the stakeholders in the art and finance industry. Maybe the wealth management industry, in partnership with art valuers and appraisers, could play a role in standardizing and creating a framework for how valuation should be carried out to promote trust and transparency. The findings from this year's survey also show that there is a significant lack of trust when it comes to art market data. This is a serious problem, as decision-making tools for valuation and risk models depend heavily on this data and the trust we place in it. Blockchain technology and the creation of data provenance models might help in this regard.

- **Legal frameworks and regulation**
  One such area is the European art-lending market, which has been affected by the lack of a registration system of charges over chattels like the Uniform Commercial Code (UCC) in the US. Each European country has its own system, and many of these systems are unsuited to the art-secured lending market as it is constituted in the 21st century. If we are to develop a Europe-wide, and eventually worldwide, compatible framework, there is a need for a global industry body to advocate, coordinate, and advise on the best way to develop such infrastructure.

- **Education and capacity building**
  To support the growth and development of the art industry, firstly through education and professional development and secondly through the development of art and wealth management services.

03. Supporting ArtTech: new investment models required

This year's survey responses indicate a much stronger sense among collectors and art professionals that technology has an important role to play in addressing many of the industry's current hurdles and challenges. However, building the next generation of ArtTech companies will require substantial investment.

- **Infrastructure building**
  Research findings[7] in this report suggest that the next generation of ArtTech investment will flow from "transactional" businesses towards art infrastructure investments in tech startups that tackle areas such as logistics, insurance, contracts, legal, storage, data, standardization, education, and new artist discovery. Solutions in these areas would help build a better and more efficient art market ecosystem.

- **Long runway models**
  ArtTech businesses often see a mismatch between the long runway that is required to establish art-related businesses and the funding available for these types of investment. With many ArtTech businesses aimed at small but important niche markets, which are often unattractive to larger investors, ArtTech businesses rely heavily on the support of individual angel investors in achieving their goals. Research findings[8] suggest that 33 percent of funding comes from individual collectors, with a further 5 percent from crowdfunding. 40 percent of ArtTech companies have between one and five investors. The nature of the art market calls for a different type of investment model (one is outlined below): one better aligned with the long-term nature of the investment horizon required to overcome the resistance that technology often faces from stakeholders in the current art market.

- **Investment angel network**
  One of the key challenges for ArtTech startups is that they do not have access to an investment community of individuals who are passionate about art and understand the challenges facing the industry. An angel network for ArtTech startups backed by collectors and art professionals could be the solution to this dilemma, both in terms of ensuring a more effective allocation of capital towards initiatives that address real issues for the art world, and to align investors' expectations and motivations with the long runway model outlined above.

04. Social impact investment models for art and culture should be explored

We are seeing a global trend among investors to focus on investments that have a positive impact on society and the world at large. With art sales having reached record levels in recent years and works of art frequently selling for many millions of dollars, the questions and conversations about the impact of wealth on the art and cultural landscape are also changing. Simply acquiring art and building a collection for private enjoyment feels increasingly outdated in today's world. In this year's survey, 65 percent of collectors said that art and philanthropy services were the most relevant service that a wealth manager could offer.

7 Source: Fuelarts—see article on page 177
8 Source: Fuelarts—see article on page 177

The community of wealth managers surveyed seem to have responded to this trend, with more than half saying they would focus on this area in the coming 12 months, up from 40 percent who said the same in 2017. According to Wealth-X, art and culture were ranked as the third most important cause in 2016 in terms of global philanthropic giving among UHNWIs, with the sector's share increasing from 9.1 percent in 2014 to 10 percent in 2015.

On this basis, it obviously makes strategic sense for the wealth management sector to combine clients' interests in art and culture and their art-related wealth with both philanthropic and social impact investment models.

This is an area in which there is significant scope for rethinking the most suitable social investment models and approaches for art and culture. In the past, philanthropic investment in art and culture has often been viewed through the narrow lenses of private patronage and museum building. Now, however, new ideas with a broader and more ambitious scope are called for, such as social investment models in public art and cultural infrastructure, and the funding of non-commercial art and cultural projects and institutions through innovative investment and financing programs.

Given the mounting financial pressures faced by cultural institutions, there should be a discussion about how to turn the value of existing public collections into working assets. For example, would it be inconceivable to explore and leverage the economic value of the collections of public institutions, to support the institutions' future strategies and development? Is it feasible that the private sector could become a valid partner in a new type of public-private partnership whereby the private sector becomes a co-owner of national heritage pieces so as to fulfil a social impact investment objective?

05. The new anti-money laundering regulation is an opportunity for the art industry to become a more transparent and trusted marketplace

In this year's survey, 82 percent of private banks and 90 percent of family offices said that the lack of transparency in the art market was one of the biggest challenges facing the art and wealth management industry. Meanwhile, 85 percent of private banks said that money laundering was a key threat to the reputation of the art market. Could the new AML regulation act as a catalyst for the creation of a more trusted art market? And if so, how should the art industry best embrace these new changes and what support is needed to help the art industry overcome and meet the new compliance environment in the future?

- **An opportunity rather than a threat**
  It is important to understand that AML requirements should not be complied with out of fear of sanctions. Instead, professionals should try to embrace the objectives of the legislation: enhancing the reputation of the art market sector and helping the government to combat money laundering. AML compliance will entail transitional pains and challenges, but in the long term it is likely to provide the foundation for a more transparent and trustworthy marketplace, which would attract more clients and increase the overall size of the industry.

- **Raising industry awareness and providing guidance**
  Lessons from other industries, such

As more art dealers and intermediaries are encouraged to take compliance to the next level, the reputation of the art market is likely to improve and potentially lead to a broadening of the market and new business opportunities.

as the diamond trade, have taught us that investing in awareness raising, guidance, and support on how to implement the new legislation in practice will pay off. Art dealer associations, such as LAPADA, SLAD, and CINOA are already assisting their members in their efforts to comply with the new legislation. However, efforts to raise awareness among the less organized parts of the art market, such as younger contemporary galleries, art advisors, and other art intermediaries that might not have an industry body representing them, will also be important. These efforts call for an urgent coordinated program across the entire art trade.

- **Sharing tools and resources and learning from other industries**
  Again, lessons from the diamond industry, for example, suggest that there could be huge advantages in sharing resources and tools at industry level. Such initiatives could include providing access to compliance databases and due diligence tools, which would be too expensive for individuals or smaller companies to purchase alone but could be provided by an industry body on behalf of its members or stakeholders. This is exactly what the Antwerp World Diamond Centre (AWDC) has done for its members and the diamond industry. As mentioned above, maybe a new industry body representing the art and finance industry could serve such a function. Sector bodies should seek inspiration and advice from other bodies that serve other sectors but fall under the same legal framework. This will ensure professionals have access to the best practices available.

  As more art dealers and intermediaries are encouraged to take compliance to the next level, the reputation of the art market is likely to improve and potentially lead to a broadening of the market and new business opportunities. The evidence from the diamond industry shows that banks (which had steered clear of the industry as part of a "better safe than sorry" approach) are slowly entering the sector again thanks to its focus on compliance and transparency and a reduction in the perceived risk level.

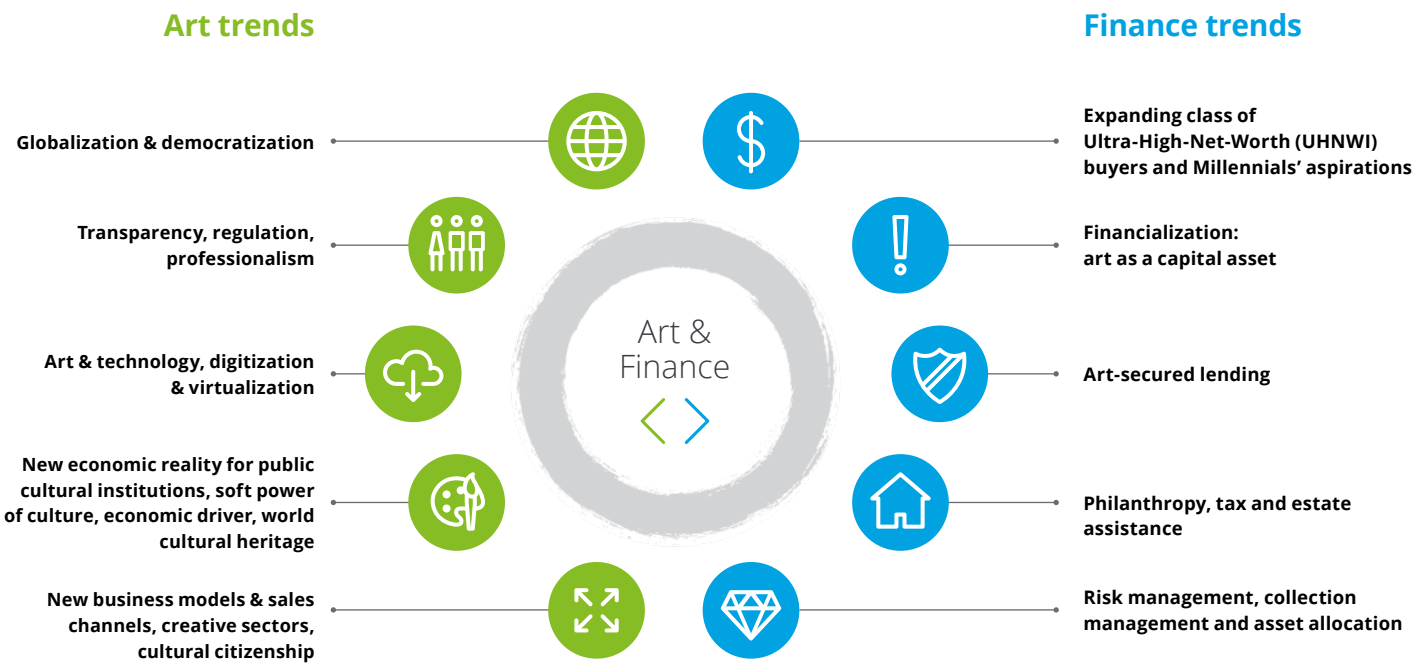
The big picture
Art & Finance is an emerging industry

The global art market is rapidly creating new opportunities at the intersection of art and finance.

As the population of high-net-worth individuals grows and the art market matures, there will be an increase in demand for financial innovation. The trend towards greater wealth allocation in the form of collectibles—such as art, collectible cars, wine, and jewelry—is creating demand for financial services to manage and preserve the value of these tangible assets.

Technology continues to shape the art market and the art industry by making art more accessible and changing how art is promoted, discovered, traded, and produced. In addition, regulation and new transparency requirements will create a new compliance environment for the art market in the coming years and address some of the concerns raised in this year's report.

The art and finance industry has the potential to grow and expand further in the coming years as a new economic reality in the cultural sector is forcing public organizations to think about finance in new and different ways. This could open up new opportunities for public-private partnerships and broaden the scope of Art & Finance to include the wider cultural and creative sectors.



Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

The art and finance industry has the potential to grow and expand further in the coming years as a new economic reality in the cultural sector is forcing public organizations to think about finance in new and different ways.

Deloitte Art & Finance: the art and finance industry is uniquely positioned at the intersection of these three interconnected sectors

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

Finance

- Private bankers
- Wealth managers
- Family offices
- Private investors/collectors
- Art/collectible fund promoters
- Art insurance companies
- Art trading companies



Culture

- Large public museums
- Private museums
- Corporate collectors
- Private collectors
- Public authorities (country, region, city, etc.)

Business

- Companies selling art
- Digital art companies
- Art logistics companies
- Art fairs
- Art & media companies
- ArtTech companies
- Cultural and creative sectors

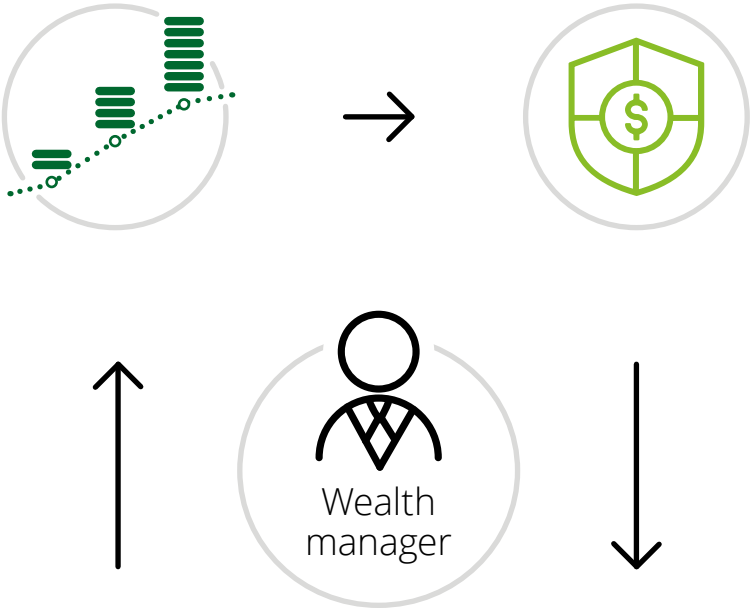
For the past eight years, we have been monitoring the development and evolution of the art and finance industry, and particularly the role of art and collectibles within wealth management services.

Types of art wealth management services

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

Accumulating wealth growing assets

- Museum endowments
- Art investment
- Art funds
- Stock of art businesses
- Private Equity in start-ups
- Financing of art business
- Social impact investment



Protecting wealth managing risks

- Art advisory
- Valuation
- Assets consolidation
- Reporting
- Art insurance
- Passive portfolio management
- Art collection management
- Art risk management

Transfering Wealth Creating a legacy

- Philanthropy advice
- Art related inheritance & estate planning
- Securitization

Converting wealth to income - Creating an income stream

- Art-secured lending

Not included

- Client entertainment
- Internal education
- Art sponsoring
- Corporate collection

The role of Art & Finance within the cultural and creative sectors

The increasing importance and recognition of the cultural and creative sectors as rapidly growing economic areas are likely to have a positive effect on the development of the art and finance industry in the future.

Companies active in the Cultural and Creative Sectors (CCS) often face difficulties in accessing debt financing for their projects, owing to the challenges inherent to these sectors, such as the intangible nature of their assets and output. For this reason, the European Investment Fund has launched the Cultural and Creative Sectors Guarantee Facility: the first EU financial instrument with a specific focus on the CCS. Under the Guarantee Facility, the consortium of Deloitte Digital and KEA European Affairs has been selected to provide capacity building services to Financial Intermediaries (FIs).

The objective of capacity building is to tackle FIs' lack of expertise when it comes to financing CCS companies by providing guidance on CCS business models through technical assistance and knowledge/ networking-building.



Todos los destinos © Lina Sinisterra (2015)

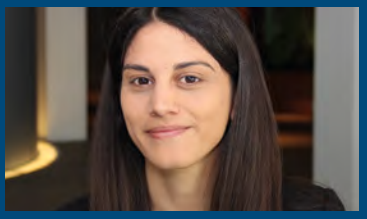
PERCEPTION VERSUS REALITY: THE UNDERRATED POTENTIAL OF THE CULTURAL AND CREATIVE SECTORS



Pascal Martino
Partner - Deloitte Digital Leader
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Deloitte Luxembourg



Andreas Steinbach
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Senior Consultant - Strategy Regulatory
& Corporate Finance (EU Policy Team)
Deloitte Luxembourg

The cultural and creative sectors (CCS) are often ignored by policymakers, financiers, and other economic actors as they are perceived to be of little relevance to the overall economy. Despite this widespread misconception about the CCS, economic data shows that the CCS constitute a driver of growth in many countries around the globe. Setting purely economic questions to one side, the CCS also spur creativity and innovation, thereby helping to stimulate social development and employment. It will hence come as no surprise that according to UNESCO, "the creative economy is one of the most rapidly growing sectors of the world economy"[9].

So, what are the CCS? In a nutshell the CCS cover "inter alia audio-visual activities (including film, television, video games and multimedia), design activities, festivals, music, literature, performing arts, publishing, radio, visual arts, architecture, activities related to archives, libraries and museums as well as artistic crafts and cultural heritage"[10]. For all of these activities, creativity (or "art") constitutes the origin and key element of value generation. The artistic content generated through this process benefits the CCS market as well as the wider economy.

For instance, a book written by an author (i.e., artistic content) could be published and sold by a publishing house. The story may then be adapted for film or inspire a video game generating spillover effects in related cultural and creative sub-sectors. However, the spillover effects do not stop at this point, as related industries and sectors benefit from the artistic content. In fact, a wide range of industries

The CCS and their influence on other industries

Source: based on a graph by KEA European Affairs "Economy of Culture in Europe" 2006



9 UNESCO (2013), Creative Economy Report 2013 Special Edition. Accessed in June 2019, available at: http://www.unesco.org/culture/pdf/creative-economy-report-2013.pdf

10 EIF (2019), "Market Analysis of Cultural and Creative Sectors in Europe: a sector to invest in". Accessed in June 2019, available at: https://www.eif.org/what_we_do/guarantees/cultural_creative_sectors_guarantee_facility/ccs-market-analysis-europe.pdf

depend on the creative output arising from CCS such as consumer electronics, telecom services and hardware, merchandising, industrial design, tourism, software, and education.

The spillover effects triggered by the CCS thus affect other sectors and foster innovation in the wider economy. The skills generated through the CCS can contribute to the development of new products and services, better management of human resources allowing creativity to prosper in companies and organizations, improvement of organizational processes by contributing to creative production or delivery methods, and the creation of the branding/identity of a company or territory[11]. Cities and regions can promote these spillovers by allowing knowledge to spread and by enhancing networking between businesses and CCS entrepreneurs. To highlight this, it should be noted that the CCS are an important factor driving the regeneration of urban areas that have previously been in decline and fostering the development of new cultural and economic communities.

Furthermore, on a global scale, the CCS are a significant source of jobs and economic growth. According to UNESCO, the CCS market employs around 30 million people worldwide[12]. Notwithstanding the challenges facing the global economy, the creation, production, and dissemination of CCS products generated an annual average growth rate of 7.34 percent during the period from 2003 to 2015. On top of this, exports of creative goods worldwide increased from US$208 billion in 2002 to US$509 billion in 2015[13].

In the European Union (EU), the CCS account for approximately 4 percent of GDP, which is comparable to the ICT, accommodation, and food services sectors. They also generate 6.7 million jobs representing around 30 percent of total employment in the EU. The EU has recognized the economic and cultural significance of the CCS as one of its most dynamic economic sectors[14]. For this reason, it has made the promotion of the CCS market a priority. Concrete initiatives include for instance the Creative Europe program from 2014 to 2020, which aims to promote Europe's cultural heritage and diversity as well as to reinforce the competitiveness of the CCS. A financial instrument has been set up to support the program, named the Cultural and Creative Sectors Guarantee Facility, managed by the European Investment Fund (EIF). The facility aims to increase access to finance for small and medium-sized enterprises (SMEs) active in the CCS through portfolio credit risk transfer (via a guarantee) and through the provision of capacity building aimed at improving financial intermediaries' ability to assess the risks associated with SMEs.

The versatility and dynamism of the CCS are highlighted by the fact that they are early adopters of digital technologies. In practical terms, this means that new digital solutions are transforming existing business models, creating new products and revenue sources that are contributing to the growth of the industry. The table below provides some examples of CCS that have seen new business models arise and well-known global players enter the market.

To conclude, the CCS should be recognized not only for their economic value to inherent industries but also for their resilience and ability to create spillovers to other seemingly unrelated economic sectors and their potential to act as a catalyst for innovation for the whole economy[15]. The adoption of digital solutions has boosted the expansion of the CCS on a global scale and created new sources of revenue and growth.

The EU has recognized the importance of the CCS market and launched programs such as Creative Europe to support the CCS and enable them to increase their contribution to jobs and growth. Further public support at national and regional level is crucial to make sure that countries reap the benefits of the CCS. According to Pascal Martino, Digital Co-Leader at Deloitte Luxembourg, "the CCS are becoming important due to their ability to combine creativity, business, and technology, which are important drivers of economic growth and social inclusion".

11 KEA European Affairs (2015), "The smart guide to creative spillovers". Accessed in June 2019, available at: http://www.keanet.eu/wp-content/uploads/SMARTGUIDE-FINAL-PDF.pdf

12 OECD (2018), "Cultural & Creative Industries (CCIs): Fulfilling the Potential". Accessed in June 2019, available at: http://www.oecd.org/cfe/leed/venice-2018-conference-culture/documents/B1-DiscussionNote.pdf

13 Unctad (2018), "Creative Economic Outlook". Accessed in June 2019, available at: https://unctad.org/en/PublicationsLibrary/ditcted2018d3_en.pdf

14 EIF (2019), "Market analysis of Cultural and Creative Sectors in Europe: a sector to invest in". Accessed in June 2019, available at: https://www.eif.org/what_we_do/guarantees/cultural_creative_sectors_guarantee_facility/ccs-market-analysis-europe.pdf

15 European Commission (2015), "Boosting the competitiveness of cultural and creative industries for growth and jobs". Accessed in June 2019, available at: http://www.dekuzu.com/en/docs/Boosting_the_competitiveness_of_cultural_and_creative_industries.pdf

CSS	Main impacts of digitalization
Music	• Rise of streaming services • Changes in consumer behavior when accessing music in real time
Film	• Shift towards shorter formats that can be easily accessed through mobile devices • Increasing amount of subscriptions to video-on-demand services
Video games	• Increased demand for mobile games • Online and mobile opportunities facilitating the distribution of video games by developers
Publishing	• Increased demand for e-books • Online retail available

Source: European Commission (2017), "Mapping the creative value chains - a study on the economy of culture in the digital age

"The CCS are becoming important due to their ability to combine creativity, business, and technology, which are important drivers of economic growth and social inclusion."



Big Bang - Excéntrica © Lina Sinisterra (2014)



Section 1

Wealth and the Global Art Market

487 Horas Pensando - Galeria El Museo © Lina Sinisterra (2009)

Highlights

Anemic global art market growth in the last 10 years stands in stark contrast to growth in wealth: Whilst HNWI financial wealth more than doubled between 2008 and 2018, from an estimated US$32.8 trillion in 2008 to US$68.1 trillion in 2018, global art market sales only saw a nominal increase of 9 percent in the same period[16].

Global wealth decline in 2018 largely led by the Asia-Pacific region: A recent wealth report[17] by Capgemini showed a decline in global wealth in 2018 relative to 2017, after seven consecutive years of growth. The Asia-Pacific region experienced the most negative impact, with China cited as the key reason for the decline.

Art and collectible wealth estimated to be $1.74 trillion: In this year's report, we estimate that UHNWIs wealth associated with art and collectible wealth to be an estimated $1.742 trillion in 2018, up from $1.622 trillion in 2016. The projection for 2023 is that this will grow to an estimated $2.125 trillion[18].

Is the art market heading for a correction? It was evident in the first half of this year that the art market is facing tougher conditions on the back of heightened political and economic uncertainty. Global auction sales from Christie's, Sotheby's, and Phillips were worth US$5.55 billion in the first six months of 2019, down 20.3 percent from US$6.96 billion in the first half of 2018. The decline in auction sales had already started in the second half of 2018 and has continued into the first six months of this year.

The outlook for economic growth and political stability has repeatedly been cited as the most important risk to the contemporary art market.

Risk perception is up 10 percent in the last 12 months: The overall perception of risk in the art market increased by 10 percent since September 2018, with the ArtTactic Risk Barometer coming in at 7.0, which was above its 10-year average of 6.4.

Autumn events may reignite fears in the art market: the outlook for economic growth and political stability has repeatedly been cited as the most important risk to the contemporary art market. Experts have raised concerns about the heightened risks of Brexit and Trump's trade war with China. Experts expect Brexit uncertainty to come to the fore again in the early autumn as the new deadline approaches.

Contemporary art market confidence down: The ArtTactic Confidence Indicator reading for Post-War & Contemporary Art in September 2019 saw a decline of 29 percent from May 2019. The current reading is signals that there is more negative than positive sentiment in among experts.

Post-War & Contemporary art market up in 2018 and 2019: After a 40.3 percent rise in sales in 2017, the Post-War and Contemporary art market saw robust sales growth of 18 percent in 2018. For the first half of 2019, the Post-War and Contemporary art auction market defied the global negative trend and sales were up 2.7 percent to US$2.26 billion.

Chinese & Asian art market sales dropped in 2018 and 2019: After a 21 percent rise in sales in 2017, the Asian art market experienced a 17 percent decline in total auction sales based on auctions at Sotheby's and Christie's in 2018. The weakening continued in the first six months of this year, with a 48.9 percent decrease in sales compared to the same period last year.

New York has retained its market share whilst London sales struggle on the back of Brexit uncertainty: New York auction sales across the three auction houses generated US$2.76 billion in the first six months of the year, down from US$3.54 billion in

16 *Source: The Art Market Report 2019 by Art Basel and UBS*

17 *Source: World Wealth Report 2019 Capgemini (July 2019)*

18 *However, with the growth in annual art market sales failing to keep pace with the increases in global wealth over the last 10 years, this estimate might be too optimistic*



2018, but up from US$2.58 billion in 2017. The results mean that New York now accounts for 49.8 percent of auction sales value. This is lower than New York's 50.9 percent market share in 2018, but still confirms its position as the main driver of the global auction market. The London market shrank in 2019, with Brexit uncertainty looming large: sales were down by 24 percent to US$1.45 billion, giving a market share of 26.1 percent (down from 27.4 percent in 2018).

Guaranteed sales jumped to record level of 30 percent in 2018: The use of guarantees has risen steadily from 39 percent of total low estimates in 2016 to 58 percent in 2018. The total value of guarantees based on low estimates increased from US$988 million in 2017 to US$1.29 billion in 2018. The value of guarantees has more than doubled since the art market dip in 2016 and ended last year 5.5 percent higher than when the market was at its peak in 2015.

The value of guarantees has more than doubled since the art market dip in 2016.

Introduction

The main aim of this section is to take a closer look at how current and future trends in the global art market are re-shaping, and will continue to re-shape, the landscape and context in which the art and finance industry is currently operating. We analyze recent regional art market trends and combine these with corresponding wealth and economic indicators, in order to get a better understanding of the relationship between the art market and the world of wealth management. We also look at the opportunities and challenges ahead.

In this context, we are delighted to have a contribution by Marion Maneker, President and Editorial Director of ArtNews Media (see p.66), giving his view on key aspects and trends that will influence the art market in the coming five years.

We are also pleased to have contributions focusing on specific art markets. In an interview with Hayashi Yasuta, Deputy Director, Cultural Economy and International Affairs Division, Agency for Cultural Affairs in Japan (see p.68), we take a closer look at the need for the re-vitalization of the Japanese art market, in the context of Asia's transformation into one of the global centers in arts and culture. This is followed by an overview of some of the recent art market trends in Holland and how they are impacting the evolving Dutch Art and Finance landscape, provided by Rudolf Janssen and Duco Wildeboer from Deloitte Netherlands (see p.70).

"Green" - Series: 487 Horas Pensando © Lina Sinisterra (2009)

Art and **collectible wealth**

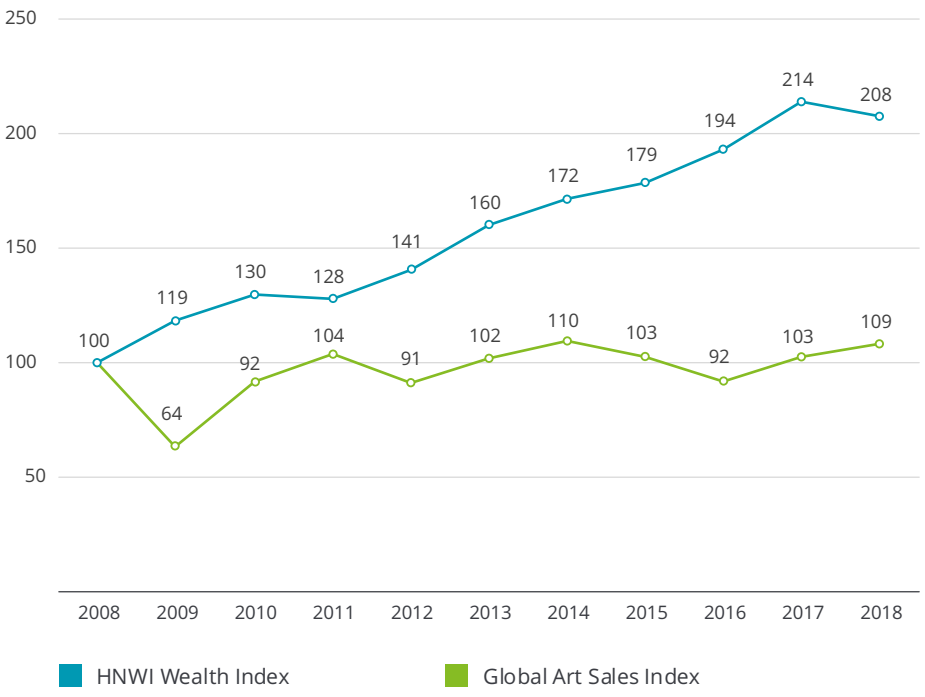
Global art market sales have declined in real terms over the last 10 years, as growth has failed to keep pace with increases in global wealth.

In recent years, new art price records have frequently hit the headlines: from the US$450 million paid for a Leonardo da Vinci in 2017 to the US$91 million price tag of the "Rabbit" stainless steel sculpture sold by Jeff Koons in May 2019. Based on these ground-breaking prices, it is easy to assume that the last 10 years were a golden age for art market sales. However, figures from the Art Basel and UBS Global Art Market Report 2019 show that global art market sales in 2018 were only 9 percent higher in nominal terms than global sales registered in 2008. This implies a decrease in real terms (i.e., when adjusted for inflation) in global art market sales over the last 10 years.

If we combine these findings suggesting a stagnant global art market with data from Capgemini's annual World Wealth Report, which shows that HNWI financial wealth more than doubled between 2008 and 2018 (from an estimated US$32.8 trillion in 2008 to US$68.1 trillion in 2018), it suggests that although individual art prices may have reached new highs, the overall art market has not. On the contrary, it seems that the global art market has failed to attract and keep pace with the wealth that has been generated over this period.

Figure 1. HWNI wealth growth (US$) vs global art market sales (US$) growth

Source: Capgemini World Wealth Report, Art Basel and UBS Global Art Market Report



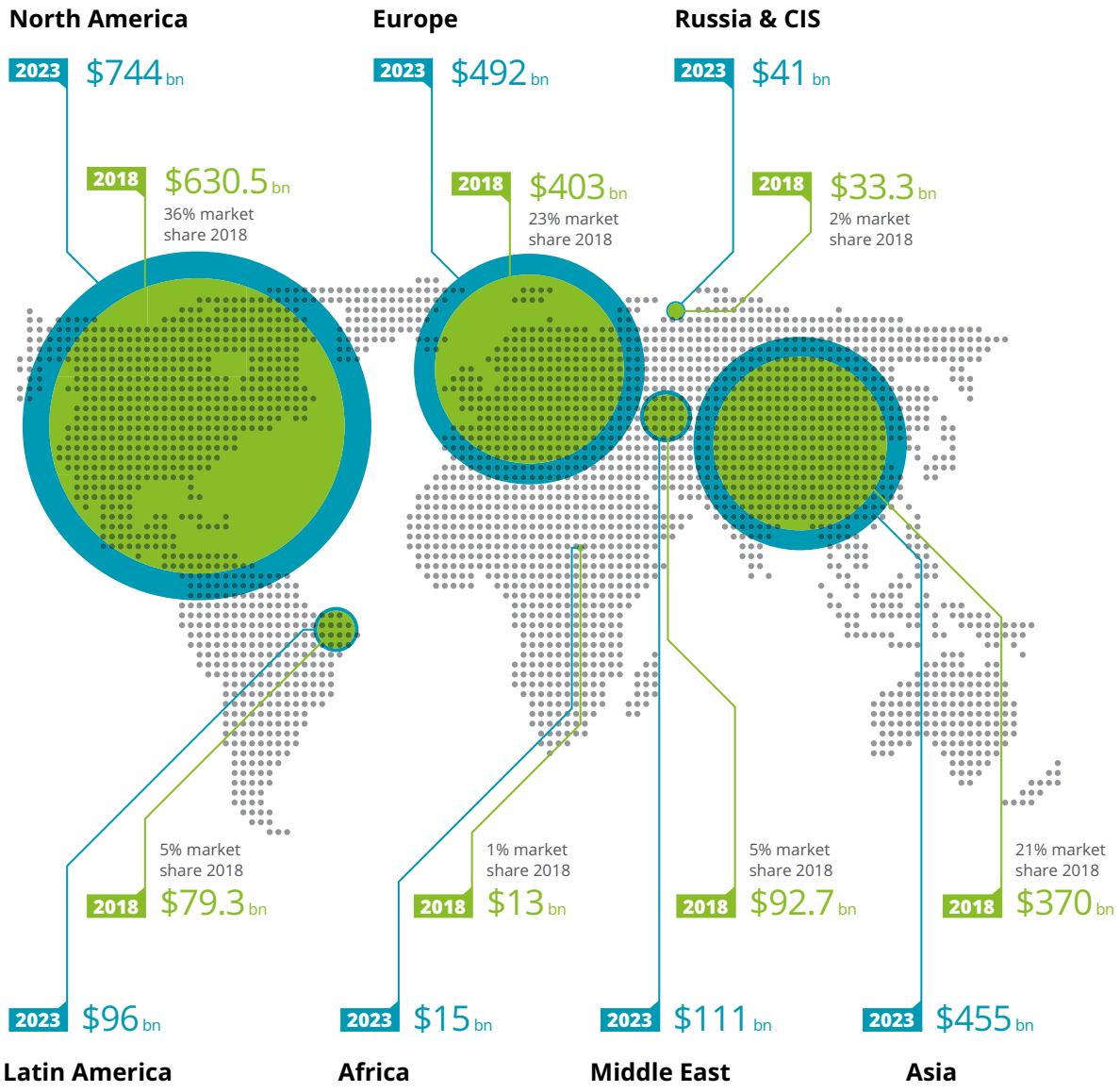
Global wealth declined in 2018, with the Asia-Pacific region most affected

A recent wealth report[19] by Capgemini showed a decline in global wealth in 2018 relative to 2017 levels. After seven consecutive years of growth, global HNWI wealth declined in 2018 by 3 percent from 70.2 to 68.1 US$ trillion, primarily as a result of a drop in equity market performance and slowing economies. The Asia-Pacific region experienced the most negative impact, with China cited as the key reason for the decline. It accounted for almost 25 percent of the fall in global wealth while Europe, Africa, and Latin America also experienced a noticeable dip in HNWI wealth last year. The Middle East was the only region that experienced an increase in both HNWI wealth and population, while North America saw a 1.1 percent decline in HNWI wealth.

The wealth of ultra-HNWIs (who represent 1 percent of the HNWI population) declined by 6 percent but still accounted for three quarters of the total global wealth decline and was the hardest hit by global economic and political turbulence.

Figure 2. Global UHNWI art & collectible wealth 2018 estimates

In this year's report, we estimate that UHNWIs wealth associated with art and collectible wealth to be an estimated $1.742 trillion in 2018.



Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

Against a backdrop of geopolitical and trade concerns, the near-term global economic recovery remains uncertain. In this year's report, we estimate that UHNWIs wealth associated with art and collectible wealth to be an estimated $1.742 trillion[20] in 2018, up from $1.622 trillion in 2016. The projection for 2023 that this will grow to an estimated $2.125 trillion[21]. However, this projection assumes that art and collectible wealth will grow as a constant function of the overall estimated growth in global wealth. But, as we have already discussed (p.48), the growth in annual art market sales have failed to keep pace with the increases in global wealth. Therefore the estimate might be too optimistic, as the evolution of prices for art and collectibles as well as the rise in annual collectible sales, may not be sufficient to compensate for the slow growth in art market sales.

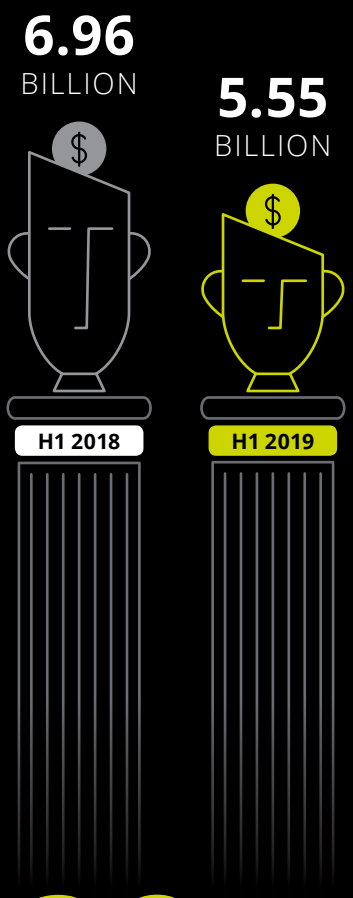
19 Source: World Wealth Report 2019, Capgemini (July 2019)

20 Wealth-X reported total UHNWI wealth of US$27.035 trillion in 2016, this was adjusted for changes in HNWI wealth in 2017 and 2018, assuming the UHNWI wealth has changed at the same rate as HNWI wealth using World Wealth Report by Capgemini as a source. The adjusted estimated figure for total UHNWI wealth of in 2018 was US$29.034 trillion. Based on an estimate from the "Knight Frank Wealth Report 2017, which states that six percent of global UHNWIs allocated to art and collectible assets (p.63) the estimated wealth allocated to art and collectibles is US$1.742 trillion.

21 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 2019. We maintain the same allocation to art and collectibles (6%) as we estimated for 2018. However, as the growth in annual art market sales in recent years have failed to keep pace with the increases in global wealth, this high-level estimate has to be considered as an indication.

GLOBAL ART **MARKET REVIEW**

Comparing the first half of 2019 with the first half of 2018



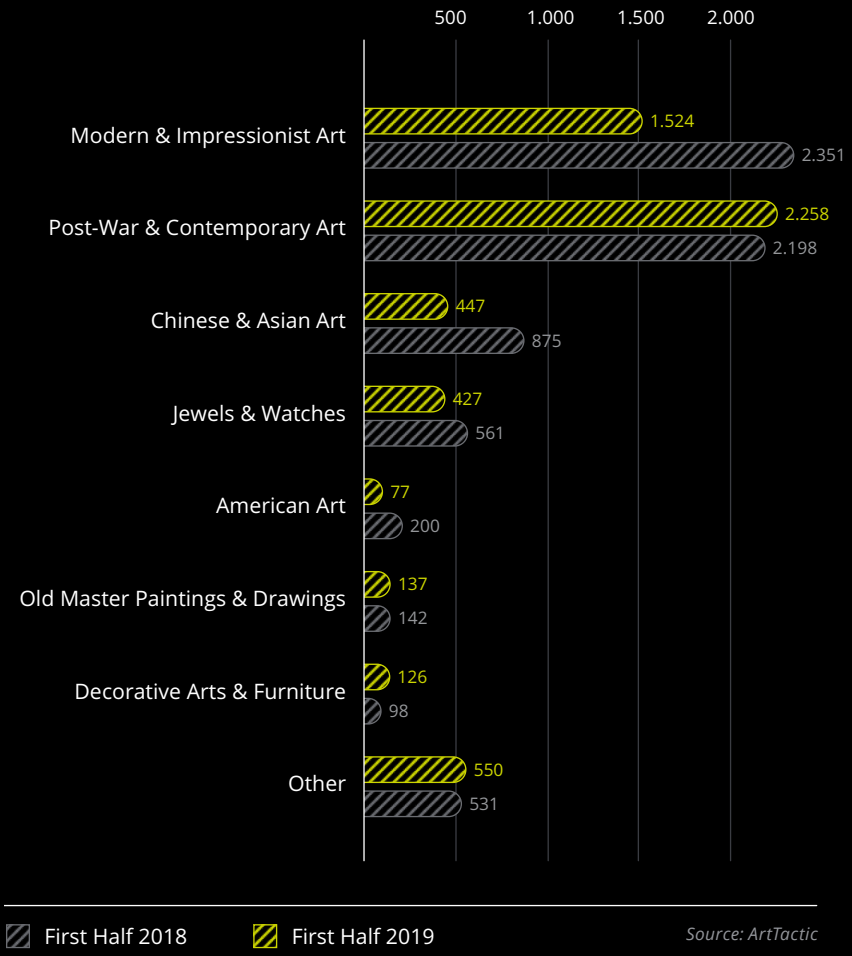
20 percent FALL
auction sales fell in H1 2019



An art market correction or just consolidation after a record year?

It was evident in the first half of this year that the art market is facing tougher conditions on the back of heightened political and economic uncertainty caused by events such as the US trade war with China and the Brexit process. Global auction sales from Christie's, Sotheby's, and Phillips amounted to US$5.55 billion in the first six months of 2019, down 20.3 percent from US$6.96 billion in the first half of 2018. The decline in auction sales had already started in the second half of 2018 and has continued into the first six months of this year.

Figure 3. Auction sales by category H1 2019 vs H1 2018
At Sotheby's, Christie's and Phillips in billions US$



Source: ArtTactic

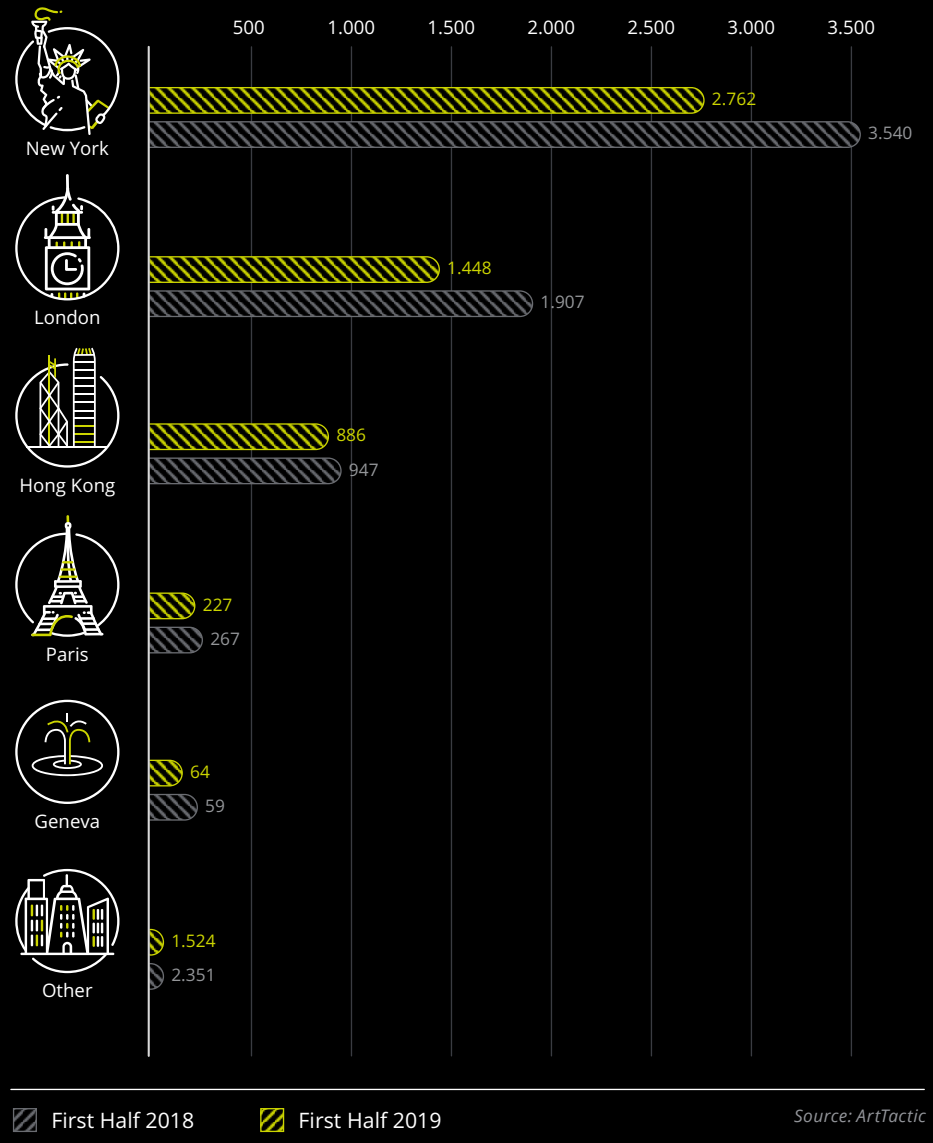
Post-War & Contemporary market back on top: the Post-War and Contemporary art auction market defied the negative trend in the first half of 2019 as sales rose by 2.7 percent to US$2.26 billion. This market accounted for 40.7 percent (up from 31.6 percent in 2018) of total auction sales in the first half of this year, ahead of the Impressionist and Modern art market at 27.5 percent (down from 33.8 percent in 2018). Overall, Impressionist and Modern art auction sales were down 35.2 percent in the first half of 2019, although this has to be seen in light of the unique Rockefeller collection sold through Christie's in the first half of 2018.

Continued decline for Chinese and Asian art as auctions see 48.9 percent decreases in the first six months of the year: one of the art market drivers in recent years has been the strength of the Asian market. However, the first six months of this year point to a weaker sales trend. Total sales of Chinese and Asian art only generated US$447 million in the first half of 2019, down from US$875 million in 2018, and US$951 million in 2017. This 53 percent decline over the last two years was largely caused by a significant fall in Chinese and Asian auction sales for Christie's, which saw its sales value drop from US$604 million in the first half of 2017, to US$392.6 million in 2018, and US$211.3 million in 2019. In 2019, Sotheby's added to the decline as its auctions decreased their sales by 32 percent from US$482.7 million in 2018 to US$235.7 million in the first half of this year, after having bucked the negative trend in 2018.

New York has retained its market share and Hong Kong has strengthened its position as the third-largest hub in the first half of 2019: New York auction sales across

Figure 4. All auctions by total sales per location

At Sotheby's, Christie's and Phillips in billions US$

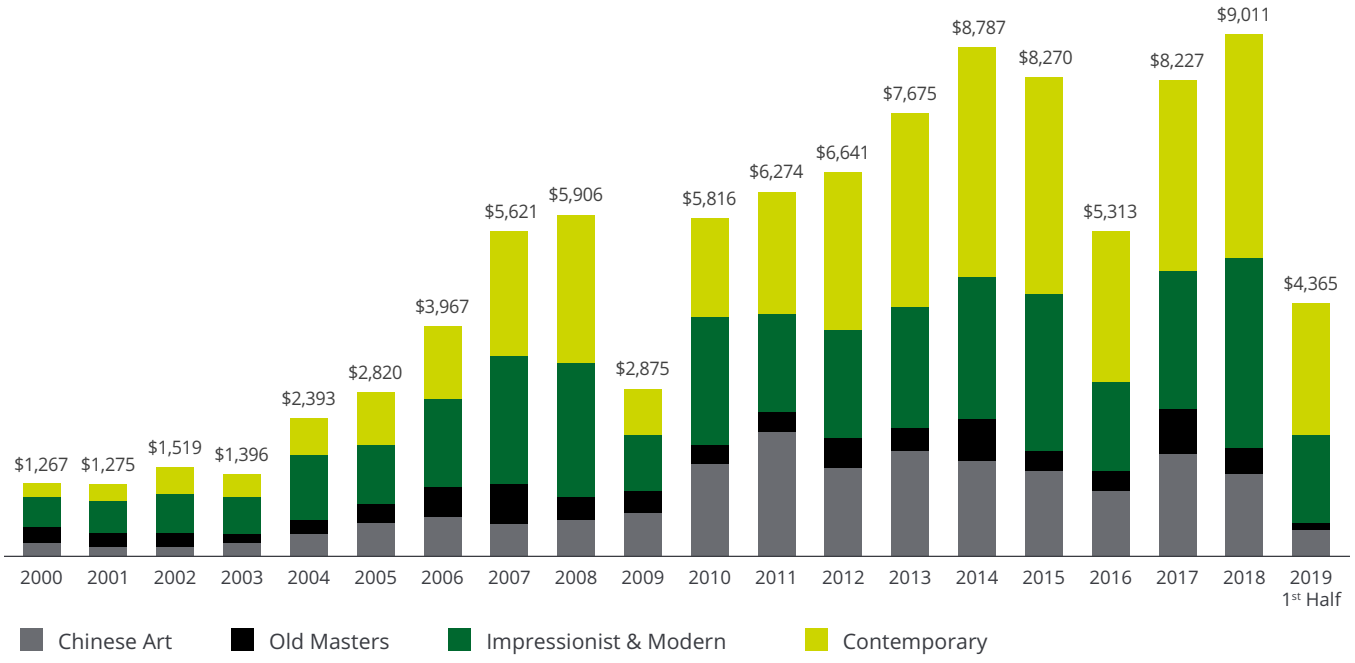


Source: ArtTactic

the three auction houses generated US$2.76 billion in the first six months of the year, down from US$3.54 billion in 2018, but up from US$2.58 billion in 2017. The results mean that New York now accounts for 49.8 percent of the total auction sales value. This was lower than the 50.9 percent seen in 2018, but still confirms its position as the main driver of the global auction market. The London market also shrank in 2019, with Brexit uncertainty looming large. Sales were down by 24 percent to US$1.45 billion, giving a market share of 26.1 percent (down from 27.4 percent in 2018). As London and New York battle for the top two positions, the Hong Kong auction market is cementing its position as the third-largest hub and absorbing market share from the top two. In 2019, Hong Kong's market share amounted to 16 percent (up from 13.6 percent in 2018) based on auction sales worth US$886 million.

Art market sales up despite a decline in global wealth in 2018

Figure 5. Christie's and Sotheby's: Auction sales (in millions US$) by category 2000 - 2019 (H1)
Source: ArtTactic



Auction sales among top auction houses rose by 8.9 percent in 2018

Last year ended on a positive note, but global auction sales slowed in the second half of 2018. Global auction sales from Christie's, Sotheby's, and Phillips amounted to US$12.21 billion in 2018, up 8.9 percent from 2017. After a strong first six months, the auction market slowed down in the second half of 2018 and this negative trend has continued into the first half of 2019. Phillips saw the largest jump in sales in 2018, with public auction sales up 28 percent last year. This was followed by Sotheby's with an 11 percent increase in total sales and Christie's with a more modest 6 percent rise in auction sales last year.

H1 2019 update

Global auction sales from Christie's, Sotheby's, and Phillips were worth US$5.55 billion in the first six months of 2019, down 20.3 percent from the first half of 2018. The decline in auction sales had already started in the second half of 2018.

Post-War & Contemporary art market up 18 percent in 2018

After a 40.3 percent rise in sales in 2017, the market saw robust sales growth of 18 percent. Total sales for 2018 came in at US$3.88 billion (up from US$3.28 billion in 2017). The Post-War and Contemporary art market still accounts for the largest share of sales at Christie's, Sotheby's, and Phillips, with a 31.8 percent share of the auction sales total. Sotheby's and Phillips saw the strongest growth in this auction category last year.

H1 2019 update

The Post-War and Contemporary art auction market defied the negative trend in the first half of 2019 as sales were up 2.7 percent to US$2.26 billion.

Modern & Impressionist art auction sales grew by 36 percent in 2018

While the contemporary art market slowed down in 2018, the Impressionist and Modern art market continued to experience positive growth. Since 2016, the Impressionist and Modern art sales category has seen the highest growth rate, with 36.3 percent auction sales growth in 2018. Sales have more than doubled since 2016. This category accounted for 26.9 percent of total auction sales last year (up from 21.5 percent in 2017). Total sales for 2018 came in at US$3.28 billion (up from US$2.41 billion in 2017).

H1 2019 update

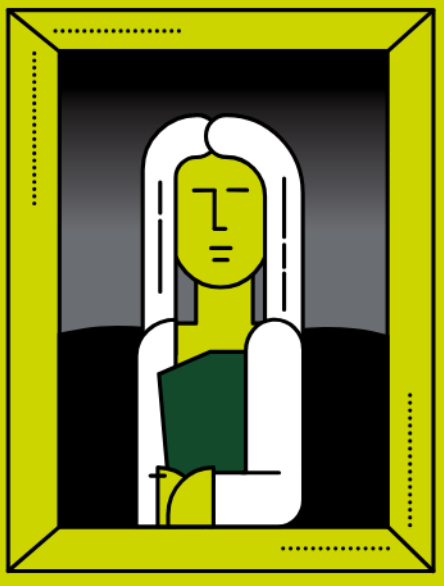
Overall, Impressionist and Modern art auction sales were down 35.2 percent in the first half of 2019, although this has to be seen in light of the unique Rockefeller collection sold through Christie's in the first half of 2018.

Chinese & Asian art market sales fell by 17 percent in 2018

After a 21 percent rise in sales in 2017, the Asian art market experienced a 17 percent decline in total sales last year. The decline in overall sales was largely due to a significant drop in sales at Christie's, from just over US$1 billion in 2017 to US$708 million in 2018. Sotheby's sales came in at US$734 million last year, which was marginally higher than the US$730 million seen in 2017. The weakness in the Asian art market continued in 2018.

H1 2019 update

The decline continued for Chinese and Asian art as auction sales were 48.9 percent lower in the first six months of this year than they were in the same period last year.



The Old Masters category suffered from the Leonardo effect

After a record year in the Old Masters market in 2017, on the back of the US$450 million sale of "Salvatore Mundi" by Leonardo da Vinci, the market reverted back to its long-term trend, with Sotheby's and Christie's generating US$407 million in 2018 vs. US$797 million in 2017—a drop of 49 percent.

H1 2019 update

Old Masters sales decreased by just over 3 percent in the first six months of 2019 compared with the same period last year. This shows that the sector remains resilient in what seems to be a weaker global art market.

Art market confidence in the Post-War & Contemporary art market

Art market confidence in the Post-War & Contemporary art market

The ArtTactic Confidence Indicator[22] for Post-War & Contemporary art in September 2019, saw a drop of 29 percent from May 2019. The indicator measuring the art market sentiment among experts, has deteriorated after a small recovery in May 2019. The overall ArtTactic Confidence Indicator for September 2019 came in at 42 (down from 60 in May 2019). A reading below 50 signals that there is more negative than positive sentiment in the current art market, and reflects the increasing economic and political uncertainty facing the US, UK and China in particular.

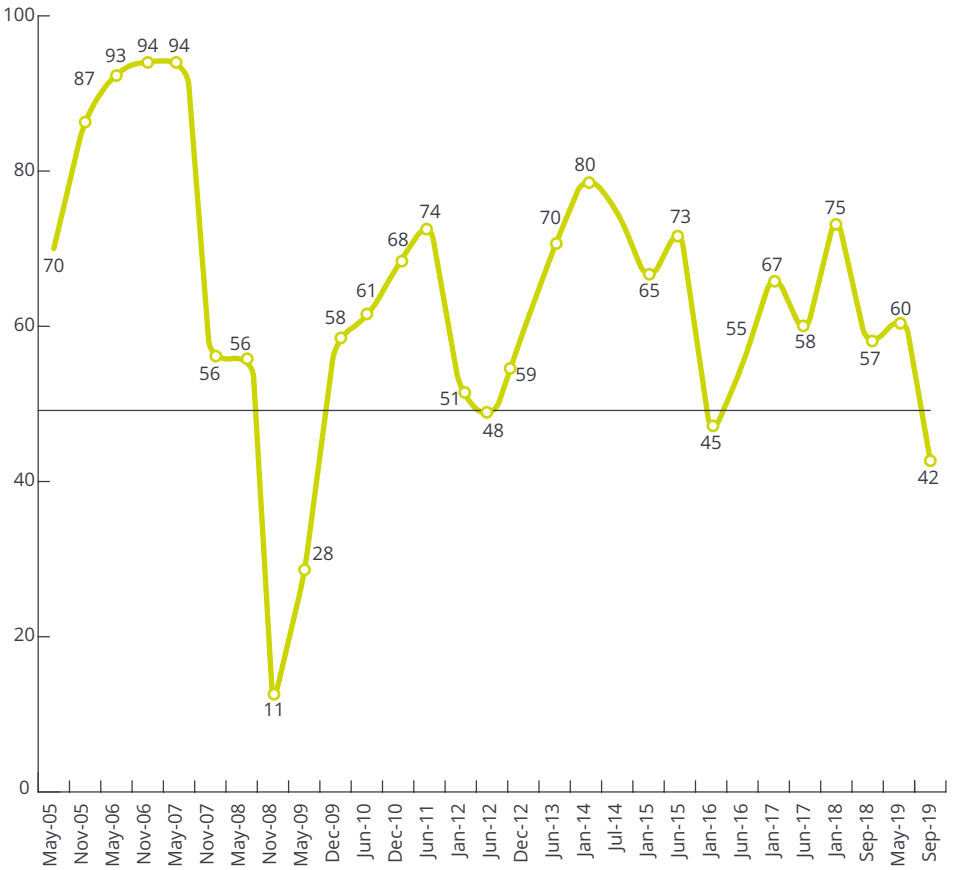
Although art market confidence has weakened in the last five months, the majority of experts believe the art market will consolidate around current levels, with 60 percent of experts saying so (up from 40 percent in May 2019), a further 29 percent of experts believe that the market will go up in the next six months (down from 51 percent who said the same in May 2019). Only 11 percent think that art market conditions will deteriorate in the coming months (slightly up from 9 percent in May 2019).

The outlook for economic growth and political stability has repeatedly been cited as the most important risk to the contemporary art market. In September 2019, the Economic Indicator component of the ArtTactic Confidence Index dropped by 40 percent relative to May 2019 levels, where experts raised continued concerns about the heightened risks of Brexit and the impact of Trump's trade war with China.

London's winter and summer sales meet expectations, whereas spring sales in New York rise 7.6 percent vs. May 2018

Figure 6. Art Market Confidence Index

Source: ArtTactic



Despite the uncertainty around Brexit, London's Post-War and Contemporary Art Evening auctions in March and June sales delivered approximately as expected with total sales of £305.6 million against a pre-sale estimate of £296.4 million to £408.4 million. The sales total was 17 percent lower than in March and June 2018. However, New York's evening auction sales of Post-War & Contemporary art in May 2019 brought in US$844 million—7.6 percent higher than the figure from May 2018.

22 The ArtTactic Art Market Confidence Indicator was launched in May 2005 and is now in its 42nd edition. Data is collected and the survey findings are made available every 6 months. The questions asked to compute the indicator has remained constant since the launch in 2005. The September 2019 survey was based on a sample of 109 international collectors, auction specialists, art dealers, art advisors and market analysts and commentators.

Risk perception up 10 percent in the last 12 months

The overall perception of risk in the art market increased by 1.4 percent since May 2019, with the Risk Barometer coming in at 7.0. This was above its 10-year average of 6.4. (The Risk Barometer operates on a scale from 1-10 where 1 = No risk and 10 = Extremely high level of risk.) The Risk Barometer has increased by 10 percent in the last 12 months, and signals a heightened level of risk, reflected in the overall decline in art market confidence.

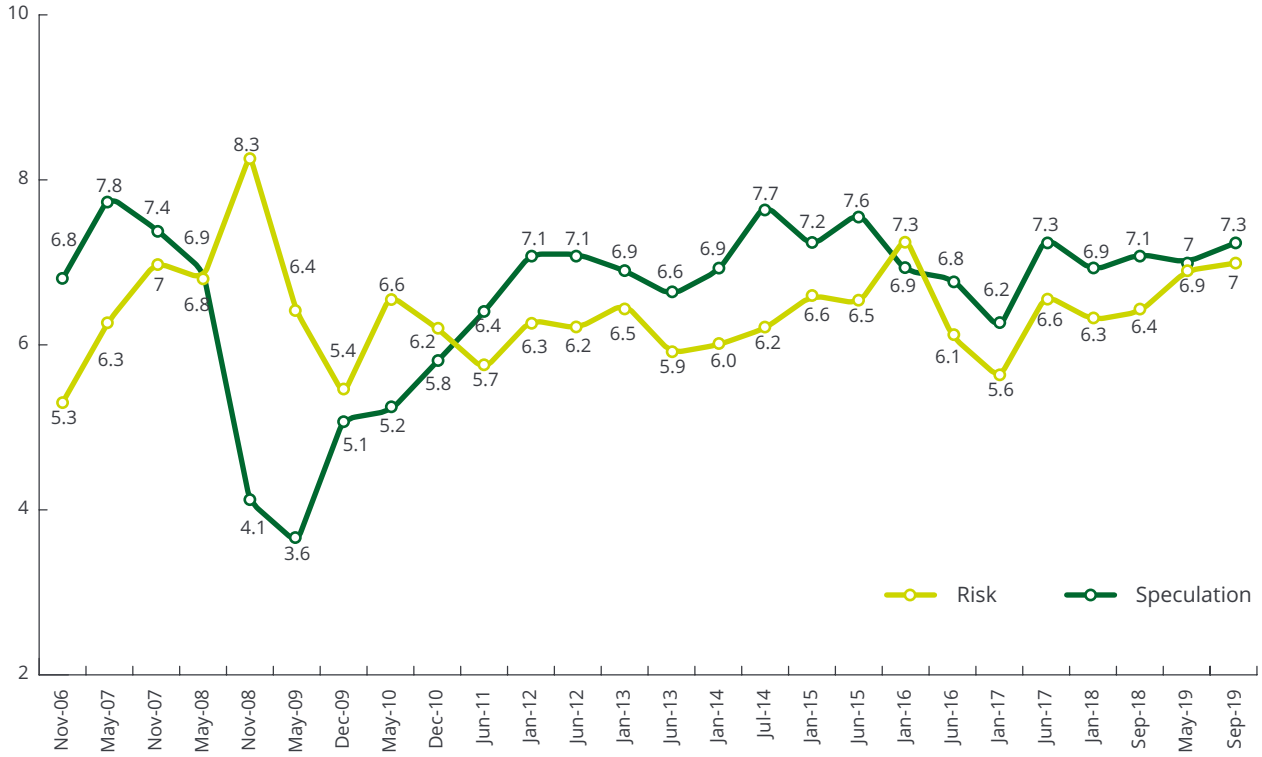
Is the risk of a speculative bubble in the contemporary art market waning?

Could the heightened uncertainty in the art market over the last 12 months take the edge off speculation? Despite falling market confidence levels, the ArtTactic Art Market Speculation Barometer saw a 3.4 percent increase from May 2019. The Barometer is currently standing at 7.3, and is still sitting 10 percent above the 10-year average. (The barometer operates on a scale from 1-10 where 1 = No speculation and 10 = Extremely high level of speculation.) This could suggest that speculative behavior is still prevalent in today's art market, and could act as a destabilizing factor in what appears to be an increasingly nervous and fragile art market.

29 percent of experts believe that the market will go up in the next six months, versus 51 percent who said the same in May 2019.

Figure 7. ArtTactic Risk & Speculation Barometer: 2006 - May 2019

Source: ArtTactic



Auction **guarantees**



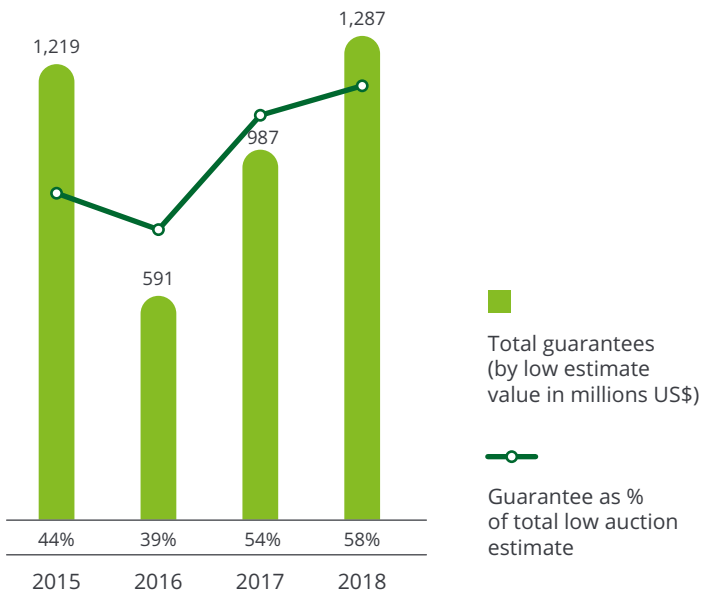
487 Horas Pensando © Lina Sinisterra (2009)

What is an auction guarantee?
An auction guarantee is a pre-arranged agreement between the seller and the auction house and/or an external third party who agrees to pay a fixed amount for a specific lot coming up for auction. If the lot fails to sell, the auction house or the third party becomes the owner of the lot and pays the seller the full guarantee. If the lot sells for more than the guaranteed amount, the winning bidder becomes the owner of the lot and the auction house or third party receives a proportion of the excess of the guaranteed amount from the seller.

Why do auction houses offer guarantees?
In a highly competitive marketplace, auction guarantees can be an effective tool in attracting consignments away from rival auction houses, as it gives the seller certainty that the lot will sell. It also helps the auction house shore up its overall sales figure by limiting the chances of a work going unsold and thereby affecting the overall total. It can also provide a good source of profits for the auction house, if the lot sells for an amount above the guaranteed amount.

Figure 8. Auction guarantees: Total estimated value (based on low estimate) and % of guaranteed value out of total low estimate

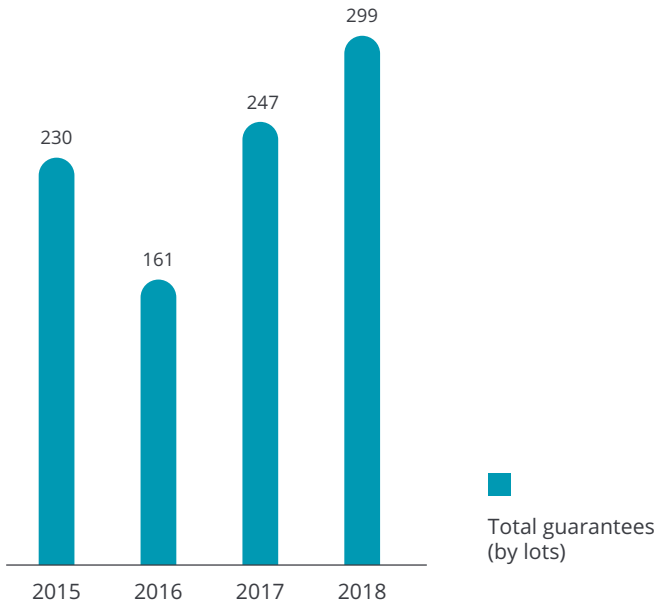
At Christie's, Sotheby, Phillips Post-War & Contemporary Evening Sales in London and New York



Source: ArtTactic

Figure 9. Auction guarantees: Number of lots guaranteed in Post-War & Contemporary Art evening sales in London and New York

At Christie's, Sotheby, Phillips Post-War & Contemporary Evening Sales in London and New York



Source: ArtTactic

Auction guarantees have become an "invisible hand" in the art market, that on one hand provide a sign of investors' art market confidence (i.e. employing capital towards artists and art works that is likely to increase in value), and on the other - introduces a new type of financial risk the art market (i.e. a market dependency on auction guarantees to ensure a successful outcome). With guarantees accounting for more than half of the total sales value in 2018, it is clear that these types of financial arrangements in the auction market is having an increasing influence on sales trends at the top end of the global art market.

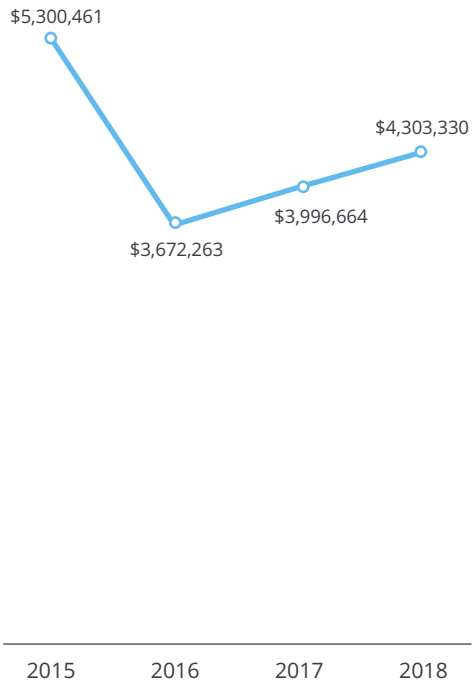
Record level as guaranteed sales jump 30 percent in 2018: the use of guarantees has steadily increased from 39 percent of total low estimates in 2016 to 58 percent in 2018. The total value of guarantees based on low estimates increased from US$988 million in 2017 to US$1.29 billion in 2018. The value of guarantees has more than doubled since the art market dip in 2016 and ended last year 5.5 percent higher than the level seen when the market was at its peak in 2015.

Auction guarantee levels fall as the market weakens: guarantees for Post-War & Contemporary art sales were down 20.8 percent year-on-year in February 2019, down 3.5 percent year-on-year in May 2019, and down 43.4 percent year-on-year in June 2019.

Improved returns attract more guarantors in 2018: the estimated average return on guarantees has increased from a low of 3.4 percent in 2015 to 11.8 percent in 2018, based on the performance of individual lots above the low estimate. The question is whether these levels can be maintained throughout 2019, with March sales in London this year showing guarantees yielding a 9.2 percent return above the low estimate. An estimated profit of US$151.7 million was generated on guaranteed lots in 2018 (hammer price vs. low estimate). This was typically shared between the guarantors and the sellers.

Figure 10. Average guarantee price

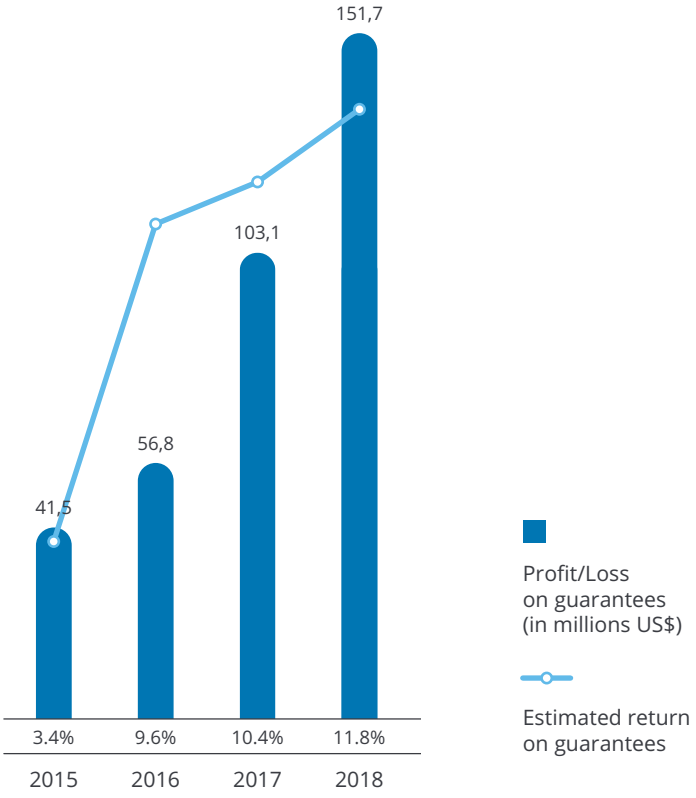
At Christie's, Sotheby, Phillips Post-War & Contemporary Evening Sales in London and New York



Source: ArtTactic

Figure 11. Estimated return on guarantees

At Christie's, Sotheby, Phillips Post-War & Contemporary Evening Sales in London and New York



Source: ArtTactic

Female artists only accounted for 5 percent of guaranteed value in Post-War & Contemporary evening sales between 2015 and 2018.

Christie's drops back in the guarantee race to secure major single-owner sales in 2018: after Christie's reduced its guarantees by 69 percent between 2015 and 2016, the auction house has steadily moved back into the guarantee race, with a 51 percent increase in the guaranteed value in 2018. This amounted to an estimated US$636 million based on the low estimate, which was only 15 percent lower than it was at the peak of the market in 2015. Christie's accounted for 49 percent of the guaranteed value in 2018, compared with Sotheby's 41 percent share and Phillips' 10 percent guarantee share.

While Sotheby's and Phillips saw average guarantee prices come down between 2017 and 2018—by 5 percent and 15 percent respectively—Christie's have seen an increase in their average guaranteed prices of 25 percent. The increase in guarantees can be largely attributed to two high-profile single-owner collections: The Collection of Peggy and David Rockefeller and The Barney A. Ebsworth Collection.

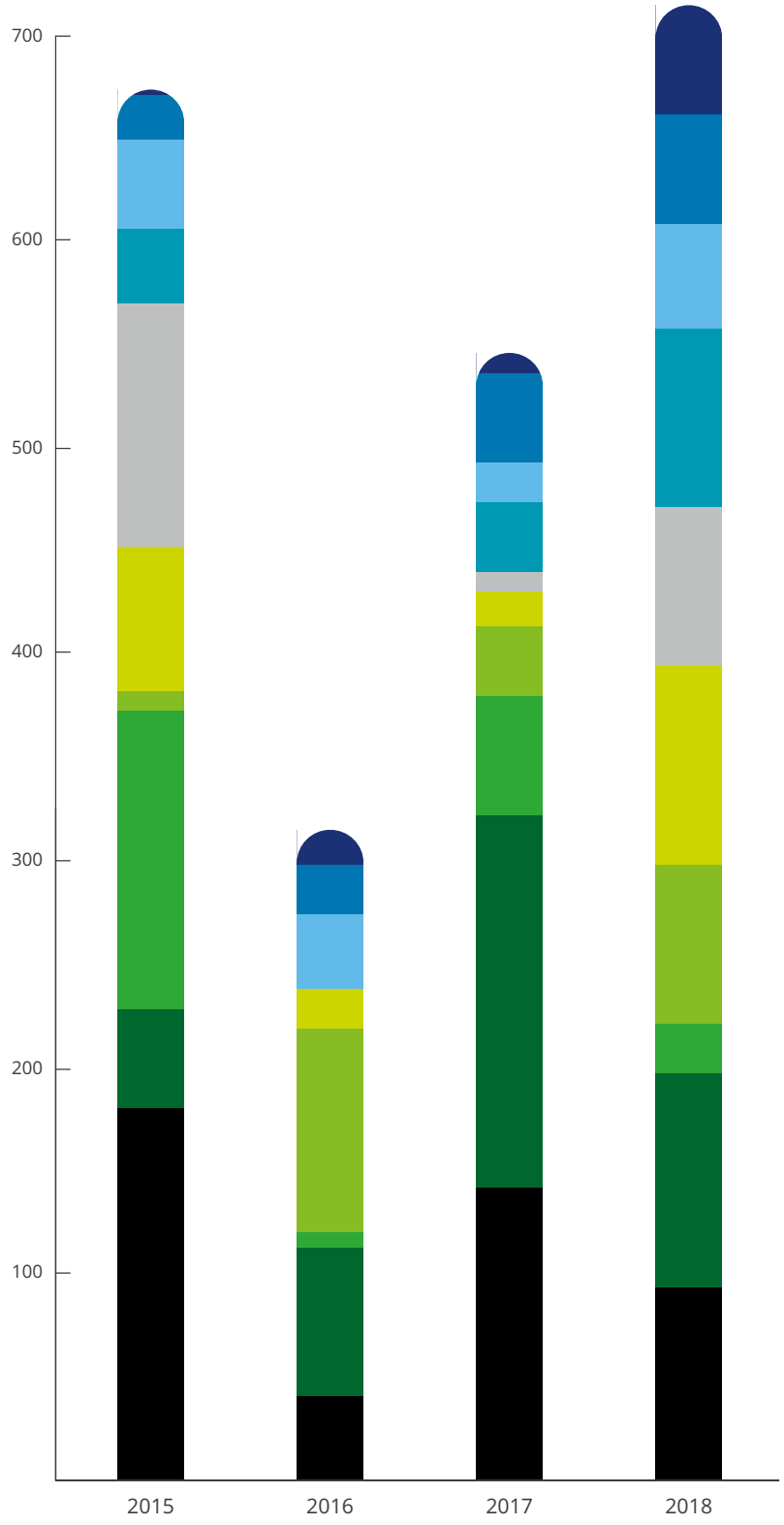
Is the guarantee market fueling gender bias in the auction market? Female artists only accounted for 5 percent of guaranteed value in Post-War & Contemporary evening sales between 2015 and 2018. Last year, the gap widened further with only 3 percent of guaranteed value accounted for by female artists.

The New York auction market accounted for 73 percent of guaranteed value in 2018, but London is now taking a larger share: auction guarantees in New York evening auction sales accounted for 73 percent of the total, with London auctions accounting for 27 percent (up from 19 percent in 2017).

Paintings accounted for 89 percent of the guaranteed value in 2018: painting is clearly the medium favored by guarantors, as it accounted for an estimated US$1.14 billion in guaranteed value in 2018 (based on low estimates). This was 37 percent higher than in 2017. Sculpture accounted for US$97.4 million in guaranteed value in 2018, down from US$106.4 million in 2017.

Figure 12. Top 10 artists by auction guarantee value 2015-2018 (based on the low auction estimate in millions US$)

At Christie's, Sotheby, Phillips Post-War & Contemporary Evening Sales in London and New York



Top 10 artists by auction guarantee value

- **Andy Warhol** US$ 495,376,659
- **Jean-Michel Basquiat** US$ 452,422,750
- **Mark Rothko** US$ 234,945,396
- **Roy Lichtenstein** US$ 230,311,712
- **Gerhard Richter** US$ 216,476,027
- **Willem de Kooning** US$ 198,670,000
- **Francis Bacon** US$ 178,996,283
- **Christopher Wool** US$ 148,475,313
- **Peter Doig** US$ 146,661,063
- **Lucian Freud** US$ 115,057,182

Source: ArtTactic

Regional trends



		GLOBAL TREND	UNITED STATES	UNITED KINGDOM	EUROPE	CHINA
ECONOMIC REVIEW 2018	Real GDP Growth 2017 to 2018*	**3.3%**	2.3%	1.2%	1.6%	6.3%
	Real GDP Growth Trend +/- *	**Negative**	Negative	Negative	Negative	Negative
	HNWI wealth growth 2017 to 2018**	**-3.0%**	-1.1%	-6.0%	-3.1%	-4.8%
ECONOMIC OUTLOOK 2020	Real GDP Growth Outlook 2020	**3.6%**	1.9%	1.4%	1.8%	6.1%
	Economic Outlook Trend	**Positive**	Negative	Positive	Positive	Negative
	Wealth Outlook 2023 (5 year growth in UHNWI population)****	**22%**	18%	21%	24%	35%
AUCTION MARKET SALES IN 2018	Art Market Modern & Contemporary Sales 2018 (US$ million)	**4367.1**	2510	1170	251	112.2
	Market Share % in 2018	**100.0%**	57.5%	26.8%	5.7%	2.6%
	Art Market Sales Growth 2017 to 2018	**14.9%**	-7.2%	51.8%	36.9%	25.3%
	5 Year Sales CAGR (2013-2018)	**-**	0.9%	**11.2%**	9.0%	-11.8%
OUTLOOK	Art Market Outlook 2020*****	⊕ ***UP: 30%*** ⊜ ***FLAT: 42%*** ⊖ ***DOWN: 28%***	⊕ ***UP: 35%*** ⊜ ***FLAT: 49%*** ⊖ ***DOWN: 16%***	⊕ ***UP: 13%*** ⊜ ***FLAT: 39%*** ⊖ ***DOWN: 49%***	⊕ ***UP: 21%*** ⊜ ***FLAT: 54%*** ⊖ ***DOWN: 25%***	⊕ ***UP: 30%*** ⊜ ***FLAT: 35%*** ⊖ ***DOWN: 35%***

** Source: IMF DataMapper- April 2019*

*** Source: Capgemini, World Wealth Report 2019*

**** CAGR - is based on the period 2016 -2018*

Wealth, economics, modern and contemporary art markets








MIDDLE EAST	SOUTH ASIA	LATIN AMERICA	SOUTHEAST ASIA	RUSSIA	AFRICA
0.3%	6.8%	1.1%	5.0%	1.6%	3.6%
Negative	Neutral	Positive	Neutral	Negative	Positive
4.3%	-6.0%	-3.6%	-4.8%	Not available	-7.1%
2.9%	7.0%	2.4%	5.1%	1.7%	3.8%
Positive	Positive	Positive	Positive	Positive	Positive
20%	39%	21%	26%	25%	23%
26.6	92	74.9	41.1	41.1	48.2
0.6%	2.1%	1.7%	0.9%	0.9%	1.1%
-19.0%	48.0%	4.0%	-16.0%	-19.9%	-13.4%
7.5%	10.1%	-15.5%	-4.2%	-8.3%	22.6%***
⊕ ***UP: 26%*** ⊜ ***FLAT: 51%*** ⊖ ***DOWN: 23%***	⊕ ***UP: 25%*** ⊜ ***FLAT: 56%*** ⊖ ***DOWN: 19%***	⊕ ***UP: 20%*** ⊜ ***FLAT: 49%*** ⊖ ***DOWN: 31%***	⊕ ***UP: 33%*** ⊜ ***FLAT: 49%*** ⊖ ***DOWN: 18%***	⊕ ***UP: 14%*** ⊜ ***FLAT: 49%*** ⊖ ***DOWN: 36%***	⊕ ***UP: 47%*** ⊜ ***FLAT: 40%*** ⊖ ***DOWN: 13%***

*****Knight Frank, The Wealth Report 2019*

****** ArtTactic Art Market Confidence Survey - May 2019*



Regional profiles

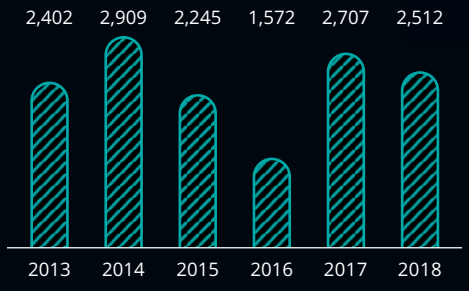
Data Sources

- HNWI Wealth Population figures are estimates from the Knight Frank Wealth Report 2019 (p.86)
- GDP figures are from IMF DataMapper, April 2019
- Art market data is provided by ArtTactic

UNITED STATES

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET	
HNWI Wealth Population (thousands): 5,944	Auction Sales in 2018 (US$ million): 2,512	
Change in HNWI Population 2017-18: 3.0%	Sales Growth 2017-18 -7.20%	
Real GDP Growth 2017-18 2.3%	Global Market Share 57.50%	
GDP Growth Outlook 2020 1.9%	Art Market Outlook 2020	⊕ *UP: 35%* ⊜ *FLAT: 49%* ⊖ *DOWN: 16%*

5-Year CAGR **0.9%**



Post-War & Contemporary Auction Sales (US$ million)

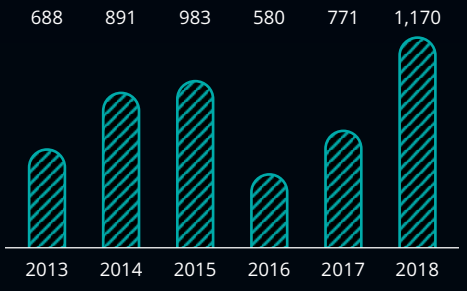
The world's largest art market experienced a slow down in auction sales in 2018, a trend that is likely to continue as both economic and political headwinds are putting a damper on buyers.

Art Market Analysis is based on Post-War & Contemporary Evening & Day Auctions - Sotheby's, Christie's, & Phillips in New York.

UNITED KINGDOM

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET	
HNWI Wealth Population (thousands): 759	Auction Sales in 2018 (US$ million): 1,170	
Change in HNWI Population 2017-18: 3.0%	Sales Growth 2017-18 51.80%	
Real GDP Growth 2017-18 1.2%	Global Market Share 26.80%	
GDP Growth Outlook 2020 1.4%	Art Market Outlook 2020	⊕ *UP: 13%* ⊜ *FLAT: 39%* ⊖ *DOWN: 49%*

5-Year CAGR **11.2%**



Modern & Contemporary Auction Sales (US$ million)

Despite Brexit uncertainty, the UK art market did well in the first half of 2018, however modern and contemporary sales in London were slowing significantly in the latter half of 2018 and first half of 2019. The outlook for the next 12 months remains uncertain, with a significant downside risk.

Art Market Analysis is based on Post-War & Contemporary Evening & Day Auctions - Sotheby's, Christie's, & Phillips in London.

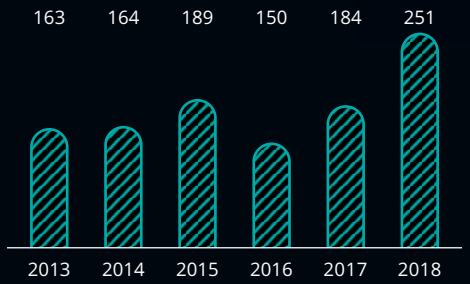


EUROPE

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET	
HNWI Wealth Population (thousands): 4,957	Auction Sales in 2018 (US$ million): 251	
Change in HNWI Population 2017-18: 3.0%	Sales Growth 2017-18 36.90%	
Real GDP Growth 2017-18 1.60%	Global Market Share 5.70%	
GDP Growth Outlook 2020 1.80%	Art Market Outlook 2020	⊕ *UP: 21%* ⊜ *FLAT: 54%* ⊖ *DOWN: 25%*

5-Year CAGR **9.0%**

Post-War & Contemporary Auction Sales (US$ million)



The European art market also experienced strong growth in 2018, however, experts have become significantly more cautious about the coming 12 months.

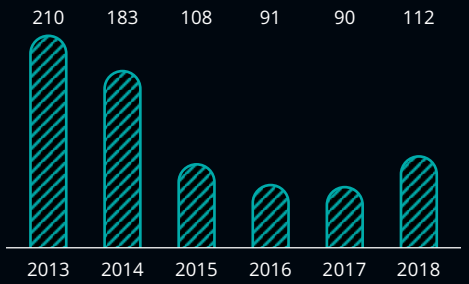
Art Market Analysis is based on Post-War & Contemporary Evening & Day Auctions - Sotheby's & Christie's in Paris, Amsterdam, & Milan.

CHINA

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET	
HNWI Wealth Population (thousands): 1,535	Auction Sales in 2018 (US$ million): 112.2	
Change in HNWI Population 2017-18: 4.0%	Sales Growth 2017-18 25.30%	
Real GDP Growth 2017-18 6.30%	Global Market Share 2.60%	
GDP Growth Outlook 2020 6.10%	Art Market Outlook 2020	⊕ *UP: 30%* ⊜ *FLAT: 35%* ⊖ *DOWN: 35%*

5-Year CAGR **-11.8%**

Contemporary Chinese Auction Sales (US$ million)



China's slowing economy and the uncertainty surrounding the ongoing trade-war with the US, is likely to have a negative impact on the art market. Experts are increasingly expressing a wait-and-see attitude, with downside risk heightened in the next 12 months.

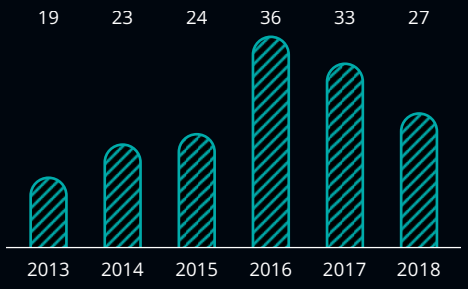
Art Market Analysis is based on Contemporary Chinese Auctions - Sotheby's, Christie's, Poly Auction, & China Guardian in Hong Kong & Beijing.

MIDDLE-EAST

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET
HNWI Wealth Population (thousands): 459	Auction Sales in 2018 (US$ million): 26.6
Change in HNWI Population 2017-18: 3.0%	Sales Growth 2017-18 -19%
Real GDP Growth 2017-18 0.30%	Global Market Share 0.60%
GDP Growth Outlook 2020 2.90%	Art Market Outlook 2020

⊕ *UP: 26%*
⊜ *FLAT: 51%*
⊖ *DOWN: 23%*

5-Year CAGR
7.5%



Modern & Contemporary Auction Sales (US$ million)

Auction sales of modern and contemporary art slowed down in 2018, however, the majority of experts believe the market will level out from here. The main risks are the uncertain global economic outlook and elevated geopolitical risks in the region.

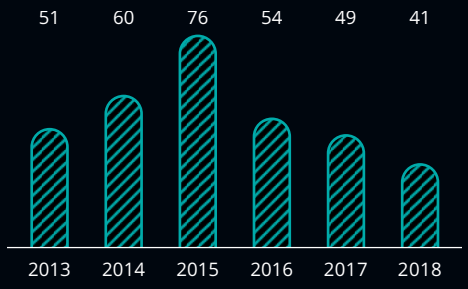
Art Market Analysis is based on Modern & Contemporary Auctions - Sotheby's, Christie's, Bonhams, & Tehran Auction in Dubai, Doha, London, & Tehran.

SOUTH EAST ASIA

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET
HNWI Wealth Population (thousands): 326	Auction Sales in 2018 (US$ million): 41.1
Change in HNWI Population 2017-18: 4%	Sales Growth 2017-18 -16%
Real GDP Growth 2017-18 5%	Global Market Share 0.90%
GDP Growth Outlook 2020 5.10%	Art Market Outlook 2020

⊕ *UP: 33%*
⊜ *FLAT: 49%*
⊖ *DOWN: 18%*

5-Year CAGR
-4.2%



Modern & Contemporary Auction Sales (US$ million)

Southeast Asian auction sales was down 16 percent in 2018, with more experts casting doubts about the direction for the coming 12 months. The market has been on a decline since the peak of the market in 2015.

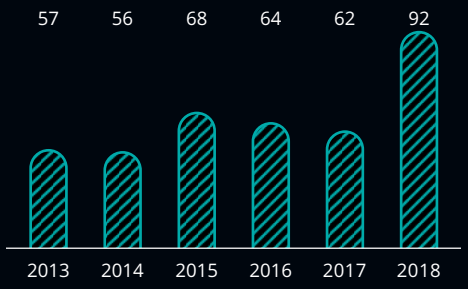
Art Market Analysis is based on Modern & Contemporary Auctions - Sotheby's & Christie's in Hong Kong.

SOUTH ASIA

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET
HNWI Wealth Population (thousands): 438	Auction Sales in 2018 (US$ million): 92
Change in HNWI Population 2017-18: 6.0%	Sales Growth 2017-18 48%
Real GDP Growth 2017-18 6.80%	Global Market Share 2.10%
GDP Growth Outlook 2020 7.00%	Art Market Outlook 2020

⊕ *UP: 25%*
⊜ *FLAT: 56%*
⊖ *DOWN: 19%*

5-Year CAGR
10.1%



Modern & Contemporary Auction Sales (US$ million)

South Asia experienced strong growth in 2018, and experts retain a neutral-to-positive outlook on the South Asian art market in the coming 12 months.

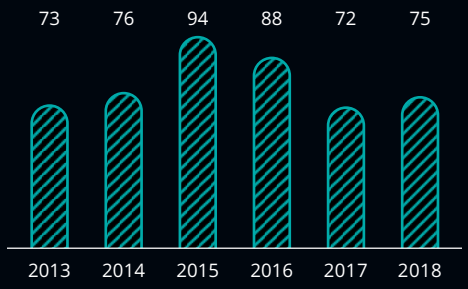
Art Market Analysis is based on Modern & Contemporary Auctions - Sotheby's, Christie's, Saffronart, Bonhams, Pundoles, Artiana, AstaGuru in Mumbai, New Delhi, London & New York.

LATIN AMERICA

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET
HNWI Wealth Population (thousands): 610	Auction Sales in 2018 (US$ million): 74.9
Change in HNWI Population 2017-18: 3.0%	Sales Growth 2017-18 4%
Real GDP Growth 2017-18 1.10%	Global Market Share 1.70%
GDP Growth Outlook 2020 2.40%	Art Market Outlook 2020

⊕ *UP: 20%*
⊜ *FLAT: 49%*
⊖ *DOWN: 31%*

5-Year CAGR
0.6%



Modern & Contemporary Auction Sales (US$ million)

Latin American auction sales experienced 4 percent growth in 2018, despite Sotheby's and Phillips discontinuing their dedicated twice-a-year Latin American sales. However, experts are in doubt whether this growth will continue this year.

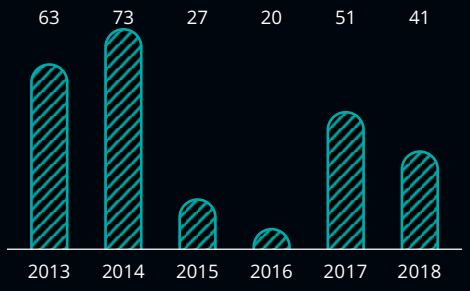
Art Market Analysis is based on Modern & Contemporary Auctions - Sotheby's, Christie's, & Phillips in New York & London

RUSSIA

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET
HNWI Wealth Population (thousands): 163	Auction Sales in 2018 (US$ million): 41.1
Change in HNWI Population 2017-18: 6%	Sales Growth 2017-18 -19.90%
Real GDP Growth 2017-18 1.60%	Global Market Share 0.90%
GDP Growth Outlook 2020 1.70%	Art Market Outlook 2020

⊕ *UP: 14%*
⊜ *FLAT: 49%*
⊖ *DOWN: 36%*

5-Year CAGR
-8.3%



Modern & Contemporary Auction Sales (US$ million)

The Russian art market has been struggling since the sanctions were imposed in 2014, however in the last years, experts have seen market confidence creeping back.

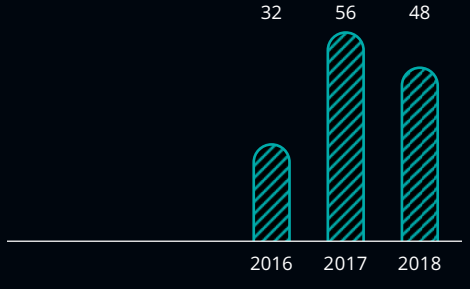
Art Market Analysis is based on Modern & Contemporary Auctions - Sotheby's, Christie's, & MacDougall's in London.

AFRICA

ECONOMIC & WEALTH INDICATORS	MODERN & CONTEMPORARY ART MARKET
HNWI Wealth Population (thousands): 177	Auction Sales in 2018 (US$ million): 48.2
Change in HNWI Population 2017-18: 3.00%	Sales Growth 2017-18 -13.4%
Real GDP Growth 2017-18 3.60%	Global Market Share 1.1%
GDP Growth Outlook 2020 3.80%	Art Market Outlook 2020

⊕ *UP: 47%*
⊜ *FLAT: 40%*
⊖ *DOWN: 13%*

2-Year CAGR
22.6%



Modern & Contemporary Auction Sales (US$ million)

Auction sales in the first half of 2019 are down 11 percent year on year. There is more uncertainty surrounding the next 12 months outlook as less than half of the experts believe the market will go up, compared to 70 percent of experts last year.

Art Market Analysis is based on Modern & Contemporary Auctions - Sotheby's, Christie's, Phillips, Bonhams, Piasa, Strauss, and ArtHouse Nigeria

The global art market experienced strong growth in the first half of 2018, however the market slowed down considerably in the second half, with the negative trend continuing into first half of 2019. A combination of increasing political and economic uncertainty, coupled with heady valuations in the art market, has raised the stakes of a possible art market contraction.



Marion K. Maneker
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Expert voices

10 THINGS YOU NEED TO KNOW TO UNDERSTAND THE NEXT FIVE YEARS OF THE ART MARKET

There is a ceiling

If the years since 2014 have taught us anything, it is that there is a top to the art market, and we have reached it. In 2011, 2014, and 2018, global sales volume peaked, according to Clare McAndrew's annual report; 2018's high point was also lower than the 2014 total. Since 2011, year-on-year growth has never exceeded 13 percent. So far in 2019, auction sales suggest another downward phase in the cycle.

There's a top—but there is a bottom too

For much of the last 15 years (a period in which the art market expanded dramatically before the global financial crisis), talk of the art market in the popular and financial press has been reflexively paired with expectations of an eventual or imminent crash. After all, a booming art market had to be a bubble. Any rational person knew that. Since 2014, those predicting an art market crash have changed their tune.

During the big drops in 2012, 2015, 2016, and this year, lower sales results have been received with equanimity. This is so normal we almost forget how different it is from the past.

The money keeps growing

The market for works of art is a function of global wealth. Although global wealth has increased greatly among Ultra High Net Worth Individuals over the last decade, Knight Frank predicts the population will grow by another 22 percent in the next five years. That means by 2023 another 43,000 individuals will have more than US$30 million in liquid assets.

The auction houses are shifting focus

The dramatic news that Patrick Drahi will take Sotheby's private should not mask the fact that auctioneers' strategies are shifting. Just as Hollywood studios shifted from producing movies to marketing them, the three main auction houses are now acting more as distributors of material gathered from collectors' estates. That means the financial deals that drove much of the top of the art market for the period from 2006 until 2014 are now taking place outside of the auction houses themselves.

A new breed of advisor is gaining prominence

The shift to selling estates has enabled the rise of a new kind of estate advisor—often a prominent former auction house specialist—who solicits financial guarantees, attracts buyers, consults on



Excéntrica © Lina Sinisterra

the presentation of the works and, in some cases, even participates in the publicity.

The buyers are changing

At the very top of the art market, the collectors are a small group of very wealthy people who remain remarkably consistent year after year. In the middle of the market, there is a whole new group of buyers—many coming in through the internet. Asian buyers continue to wield the crucial swing money that can light up a specific, sought-after lot. But their taste remains sophisticated and the buyers are well-educated and advised.

New buyers have new tastes

New collectors (who are new either because the basis of their wealth is in emerging markets or because of their age) are likely to find different types of objects valuable in coming years. We've seen a growth in value for everything from watches to sneakers to comic books which recapitulates an earlier growth in the value of wine and classic cars.

Collectors value objects that have historical, personal, and emotional significance as well as objects that connect them to history and superlative talent.

Warhol takes a rest

After nearly two decades as the primary force in the growth of the Contemporary art market, Andy Warhol's works are increasingly scarce on the market. Pricing remains an issue for the artist's canvases though we know that Warhol's imagery remains important to buyers from the activity in the print market. Surpassing Warhol in auction turnover is an artist like Zao Wou-ki whose work is beginning to rival global artists like Claude Monet.

Technology has already transformed the art world

Email, the video transmission of auctions, and increasing access to public prices outside of paid databases have already had a massive impact in creating visibility, transparency, and trust in the art market. The current shape of the art market would be impossible without digital imagery and dealers having access to direct, immediate, and constant contact with clients. That happens on WeChat, WhatsApp, email, and Instagram—tech platforms all.

Globalization turns regional artists into global artists

For the art market to continue at this level—or go higher—it needs the work of more artists. Globalization has created greater value for the world's best and most admired artists including Picasso, Giacometti, Rothko and many more. But there is also a global search for artists from all regions who can rise to the level of global artists. We can see this in the rising market value of modern British artists and European post-war artists. Hong Kong has created a distinctive market for a growing number of pan-Asian artists.

Asian buyers continue to wield the crucial swing money that can light up a specific, sought-after lot.



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Expert voices

THE ART ECOSYSTEM FOR FUTURE GENERATIONS

UNITING THE BUSINESS WORLD, THE CULTURAL SECTOR, AND THE HOSPITALITY INDUSTRY IN OPENING UP A CLOSED MARKET

Against the backdrop of Asia's transformation into one of the world's bastions of art and culture, there are growing calls for the revitalization of the Japanese art market. With Tokyo 2020 as the key driver, Agency of Cultural Affairs, Japan (ACA) has set out a culture and economic strategy that signals a departure from the traditional focus on heritage conservation. Deloitte interviewed Yasuta Hayashi, Deputy Director, Cultural Economy and International Affairs Division Agency for Cultural Affairs on the strategy and his vision for the desired art ecosystem.

Demystifying Japanese in the context of art and culture: the harmonious integration of nature, aesthetics, and mindfulness through art

Japanese culture has traditionally emphasized living in harmony with nature. With a devastating natural catastrophe so fresh in our memory, a key part of our national experience is our ongoing desire to build a harmonious relationship with the majesty of nature. This has, in turn, shaped our sense of aesthetics and our attitude towards art and culture. Japanese tradition has at its heart our desire to assimilate elements of nature and aesthetics into our lives, cemented through changes in time and undergoing millennia of evolution. Since Japan opened its doors to the world in 1853, a thirst and admiration for foreign cultures and lifestyles have greatly affected the values assigned to traditional arts. Intense efforts to rebuild the nation in the aftermath of World War II have also led to the unintended consequence of distancing arts and aesthetics from modern Japanese lives. Our agency's goal is to close this distance, and to bring the joy of aesthetic appreciation, collection, and patronage firmly back into our national vocabulary.

The current state of the Japanese art market: domestic centricity and limited recognition of art as an investment

A recent study published in March 2019 estimated the size of the current Japanese art market as US$2.25 billion. While this represents three consecutive years of growth, and thus a move in the right direction, the Japanese art market has yet to blossom and our cultural GDP remains considerably lower than that of our peers as a consequence. While the reasons for this are multifaceted, relatively low recognition of art as an investment

ArtTech and traceability: redefining the Japanese art market on a global scale.

can certainly offer one explanation. Despite increasing popularity among new generations of collectors, viewing art as an investment vehicle has not entered the mainstream of Japanese art collecting. This is partly the result of our hesitation to link art to monetary gain. Consequently, market, financial, and regulatory infrastructure surrounding art investment remains underdeveloped, particularly when compared to other classes of asset such as real estate where long-standing asset valuation mechanisms exist. In addition, the Japanese art market has so far operated somewhat in isolation from the global supply channel, in that reputable department stores known for safety and quality remain the main suppliers of artworks in Japan. Such domestic centricity has so far limited the growth of Japanese art collectors, as well as serving to cap the active promotion of Japanese artworks overseas and the value at which artworks can be priced with a primarily domestic audience in mind. Another key element is the mandatory arts education in Japan, which has traditionally emphasized output to allow children to express their creativity.

This differs from the arts education in many comparable countries, where children are taught how to establish a personal link with artists and artworks from an early age, and thus naturally progress from appreciation to collection.

Key drivers of change: tax reform and other governmental pushes towards market vitalization

As an example of a governmental push, we enacted a tax reform in 2019 that introduced conditional exemptions to inheritance tax linked to artworks. In conjunction with our efforts to encourage donation to museums and other academic collections, we hope this serves to protect artworks when they change hands, as well as enhancing what our public collections can offer. We are also revisiting the roles museums play in our society and how they could evolve to keep pace with the times.

As seen in many recent examples overseas, leading museums are increasingly moving beyond the traditional bounds of collection and display to make their voices heard on societal issues. Without diluting the emphasis on conservation and academic excellence, we would like museums to incorporate entrepreneurial spirit in their operations so as to utilize their valuable assets fully and in a more globalized context through joint efforts with the hospitality industry. We would like our museums to explore innovative ways to engage with society and play an active part in shaping our shared future.

Culture and economic strategy: establishing an art ecosystem for sustainable investment in arts and culture

In December 2017, our government enacted a culture and economic strategy with the ultimate aim of establishing an art ecosystem that unites different sectors in sustainable value creation and reinvestment. Through strategic coordination of the public and private sectors, we hope to build a mechanism bringing together the business world, the cultural sector, and the hospitality industry to elevate the Japanese art industry. Various initiatives are currently being considered, including appropriate incentives to encourage foreign investment in the Japanese art ecosystem as well as proactive coordination with Government of Japan such as the Ministry of Economy, Trade and Industry and the Financial Services Agency in our efforts. The strategy represents a significant departure from our traditional focus on the conservation of cultural heritage, reflecting a growing recognition of the potential of the arts to spark a virtuous cycle of economic activities.

Support mechanism for emerging artists: borderless curatorial network

Several Japanese artists have entered the global art scene and been met with considerable support and recognition. Yayoi Kusama and Takashi Murakami have become household names, and Shinro Ohtake, Leiko Ikemura, Kōhei Nawa, and Izumi Katō are following in their footsteps. In addition to our international artist exchange program, the ACA is actively seeking ways to enhance our support for the next generation of artists. For instance, we are focusing on building an international curatorial network that will play a central role in promoting emerging artists. We envisage a positive exchange where overseas artists find support in Japan and Japanese artists find support overseas. Our vision for supporting emerging artists is one that transcends national borders and engages multitudes of players including curators, art galleries, media agencies, and businesses.

Our strength: technology meets art

Recent years have seen the emergence of artists who integrate technological elements in their expression. TeamLab and Rhizomatiks are the chief examples of our position in this field. Various collaborative projects and successful permanent exhibitions continue to captivate audiences from across the globe. Since 1997, the agency has sought to promote the intersection between technology and art through the Japan Media Arts Festival as the primary forum for talent discovery. We hope to elevate the festival to the international stage in the near future. Another key recent development is the birth of Japanese blockchain platformers, who are intensifying their preparations for market launch. Whether they focus on traceability or seamless compliance with the incoming AML stipulations in Europe, we hope that our technological expertise can help to redefine the Japanese art market on a global scale.



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Expert voices

ART & FINANCE HIGHLIGHTS FROM THE LOW COUNTRIES

The views expressed in this article are the personal views of the author and not those of Deloitte.

The Dutch have an interesting track record in the Art & Finance sphere. Just think of our compatriots Mr. Joseph Duveen and of Vincent van Gogh's brother and uncle, who were both associated with the firm of Goupil & Co. We were delighted to contribute to this edition of the *Art & Finance Report* a summary of recent events within the Dutch Art & Finance landscape to show that this tradition is still very much alive.

Royal Rubens

One sale that received considerable media attention was Sotheby's auctioning off of a small selection of drawings that came with an impressive royal pedigree. Consigned by Her Royal Highness Princess Christina of the Netherlands, the highlight of this selection was a preparatory drawing by Rubens for one of his masterpieces that adorn the Cathedral of our Lady in Antwerp, the magnificent "Raising of the Cross". The provenance of this drawing included the collection of the princess's forebears and renowned art collectors King William II and his wife Anna Pavlovna (or Paulowna to use the Dutch spelling). In the Dutch press a rather lively discussion was held on whether or not this was the royal way of disposing of an artifact that had in particular the Boymans van Beuningen Museum of Rotterdam frothing at the mouth. As the drawing was considered private property by the Dutch government, it felt it had no say in what should or shouldn't be done with it by its proprietress. In a rather unusually direct way, even by Dutch standards, the director of the Boymans and the Rembrandt Association took clear positions arguing that the drawing should be offered to a Dutch museum before being turned into more liquid assets on the international art market.

An alliance between the Boymans Museum and several Dutch supporting funds engaged Bob Haboldt to bid at the auction. Even Mr. Haboldt's last bid, with which he surpassed the instructions given to him, could not secure the drawing for the museum as he was outbid and the lot went to an unknown buyer (rumored to be Leon Black, the US hedge fund tycoon) for a hammer price of US$7.2 million. Given the estimate of US$2.5 million to US$3.5 million, the Boymans clearly pushed the bidding to its limits. Meanwhile, an independent committee has been instructed to advise on the efficiency of current legislation aimed at protecting artwork of national importance. Again, installing independent committees to investigate touchy subjects is a very Dutch measure to take. To be continued.

Rotterdam Rubens

The Boymans Museum was a key participant in the discussion on the Rubens that it wanted to secure. It was also involved in a string of lawsuits regarding a collection including several Rubens drawings that it might stand to lose. Ms. Christine Koenigs has been claiming ownership of a collection of drawings that her grandfather Franz Koenigs had assembled and that includes works by Fra Bartalomeo, Rembrandt and 45 drawings by Rubens. Part of this collection is with the Boymans Museum, and part of it was sold to the Führer museum and is still held by Russia as compensation for damages during WWII. While the District Court of The Hague ruled against Ms. Koenigs' claim to the collection earlier this year, another descendant offered a bust of Mr. Koenigs to the museum as a token of support. To be continued?
The Boymans van Beuningen Museum will, in any case, very much remain in the

spotlight, given that it is constructing an art storage facility that will give the public access to its entire collection. A world first, it is due to open in 2021 in a building as splendid as they come: entirely covered in mirrors. Again, this new venue has been created as a collaboration between the museum, the city of Rotterdam, and the privately funded De Verre Bergen Foundation.

The Rembrandt divorce: the sequel?

Despite an appeal for private funding, in the end the portraits by Rembrandt of husband and wife Marten Soolmans and Oopjen Coppit were bought in 2015 by the French and Dutch states from Eric de Rothschild: Marten's portrait was acquired by the Dutch state and Oopjen's by the French. Although exhibited together, legally they would remain apart, never to be joined in ownership again. Recently there have been rumors that representatives of the Rijksmuseum are in conversation with the children of Elie de Rothschild who inherited yet another Rembrandt masterpiece from their father: "The Flag-bearer". Rumor has it that this single painting will have a similar price tag as Marten and Oopjens' portraits combined.

To date, the accuracy of these rumors has been unclear. We are beginning to wonder whether this masterpiece, that was part of the collection of George IV, will also end up returning home through a French connection. To be continued (and if so, very publicly, no doubt).

Renaissance of the public private collections

A fascinating recent development is the opening of a number of privately funded yet publicly accessible museums. Museum Voorlinden, initiated and funded by collector Joop van Caldenborgh, showcases modern and contemporary art from his eclectic Caldic collection in the idyllic setting of the Voorlinden estate surrounded by gardens designed by Piet Oudolf. The Lisser Art Museum is an initiative of Jan van den Broek. It will focus on contemporary art from the collection of the VandenBroek Foundation and will be part of the Keukenhof estate (world famous for being the showcase of Dutch flower expertise, including those once overpriced tulip bulbs!) And then there is the Museum More, which is another private initiative from a Dutch entrepreneur: in this case, Hans Melchers. It specializes in modern realism (hence the name "mo-re") and includes a collection of Dutch magic realism. Interestingly, all three museums are located outside large urban areas and all three have turned out to be major successes in attracting crowds. This success has also brought Museum Voorlinden and Museum More into disputes with their respective municipalities because of there being too few parking spaces to cope with the traffic they generate. Obviously, even where private art is concerned, the Dutch government and public opinion are important factors.

Reshaping the TEFAF

Once a year, the attention of international art lovers with deep pockets is focused on the Netherlands. In early March, the TEFAF offers entry options with varying degrees of exclusivity: some viewings are highly selective whereas others are open to paying guests and others can be accessed by connoisseurs from around the world. Whether the visitor is particularly interested in classical, contemporary, modern or ancient art, the best of the best is showcased in displays that often constitute works of art in their own right.

This practice of combining artefacts from across the globe and from all periods has increasingly come to the fore because the competition in this part of the financially relevant artistic stratosphere is becoming more and more fierce. In a move that was at once drastic and effective, the new management team shook things up by not renewing their invitation to particular dealers who had been part of the TEFAF since its inception and by adding new names to the list to increase the level of quality across all sections. Indeed, this revamped and tweaked selection of dealers gave a refreshed, upbeat image to the TEFAF, and meant that everyone knew they had to earn their place in the next event.

The art trade looks to auction house veterans to lead their fairs

Both the TEFAF and PAN Amsterdam were created by and for the art trade in the Netherlands and have proven such a success that they have been copied extensively. Now that many of the original founders have passed away, the younger generation of art dealers is increasingly turning to former auction house directors to lead the fairs. Patrick van Maris van Dijk was engaged as CEO of the TEFAF a few years ago and very recently his ex-Sotheby's colleague was appointed Managing Director of PAN Amsterdam.

This new crossover trend is luckily working both ways as former Christie's MD Jop Ubbens is making waves as a private dealer with great taste.

Buddha litigation

An Amsterdam court case that ended in December 2018 and generated considerable media attention had a Song dynasty Buddha statue as its litigious centerpiece. Two Chinese municipal committees claimed that the statue, held by an Amsterdam dealer, and containing the mummified remains of Master Zhang Gong, had in fact been stolen from them in 1995. However, as these municipal committees could not be recognized as legal entities, the claim could not be judged.

Looking to the past and the future

Given the strong historical Dutch footprint in South East Asia, many Dutch collections contain yet-to-be-identified treasures that will appeal to buyers with a cultural link to the areas of production. A Chinese Yuan dynasty vase from a Dutch estate was auctioned off at Christie's in 2013 for €23 million. The object is said to have been in use as an umbrella stand. Local auction houses are reported to be seeing increased interest from Asian buyers looking for hidden gems for which they are willing to pay appropriate prices. A picture by Indonesian artist Lee Man Fong was hammered off in 2018 at €402,000 at Vendu Notarishuis in Rotterdam. This record did not last long as the news reports on staggering prices made a young heiress in Iceland check the family records on a painting, and another Lee Man Fong was found. Due to its strong reputation in selling Asian works of art, the family consigned the painting of an eagle to the Zeeuws Veilinghuis. The auction itself was spectacular! Bidding went in increments of €200,000 and a hammer price of €900,000 set a new record for the artist. We expect more of these finds to turn up at Dutch auctions and generate significant interest from foreign buyers. That brings us back to our history as traders on the art market: a history that is very much alive today.



Section 2

Art & Wealth Management

Noospheres © Lina Sinisterra (2017)

Highlights

Wealth managers forced to rethink the client experience
Recent wealth management research[23] suggests that wealth industry stakeholders will have to change their business models and the relationships they have with clients. Value propositions focused on personal and emotional connections will become increasingly important as a way to stand out from the competition. Creating a personal and emotional connection with clients through passion-related wealth could be the key to unlocking the value of art and wealth-related services.

Holistic wealth management is a key driver behind the focus on art-related services
The benefits of developing a holistic wealth management advisory service remain the key argument for service providers to include art and collectibles in their service offering. A large majority (83 percent) of wealth managers said that a desire to offer more holistic services to their clients was a vital motivating factor (down from 85 percent in 2017).

In general, stakeholders agree on the value of art as one aspect of a wealth management offering
This year's findings show the highest reading since the launch of the survey in 2011, and a strong consensus among wealth managers, 86 percent of whom said art should be part of a wealth management offering. The vast majority (86 percent) of art professionals and art collectors (81 percent) said the same.

The wealth management community has introduced more art-related services for clients in recent years
This year, 72 percent of wealth managers said they offered art-related services to their clients. This was up from 64 percent of wealth managers in 2017. This shows that more private banks and family offices are responding to client demand for additional services; however, the future is somewhat uncertain.

Collectors increasingly see their art as an integral part of their total wealth
81 percent of collectors surveyed said they wanted wealth managers to incorporate art and collectibles into their service offering, which was up from 66 percent in 2017 and the highest reading since the report was launched in 2011. This suggests that collectors are increasingly seeing art and collectibles as part of their overall wealth.

Consolidated reporting is needed
With more collectors viewing art and collectibles as part of their overall wealth, there is also a need for consolidated reporting. A large majority (84 percent) of art collectors surveyed this year said that they wanted to include art and other collectible assets in their wealth reports so as to have a consolidated overview of their wealth and a better understanding of their exposure (up from 61 percent in 2017). Including art in wealth reporting could be an effective way for wealth managers to introduce an art-related wealth management offering and be in a position to offer a proactive and meaningful value proposition to their clients.

Value propositions focused on personal and emotional connections will become increasingly important as a way to stand out from the competition.

23 *World Wealth Report 2019, Capgemini*

Changing perceptions around the financial aspect of art ownership
This year's survey findings among collectors indicate a shift towards more financially motivated art ownership models. The numbers of respondents who reported buying art for the purposes of boosting investment returns or diversifying their portfolio have seen an increase since 2017: 52 percent of collectors said that portfolio diversification was a strong/very strong motivation for buying art this year (up from 36 percent in 2017). This is the highest reading since 2011.

A transfer of wealth to the next generation is boosting demand for art and estate planning services
Most collectors (76 percent) said that estate planning would be the most relevant service for them (up from 69 percent in 2017). This indicates that collectors' top priorities are estate planning and generational wealth transfer. Art professionals agreed with collectors, with 78 percent saying this would be a very valuable service. Mounting pressure to ensure transparency and regulatory changes may also be driving this trend.

Art philanthropy and social impact investment are attracting more attention
Another area in which the collectors surveyed this year said that they believed wealth managers could play a more significant role is art philanthropy. 65 percent of collectors said this would be a helpful service, up from 45 percent in 2017. This is also the only area in which we have seen increasing interest among wealth managers, with 51 percent saying they will focus on this in the coming 12 months (up from 40 percent in 2017). The role of impact investing in art and culture will be explored in greater depth in section 4.

Collectors are increasingly willing to share their collections with the public
Art foundations, private museums, and new technological platforms (virtual collections, virtual reality, etc.) are increasingly making private collections accessible to the public. We are seeing a paradigm shift in the way private collectors share their collections for the good of wider society, and we are likely to see this trend continue among the next generation of art buyers. The notion of being a "caretaker" rather than an owner is likely to be one of the motivations underpinning art philanthropy models over the next decade. This is discussed further by Christian Kaspar Schwarm (p.82)

Collectors and art professionals feel valuation services should be provided by the wealth management industry
87 percent of art professionals (versus 74 percent in 2017) and 73 percent of collectors (compared with 74 percent in 2017) said that valuation would be one of the most relevant services for wealth managers to offer. This could indicate that there is demand for a higher level of trust and standardization around valuation, and suggests there is demand for the wealth management industry to help standardize the valuation process (see also Priorities section p.31).

Urgent need to address art and estate planning issues
In this year's survey, art and estate planning was the service identified by the highest number of collectors (76 percent this year compared with 69 percent in 2017) and art professionals (78 percent compared with 80 percent in 2017) as the most relevant art wealth management service. With the entry into force of new transparency requirements for entities, discussed on p.100, it is essential for entities to anticipate and adapt to upcoming changes. With more than a third of the private banks surveyed yet to discuss art-related wealth with their clients, addressing how art assets should be organized is now an urgent matter.

Strategic approach to art and wealth management required
Over the eight years we have been surveying the wealth management community, we have seen issues around art and wealth move from the periphery to the mainstream as a central part of the discussion on how wealth managers should respond to clients' needs as part of a more holistic service offering. It is evident from this year's findings that collectors want more from their trusted advisors, and it is important that wealth managers are prepared to respond to questions and put forward a clear client proposition when it comes to art and collectible wealth.

It is evident from this year's findings that collectors want more from their trusted advisors. It is important that wealth managers are prepared to respond to questions and put forward a clear client proposition when it comes to art and collectibles wealth.

Introduction

Creating a personal and emotional connection with clients through passion-related wealth



Professionals in the wealth management industry are going through a transition process as they seek to adapt to the different needs of a younger generation of clients. Recent research by Capgemini[24] shows that a new wealth manager/client dynamic is forcing the industry to reinvent the **client experience**. Industry executives and wealth managers agree that this trend will continue to accelerate and ultimately transform the industry.

An interesting finding from the abovementioned research was that the next generation of wealth management clients seek connections—particularly **emotional** and **personal connections**. To improve the client experience, the research suggests that wealth managers must consider connecting emotionally with clients. 28 percent of surveyed HNWIs cited their advisor's lack of emotional intelligence as the reason they did not connect well. HNWIs also said that to build an authentic emotional connection, their wealth manager needed to offer strong investment expertise (35 percent), trust and security (28 percent), and personalized attention (nearly 15 percent).

The HNWI survey measured the personal connection between HNWIs and their primary wealth managers over the previous two years and determined that those companies that ranked in the top 25 percent for strong personal connection (Connection Leaders) outperformed the bottom 25 percent (Connection Laggards) in a comparative analysis on several measures.

The findings suggest that wealth managers will have to rebuild their business models and redefine the relationships that wealth managers and clients share. A value proposition that focuses on personal and emotional connections will become a differentiating factor in an increasingly competitive marketplace.

It is in the domain of personal and emotional connections specifically that we believe that art and wealth management could develop a mutually beneficial partnership. The tangible benefits of developing a client relationship model built around clients' interests, hobbies, and passions will be an essential part of understanding and engaging with these individuals.

From the perspective of art-related wealth, this would mean devising a strategy that identifies and addresses client needs when it comes to art and collectibles. As the survey findings in this section show, this could range from education, events, and experiences to more hands-on services such as art advisory and collection management, or financial services such as estate planning, art-secured lending, and art investment.

24 World Wealth Report 2019, Capgemini

487 Horas Pensando © Lina Sinisterra (2009)

Collectors & Art Professionals

Survey findings 2019

Collectors increasingly see their art as an integral part of their total wealth

If market experts are correct in estimating that 6 percent of the assets held in global wealth portfolios are allocated to "luxury investments", this would amount to a total of approximately US$1.74 trillion[25] in art and collectible wealth held by UHNWIs in 2018. It is also clear that art and collectibles account for a growing share of UHNWIs' overall wealth. This year, 84 percent of wealth managers surveyed said they had clients with art collections (90 percent of family offices and 82 percent of private banks); this highlights the opportunity for wealth managers to create both emotional and personal connections with their clients around art and collectible wealth.

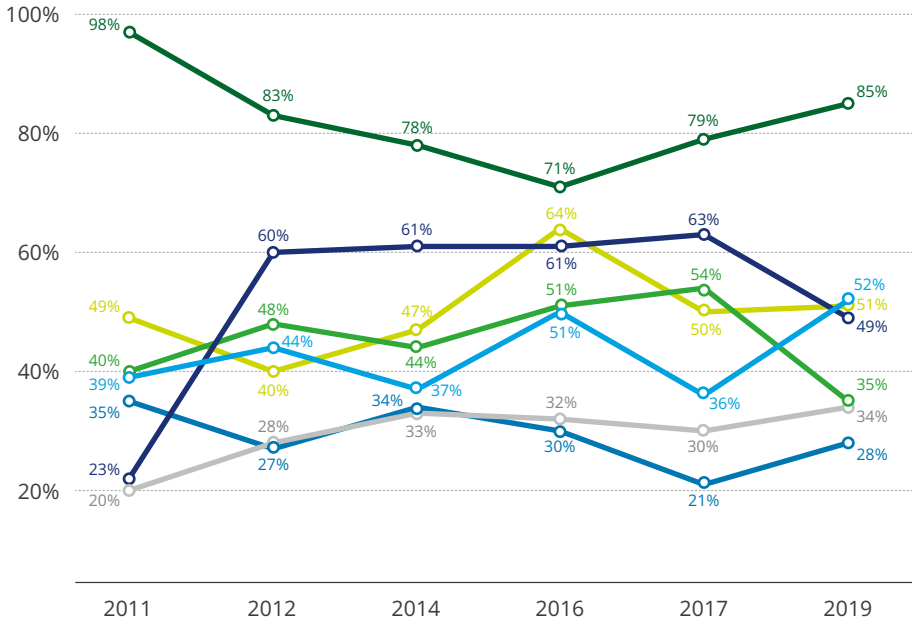
This year, 81 percent of collectors surveyed said they wanted wealth managers to incorporate art and collectibles into their service offering (up from 66 percent in 2017). This suggests that collectors are increasingly seeing art and collectibles as part of their overall wealth and indicates that the broader wealth management industry needs to start thinking about a cohesive strategy around integrating art-related wealth into existing services and reporting mechanisms. 84 percent of the art collectors surveyed said that they wanted to include art and other collectible assets in their wealth reports so as to have a consolidated overview of their wealth and a better understanding of their exposure (up from 61 percent in 2017).

Changing perceptions around the financial aspect of owning art

The findings set out below indicate that we are seeing a shift towards a more financially motivated art ownership model. This could have a significant impact on the development of the wealth management industry over the next few years.

Figure 13. Collectors: which of the following motivations are most important in buying art?

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Stronger financial motivations as buying art becomes more "normal"

Both art collectors and art professionals see "social value (status)" as less important than they did in the last reading. This may signal that buying art is becoming less elitist and demonstrate a shift in focus from external values (i.e., how we are perceived) towards personal values (i.e., emotional pleasure, individual happiness, etc.) and towards the financial value of owning art. Both investment returns and portfolio diversification have seen an increase since 2017. 52 percent of collectors said that portfolio diversification was a strong/very strong motivation for buying art (up from 36 percent in 2017); this is the highest reading since 2011. This finding clearly resonates with the idea that more collectors want art-related services to be included as part of wealth management.

25 *In the Deloitte Art & Finance Report 2017, we reported an estimated US$1.62 trillion in art and collectible wealth based on estimated UHNWI wealth in 2016. In this report we have used the same methodology and assumed that UHNWI wealth has grown at the same rate as HNWI wealth (using growth estimates from Capgemini's World Wealth Report 2017 and World Wealth Report 2018). We have also assumed that the allocation of assets to art and collectibles is the same as that reported in the Knight Frank Wealth Report 2017 as the Wealth Report 2019 published different figures based on passion investment as a percentage of the investment portfolio and not of total wealth as in 2017.*

Figure 14. Emotion vs investment: why do your clients buy art? (art professionals)

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

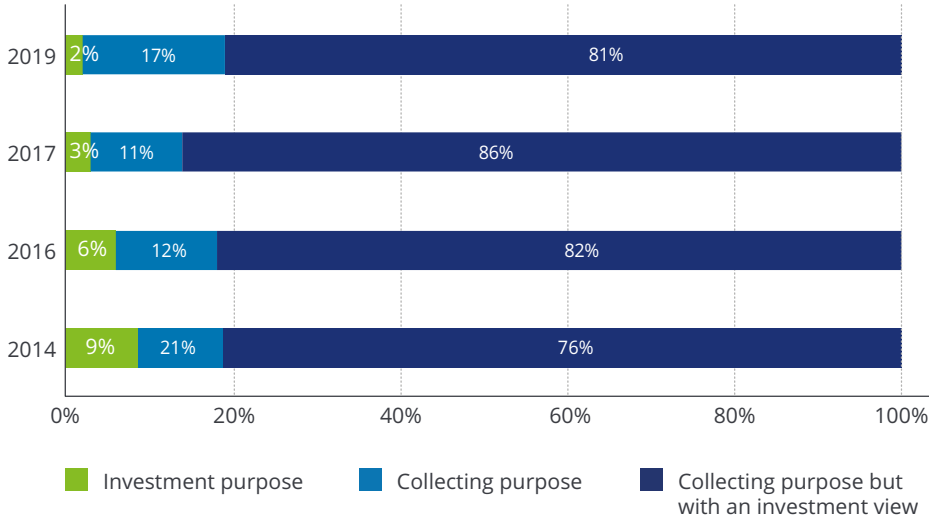
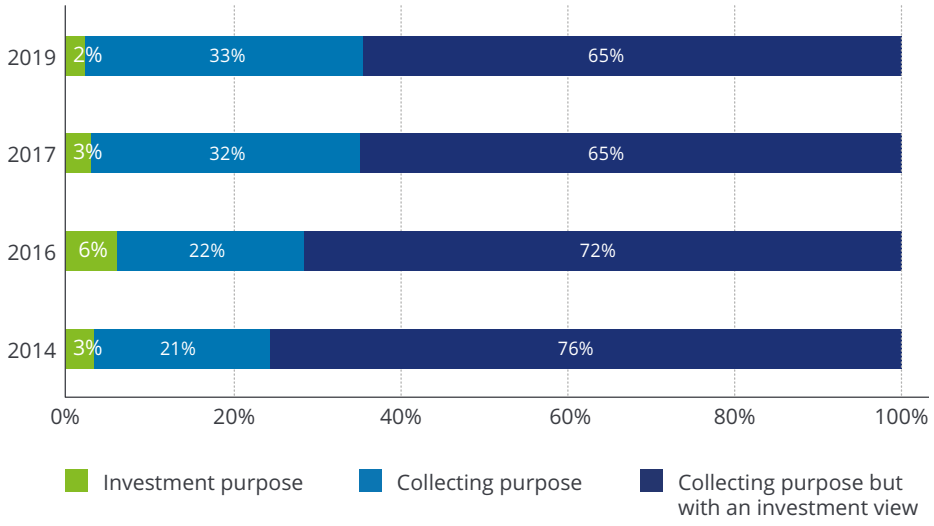


Figure 15. Emotion vs investment: why do you buy art? (art collectors)

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



The art trade is increasingly catering to a financially motivated audience

81 percent of art professionals said their clients bought art for collecting purposes, but with investment in mind (this is slightly lower than the 86 percent who said the same in 2017). 33 percent of the collectors surveyed said they bought art for collecting purposes and not for its financial value; however, the majority of collectors (65 percent) said they bought art for both emotional and financial reasons (same as in 2017).

It is interesting to note that 81 percent of the art trade (based on findings from the advisors, dealers, and auction houses surveyed) believe their clients are motivated by both emotional benefits and financial returns when buying art (this was up from 79 percent in 2017). With higher prices, more media coverage, and more financial value associated with art, it is evident that collectors and art professionals alike, including within the art trade, are becoming increasingly aware of the financial aspect of art ownership. We have noted an interesting trend among both auction houses (Sotheby's acquisition of art index company Mei & Moses) and galleries (such as Gagosian) to launch their own art market tools and analytics for their clients. This is a sign that perceptions around art collecting are changing and that clients are demanding more sophisticated art market data, information, and tools when deciding to acquire or sell a work of art.

This year, 81 percent of collectors surveyed said they wanted wealth managers to incorporate art and collectibles into their service offering (up from 66 percent in 2017).

Demand for art-related services

Where have we seen the **biggest shifts** and changes over the past two years?

The following are the areas in which we have seen the most significant changes in perception among collectors and art professionals:



Art valuation



Estate planning



Art philanthropy



Demand for education

Art valuation

87 percent of art professionals (versus 74 percent in 2017) said that valuation would be one of the most relevant services for wealth managers to offer. Although art valuation is not typically an area in which wealth managers have extensive skill and experience, this could signal that art professionals feel that valuation needs standardization and maybe regulation. After all, these efforts would boost trust in the valuation process and trust is a fundamental aspect of the entire art and finance industry. Art valuation also features high on collectors' wish lists, with 73 percent of collectors saying that valuation would be an important service (compared with 74 percent in 2017). The focus on valuation this year also overlaps with both art professionals' and collectors' fear of price manipulation: 75 percent said that this was a very strong threat to the reputation of the art market. In practice, this could mean that the wealth management industry, in partnership with art valuers and appraisers, could play a role in standardizing and creating a neutral framework for how valuation should be carried out in order to promote trust and transparency in art valuations.

Estate planning

76 percent of collectors said that estate planning would be the most relevant service for them (up from 69 percent in 2017). This indicates that estate planning and generational wealth transfer are collectors' top priorities and should be a focus area for wealth managers in the future. Art professionals agreed with collectors: 78 percent said this would be a very valuable service. Mounting pressure to ensure transparency and the change in regulation could also be a driver for this trend (see more on Art & estate section p.98 and the article by Pascal Noel on p.100).

Art philanthropy

Another area in which this year's collectors believe wealth managers could play a more significant role is art philanthropy. 65 percent of collectors said this would be a relevant service, up from 45 percent in 2017. This should be seen in the context of collectors' interest in estate planning issues, as there is an opportunity for art philanthropy to be incorporated into an estate planning strategy.

Demand for education

63 percent of collectors said that this would be a relevant service for the wealth management community to offer, up from 52 percent in 2017. This indicates that wealth managers have an opportunity to interact with new and existing clients through educational activities, which could act as a springboard for more formal relationships with other wealth management services and products.

Figure 16. Collectors: which of the art wealth management services are most relevant to you?

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

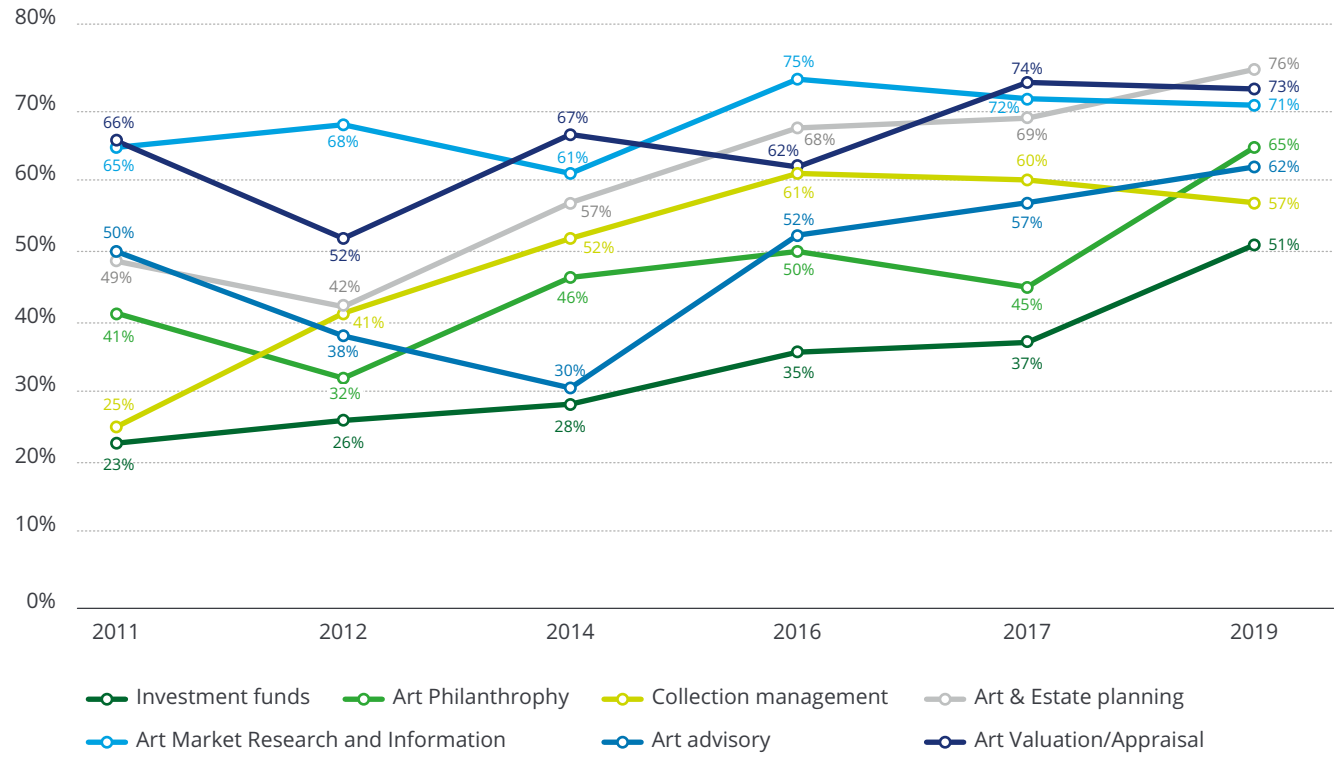
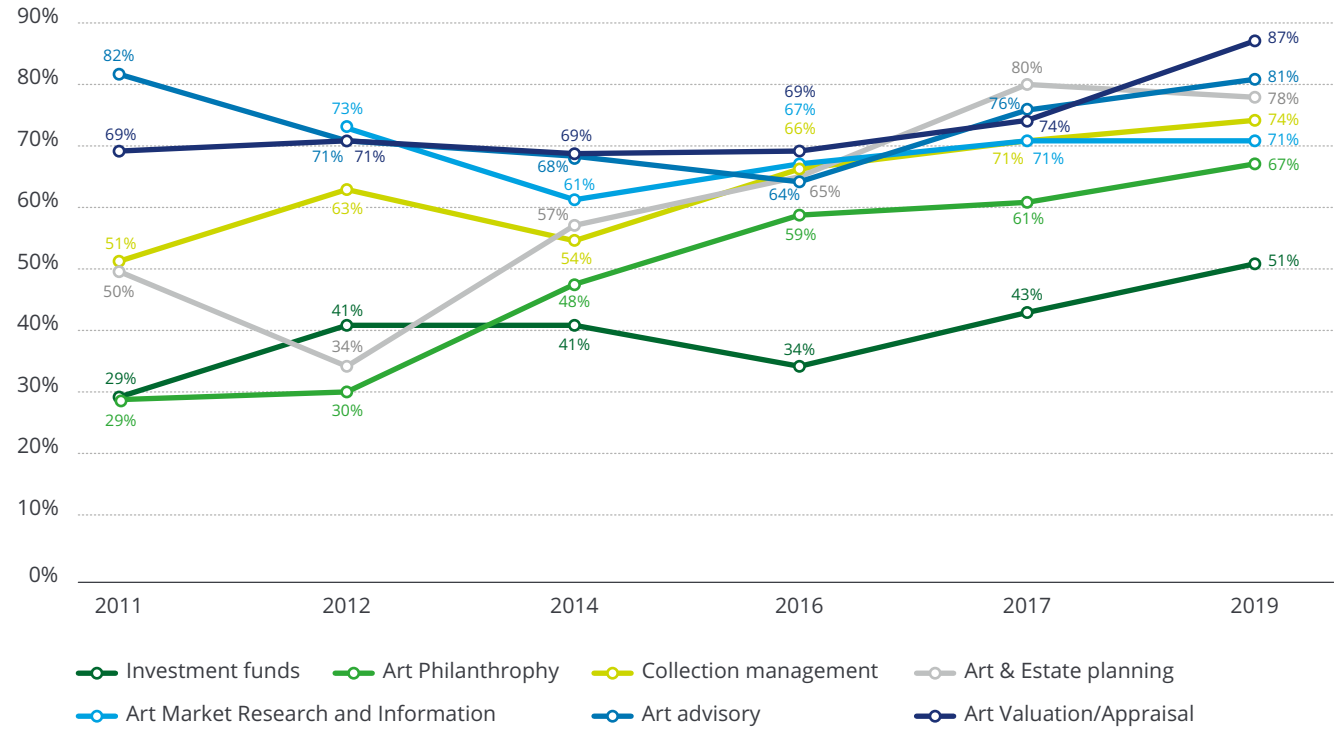


Figure 17. Art professionals: which of the art wealth management services are most relevant to your clients?

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Expert voices

A PARADIGM SHIFT IN COLLECTING ART

A conversation with Christian Kaspar Schwarm, founder of Independent Collectors, by Markus Seiz, Deloitte



Christian Kaspar Schwarm
Founder of Independent Collectors

Christian Kaspar Schwarm, Berlin 2019. Photo: Jana Gerberding

Christian, 11 years ago you founded the first global, non-commercial, online platform for collectors of contemporary art. Despite the fact that this was only just over a decade ago, it seems that we live in a different world today. What changes have you observed among collectors?
There have indeed been major changes in terms of the general mindset and the behavior of most collectors—especially when we look at their basic willingness to make their own collections publicly visible. Nowadays it has become almost a kind of social responsibility to give the general public the chance to see artworks that had previously been kept behind closed doors. It does not really matter whether a collector meets this obligation by setting up an actual space in "real life" or by granting access online. Most of the major collectors we work with are actually doing both.

Would you call that development a paradigm shift?
Absolutely! When we started Independent Collectors in 2008, the guarantee of undisturbed privacy was one of our most important principles. Back then, our website was actually a kind of "closed" platform that you had to apply for. This approach perfectly reflected the prevailing philosophy at the time: we provided almost 7,000 free memberships for Independent Collectors and had to deny around 10,000 other applications because we could not confirm that the person behind them was a "real" collector. This shows that the most important priority was to create a safe space, free of any commercial interests, where engaged collectors could find likeminded people, e.g., people who lived in the same city or shared their passion for a specific artist.

What happened then?
As you said, it was only a decade ago, but let us recall for a moment that Facebook only had 360 million monthly users in 2009 (today it's 2.38 billion) and they only started their chronological timeline function in late 2011. Instagram did not even exist before 2010. So, the whole social media phenomenon is one of the main change drivers, which of course, has affected the art world and collectors too.

So, is social media the only factor behind this drive for greater transparency among collectors?
As always, it is more complicated than that. I would describe the tendency to make an art collection publicly accessible (as mentioned, either offline or online) as a development based on four powerful trends. The first of these trends is the rise of a new technological, digital era that brought the ability to send and receive messages worldwide almost instantaneously literally to our fingertips. The second trend, which is connected to the first, is the general shift towards greater publicity, in both the private and the corporate spheres. Third, in terms of the art world, the function of collecting art has changed. It has definitely become a multidimensional passion, rather than one based around a singular aim. The French philosopher and sociologist Pierre Bourdieu differentiated between economic, social, and cultural capital. Whereas in the past most collectors focused on one of these three aspects at the expense of the others, modern collectors often treat them as completely interdependent.

And the fourth trend?
Since art can be a very beneficial asset to hold, we have also seen literally thousands of new foundations spring up in recent years. This includes many foundations that specialize in art collection. Again, in most cases there are several reasons why an investor might choose to set up their own organization or institution. Some collectors just want to make sure that their collection will endure and not be split up after their death. Others might be trying to reduce their tax burden. Giving the public some form of access to the collection will help in all of these cases. In my opinion, this is another important factor driving the shift towards increased public access to collections.

How has your platform reacted to these trends?
We have monitored the situation almost "live" (for want of a better expression). This gave us the chance to follow it step by step. Year on year, we became more public too, by opening up more and more categories not only to our registered art collectors, but also to every art lover out there. Two years ago, our website was 90 percent public and there was only one single category left that was still exclusively reserved for our members. We have now been completely public since January of this year. So, if you like, our mission as a platform has completely changed within a decade—from a closed community to an open hub that acts as a contemporary archive showcasing the activities of the world's leading private art collections. We adapted because collectors' behavior changed, and they suddenly needed something totally different. They were asking for a different kind of opportunity to reach out to people.

An article in Forbes magazine quoted your opinion on the changing role of the collector—from market speculator to cultural interpreter. What do you mean by this?
The more collections become public, the more powerful they get. That might be seen as a positive or even as a critical development. But either way I think it comes with a huge cultural responsibility. Art is not just another asset class—in some ways, every important work of art belongs not only to a single collection but always to the whole of humanity too. If we take that seriously, collectors are indeed cultural interpreters.

In contrast to public museums, private collectors are not obliged to collect in the context of a specific social consensus, they are free to follow their own nose. But this does not excuse us collectors from the idea of preserving what is or could become relevant and therefore important in the future.

Do you have any advice for wealth managers on how to deal with this new, more modern type of art collector?
Every collector, and therefore every collection, is different. So are their motives for collecting art in the first place. Casually speaking, there could be maybe two or three reasons to buy a luxury car. But if somebody bought an artwork for about the same price, there are actually hundreds of possible reasons why she or he did so.

I have been in meetings where inexperienced consultants have destroyed any potential trust with one single wrong question. It might sound too simple, but always ask. Ask about the personal reasons why a person collects, about their personal background and knowledge, and about their interest in a single position or artwork. The most experienced collectors teach you that art is an endless universe, full of inspiration, questions, and stumbling blocks and that you'll only navigate your way through it with sincere openness and curiosity.

What should the wealth manager's role be in dealing with collectors?
Once you realize that there are already a lot of other experts who offer their services to collectors—think of all the gallerists, art consultants, tax advisers, and lawyers—it is rather difficult to answer this question in a general way. I am a consultant myself and, as always in business, it is good to focus on whatever it is that you do better than anyone else. Keeping that in mind, I see two different scenarios for wealth managers: they can either define themselves as linesmen or as referees. As a line judge, they keep an eye on what is happening on the playing field and if needed, they wave their flag, and stop the match.

Alternatively, they place themselves right in the center of everything and intentionally take control of all aspects of the game. In practice, this means offering an exhaustive range of services that may or may not be related to art. That might sound attractive but let me be clear: the latter needs a lot of expertise and I have definitely come across more people in my life who have completely underestimated the complexity of the art world, than I have met reliable professionals who always knew what they were talking about.

Wealth Managers

Survey findings 2019

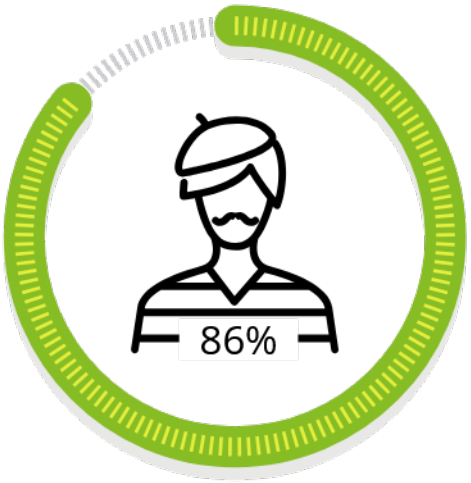
Key motivations for including art & collectibles in wealth management

Wealth managers continue to see significant benefits in including art and collectibles as part of their product and service offering

86 percent of wealth managers said they thought there was a convincing argument for including art in their wealth management service offering (82 percent of private banks and 94 percent of family offices held this view). This was slightly lower than in 2017, when 88 percent of wealth managers were strongly in favor of the inclusion of art. This year's findings show the largest consensus so far among wealth managers, art professionals (86 percent of whom said art should be included in a wealth management offering), and art collectors (81 percent of whom agreed).

The desire to develop a holistic wealth management advisory service remains the key argument for including art and collectibles as part of a service offering A large majority (83 percent) of wealth managers said that the growing push to offer more holistic services to their clients was a prime reason to include art and collectibles as part of a broader range of services (this was slightly lower than the 85 percent seen in 2017). It is clear that as more wealth managers move towards a holistic management approach, fewer banks describe competition in the sector as the prime reason for including art in their wealth management offering, as only 58 percent of wealth managers said this was the case (down from 72 percent in 2017).

86 percent



of wealth managers said they thought there was a convincing argument for including art in their wealth management service offering

Shifts in opinion among wealth managers

Wealth managers are not motivated by rising art valuations

The fact that art now accounts for a larger share of clients' overall assets is seen as a significantly less important argument this year: only 39 percent of wealth managers said this was important, compared with 73 percent who said the same in 2017.

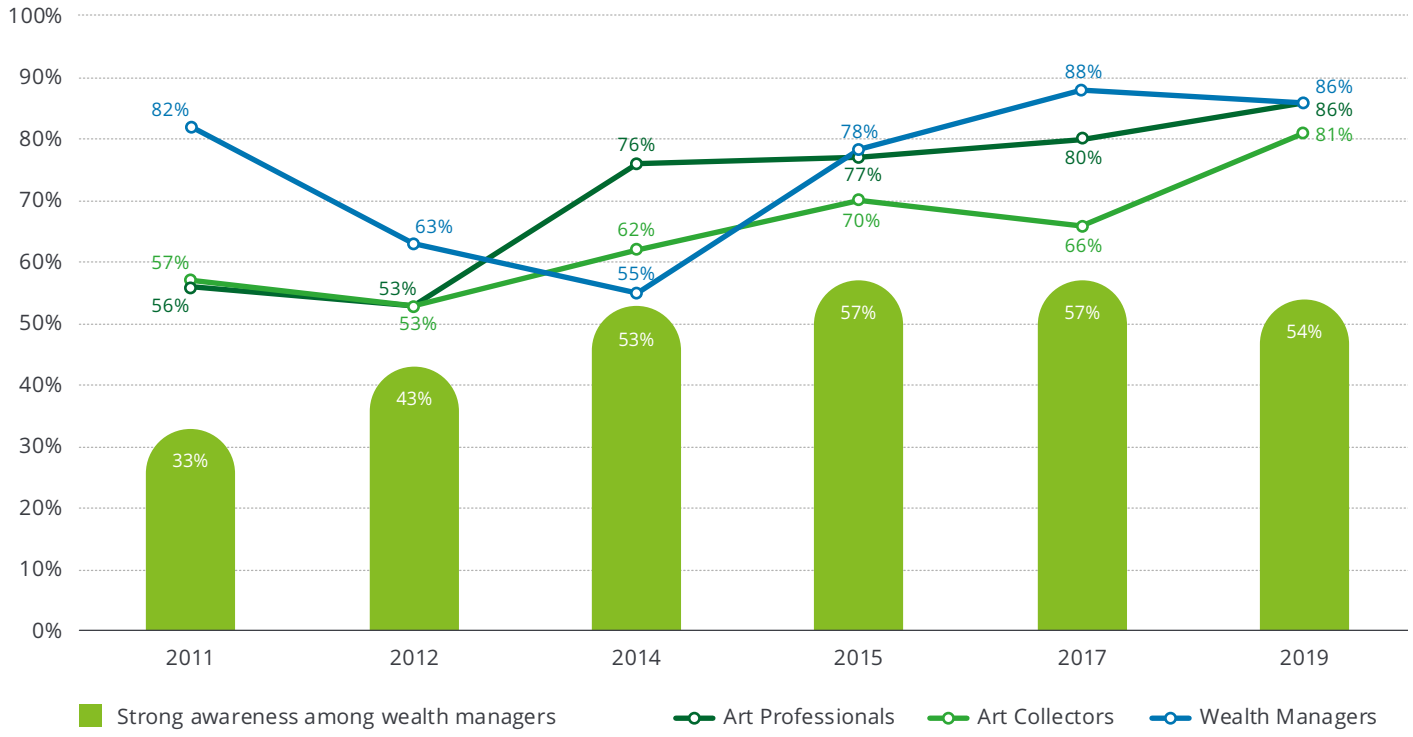
A number of conclusions may be drawn from this. Firstly, the wealth management community views the rise in art market sales and prices with suspicion, and professionals are not prepared to change and adapt their strategy according to these market trends. Secondly, there is a lack of understanding and knowledge about the art market and how to respond to rising art valuations. In other words, wealth managers do not know how to properly assess the risks and rewards linked to providing art-related services aimed at protecting, enhancing, and leveraging the increasing value of art.

Less pressure from clients

Just 34 percent of this year's wealth managers said that they were seeing growing calls from clients for wealth

Figure 18. Do you think that art and collectibles should be part of a wealth management offering?

% answering Yes - Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



managers to help with art-related issues (tax planning, estate planning, etc.). This was significantly lower than the 55 percent who expressed this view in 2017.

The portfolio diversification argument is back in vogue

While the results from this year's survey indicate weaker support for many of the arguments that were among the most important in 2017, it is interesting to note that more wealth managers (54 percent this year compared with 48 percent in 2017) now believe that art and collectibles offer portfolio and asset diversification benefits and therefore should be included in wealth managers' services. This finding also echoes the changing motivations for buying art reported by art collectors and art professionals.

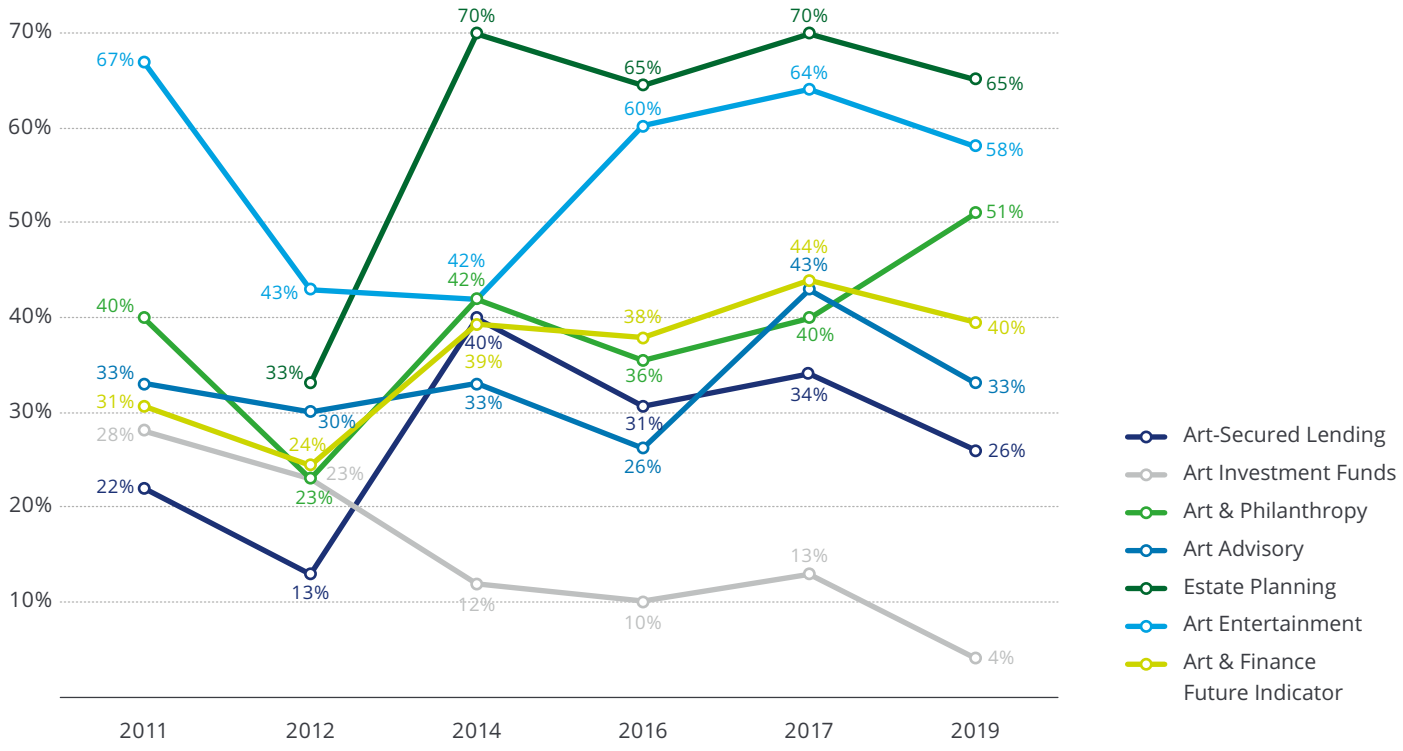
Perceptions of the importance of art as an asset class have diverged and should be brought back into line

Recent years have seen the wealth management community respond to demand by offering clients more art-related services

72 percent of wealth managers surveyed this year (80 percent of private banks and 53 percent of family offices) said they were currently offering art-related services to their clients. This was up from 64 percent of wealth managers in 2017. This shows that more private banks and family offices are responding to client demand for

Figure 19. Future: which services will you focus on in the next 12 months?

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



additional services; however, the near future looks somewhat uncertain.

Strong consensus among stakeholders about the value of art as part of a wealth management offering

This year's findings show the highest reading since the launch of the survey in 2011, indicating a strong consensus that art should be part of a wealth management offering among wealth managers (86 percent expressed this view) art professionals (86 percent), and art collectors (81 percent).

There has been a slight decrease in awareness among wealth managers about developments in relation to art as an asset class; however, this could be the result of differences between this year's sample and the sample from 2017.

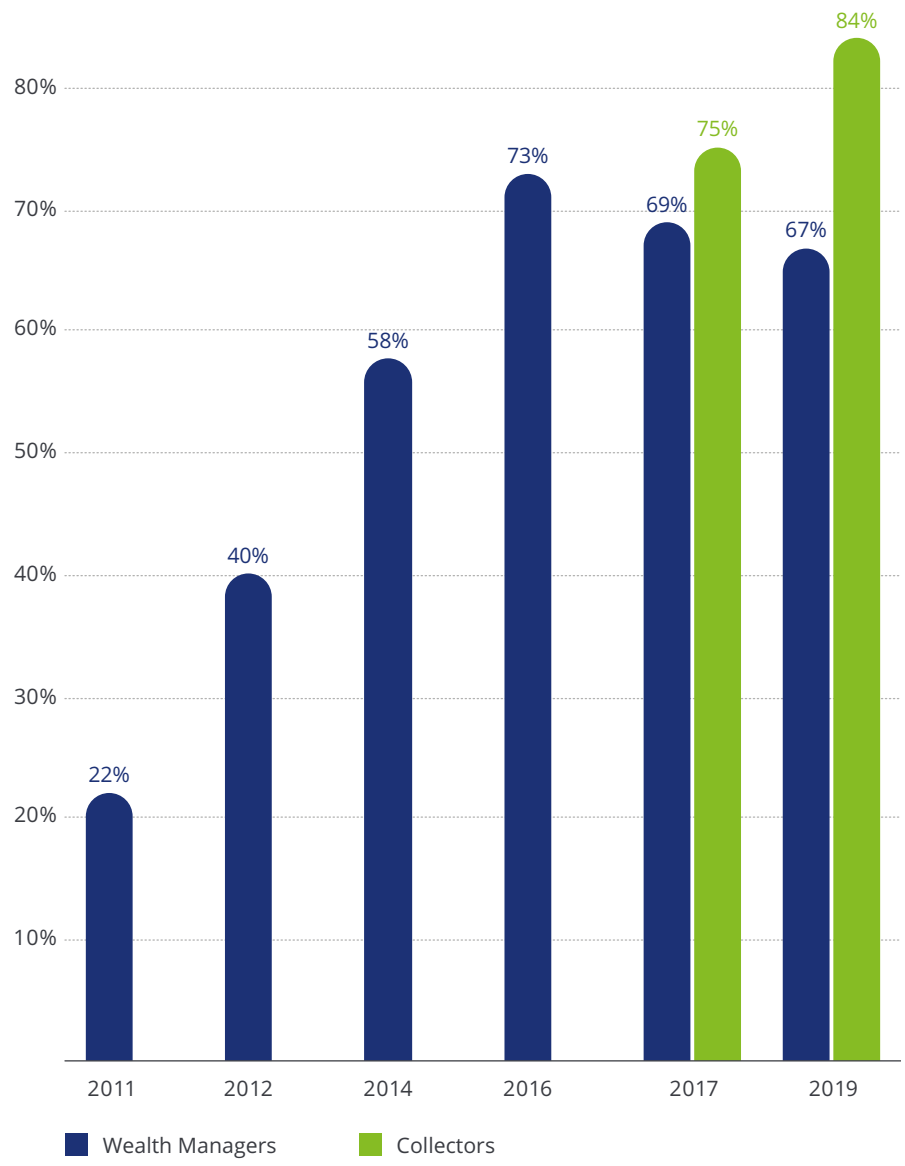
Uncertainty around future investment in activities relating to Art & Finance could reflect a maturing market

This year's survey shows that both collectors and art professionals believe that art and collectibles should be part of a wealth management offering. This finding was echoed by the wealth management community, with a large majority (86 percent) of wealth managers expressing this view (compared with 88 percent in 2017). However, this year's findings signal a lower level of focus on most activities related to Art & Finance. The exception to this was art philanthropy, as 51 percent of wealth managers said they would focus on this in the coming 12 months (up from 40 percent in 2017). Whilst these findings could be interpreted as suggesting that the wealth management community plans to invest less in the future, in light of the other findings and with 72 percent of banks already offering art-related services (up from 64 percent in 2017), it seems more likely that the wealth industry is preparing to meet client demand for services associated with art-related wealth.

We will explore these issues in more detail throughout this report in order to better understand the perceptions and fears that currently exist within the wealth management sector when it comes to art as an asset class. We will also be considering why investment in services related to Art & Finance seems to be falling precisely when demand and interest among clients are on the rise. Are the challenges and threats posed by current art market practices undermining confidence within the wealth management industry? If so, how can this trend be reversed?

Figure 20. Future trend: do you expect your clients to want to include art and other collectible assets in their wealth reports so as to have a consolidated overview of their wealth and a better understanding of their exposure?

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



*This question was first added to the art collector survey in 2017

Art-related wealth and consolidated reporting

67 percent of wealth managers 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 wealth and have a better understanding of their exposure (compared with 69 percent who said the same in 2017). There was no difference of opinion between private banks and family offices on this point.

Although private banks are aware of the need for consolidated reporting, only 28 percent said they currently offered this service. In contrast, 77 percent of family offices said they already included art and other collectible assets in their clients' wealth reports.

This year, 84 percent of collectors and art professionals surveyed said that their clients were likely to want to include art and other collectible assets in their wealth reports. Again, this finding suggests that there is a difference between what wealth managers are offering and what their clients would like to see.

This could represent an opportunity for wealth managers and be an effective way to introduce an art-related wealth management offering in order to offer a proactive and meaningful value proposition to clients.

This year, 84 percent of collectors and art professionals surveyed said that their clients were likely to want to include art and other collectible assets in their wealth reports.

Art-related services offered by the wealth management industry

What art-related services do wealth managers currently offer?

Client entertainment

This year, 77 percent of the wealth managers who offered art-related services said they offered client entertainment in the form of private viewings, visits to art fairs, museum exhibitions, etc. (this was down from 94 percent in 2017). 58 percent of wealth managers said they were likely to be investing more in art-related client entertainment over the next 12 months.

Estate planning and philanthropy rank high on the list of services

77 percent of wealth managers said they helped their clients with art and estate planning issues (compared with 89 percent who said so in 2017). 67 percent of wealth managers offered advice around art philanthropy and individual giving (compared with 72 percent in 2017). 88 percent of wealth managers said they offered estate planning services in-house (compared with 77 percent in 2017), and 74 percent said they offered in-house art philanthropy services (this was the same as in 2017). 65 percent of wealth managers said they intended to increase their involvement in estate planning over the next 12 months (compared with 70 percent who said the same in 2017).

Client education

71 percent of wealth managers who offered art-related services said they were focusing on client education (compared with 76 percent in 2017). 73 percent of wealth managers said that these services would be provided by in-house experts. Client education was also at the forefront of 47 percent of wealth managers' minds as a key focus area for the next 12 months.

More than half of wealth managers offer their clients the option of investing in art and collectible investment funds

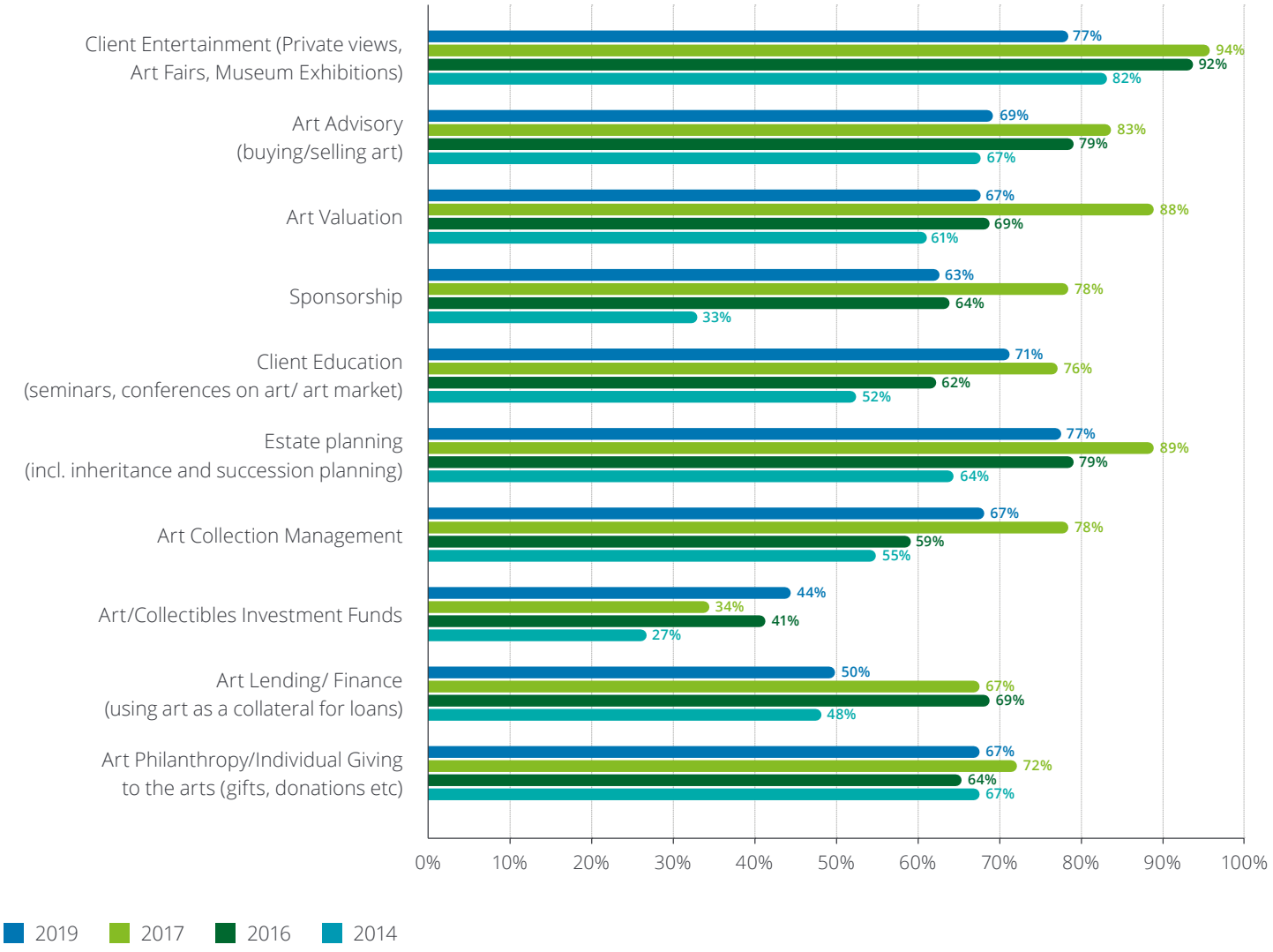
44 percent of wealth managers said that they offered art investment fund services, with 78 percent of these reporting that this service was provided by a third party. Only 4 percent of wealth managers said they would focus on this service in the coming 12 months, down from 13 percent in 2017.

Art collection management remains a priority

67 percent of wealth managers who already offered art-related services said they offered their clients art collection management services (78 percent said the same in 2017). 40 percent of wealth managers said this service was provided in-house, while 60 percent said they were using a third-party provider. 37 percent of wealth managers (compared with 36 percent in 2017) said they intended to develop art collection management services for their clients. On the technology

Figure 21. Which of the following services do you offer? (Percentages shown represent banks who offer art-related services either in-house or through a third-party provider)

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



side, some new tools are being developed in this regard, such as the tool created by Arteïa (see p.181). Frédéric de Senarclens, founder of ArtMarketGuru, discusses collection management systems in his article entitled "The holistic wealth manager as art adviser" (p.92).

Art valuation services remain important and are predominantly provided by external parties

67 percent of wealth managers said they could help their clients with valuation issues (down from 87 percent in 2017).

71 percent of wealth managers who offered art-related services said they were focusing on client education.

86 percent of wealth managers said they would use a third party for this service (79 percent said the same in 2017). In the short term, 30 percent of wealth managers said they intended to start providing valuation services for their clients (37 percent said the same in 2017).

Figure 22. Which art-related services do you offer in-house and which through a third party?

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

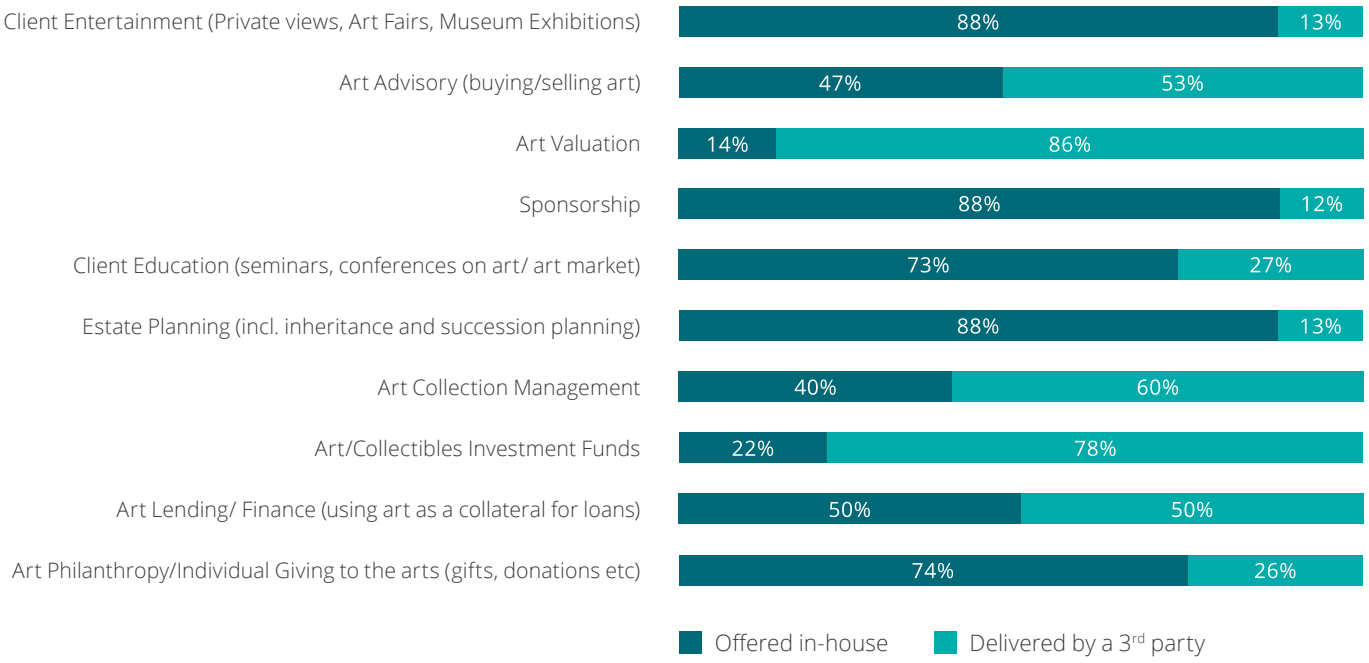
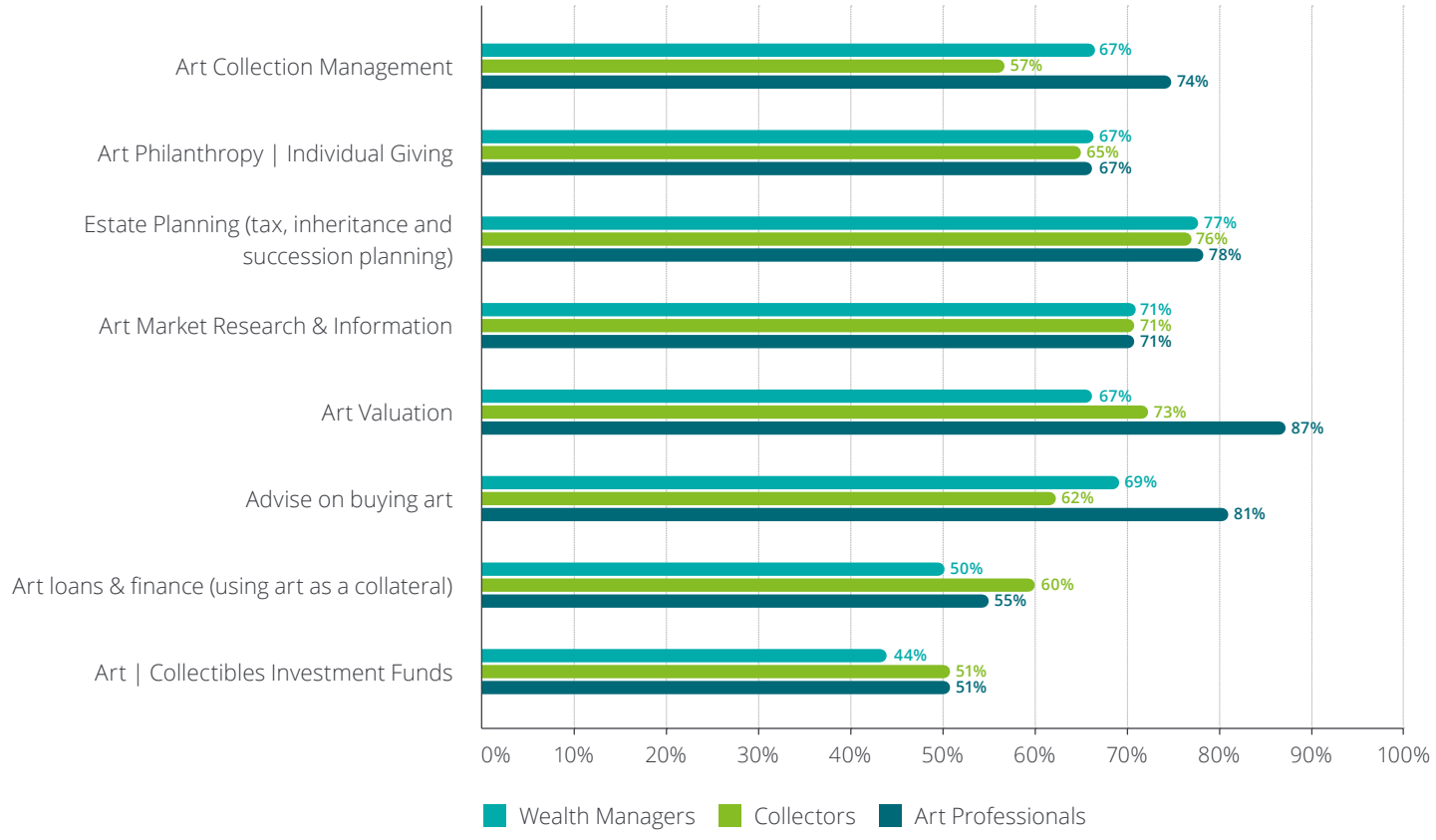


Figure 23. Gap analysis: services that are most relevant to collectors and art professionals vs services currently offered by wealth managers

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Key challenges

Why are wealth managers struggling to incorporate art and collectibles into their services?

Low transparency

Lack of market transparency was cited as the top challenge by 58 percent of wealth managers this year. However, this was lower than 2017, when 75 percent of wealth managers said this was the key challenge.

The unregulated nature of the market

58 percent of wealth managers said this was a major obstacle to providing art-related services to their clients (compared with 65 percent in 2017).

Lack of internal expertise

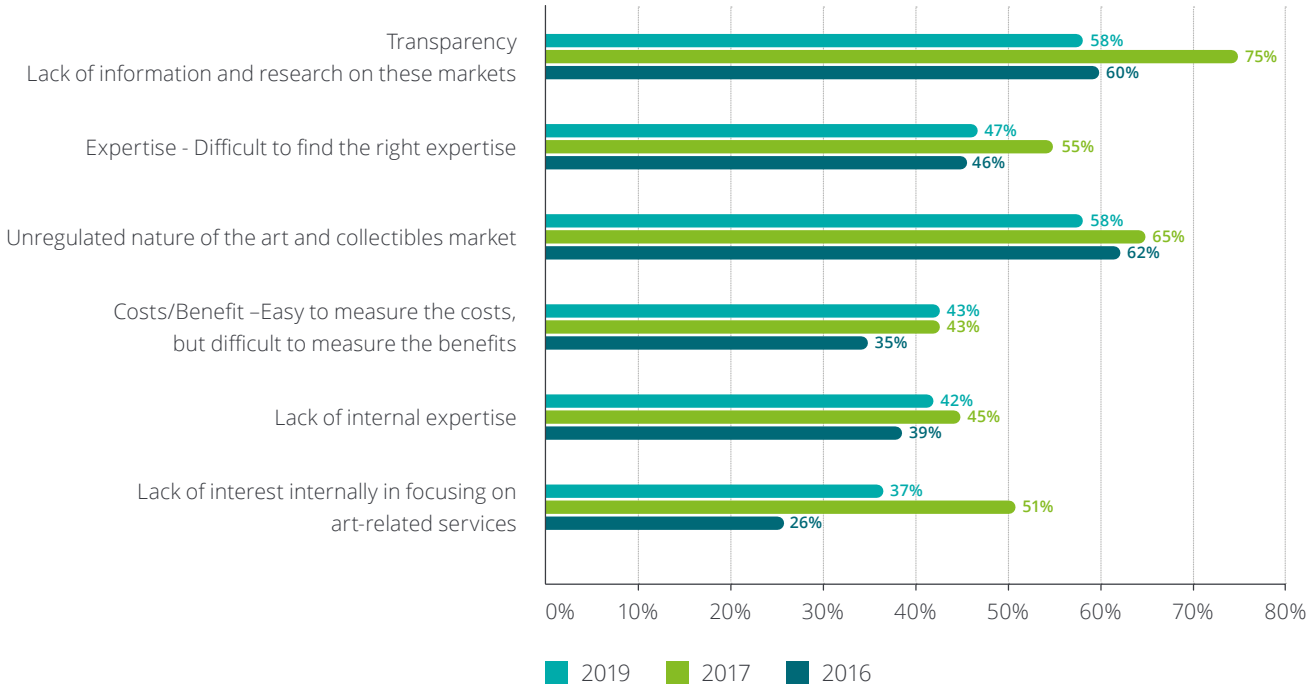
42 percent of wealth managers said that the lack of internal expertise was a key challenge to offering art-related services and products, down from 45 percent in 2017. Finding the right expertise was also mentioned by 47 percent of wealth managers as a key constraint (compared with 55 percent in 2017).

Difficulty in measuring benefits

Almost half of wealth managers (43 percent) said it was hard to measure the benefits of art-related services (the same figure as in 2017). However, as wealth managers move towards focusing on improving the personal connections they have with their clients, it is likely that the benefits of offering art-related services will become more apparent and therefore easier to sell internally.

Despite these challenges, Harvey Mendelson, Managing Director of 1858 Ltd. Art Advisory, shares his views on p.94 of the recent growth of art wealth management in the financial world. Melanie Damani, Co-founder and Managing Director at Hottinger Art Limited, also shares her opinions on an art advisory service within an international multi-family office, ruled by strict ethical and high professional standards, on p.96.

Figure 24. Wealth managers: what do you see as the biggest challenge in offering art-related services/products?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Expert voices

THE HOLISTIC WEALTH MANAGER AS ART ADVISER



Frédéric de Senarclens
Art consultant and entrepreneur, founder of ArtMarketGuru

An opportunity for wealth managers
Over the past 10 years, online platforms and marketplaces have been a dominant force in re-shaping the art industry. In the coming five years, ArtMarketGuru foresees a radical shift in the way we deal and exchange art as art dealers and consultants adapt to a new set of rules. We believe that this shift will also present the opportunity for wealth managers to offer new services and ultimately play a bigger role in the management of their clients' art and collectible wealth.

From paper to digital
For many years, managing collections meant logging an object's every move in a book. Artists, collectors, dealers, and museums recorded all activities and information relating to artworks (acquisition, inventory, loan, sale, condition, damage, location, etc.) in a dedicated filing system. At the end of 1990, the transition to office computers and the availability of easy-to-use software meant that organizations were able to record their collection in a digital format, using Word or Excel. In addition, a popular software program allowed inventory managers to create their own framework and environment with personalized fields.
Today, the art market has seen start-ups flourishing, offering practical, easy-to-use online art inventory management systems. These range from basic online artwork tracking systems to more sophisticated integrated collection management applications. Some providers include: Art Base, ArtBinder, Artbutler, Artcloud, Artlogic, ArtEngine, Arteia, Arternal, ArtFundi, Art Galleria, ArtLook, Artmoi, ArtVault Software, Artwork Archive, CatalogIt, CollectorIQ, GallerySystems, galleryManager, GalleryTool, Managed Artwork, PastPerfect, PortoVenere, and WrkLst.

Powerful inventory management services
Most of these applications offer data protection, inventory management, customer relationship management (CRM), and built-in marketing tools. They allow users to securely store images and documents relating to artworks such as certificates of authenticity, invoices, provenance information, condition reports, and location history. Most providers have built-in search and tagging capabilities, easy-to-use interfaces to browse and share inventory, standard insurance and personalized reporting functions (overview by artist, price, location, etc.), with advanced providers also offering embedded art market research tools, competing with the existing price data players.

Holistic wealth management
The wealth management industry is well established, regulated, and fast-growing. Private bankers and family officers offer sophisticated asset management and concierge services to high-net-worth individuals (HNWI) and families.

The Credit Suisse Global Wealth Report 2018 estimates global household wealth in 2018 to be US$317 trillion and records that there are 42.2 million millionaires worldwide. It defines ultra-HNWI as adults with a net fortune above US$50 million and it estimates that there are 149,890 ultra-HNWI worldwide. Credit Suisse is expecting these numbers to continue to grow and predicts that global wealth will reach almost US$400 trillion by 2023, with 55 million millionaires and 205,000 ultra-HNWI[26].

A wealth manager's main goal is to safeguard the interests of their clients. This covers everything from preserving family harmony to arranging for a fortune to be passed on to the next generation. Traditionally, wealth managers help their clients to optimize taxes and grow their investment portfolio. However, with digital transformation and the emergence of technologies such as blockchain, Artificial Intelligence (AI), Robotic Process Automation (RPA), and Application Programming Interfaces (API), wealth management software programs are enabling even small and mid-size firms to offer a more holistic approach. Firms are increasingly managing more than just their clients' wealth and are expanding to areas including estate planning, debt, loan management, education, insurance, and retirement planning.

ArtMarketGuru has interviewed a variety of family officers and bankers who report growing demand for sophisticated services and holistic wealth management among HNWI. Potential clients now expect that the ability to monitor the value of an art asset will be offered as standard. Although wealth managers are increasingly reporting allocations involving "passion assets" such as wine, art, jewelry, and cars, many private bankers lack art expertise and rely on third-party experts for auditing, collection management, and valuation. "Our core business is to manage money, not art," says one Zurich-based family office manager.

Collections are generally recorded at the buying price and are manually updated as and when needed. Wealth managers are generally cautious when it comes to providing advice or services in relation to managing art and collectibles as they perceive collection management to be challenging given that art assets are illiquid and yield no recurring revenue. Most wealth managers are not equipped to offer and charge for any art management services.

Art and collectibles: an asset class that cannot be ignored

Analysts estimate that worldwide, privately owned art and collectibles make up trillions of dollars' worth of assets. In the Art & Finance Report 2017, Deloitte estimated that UHNWI held US$1.62 trillion in art and collectible assets. It expected this figure to grow to US$2.7 trillion by 2026[27]. Some analysts even claim that art and collectibles worldwide account for US$6 trillion[28]. We believe wealth managers cannot ignore the value of the art industry and it is their duty to ensure adequate reporting, valuation, insurance, promotion, and management. Holistic wealth managers should keep appropriate records of all acquisitions, loans, and sales and keep an overview of insurance and day-to-day art logistics.

Collecting art is not just a matter of accumulating objects: it is about understanding trends, pricing, future taste, cultural differences, and market opportunities. It is about mastering logistics, branding, and promoting pieces through museum lending and cataloguing. In short, art management is not something a person can or should try to improvise. It is about time for an application to provide an all-in-one art decision and management tool dedicated to meeting wealth managers' needs.

Traditionally, the role of art experts—e.g., art consultants, dealers, and auctioneers—has been to act as an authority on price, quality, and authenticity. Art collectors agree to pay large premiums to secure an acceptable level of transparency and avoid fraud and forgery. New technologies are pushing the boundaries and setting new standards in this regard. For instance, blockchain technology combined with smart tagging is creating environments with increased trust between parties and will eventually reduce the need for intermediaries. New applications utilizing AI will, at some point, provide sufficient data for anyone to be able to make decisions on an art acquisition or sale.

The need for robust art collection management systems

Holistic wealth managers should be equipped with software that allows them to securely store and share collection information, analyze market data, receive alerts, and gather price estimates and information on asset liquidity. Wealth managers should have a dashboard they can use to better value, monitor, and promote art collections whilst optimizing art assets. New players are already pushing the boundaries by offering efficient and sophisticated tools to collectors and art advisers. They are enabling collection managers to have a better sense of value and facilitating liquidity over time. Furthermore, they are developing APIs allowing wealth managers to connect with their existing wealth management software and synchronize client collections, whilst aggregating data and keeping track of art market trends.

CollectorIQ, a relatively new player based in New York, is actively working to deploy their application with wealth managers. It claims to be the "Preferred Art Services Provider for UBS" and provided ArtMarketGuru with concrete examples of wealth managers taking interesting new roles in managing client's assets. For instance, they mentioned an Atlanta-based money manager contributing to the sale of artwork or and a family office reducing their client's tax exposures by arranging a charitable contribution.

Collection management application providers should go one step further and give family office managers enough confidence to actively enter the sector and offer new services to their clients, either in-house or in collaboration with third-party art experts.

26 Credit Suisse, Global Wealth Report 2018, October 2018, pp. 2, 4, 22-23, 33
27 Deloitte, Art & Finance Report 2017, p.36
28 This estimated figure was given by CollectorIQ

Expert voices

MATCHMAKING FOR THE FUTURE—WEALTH MANAGEMENT AND ART ADVISORY



Harvey Mendelson
Managing Director
1858 Ltd. Art Advisory

As an art advisory firm operating across the art and wealth management space, we have gained an extraordinary amount of market insight from our banking partners over the years and are delighted to share it with Deloitte for the sixth edition of the *Art & Finance Report*.

Why we believe art advisory services are becoming increasingly important for the wealth management sector

Despite an uncertain economic outlook, the stakes are high with the global UHNWI population forecasted to rise by 22% over the next four years, meaning an extra 43,000 people will be worth more than US$30 million by 2023.

Now is the time for wealth managers to act pre-emptively to seize the immense potential offered by this market. Private banks are well aware that HNWIs and UHNWIs maintain relationships with multiple banking institutions at once and that if they are to compete in an increasingly competitive marketplace they need to provide expert advice in relation to a growing number of aspects of clients' lives. Securing assets under management (particularly over the long term) means following clients' interests, which we have noted are increasingly moving towards art, cars, watches, wine, and more.

These goods are commonly referred to as "passion investments". Confidence in this sector has grown steadily and it has gained in popularity over the past 15 years, inadvertently enhancing our business along the way. We have expanded our team of preferred partners to include car, wine, and watch specialists to service the 30 percent increase in demand for advice on passion investments.

Through our global operations, we have observed several of our banks ramping-up their service offerings in H1 of 2019. One of the more exciting expansions saw one of our existing clients roll out their art advisory services to offices across Continental Europe and Russia. The acquisition of a Russian bank has meant that the bank's clients now expect access to the same services their European counterparts were receiving. We have since designed a unique range of services for the bank and trained the private wealth teams in how to deliver this expertise to their clients. Clients can now access expert advice at home in Moscow whereas they previously had to travel to London. The timing of this recent service launch in Russia coincides with a change in Russian law in 2018. At long last, legislation has been passed recognizing contemporary art as art. Previously, works of art created under 50 years ago were treated as "luxury goods" and subject to a 30 percent import tax. The new law passed on 29 January 2018 was one aspect of a radical revision of Russian art import-export regulations. The legislation prevailing before that date (created in the chaos of the 1990s following the collapse of the Soviet Union) prohibited the exportation of cultural treasures. This also made it impossible for collectors to import art. Import tariffs and the fact that there was no guarantee of re-export made it difficult for many of our clients to enjoy their collections in Russia. As a result, they would often base their collections in Europe, where we would deliver the majority of our collection management services.

We partner with banks and third-party advisers to work with a number of Russian clients, ensuring they are able to enjoy their collections both in Russia and abroad. We are now able to import art directly for our clients in a much more cost- and time-efficient manner and this has driven up demand for the new holding structures. When a relationship manager concludes that a client could benefit from our art-market expertise, they bring in our team to meet with the client and identify ways in which we can improve buying and selling processes, logistics around importation, and strategies to seamlessly integrate the client's art collection with holding structures in Russia and abroad.

Art bankers of the future

We are delivering a growing number of lectures to business school students enrolled on wealth management programs at institutions. The trend to educate future bankers on the importance of the art market and investing in art is another strong indicator that the banking community is not shying away from engaging with clients' passion investments. Over the past two years, we have also noticed unprecedented demand from North American and offshore banks, which are taking advantage of the substantial first-mover advantage those already specializing in passion investments have as they seek to serve their existing clients and win over prospects. This is especially true in relation to setting up and managing art finance services, which banks see as a growing area and an additional revenue channel. The same could be said for our partner banks in South East Asia and demand is particularly high in Hong Kong and Singapore where the service offers added value to existing clients and acts as a strong calling card for prospects. The latter are now more likely to do business with a bank and bring in assets under management if an art and collectibles advisory service is available.

One of our Swiss banking clients is continuing to see major advantages in effective art-related trust advice—opening up a whole new type of dialogue and service offering to its clients. We are also advising the bank on due diligence for its art-finance services, which are already in high demand among its HNWI and UHNWI clients. This increase in uptake is due to the fact that clients now trust their bank to provide such services and no longer feel the need to contact an external service provider. Furthermore, we are working with them at the onboarding stage, meaning that clients joining the bank will be aware of the art and passion investment advice available to them from the outset.

These examples typify a new way of thinking for wealth managers, who now see that the question is not "if" but rather "when" and "how" they will provide this service to clients before clients seek it elsewhere. To a certain extent, this is a prudent and proactive way of safeguarding the interests of all of their clients.

Families are becoming more sophisticated and mobile

Family offices and/or in-house managers recognize the need to provide services in relation to collectible assets such as art, cars, watches, and wine across a number of geographical locations. From fast cars in France, to Monets in Monaco, there is a need to insure, maintain, and track these valuable assets as well as to decide on a strategy for acquiring and divesting along the way. We recently received a request to curate an art fair that the client was considering organizing on his mega yacht. This involved marine insurance, multiple boat-loads of art, maritime police, security teams, climate-control equipment, and so on.

The links between the art world and the yachting community are plentiful. This is arguably a result of the fact that major art collectors are often owners of super yachts themselves. Moreover, displaying art on a yacht makes sense—the experiences of both yachting and collecting art are the height of leisure, passion, and luxury. The main issues we advise clients on tend to concern the best ways of displaying artwork on a yacht, including environmental safeguards, security, and insurance. Insurance in itself is a complex topic and the devil is in the detail when it comes to ensuring that artworks are properly covered at all times. Clients are increasingly coming to realize that valuable art assets require and merit appropriate advice and expertise in line with the advice that they seek out in relation to the other assets they hold. Furthermore, a review of a client's insurance coverage can be a worthwhile exercise. We recently saved a client a six-figure sum on his premium while at the same time obtaining broader coverage that included earthquake and water damage protection, which the previous provider had excluded.

Making life less complicated

Another reason we are seeing increased interest in art advisory services is that clients are looking to simplify life by having a single point of contact for multiple requirements. If a private bank is trusted to look after most financial assets, then it is a logical step to entrust it with passion investments too, so all matters can be coordinated for the client by the bank and its trusted advisers. From a practical standpoint, once the relationship manager identifies that a client has art-related requirements, we are brought in to meet the client and deliver a detailed schedule of services tailored to the client/family's objectives, timescales, and budget. Some clients have one-off requirements such as arranging insurance, shipping, logistics, or a valuation. Others have transaction-based or finance-led requirements. Depending on the requirement, clients are charged a fee based on performance and/or specialist advisory time. Our clients with major collections across multiple locations tend to prefer a monthly or annual retainer for us to meticulously manage all aspects of the collection.

We have found that transparency and responsiveness are key and these have helped us to build strong relationships with bankers and their clients. The macro environment is also playing a pivotal role, we believe, in how clients view art advisory services. More than ever, they are looking for trusted advice during these turbulent times—and that is before we even broach the thorny topic of Brexit. During periods of financial and political instability, art has historically been viewed as a safe haven because it is a reliable long-term store of value as well as an inflationary and currency hedge. We are likely to see more funds flowing in this direction as a consequence of further uncertainty.

For more information on 1858 Ltd. and their services, please visit www.1858ltd.com

Source for all figures included in this article: The Knight Frank Wealth Report 2019

Expert voices

THE EVOLUTION OF ART ADVISORY SERVICES



Melanie Damani
Attorney-at-law (LL.M. Berkeley)
Co-founder and Managing Director
Hottinger Art Limited

In a landmark case, the Court of Appeal in London recently ruled in favor of an art dealer who facilitated the sale of artwork belonging to a long-standing friend and collector without a formal commission agreement in place. The Court accepted the dealer's case that they should nevertheless be entitled to receive US$10 million in commission. The three judges unanimously rejected the appeal of the seller, who had refused to pay the commission, stating that despite the lack of written agreement, the commission amount was part of a 'gentleman's agreement', sealed with a handshake.

This decision—undoubtedly an interesting precedent when it comes to the nature of a contract in general—forces us to question the common practices of advisors in the art world. Should it not be necessary to sign an agreement for a transaction involving potential fees of US$10 million? Would it not be the case for a similar transaction in another industry? Can it really be argued that such an agreement is not compulsory when dealing with a friend?

The art world is certainly one of the last industries providing complete freedom to its professionals in terms of the way they conduct their business. The issue is that without some form of limit or set of acceptable parameters, any aspirational individual can become an art advisor, whereas many other professions ensure certain standards of practice through education, professional associations or even regulations. As a consequence, it is difficult: (1) for collector to be sure that they have hired a serious and competent advisor, (2) for excellent advisors to be rewarded fairly for high-quality performance in a market that does not operate at a uniformly high standard, and (3) for other industries to take the art world as seriously as they perhaps should.

Quality control

Art advisors should be operating according to the values expected of them, such as independence, transparency, suitable qualifications, and avoidance of conflicts of interest. When it was launched in January 2019, Hottinger Art Limited decided to implement a business model that would set the highest standards of ethics and professionalism for an art advisory firm. As part of an international multi-family office, the idea was to combine best practice from the wealth management industry and legal sector, drawing on the professional experience of its founder Melanie Damani. This model was created to meet growing demand from collectors, who are often in an uncomfortable and weak position in which they are forced to play by the rules of the art market rather than relying on their advisor to put their interests first. For example, collectors confess to feeling pressured to follow instructions from galleries to grant access to certain

works. Inexperienced collectors often pay more for works than established collectors. These days, collectors are growing impatient of paying extortionately high commissions, well above what is considered acceptable in most other industries. In an ideal world, any business model should be created to serve the clients' best interests and to ensure a sustainable and long-term existence for the company. As such, business models should primarily focus on independence and transparency. And yet, in the art world, this starting point is seen as a disruptive model rather than the norm.

Stand alone

To illustrate the point, a focus on independence immediately prevents the art advisor from accepting commissions from third parties. Yet this is contrary to the norm and third-party kickbacks are in fact often a large part of the art advisor's income. Would it not be possible for an art advisor to be paid on a retainer basis like advisors in many other professions? Such a model actually benefits all parties. First of all, the client has the guarantee that their art advisor does not have another agenda besides serving their best interests—they should be reassured that nothing other than achieving the best outcome for their client will influence their choice of strategy or third party. For example, if the art advisor is assisting the client with building a collection, the client will be assured that recommendations to buy an artwork will be given for the right reasons and not because the advisor would receive a higher commission if the artworks are sourced from specific galleries. The galleries themselves are certainly happier to receive the full price for the sale of an artwork rather than having this eaten into by third-party commissions. Similarly, even the artist is more likely to receive the full amount due to them on the sale of the artwork and not just, as occurs in some cases, their share after the deduction of commission payable to the art advisor. As a side note, this also creates healthy competition between galleries and encourages a level playing field with merit-based decision-making, which can be absent where a different fee model is used.

Just to be clear

Transparency is also a key value. Financial institutions follow a heavily prescriptive range of regulations (e.g., MiFID II), where all costs and charges are required to be disclosed to clients in good time before the relevant services are provided. In that sense, an art advisory firm operating in partnership with a financial institution like a bank or a family office provides the assurance of transparency, since its art advisory work will fall in line with its other established practices. Whilst not regulated, art advisory firms can also benefit from applying such regulatory principles. In fact, some art advisory firms have now voluntarily opted or requested to fall under the remit of the financial services regulator to provide this extra layer of comfort to their clients. Some other non-regulated art advisors, , disclose in writing the fees they have received from clients and business partners, which is a welcome new practice on the market and a sign of a move towards greater transparency.

Whilst it is undoubtedly the right thing to do and should benefit all sides as detailed above, it is not always easy to be the first mover with respect to adopting best practice. The question might therefore be: can an art advisor with high values and standards of practice have a chance of survival in an industry that has been functioning without independence and transparency for many years, and in which less scrupulous providers may decide not to adopt what are (at least currently) voluntary standards? From the perspective of the wealth management industry, the answer is yes.
Earlier this year and for the first time, the panel at the Goodacre UK City of London Wealth Management Awards awarded a business development prize to an art advisory firm, as testament to the efforts made to implement an offering that assures independence and transparency for clients. This is a sign that the wealth management industry, if not the art market, is willing to encourage better practice, with the aim of creating a better global market for all participants.

Rules and regulations

Furthermore, if the art market does not clean up its act from within, it is most likely that it will eventually be forced to do so by the introduction of new regulations. In fact, the art market has already had to adjust to regulations that are not directly aimed at art businesses, but which have an indirect effect on them. For example, the recent more conservative rules to prevent money laundering affect art transactions. Financial institutions are now forced to document the source of any funds passing through their services. As such, clients of banks cannot simply receive or transfer money using their bank account and describe the origin of the funds as the sale of an artwork "by handshake". More recently, the Council of the European Union adopted the Fifth Anti-Money Laundering Directive (AMLD5), which will enter into force in 2020 and be directly applicable to art galleries and auction houses. This will force European art businesses to implement anti-money laundering protocols and strictly limit cash payments to €10,000, as well as restricting payments to third parties. In the USA, there is not yet a direct regulation applicable to art dealers but discussions are already underway in this regard. On 13 March 2019, the House of Representatives agreed to House Resolution 206, whereby they recognized the global nature of money laundering and its relevance for the art market. Although the Resolution is not binding, it suggests that legislation similar to AMLD5 may be passed in the near future.

Tomorrow's business

Finally, and with a long-term strategy in mind, art advisors will soon be serving not only millennials but also Gen Z. So far, these generations have shown a high interest in the DNA and values of the brands and companies they opt to embrace. This might mean that even without a regulatory revolution on the art market, we are organically moving toward a better place, where high standards of ethics and professionalism will matter and make a difference in terms of winning business.

In conclusion, art advisors should follow the best practices possible to at least ensure independence and transparency for their clients. This business model, when widely adopted, works in the favor of all the other participants on the art market. Art advisors can always be inspired by the best practices of other industries, including the wealth management industry. It can be challenging at times to operate as one of the pioneers of this approach in the art world. However, the rewarded of clients, who embrace such a practice and the peace of mind it affords them, is very fulfilling.

Art & Estate Planning
Survey findings 2019

Wealth planning with respect to a future art legacy can be complex, and the challenges it poses are often far easier to avoid than to address. However, effective planning can reduce the likelihood of family disputes 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.



El Silencio Del Color © Lina Sinisterra (2016)

In this year's survey, art and estate planning was identified by most collectors (76 percent this year versus 69 percent in 2017) and art professionals (78 percent this year versus 80 percent in 2017) as the most relevant art and wealth management service.

With an estimated US$1.74 trillion of art and collectible wealth currently held by UHNWIs, it is estimated that over the next decade, more than 14,000 ultra-high-net-worth individuals (UHNWIs, defined as those with assets, excluding their main property, worth US$30 million or more) are likely to transfer their wealth to the next generation, which is likely to include art and collectible wealth. This will be the greatest transfer of wealth the world has ever seen. How prepared are wealth managers to take on this art and estate planning challenge?

Later in this section, we will be taking a closer look at the new transparency requirements for entities, as explained by Pascal Noel (Director, Deloitte Monaco) in the article on p.100. Section 6 also explains why it is important to anticipate and adapt to these upcoming changes. On p.102, Markus Seiz (Director) and Maida Mulic (Senior Manager, German Tax Advisor, Deloitte Germany), look at art and taxation in Germany and on p.104 Janet Xanthopoulos (Legal Adviser, Yacht Ownership & Administration Department Manager at Rosemont Yacht Services) and Karolina Blasiak (Art Advisor, Rosemont International) discuss particular considerations when art is stored on a yacht.

67 percent of wealth managers said their clients had an estate plan that included their art



More than a third of private banks have yet to discuss art-related wealth with their clients

19 percent of private banks and 53 percent of family offices said their clients maintained an inventory of their collection that at a minimum identifies each piece, its present location, and its approximate value so that they could help to administer the estate without the collector's input. A further 28 percent of private banks and 24 percent of family offices said that their clients kept an inventory of the collection, but that the information was not up to date. However, 35 percent of private banks and 12 percent of family offices said they were unsure as they had not had this discussion with their clients. The findings suggest that wealth managers need to increase their efforts in terms of finding out and mapping what art-related wealth clients have in the first place. This could be an opportunity for wealth managers to build more of a personal connection with clients around the things that matter to them. This is an important trend that was mentioned at the beginning of this section.

Figure 24. My clients have estate plans that sufficiently address their art collection *Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019*

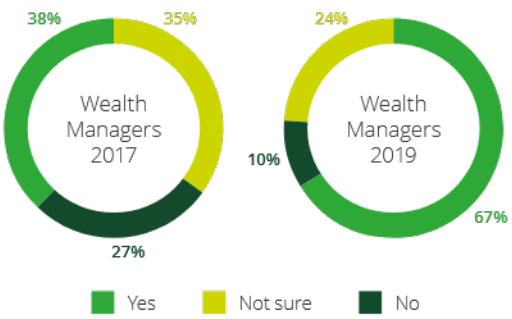


Figure 26. Private banks: my clients maintain an inventory of their collection that at a minimum identifies each piece, its present location, and its approximate value so that we could help to administer the estate without the collector's input
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

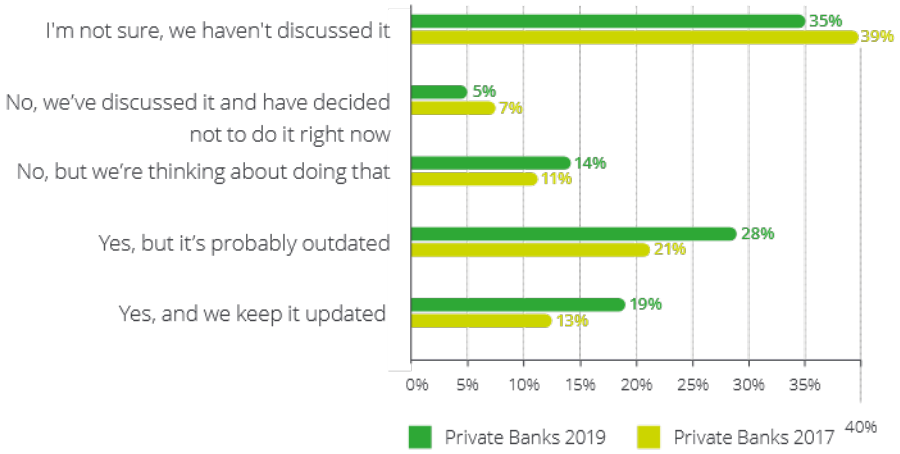
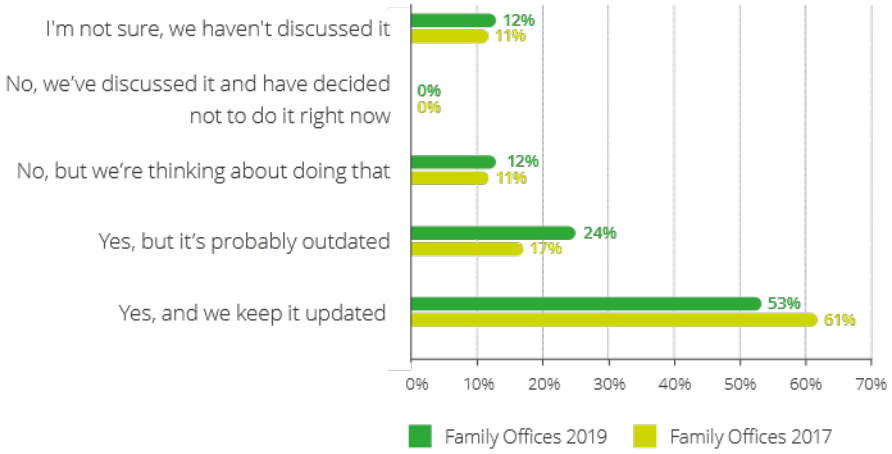


Figure 27. Family offices: my clients maintain an inventory of their collection that at a minimum identifies each piece, its present location, and its approximate value so that we could help to administer the estate without the collector's input
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Expert voices

DO THE NEW TRANSPARENCY REQUIREMENTS FOR ENTITIES AFFECT YOU?



Pascal Noel
Director, Deloitte Monaco

The European Union (EU) and the Organisation for Economic Co-operation and Development (OECD) have recently developed new standards mainly dealing with the fight against:

- Money laundering
- Tax evasion by individuals
- Tax optimization by multinational groups

These new standards will have implications for professionals in the art market as well as investors who use dedicated structures to hold their assets. Sophisticated investors have many good reasons to invest in fine art and other collectible assets through dedicated structures such as tax efficiency and estate planning, facilitating the management of the assets by experts, facilitating the acquisition of assets by multiple investors, and allocating assets to a charitable foundation. Confidentiality regarding the beneficial owner of the assets was also one of the key reasons for structuring investments using dedicated entities such as offshore companies, trusts, and investment funds. However, this may no longer be easy to achieve considering the impact of the following new transparency requirements:

Automatic Exchange of Information (AEOI)

Introduced in 2014 through the US Foreign Account Tax Compliance Act (FATCA) and in 2016 through the OECD's Common Reporting Standard (CRS), the objective of the new rules is to ensure that the tax authorities in an investor's country of tax residence receive information on the investments they hold abroad. Fine art is not a financial asset; this may lead people to conclude that investments in collectible assets should not be affected by the new rules. However, this is not always the case, considering that most asset-owning entities are passive entities holding a bank account. Under the CRS, information on the bank accounts of passive entities (including the account balance and financial income generated) may potentially be reported annually to the tax authorities of the country of residence of their controlling persons (i.e., individuals who are the ultimate

beneficial owners with an interest of more than 25 percent in the structure). If the collectible assets are directly or indirectly owned by a trust, such reporting may not only cover the grantor but also the beneficiaries, protector, and trustees. Investing through a Collective Investment Vehicle (CIV) will not always prevent reporting to the taxman. If the assets are owned by the CIV through asset-owning companies, all investors in the CIV will potentially be subject to reporting regardless of the size of their investment in percentage terms. The rules are relatively similar under FATCA but the reporting only targets US persons (residents or citizens of the USA).

Trade register and register of beneficial owners

In most countries, information on local companies is available to the public (articles of association, names of directors and sometimes shareholders, annual financial statements, etc.). Previously, offshore companies and nominees could minimize the information available to the public, especially regarding the identity of beneficial owners.

Following the introduction of the new anti-money laundering directive (AMLD5), this is no longer possible within the EU. All member states are now required to keep a register of beneficial owners of companies and trusts. Similar rules have been introduced in a large number of non-EU countries, including offshore jurisdictions. While the law in many non-EU countries states that only professionals with AML obligations can access the register, the EU directive requires all member states to ensure public access. AMLD5 also requires EU members states to set up, from 2020, a register of all existing payments and bank accounts (identified through their IBAN number), as well as all safe-deposit boxes held by credit institutions. Only local authorities will have access to this information initially, but the directive anticipates a connection with other member states in order to facilitate AML investigations by foreign authorities.

New requirements for substance

Locating an asset-owning company in an offshore jurisdiction is becoming more difficult and expensive. This is linked to new regulations forcing such jurisdictions to introduce stricter rules on the substance of local companies. This is mandatory to comply with the OECD's Base Erosion and Profit Shifting (BEPS) recommendations on substance as well as to avoid EU blacklisting.
As a result, many financial institutions are becoming reluctant to open financial accounts for entities located in offshore jurisdictions, even if those jurisdictions are not blacklisted. For accounts already opened, banks will need to be informed in advance of all significant cash transfers linked to the purchase or sale of assets. Entities that fail to provide banks with the required documentation in advance run the risk of having their bank accounts blocked, which will affect their ability to buy and sell assets.

Mandatory disclosure rules (MDR)

Finally, the EU recently introduced new rules (based on the OECD BEPS recommendations) requiring intermediaries such as advisers, lawyers, trust companies, and banks to inform their home country tax authorities of all transactions considered to be tax aggressive. Since these rules target all types of taxes (including inheritance taxes) and all transactions of which tax optimization is the main benefit, MDR may potentially affect all types of tax-efficient structure currently used to hold private art collections. Keep in mind that a reportable structure/transaction will need to be reported by the beneficial owner of the structure if it is not reported by an intermediary. It is vital to pay close attention to the dates on which the new rules take effect: MDR reporting will start on 31 August 2020 (quarterly reporting) but the initial reporting will cover transactions and structures set up as from 25 June 2018.

How to proceed

Until recently, ensuring confidentiality in relation to a structure dedicated to holding a collection was possible even if the banks involved in the structure had to check the identity of the beneficial owner(s) and the source of the wealth used to acquire the assets. Today, tax and AML authorities are automatically receiving and sharing information on the bank accounts and beneficial owners of passive entities, while the public is now getting access to the identity of all beneficial owners of EU companies and trusts. From next year, tax authorities will automatically be informed of any new tax-efficient cross-border structure used by EU individuals to hold their assets, including fine art.

With this context in mind, we recommend that you consider taking the following action in anticipation of MDR implementation:

- If you are an adviser, make sure you understand your new responsibilities and have identified and contacted the relevant clients. You will need to coordinate with a range of other advisers (lawyers, tax advisers, trust companies, and potentially banks) in order to avoid duplicate reporting under mandatory disclosure rules
- If you are the investor, revisit your current set up with your advisers in order to understand whether your structure will be subject to reporting from 2020. If not, bear in mind that changes to the structure may be subject to reporting at a later stage. For new or existing reportable structures, you need to determine which adviser will be in charge of reporting to the tax authorities
- In all cases, you should minimize cross-border investments subject to reporting and favor investment in the country of tax residence of the beneficial owner. If this is not possible, you should consider investments in countries that are robust from a data protection point of view

Deloitte would be delighted to guide you through this process, especially as regards the identification and monitoring of reportable transactions, as well as reporting to the tax authorities.

Case study

Art and taxation in Germany





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In Germany and further afield, collecting art is likely to remain one of the most popular ways to invest energy, time, and money. Irrespective of the individual's goals and reasons for collecting art—they may be driven by enthusiasm, a desire to have fun, investment objectives or something else entirely—there comes a time when art collectors will start asking questions:

What can I do to pass on my collection to the next generation at a favorable (gift) tax?
What about donating my collection to a foundation in order to preserve it?
I would like to dispose of my assets—what is the smartest way to sell?
What will happen to the art collection when the collector passes away and whether to donate the collection to charity or sell it are challenging questions that merit careful consideration on the part of the collector.

In this article, we will be highlighting some specific German tax planning ideas that both collectors and advisors may find useful. There are many potential solutions on the market; this article will focus on a small number of options that are best suited to private collectors who are tax residents of Germany. It is important to remember that each collector's personal situation is unique and must be considered individually.

How can works of art be passed on to family members in Germany at a favorable rate of gift tax?

If a collector wants to give privately held art to family members, the persons involved (i.e., the donor and the beneficiary) should consider the tax implications they will face. In Germany, many of the relevant tax obligations are set out in the German Gift and Inheritance Tax Act (which also covers inheritance). In general, a gift tax liability arises if either of the parties involved (donor or beneficiary) is a resident of Germany. In this instance, a "resident" of Germany is defined as anyone who is domiciled in the country for tax purposes.

Hence, even if the work of art itself is located abroad, the donation is generally subject to German gift tax. In the rare event, that only the work of art is located in Germany, but neither the donor nor the beneficiary is a tax resident of Germany, the gift is not subject to German gift tax. In principle, the gift/inheritance tax is assessed on the basis of the fair market value of the artwork. Determining the market value of a work of art is therefore crucial to defining the tax burden for the parties involved; as such, expert opinions are usually sought at this stage of the process.

Under certain conditions, the German Gift and Inheritance Tax Act grants an allowance of either 60 percent or 100 percent of the value of privately owned artwork. This means that only 40 percent of the value of the artwork is subject to taxation or that it is completely tax-exempt. To be eligible for the 60 percent tax exemption, the artwork must especially meet the following criteria:

- Preservation of the artwork is in the public interest
- Annual costs normally exceed the revenue generated
- The artwork is or will be used for the purposes of research or public education

To qualify for the 100 percent tax exemption, two additional requirements must be met: firstly, the work of art must have been in the possession of the family for at least 20 years. Secondly, the piece must be subject to the requirements of state monument protection. It has to be said that at least the second condition is typically difficult to achieve.

It should be noted that the tax exemption, whether 60 percent or 100 percent, ceases to apply with retroactive effect if the works of art are sold within 10 years after the gift or the conditions for the tax exemption cease to apply within this period.
In addition to the allowances mentioned, there are other allowances that depend on the relationship between the donor and the beneficiary (or the testator and the heir). These vary from €20,000 to €500,000.
The German gift and inheritance tax rate is between 7 percent and 50 percent.

How can a donor benefit from art donations under the German Income Tax Act?

Under the German Income Tax Act, anyone who is subject to German income tax (usually people who are resident in Germany or foreigners with German income) may, under certain conditions, deduct donations to charitable institutions from their income to reduce their tax burden. In principle, donations worth up to 20 percent of an individual's annual income are tax-deductible. If a donation cannot be completely deducted in one year, it can be considered in subsequent years. The donation reduces the person's taxable income, which is taxed at an individual rate of up to 45 percent. There is no direct refund of the donation from the income tax amount payable. A donation of art to charitable institutions can also be tax-deductible. In such cases, the artworks in question are valued at the market rate.

In addition, works of art that are donated to a foundation can be deducted in the year of the donation and in the following nine years up to a total amount of €1 million. For spouses filing their tax return jointly, the total amount rises to €2 million. One of the prerequisites for this is that the foundation is charitable. Donations to the consumable assets of a foundation are not tax-deductible. Donations of art to foundations domiciled in the EU or EEA are also generally eligible.

What is the most tax-efficient way to sell art in Germany?

If a resident of Germany wants to sell art from their private collection, the profit from the sale is generally not subject to German income tax if a holding period of at least one year between the purchase and the sale is observed. However, it has to be pointed out that the period is extended to ten years if the artwork is used as a source of income (e.g., rental income is earned by the owner).

Under certain conditions, the German Gift and Inheritance Tax Act grants an allowance of either 60 percent or 100 percent of the value of privately owned artwork.

Collectors resident in Germany should make sure that they do not switch from private sales to commercial sales. Although there is in principle no legally defined threshold to commercial sales here, it can be assumed that someone who becomes active as a dealer through the purchase and sale of artwork and regularly appears externally on the market will be classified as a commercial entrepreneur. This would mean that proceeds from sales outside the period mentioned above would also be subject to German income tax (and trade tax). Under certain circumstances, additional VAT of 19 percent of the sale price may also be payable.

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Expert voices

ART ON YACHTS: WHEN ONE LUXURY ASSET HOUSES ANOTHER

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The views expressed in this article are the personal views of the author and not those of Deloitte.

The global markets report the increasing prevalence of high-value luxury items such as fine art, classic cars, and yachts among the assets of ultra high net worth (UHNW) clients. Art, in particular, is on the up.

The number of billionaires worldwide has more than quadrupled since 2000, and many devote part of their wealth to a passion for art. The *Deloitte & ArtTactic 2017 Art & Finance Report* forecasted that UHNW individuals would hold US$2.7 trillion in art and collectible wealth by 2026. These facts and figures show us the scale of the opportunity in front of us today. One of the main risks associated with so-called "passion investing" is in its name—the high level of adoration and emotion involved, which sometimes take the place of rational decision-making. What passion investor, caught up in their own enthusiasm, is going to stop to think about tax reporting? And who would have the penalties for inadvertently failing to comprehend tax rules at the forefront of their mind when experiencing the joy of seeing their favorite Picasso painting on their superyacht for the first time? Investors and wealth planners ought to apply the same level of tax and legal consideration to the purchase of a luxury asset as they do when investing in a business or investment portfolio. There is a common misconception that luxury "real" assets cannot be structured in the same way as traditional financial assets. This means that there is a significant opportunity for wealth managers to introduce appropriate structures to protect and make the most of these assets. By doing so, wealth practitioners stand to significantly increase assets under management and grow their clients' portfolios. This is all the more important because a client's luxury assets define who they are and should be protected just as much as their real estate, liquid funds, and other investments.

Keeping art aboard yachts is a growing trend. Indeed art can be successfully carried within a yacht interior, but there are sadly examples of tragic ignorance resulting in loss of precious art and artefacts. Taking a holistic look at the subject, the following is a list of important points—predominantly the legal, tax, and insurance implications—that need to be addressed when carrying and/or internationally transitioning art aboard a yacht.

01. Proper insurance and security

Very often the value of the art outweighs the value of the boat. Marine insurance policies are rarely standardized, so your art collection can probably be incorporated into it. However, if the art is likely to outweigh the value of the vessel, you may need additional specialist art insurance.

02. Proper light and climate control to extend the life of art on board

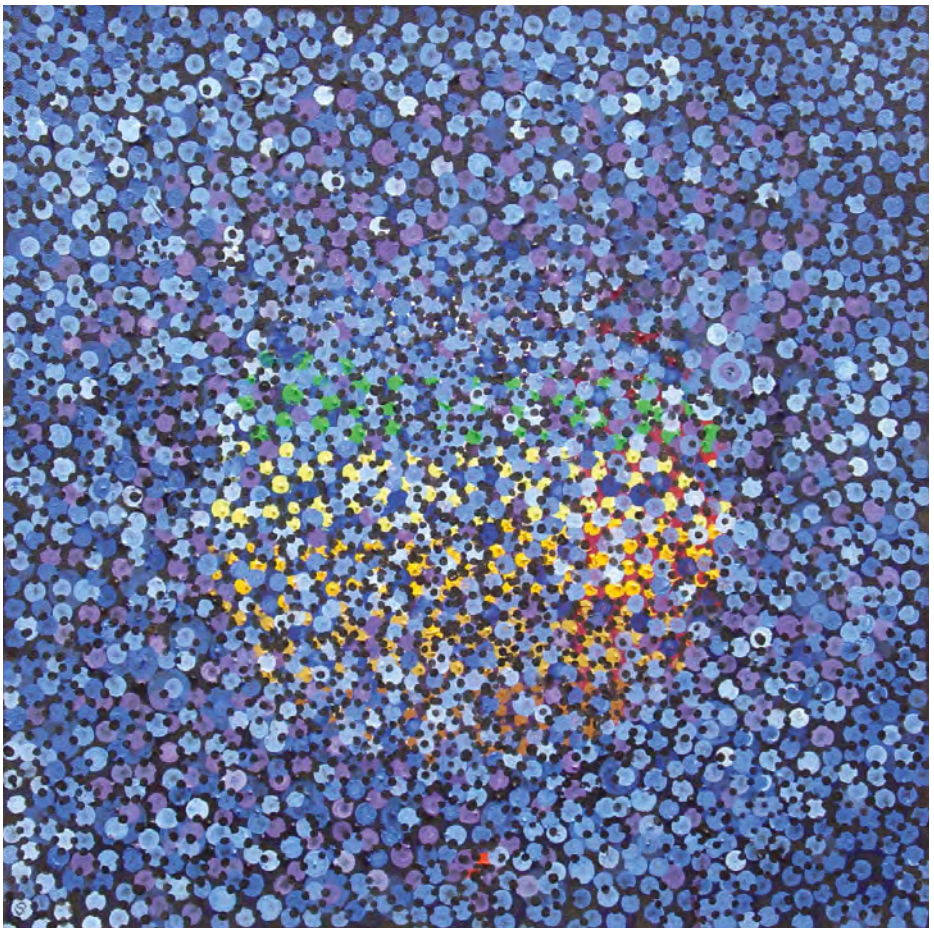
Lighting and climate control is very important, as too much light can damage a yacht's artwork. Considering fluctuations in light, humidity, and heat is vital. Photography, watercolours, and drawings need to be protected from natural light and require specific framing.

03. The art of installing, conservation, and maintenance

Hanging art on board a yacht needs an adequate installation system. The same goes for fixing small sculptures and objects, which is where you need to use museum quality tools for installation. Proper education for your crew on how to handle and maintain art on board is ultra important.

04. Get expert advice from a trusted art advisor

Seek qualified advice before buying so you can plan the perfect surroundings for existing pieces or choose the perfect piece for an existing interior. Also be mindful that you do not engage in art acquisitions related to protected species (e.g. ivory or butterflies), and looted or forged art.



Excéntrica © Lina Sinisterra

There is, of course, the danger of your art being seized by Customs & Excise if you attempt to avoid paying duty on objects bought in other parts of the world. Recent court cases should serve as warnings to collectors trying to hide their assets by sending them out to sea.

Such cases raise interesting questions in a world where yachts, often with a complex web of ownership, transport valuable art from one jurisdiction to another. In 2015, for example, French customs officers seized Picasso's "Head of a Young Woman" (1906) from the Adix, the Spanish billionaire Jaime Botín's yacht. Although it was moored in Corsica, he argued that it was sailing under a British flag and was thus in the UK's jurisdiction, but this held no sway with Spain's judges, who deemed the work a national treasure and ruled that the Adix was subject to Spanish law.

There are a whole host of local rules and regulations governing the inventories of yachts, and they vary from country to country and even from port to port. All of these complications make climate and light control seem like the least of a collector's concerns. While many yacht owners opt to enjoy their valuable artworks by displaying them on board, this decision has hidden risks when sailing to multiple destinations. It is crucial to know the tax status of both the yacht and the art—and how this will be treated by different tax authorities.

Each holistic wealth manager should work closely with their network of independent legal, tax, and art advisers, specialist insurers, auction houses, and free ports to hold and maximize returns from their clients' luxury assets. Beyond portfolio enhancement, structuring these assets provides clients with multiple other benefits. These include long-term asset protection, facilitation of estate planning and wealth transition, and comprehensive administrative support including ongoing reporting, accounting, and audit as well as arrangements for insurance, safe storage, maintenance, transportation, and more.

A convergence of factors in recent years has generated higher interest in art as an asset that has the potential to appreciate. These include interest rates at historic lows, stock market volatility, technology creating increased transparency in the art market, and increased interest in art globally.

Although demand for art fluctuates, with different areas of the art market experiencing varying levels of demand, the growing tendency to view art as an asset class has meant increased interest among wealth management professionals. Nearly 90 percent of wealth managers said they think art and collectibles should be included in wealth management offerings, according to the *Deloitte 2017 Art & Finance Report*.



Section 3

Art-Secured Lending

"Gap" - Series: Noospheres - Inks on cotton paper (70x70) © Lina Sinisterra (2019)

Highlights

Collector finance dominates the art-secured lending market
The market for art-secured lending has grown over the last ten years, with market size in 2019 estimated to stand at between US$21 billion and US$24 billion in outstanding loans against art. Based on existing research and interviews with art finance providers, we estimate the value of loans underwritten[29] to collectors and private individuals to stand at between US$18 billion and US$20 billion: around 90-92 percent of the overall art-secured lending market.

Art-secured lending ranks among the most popular art and wealth management services in 2019
There seems to be stronger interest in art-secured lending among collectors this year, with 60 percent saying that this was one of the most relevant wealth management services, compared with 46 percent in 2017.

Collector demand for art-secured lending is on the rise
This year, 69 percent of collectors said they would be interested in using their art collection (or parts of it) as collateral (versus 57 percent in 2017). This was echoed by art professionals, 72 percent of whom said that their clients would consider using their art collection as collateral for a loan (compared with 75 percent in 2017). It is also evident that the art trade (art dealers, auction houses, and art advisors) also sees the benefit of art finance, with 69 percent saying their clients would take advantage of such a service.

29 In 2017

This year, 69 percent of collectors said they would be interested in using their art collection (or parts of it) as collateral.

European private banks reluctant to offer art-secured lending services
Despite significant demand for art-secured lending services among collectors and art professionals, only 26 percent of wealth managers (32 percent of private banks and 13 percent of family offices) surveyed this year said that this would be an area of focus in the coming 12 months. In contrast, 80 percent of US private banks said they would focus on art-secured lending services in the coming 12 months, while only 16 percent of European banks said the same.

Consolidation among asset-based lenders
The low interest rate environment and easy access to finance combined with increasing competition resulted in two acquisitions in the first half of 2019, with Falcon Fine Art acquired by the Fine Art Group in January 2019 and Athena Fine Art acquired by Yield Tree in April 2019.

The lack of a legal framework is holding European art lending back
The European art lending market has been affected by the fact that the notion of art as an asset class is less developed in Europe than in the US and the fact that there is no uniform system for registering charges over chattels such as the US Uniform Commercial Code (UCC). Instead, each European country has its own system, many of which are unsuited to the art-secured lending market as constituted in the 21st century. This has resulted in the US accounting for an estimated 90 percent of the global art-secured lending market.

Risk management
In this year's survey, 71 percent of private bankers said that the difficulties associated with measuring and assessing risk were a key challenge to incorporating art-secured lending in their art and wealth service offering (the same percentage as in 2017).

Assessing the value of art
Valuation is another source of concern for private bankers when it comes to art-secured lending, with 63 percent of private bankers saying this was one of the main hurdles (down from 73 percent in 2017).

Lack of art market knowledge
61 percent of private bankers said that a lack of knowledge of the art market was a key hurdle (compared with 66 percent in 2017).

The art-secured lending business has yet to reach the mainstream
However, there is potential for growth in this area in light of the development of regulations and new technologies aimed at reducing risk and standardizing processes.

71 percent of private bankers said that the difficulties associated with measuring and assessing risk were a key challenge.



Introduction

The market for art-secured lending has experienced growth over the last ten years, with a conservative size estimated in 2019 to be between US$21 billion and US$24 billion[30] in outstanding loans against art. Although this might seem like a large amount of leverage, it only accounts for just over an estimated 1 percent of art and collectible private wealth[31] today.

In this section, we present the results of the surveys and trends in the art-secured lending market supported by the contributions of US Trust, the Fine Art Group and Griffin Art Partners.

30 Source: Art & Finance Report 2017 by Deloitte and ArtTactic, adjusted for an average annual growth rate of 10% per annum. This is the most conservative annual growth rate estimate from a sample of traditional US lenders surveyed in August 2019

31 This estimate is based on US$18-20 billion of outstanding loans from private banks (typically lending to UHNWIs) in relation to the estimate of US$1.74 trillion of UHNWI art and collectible wealth.

"Energy of Love" - Series: Noospheres (courtesy Paola Lozano collection NY) © Lina Sinisterra

Survey **findings 2019**

Art-secured lending ranks among the most popular art and wealth management services in 2019

There seems to be stronger interest in art-secured lending among collectors this year, with 60 percent saying that this was one of the most relevant wealth management services, compared with 46 percent in 2017. 55 percent of art professionals said the same (up from 53 percent in 2017).

Growing demand for art-secured lending among collectors

In this year's survey, 69 percent of collectors said they would be interested in using their art collection (or parts of it) as collateral (versus 57 percent in 2017). This year, 53 percent of the collectors who said they would be interested in doing so said they would use the funding to buy more art. 41 percent said they would use it to finance other business opportunities and 5 percent said they would use it to refinance existing loans. This indicates that there is significant interest among wealthy individuals in extracting the capital value locked up in artwork. Moreover, this has been a growing business for private banks in recent years. This was echoed by art professionals, 72 percent of whom said that their clients would consider using their art collection as collateral for a loan. Among the art professionals surveyed this year, art dealers, auction houses, and art advisors also see the benefit of art finance, with 69 percent saying that their clients would take advantage of such a service.

The art trade is also seeking alternative ways to finance acquisitions

However, it is not only collectors who are interested in art-secured finance. A research report written by ArtTactic in 2018 for TEFAF[32] showed that 31 percent of the art dealers surveyed said they would be interested in art-secured lending. 87 percent of the dealers surveyed said they would like to see better access to acquisition finance. Art dealers currently rely on either retained earnings (59 percent of dealers) or co-investment from private investors (63 percent of dealers) to finance acquisitions and new business opportunities.

Access to dealer credit remains poor, although the new compliance environment may increase opportunities

57 percent of dealers surveyed in 2018 for the TEFAF report said that access to credit for dealers was poor/very poor, which suggests that there is an opportunity to develop the art-secured lending market for the art dealer community. However, high funding costs, combined with a bureaucratic due diligence and underwriting process, were cited as impediments to art dealers pursuing this funding route. Art dealers being forced to become more transparent and professional as a result of the fifth AML directive (see section 6) may lead to an increase in the credit available to support further growth of art dealers in the future. 28 percent of dealers[33] said that a lack of access to credit had affected their business growth, with a further 18 percent saying they were unsure whether or not this was the case.

Fewer wealth managers are offering art-secured lending

In 2017, 67 percent of wealth managers said that they offered their clients the opportunity to borrow against their art or art collection. However, this year only 50 percent of wealth managers said that they offered their clients this service. Among the wealth managers offering art-secured lending services, 50 percent said they would use external providers for this type of financing arrangement (versus 42 percent in 2017). However, there were some significant differences between US private banks, 77 percent of which

Art dealers being forced to become more transparent and professional as a result of the fifth AML directive may lead to an increase in the credit available to support further growth of art dealers in the future.

32-33 TEFAF REPORT – Art Dealer Finance 2018

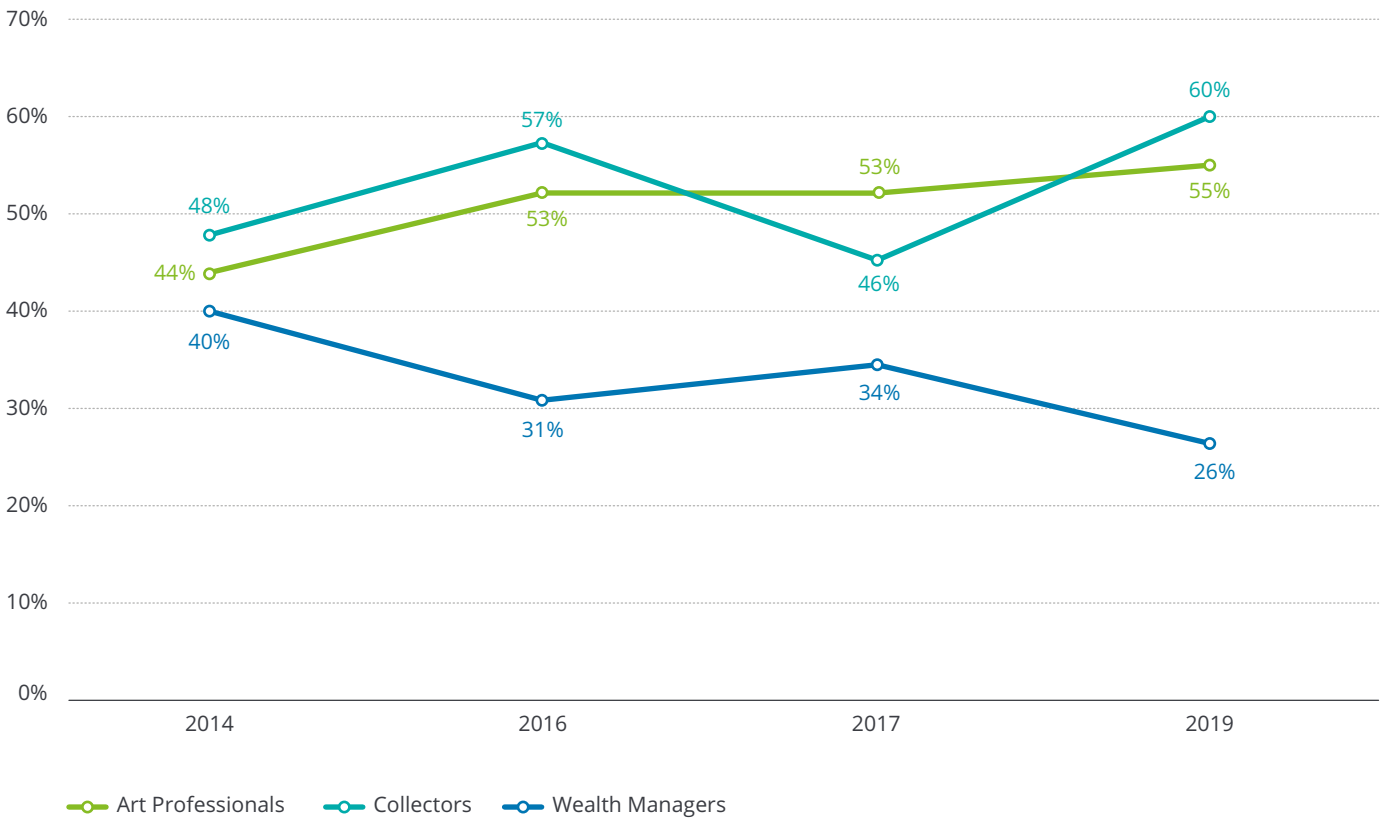
said they offered art-secured lending (69 percent offered this as an in-house service), compared with 50 percent of mostly European private banks who said they offered their clients art-secured lending. This difference reflects the significantly more developed art-secured lending market in the United States.

European private banks reluctant to invest in art-secured lending

Whilst there seems to be significant demand for art-secured lending services among collectors and art professionals, only 26 percent of wealth managers saw this as a strategic focus area over the coming 12 months (compared with 34 percent in 2017). However, there is a significant difference between US and European private banks, with 80 percent of US private banks saying they will focus on art-secured lending services in the coming 12 months, compared with only 16 percent of European banks.

Figure 28. Gap analysis: how relevant is art-secured lending to you and your clients versus what wealth managers are focusing on in the coming 12 months?

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



71 percent of private bankers said that difficulties associated with measuring and assessing risk was the key challenge to incorporating art-secured lending in their art and wealth service offering.

Art-secured lending:
what are the key challenges when using art as collateral for a loan?

Risk assessment
71 percent of private bankers said that difficulties associated with measuring and assessing risk was the key challenge to incorporating art-secured lending in their art and wealth service offering (the same as in 2017). This shows that this remains a key area that needs to be addressed if the art-secured lending market is to grow.

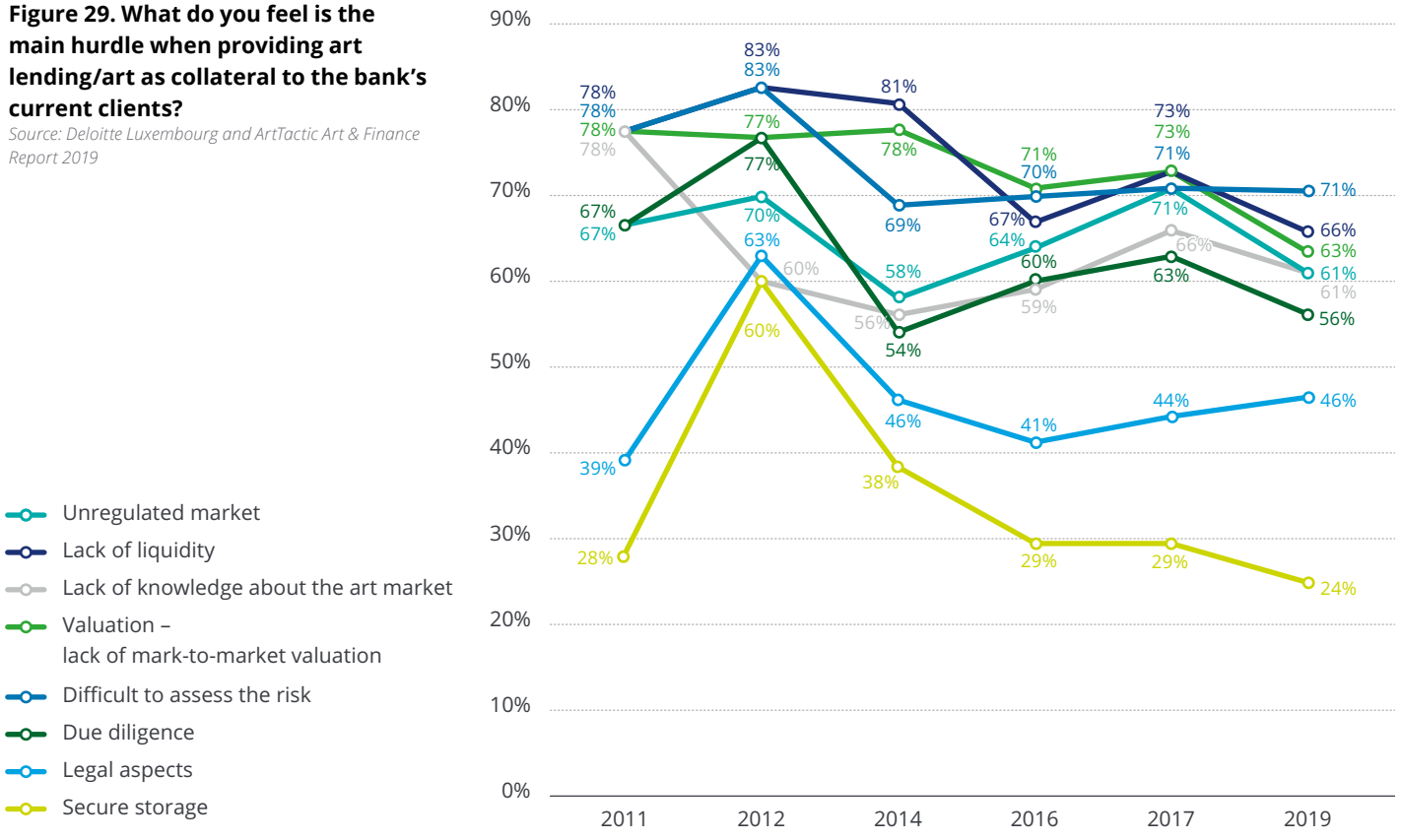
Lack of liquidity
Another major concern this year was the illiquidity of the art market; 66 percent of private banks surveyed said this was a major concern (compared with 73 percent in 2017).

Assessing the value of art
Valuation is another cause for concern among private bankers when it comes to art-secured lending, with 63 percent saying this was one of the main hurdles (down from 73 percent in 2017).

Lack of knowledge
61 percent of private bankers said that a lack of knowledge about the art market was a key hurdle (compared with 66 percent in 2017. This suggests that the majority of private banks are hesitant about providing art-secured lending because they do not have sufficient knowledge about how the art market works, and therefore feel that they will not be able to assess the risks and opportunities present in the market.

Unregulated market
61 percent of private banks felt that the unregulated nature of the art market was a key challenge when offering art-secured loans, whereas 71 percent said the same in 2017. The lack of a uniform legal framework across different global art markets (similar to the UCC code in the United States) may be a pivotal factor, but this view is also likely to be linked to the lack of standardization around the issues mentioned above, such as valuation and risk assessment.

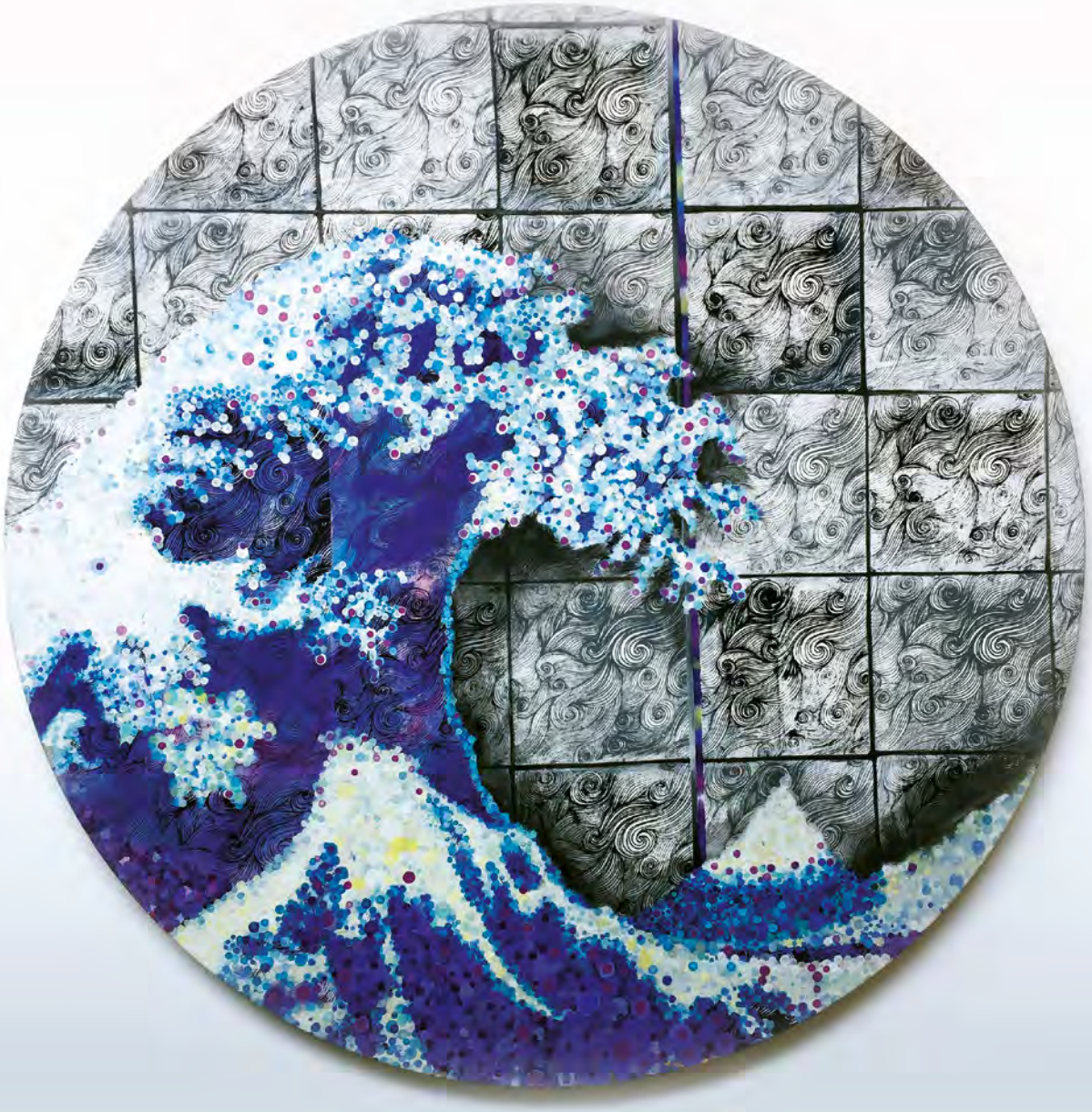
Figure 29. What do you feel is the main hurdle when providing art lending/art as collateral to the bank's current clients?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Size and structure of the art lending market

Based on existing research and interviews with art finance providers, we estimate the value of loans underwritten[34] to collectors and private individuals to be between US$18 billion and US$20 billion—around 90-92 percent of the art-secured lending market—with the remaining share, accounted for by galleries and dealers, estimated to be worth between US$1.7 billion and US$2.4 billion, or 8-10 percent of the global art-secured lending market. Although it is difficult to put a precise figure on the geographical breakdown of this market, the lenders that ArtTactic spoke to for the TEFAF report in 2018 said that over 90 percent of art-secured finance to art galleries/dealers would be underwritten in the US.

Funding sources	**Selected Providers**	**Estimated total loan portfolio against art 2019[35]**	**Estimated loans to dealers/ galleries[36]**	**Percentage of dealer-related art loans**
Private banks	Citi Private Bank Emigrant Bank Deutsche Bank Goldman Sachs JP Morgan Morgan Stanley US Trust	US$18–US$20 billion[37]	US$500–US$700 million	3-4 percent
Commercial banks[38]	JP Morgan Citibank	-	US$300–US$400 million	-
Boutique lenders (asset-based lenders, including hedge funds and family offices)	Yield Tree Artemus Borro AOI-Advisors TPC Art Finance Fine Art Group Griffin Art Partners WestendArtBank	US$1.0 billion – US$1.7 billion	US$500 – US$700 million	50–60 percent
Auction house finance	Sotheby's Heritage Auction Phillips	US$1.3 – US$1.9 billion	US$350 – US$600 million	25–30 percent
OVERALL SIZE		**US$21-US$24 billion**	**US$1.7–US$2.4 billion**	**8–10 percent**



34 In 2017

35 Source: Art & Finance Report 2017 by Deloitte and ArtTactic. All the art secured loan estimates have been adjusted for a average annual growth rate of 10% per annum. This is based on the most conservative growth estimate from a sample of traditional US lenders surveyed in August 2019.

36 Based on interviews with private banks, commercial banks, and asset-based lenders, these estimates are based on the average percentage share of art loans currently underwritten to art dealers and galleries. For private banks, these would typically be art-based recourse loans provided to the owner of the gallery/ dealership, which would be a private wealth client of the bank.

37 Source: Art & Finance Report 2017 by Deloitte and ArtTactic. All the art secured loan estimates have been adjusted for a average annual growth rate of 10% per annum. This is based on the most conservative growth estimate from a sample of traditional US lenders surveyed in August 2019.

38 This estimate is based on interviews with three of the biggest US commercial lenders to dealers and galleries. This number is likely to underestimate the value of commercial loans provided to European galleries.

Based on existing research and interviews with art finance providers, we estimate the value of loans underwritten to collectors and private individuals to be between US$18 billion and US$20 billion.

Series: Se me Movio el Piso - Museum of Contemporary Art Bogotá © Lina Sinisterra (2014)

Art-secured lending trends 2019

A number of private banks have seen their loan book grow for art-secured lending in recent years, as illustrated by Evan Beard (National Art Services Executive at Bank of America Private Bank), Ramsay Slugg (National Wealth Planning Strategies Advisor at Bank of America Private Bank), and Dana Prussian (Vice President of Art Services at Bank of America Private Bank) in their interview on p.118.

We are starting to see early signs of consolidation among asset-based lenders and in January this year London-based Falcon Fine Art sold its art lending division to the Fine Art Group. The Fine Art Group started its lending business three years ago, charging annual interest rates in the mid-single to high-single digits. The company established a US$300 million credit fund to finance loans with investments from large family offices, institutions, and high-net-worth individuals and can fund loans of as much as US$150 million. Freya Stewart from the Fine Art Group shares her views on the current state of the asset-based art-secured lending market, and the challenges and opportunities the next five years will bring on p.120.



Series: Se me Movio el Piso - Museum of Contemporary Art Bogotá © Lina Sinisterra (2014)

In April 2019, another art finance company, Athena Art Finance, was acquired by YieldStreet, a rapidly growing digital wealth management platform backed by billionaire George Soros, for US$170 million. Athena was launched four years ago by a consortium of investors led by the private equity group Carlyle and counted Banque Pictet among its founding investors.

Despite industry consolidation, new initiatives are also appearing. In May 2019, LA-based Shinnecock Partners announced[39] they had launched an open-ended, standalone dedicated alternative art lending fund, building on their seven-year track record in non-bank and fine art lending. Art Rights, the Italian ArtTech company, has announced that it is working on a new art lending service called Art Collateral, which will be the art world's first escrow agent dedicated to art lending.

Furthermore, the Bank Reyl & Cie and art advisory firm LINK Management teamed up to launch Griffin Art Partners in June 2017 in Luxembourg. This securitization platform structures non-recourse art loans; an interview with the founders on the development of the business appears on p.122.

Legal framework and regulations

Based on interviews with art-secured lenders for the TEFAF Art Dealer Finance Report in 2018, it is estimated that more than 90 percent of current art-secured lending business takes place in the US. The European art lending market may start to pick up pace if and when the legal framework becomes more robust as regards the issue of perfecting security interest, or in other words protecting a security interest in an asset (mortgaged as collateral) from claims by other parties. A lien is perfected by registering it with the appropriate statutory authority so that it

39 https://www.hedgeweek.com/2019/05/31/276162/shinnecock-partners-launches-alternative-fine-art-lending-fund

is legally enforceable and any subsequent claim on that asset is given junior status.

It is exactly this framework that has given the US a lead in the art-secured lending market, through the Uniform Commercial Code (UCC). The UCC allows the borrower to retain possession of the artwork while the loan is still outstanding. This can happen because the lender can register its security interest in the art on a public register under the Uniform Commercial Code (UCC), thereby putting the world on notice that the art is subject to a charge (or lien).

The European art lending market has been adversely affected by two main factors: 1) the fact that the notion of art as an asset class is less developed in Europe than in the US and 2) there fact that there is no uniform system for registering charges over chattels such as the US Uniform Commercial Code. Instead, each European country has its own system, many of which are unsuited to the art-secured lending market as constituted in the 21st century.

According to an article by Tim Maxwell[40], the UK—a jurisdiction with a sophisticated financial and legal system—should account for a significant proportion of the art lending market. However, the UK art lending market is tiny in comparison to both the relative size of the UK art market and its counterpart in the US. There is significant interest in art lending in the UK, but the market appears to have been hampered by the current legal framework.

In 2018, the UK's Law Commission published a draft bill for a new Goods Mortgages Act. The proposed legislation would have allowed individuals and unincorporated bodies to use goods (tangible moveable property) that they own as security for a loan, whilst retaining possession of those goods (this would be similar to the UCC system in the US). However, with the advent of Brexit (i.e., other priorities) and unconvinced by the extent of the consumer protections to be provided by the possible new regime, the government announced in June 2018 that it would not be introducing the anticipated changes for the moment. However, as outlined in the *Deloitte Art & Finance Report 2016*, several European countries have introduced a register of charges against chattels. This fact, coupled with the new insurance products coming to the market, imply that the European art-secured lending industry is starting to gradually catch up with its US counterpart, albeit at a slow pace.

Insurance providers could pave the way for growth in the art-secured lending market

Another important driver of the development of the art-secured lending market is the emergence of new insurance products aimed at reducing and managing various risks associated with art-secured lending. For example, art-secured lenders now have the option to insure against the residual value in case of default or to take out infidelity insurance that would allow borrowers taking out an art-secured loans to continue to enjoy their art objects in their homes.

Other forms of lending activities in the art market are also developing, such as consumer loans. Art Money, founded by Australian entrepreneur Paul Becker in 2015, is a global art FinTech that has already partnered with over 900 galleries worldwide and is currently offering buyers from New Zealand, Australia, and the US the opportunity to repay purchases of artworks over 10 months interest free.

Risk management tools

In order to evaluate and prioritize risks within the market or project, it is naturally of the utmost importance to initiate the best risk management tools. Overstone enables borrowers, lenders, investors and insurers to work with art as an asset by scoring and monitoring the risk of works of art. Within its range of services, their data driven Art Risk Monitor™ & Qualitative Risk Monitor™ aims to generate a rating score within 48 hours, covering 10,000+ artists. Combined with its due-diligence process, the firm aims to enable participants within the finance, insurance, and art markets to understand and employ these assets across an array of transaction structures. With several projects contracted by institutional players in both the US and European markets and a strategic partnership with Marsh & McLennan, Overstone's international team is seeking to secure an established track record with the continued expansion of its pool of partners.

The future

With art-secured loans accounting for an estimated 1 percent of art and collectible private wealth[41] today (a small figure compared to other industries), the potential for growth in the art-secured lending market could be significant. There is also scope for cultural institutions to tap into the art-secured lending market and use their collection to release resources for other priorities and projects. We are already starting to see new types of innovative financing for art and cultural institutions. One such provider is the UK-based Nesta. Fran Sanderson from Nesta sets out her vision of impact investing in her article on p.161 in section 4.

The art-secured lending business has yet to reach the mainstream, but with the development of regulations and new technologies aimed at reducing risk and standardizing processes, there is potential for future growth in this area.

40 Article contributed to TEFAF Report – Art Dealer Finance 2018

41 This estimate is based on US$18-US$20 billion of outstanding loans from private banks (typically lending to UHNWIs) in relation to the estimate of US$1.74 trillion of UHWNI art and collectible wealth estimated in the Deloitte Art & Finance Report 2019



Expert voices

ART AND FINANCE OUTLOOK

Adriano Picinati di Torcello, Global Art & Finance Coordinator poses a Q&A to Evan Beard, National Art Services Executive at Bank of America Private Bank; Ramsay Slugg, National Wealth Planning Strategies Advisor at Bank of America Private Bank; and Dana Prussian, Vice President of Art Services at Bank of America Private Bank.

Adriano: Why does a global financial institution like Bank of America have a dedicated Art Services Group?
Evan: A few years ago, we as an institution noticed that the art market was maturing as a global industry and our clients were demanding a new level of sophistication around art-secured lending, art planning, consignment services, and arts philanthropy so we structured a dedicated business group to work closely with collectors and arts institutions.

Adriano: Do collectors view their art any differently than they used to?
Evan: The stratification of wealth coupled with cheap money globally has driven significant capital into the upper reaches of the art market. We've also seen a new breed of enterprising collector, still mostly men, who increasingly manage their art collection as a capital asset—not necessarily as an investment, but a capital asset from which they can unlock and redeploy capital into other investment areas.

Adriano: What are you seeing from U.S. collectors?
Evan: Our client base at Bank of America Private Bank falls into four categories. The enterprising collector I mentioned, the legacy and status-minded trophy hunter, the knowledge-driven connoisseur, and the visually driven aesthete. Collectors hailing from the enterprising and trophy hunting tribes tend to be our most active borrowers and consignors. Most are private equity, hedge fund, and real estate executives. We're also seeing more credit facilities being used to back third-party guarantees at auction.

Adriano: You mentioned how quickly art lending has expanded. What types of clients borrow against their art?
Evan: Our art loan book has been growing at about a billion dollars per year over the last few years and now sits in the several billions in terms of loan commitments. Collectors who leverage







Evan Beard
National Art Services Executive at Bank of America Private Bank

Ramsay Slugg
National Wealth Planning Strategies Advisor at Bank of America Private Bank

Dana Prussian
Vice President of Art Services at Bank of America Private Bank

their art tend to fall into four categories:

01. The interest rate arbitrage play whereby the collector (often a finance or real estate professional), unlocks capital to redeploy into other investments
02. The business owner who uses art to fund a working capital line for the private business
03. The collector who uses the line to buy art without having to sell other assets
04. The multi-generational family who uses art lending in the context of estate planning

Adriano: Speaking of planning strategies, Ramsay, what should collectors consider when thinking about art as part of their overall estate?
Ramsay: First and foremost, use a competent advisory team. The team should include art experts, private bankers, an attorney, and an accountant. By communicating with you and with each other, they will be able to help you think about your goals and your family's goals as it relates to your collection. You should also think about risk management.

Adriano: What do you mean by risk management?
Ramsay: Engage an insurance expert who is experienced with art, prepare an inventory of your collection, keep up-to-date appraisals, and maintain records of ownership. Staying organized and up to date as your collection evolves over time will help you and your family make decisions down the road.

Adriano: Once you have taken steps to work with the right people and keep your collection organized, what can you do with a family collection, besides just keeping it in your home?
Ramsay: Art is by nature an illiquid asset. While it can be sold, it comes with a high tax cost and timing is often an issue. You should consider whether art lending may be appropriate for your liquidity needs. You can also consider gifting your collection to charity. It is often the most tax efficient way to keep a collection intact. If you determine that a gift makes sense for you and your family, talk to the museum about whether your collection is a fit for the institution.

Adriano: If we take a step back and consider the art world more globally, what do you see, Dana, as an international headwind that could affect the art market in the coming months?
Dana: Recent tariffs implemented between the U.S. and China won't affect the art market in the near term but could become sand in the gears down the road if a trade deal is not reached and relations between the world's two largest economies become fraught. We're paying special attention to the credit cycle, global interest rates, and the likelihood of a global slowdown.
Developed economies are slowing down, equity valuation ratios have increased, and the credit cycle appears to be in the early stage of a down-cycle. If these trends worsen, expect an art market slowdown. But, for now, the music continues.

Adriano: What about Brexit? Have you seen changes in the European art market as a result of the negotiations?
Dana: Like much of the global economy, the art market has given a giant shoulder shrug to Brexit. That said, the ongoing negotiations, and the result that may finally become clear at some point in the future, have left European collectors scratching their heads. While the Arts Council of England has published a guide on how to deal with no deal, there are still question marks on how to handle (and at what pace) import taxes, VAT, and the shipping and movement of artwork within the EU.
After all, without EU membership, the UK no longer retains the advantage of free circulation in its current form. At least in the short term, we see Brexit as providing logistical complications and questions for collectors, but do not think it will send shock waves through the market.



Freya Stewart
CEO of Art Lending
and General Counsel
The Fine Art Group

Expert voices

THE CURRENT STATE OF THE ASSET-BASED ART-SECURED LENDING MARKET, AND THE CHALLENGES AND OPPORTUNITIES THE NEXT FIVE YEARS WILL BRING

From a demand-side perspective, the art-only asset-based lending market is healthy; demand is strong and increasingly sophisticated. The Fine Art Group's art financing business is busier than ever—Q2 of 2019 has been our busiest to date and we have executed a number of 'A grade' loans with important collectors. In its 2017 *Art & Finance Report*, Deloitte estimated that the global value of art-secured loans in 2017 was US$17-20 billion, which represented growth of 13 percent since 2016. Awareness and understanding of art-only asset-based financing among the top-end collecting community and, importantly, their financial advisors and family offices, have without doubt risen in recent years. Increasingly, buying tens or hundreds of millions of dollars of high-value art with equity alone is, rightly, not seen as being capital efficient, and advisors to UHNWIs are encouraging their clients to look at leverage. In particular, significant younger collectors, and collectors who are entrepreneurs in other markets, are coming to recognize the diverse utility of art-secured credit facilities. As such, we are seeing an increasingly diverse range of rationales and motivations from borrowers using the product. Recent examples include supporting long-term collection acquisition objectives, auction and private sale purchase financing (including irrevocable bids), providing capital for IPOs, providing liquidity for the collectors' business operations, providing liquidity to trustees using trust assets as collateral, bridge financing to sale, and providing capital to plug margin calls on a collector's investment portfolio.

More generally, the growing demand for art-backed loans is a natural reflection and extension of the increasingly sophisticated nature of the world's most active and prominent art buyers. This demand is also global: we have executed two loans with first-time Hong Kong borrowers this quarter and our most recently executed loan involved no fewer than five jurisdictions.

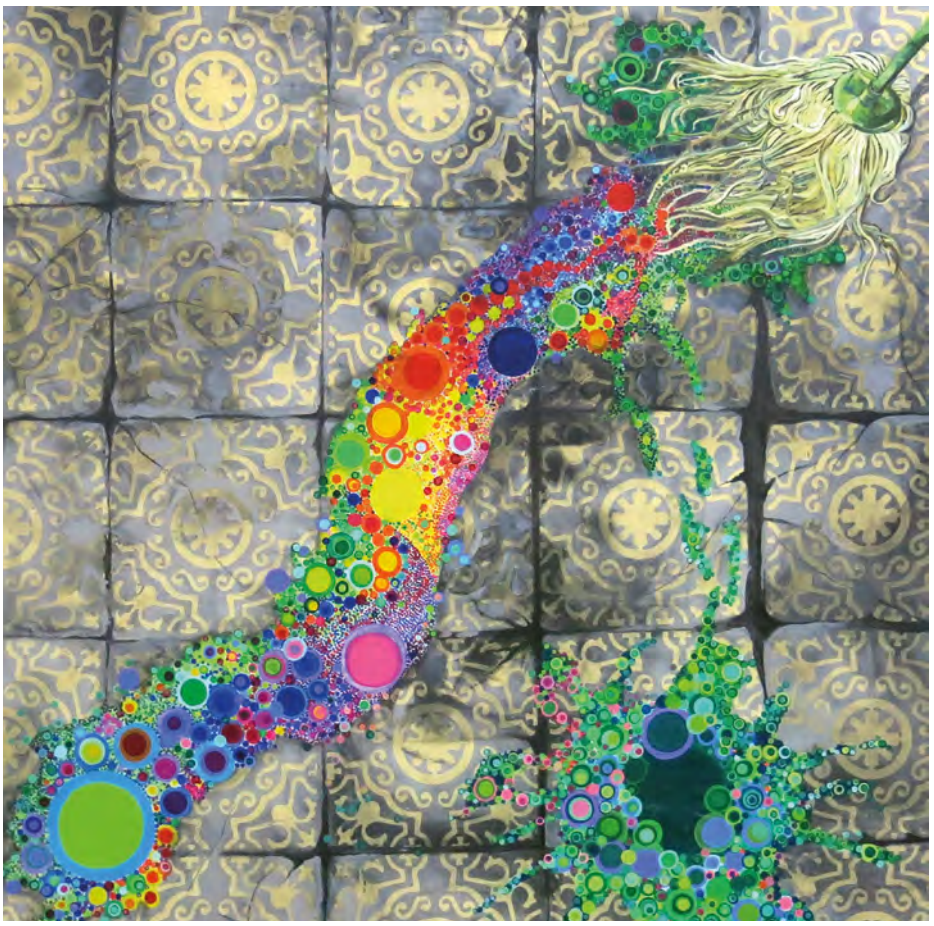
We have also seen an increase in art trade using art-secured loans, either to

supplement their traditional sources of working capital from traditional bank facilities, or to replace such traditional sources of financing altogether. The 2019 Art Basel and UBS report cites access to credit and financing as the third-biggest challenge dealers felt they would face in the next five years. It is widely known fact that banks have been more conservative in the provision of credit to businesses in recent years, and specialist art lenders with in-depth knowledge and understanding of how the art trade operates, delivering a more flexible, tailored product, have fueled this higher demand from the art trade.

On the supply side, we are seeing and will continue to see the best art-only art-secured lending products and services being provided by specialist art lenders with in-depth domain expertise. High barriers to entry to delivering first-rate art-focused credit products will remain.

Staying on the supply side, there are some interesting dynamics at play with a number of lenders. With Sotheby's being taken back into private hands by Patrick Drahi later this year, we will have to wait and see what the new owner's plans for Sotheby's Financial Services are. Will they follow the path of Christie's, also privately owned, by focusing on the core auction and private sale business more than financial services? We are yet to see how the new home for Athena Art Finance will play out will an alternative investment platform for retail investors be a good fit for high-end collectors seeking credit?

The long-term challenge and opportunity for the art-secured lending market will remain the long-term commitment to increasing awareness and understanding of the product and its diverse utility to collectors and traders in all key regions of both the art market and HNWI wealth management markets (namely the USA, Europe, and Asia). Specialist lenders' ability to robustly underwrite art asset risk will also remain central to the long-term health of any lender in this space, which in itself is an opportunity for specialist lenders with in-house art experts.



Series: Se me Movio el Piso - Courtesy Jeyson Campo Colection © Lina Sinisterra (2014)

The growing demand for art-backed loans is a natural reflection and extension of the increasingly sophisticated nature of the world's most active and prominent art buyers.





Aymeric Thuault & Aude Lemogne
Co-founders and Managing Directors of LINK Management



Xavier Ledru
Deputy Head of Corporate Advisory & Structuring, REYL & Cie

Expert voices

IT IS STILL POSSIBLE TO INNOVATE IN THE ART LENDING INDUSTRY

In June 2017, bank REYL & Cie and art wealth management firm LINK Management teamed up to launch Griffin Art Partners (GAP), a securitization platform structuring non-recourse art loans.

Please could you start by introducing your companies and explain why Griffin Art Partners was created?
AT: LINK Management is an art wealth management company founded in 2009, based in Luxembourg, Germany, and France. In addition to the classic advisory approach of analyzing a work of art from an aesthetical and historical point of view, we integrate the notions of in-depth due diligence, market timing, and risk management as well as asset allocation strategies for those individuals eager to consider their art as a means of diversifying their wealth.

We first became involved in art financing long before Griffin Art Partners was launched; as LINK Management had been providing funding directly to a number of art market professionals in the form of co-investments in works of art. In light of various constraints, our ambition was to be able to simultaneously address substantial financing needs and to design a new finance structuring model. We had a long-standing relationship with REYL & Cie, and as we had both identified an opportunity in the art lending space in Europe, we decided to launch Griffin Art Partners together.
XL: Founded in 1973, REYL is an independent banking group that manages assets in excess of CHF 15 billion (including minority affiliates) and has offices in Switzerland (Geneva, Zurich, and Lugano), Europe (London, Luxembourg, and Malta) Singapore, Dubai, and the United States. Having developed an innovative approach to banking, the group serves a clientele of international entrepreneurs and institutional investors through its *Wealth Management, Entrepreneur & Family Office Services, Corporate Advisory & Structuring, Asset Services*, and *Asset Management* business lines.

REYL & Cie has been active in the art world for some time through its Entrepreneur and Family Office Services. On the investment side, we had identified the need for innovative services in relation to art as an investment and were therefore keen to position ourselves in this market segment. We then looked for a tool with a lower risk profile than art funds. By using the bank's various skills, particularly in terms of legal and financial structuring, we partnered with

Art-backed notes are an innovative alternative to an art fund, as they provide exposure to art with much lower risk.

LINK to focus on devising a fixed return instrument (5 percent to 10 percent per annum), fully backed by the borrower's art collection. Such fixed income products are particularly attractive for investors looking to diversify their portfolios and de-correlate their asset allocations from other, more traditional asset classes, as a complement to more liquid positions.

How does GAP differentiate itself from other art lending solutions?

XL: Like a traditional art lender, GAP is involved in non-recourse loans; however, our structure is unique because we offer a proprietary securitization setup. GAP issues art-backed notes for each new loan, which is thus financed by a limited pool of institutional and private investors interested in generating a high return over a short- to medium-term horizon. Each loan is structured by issuing notes with an international ISIN code and cleared through the leading clearing houses. Art-backed notes are an innovative alternative to an art fund, as they provide exposure to art with much lower risk, through a maximum loan-to-value of 50 percent, while generating a fixed return.

AL: One of our aims was to set up highly transparent procedures as well as a flexible structure that can be adapted, when possible, to the borrower's specific needs. We can operate in all European jurisdictions and have the ability to permit some of our clients to keep their art at home, thus avoiding dispossession. It is worth noting that there are no conflicts of interest in the event of default as GAP will never take possession of the collateral itself at a discounted value. It will sell the asset in a public sale and return any amount outstanding after repayment of the loan to the borrower. Furthermore, we will not proceed with credit due diligence on the borrower and we will not require the latter to provide any personal collateral or assets under management.

XL: I would also add that, as a Luxembourg platform, GAP does not have cumbersome documentation processes. Our agreements are simple and straightforward. Besides strict due diligence on the collateral itself, KYC and AML procedures have been delegated to REYL & Cie in order to ensure maximum investor protection.

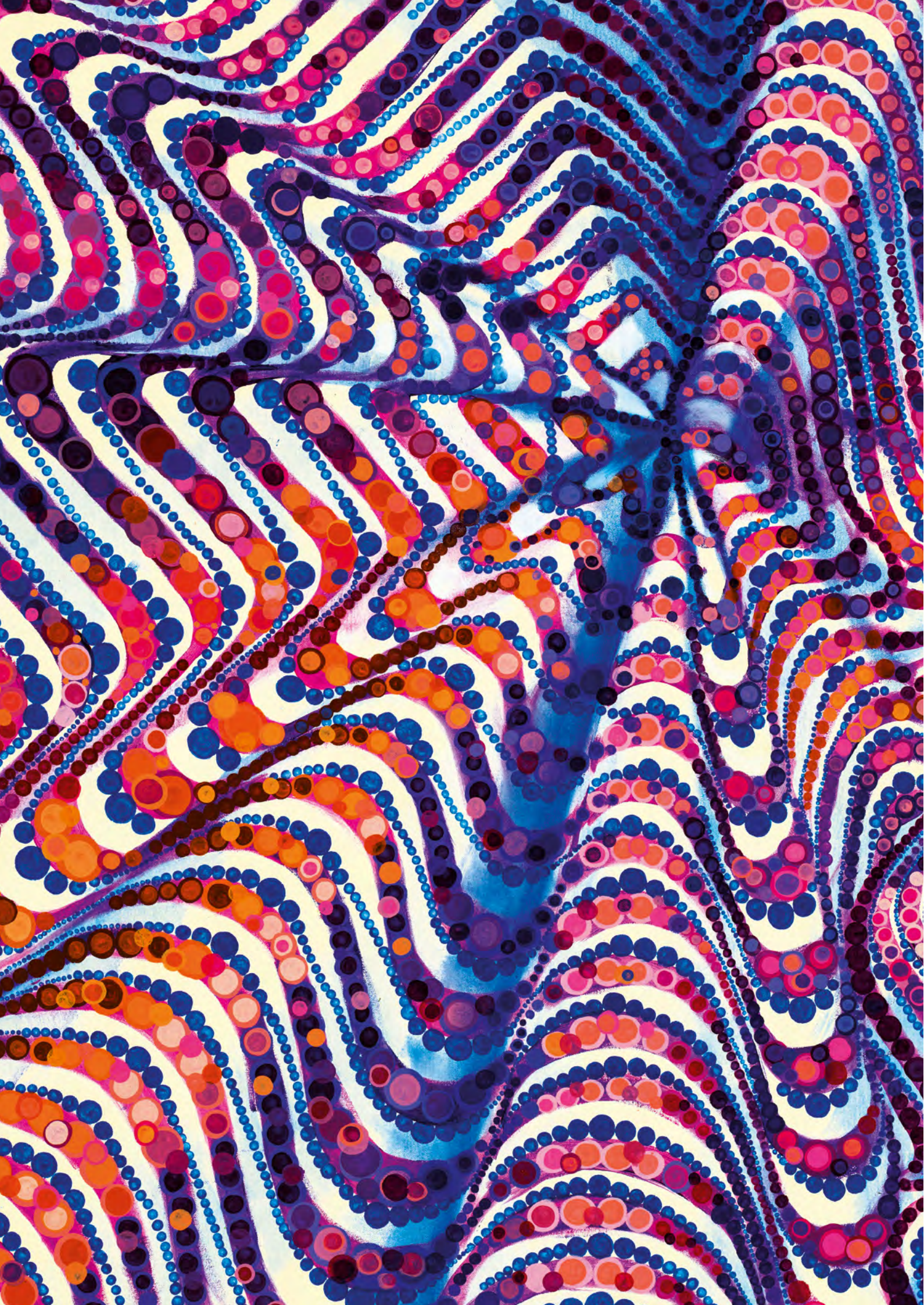
What do you see as the biggest challenges when providing art-secured lending to your clients?

AL: I would say that the two main challenges are artwork valuation and documentation quality.
In order to establish an accurate valuation, you need to pick suitable points of comparison from auction data, but that is not sufficient to identify price trends early on. Too often auction data confirms an existing trend that has already built up over a certain period in private dealings. If you rely solely on auction data, you run the risk of missing key elements. As LINK Management is active in private art transactions, we leverage the information flow to build up our proprietary price databases and to track price developments before they crystallize at auction. This allows us to manage the collateral on our loans much more efficiently. Regarding the documentation accompanying artworks, we observe a wide spectrum of completeness. Some collectors have painstakingly archived all certificates, invoices, insurance documents, and literature references related to their artworks. This facilitates our due diligence process and ultimately increases the chances that the works are deemed eligible. But we still come across some collectors who have failed to hold on to their full documentation, which negatively affects the marketability of the works. And, of course, there is the not-so-unusual case of extremely abundant authentication files that are a compilation of unknown art experts. These have to be rejected systematically.

What is the demand in terms of borrowing and investing?

AT: Europe is still a relatively untapped territory, especially compared with the United States. But leveraging an art collection is not for everybody, and there are cultural differences that make the appetite for leverage more developed in certain countries than in others.

XL: Nevertheless, the load quantum has increased since our launch two years ago and, as an example, we are currently looking at various transactions presenting a collateral value of between €25 million and €40 million.



Section 4

Art & Investment

"Feeling Blue" - Series: Noospheres - Courtesy Paola Lozano Collection NY © Lina Sinisterra (2019)

Highlights

PERFORMANCE

Positive returns in the art market between 2000 and 2018:
artnet's Index for the Top 100 Artists produced an 8 percent Compound Annual Growth Rate (CAGR) between 2000 and 2018, compared with 3 percent for the S&P 500. Between January 2000 and October 2018, artnet art market indices showed a positive CAGR of between 2 percent and 9 percent across the varying collecting categories.

Returns on European Old Masters and Impressionist and Modern Art level out, whilst Post-War & Contemporary outperform
According to artnet indices, returns on Old Masters have stabilized at a level below the S&P 500, with no significant growth or decline since 2017. The Global Impressionist and Modern Art markets show comparable trends and have been unable to regain the momentum seen a decade ago.

The artnet Index for Global Impressionist Art today is comparable to the S&P 500 level. However, Post-War & Contemporary Art has significantly outperformed other art markets as well as the S&P 500, particularly since the financial crisis in 2009.

Declining performance in the Chinese art market
The artnet indices for both 20th Century & Contemporary Art and Fine Chinese Paintings and Calligraphy have shown recent declines, with the latter category steeply dropping in 2018.

Historical collecting categories show lower correlation with other asset classes
European Old Masters and Global Impressionist Art display the lowest correlation with the S&P 500, real estate, and gold compared with other collecting categories, such as Global Post-War and Contemporary Art, which show a higher correlation with the S&P 500. Across the board, for all collecting categories, art as an asset class has a stronger positive correlation with the price of gold than with other asset classes reviewed in this study, indicating that investors perceive art as an asset that retains its value rather than an investment vehicle.

Long-term holding periods
Repeat auction sale data analyzed from Sotheby's Mei Moses suggests that works of art held off the auction market for at least ten years benefitted from the "holding period effect", whereby works with long holding periods were more likely to be sold for a profit and had less volatile compound annual returns (CARs).

FRACTIONAL OWNERSHIP IN ART

With the global art fund industry in decline, new art investment models are emerging
Fractional art ownership models have emerged in recent years aimed at democratizing an art investment market worth billions of dollars.

Tokenization has the potential to affect the financial world in the same way as email affected the postal system
While the existence of tokens in general, and digital tokens in particular, is not new, the speed with which these cryptographic tokens are being deployed and issued is an indicator they might just be the killer blockchain application many people have been waiting for.

Token contracts are essentially rights management tools
Tokens can represent any existing digital or physical asset or access right to assets someone else owns. Tokens can represent anything from a store of value to a set of permissions in the physical, digital, or legal worlds.

Fractional ownership of art
In the future, low-net-worth individuals who would usually be excluded from this type of investment opportunity may be able to own a fraction of an expensive work of art. This could prove particularly valuable and interesting for small investors who have not been able to meaningfully invest in fine art in the past.

Crowdfunding/investing
Tokens can also be used to crowdfund future art projects that investors can own fully or partially. Anyone who contributes to the funding of an art project could receive a proportional share of the tokenized value of that project, according to the terms laid out in a smart contract.

Derivative artworks
The emergence of new derivative artworks is another potential application of tokenized art. It would be possible to create complex smart contracts that grant access rights to derivative art works with the purchase of a fraction of a painting. Art tokens also open up new forms of artistic expression and value creation, such as gamification, and could lead to the fusion of art, virtual reality, and gaming.

SOCIAL IMPACT INVESTING IN ART AND CULTURE

Shift towards impact investing as the world faces even greater challenges
An increasing number of investors are keen to ensure that their money has a positive impact on society and the world at large, and there is a global shift in investment trends towards focusing on more than just the financial returns on a given investment.

Socially responsible investment products in art and culture are ranked highly by private banks
In this year's survey, 28 percent of wealth managers said that socially responsible investment products in art and culture would be most relevant to their clients.

Technology is driving change in the world of impact investing
The advent of blockchain technology and tokenization looks set to usher in the next generation of art and cultural impact investment models that combine fractional ownership with social impact investment.

Millennials want to do things differently
Despite only holding a small proportion of total UHNWI wealth, millennials are having an impact on philanthropy by combining charitable giving with profit-making endeavors and social enterprises. This is the generation that is likely to develop the social impact investment and philanthropic models for art and culture that will prevail in the 21st century.

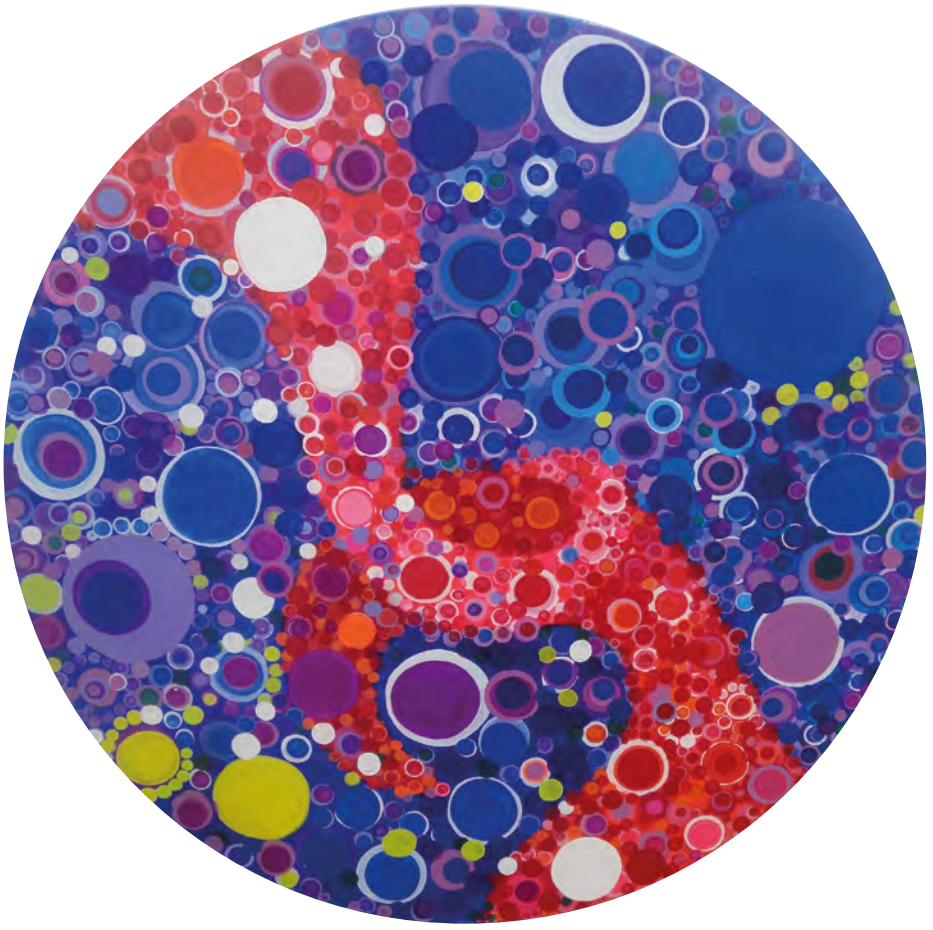
Investment in art and cultural infrastructure
According to AEA Consulting, the past three years have seen annual investment in art and cultural infrastructure projects hovering between US$8 billion and US$9 billion based on an average of 115 completed projects per year. One of the three main motivations for developers to invest in cultural projects is that cultural infrastructure can define and redefine the character of a place, and the cost of investment in cultural infrastructure is offset by the enhancement of adjacent residential or commercial property values.

Most investments are being driven by variations on the Bilbao/Guggenheim success story
Most investments in art infrastructure reflect sophisticated strategies and are built on an interpretation of the many dimensions of Bilbao's success: architecture, tourist strategy, revenue funding from regional government to support great museum programming, an understanding of the market catchment area, investment in hotels and airports, etc.

The surge in private museums
As in the last gilded age, the increase in new private museums is the outcome of wealth accumulation, which is fueled by the benign tax framework in place in many countries.

Impact investment in art and culture is gaining momentum internationally
Organizations such as Nesta and its Arts Impact Fund have attracted significant international attention, with funders, policymakers, and national agencies across many countries looking at how to replicate the fund in their own jurisdictions.

Private-public partnerships can promote new social impact investment models in the cultural sector
Public-private partnerships could be considered to unlock the value of public collections in order to support the cultural sector and ensure that public institutions receive the funding they need to fulfil their social role.



487 Horas Pensando © Lina Sinisterra (2009)

Introduction

The financial aspect of art ownership has become even more important since our last survey in 2017. More of today's collectors are motivated by investment returns and portfolio diversification, as well as a desire to hedge against inflation and store wealth in a safe haven asset.

This section is divided into three parts:

01. **Firstly, we take a closer look at the past performance of art as an asset class.** This part includes an art market performance analysis by artnet of the 2000-2018 period and a study by Sotheby's on the benefits of holding art for a long time. Peter Man Kit Lee, a Partner from Deloitte Hong Kong, also reports on the growing expertise of Asian investors and rising demand for art as an alternative form of investment.

02. **Secondly, we look at the developing market for fractional art ownership.** We are delighted to be able to share Dr. Shermin Voshmgir's view on tokenization and fractional art ownership. Matteo Cernuschi, COO & Co-Founder of ANote Music, also presents the company's cutting-edge technology to invest in music copyrights, which is due to be launched in the near future.

03. **Finally, we introduce a different investment perspective** by focusing on the rising interest in social impact and infrastructure investing, and explore what this may mean for the art and culture industry in years to come. We are delighted to have Fran Sanderson presenting her views on impact investment, through her work at Nesta, we are also very grateful to have Adrian Ellis discussing investment in cultural infrastructure and its impact on real estate values and we are very proud to have an interview with Manoelle Lepoutre, Senior Vice President Civil and Society Engagement at Total and Managing Director of the Fondation Total discussing their involvement with Culture.

Part 01
Performance:
Art as an asset class



Ning Lu
Vice President of Operations
artnet



Michaela Ben Yehuda
Junior Art Market Analyst
artnet



Robert Cacharani
Senior Data Analyst
artnet

The first half of 2019 saw a decline in the total sales value for Fine Art and Decorative Art at auctions year-on-year, despite a 13 percent increase in works consigned. The Fine Art auction market decreased in value to US$6.9 billion, compared to US$8.2 billion in the first half of 2018. Decorative Art sales also took a hit in the first half of 2019, although more lots were transacted than in 2018 within the same time period. The average price of Fine Art lots decreased from US$61.6 thousand to US$46.5 thousand from the first half of 2018 to 2019. Decorative art lots experienced similar declines in the first six months of 2019, although the sell-through rate for the category increased to 66 percent in 2019, compared to 64 percent in 2018.

The decline in the total sales value was felt across collecting categories, despite an increase in lots offered and sold year-on-year. The Ultra-Contemporary art sector was the exception to the rule, with 51 percent growth in total sales value and 30 percent growth in average sale price in the first half of 2019 year-on-year as supply and demand surged.

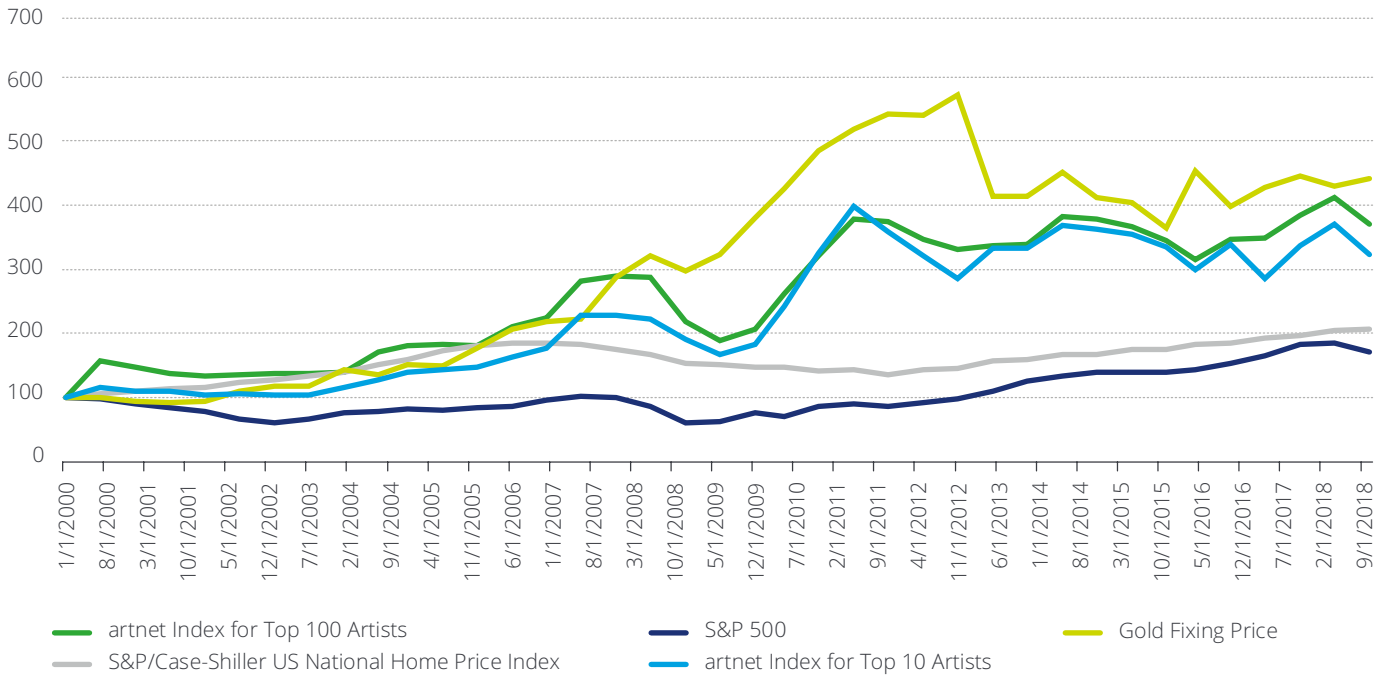
The global power houses—the United States, China, and the United Kingdom—continued to lead the market despite their individual losses in sales year-on-year. The countries experienced declines of 18 percent, 11 percent and 24 percent, respectively.

Germany, however, gained some momentum in the first half of 2019, with positive Fine Art trends from 2018 to 2019. It's also worth noting that countries facing political and social unrest, such as Iran, Turkey, and Israel, experienced particularly high market contractions by total sales value.

Evaluating the performance of art as an asset class over the last two decades, the artnet Index for the Top 100 Artists displays a considerable positive return over time for art. The index has outpaced the S&P 500 in growth consistently, even considering the 35 percent hit the art index took between 2008 and mid-2009. artnet's Index for the Top 100 Artists produced an 8 percent compound annual growth rate (CAGR) between 2000 and 2018, compared to 3 percent for the S&P 500. Although the Index for the Top 100 Artists has remained bullish since 2016, art prices and the S&P alike faced a decline in 2018.

The artnet Index for the Top 100 Artists displays a considerable positive return over time for art.

Figure 30. artnet Price Indices: Top 100 Artists
Source: 2019 © artnet Worldwide Corporation



Over the last few years, prices for European Old Masters have stabilized at a level below the S&P 500.

While the artnet Index for the Top 100 Artists is testament to the strength of the market at a given time, the art market consists of varying segments that often perform independently of each other. A closer look at particular market sectors provides investors with additional insight on the strengths and weaknesses of specific collecting categories. According to artnet's Indices, the European Old Masters market showed steady growth up until 2008. Since then, this particular market has stagnated, unable to reach the peak numbers seen in the run-up to the 2008 financial crisis. Over the last few years, prices for European Old Masters have stabilized at a level below the S&P 500, with no significant growth or decline since 2017. The Global Impressionist and Modern Art markets show comparable trends, unable to regain the momentum reached a decade ago. The artnet Index for Global Impressionist Art today is comparable to the S&P 500 level. Artists from Europe, however, continue to outperform American artists in the Modern Art category.

Figure 31. artnet Price Indices: European Old Masters

Source: 2019 © artnet Worldwide Corporation

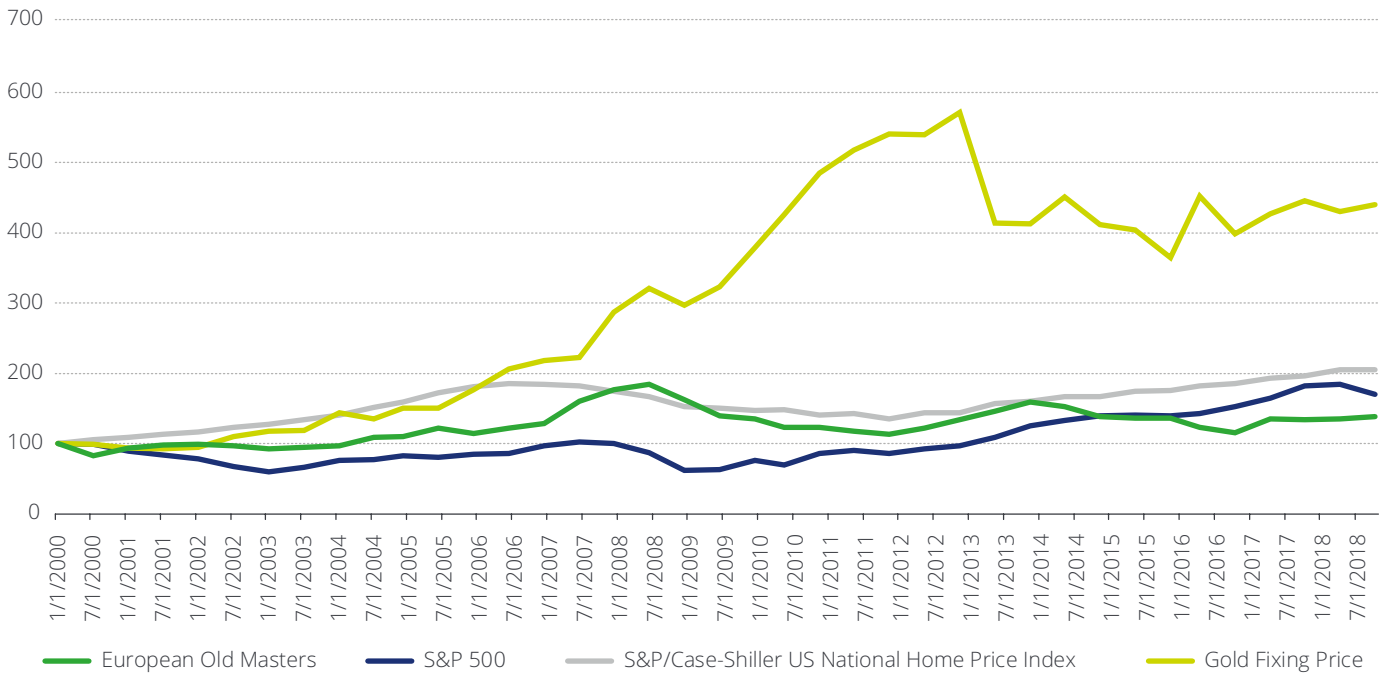


Figure 32. artnet Price Indices: Global Impressionist Art

Source: 2019 © artnet Worldwide Corporation

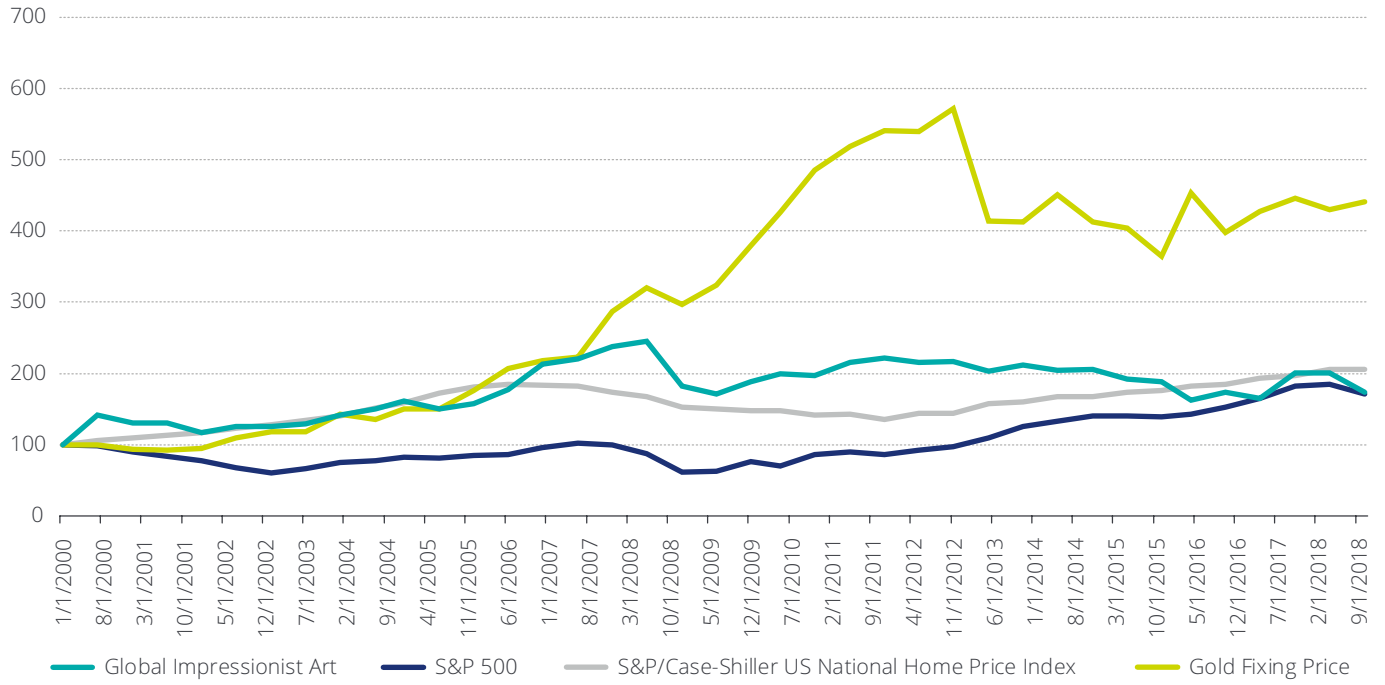


Figure 33. artnet Price Indices: Modern Art

Source: 2019 © artnet Worldwide Corporation

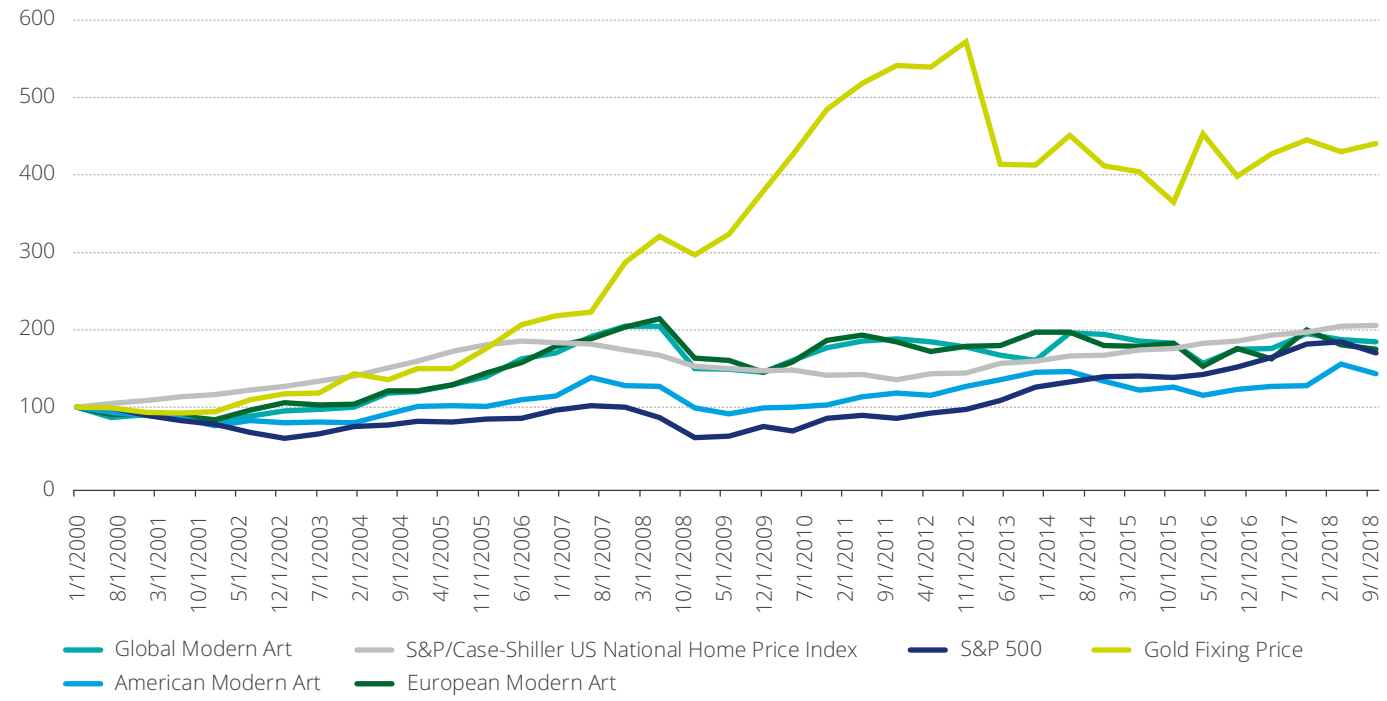


Figure 34. artnet Price Indices: Post-War Art

Source: 2019 © artnet Worldwide Corporation

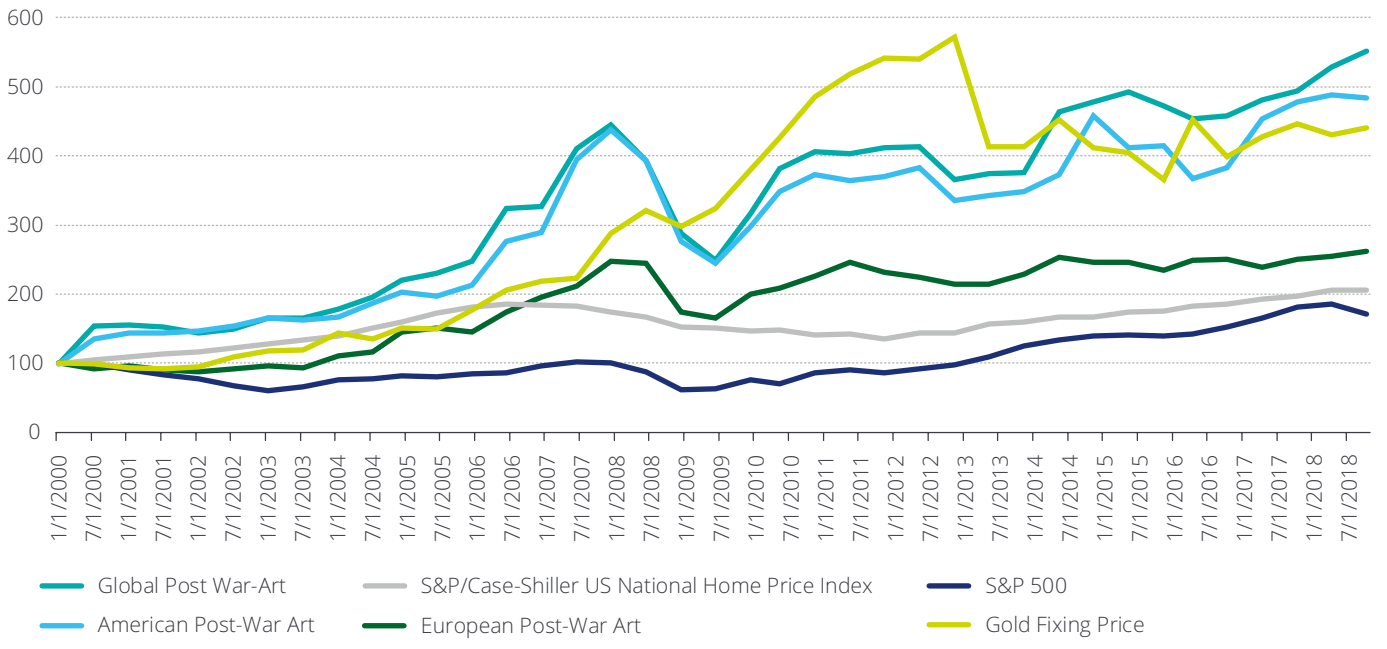
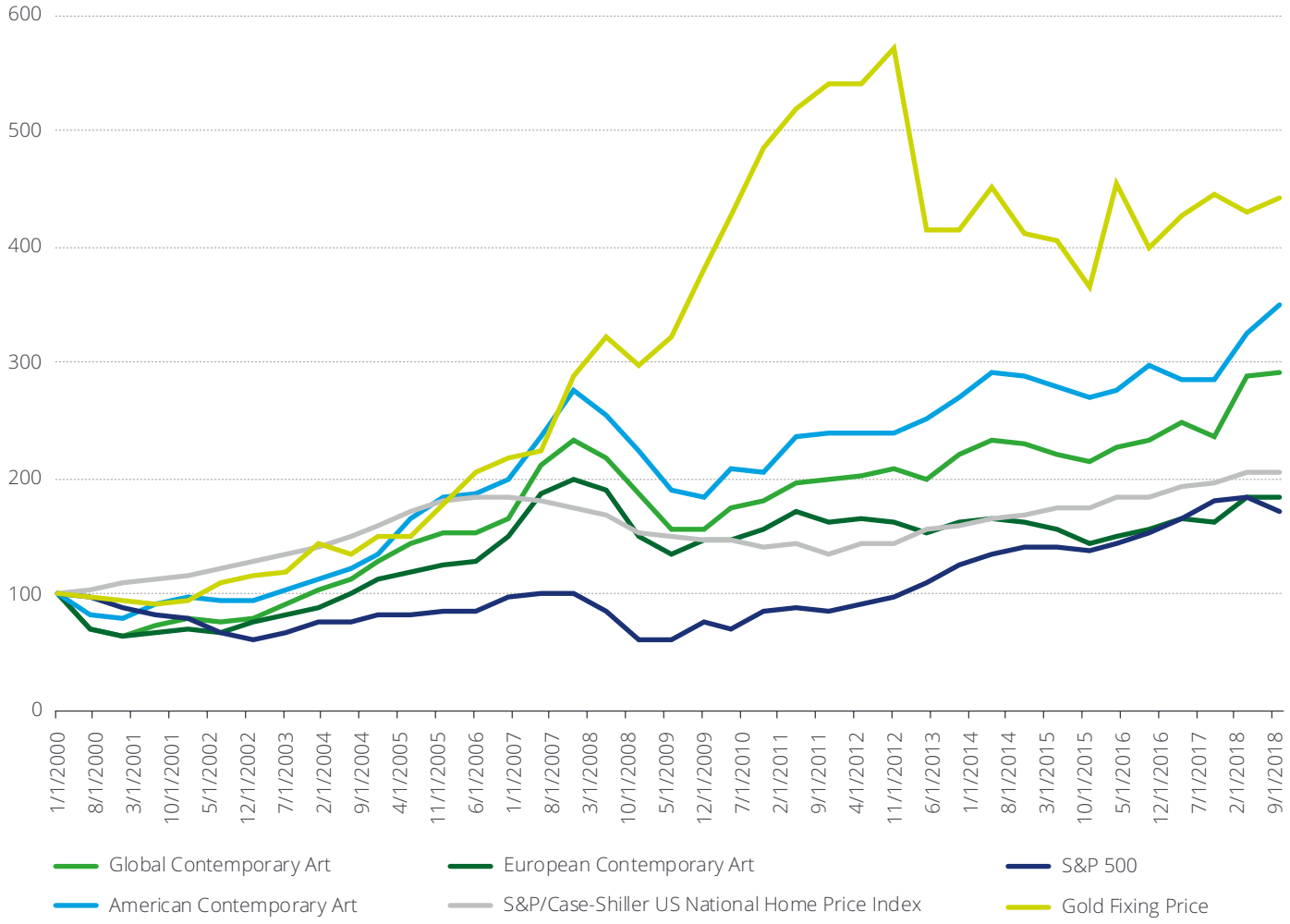


Figure 35. artnet Price Indices: Contemporary Art
Source: 2019 © artnet Worldwide Corporation

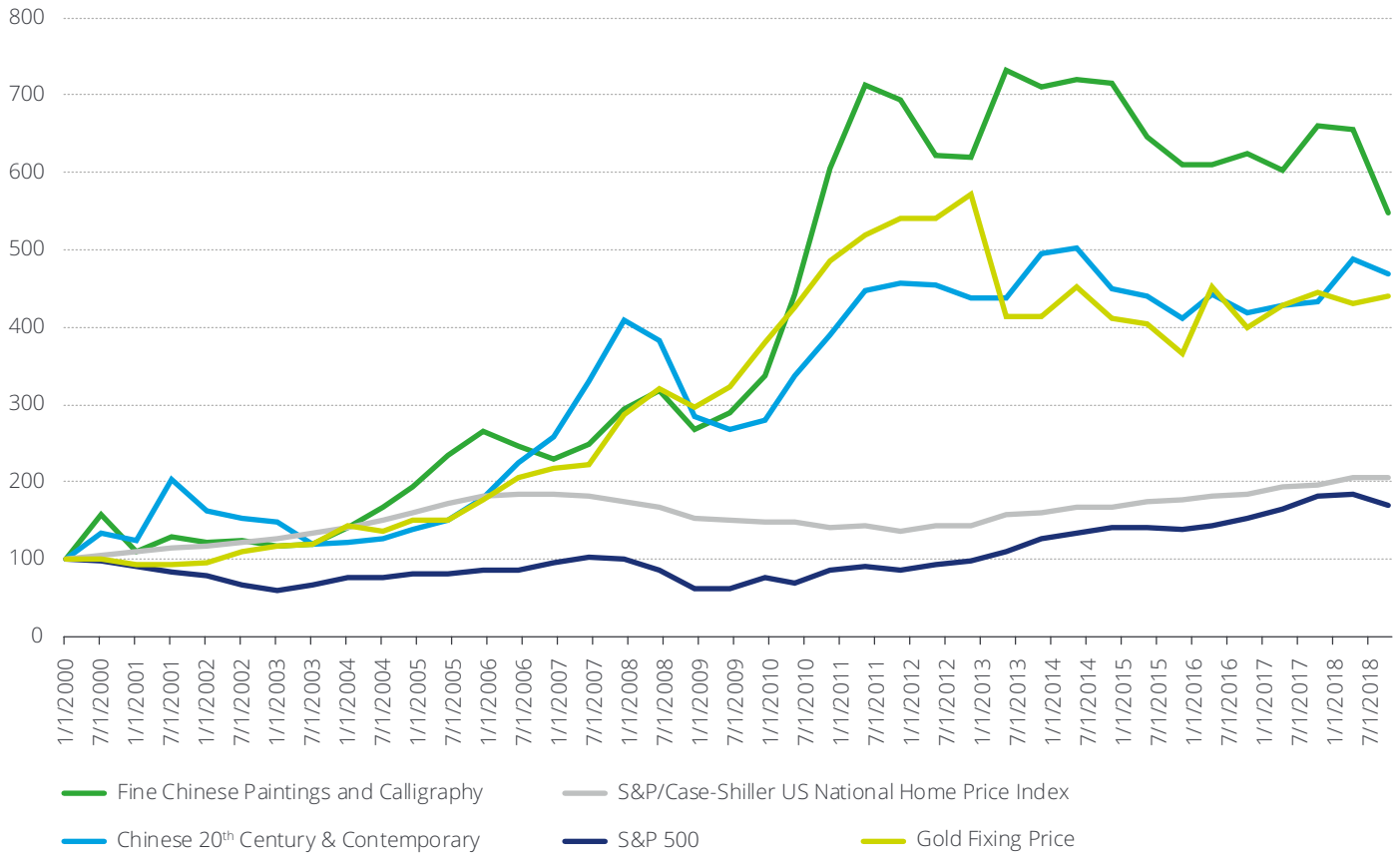


The artnet Indices for Post-War and Contemporary Art tell a different story, as the two movements underwent significant growth after 2009. With American artists leading the push for both collecting categories, Post-War and Contemporary prices took a dive from 2008 to 2009 but have aggressively outpaced the financial index over the last decade. Interestingly enough, European artists only outperform American artists in the Modern Art category, where returns for European artists have been consistently higher than American artists' returns over the last two decades.

Looking at the market for Chinese art, the artnet Indices for both 20th Century & Contemporary Art and Fine Chinese Paintings and Calligraphy have shown recent declines, with the latter category steeply dropping in 2018. Led by the Fine Chinese Paintings and Calligraphy sector, both categories for Chinese works grew bullish starting in 2005, significantly outpacing the S&P 500. The success of Fine Chinese Paintings and Calligraphy works can be attributed to the large Chinese collector base they attract. Vastly supported by growth in the buying power of Chinese collectors, the category is typically more stable and reflective of the overall Chinese economy. In contrast, 20th Century & Contemporary works from China were initially supported by interest from an international collector base. In more recent years, after a period of volatility between 2008 and 2010, the genre garnered increasing local interest and continued support from a new class of Chinese buyers.

Figure 36. artnet Price Indices: Fine Chinese Paintings & Caligraphy and 20th C. & Contemporary Art

Source: 2019 © artnet Worldwide Corporation



According to data from the *Global Chinese Art Auction Market Report*, the volume of Chinese works sold has dropped significantly since 2012. Both artnet Indices for Chinese artworks, however, suggest a much milder decline in value for blue-chip artists, indicating a shift from quantity towards quality in this market.

If we go one step further to look at the return on art investments over varying time periods, we observe a positive compound annual growth rate (CAGR) in the long run across all art price indices in this report. Between January 2000 and October 2018, artnet art market indices show positive CAGR of between 2 percent and 9 percent across the varying collecting categories. The best-performing art categories for this period were Fine Chinese Paintings and Calligraphy, and Chinese 20th Century & Contemporary Art, followed by Global Post-War Art, and Global Contemporary Art.

Among the various Fine Art collecting segments, Global Post-War and Contemporary Art have generated the most consistent returns over the past 15 years, with positive CAGR across all investment cycles. Moreover, the Chinese Indices for Fine Paintings and Calligraphy and 20th Century & Contemporary have showed negative returns in the short run over the last 12 months, but the strongest positive CAGR over a 15-year period. In contrast, as the market for the European Old Masters stagnates, this category shows much less variance in CAGR across different investment cycles, but it also saw a relatively smaller CAGR over a longer investment cycle than other categories that are on the rise.

	Last 12-month return	5-year CAGR	10-year CAGR	15-year CAGR
European Old Masters	1.99%	-2.82%	-1.63%	2.38%
Global Impressionist Art	-13.69%	-3.92%	-0.48%	1.33%
Global Modern Art	-1.43%	2.87%	2.10%	4.15%
Global Post War Art	4.42%	7.92%	6.69%	7.81%
Global Contemporary	1.27%	5.70%	4.58%	7.12%
Fine Chinese Paintings and Calligraphy	-16.41%	-5.06%	7.45%	9.43%
Chinese 20th Century & Contemporary	-4.21%	-1.15%	5.13%	9.31%

Source: 2019 © artnet Worldwide Corporation

It is worth noting that while indices are helpful tools to use as reference points for the performance of top-selling artists over time in particular sectors, investors should consider their limitations and restrictions.

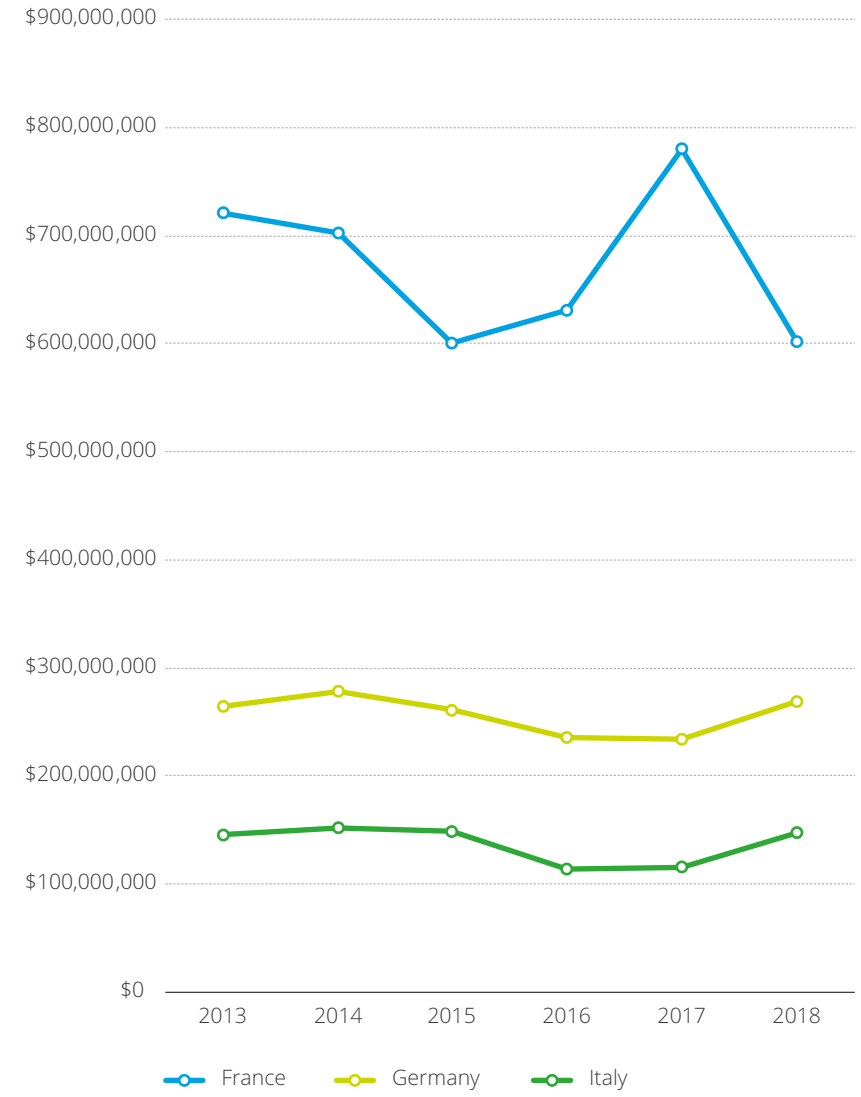
Art particularly attracts investors as it is regarded as a value-preserving asset class. Like gold, artworks are less susceptible to risks associated with financial market crashes than stocks and bonds. Because of the intrinsic value of art as luxury item, art is able to rebound and even grow faster than traditional asset classes in response to financial turmoil. This pattern is evident following the 2008 financial crisis. While the artnet Index for the Top 100 Artists was able to recoup its peak value by 2011, the S&P 500 took five years to recover.

Additionally, art is particularly attractive to investors owing to astounding resale success stories such as Leon Bonnat's 1891 painting. *Samson's Youth* first sold at auction in 2006 for US$408,000. When the work resurfaced in London 12 years later at Christie's, the same oil on canvas earned almost five times its original sale price, selling for more than US$2 million with a premium. Bonnat's profitable painting is one of thousands of works to soar in value upon returning to auction.

It is worth noting that while indices are helpful tools to use as reference points for the performance of top-selling artists over time in particular sectors, investors should consider their limitations and restrictions. As a lack of transparency and illiquidity have always been unfavorable characteristics associated with investment in art, we recommend that readers consider the methodology behind the indices in order to leverage the data in the most advantageous way.

To elaborate, evaluating the various risks particular to works of art is crucial for investors interested in allocating capital in the sector. The risks associated with traditional assets differ from those associated with investing in artworks. Unlike bonds and the stock market, for example, the art industry lacks market transparency. Stock performance and bond prices are monitored consistently and adjusted constantly to reflect shifts in the industry. Additionally, prices are public, and transactions are regulated. In contrast, the art market is more nascent, uncertain, and obscure. Market transparency is an obstacle in the field: dealers keep details of sales private, galleries do not publicize artwork pricing, and buyer information is often undisclosed. Although auction records are accessible through subscription services such as artnet's Price Database, buyers are still reliant on appraisers' knowledge and analysis. Auction houses also cater to clients who prefer to sell their works through private transactions rather than public bidding processes, so the whole market is never fully accessible.

Figure 37. Total sales value ($US) by country, 2013-2018
Source: 2019 © artnet Worldwide Corporation



By placing unprecedented requirements on art exports of a certain value, art owners are now required to have licenses in order to legally trade art assets.

Government regulations also pose risks to investors. Although many regional art markets typically do not have strong restrictions on pricing, commission rates and trading policies as compared to financial markets, the risk of governmental policy changes is mounting as the industry grows in size. This issue has come to the fore over the last few years in Germany, as the government passed a law in 2016 in favor of regulating the country's art market. By placing unprecedented requirements on art exports of a certain value, art owners are now required to have licenses in order to legally trade art assets. Similar controls were also implemented in Italy a couple of years earlier. It comes to no surprise, then, that the Italian and German art industries saw a decline of total sales value in the years preceding the ratifications of their respective laws. Neighboring European countries such as France, in comparison, saw a spike in their market during the same time period, likely absorbing works sold by German and Italian collectors attempting to liquidate their assets in anticipation of the regulatory changes.

In contrast, the Chinese art market faces issues due to the lack of government control over its auction sales, as payment default or delay continues to plague the secondary market. On average since 2011, only about 54 percent of total sales values each year are successfully paid to auction houses based on data collected by the China Association of Auctioneers the following year; the percentage drastically drops further amongst top-selling lots. This demonstrates that there is no guarantee that works will change hands in the region even after an auction occurs.

Between 2008 and 2011, the Chinese art market experienced an exceptional growth rate of 500 percent, outpacing any other region in the world. However, as the government launched an anti-graft campaign against corruption in 2012, the market volume in mainland China was almost cut in half and never regained its momentum. The current trade war between the U.S. and China casts further uncertainty on the Chinese art market and the art trade between the two countries. At any given time, each regional art market can undergo changes due to sociopolitical and regulatory influences that cannot be easily predicted by investors, especially considering the longer investment cycle for art as compared to financial assets.

Along with a lack of market transparency and unpredictable regional market regulations, low liquidity and the heterogeneity of art pieces are additional risks associated with art as an asset class. Works of art are illiquid, as they are hard to exchange for cash in comparison to bonds and stocks. Additionally, artworks' authenticity, provenance, attributions, and the potential for forgery are risks that investors are aware of when investing in art. The quality of a work, craftsmanship, technical skill, and physical durability, can also be a concern, as the price of a work is largely affected by such details. Due to the nature of the asset class, works of art are heterogeneous and one of a kind, rather than exchangeable. Ultimately, the financial rate of return is hard to calculate due to the uniqueness of each object of exchange.

Looking ahead, as we are entering a late stage of an economic cycle, it's worth taking a look at how the art market has performed in past recessions and slowdowns in the financial markets, so as to outline the correlation between various categories in the art market and other asset classes for investors looking to diversify their asset allocations.

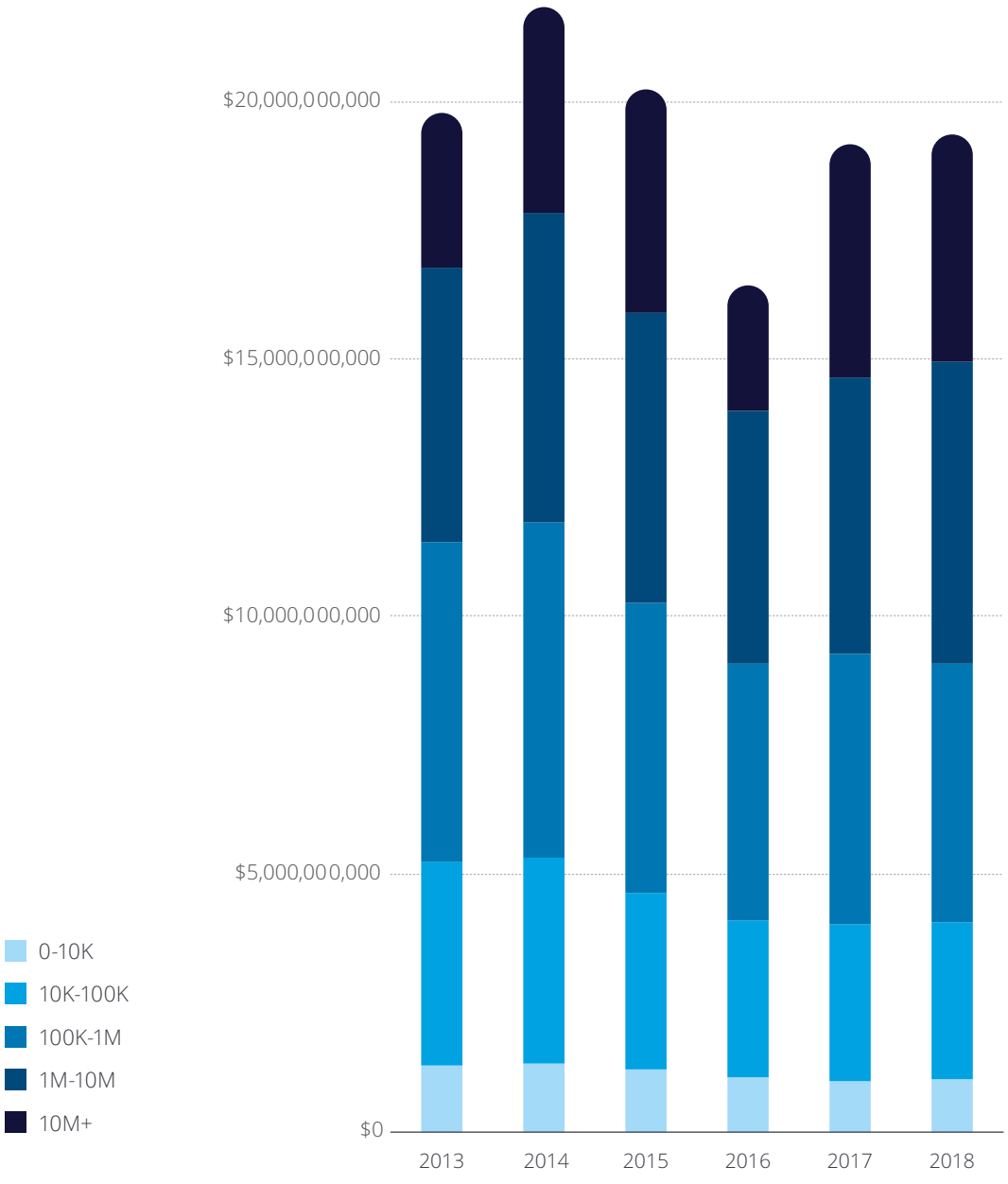
Following the 2008 financial crisis, markets for virtually all assets experienced a steep decline. While the S&P 500 was only able to regain its strengths by 2013, the index for the top 100 artists bounced back and even outperformed its 2008 peak within two years of the drop. This suggests that artworks by blue-chip artists are able to retain value during economic crises. The same cannot be said for specific collecting categories such as Impressionist and Modern art, for example, which to this day have been unable to recover from the recession.

Similar trends are showcased in the latest stock market selloff in 2015 and 2016. As the S&P 500 flat-lined, the index for the top 100 artists reflected the financial slow-down, also taking a hit during the time period. Yet, a breakdown of total sales value by price bracket suggests that high-end works worth US$1 million and above were able to lead the market comeback following the 2015 and 2016 slump. While works of art below the price threshold never achieved volumes comparable to the 2014 peak, blue-chip works were able to stand the test of time.

Between 2008 and 2011, the Chinese art market experienced an exceptional growth rate of 500 percent, outpacing any other region in the world.

Looking at the correlation between art and other asset classes over a longer time span, European Old Masters and Global Impressionist Art display the lowest correlation with the S&P 500 as well as with the price of houses and gold compared to other collecting categories. In contrast, Global Post-War and Contemporary Art show the highest correlation with the S&P 500. Across the board for all collecting categories and led by the Fine Chinese Paintings and Calligraphy genre, art as an asset class has a stronger positive correlation with the price of gold than with other asset classes reviewed in this study, indicating investors' perception towards art more as a value-preserving asset class than as an investment vehicle.

Figure 38. Global total sales value by price band, 2013-2018
Source: 2019 © artnet Worldwide Corporation



Correlation based on artnet Indices	Correlation with S&P 500 between 2000 and 2018	Correlation with Case-Shiller U.S. National Home Price Index between 2000 and 2018	Correlation with Gold Fixing Price between 2000 and 2018
European Old Masters	29.96%	59.28%	51.14%
Global Impressionist Art	27.45%	51.85%	74.19%
Global Modern Art	54.20%	71.61%	81.94%
Global Post-War Art	74.45%	76.93%	84.30%
Global Contemporary	73.63%	80.53%	81.97%
Fine Chinese Paintings and Calligraphy	65.84%	48.91%	92.65%
Chinese 20th Century & Contemporary	65.84%	56.61%	92.14%

Source: 2019 © artnet Worldwide Corporation

Given the various risks associated with the art market, there is an added benefit that is unique to this asset class and not shared by any other luxury item. Although capitalizing on the art market always involves a word of caution for investors, artworks can be enjoyed by owners who are passionate of a work regardless of its monetary value. Whether a painting hangs in a living room, or a sculpture greets visitors in a public space, the non-financial worth of a piece of art is unparalleled by any other asset class.

Looking at the correlation between art and other asset classes over a longer time span, European Old Masters and Global Impressionist Art display the lowest correlation.

Notes

Data sources for artnet and financial indices

- All data used to calculate artnet indices is based on information reported to the artnet Price Database Fine Art and Design as of:
  – Year(s): 2019
  – Data extracted on: 26/6/2019
- All prices are converted from their original currency to USD, based on the exchange rate on the day of the sale. All prices are adjusted to include the buyer's premium.
- The artnet price index employs a hedonic regression framework explicitly based on an underlying stochastic process, allowing the volatility parameter of fine art to be treated as the object of interest. The model can be estimated using maximum likelihood in combination with the Kalman filter. More about the artnet indices methodology can be found in this paper.
- **S&P 500** data is sourced from GSPC on Yahoo Finance (link).
- **S&P/Case-Shiller US National Home Price Index** data is sourced from DJI (Dow Jones Indices) from the Federal Reserve Bank of St. Louis (link).
- **Gold Fixing Price** data is sourced from IBA (ICE Benchmark Administration Limited) from the Federal Reserve Bank of St. Louis (link).

Data scope for artnet indices

- The top 100 artists for each category were selected based on their aggregate total sales value for paintings and works on paper sold between 2016 and 2018.
- The art categories are defined as follows:

Art Category	Index Description
Top 100 Artists	All artists were considered for this category.
European Old Masters	Works created by European artists born between 1250 and 1820.
Global Impressionist	Works created by artists born between 1821 and 1874, excluding Chinese artists.
Modern Art	Works created by artists born between 1875 and 1910, excluding Chinese artists.
Post-War	Works created by artists born between 1911 and 1944, excluding Chinese artists.
Contemporary	Works created by artists born after 1944, excluding Chinese artists.
Fine Chinese Paintings & Calligraphy	Works created by Chinese artists including classical, modern, and contemporary Chinese traditional-style paintings.
Chinese 20th Century & Contemporary	Works created by Chinese artists including oil painting, sculpture, installation, photography, etc.

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The Holding Period Effect: benefits for holding art long-term

Repeat auction sale data analyzed from Sotheby's Mei Moses indices suggests that works of art held off the auction market for at least ten years benefitted from the "holding period effect", in which works were more likely to be sold for a profit, had substantially lower compound annual return (CAR) volatility, and had much higher risk-adjusted returns. The study analyzes over 10,500 Impressionist & Modern and Contemporary works resold at auction between 2014 and 2018.

Consignors realized outsized gains and losses when they resold artworks within three years

From 2014 to 2018, collectors holding art for at least ten years were much less likely to lose money than those reselling within three years (the red sections below). A total of 88 percent of Contemporary works and 80 percent of Impressionist & Modern works held for over ten years had a resale price higher than their purchase price, while only 65 percent of Contemporary works and 57 percent of Impressionist & Modern works resold within three years sold for a higher price.

However, consignors were more likely to realize outsized gains and losses (i.e., +/- 20 percent CARs) when reselling a work at auction within three years than when holding a work of art for longer time periods. This contrasts with consignors who held works for over ten years—none suffered outsized losses for either Contemporary or Impressionist & Modern pieces.

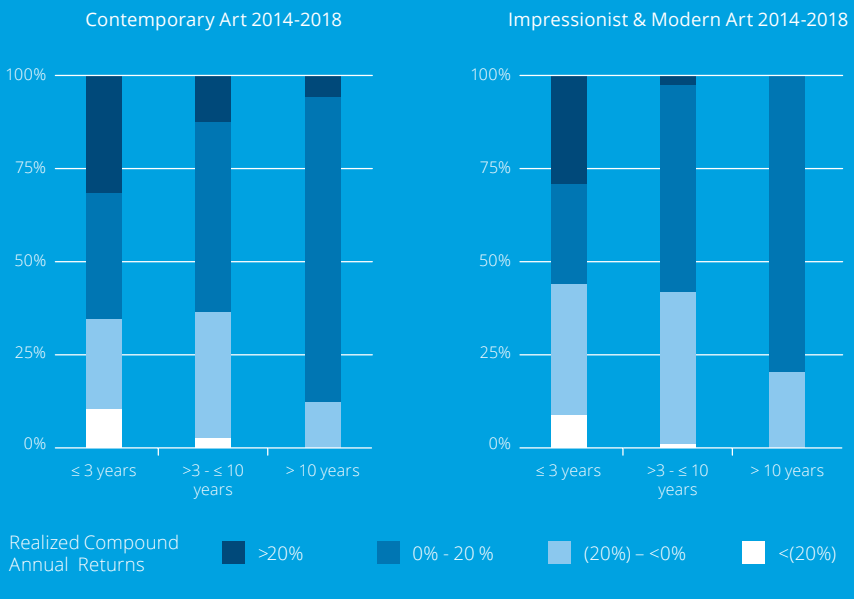
While the median CARs were similar for works with different holding periods, this calculation looks at the change in market value and does not factor in transaction costs. Transaction costs, which vary between works, typically have a larger effect on annual returns for works with shorter holding periods. This leads to an additional benefit in aggregate terms for works held for ten years or more.



Michael L. Klein
Sotheby's, Head of Sotheby's Mei Moses

Collectors who resold within three years of purchasing were more likely to realize outsized gains than losses between 2014 and 2018.

Figure 39. Global Total Sales Value by Price Band, 2014-2018
Source: Sotheby's Mei Moses indices



Contemporary Art	**≤ 3 years**	**3–10 years**	**> 10 years**
Number of repeat sales	681	2,423	2,453
Median CAR	7.0%	3.8%	7.5%
% resold for higher price	65%	64%	88%

Source: Sotheby's Mei Moses indices

Impressionist & Modern Art	**≤ 3 years**	**3–10 years**	**> 10 years**
Number of repeat sales	373	1,359	3,280
Median CAR	5.4%	1.4%	3.7%
% resold for higher price	57%	59%	80%

Source: Sotheby's Mei Moses indices

Higher risk-adjusted returns for works kept off the auction market for longer

The scatterplot graphs show works of art resold at auction between 2014 and 2018, with the holding period on the horizontal axis and the CAR on the vertical axis. The realized CARs for works held for under three years were highly volatile, with a standard deviation of 43 percent for Contemporary Art and 51 percent for Impressionist & Modern Art. The realized CARs for works held for at least ten years had a standard deviation of 8 percent for Contemporary Art and 5 percent for Impressionist & Modern art, which were both substantially lower.

Due to the large number of outsized winners for works held for three years or less, the average CAR was 15 percent for Contemporary Art and 19 percent for Impressionist & Modern Art; these figures were higher than the average CARs of 8 percent for Contemporary Art and 4 percent for Impressionist & Modern Art for works held for at least ten years. However, on a risk-adjusted basis, works resold within three years incurred more than three times as much risk per unit of reward compared to works held for at least ten years for Contemporary Art, and over twice as much risk per unit of reward for Impressionist & Modern Art.

Interestingly, the average returns and volatility of works were relatively consistent for works held for approximately 20 years or more. This means that once a work had been off the market for a substantial period, there was no additional penalty or reward for holding it longer. Thus, most auction consignors who held works of art for at least ten years benefitted from the "holding period effect" as their art grew in value.

Art works held for longer were more likely to achieve the category average, as the volatility of realized returns decreased with longer holding periods.

Figure 40. Contemporary Art: realized compound annual returns 2014–2018

Source: Sotheby's Mei Moses indices

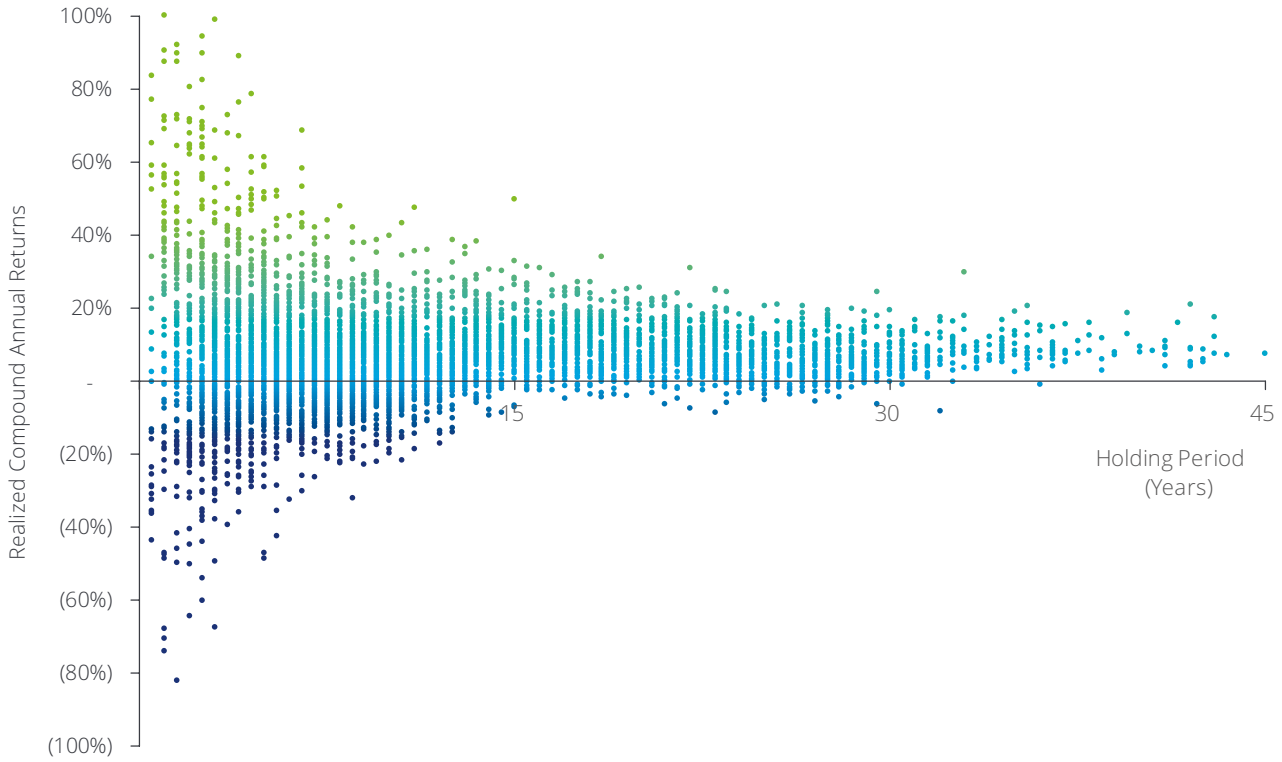
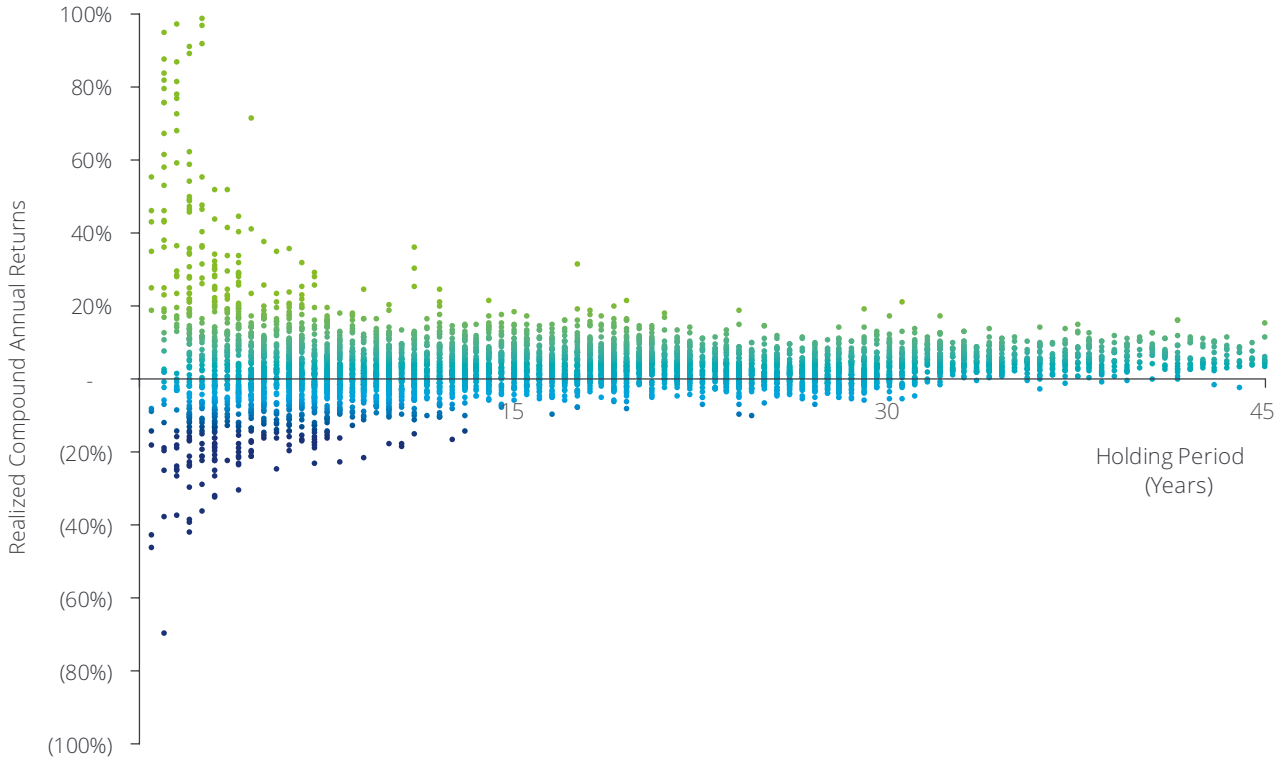


Figure 41. Impressionist & Modern Art: realized compound annual returns 2014–2018

Source: Sotheby's Mei Moses indices



Notes

Methodology
Sotheby's Mei Moses index uses the purchase prices of the same painting at two distinct moments in time (i.e., repeat sales) to measure the change in the value of unique works of art. Based on approximately 50,000 repeat sales from 1810 to the present, Sotheby's Mei Moses index is the financial industry's preferred instrument to compare the investment performance of art as an asset class, identify trends and internal dynamics on the market, and understand the market's relationship with broader economic and societal factors.

Founders
Developed in 2002 by New York University Stern School of Business professors Jianping Mei, PhD, and Michael Moses, PhD, Sotheby's Mei Moses index is used by wealth management firms such as JP Morgan and Morgan Stanley and has been cited in publications such as The New York Times, The Wall Street Journal, The Economist and The FT.

Disclaimer
Please note that the prior performance of the indices and realized returns contained herein do not guarantee future results. In addition, there is no guarantee that random collections of individual works of art or stocks will yield returns in line with the index. We are not financial advisors and we are not in the business of recommending art as an investment. We also have no comparative advantage in forecasting the future direction of the art market. Investment decisions should be based on the risk tolerance and time horizon of the investor with, if desired, the support of a licensed financial advisor. This information is provided "as is" and with no representations or warranties, either express or implied, of accuracy, merchantability, fitness for a particular purpose or of any other nature are made with respect to this information or to any expressed views presented.



From the series: Comer del Arte Quiero © Lina Sinisterra (2011)





Peter Lee
Leader, Family Office and Family Enterprise Consulting Services
Partner, Deloitte China

Expert voices

GROWING DEMAND AND SOPHISTICATION IN ASIA

"I agree that art and collectibles are a fast-growing alternative investment in Asia in general and China in particular. As an alternative asset class, art and collectibles are growing in importance as a way to hedge exposure to the public markets. Allocation to this asset class in Asia is accelerating rapidly but still negligible compared with the level seen in developed markets. A rising number of art funds are being set up in HK and SEA."

Asian families have seen art and antique collections as an important tool for the preservation of wealth and familial assets for centuries. They collect items such as centuries-old bridal chests, wooden furniture, jewelry, and paintings. Many Asian families collect art and antiques with the intention of passing on the collection as a gift to future generations. In the olden days, there was no way to determine the future value of the collection. As more auction houses have entered the Asian market and secondary market activities have grown rapidly, art and collectibles can now be priced and traded in an open and transparent market, hence generating liquidity.

Chinese art and antique investors and collectors have fueled the growth of the auction market domestically and abroad in the past decade as discussed elsewhere in this report. Based on our observations, we believe that this increasing appetite is mainly driven by the following factors:

- Chinese investors are becoming more familiar with the value proposition of art as an alternative asset class
- Over recent decades, more sophisticated family offices have been established in Asia that are increasingly inclined to view art as an important asset class in the asset allocation strategy
- Art investment helps to diversify traditional investment portfolios, which are typically composed of stocks and bonds
- The track record of art investment has gained recognition in Asia as the level of investment activities increase and there is more empirical data showing the benefits of investing in art
- Millennials are a new class of emerging active investors in Asia. They are typically more receptive than older generations to investing in alternative assets such as art as the majority of them have lived and studied abroad where they have been exposed to foreign art culture
- Wealthy Chinese collectors are eager to retrieve national treasures that were sold off in the past. For instance, a 900-year-old Northern Song dynasty dish was sold at an auction for US$38 million, which set a record for Chinese ceramics.

There is a growing trend for new products aimed at UHNWIs offering art investment coupled with wealth planning solutions such as trusts and foundations. When a person invests in art partly for the purposes of amassing familial wealth and creating a family legacy, combined wealth planning solutions can fulfil both wealth protection and estate planning objectives.

However, the market in Asia faces a number of challenges, including the limited amount of public information in relation to art and the illiquid nature of art. Another area that requires further development in Asia is the availability of art investment management expertise. This is an issue because the industry in Asia is still young compared with that of other markets, which may be due to a lack of experienced art investment professionals and the fact that most Asian investors prefer to be more hands-on with their personal investments.

According to our research, there are about 16 art investment funds operating in China with total AUM of US$300 million (the largest fund has AUM in excess of US$100 million and the smallest has less than US$2 million). However, this data does not include international art investment funds that invest in Chinese art or private funds set up by private individuals or family offices to invest in art.

Part 02
Fractional ownership
The new age of art investment?

The fact that collectors are expressing a greater focus on investment when buying art, coupled with a decline in the global art investment fund market in recent years[42], suggests that new models for art investment may be needed. One of the models that have emerged in the last 10 years is the notion of fractional ownership. This model has gained traction in the last two years on the back of rapid developments in blockchain technology and a willingness among investors to invest in a wide range of assets from real estate to intellectual property and art.

Fractional ownership of art has been tried and tested over the last 10 years with limited success, from early European initiatives such as SplitArt and A&F Markets to the Chinese art exchanges[43] that emerged between 2009 and 2011 and were subsequently shut down or consolidated by the Chinese government towards the end of 2011. Despite this patchy history, could we see the current generation of fractional art ownership platforms succeed where past generations have failed? Could fractional ownership be a way of attracting new audiences to the art market, or will history repeat itself?

Fractional investment models have yet to convince the art market: only 19 percent of collectors and art professionals said that they were interested or very interested in fractional investment. In contrast, 33 percent of collectors and 38 percent of art professionals said the same about traditional art funds. Whilst art funds have been around for several decades, it seems that established collectors and art professionals alike have yet to be convinced of the viability of other fractional investment models (some linked to blockchain technology). Wealth managers are equally skeptical as regards fractional investment models, with only 10 percent saying that fractional investment in art would be relevant/very relevant to their clients.

Fractional investment models have yet to convince the art market: only 19 percent of collectors and art professionals said that they were interested or very interested.

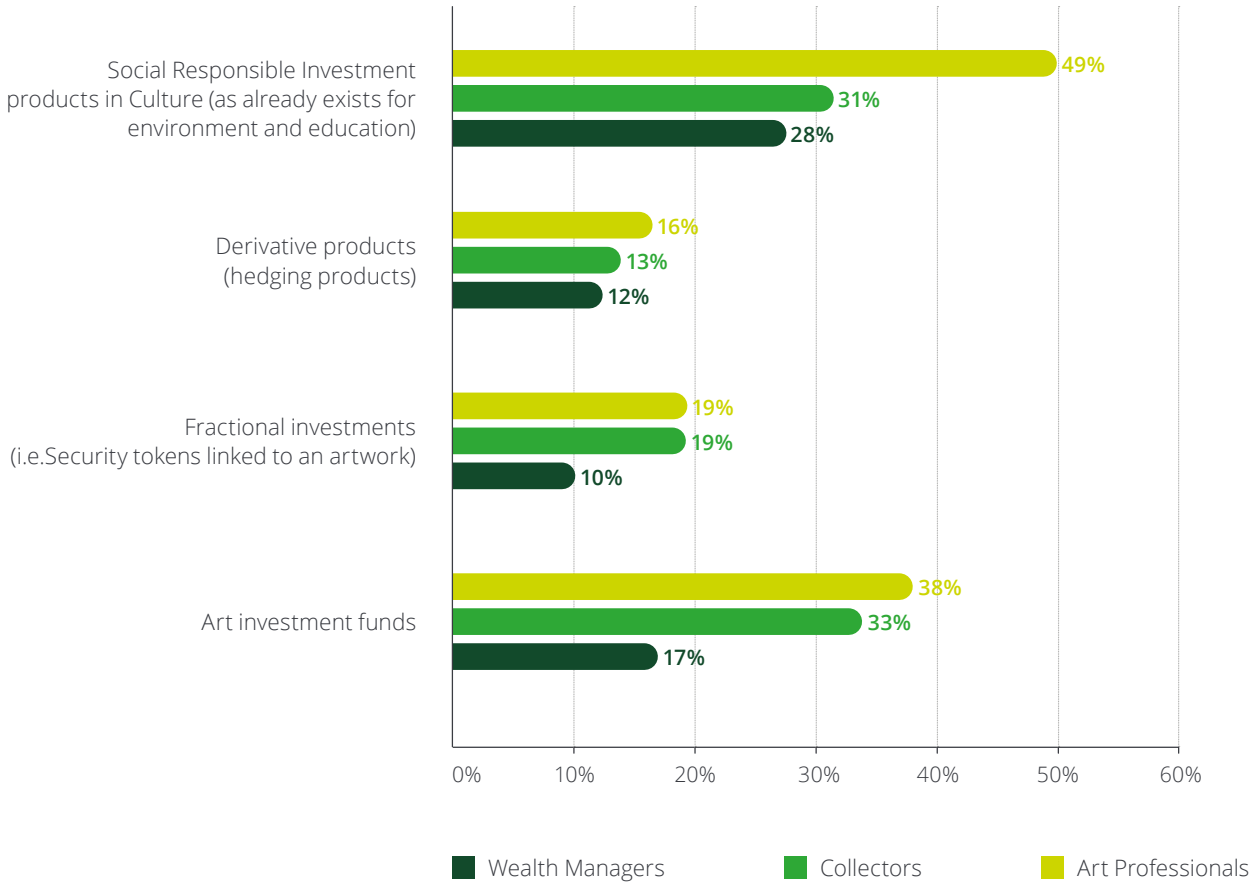
However, the *Hiscox Art Online Report 2019* found that 46 percent of millennial art buyers (aged 35 and below) said they would consider fractional ownership of art as a form of investment. An even higher share (51 percent) of younger buyers (those aged under 30) said they would consider it.

New art buyers (defined as having been collecting art for less than three years) also showed an appetite for fractional

42 This is based on trends observed by the research findings of the Art & Finance Reports between 2011 and 2017. This year, we have decided to look at art investment from a different perspective, as only limited public information is now available on art funds. This does not, however, mean that there is no art investment fund market, but rather that we have experienced a decrease in transparency in this market, as it seems that art investment funds have been moving out of the public eye.

43 This art trading model was introduced to the Chinese art market after the Shanghai Cultural Assets and Equity Exchange opened for business on 15 June 2009. The exchange was the country's first comprehensive artwork exchange. This was followed by a number of similar exchanges and, by June 2011, 20 art stock exchanges were reported to be operating in China.

Figure 42. Generation Gap: In terms of investing in art, which of the following art investment products would be more of interest to you?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



ownership of art, with 43 percent saying they would consider it. This suggests that there is a clear generational gap when it comes to the topic of fractional investment, as only 29 percent of art buyers above the age of 50 said they would consider investing in art through fractional ownership models.

The Qoqa case in Switzerland is a very interesting case study in terms of the interest in fractional ownership. Qoqa, a Swiss bargain commerce site, put Picasso's Buste de mousquetaire up for sale last December, offering 40,000 shares in the painting at a cost of US$51 each. Over the course of just three days, 25,000 people purchased a piece of the artwork through the platform.

In her article entitled "Tokenizing Art & Fractional Ownership" on p.150, Dr. Shermin Voshmgir presents several tangible applications for crypto-token technology in the art market. Tokenizing art has considerable potential when it comes to resolving many of the inefficiencies of the current art market: (1) fractional ownership, (2) provenance, (3) digital rights management and settlement, and (4) crowdfunding. Moreover, tokens may also pave the way for the creation of new derivative artworks.

Examples of **fractional art** ownership platforms

ARTFINTECH.ONE

Artfintech.one is a technology company that grew out of Artplus Inc., which was founded in 2012 by David Dehaeck and Nathalie Haveman. The company has developed Patron Protocol, a blockchain-based technology that facilitates fractional ownership of digital artwork. Recent developments include WUNDER, a decentralized blockchain-based digital art museum that partners with the most promising young and emerging artists, commercial galleries, and seasoned curators from around the world. WUNDER announced in August 2019 that they had completed the first digital art-backed asset transaction using Patron Protocol. The ING Collection in Amsterdam purchased one of the first fractional ownership shares, representing 12.5 percent ownership in a master copy from the video art work by the Romanian artist, Dragos Alexandrescu. WUNDER is preparing for a security token offering (STO) with artfintech.one later this year.

ARTOPOLIE

A new fractional ownership platform aimed at enabling everyone to invest as little as US$50 in works by Pablo Picasso and similar artists. It was launched in early January 2019 and founded by Bruno Costa and Victor Costa.

FERAL HORSES

Founded in 2017, Feral Horses enables individuals to purchase shares of works of art by contemporary artists. Shareholders may own as little as 0.1 percent and are free to trade as they please. The platform positions itself as a part-investment, part-patronage space. "We're in the market to offer a different value proposition; we want to allow people to connect, own, and invest in art more than they are today," said one of the co-founders.

LOOK LATERAL

Look Lateral was founded in 2018 and aims to use blockchain technology to enable anyone to invest in the global art market by buying and selling fractions (shares) of works of art. The company recently announced a security token offering (STO) called The LOOK. They plan to launch a fractional investment marketplace for art (FIMART) to the public in Q1 2020.

MAECENAS

Founded in 2017, Maecenas enables users to purchase up to 49 percent of valuable art collectibles using Bitcoin (BTC), Ethereum (ETH), or the platform's native ART token. Maecenas used its blockchain platform to auction a 31.5 percent share of an Andy Warhol painting (14 Small Electric Chairs) for US$1.7 million in the autumn of 2017.

MASTERWORKS

Founded in 2017 by Scott Lynn, Masterworks was the first company to allow investors to buy shares of great masterpieces. Their first offering, Andy Warhol's Marilyn painting, was qualified by the SEC in late May and they began selling shares in June.

OTIS

Launched in July 2019, Otis positions itself as "a culturally relevant, community-owned museum, powered by the people in the community," according to founder Michael Karnjanaprakorn. Otis's first offering will be Kehinde Wiley's St. Jerome Hearing the Trumpet of Last Judgement (2018), purchased by the platform for US$237,500 earlier this year.

This will be followed by co-investment opportunities in Supreme skateboard decks, a Hermès Birkin bag and a Rolex 6265 Daytona watch. A KAWS tondo painting will also be part of the initial suite of offerings; given the recent market fervor around the artist, it seems likely to spark interest.

ANOTE MUSIC

Other cultural and creative sectors are also looking at fractional investment. Matteo Cernuschi, COO & Co-Founder of ANote Music, a company based in Luxembourg, intends to promote fractional investment in music copyrights. The company fully intends to finish the offline phase in December and to then start with the official online launch in the course of 2020. More can be learnt about this interesting case study on p.152.



Example of a **non-fractional art** ownership platform

MALEVICH

Malevich, a new art investment platform built on blockchain, was launched on 5 July 2019. As an alternative to fractional art ownership models, Malevich gives investors 100 percent ownership of an art work, although it will not be physically delivered to the investor unless requested.

The idea is that the art work remains in the possession of the consigning gallery. In collaboration with galleries and museums, Malevich aims to promote the art work and build its provenance and value. The platform uses blockchain technology to create an alternative market place with lower commissions and increased transparency. It aims to resolve issues around provenance, authenticity, and valuation, as well as ensuring compliance with the new anti-money laundering regulations.

Noospheres © Lina Sinisterra (2019)

Expert voices



Dr. Shermin Voshmgir
Director of the Institute for Cryptoeconomics, Vienna, University of Economics and founder of blockchainhub.net
Author of "Token Economy"

TOKENIZING ART AND FRACTIONAL OWNERSHIP

This is a modified chapter from the book Token Economy, Shermin Voshmgir, 2019

Cryptographic tokens represent programmable assets or access rights and are managed by a smart contract and an underlying distributed ledger. They may only be accessed by the person who has the private key for that address and can only be signed using this private key. Tokens might may affect the financial world in the same way as email affected the postal system. While the existence of tokens in general, and digital tokens in particular, is nothing new, the speed with which cryptographic tokens are being deployed and issued is an indicator that they may prove to be the killer application of blockchain many people have been waiting for. As of April 2019, less than a decade after the Bitcoin Whitepaper, an ecosystem of over 2,200 publicly traded crypto assets were listed on Coinmarketcap, and over 175,000 Ethereum token contracts were to be found on the Ethereum main network. Cryptographic tokens are often issued with just a few lines of code, using a simple smart contract running on a blockchain. They define a bundle of conditional rights assigned to the token holder. Token contracts are essentially rights management tools that can represent any existing digital or physical asset or access right to assets someone else owns. Tokens can represent anything from a store of value to a set of permissions in the physical, digital, and legal world. They facilitate collaboration across markets and jurisdictions and allow for more transparent, efficient, and fair interactions between market participants, at low costs. Tokenizing art has a lot of potential benefits in relation to resolving many of the inefficiencies of the current art market: (1) fractional ownership, (2) provenance, (3) digital rights management and settlement, and (4) crowdfunding. Tokens may also enable (5) new derivative artworks.

Fractional ownership

Low-net-worth individuals, who would usually be excluded from this investment opportunity, could now own a fraction of an expensive work of art. This is particularly valuable for small investors who have so far been unable to meaningfully invest in fine art. Fractional ownership could lead to increased demand for art investments, potentially increasing overall art prices, and by extension, the subsequent production of new types of art. The main question that arises is how collective ownership of a piece of art can be managed. The artwork itself could, for example, be maintained by a custodian, who has been agreed upon and has the resources and experience to maintain a collection. The cost of this maintenance would be distributed across all token holders and payments managed by the smart contract. An example of such fractional ownership is Andy Warhol's painting, "14 Small Electric Chairs" which was tokenized and sold on the Maecenas platform in 2018. Both the sale and subsequent trading of these tokenized

certificates could be tracked through the use of blockchain technology. Owners of the tokenized and fractionalized artworks could sell their certificates to other buyers at any time via the Maecenas marketplace. The final price for the piece was determined by a smart contract run on the Ethereum Blockchain, in a fair and transparent manner.

Provenance

Tokenizing art could pave the way for a more transparent market, where a larger pool of participants have access to a more diverse range of verified artworks. Assigning provenance using tokens managed via a public blockchain can resolve the challenges of conventional systems, like corruption, counterfeiting, and hacking. The current system relies on trusted third parties managing a fragmented patchwork of databases where these digital certificates are stored. Tokenized systems can use hashes and cryptography to ensure documents are not tampered with by providing a publicly verifiable provenance for artworks, enabling real-time digital settlement of tokenized transactions. The underlying blockchain infrastructure can thereby eliminate the need for many intermediaries, while at the same time guaranteeing the publicly verifiable provenance of artworks. Management of asset transfers is ensured via smart contracts, at drastically lower costs.

Rights management

Tokens also allow for inbuilt rights management and settlement options, which means that they offer artists better protection of intellectual property rights and more market transparency about who has used their art. Tokenization allows for more transparent and disintermediated management of intellectual property rights and subsequent real-time settlement of royalties. This would allow for mechanisms whereby artwork can be rented out to a gallery. The royalty fees can be settled directly, and sent in the form of tokens to the artist in real time, based on the number of people who view the art.

Crowdfunding/investing

Tokens can also be used to crowdfund future art projects, with investors owning the resulting work fully or partially. Anyone who contributes to the funding of an art project could receive a proportional share of the tokenized value of that project, accepting the terms laid out in a smart contract. The artist could define the smart contract in such a way that the artist maintains a share of the artwork produced, while other token holders are free to sell their tokens on the open market, or alternatively cash out, should the piece be collectively sold. In such a setup, an artist can receive funding before production, while still maintaining at least partial ownership of the art. Tokens also enable galleries to pre-fund purchases of artworks. An artist could make a proposal for a piece of art that should be tokenized and the tokens pre-sold.

Derivative artworks

The emergence of new derivative artworks could be another application of tokenized art. One could create convoluted smart contracts that give access rights to derivative artworks with the purchase of a fraction of a painting. Alternatively, one could add extra features, for example, by integrating a digital media counterpart into the physical art, like integrating augmented reality features into the token, such as a video documenting the process of producing the piece. Since tokens permanently connect the artwork to its digital media counterpart, so that the digital media becomes part of the artwork, this adds to its value. Art tokens also open up new forms of artistic expression and value creation, like gamification, and could lead to the fusion of art, virtual reality, and gaming.



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Expert voices

ANOTE MUSIC CUTTING EDGE TECHNOLOGY TO INVEST IN MUSIC COPYRIGHTS

The views expressed in this article are the personal views of the author and not those of Deloitte.



Matteo Cernuschi
Chief Operating Officer - Founding Director
ANote Music

What is ANote Music?
ANote is the first stock exchange for music royalties. Based in Luxembourg, we empower music fans and private investors to own shares in songs and music catalogues, while simultaneously facilitating music development. Totally secure and fair, ANote represents a paradigm shift in how music is funded and places blockchain technology center stage.

Please could you summarize the status quo for music investment?
At present, artists, record labels, and a series of industry middlemen own music royalties. Transactions involving these rights are negotiated privately; there are barely any entry points for private investors at this time. We believe that this opaque and often inefficient process is now ready to be opened up to the public, permanently changing how music rights are funded. Our value proposition stems from spotting the strong similarity between IP music rights and stocks; namely, that they both generate income (royalties vs. dividends). While companies generate income by selling products or services, music catalogues receive royalties when their music is played (e.g., via streaming services), performed, or sampled (e.g., in commercials). Music catalogues often rise (or fall) in value based on profit forecasts, just as the financial markets fluctuate on a daily basis. While the environment is restricted at present, we aspire to enable everyone to invest directly in music royalties—an innovative asset class uncorrelated with traditional financial instruments.

Please could you summarize the status quo for the music industry?
The last 20 years have been tough for everyone in the music industry. Margins and turnover have collapsed, and there is still a significant gap between the value created by content producers and their earnings potential. However, since 2014, the music business has witnessed a sea change. After a "lost" decade of negative growth, the business has been enjoying a decisive upturn, mainly driven by digital and streaming channels. And yet there is plenty of room to grow: revenues are still far from the level reached in 1999, and the penetration of streaming services is on a steadily ascending trajectory. Moreover, there is a growing dislike among younger generations for piracy, as well as awareness of and concern over the value gap. Social media and the prevalence of online music have unquestionably weakened the foundations of the traditionally capital-intensive music business model (centered around record labels); this means that there is scope for innovative business models to set a new standard.

As well as actively contributing to the growth of the music industry, ANote is at the forefront of efforts to secure a favorable political and economic framework. It is clear that the EU regulator's goal is to integrate the EU's online marketplace. This was explicitly stated when the Digital Single Market policy was launched by the European Commission under Jean-Claude Juncker in 2015.

What collective efforts can be made to improve on the status quo?
ANote is the integrated solution to three crucial problems adversely affecting the music industry at present:

01. Artists, publishers, and record labels receive royalties on a deferred basis. The resulting time lag between performance and revenue collection means that re-investment opportunities are restricted for all players in the music industry.
02. The music industry is capital intensive. Continuous investments are necessary for an artist's career to blossom, but the traditional financial markets lack the know-how to provide funding. An injection of liquidity is highly desirable for all industry players.
03. Music rights are negotiated behind closed doors, mainly in private transactions between industry players, resulting in opaque and often mispriced transactions. The process is ready to be opened up to the public.

What can you buy through ANote Music?

ANote offers investments in shares of music catalogues—collections of songs—that have been paying out royalties steadily for a number of years. Investors may visit anotemusic.com at any time for further details.

Why should people buy shares in music catalogues?

Music is an alternative asset class. Investors are always on the lookout for returns, diversification, and certainty, which is why music could become the next focus of attention. Since payments are received every time someone uses music from a catalogue, anywhere in the world, the music market provides sources of income that are uncorrelated with the traditional economy. When compared with both liquid and alternative asset classes, the music business stands out in terms of recent performance: as the growth of streaming continues to outpace the decline in digital downloads and physical sales, analysts from Goldman Sachs predict that the sector will double by 2030 from 2016 levels. By the same token, according to music industry valuation standards, royalty contracts trade at multiples ranging from between 6 and 17 times past earnings, thus implying potential net yields in the range of 6 percent to 16 percent.

Finally, music listening habits are not correlated with either the traditional economy, or the financial markets, making investing in music an appealing diversification opportunity.

Why should people sell shares in music catalogues?

People are often unaware of the importance of funding in developing an artist or a music project. From recording a song to marketing it through airtime on the radio and concerts, achieving the right funding is a key element for a successful music catalogue. Still, many stakeholders in the music industry complain that it is extremely difficult to receive funding for new music projects from regular financial firms.

The reasons for selling royalty flows are numerous. Artists may want to become financially independent, whereas labels and publishers may need funds to invest in new projects. Other players may want to benefit from ANote's network and visibility. Plus, some artists may want to generate an opportunity to give something back to their fans, who will feel even more involved if they own a stake in the music rights. Or they may simply want to cash out.

How can blockchain help make transactions more secure?

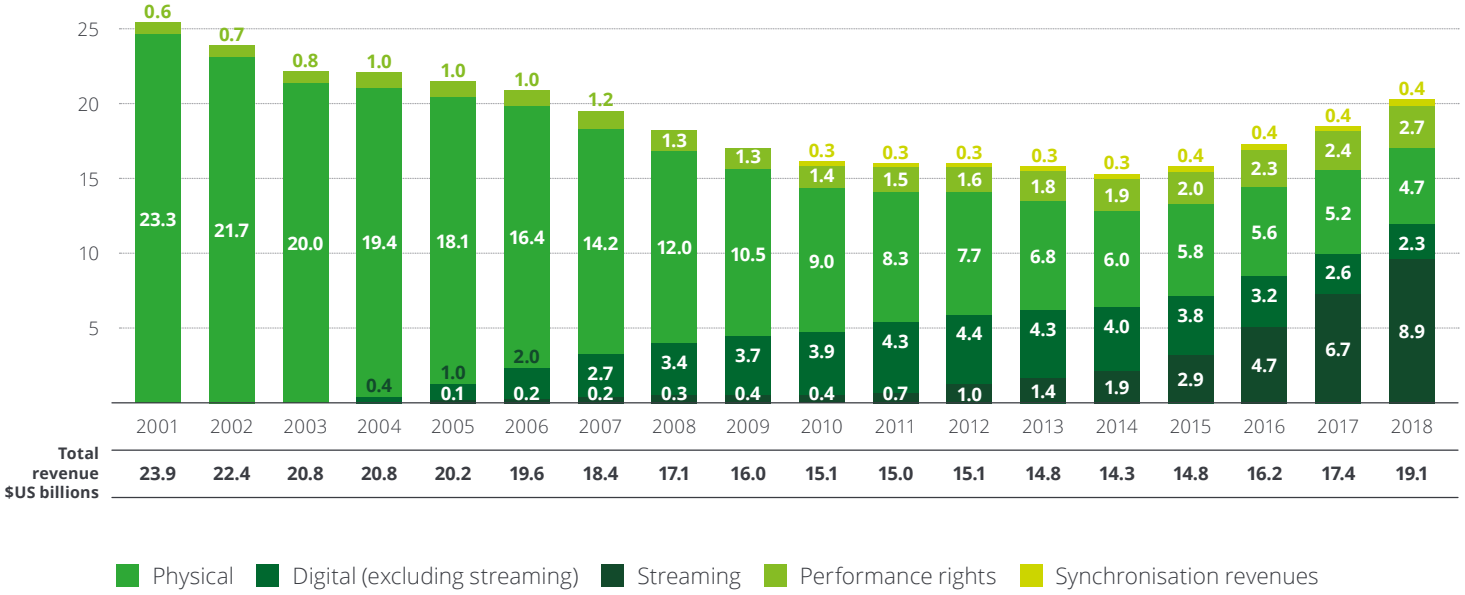
Any transaction in the financial markets requires trust between the parties involved. We have been placing our trust in banks for a long time; it is much harder for young businesses to earn the same level of trust. Blockchain technology is a way of ensuring that each party to a transaction has a good reason to trust the other without extensive two-way audits having to take place beforehand. When a user sets up a transaction on ANote (e.g., a bid on the primary market, a secondary market order, or a statement of intent to import or export fiat money), the platform asks for the password. That allows ANote to sign the request, register it on the blockchain, and execute it immediately, thereby creating a chain of secure transactions.

What else does ANote focus on?

ANote's mission is to facilitate investment in illiquid asset classes, since there are often appealing diversification opportunities in assets that are disregarded by the broader financial markets. From a technical point of view, the ANote platform could be expanded to include different assets besides music, including art, photography, and rights connected with the film industry: i.e., anything that generates a revenue stream or is perceived as a safe haven asset.

Figure 43. Global Recorded Music Industry Revenues 2001-2018 (US$ Billions)

Source: IFPI – Global Music Report 2019





Series: El Silencio del Color © Lina Sinisterra (2016)

Part 03
Social investment models in art and culture

INTRODUCTION

The relationship between arts, culture, and sustainability

Over recent years, the relationship between sustainability, arts, and culture has attracted growing interest. According to diverse sources, culture brings added value to societies and local communities in both monetary and non-monetary terms, for example by promoting cultural diversity[44], improving the tourism and eno-gastronomic sectors[45], and boosting the use of arts as a medium for urban regeneration[46]. Moreover, culture has the power to create decent jobs and economic growth, reduce inequalities, and build more peaceful and inclusive societies[47].

The international community has also recognized the role of culture as a driver of sustainable development. In fact, the Agenda for Sustainable Development unanimously adopted by UN Member States in September 2015, comprising 17 Sustainable Development Goals (SDGs) and 169 specific targets, includes several explicit references to cultural topics. In particular, SDG 11 aims to ensure that the cities of tomorrow are "inclusive, safe, resilient and sustainable" and target 11.4 focuses on protecting and safeguarding "the world's cultural and

natural heritage". Moreover, the Agenda aims to ensure "inclusive and equitable quality education and promote lifelong learning opportunities for all", highlighting the importance of culture for sustainable development. In this way, the international community is drawing attention to the fact that the support and development of culture requires strong commitment from all stakeholders, including governments; private, public, and nonprofit organizations; and every single individual.

Fortunately, an increasing number of companies have already chosen to set up initiatives to support and promote arts and culture. These initiatives can have an impact both inside the business (on the company's value creation)[48] and outside the business (across the social and economic landscape)[49]. This is why arts and culture are often included in corporate social responsibility and sustainability strategies. The private sector may thus take on a key role in sustaining the cultural and heritage sector, largely as a result of a lack of government investment in its support and promotion[50]. Moreover, the increasing number of private museums, foundations, and corporate collections at international level[51] underlines the potential benefits created by companies or individuals with philanthropic purposes. In fact, such organizations help to expand the audience engaging with arts and culture, especially in developing countries, and also support the local cultural landscape through grants, scholarships, education programs, and exhibitions.

At the same time, cultural institutions, and especially museums, are showing a growing interest in sustainability and in their impact on the environment, society, and local communities. In particular, various initiatives[52] focus on raising awareness of how cultural institutions can help to create a more sustainable world, communicate challenges such as poverty and climate change to audiences, and support campaigns that are working for a fairer and more sustainable society. In this context, cultural organizations and museums are contributing to sustainable development; in fact, many already play a central role in this regard as they are traditionally aimed at preserving and promoting their heritage for the benefit of the community. Cultures, and the tangible and intangible elements of culture, are undoubtedly a resource for the construction of the identities of people and communities, and must be preserved for future generations[53].

The arts and the wider cultural sector are, therefore, strongly connected with sustainability. On the one hand, companies have an increasing tendency to include arts and culture in their sustainability strategies. On the other hand, cultural institutions are showing a growing interest in sustainability and in their impact on the environment, society, and local communities. Moreover, the international community and various other actors recognize the essential role of culture as an enabler of development. In this context, SDG 17 represents an opportunity to enhance the support and development of arts and culture: "Strengthen the means of implementation and revitalize the global partnership for sustainable development".
Coherent and collaborative efforts are required if we are to implement appropriate protection and valorization strategies for arts and culture, complemented by "multi-stakeholder partnerships that mobilize and share knowledge, expertise, technology and financial resources"[54]. Effective public, public-private, and civil society partnerships are thus a common target for preserving and promoting arts and culture. "Culture is who we are, where we have been, and where we are going. Development cannot be sustainable without it."[55]

In summary, preserving ancient, modern, and contemporary art is a key task for the present generation. In doing so, we will be fostering cultural heritage and enabling future generations to make the present a part of the past to be handed down.
In following their passions or economic interests, investors and collectors have an equally prominent role to play in relation to sustainability that is absolutely comparable in intrinsic future value to present returns in terms of visibility and wealth. Furthermore, impact investing and philanthropy in arts and culture are invaluable tools to turn the benefactor's current social standing into a gift for the future of society and the wider world.





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44 Committee on Culture of UCLG, Culture in the Sustainable Development Goals: a Guide for Local Action, 2018.

45 OECD, The Impact of Culture on Tourism, 2009.

46 Rizzi, P., Dioli, I., Graziano, P., Bradbee, C., "Urban regeneration through arts and culture: The case of a multicultural neighbourhood in a medium-sized Italian city", in Journal of Urban Regeneration & Renewal, Volume 10/Number 3/Spring 2017.

47 UNESCO, Culture for the 2030 Agenda, 2018.

48 Schiuma, G., The value of arts for business, Cambridge, Cambridge University Press, 2011.

49 Arts Council England, Great Art and Culture for Everyone, 2nd edition, 2013.

50 Massi, M., Piancatelli, C., Ghilardi, R., "Preserving Memory Through Branding: Museums Brands as Vectors for Advocacy, Promotion and Public Programming" in P. Ngulube, Handbook of Research on Advocacy, Promotion, and Public Programming for Memory Institutions, IGI Global, 2019.

51 Zorloni, A., Musei privati. La passione per l'arte contemporanea nelle collezioni di famiglia e d'impresa, Egea, Milan, 2019.

52 Relevant recent initiatives include ICOM's creation of a Working Group on Sustainability, aimed at helping ICOM to consider how to bring the Sustainable Development Goals and the Paris Agreement into the mainstream across its range of activities, and to help its members and member museums to contribute constructively to upholding the Sustainable Development Goals, fostering climate change adaptation, and mitigating the impact of climate change. The theme of the Museums Association Conference & Exhibition is "Sustainable and Ethical Museums in a Globalised World". It will look at how the sector can help to create a more sustainable world, how it can communicate challenges such as poverty and climate change to audiences, and how museums can support campaigns that are working for a fairer and more sustainable society.

53 UNESCO, Declaration on the Responsibilities of the Present Generations Towards Future Generations, 1997.

54 ONU, target 17.16.

55 UNESCO, Culture for Sustainable Cities, https://en.unesco.org/node/281458.

A paradigm shift: From shareholders' value to stakeholders' value

On 19 August 2019, a business roundtable group, comprising of 181 US companies agreed that corporate America is responsible for providing economic benefits to all, not just its investors. Large corporations have been under increasing scrutiny to balance shareholder responsibility with social responsibility, and the key message from this roundtable, was that corporations have obligations to all its stakeholders. This sentiment is also reflected in the increasing number of investors who are looking for opportunities to ensure that their money has a positive impact on society and the world at large. We are seeing a global shift in investment trends towards a greater focus on more than just the financial returns of a given investment. This worldwide impact investing trend, which accounted for more than US$1 out of every US$4 in assets under management in the US in 2018[56] (over US$12 trillion in annual AUM), also has immense potential for investment models in the art and cultural sectors. In terms of global philanthropic giving among UHNWIs, art and culture ranked as the third-most-important cause in 2016[57], with the sector's share increasing from 9.1 percent in 2014 to 10 percent in 2015.

The main challenge facing art and cultural organizations when it comes to impact investing is that although many cultural projects and organizations deliver on social impact, they struggle to provide financial returns in the way that investors expect.

The question is how much financial return is required for these investments to become attractive, and could social impact investments compensate the individuals involved by offering "alternative" returns, such as emotional and social returns instead? In this regard, there is potential for a close relationship with art and philanthropy models, where financial returns are replaced by an emotional component, in the spirit of art patronage. The article entitled "Reimagine: Supporting the arts" by Fran Sanderson from Nesta (p.161) looks at how finance and loans are examples of new social impact investment models applicable to the cultural sector.

Large corporations have been under increasing scrutiny to balance shareholder responsibility with social responsibility.

Definitions

ESG

(environmental, social, and governance) criteria are used to measure a company's environmental, social, and governance practices, alongside more traditional financial measures.

SRI

(socially responsible investment) involves actively removing or choosing investments based on specific ethical guidelines.

Impact investing

seeks to help businesses or organizations complete projects and develop programs that will have a positive impact on society.

56 According to a 2018 survey by the U.S. Forum for Sustainable and Responsible Investment.

57 WealthXArton Changing Philanthropy Trend shifts in ultra-wealthy giving report, third edition (2016)

Survey findings 2019

Socially responsible investment products are ranked highly by private banks

In this year's survey, we broadened the spectrum of art investment products to include fractional investment products, derivative products, and socially responsible investment products, which was the highest-ranking service among private banks. 28 percent of private banks said that socially responsible investment products in art and culture would be most relevant to their clients. For comparison, 17 percent said that art investment fund products would be attractive to their clients this year (this was down from 43 percent in 2017). This could imply that the right model for art investment products going forward is effectively combining social impact with sound financial investments. This trend has been growing rapidly in the investment industry in recent years. These findings were in line with the feedback and interest expressed by collectors and art professionals. Socially responsible investment products in culture would be of most interest to art professionals: 49 percent said they were interested/very interested and a further 31 percent of art collectors said the same.

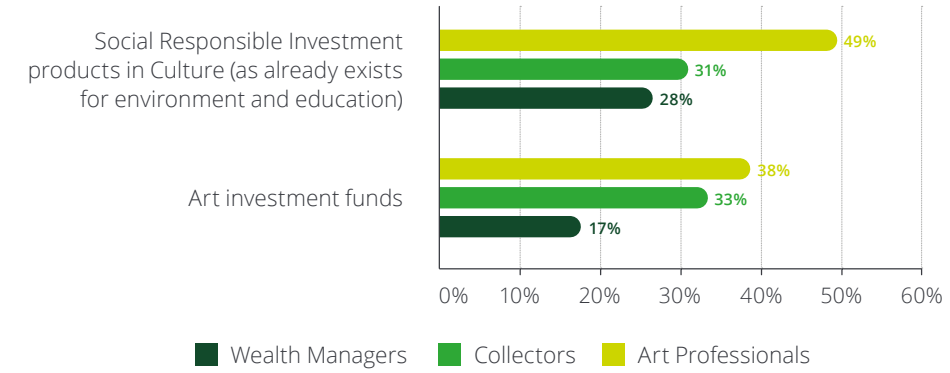
Art patronage, crowdfunding, and fractional ownership

Despite the fact that most recent fractional art ownership models focus on "democratizing" art investment (see part 2 of this section), it may be the case that fractional ownership is a more suitable model or vehicle for democratizing art patronage.

Could fractional ownership be the funding model of the future for public art projects and museum fundraising? What can we learn from crowdfunding[58] platforms such as Kickstarter, which has already demonstrated the impact of crowdfunding on funding art and cultural projects? Over US$70 million had been pledged to support art projects on Kickstarter by May 2017[59].

Figure 44. Social impact vs financial investment in art: in terms of investing in art, which of the following art investment products would be of most interest to you?

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



- More than 600,000 people have backed at least one successful art project, and over 90,000 have supported two or more
- The largest art project, by the Amplifier Foundation, raised over US$1.3 million from more than 20,000 backers across the globe to distribute art at the Women's March on Washington and beyond
- Over 700 creators have launched multiple successful art projects. The Invisible Dog, an arts space in Brooklyn, has launched five, while artist Jose Pulido has launched 30
- Today, more than 600 pledges are made to art projects on Kickstarter each day, compared with just 17 pledges per day in Kickstarter's first year
- Of the 10,000+ successful art projects, over 1,400 have been public art

Source: Kickstarter

The advent of blockchain technology and tokenization could usher in the next generation of art and cultural impact investment models. Potentially, these could be models that enable art and cultural institutions to raise finance for specific projects or maybe even to acquire works of art for their collections, and that enable investors to enjoy the benefits of fractional investment through the emotional, social, and (maybe) financial benefits of being a patron.

Private-public partnerships are promoting new social impact investment models in the cultural sector

One potentially provocative idea to tackle a widespread lack of finance in the culture sector is to turn existing public collections into yield-generating assets to ensure public institutions have enough funding to fulfill their social mission. The cultural sector faces numerous challenges: the reduction in public budgets; increasing competition with other cultural institutions; competition to find donors, patrons, and sponsors; the increasing development of private museum infrastructure; the pressure to continue to develop customer and visitor experiences with the support of digital technologies, and so on. Would it be inconceivable to explore and leverage the economic value of collections owned by public institutions with a view to supporting the institutions' future strategies and development? Could the private sector become a valid partner in a new type of public-private partnership in which the private sector becomes a co-owner of and partner in national heritage projects with a strong social impact investment objective?

On p.158, Adrian Ellis shares his thoughts on the rationale behind investment in cultural infrastructure.

58 According to Market Wired, in 2014, global crowdfunding for films and performing arts received funding of US$1.97 billion; music and recording arts received US$736 million in donations.

59 Source: Kickstarter - https://www.kickstarter.com/blog/10000-art-projects-funded-on-kickstarter

Expert voices

THE LONG BOOM: INVESTMENT IN CULTURAL INFRASTRUCTURE

The views expressed in this article are the personal views of the author and not those of Deloitte.



Adrian Ellis
Director
AEA Consulting

Adrian Ellis founded AEA Consulting (aeaconsulting.com) in 1990. With offices in London and New York, AEA works around the world on strategic and operational planning for the cultural sector and cultural planning for cities. He is also the chairman of the Global Cultural Districts Network (gcdn.net).

AEA Consulting has worked on the planning of cultural facilities around the world for 30 years. We have always kept an envious weather eye on projects with which, through some inexplicable error of judgement on the part of the client, we were not actually involved. Five years ago, we replaced envy with analysis and began to track more formally the level and character of investment in cultural infrastructure globally, seeking to log the inception and completion of projects with an estimated out-turn capital cost above US$10 million. For the past three years, we have published the results, breaking down the level and character of investments by type, size, and geographical distribution. The reports for 2016, 2017, and 2018, with a complete list of projects, can be found here[60]. Each year we refine our methodology and expand our analysis. These exercises become richer as longitudinal datasets are created, but even three years in, it is interesting.

Perhaps the most striking single takeaway is the continued level of investment in arts buildings globally despite major changes in cultural and social priorities, in geopolitical and economic fortunes, and the general gravitation of people's social lives from the physical to the virtual. The past three years have seen annual investment hovering between US$8 billion and US$9 billion for an average of 115 completed projects. Two thirds of this money has been invested in new institutions, and the balance is split between extensions and renovations. Museums dominate, followed by performing arts spaces, with multifunctional arts centers in third place but growing. We do not have a good handle on projects below US$10 million, but a crude extrapolation of the distribution by project size suggests that a picture that included all projects above

and below US$10 million would broadly double the investment total to a little under US$20 billion per year.

Headlines from this year's analysis include:

- US$8.0 billion-worth of new physical assets were completed globally in 2018 across 148 projects and a further US$8.7 billion investment was announced for 122 new projects
- The volume of investment in completed projects was focused in North America (36 percent), Asia (27 percent) and Europe (21 percent)
- The median size of completed projects was 6,252 square meters
- The median budget was US$34.5 million.

This long boom in arts buildings is, in some ways, unexpected. These things are expensive to create and also expensive to run—definitely cost centers not profit centers. They are axiomatically fixed assets and *highly* specified in their design, so there is not much by way of a secondary market. And the general trajectory of the art forms for which they are designed—opera, drama, classical music, dance, visual art, as well as science and history museums—is that audiences globally are declining at worst and level at best, particularly in the West. Arts organizations have, in response, scrambled to try to ensure that demand and supply remain in some sort of equilibrium as the sector's basic infrastructure grows. This has involved changing gears from sales, to marketing, to audience development, to complex (and expensive) multiyear audience engagement strategies, all with the ambition of sustaining visitation levels and broadening their demographic base so as to maintain political and public support and funding.

Results have been mixed for all but the premiere league. Culture tends to be a "winner takes all" market, in which high-profile institutions like the British Museum, Sydney Opera House, Washington DC's Kennedy Center or the Louvre—i.e. strong brands in great locations—are in a virtuous circle of growing programs, buzz, acquisitions, visitors, and donors, while the lower leagues struggle to escape the opposite downward spiral.

So, the long boom in arts building does not appear, for the most part, to be demand-led. We therefore need to look at the supply side to understand what is happening. The most obvious driver is globalization: deregulation and technological innovation create mobile capital, knowledge workers, and high-end tourists (cultural tourists stay longer, spend more, and return more often). Globalization also generates rapid urbanization. But in the process globalization "commodifies" cities, making them undistinguished and indistinct, offering the same hotels, the same shops, the same brands, and same *ennui*. If they are to attract mobile resources, they need to thrive by becoming attractive "brand" destinations. How? Public safety, education, and transport will only get you so far in these "livability" contests. You also need a well-expressed cultural identity, or at least that's what many cities have come to believe. Cultural institutions, housed in iconic architecture, are part of the formula.

Much of this investment is driven by variations on the Bilbao/Guggenheim theme, some organized around highly sophisticated strategies, built on an understanding of the many dimensions of Bilbao's success: architectural bravura, of course, but also a broader tourist strategy, funding from regional government to support great museum programming, an understanding of the market catchment area, and investment in hotels and airports. This is not to mention Bilbao's first-mover advantage: Frank Gehry's architecture took advantage of advances in material science, CAD, and structural engineering to be the first of a generation of strikingly expressive architecture. There are now strangely torqued buildings all round the world and that is perhaps why the race to be the biggest (e.g., the new Grand Museum in Cairo) has replaced the race to be the first. Many strategies are less well-thought-through than Bilbao's, leading to a naïve "build and they will come" approach that creates problems of visitation and programmatic quality down the line[61].

Perhaps the most striking single takeaway is the continued level of investment in arts buildings globally despite major changes in cultural and social priorities.

60 The 2018 index can be found athttps://aeaconsulting.com/uploads/900009/1566502763351/AEA_-_Cultural_Infrastructure_Index_2018_-_FINAL_-_web_copy.pdf
The 2017 index is at https://aeaconsulting.com/uploads/800008/1536717435612/AEA_-_Cultural_Infrastructure_Index_2017_-_web.pdf
The 2016 index is at https://aeaconsulting.com/uploads/700007/1497384740281/AEA_-_Cultural_Infrastructure_Index_-_web.pdf

61 This arts sector "build and they will come" trope never actually appears in Field of Dreams, the 1989 film to which it is attributed, or indeed in W.R. Kinsella's book Shoeless Joe, on which it is based. The quote is "Build and he will come"—"he" being the Kevin Costner character Terence Mann's father, or Shoeless Joe Jackson, or possibly God, depending on how you read the (let's be honest) very strange book and film.

Whether more or less sophisticated, and ultimately more or less successful, culture and cultural infrastructure have become the policy tools of strategic place-making, led by the public sector and happily supported by non-profits, with promises of urban regeneration, inward investment, animation of the night-time economy, and the creation of social capital. The arts—or at least arts buildings—have a seat at the policy table, from Beijing to Riyadh, and from New York to Moscow.

Developers are looking for "experiential" alternatives to define developments at street level, animate public areas, and drive footfall.

The private sector is a significant player in this growth too. The surge in private museums is relatively easily explained. As with the last gilded age, it is the outcome of wealth accumulation, assisted in many countries by a benign tax framework. Someone should analyze the relationship between the Gini coefficient and the formation rate of private museums. Some of these museums will fizzle out when their benefactors tire of the on-going operating costs but many will become significant institutions, supported by generous legacies. Before one dismisses them as "vanity museums", it is worth remembering that many great institutions began in exactly this way, including America's Met, Frick, Morgan, and Gardner to name the most resonant, never mind the royal collections that are at the heart of many European museums.

But there are also other drivers behind private-sector investment in cultural infrastructure that are perhaps less predictable but of growing significance. Interestingly, real estate developers are increasingly significant players in cultural investment around the world: we need only look at Emaar's Opera House in Dubai, the recently completed Tadao Ando museum funded by Genesis in central Beijing, and New York's Shed, which has received substantial support from Related. These represent significant additions to the world's cultural capital.

Historically, developers have invested in cultural projects for, broadly, three reasons. First, because they can: they have the maneuverability to pursue other goals alongside profit maximization, and culture and its housing can loom large. This can be motivated by altruism, or love of art but also because culture is a well-documented mechanism for converting money into social standing, and many developers need just that. Second, cities with density and development pressures, like New York, often use zoning incentives, relaxing FAR (floor-area ratio) requirements for developers in return for the developer providing space (usually "core and shell") for a cultural non-profit. New York's Jazz at Lincoln Center, a 100,000 sq. ft building tucked into the Times Warner Center, is a great example of this win-win strategy. (Declaration of interest: I ran it for five years.)

The third motive is that cultural infrastructure can define the character of a place, and the cost of investment in cultural infrastructure is offset by the enhancement of adjacent residential or commercial property values. It is a strategic play. This third type of developer-led cultural investment appears to be growing for two reasons. The larger the development, the greater the value of the impact of investment in cultural branding, so the global increase in mega developments means this kind of definitional investment in culture becomes more financially attractive. Second, the global softening of high-street retail—chased out by the growth of online retail—means that branded retail makes less and less sense as definitional street level usage. Developers are looking for "experiential" alternatives to define developments at street level, animate public areas, and drive footfall. Some of this is not well-thought-through and there is a spate of museums of ice cream and similar. But, phenomena like MeowWolf, the Santa Fe-based arts collective developing visitor experiences in Las Vegas and Denver, appear to stem directly from this dynamic.

We are now in a period in which populism as a political response to globalism is on the rise. It will be interesting to see how this affects trends in cultural investment. Early indications are that it is affecting the nature of cultural investment, but not the volume. But the paradox—and long-term challenge—at the heart of the cultural infrastructure boom remains: the infrastructure only pays off if it works its strategic magic, and its strategic magic requires not just drop-dead gorgeous architecture, but vibrant institutions generating programming—exhibitions, concerts, experiential events, etc.—that engages audiences and commands attention.

As countries, cities, developers, and philanthropists continue to invest in infrastructure, they will need to devote increasing attention to the challenge of dynamic, engaging, and viable programming.

Expert voices

REIMAGINE: SUPPORTING THE ARTS

The views expressed in this article are the personal views of the author and not those of Deloitte.



Fran Sanderson
Director
Arts & Culture Programmes
and Investments
Nesta

The backdrop is the sun, drifting gently down through the few clouds dotting the sky above the roof terrace. Nesta's office sits on the north bank of the Thames, and is owned by the trust that governs the innovation foundation, which was set up in 1998 as the National Endowment for Science, Technology and the Arts, and established as an independent charity in 2012. A mesmerized crowd listens, drinks in hands, as Judah Armani tells us all about how our unsecured impact loan to InHouse Records will help them use the power of music within prisons to bring people from the outside of society to the inside. Most of the people listening are representing other organizations that we've invested in through our Arts and Culture Finance impact funds.

There's Geoff from the National Holocaust Centre and Museum, who we've supported to develop and scale a pioneering technology venture that preserves the experience of interacting directly with a Holocaust survivor for future generations, and Rachel from South East Dance—we funded her organization to complete a transformative creative and performance hub in one of Hove's most deprived wards. We're also supporting their ongoing work around dance as a rehabilitation tool, both for elderly people at risk of falls, and recovering victims of domestic abuse.

Taking a break from their tireless work across a range of projects from grant programs to challenge prizes, in areas from health to innovation policy, our Nesta colleagues make up the other audience members grooving, applauding, and whooping as three of InHouse's artists perform an intimate set of their own material. It's hard not to believe, as I cycle home afterwards, that I have the best job, the best team, and the best employer in the world.

Arts and Culture Finance by Nesta—repayable impact funding

It was our annual Arts and Culture Finance portfolio day, where we bring together the organizations we've invested in to meet each other and hear about work going on elsewhere in Nesta that might be of interest or support to them. This year, this included our work on the Royal Shakespeare Company's Audience of the Future project, our Experimental Culture future scoping report, and our Amplified program, which provides grants and support to cultural and creative organizations using digital to generate positive social outcomes. The aim is also to crowdsource solutions (or at least empathy!) for common challenges and to learn more, as a team, about how we can adapt and amend what we do to meet the needs of the community we're trying to serve.



"The Kiss" - Series: Comer del Arte Quiero" © Lina Sinisterra (2011)

The positive impact of arts, culture, and creativity on individuals, communities, and society is understood and enjoyed by as many people as possible.

The impact fund story began in 2015, when, with a coalition of public, philanthropic, and private arts funders (Arts Council England, Esmée Fairbairn Foundation, and Bank of America, with additional support from the Calouste Gulbenkian Foundation) who were all looking to do things a bit differently, we launched the Arts Impact Fund. This is a £7 million blended capital fund set up to lend between £150,000 and £600,000 to arts organizations delivering positive outcomes for individuals, communities or society. Interest rates range from 3-8 percent, repayment terms are determined according to cashflow modelling, and we lend for up to seven years. In the four years since 2015, we've made nearly £10 million available to 29 diverse organizations in England, representing a wide range of local geographies, art forms, and target social outcomes. As another example, we funded Village Underground to open a new live music venue (EvolutionaryArtsHackney, or EartH) in Dalston, which not only boosts local performance capacity just as many grassroots venues are being forced to close, but has also, as a condition of our loan, formalized its relationship with the youth charity Community Music, committing to opening up their space and facilities to young people not in education, employment, or training.

Three organizations have repaid in full, well ahead of schedule; we've had write-offs of just £224,000, and aside from these we've received over 99 percent of scheduled capital and over 95 percent of scheduled interest payments. The arts organizations we support see investment in the generation of long-term, unrestricted earned income as an opportunity to reduce their reliance on shorter-term funding cycles and threatened public subsidies.

In 2017, we commissioned research to explore our observation that there was demand for smaller loans than this. The study not only verified this observation, but also demonstrated huge demand for the range we were offering: £309 million in total over the next five years. In 2018 we launched the Cultural Impact Development Fund after a successful application to Access - The Foundation for Social Investment's Growth Fund program, with finance being provided by its partners The National Lottery Community Fund and Big Society Capital.

We are currently fundraising with institutional investors to scale up the pilot to a £30 million fund: the Arts & Culture Impact Fund. All of our original investors have committed to invest, and two additional investors take our indicated interest to over £20 million, with £12 million in hard commitments. We hope to be able to open this up to individuals in a second phase and are looking into the possibility of these investments qualifying for social investment tax relief. We believe that there is a huge opportunity for patient, flexible, affordable loans from specialist lenders to build powerful enterprises with growing asset bases in the sector, and that demand will only increase as we build awareness. Investors can of course make loans directly to arts organizations, sometimes attracting the tax relief mentioned above, and we are aware of several instances of this, usually from long-term supporters who understand the business model (often Board members).

In an increasingly inward-looking world, let's decide to look out together at our shared human experience, through the prism of imagination.

Nesta

These projects are typical of how Nesta thinks differently about capital. Originally endowed with £250m from the national lottery, our focus is on bringing 'bold ideas to life to change the world for good'. The organization brings together proprietary and third-party capital with a view to making positive change, and deploys it, informed by its own research, analysis and policy function, through a variety of innovation methods, including but not limited to accelerator programs, challenge prizes, experimentation, futures, impact investment, innovation mapping, prototyping, and social innovation labs.

All of our national and international work is intended to generate meaningful positive impact, whether through depth, scale, primary innovation or imaginative application of established methods in new areas. Our current strategy focuses on five strategic priorities: education, government innovation, innovation policy, health, and the creative economy. We believe passionately that strategic consideration and structured experimentation can multiply the impact of philanthropic and impact capital, whatever field you're focused on, and ultimately bring about systemic change.

Our work with the Arts Impact Fund, for example, has garnered significant international attention, and we have met with funders, policymakers, and national agencies from over 30 countries to talk about our experience and how they might be able to replicate the fund in their own jurisdictions. Triodos Bank ran a related product, Cultuurfonds, between 2006 and 2018, investing in secured loans in large organizations listed on the stock market. Nesta Italia is in discussions with local partners to launch the first international replica of AIF later this year.

Our broader work in arts and culture

All of our creative-economy-focused activity is shaped by a three-pronged vision of the arts and culture sector, helping it benefit from, and drive, the dual prevailing trends towards the experience economy and more conscious consumerism:

- The positive impact of arts, culture, and creativity on individuals, communities, and society is understood and enjoyed by as many people as possible
- There are new funding and business models underpinning the sector, allowing it to thrive and make the most of continued public and philanthropic funding
- Organizations are enabled to experiment, allowing brilliant and economically productive new cultural experiences to emerge and proliferate

We are passionate not only about the power of arts and culture to transform lives, but also about ensuring that access to the positive benefits is as wide as possible, particularly as global trends in wealth concentration threaten to bring down average quality of life. In our vision, arts organizations are thriving enterprises, bringing people together in shared experiences, and providing inspiring centerpieces for communities everywhere. We believe that measuring the value of art using a linear financial metric vastly underrepresents it—like looking at a photo of a Barbara Hepworth. In an increasingly inward-looking world, let's decide to look out together at our shared human experience, through the prism of imagination, wit, awe, beauty, and challenge that only the arts can provide.

Expert voices

SUPPORTING CULTURE

An interview with Manoelle Lepoutre, Senior Vice President Civil and Society Engagement at Total and Managing Director of the Fondation Total, by Amandine Roggeman

The views expressed in this article are the personal views of the author and not those of Deloitte.



Manoelle Lepoutre
Senior Vice President Civil and Society Engagement at Total and Managing Director of the Fondation Total
© Alexandre Surre



Amandine Roggeman
Project Manager Cultural Dialogue and Heritage, Civil and Society Engagement, Total
© Philippe Schaff

How is the Total Group's societal policy organized today?
In 2017, we decided to review our philanthropic orientations to develop a new strategy, in accordance with the Group's ambition to become the leading provider of responsible energy. Our objective was to turn the company into a genuine driver of transformation for the communities that welcome us by leveraging collective intelligence to provide concrete and effective solutions to societal and environmental issues at the scale of each territory.

To this end, we have created the Total Foundation international program, which oversees the community work carried out every day by our sites, our subsidiaries, and our Corporate Foundation in France. This work now has two main focal points: developing the Group's anchor territories and supporting young people.

How does supporting culture fit into your community work? And why is a company like Total investing in this field?
We focus on culture in its own right (our work encompasses also road safety, forests, and climate, as well as educating young people and helping them to find their place in society). This commitment reflects the Group's history and values: present in 130 countries and with more than 150 nationalities, Total knows the importance of dialogue between different cultures to promote peaceful coexistence, intellectual openness, and development. In the context of globalization and the need for mutual understanding, it is essential to ensure that the specific characteristics of each territory are safeguarded and given space to shine.

As such, Total Foundation works to preserve and transmit heritage through restoration projects and exhibitions,

supports the creation and emergence of innovative and inclusive artistic projects, and promotes artistic education for vulnerable young people.

The key point to understand here is that, unlike other companies, we have not chosen to compile a collection of works; instead, we exclusively finance projects that use culture as a vector for the development of territories and young people. This prism allows us to forge bridges between different worlds, such as between contemporary art and professional integration. For example, next September, we will be supporting the Biennale d'art contemporain de Lyon event, which aims to produce the majority of works on the spot, with the help of the key groups within the region. As regards the artistic production of the event, we collaborated with the French Fédération Nationale des Écoles de Production, which trains young school dropouts to work in sectors experiencing skills shortages, particularly in the industrial sector. Students from the woodwork and metalwork streams of certain Lyon establishments were thus able to contribute to the creation of works by international artists. Culture is what permits these interconnections, and that's what we want to promote at Total.

In your view, what role should private funding play in the cultural sector?

The share of culture funding coming from the private sector has increased steadily in recent years, as it has in other fields. We see this development as a great opportunity for all players in the sector as long as we are all on the same page.
As a private actor, we are aware that our support sometimes makes a difference to a project leader who would like to embark on an experimentation phase. The pioneering spirit is one of Total's values, and we are committed to cultivating it in both our industrial activities and citizenship initiatives.It should be noted that our support is not exclusively financial. With the launch of the Action program at the end of 2018, which allows each Group employee to devote up to three days a year of their working time to community aid, Total also provides human support to its partners. Recently, for example, we decided to contribute to efforts to repair the damage to Notre-Dame de Paris, an iconic symbol of French national heritage, with a donation of €100 million; our employees also mobilized through Action by donating their time to the Fondation du Patrimoine to help manage the influx of donations and process cheques from individuals.

How do you measure the impact of the work that you do in the cultural sector (and other sectors)?

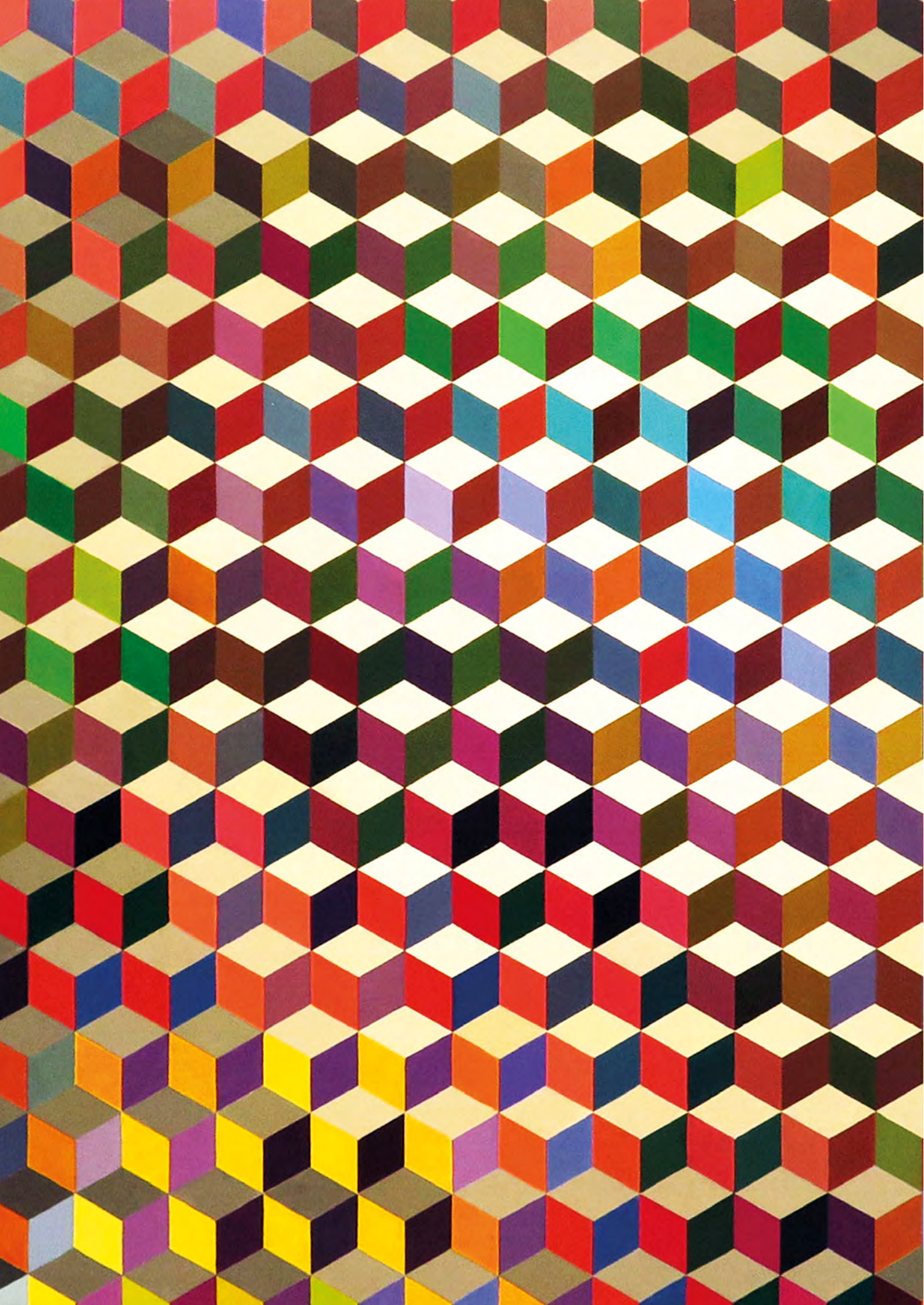
Good intentions are not enough, and philanthropy must not be limited to an ideology. That is why we pride ourselves on ensuring that the positive impact of our activities is always measurable, tangible, and sustainable for communities. It is essential to evaluate the scope of our activities in order to objectively observe changes, adjust our programs effectively, and develop partnerships to constantly improve on what has been done in the past. With each new project, we help our partners to think about the viability of their efforts over time and how they might be scaled up in the future.

In order to enhance the social contribution of the activities supported by Total, we have engaged in a collective approach based on a social impact assessment.This approach aims to include our partners as much as possible in order to reflect the diversity of the projects we support. It is part of a long process: a process that is essential if we are to carry out high-quality impact assessments.

Firstly, we consult with our partners: we propose a list of results, achievements, and impact indicators, which we hope they will complete, depending on their ability to recover the data. At the end of this phase, we select the most relevant indicators by area of intervention. Secondly, collection tools are developed to support all of our partners in France and abroad. Finally, we propose a more targeted impact assessment protocol to our strategic partners to help project leaders develop their activities and promote even greater impact for beneficiaries.

The cultural sector has long been a pioneer in this field and has tirelessly advocated the pedagogical virtues of an artistic education, which makes it possible to develop not only artistic skills (creativity, expressiveness, etc.) but also cognitive (learning) and behavioral skills (listening, respect for others, collaboration, etc.).

The OECD has identified three key behaviors that underpin all human and collective development: trust, solidarity, and cooperation. The organization has found that engaging in a cultural practice over time (at least several months) was one of the most effective ways to achieve this development, especially among the most vulnerable young people. These were also the conclusions of a study we funded in 2019 to research the Paris Opera's flagship educational program "Dix Mois d'Ecole et d'Opéra", of which we have been a patron since 2004: the behavior of young people who learn about opera and related professions, particularly dance and music, is greatly improved, and this is reflected by clear improvements in academic attainment.



Section 5

Art & Technology

El Silencio del Color © Lina Sinisterra (2016)

Highlights

ArtTech startups raised US$600 million over the last eight years
The first generation of ArtTech startups have received nearly US$600 million in investment, with 50 percent of this investment going into transaction-related businesses, 25 percent into discovery and social, 15 percent into logistics and collection management, and 10 percent into data-related ArtTech startups.

NextGen ArtTech startups are focusing more on peripheral business segments
The next generation of startups are likely to focus on several key areas: logistics, insurance, contracts, legal, storage, data, standardization, education and new artist discovery.

Online sales growth slowing down
According to the *Hiscox Online Art Trade Report 2019*, the online art market grew by 9.8 percent overall in 2018 to US$4.64 billion. This was a slower pace of growth than the 12 percent experienced in 2017.

Industry consolidation likely to continue
71 percent of the online platforms surveyed for the Hiscox Online Art Trade Report 2019, said they expected more consolidation among online art platforms in the coming 12 months.

Technology will drive change in the art market
Collectors and art professionals believe technology could have a profound impact on a number of aspects of the art market, including transparency and regulation.

Provenance and traceability
84 percent of collectors surveyed (up from 45 percent in 2017) and 76 percent of art professionals (up from 54 percent in 2017) believe technology will improve provenance tracking and the traceability of artwork. This view was shared by wealth managers, with 79 percent agreeing.

Establishing authenticity
80 percent of collectors surveyed (up from 29 percent in 2017) and 75 percent of art professionals (up from 31 percent in 2017), as well as 69 percent of wealth managers believe technology will improve the process of authenticating artwork.

Improving valuation
In this year's survey, 64 percent of collectors (up from 51 percent in 2017), 73 percent of art professionals (up from 51 percent in 2017), and 58 percent of wealth managers said that they believe technology will improve the artwork valuation process. With improvements in data availability in the art market (different data sets in addition to auction data), a number of ArtTech companies have been set up in the last two years to address this area, such CollectorIQ, ArtBnk, Wondeur, Art World Insight, and ArtForecaster.

Technology will lead to a more regulated market
56 percent of the collectors surveyed (up from 35 percent in 2017) and 51 percent of art professionals (up from 35 percent in 2017) believe technology will drive change and lead to a more regulated market. This sentiment was echoed by 53 percent of wealth managers.



Collectors and art professionals believe technology could have a profound impact on a number of aspects of the art market, including transparency and regulation.

El Silencio del Color © Lina Sinisterra (2016)

Introduction

For this year's report, we have divided the art and technology section into the following five parts:

01. Survey findings 2019
This part looks at how Art & Finance stakeholders (wealth managers, art professionals, and collectors) view the impact of technology on the art and wealth space now and in the future.

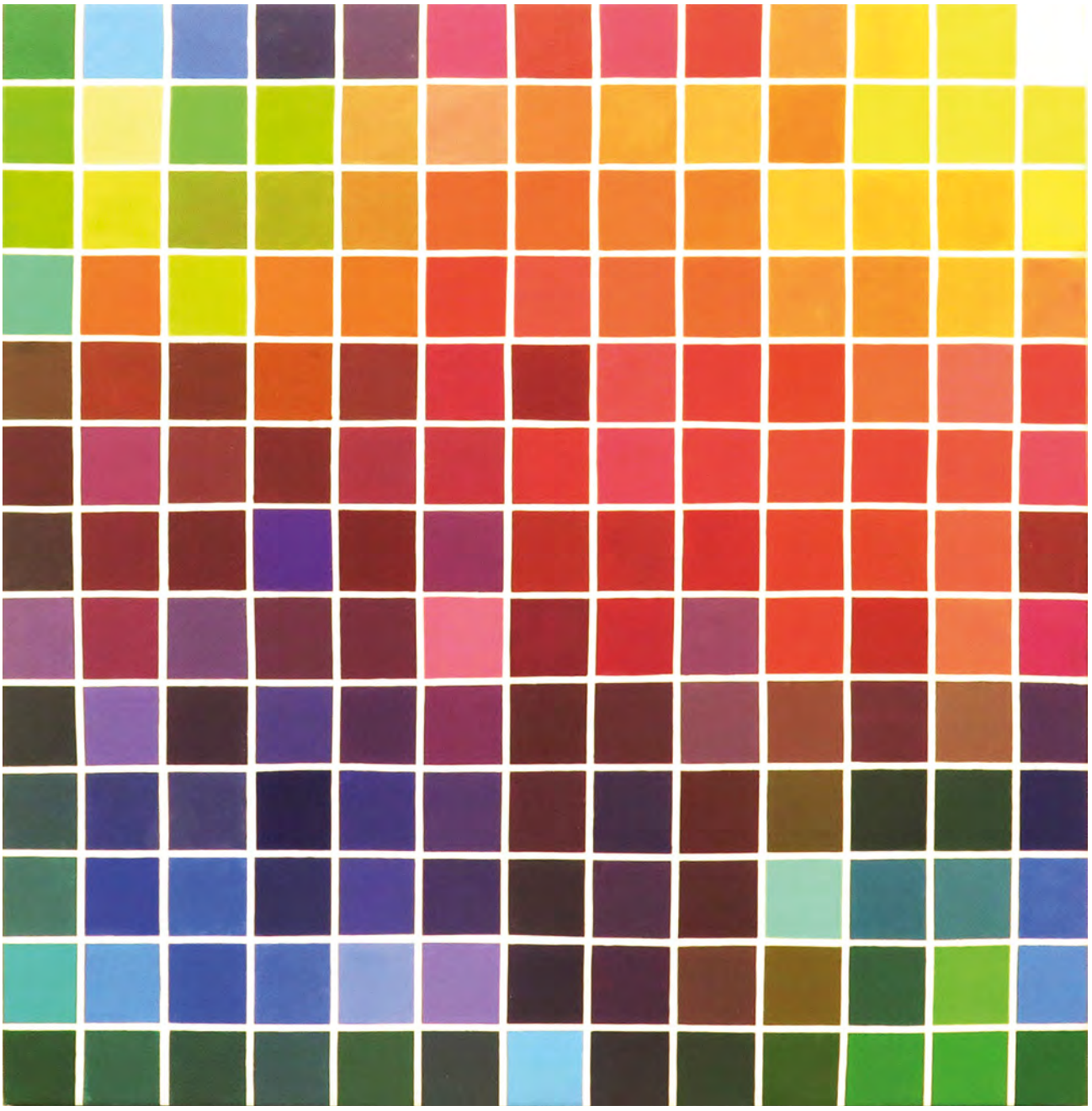
02. ArtTech trends and case studies
In this section, we look at how the ArtTech landscape is changing, and what types of business and technology are being funded and by whom. This section also provides an overview and short case studies of some of the companies and initiatives at the forefront of the ArtTech paradigm shift.

03. Blockchain versus user experience
This section discusses blockchain technology and why it is important to focus on the user experience and benefits to the customer journey rather than the technology in isolation. We consider Deloitte's innovation lab, D.Lab—a new prototype that combines the different platforms and has an innovative user-centric approach.

04. Snapshot from the Hiscox Online Art Trade Report 2019
This section presents some of the key online art sales trends from the Hiscox Online Art Trade Report 2019.

05. Digital art and its market
This part provides an overview of how digital art is increasingly becoming one of the key focal points on the international art market scene, thanks to rapid advancement in terms of technology such as blockchain.

Part 01
Survey findings 2019



El Silencio del Color © Lina Sinisterra (2016)

Wealth management: Survey findings 2019

Transparency and technological advancement
77 percent of wealth managers said that a lack of transparency in the art market was the greatest threat to its reputation and credibility. However, 76 percent of the wealth managers surveyed said that they believed that technology would increase transparency in the art market and help the art and finance industry to grow. What is not yet evident from the surveys is which technologies wealth managers see as most useful in terms of increasing transparency.

Increasing trust in the art market
One of the key sources of concern among wealth managers are issues linked to authenticity, lack of provenance, forgery, and attribution difficulties (84 percent expressed this view in 2019). However, there seems to be great hope placed in the ability of technological advancement to start to address these issues effectively. 79 percent of the private banks surveyed said that technology would be able to improve provenance and traceability problems, and a further 69 percent said that technology would also help deal with authenticity issues more effectively.

Education
68 percent wealth managers surveyed said that technology would increase access to information and help to educate the market and its participants (67 percent private banks and 71 percent of family offices held this view). 49 percent of private banks and 50 percent of family offices believed that this would help broaden the collector base for art.

Are big data, analytics and AI the holy grail?
Like many other industries, the art market is starting to feel the impact of big data and AI. 41 percent of private banks believe this could also start to affect the art and wealth management space. However, responses from the family office community were more reserved, with only 13 percent saying that they thought this would have a significant impact on art and wealth-related services.

Advances in DNA technologies
Just over half of private banks (53 percent) said that they believed advances in DNA related technology, which could facilitate provenance tracking and authentication, are likely to have a major impact on the art and wealth management space in the future. In contrast, only 25 percent of family offices said the same.

Blockchain and art
The jury is still out as regards the actual impact of blockchain for art and wealth-related services. 23 percent of private banks said it could have a significant impact, whilst only 6 percent of the family offices surveyed said they thought it would be important for the development of art-related services. This could reflect the fact that there is still a lack of understanding of the appropriate use cases for art and blockchain, rather than a lack of confidence in the technology itself. However, as blockchain evolves and become more mainstream, we would expect the blockchain infrastructure to play an important role in promoting transparency and increasing trust in the art market.

77 percent of wealth managers said that a lack of transparency in the art market was the greatest threat to its reputation and credibility.

Collectors and art professionals survey findings 2019

Collectors and art professionals believe technology could have a profound impact on a number of aspects of the art market, including transparency

There has been a significant shift in perception among collectors and art professionals about the impact of technology since our last survey in 2017. This is particularly true in relation to technologies that seek to facilitate the dissemination of information and would help to educate the market (79 percent of collectors and 84 percent of art professionals believed this would be an area where technology is playing and will continue to play an important role, versus 75 percent and 76 percent respectively in 2017). A large majority (75 percent) of collectors (up from 60 percent in 2017), also believed technology would lead to more transparency, and 76 percent of art professionals said the same (up from 55 percent in 2017).
However, there are four areas in which collectors and art professionals believe ArtTech businesses could have a real impact:

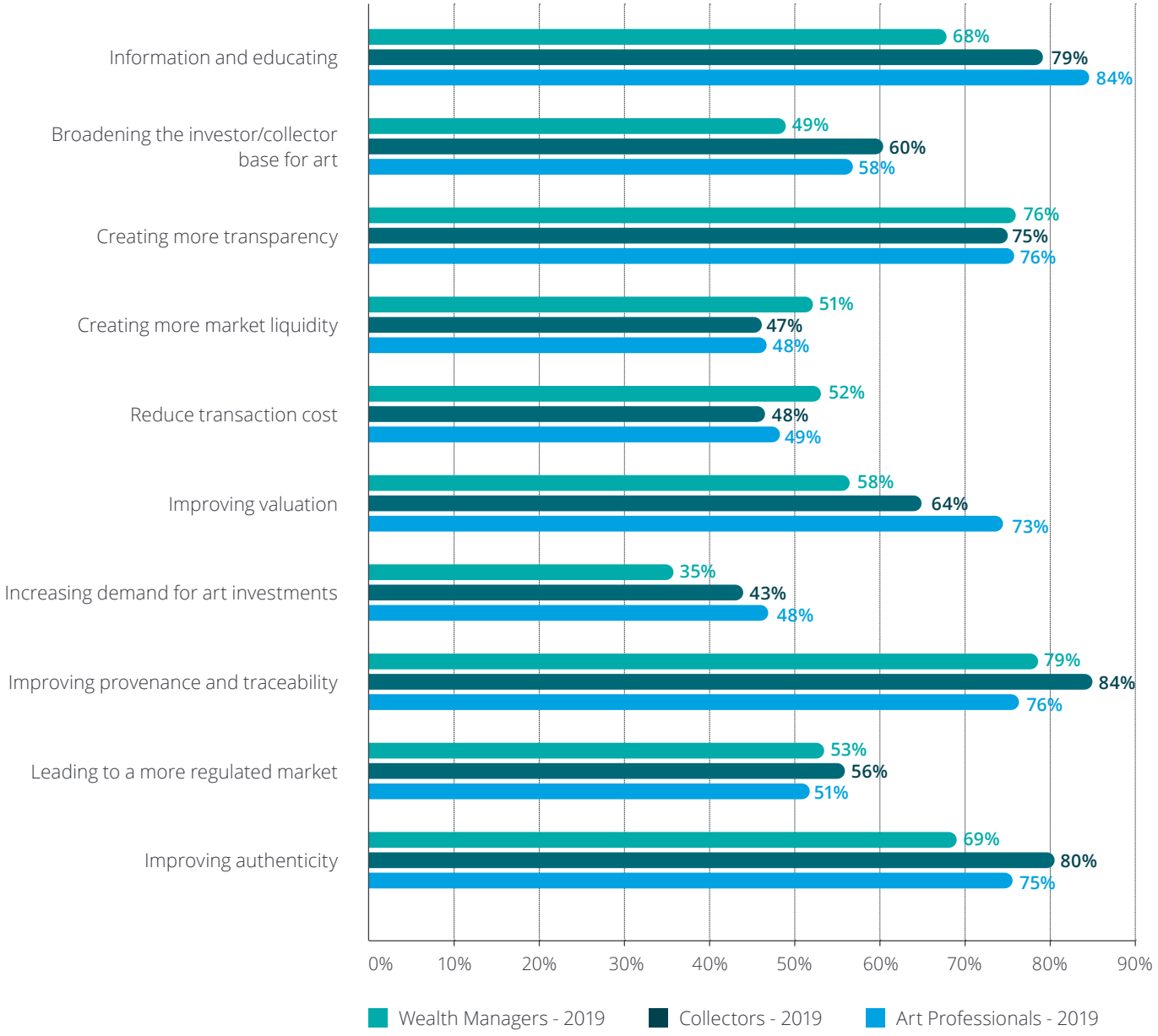
Provenance and traceability
84 percent of the collectors surveyed (up from 45 percent in 2017) and 76 percent of art professionals (up from 54 percent in 2017) said that they believed technology would improve provenance tracking and the traceability of artwork. This is a significant jump and a response to the high number of blockchain-based companies that have emerged in the last two years, many of which are focused on building art registries and providing mechanisms for tracking works of art and their provenance (profiles of some of these companies are provided on pages 180-187). Research by Fuelarts shows that 80 percent of ArtTech companies that emerged after 2017 were using blockchain as their core technology.

Improving authenticity
80 percent of the collectors surveyed (up from 29 percent in 2017) and 75 percent of art professionals (up from 31 percent in 2017) believe technology will improve the process of authenticating works of art. Again, this demonstrates a shift in perception in relation to what science and technology could be capable achieving of in terms of addressing issues around authenticity. Technologies centred around material science and optical science combined with big data and artificial intelligence (AI) could make the authentication process more scalable and cost-effective, and help the art industry reduce the amount of fakes and forgeries that have entered the art market.

Improving valuation
64 percent of the collectors surveyed (up from 51 percent in 2017) and 73 percent of art professionals (up from 51 percent in 2017) believe technology will improve the artwork valuation process. As more data is now available in the art market (different data sets in addition to auction data), a number of ArtTech companies have been set up in the last two years to address this question, such as ArtVenture, ArtBnk, CollectorIQ, Art World Insights, ArtForecaster, and Wondeur (see article p.184). One issue related to artificial intelligence and its application to valuation is associated with trust in the data used to

84 percent of the collectors surveyed and 76 percent of art professionals said that they believed technology would improve provenance tracking and the traceability of artwork.

Figure 45. How important do you believe online art businesses and new technology will be in the following?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

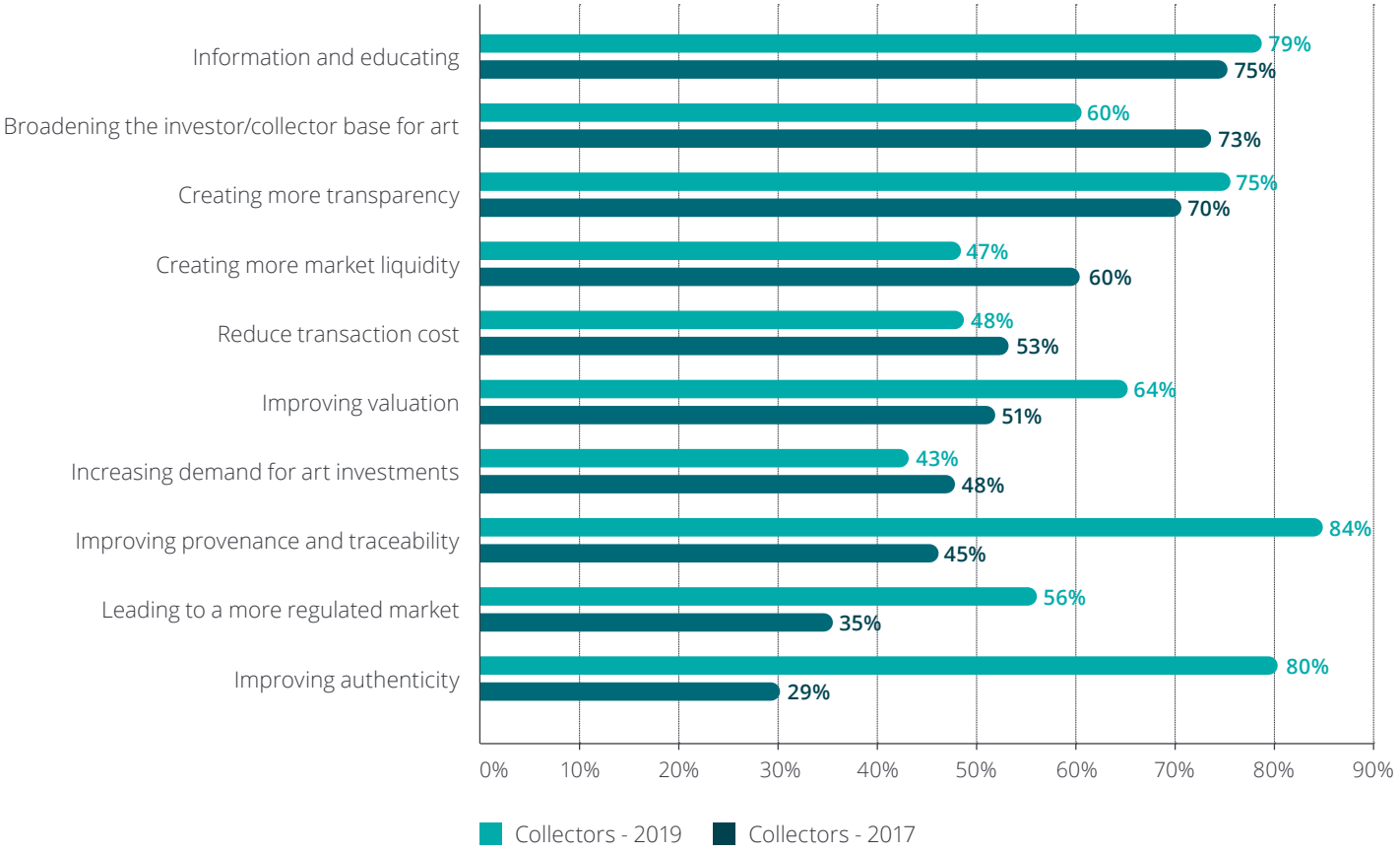


feed the models. This year's survey showed that only 27 percent of the private banks surveyed said they had a high level of trust in art market data; 30 percent of collectors and 31 percent of art professionals said the same. This suggest we need to increase the trust around the art market data that exists (this is discussed further in the section entitled "Priorities").

Technology will lead to a more regulated market

56 percent of the collectors surveyed (up from 35 percent in 2017) and 51 percent of art professionals (up from 35 percent in 2017) believe technology will drive change and lead to a more regulated market. With technological progress predicted to create more transparency in the art market, and expected to help improve methods and processes for establishing authenticity, provenance, and valuation, it is likely that many of the current threats to the reputation of the art market can be addressed.

Figure 46. Collectors: how important do you believe online art businesses and new technology will be in the following?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Todos los destinos © Lina Sinisterra (2015)



Figure 47. Art professionals: how important do you believe online art businesses and new technology will be in the following?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019

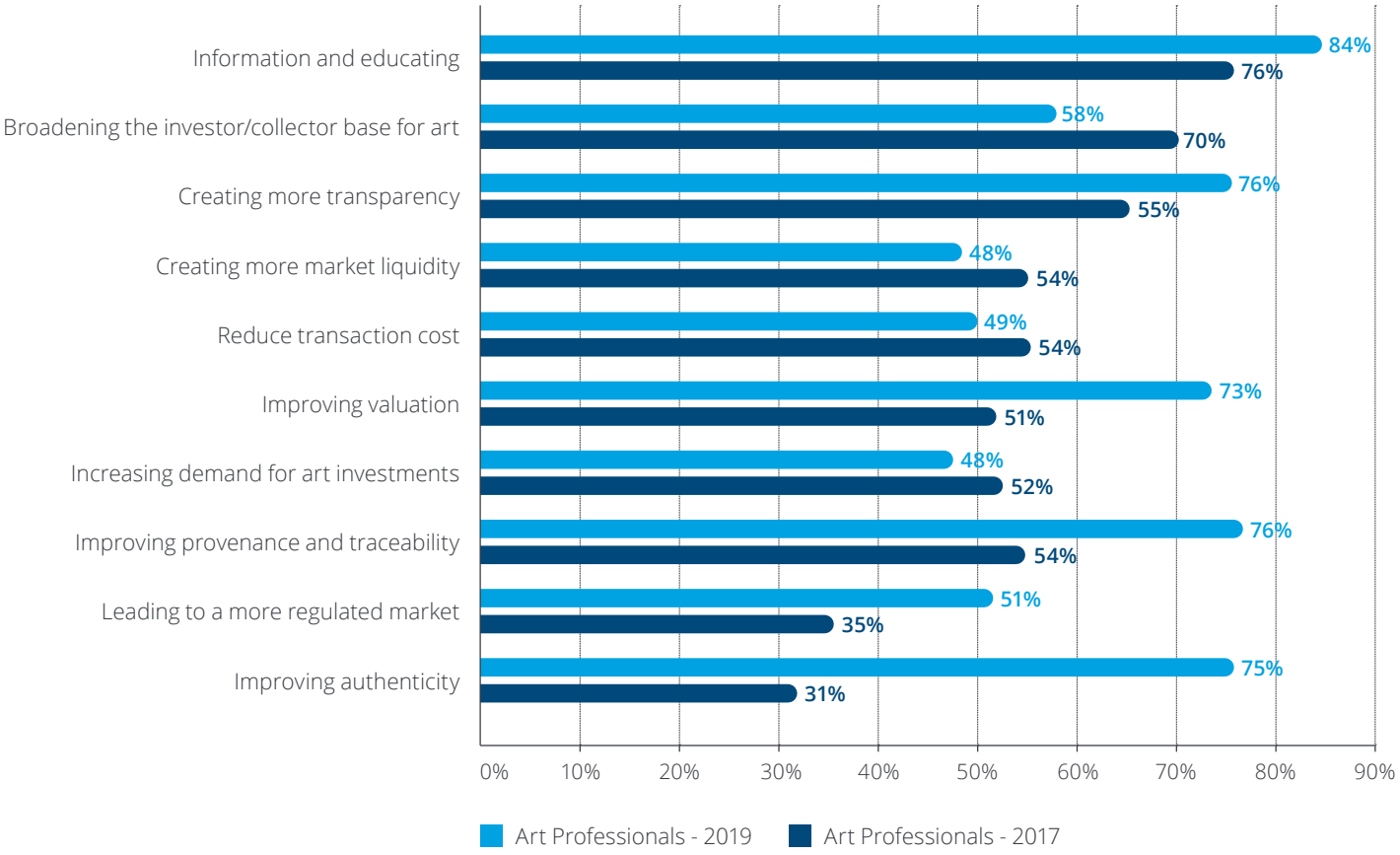
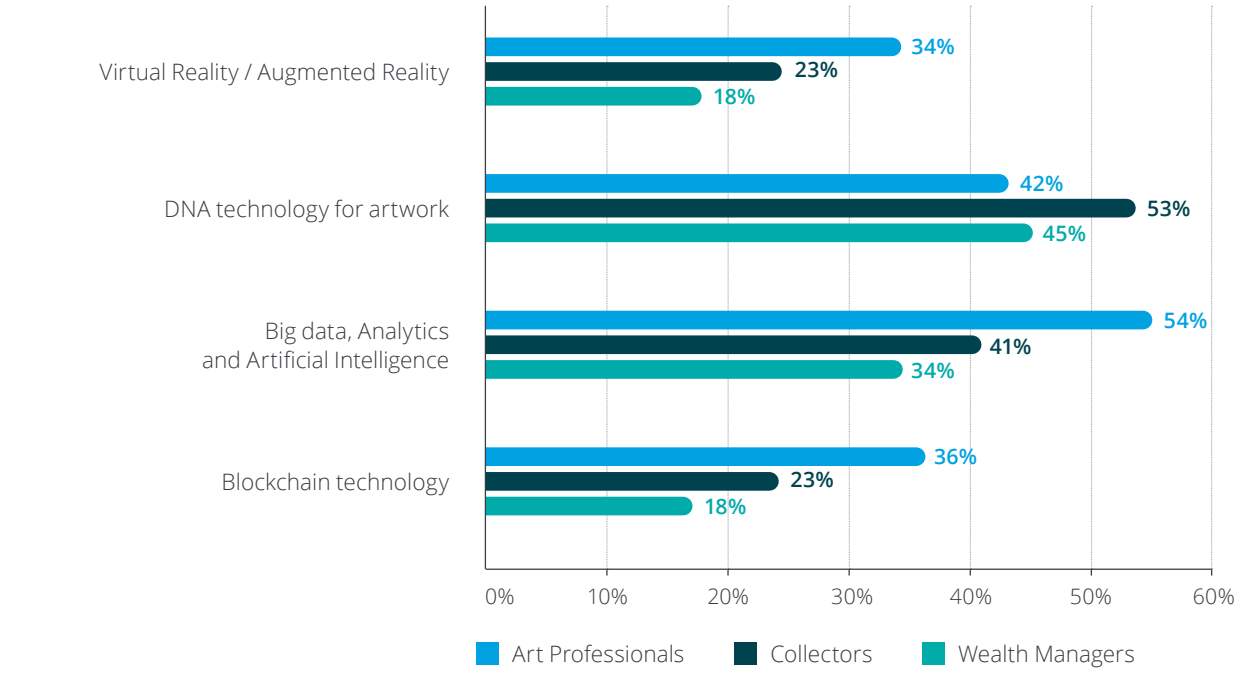
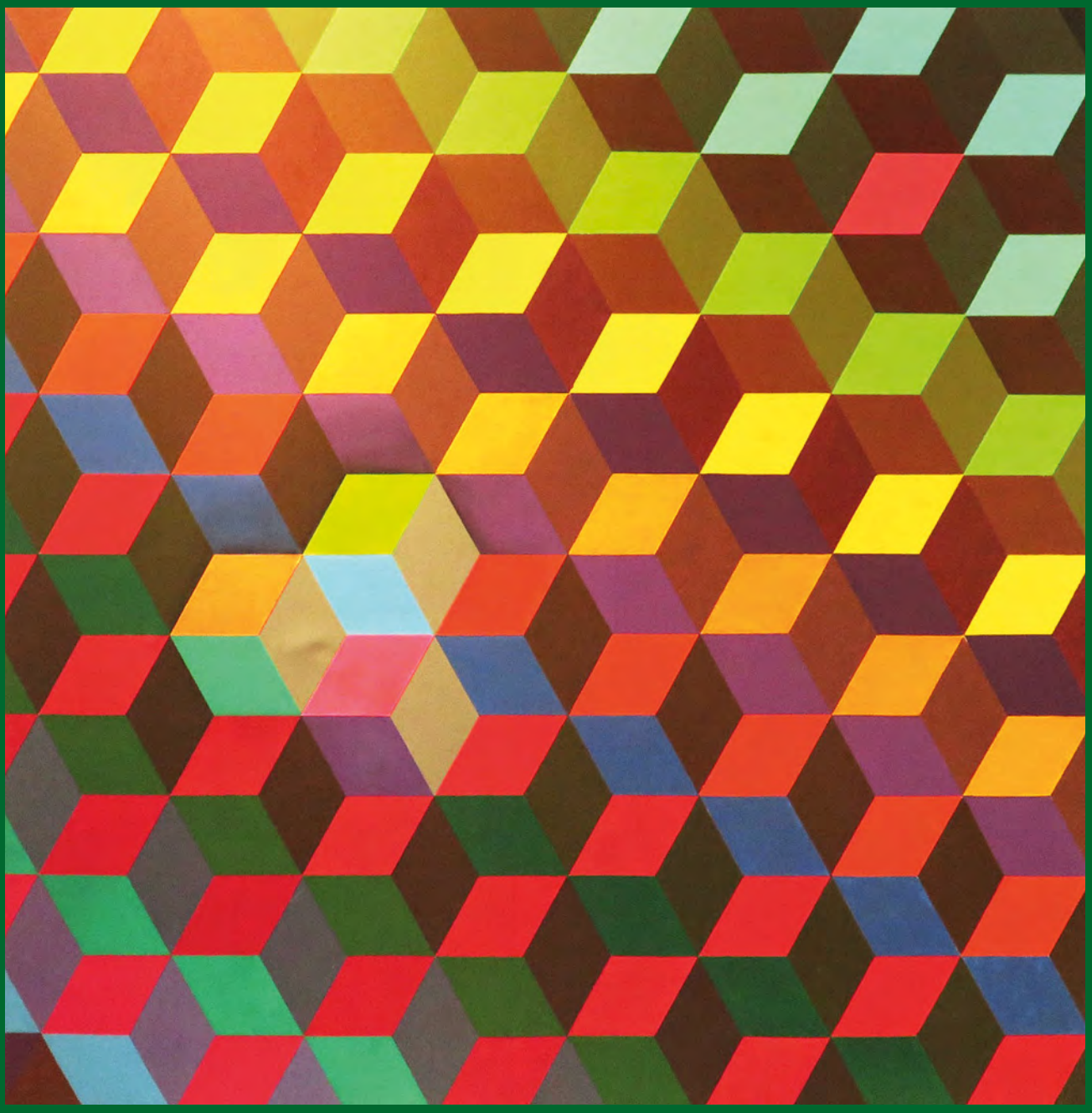


Figure 48. Which of the following technologies do you think could have the most impact on the development of art and wealth management services?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Part 02
ArtTech trends and case studies



El Silencio del Color © Lina Sinisterra (2016)

The future of the art world ecosystem: a study of technology, education and growth

The views expressed in this article are the personal views of the author and not those of Deloitte.





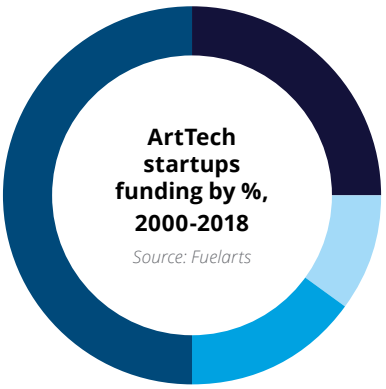
Denis Belkevich
Co-founder
of Fuelarts

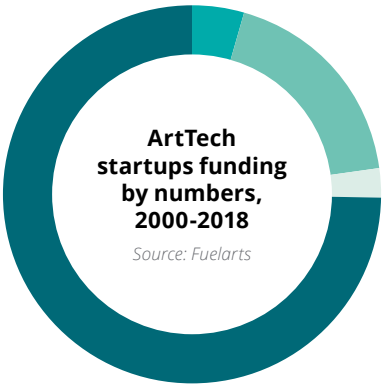
Roxanna Zarnegar
Co-founder of Fuelarts
Director of Operations,
Training and Development
ARCIS Art Storage

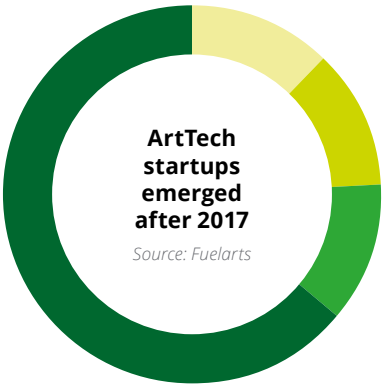
How have technology startups performed in the art world ecosystem?
In the last eight years, the first generation of ArtTech startups have received nearly US$600 million in investments. As a result, ArtTech Gen I has successfully pushed through the barriers to entry blocking access to the 200-year-old fine art ecosystem. We now find ourselves entering the next phase of art and technology. Gen I focused on the segments of the ecosystem that "directly sell art (transactions)".

What is your prediction for Gen II ArtTech startups?
New ArtTech (beyond 2018) startups are carving out a niche for themselves in relation to art business segments. "Peripheral Business Segments" consist of several key areas: logistics, insurance, contracts, legal, storage, data, standardization, education, and new artist discovery.

What is the greatest challenge facing Gen II ArtTech startups?
We have seen a 72 percent increase in ArtTech startup investment since 2013 and over 30 ArtTech startups have emerged since 2017. The 2018-2020 period will







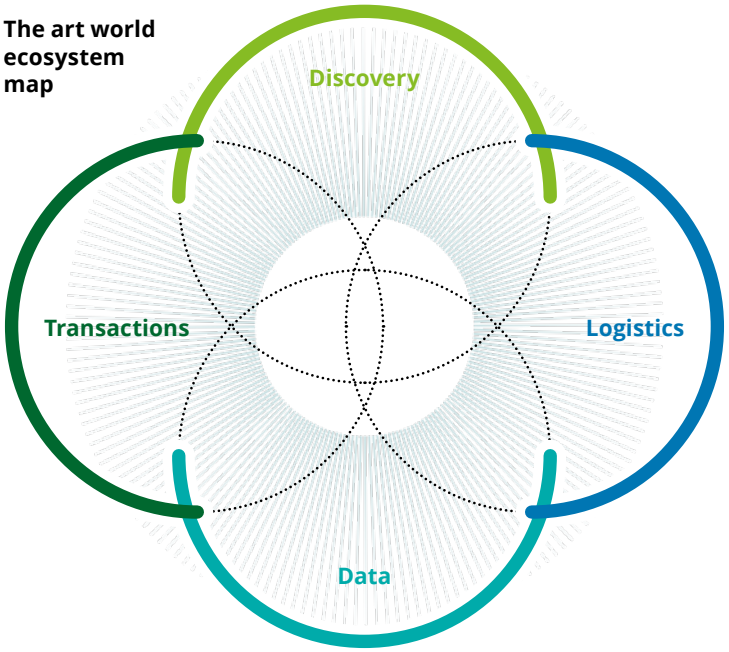
be characterized by increased momentum; however, existing startups still operate in an isolated manner with very little collaboration between them. This is because the tech community is young and fragmented. In order to keep innovation consistent and robust, ArtTech startups need community-based access to use cases and training, as well as education on customer segments, collectors, investors, end users, and mentors. There are a number of technology startups that overlap, offer similar products, or replicate existing brick and mortar processes without innovating or solving problems.

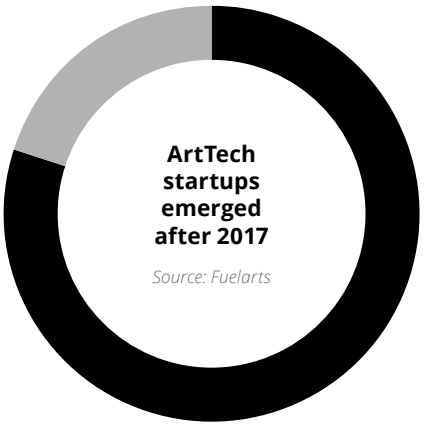
What types of technology have been the primary focus of ArtTech players?
Primarily, we see a focus on blockchain technology. This reflects a genuine need to capture and share the same data. Data standardization and democratization should be seen as prerequisites for transactions.

What types of investors do ArtTech startups attract and how much has been invested?
We have identified four groups of investors that have invested in ArtTech startups so far: institutional investors, tech companies, art collectors/dealers, and finally crowd-investing campaigns such as ICOs. The level of each group's involvement may be seen in our infographics.

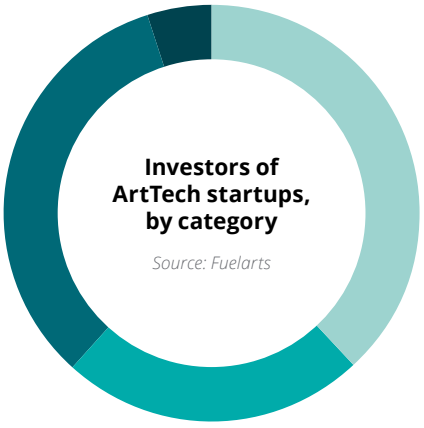
What difficulties are ArtTech startups and investors addressing at present?
Unfortunately, most ArtTech startups are supply-focused rather than demand-focused. In other words, they create solutions that are not needed by the art market. The second main problem is that ArtTech startups lack access to the collectors-as-investors community, which would offer an alternative source of funding. Meanwhile, investors are reluctant to trust startups until they see evidence of growth.

The art world ecosystem map

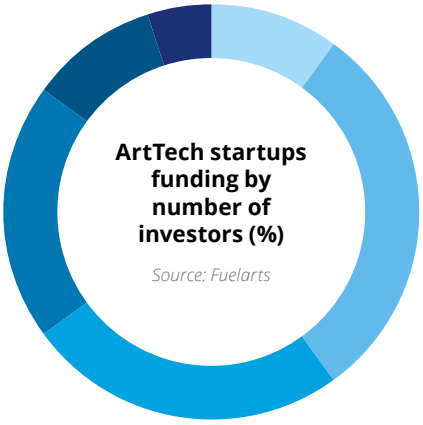




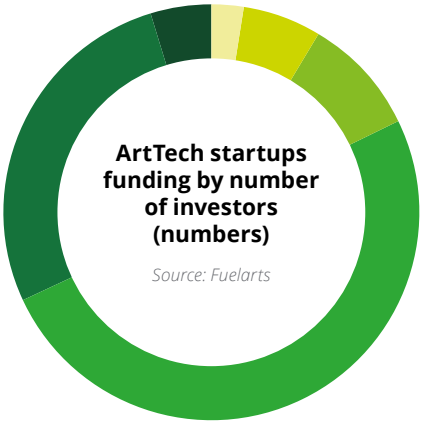
- Without blockchain 20%
- Using blockchain technology 80%



- Institutional Investors 38%
- Tech Companies 24%
- Art Collectors 33%
- Crowd-Investing (ICO) 5%



- 1 Investor 10%
- 2-5 Investors 30%
- 6-10 Investors 25%
- 11-20 Investors 20%
- 21-50 Investors 10%
- Multiply Investors (ICO) 5%



- 1 Investor $10,000,000
- 2-5 Investors $23,330,000
- 6-10 Investors $35,200,000
- 11-20 Investors $192,700,000
- 21-50 Investors $104,800,000
- Multiply Investors (ICO) $17,500,000

What is an accelerator and why should the art market care about acceleration?
Accelerators are fixed-term, selective, group-based programs that cover viability, product testing, mentorship, and educational content. Particular programs may offer a pitch night to boost support via financial investments and offerings. According to recent statistics, 90 percent of all startups fail. Successful startups have well-defined customer segments within a specific industry, are constantly pivoting to solutions-based Minimal Viable Products (MVP), and take advantage of mentors and industry-specific communities.

Accelerator communities generally enhance a startup's chances of survival by 25 percent through education, networking, and prototype testing. The two most successful tech accelerators are Y Combinator and Tech Stars. They have accumulated nearly US$200 billion in valuation and have supported 8,000 startups. The number of ArtTech startups represented in these figures is less than 1 percent. An industry-focused accelerator community could increase business model sustainability and boost positive growth by 7x[62].

62 23 percent (survival rate of accelerated startups)/ 3 percent (startups before acceleration) = 7x

How does Fuelarts enhance the art market?
It is the first dedicated ArtTech growth accelerator designed to support ArtTech founders through an intensive mentorship program and a pitch night event in front of a curated group of investors.
It operates as a neutral umbrella encompassing investors, ArtTech founders, and a mentorship community. We strive to give investors confidence that they have invested in useful products and services with integrity that will have a positive impact on the entire art world ecosystem.

Who can join?
In Q4 2019, Fuelarts will be accepting applications from ArtTech founders with prototypes of tech-based products and services within its four art world innovation pillars: discovery, logistics, data and collection management, and transactions. Based in New York City, Fuelarts' founders possess combined experience of 25+ years in art education, art markets, technology, and events. Our program runs twice per year and is re-designed each season to fit the needs of each qualified applicant.

How will Fuelarts measure success?
Success will be measured in terms of trust in our due diligence process. We define trust as:

- Economic viability
- Working tools and services that exceed existing standards
- Problem-solving through creativity
- Innovation in business structure
- Solutions-driven value propositions

What is the business model of Fuelarts and what value does it add to the art world ecosystem?
Fuelarts' business model fosters growth and relationships between two main customer segments: investors and ArtTech founders. The standard for most accelerators is an equity stake and admission fees payable to the program.

For Fuelarts, these amounts vary based on our assessment of the extent to which the founders' project is innovative and likely to have a positive impact on the art market. The bespoke Fuelarts program harnesses entrepreneurship in a competitive environment. Successful applicants become long-term members of our community, which provides resources, feedback, knowledge through industry figures, temporary working spaces, networking, and an opportunity to present products at events with investor-centric audiences.

PROFILES OF ARTTECH STARTUPS: Authentication, art registry and provenance tracking

Case Study 1

4ARTechnologies

Founded in: *2017*
Management: *The company is headed by founder and CEO Niko Kipouros.*
Investors: *Founders Niko Kipouros and Rolf Maier were the first to invest in 4ARTechnologies. Crowdfunding efforts in 2018 and 2019 raised US$27 million to support the growth of 4ARTechnologies and enable the company to launch its first services.*

4ARTechnologies sets a new standard for the global art world. Combining patented and cutting-edge technologies, 4ART serves all art market stakeholders. Its Augmented-Authentication-Technology allows users to create a unique digital fingerprint of virtually any artwork using their smartphone and to secure the fingerprint and provenance for future generations via blockchain technology.

The foundation for future use cases, blockchain permanently links the digital information to the physical object and allows for digital condition reports to be created, certificates to be transferred, and many other vital art trade procedures to take place. 4ARTechnologies brings the digital revolution to the arts, making everybody's work easier, faster, more secure, and more cost-efficient.

Milestones

- The first major milestone was the launch of MVP in August 2018
- The next milestone was the launch and testing of the beta version in October 2019
- The public product launch and most important milestone will take place in the first quarter 2020

What are the biggest challenges facing your business today?

Despite many technical innovations, especially in the areas of digitization and data management, the art world is one of the few industries that has so far been unaffected by the rapid developments we see all around us. This is not a result of chance; instead, it indicates a persistent reluctance to address the challenges all participants in the art world face on a daily basis.

A few key players hold a large amount of power, both in financial and structural terms, while many others are struggling to work in the field that is their passion. In today's borderless global market, the established way of doing things has become obsolete—it is no longer able to meet the demands of our time. With a product as innovative and a team as forward-thinking as ours, 4ARTechnologies is bound to encounter pockets of resistance. But we are ready to lead the way and finally break through these barriers.
Everyone is welcome to join us in bringing about a genuine art market revolution. Many partners of ours have already recognized the changes on the horizon, and we are always looking for more to do the same.

Where do you see your business in five years' time?

Our vision is to equip every work of art sold around the world with a digital fingerprint and passport. By doing so, 4ARTechnologies can not only reduce the obscene amount of forgeries and questionable pieces circulating in the market, but also enable every piece to benefit from modern tracking and tracing solutions, more secure handling and shipping, less costly insurance, and easier transfers around the globe. We envision a time when the art buyer can be absolutely certain about the authenticity and history of a work of art. When every artist can easily secure their copyright, monitor their pieces, and benefit from the increasing value of their art over their lifetimes. When every collector, large or small, can manage their collection and its condition with a few clicks, and share it with the world just as easily. When every gallerist can securely deal with buyers they have never met, offering better services at a lower cost.
When insuring a work, no matter the value, is easy and inexpensive, for both the owner and the insurer. The art world has always been based on trust; we want to underpin that trust with certainty and security while reducing the costs for all participants. There is so much to come that we cannot divulge just yet, but we are very excited for the future that 4ARTechnologies is helping to build.

Case Study 2

Arteïa SA

Founded in: *August 2016*
Management: *Philippe Gellman (Co-founder and CEO), Marek Żabicki (Co-founder and CTO), and Olivier Marian (Co-founder and CSO)*

Investors: *Hugues and Marie Taittinger, and Olivier Marian were the co-founding investors. Since 2016, Arteïa has raised more than €3 million in total from 21 private investors, the majority of whom are avid collectors themselves, like the Marian family (founders of Orpéa group in France).*

Arteïa brings together a diverse team of art-loving collectors, IT professionals (management and development team of 22 people in Krakow, Poland), and technology enthusiasts, whose singular mission is to revolutionize the art market. We believe that every art lover should have the freedom to focus on their art and their personal relationship with it. As a result, the process of buying, managing, and sharing artworks should be seamless, secure, and as private as possible. We aim to achieve this by employing modern tools such as distributed ledgers, cryptography, and machine learning. Our first product is Arteïa Collect: a SaaS platform that art collectors, artists, and art professionals can use when cataloguing and managing their artwork (available since October 2018).

Milestones

- We launched Arteïa Collect in October 2018. You can subscribe online at www.arteia.com and also test our smartphone app.
- We are now on a mission to build an open art provenance protocol, anchored on blockchain, creating a standard for the industry. For this project to be successful, a coalition of diverse art market players needs to be formed. One of the strategic alliances we have already secured is Raisonline, with Cahiers d'Art, the renowned French publisher of catalogues raisonnés, including those of Pablo Picasso and Ellsworth Kelly. This is a major milestone, as it allows us to tap into the resources of an experienced art market player and will help us win the trust of artists and art foundations. We are currently digitizing the Catalogue Raisonné of Adel Abdessemd, which will be the first on the Raisonline platform, by the end of this year.
- We also made a partnership with Eeckman, the biggest art insurer in Belgium, who will use our technology to digitize its relationship with his customers.

What are the biggest challenges facing your business today?

The art market suffers from three main problems: a lack of transparency, a highly insufficient level of liquidity, and difficulties tracking provenance. In other words, data is centralized and hard to obtain, and reselling works of art is a difficult process further complicated by the scarcity of information about authenticity, history, and condition.

This, in particular, increases the barriers for new participants entering the market and in turn diminishes the overall potential of the market. Having built a diverse team of professionals with expert knowledge of art, IT security, data science, and blockchain technology, we firmly believe that we can tackle the challenge of information asymmetry in the market. We are also currently hard at work at Arteïa solving the problem of reliably linking physical assets (artworks) to their digital representation within the distributed ledger. In our view, this complex task calls for a holistic approach.

There is no silver bullet: input is required from key actors across the art ecosystem and solutions must be firmly anchored in the realities of the business.

Where do you see your business in five years' time?

In five years, technology companies will have become significant players in the art market. Technologies like blockchain and AI embedded in so-called "edge devices" will be operational and no longer be novelties because they will have become almost seamlessly woven into the fabric of our daily lives.

The result for large sectors of the art market will be an increase in transparency, efficiency, and liquidity as regards art-based assets. This will be beneficial for artists, art collectors, and all other actors within the ecosystem who are prepared for this new reality. At this stage, Arteïa, with the products it has already developed and launched, or is in the process of developing, will have established a firm position in the art market as a supplier of smart solutions for cataloguing, buying, selling, and investing in art. The companies that succeed in this new environment will be those that have the ability to access and leverage the vast amounts of data thus generated for the benefit of their clients.

We deeply believe that combining our network and our knowledge of the art market with our mastering of technology, we will be one of the major actors of these changes.

Case Study 3

Artory

Founded in:
2016

Management:
Nanne Dekking (Founder & CEO), Lindsay Moroney (COO), and Paul Stabe (CPO & MD, Berlin)

Investors:
Hasso Plattner Capital, 2020 Ventures, and Private Capital

Lots of valuable information is gathered before a work of art changes hands, and this information is typically lost again after the sale.

Artory exists to protect those who buy, own, and sell art and collectibles and to increase the financial and personal value they derive from these activities. The company's core product, the Artory Registry, is a registry comprising millions of records, in which verified information about artworks, collectibles, and their history are secured using blockchain technology. This gives buyers and collectors confidence and peace of mind because they can be sure that they are making decisions based on the most accurate, up-to-date information available.

Milestones

- November 2018: The Artory Registry was launched in collaboration with Christie's to register each piece of art sold as part of the US$300 million Barney A. Ebsworth Collection. This collection, which is considered one of the most important collections of US artwork, has broken several auction records. It includes Edward Hopper's Chop Suey, which sold for over US$90 million.
- March 2019: Acquisition of Auction Club (a comprehensive database of fine art auction records), which will serve as a baseline for the validated data on the registry from our partners.
- April 2019: Secured US$7.3 million in the Series A funding round, with investors including Hasso Plattner Capital and California-based VC firm 2020 Ventures, which holds stakes in companies such as Spotify, Postmates, and The RealReal.

What are the biggest challenges facing your business today?

Blockchain is presented by most blockchain art companies as a disrupter—an alternative to a broken system. Plus, blockchain is often perceived as being the same as cryptocurrency.
In reality, the art industry is not broken; at least, not at the level at which serious market players operate. Instead, it is heavily reliant on thorough due diligence processes and research. Lots of valuable information is gathered before a work of art changes hands, and this information is typically lost again after the sale. Through our Registry, that information will stay with the object on a public site so that many more people can see the opinion that was formed, who it was formed by, and what information they based this opinion on. The owners of the work of art remain completely unknown to Artory and to the public, which ensures absolute privacy throughout the process. In addition to this, we are exploring how our unparalleled database can provide collectors with customized analyses and content targeted to their interests.

An exciting feature of the Registry is the encrypted messaging system that will enable millions of collectors who have kept detailed records to communicate with trusted players in the art market as well as ancillary services providers such as shipping, storage, insurance, and valuation companies. By working with the leaders in the art industry and offering them services they want, we can overcome the challenges to blockchain adoption.

Where do you see your business in five years' time?

Our main priority in the near term will be to increase the number of validated records in the Registry. We are doing this by empowering collectors to confidentially register their artworks for digital signature by vetted institutions through our website and by onboarding more auction houses and dealers, as well as working with art data providers.

In the longer term, it is our expectation that an increasing number of buyers will ask for their purchases to be registered on the Artory Registry, making it a matter of standard practice. By offering peace of mind, especially to new buyers who are more risk averse, we are optimistic that new collectors will be embraced. This will mean that Artory has been successful, but it will also be hugely beneficial for the art market more broadly.

Case Study 4

Verisart

Founded in:
2015

Management:
Robert Norton, CEO

Investors:
Sinai Ventures, Galaxy Digital, and Rhodium

Verisart provides an optimized blockchain certification and verification platform for artworks and collectibles. The platform is aimed at artists, collectors, galleries, auction houses, and ecommerce businesses and is designed to foster trust and liquidity in the art market. By creating digital certificates using blockchain technology, Verisart offers immutable identities to physical works and helps to reduce fraudulent activity and unauthorized reproductions. Verisart combines certification, provenance and registry services on one easy-to-use platform based around the Bitcoin blockchain. We also offer museum-grade classification, Bitcoin timestamps, and image verification and provide users with a customizable certificate that can be easily updated and transferred.

Milestones
In 2015, we started with a free mobile iOS app for artists. For the first year we were mobile only and then, towards the end of 2016, we released a web app. In 2017, we started to open up the web app to partners to use via an API. We have worked with eBay, Paddle 8, Avant Arte, Vast Photos, and DACS and have product integrations in the works with Art Systems. We are also the first blockchain app to launch on Shopify. Since 2015 we have also completed three funding rounds with angel investors and institutional investors.

What are the biggest challenges facing your business today?
As with any tech startup, access to the best engineers remains one of the biggest challenges to scaling the platform. Disruptive companies need to build an engineering culture and ensure they can on-board new developers quickly in order to iterate the product in line with the changing feedback of users. There is no silver bullet for market fit and adoption—it just takes time. We have to listen to our customers and ensure we provide a service they truly value. As we prepare to launch consumer and business subscription plans, we have to make it easy for users to integrate their data, trust the records, and tie these records more closely to physical objects. We are evaluating the different technologies available to help us do this and the choices we make will define us. So, in a nutshell, our biggest challenges are to hire well, to listen to our customers, and to introduce new technology that truly fits the purpose of our product and platform.

As with any tech startup, access to the best engineers remains one of the biggest challenges to scaling the platform.

Where do you see your business in five years' time?
Five years ago I heard the word blockchain for the first time and wondered how this could be applied to the art market. I spent the first two years after this evangelizing about distributed ledger technologies as much as Verisart. I feel the conversation has now evolved and it's very clear that the current ways of recording provenance are unsuited to our digital age. We are on a trajectory that started with building an evidentiary infrastructure for digital certification and will take us towards artist rights management and value-based participation to mark both cultural participation and fractional ownership. We want to win trust and set the standard when it comes to registering claims of creation and ownership for cherished and valued objects across many categories. We will use the best of blockchain, AI, and computer vision to provide powerful new tools to register, discover, and trade art.

Case Study 5

Wondeur

Founded in:
2018

Management:
Olivier Berger and Sophie Perceval, Co-founders of Wondeur

Main investors:
- Globalive
- N49P Ventures
- Two Small Fish Ventures
- Kima Ventures
- BoxOne Ventures
- Relay Ventures
- Dennis Smith
- William Tunstall-Pedoe

Website:
www.wondeur.ai

Wondeur is an AI platform that can analyze and compare the careers of all contemporary artists based on non-transactional metrics. This approach allows our technology to cover 90 percent of all Post-War and Contemporary artists, most of whom do not have auction market records. Wondeur is currently used by insurers, appraisers, museum professionals, and financial institutions as an alternative assessment method for Post-War and Contemporary art.
Our Toronto-based team includes 17 art historians, developers, and PhDs in artificial intelligence and biology from the University of Toronto and the MIT & MIT Media Lab, working under the supervision of Richard Zemel, co-founder of world-renowned Vector Institute alongside the "godfather" of deep learning, Geoffrey Hinton.

How did it start?
We started Wondeur in the summer of 2017, with the objective of analyzing the historical drivers of art value. Our belief was that price transparency alone would not make the art market efficient and achieve faster growth. We started by compiling data manually and spent two years developing an engine that could automatically collect and verify data from 50,000 sources globally. We constantly research, reconstruct and verify the careers of 250,000 artists born after 1900. Our engine also scans and tracks hundreds of museum collections, as well as six more layers of data (from contextual information to historical information) sourced from large private collections. Today, we have the largest art data repository for artists born after 1900.

What did you discover during the process?
As Cathy O'Neil points out in *Weapons of Math Destruction*, scientists have a responsibility to choose which data to pay attention to—and which to leave out. At Wondeur, we made a conscious decision to ignore auction data. Instead, we embraced the art historian's perspective on the art world, which is more focused on cultural validation than sales numbers.

Whereas the best art historians are able to develop in-depth knowledge on a few hundred artists, our models can analyze several hundreds of thousands of artists and several thousands of galleries and art organizations at any given time. The massive scale of the data we were able to gather had a huge impact on the type of models we built. We developed a series of AI models that help us understand the art world at a global scale, by measuring the relative importance and impact of 27,000 museums and galleries worldwide. The result is a mapping of the art ecosystem that sheds light on artists' trajectories, growth, evolution of value, institutional influence, systemic bias, and global trends in the art world.

What we found in the process is that the art world functions like a living organism, in which every institution, gallery or curator, no matter how big or small, heavily depends on other institutions to complete their tasks. This highly structured ecosystem is acting as a complex filtering system that defines the value of art. It also comes as no surprise that a wide range of biases plagues it, whether they are based on gender, cultural background, content, ideas, or medium. This is currently one of the key aspects of our research, since bias analysis generates tremendous opportunities for arbitrage and impact investing for collectors. We're also hopeful that it will power the necessary adjustments within private and public collections.

What are the applications of your technology?
Based on a data-driven analysis of an artist's career, Wondeur is able to provide benchmark values for their works. Museums and curators use this data to understand bias in the art world, research overlooked artists, and strategize acquisitions. Certified appraisers use Wondeur to access historical information and understand the growth profiles of a vast quantity of artists that don't have auction records. Insurers use the technology to filter through auto-renewals and automatically identify which artists have most likely changed in value since their last valuation update. Risk teams in the art lending business use our data as an alternative assessment method that allows them to accept artworks by a wide diversity of artists as collateral, beyond the handful of marquee names that show repeat sales at auction. Wealth management firms use our platform to initiate conversations, foster deeper relationships with their clients, and help their clients to manage the growth potential of their art assets.

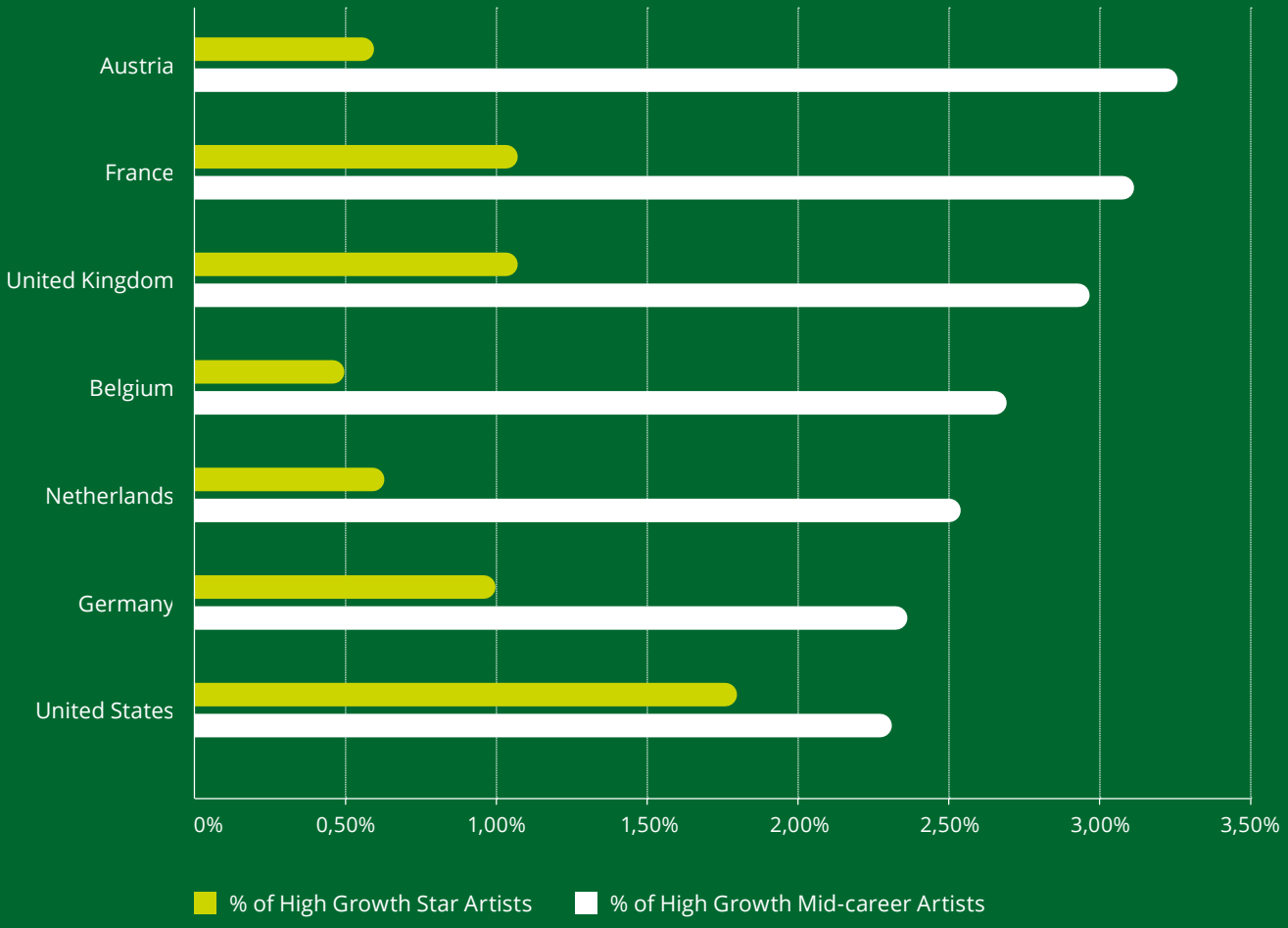
What are your challenges and limitations today?
While we can forecast how an artist's career is likely to progress, it's hard to predict what the impact of our technology will be on the market. Helping more people understand how the value of art is defined, how prices are formed and how artists' careers develop is the way in which AI can power the art market. Our belief is that more access to knowledge will break down barriers and bring about a positive change in the art world. Interestingly, museums, collectors, gallerists, and artists seem to agree.

Nurturing ecosystems vs market makers

Comparative impact of local ecosystems on artists' career development:

Although the United States' domination of the global art market is exemplified by the country's ability to produce high-growth[63] star artists (1.80 percent of all artists active in the US market vs 1.06 percent in France and the UK), local ecosystems in the UK and several European countries perform better when it comes to nurturing the careers of artists at the mid-career stage, allowing them to achieve high growth for 3.26 percent of all artists active in Austria for example, vs 2.32 percent in the US.

Figure 49. Nurturing ecosystems vs market makers
Source: Wondeur



63 Wondeur's Artist growth measurement reflects the momentum in an artist's career, which is indicative of changes in market value.



Expert voices

UNLOCKING BLOCKCHAIN'S POTENTIAL FOR CREATORS AND RIGHTSHOLDERS



Michael Rose
Partner, Blockchain
Deloitte Canada



Vikas Singla
Senior Manager, Blockchain
Deloitte Canada

Access Copyright and Prescient Innovations are on a mission to build a global digital footprint for ownership in creative works by bringing blockchain-powered tools to creators and publishers.

With expertise spanning ideation to commercialization, Deloitte Canada's Blockchain team works with Prescient, a creator-focused innovation lab, to assist in its development of its Attribution Ledger and other digital services: a tool to track and trace art provenance and ownership as well as a peer-to-peer (P2P) eBook sales platform.

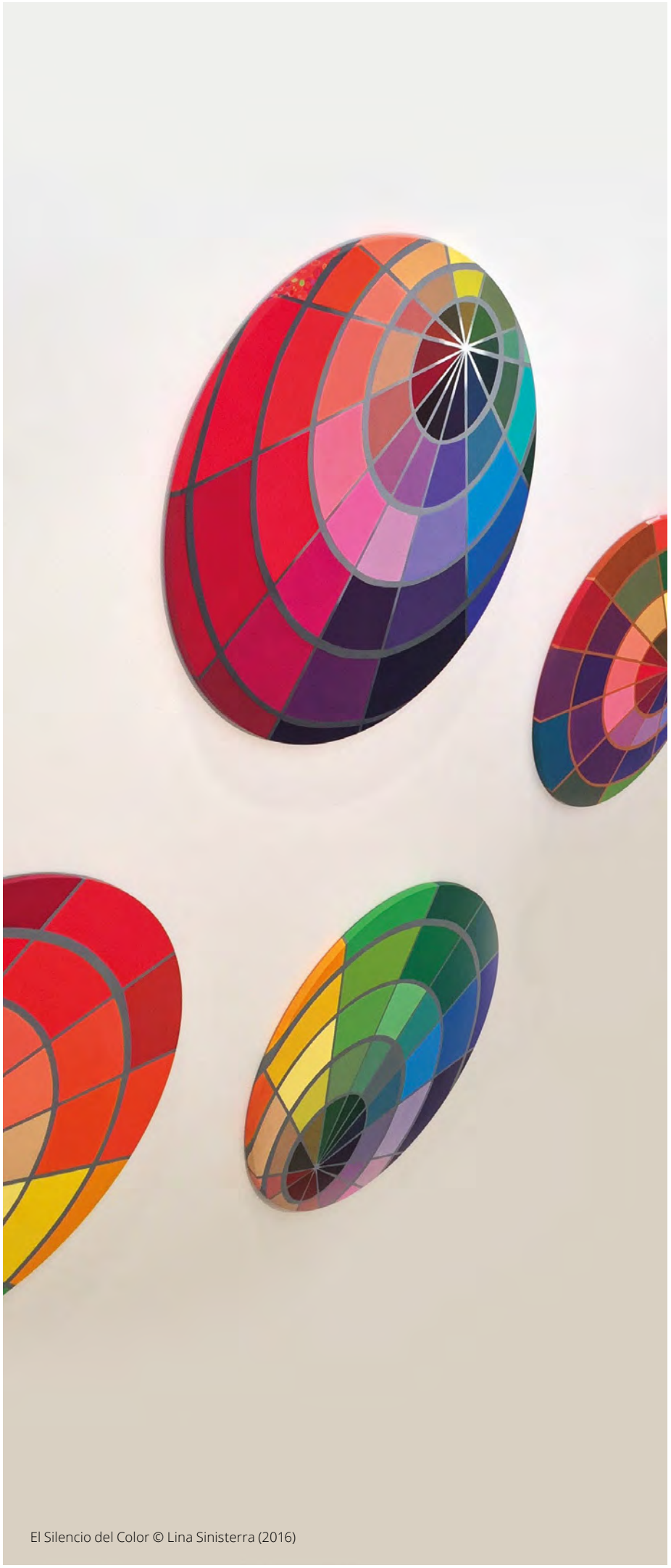
The Attribution Ledger is a blockchain-powered public, transparent, and open ledger that will establish a reliable and authoritative connection between a creative work (or its digital version), data related to the work, and the rightsholder. More broadly, it will create a verified registry of creative works that anyone, including digital services, can audit.

While there has been extensive discussion surrounding blockchain's application in the financial sector, its potential for creative industries is now emerging.

In time, the Attribution Ledger, along with the P2P eBook sales and visual arts digital passport platforms, will provide benefits across the creative ecosystem. For example: Artists will have the necessary tools to verify their work and manage copyright; they will be able to build new ways to assert their rights, share and monetize their work.

Canada has emerged as a blockchain hub, recognized as such around the world. There is an increase in organizations, such as Prescient, implementing blockchain in new and compelling ways and is an example of Canada's position as an innovation leader in emerging technologies.

For more than 30 years, Access Copyright has been a strong voice for creators and publishers, building relationships with more than 12,000 creators and 650 publishers in Canada, as well as rights management organizations internationally. Prescient Innovations, as a wholly-owned subsidiary of Access Copyright, shares the same DNA and is one of the few organizations globally dedicated to exploring creator-centred blockchain applications.



El Silencio del Color © Lina Sinisterra (2016)

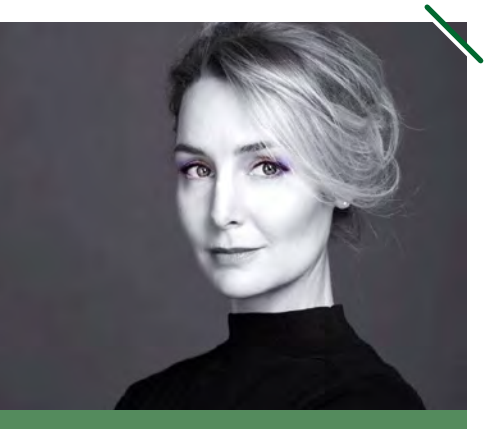
The deep rights management experience shared by both companies, provides a unique perspective on the developing blockchain economy. By developing products to specifically serve creators and publishers, they are leveraging this new technology's power to benefit Access Copyright members and the international creative economy.

The first version of the Attribution Ledger, the P2P eBook sales and art provenance platforms will be available to select creators in late 2019.

There is an increase in organizations, such as Prescient, implementing blockchain in new and compelling ways and is an example of Canada's position as an innovation leader in emerging technologies.

Expert voices

ART & TECH ASSOCIATION



Kate Vasilieva
Co-founder/president
F.A.R.E. Consulting GmbH, Kate Vass Galerie GmbH (founder, creative director)

As owner and creative director of Kate Vass Galerie, Ms. Vasilieva has excellent contacts with museums, private collectors, and artists' estates all over the world and has organized many art exhibitions (photography, contemporary, generative, and blockchain art). She has been an advisor and provided collection concepts for many Swiss and international companies, as well as international private collectors.

As a freelance exhibition curator and experienced specialist in the art market, Kate Vasilieva, the owner of Kate Vass Galerie, has experience advising private collectors and companies since 2013. She is a certified Curator (Sotheby's Institute of Art) and has a master's degree in Arts Studies from the University of Zurich, as well as Business Management at the European Business School London (EBS) and Swiss Business School (MA in Wealth Management). She has built up her own private contemporary art collection as well as an extensive library, with a particular emphasis in the field of photography and new media art. Ms. Vasilieva worked for UBS with private collectors and offered wealth planning advice for many years before opening her own advisory firm, concentrating on art consulting.

Motivation
We were inspired by our previous interactions with other companies at a number of art shows, including the blockchain art exhibition "Perfect and Priceless", which took place at the Kate Vass Galerie in November 2018. At this event, we hosted a number of education panels and talks and brought different participants together around one table. This experience showed us that the art and technology worlds are closely connected through new forms of artistic expression and convinced us of the value of bringing in additional market players from other industries who are interested in learning more about blockchain, AI, the opportunities they open up and how to implement them. The Art & Tech Association was founded to create a space in which these two worlds could come together.

How do you define art and technology companies?
At the Art & Tech Association, we explore the possibilities offered by the fusion of art and technology in various fields:

- Art creation: new technologies, software, AI, blockchain
- Art collection: conservation, display, blockchain, fractural ownership, etc.
- Art exhibiting: screen, signage, AR, VR
- Art in business: art in digital spaces, art in events

Therefore, we mainly focus on companies from the art, creative, and technology sectors, as well as those that work in and profit from digital implementation/ transformation in related industries, such as finance, legal, luxury brands (watches, jewelry, fashion), media, blockchain, cars, and real estate. Art also plays an important role in branding, advertising, investment, and architecture.

Please could you provide further details of what you are looking to achieve and how?
The Art & Tech Association Switzerland is a non-profit organization founded by two companies in 2019. Our work entails hosting regular conferences, promoting art and technology exhibitions and international art fairs, and hosting panel discussions and lectures on topics ranging from art, blockchain and AI to legal aspects. We predominantly have corporate members although we also have some private members from various industries around the globe. The mission is to forge links between members and find new synergies, build future initiatives, and unite sectors including finance, legal, IT, art, and many others to create the eco-system in which new projects can prosper.

How can a person or company become a member of the association?
We have both corporate and individual members to whom differing terms and conditions apply. Members usually join by invitation or recommendation, but we also receive applications through our website, meet in person, and then decide after talking to each member whether their application can be accepted.
For more information on becoming a member, please go to: www.artandtechassociation.org or email artandtechswitzerland@gmail.com

PROGRAM	DATE	CONTINGENCY
Panel discussion: Tokenization of assets, art coin Unity Investment, Sean Prescott CEO as a speaker	JAN 2019	1
4ArtTechnology, new technology presentation, "Blockchain against forgeries" Zurich, CH	28 FEB 2019	1
Art Exhibition: "Pixels and Crypto" by Mark Bern, Zurich, CH	18 MAR 2019	1
CADAF NY, First Contemporary and Digital Art Fair, NY USA	3-5 MAY 2019	3
"Automat und Mensch" AI and generative art exhibition opening @KateVassGalerie Zurich	29 MAY 2019	1
Panel discussion: "Art&Tech" AI impact on industries Artory, HEK Basel, Deloitte, NOOW, VR all ART, 4ArtTechnologies and many more. Basel, Zurich	13 JUNE 2019	3
Bitpolis AG company launch (cryptofunds)	18 SEP 2019	1
NZZ - guided art tour	8 OCT 2019	1
Opening of solo show "Alternatives" by Espen Kluge. Digital vs prints, collectors will be able to buy digital and physical works, Jason Bailey as a speaker and Espen Kluge will be present.	31 OCT 2019	1
Art Basel Miami, Panel Discussion: Collecting digital art. Legal and copyright issues in the art sector (new media art) Miami, USA	7 DEC 2019	2
Frieze LA Art&Tech panel. Los Angeles, USA	FEB 2020	3
Art exhibition: digital and generative art. Los Angeles/San Francisco, USA	FEB 2020	1
CADAF NY Contemporary and Digital Art Fair, NY USA	3-5 MAY 2020	3



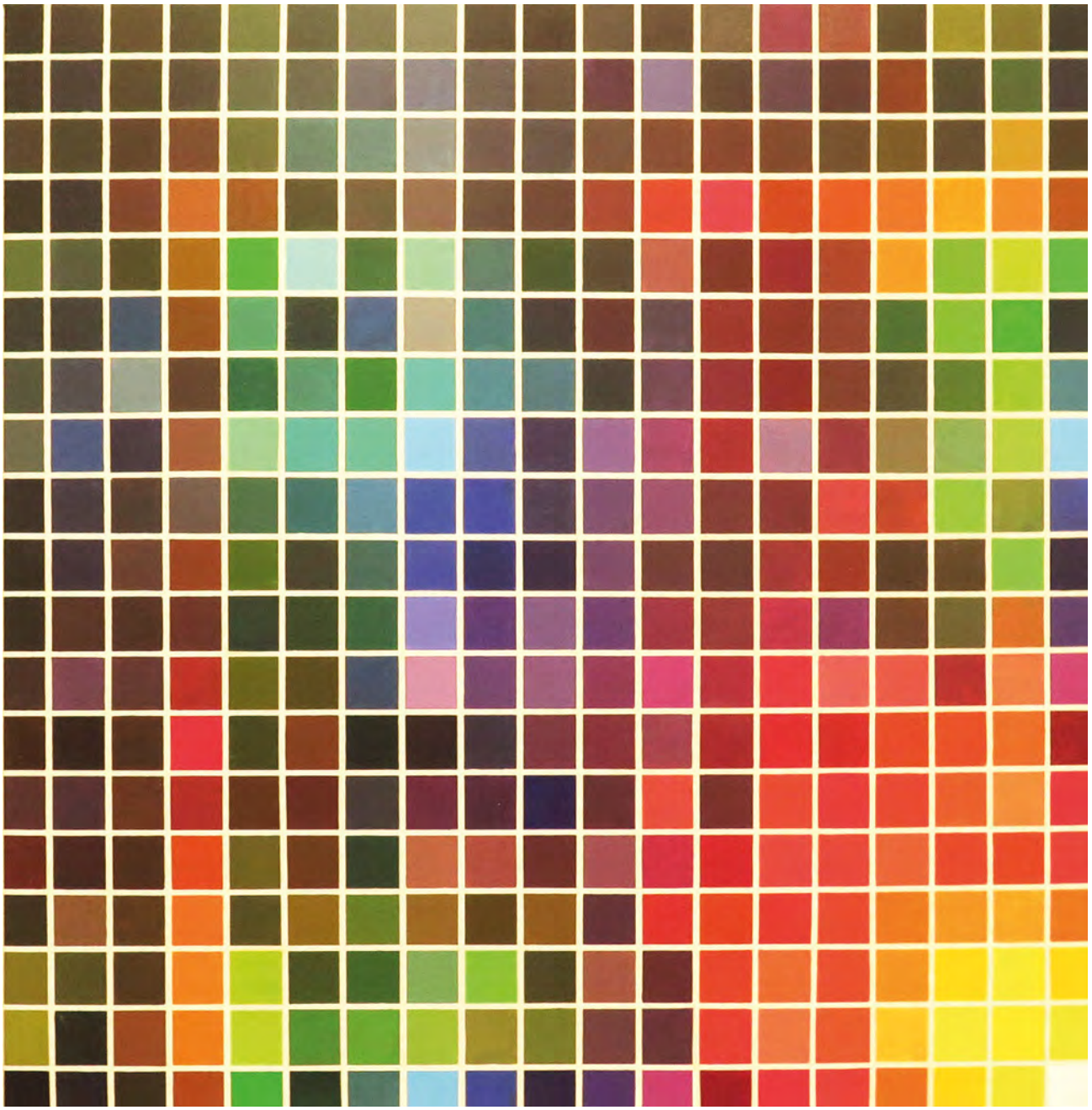
Tom Rieder
Co-founder and vice president
CEO dloop, founder NOOW.ART

Tom Rieder is the co-founder and CEO of dloop.dloop provides the gateway to experience art in the connected world. It offers artists, collectors, and art lovers easy ways to discover, trade, and exhibit art.

Tom has built the company and developed the platform for digital art NOOW since May 2018. NOOW provides a blockchain-based art registry and a marketplace for digital art. It has 45 artists under contract and diverse partnerships to distribute art on screen.

Tom is a business developer and marketing professional, who has worked in several marketing positions in internet and telecoms companies. He has broad experience in the technology field, digital transformation, culture, sports, and media rights.

Part 03
Blockchain versus user experience: Deloitte Luxembourg



El Silencio del Color © Lina Sinisterra (2016)

New prototype to connect all aspects of the art ecosystem

Mixing art and technology is not a new concept anymore. Today, the art world is bringing a lot of innovative experiences to connoisseurs and even expanding the notion of what constitutes art. New York's Metropolitan Museum of Art has offered virtual reality visits of some of its collections since 2016, the Mosul Museum in Iraq is now showing 3D models of previously destroyed exhibits, and Christie's has sold the first AI-generated works of art.

Blockchain is a very promising technology for the art world too, as its characteristics offer solutions for problems that the art world has struggled with in the past: transparency for buyers and sellers, the traceability of artworks, and the security of transactions. While these solutions can bring real added value, their adoption remains low in the art market and in other industries. A 2018 survey by Gartner predicted that blockchain adoption rates would not rise by more than 8 percent globally in the short term. One of the reasons for this may be the complexity of the technology. By focusing on the user experience and benefits to the customer journey, and taking a step back from the technology used, blockchain platforms stand a chance of becoming more attractive and accessible. To showcase the potential for a user-centric solution based on this technology, Deloitte developed a prototype to solve traceability issues in art in 2016: ArtTracktive. The goal was to demonstrate how blockchain technology can be used to provide a reliable and unchangeable trace of where an artwork is at any point in time, which is of particular importance in a sector where damage to or the disappearance of a piece can have dramatic and irreversible consequences.

Since 2016, the technology and the market have evolved. Different trading, certification, and tracking platforms have emerged and 2018 saw the first traditional art pieces sold in cryptocurrency shares, digital art specifically created to trade through cryptocurrencies, and sales and auctions carried out via blockchain-secure registries.

Deloitte's innovation lab, D.Lab, has developed a new prototype that combines the various platforms and provides a new user-centric approach. This prototype highlights the feasibility of connecting all members of the art ecosystem from investors to sellers, artists, and certifying bodies on one network. This prototype demonstrates the opportunity to combine an end-to-end tracking system, a transparent marketplace, and an investment platform.

Thanks to this new blockchain prototype, the user can:

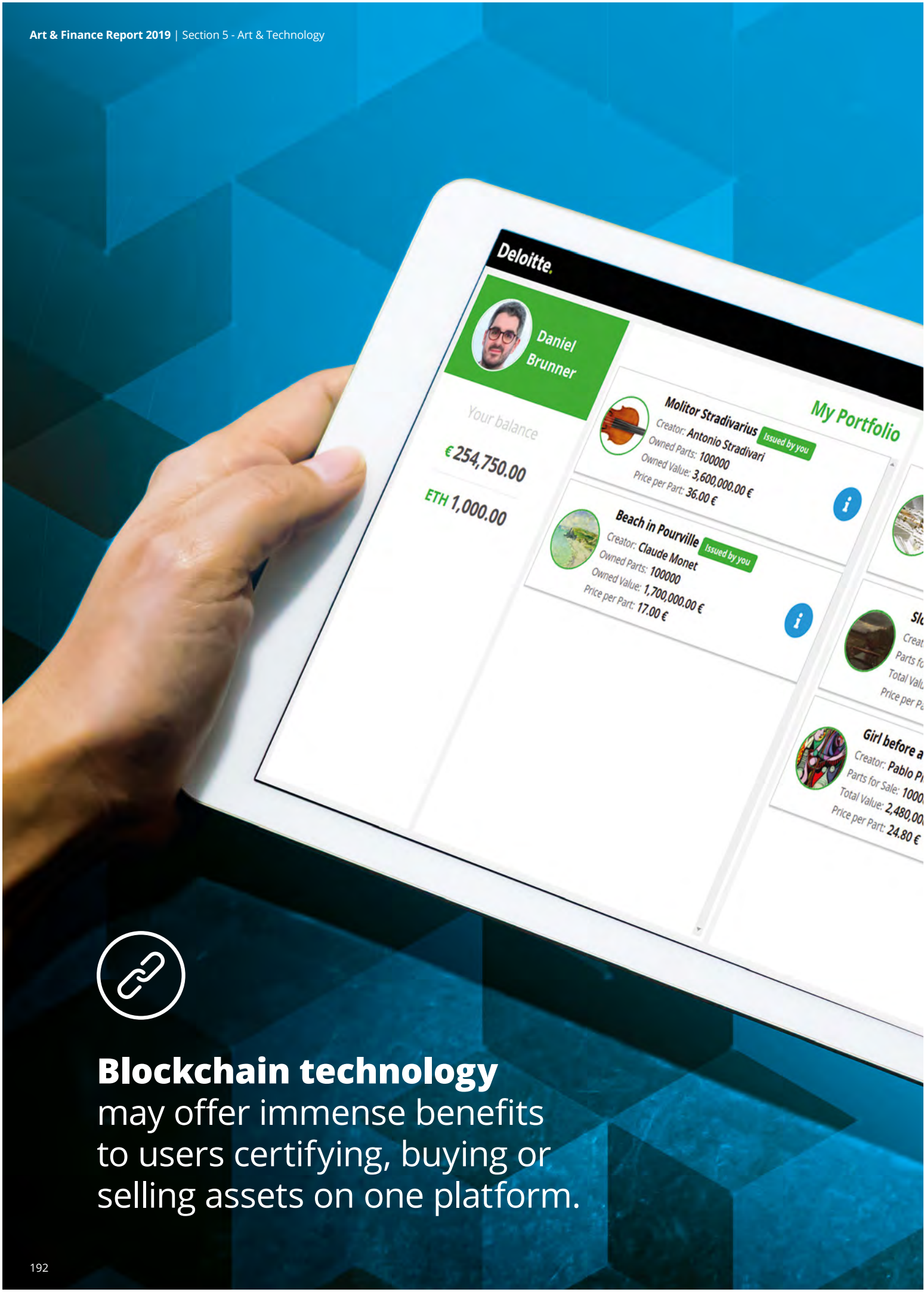
- Have art certified by a recognized body
- Register all important details and characteristics of the art
- Buy or sell certified art pieces
- Invest in a fraction of an asset that has been split into multiple parts with designated values
- Have an overview of all art pieces and fractions they hold



Nadia Andersen
Manager – Innovation
Deloitte Luxembourg



Daniel Brunner
Assistant Manager
Head of D.Lab
Deloitte Luxembourg



Blockchain technology may offer immense benefits to users certifying, buying or selling assets on one platform.

All prototype functionalities are accessible via Web Services connections to the blockchain behind, allowing instant feedback and a smooth user experience for art enthusiasts.



On the home page, users see three zones:

Their balance,
in both Ether (ETH) and euro

Their portfolio,
containing all asset fractions owned by the user

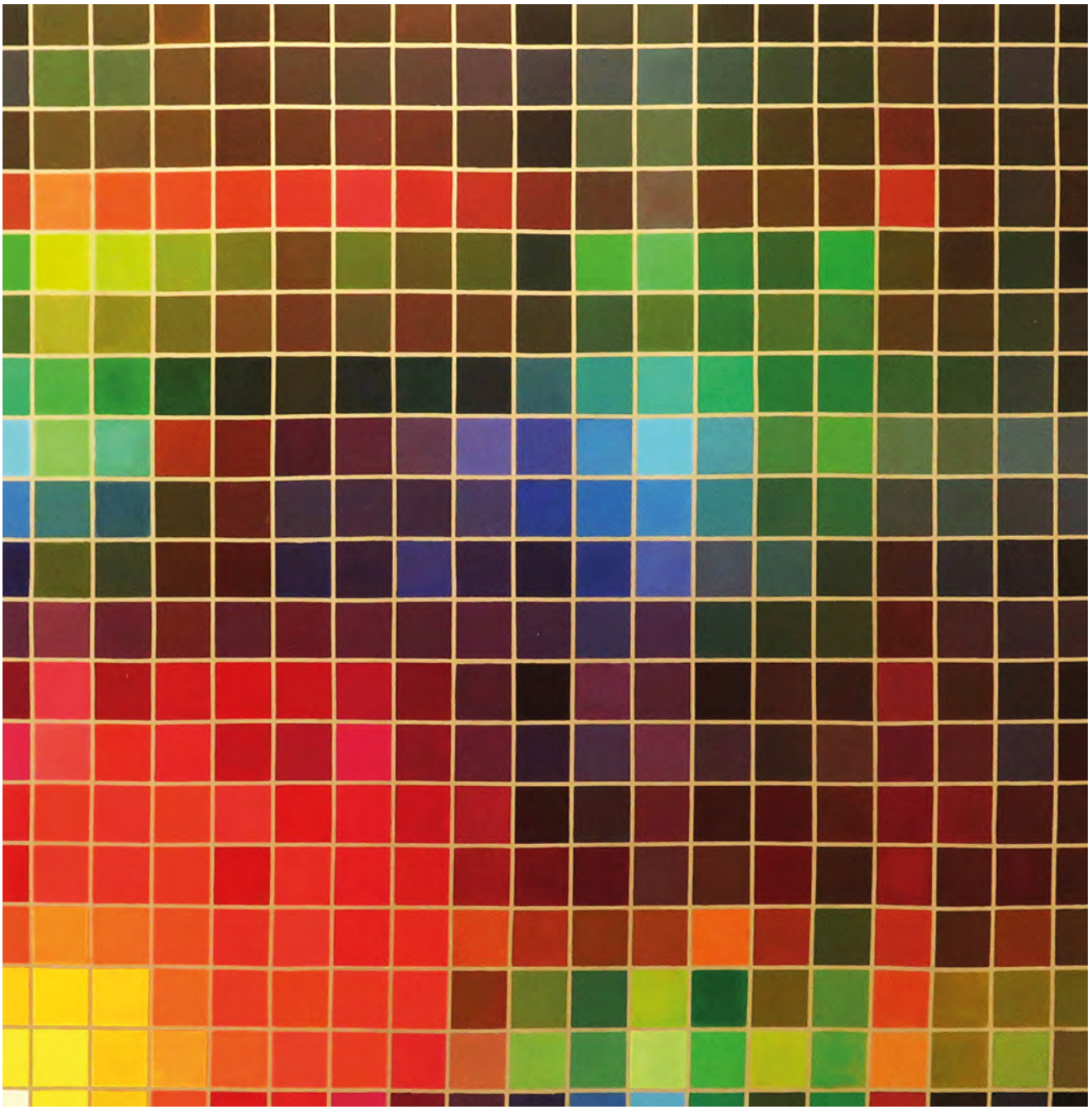
The marketplace,
presenting all artworks available for sale

For each artwork, a detail window allows all platform users to see useful information about the piece.
All important information to certify a work of art can be stored and linked to the art token.

Blockchain technology may offer immense benefits to users certifying, buying or selling assets on one platform, but this does not necessarily need to be pointed out to the user. This concept of a "UI shield" allows people to enjoy the benefits of technology without necessarily understanding the technical details of how it works. The platform prototype developed by Deloitte Luxembourg and its D.Lab gets this balance right and constitutes a solution that could work in practice.

Innovations, enabled by different technologies, will change the world as we know it today. Whilst it is difficult to predict to what extent, we can be certain that the art market will continue evolving, since artists have been pushing the boundaries of what is possible for all of human history. This is a great opportunity for Deloitte Luxembourg to highlight its capabilities for increasing adoption of these innovations on the market.

Part 04
Snapshot from the ***Hiscox Online Art Trade Report 2019***



El Silencio del Color © Lina Sinisterra (2016)

Online art market sales growth slows in 2018

The online art market grew by 9.8 percent overall in 2018 to US$4.64 billion. This is a slower pace of growth than the 12 percent experienced in 2017. Whilst the online art market has been riding on the back of an overall art market boom since the financial crisis in 2009, global economic and political uncertainty is expected to test the resilience of online art buyers in 2019. Although 77 percent of the online platforms surveyed for the Hiscox report feel positively about the outlook for the online art market in the coming 12 months, this is down significantly from 96 percent in 2018.

More millennials bought art online in the last 12 months, and 79 percent said they had bought more than once (up from 64 percent last year). New art buyers are also more engaged, with 36 percent saying they have bought online in the last year, up from 31 percent previously, and 70 percent said they had bought art online more than once, up from 64 percent last year. Among millennials, 23 percent said they had never bought a work of art in a physical space (e.g., a gallery, auction, or art fair) prior to buying art online, up from 18 percent last year. This indicates that the online art market plays an important role in educating and introducing new generations of buyers to art collecting.

Industry consolidation likely to continue

71 percent of online platforms said they expected more consolidation among online art platforms in the coming 12 months. Among those that believed consolidation would take place, 63 percent anticipated horizontal mergers (companies operating in the same space), whereas 37 percent expected vertical mergers (companies operating in different parts of the value chain). This signals that larger online art platforms will continue to absorb smaller niche players to either broaden their geographical reach and/or to access new collecting segments.

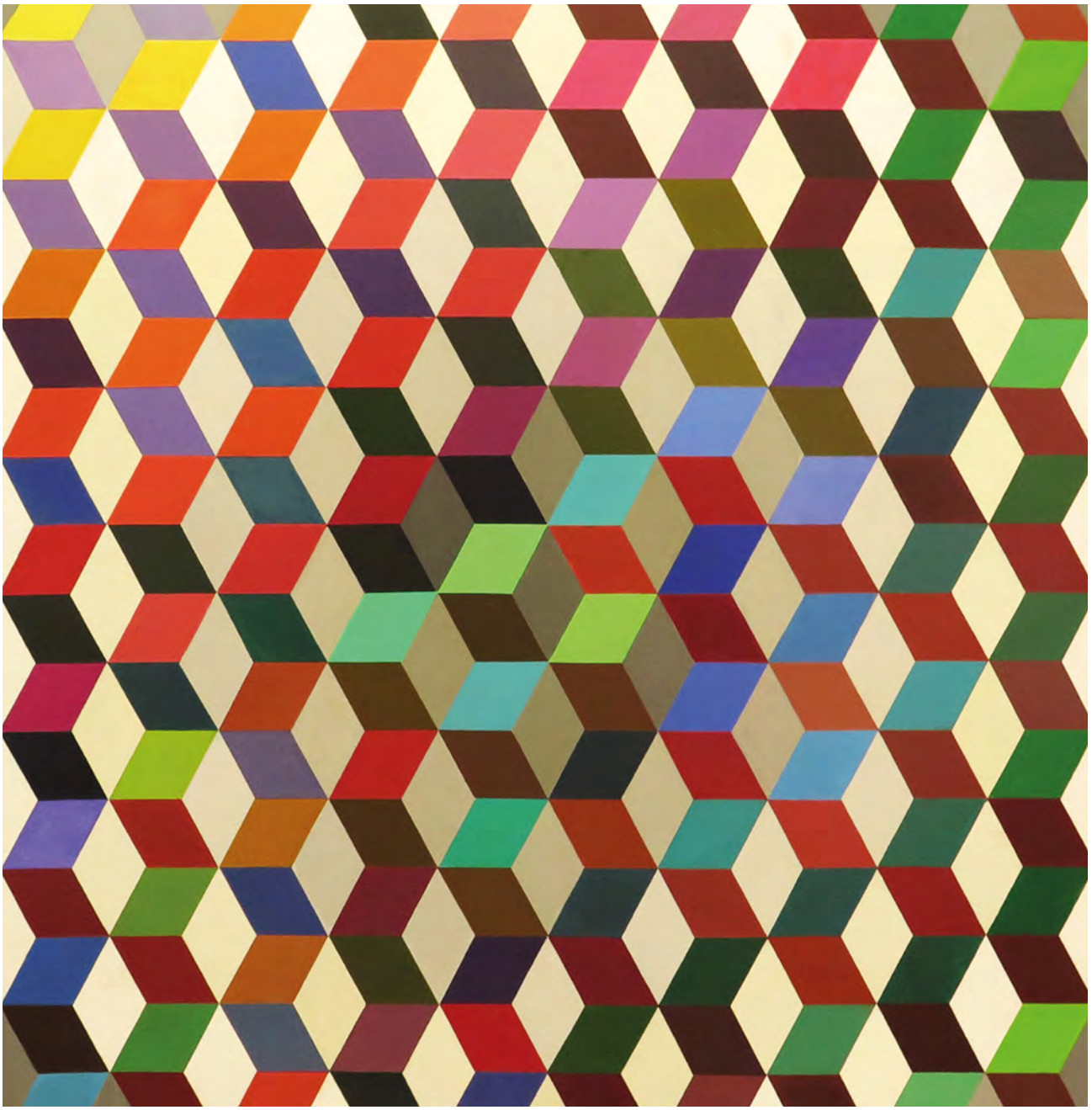
It was a relatively quiet year in terms of mergers and acquisitions. Barnebys, the search engine serving the design, antiques, and art community, has acquired CollectorsWeekly.com, Simple Auction Site, and the valuation service ValueMyStuff in the last 18 months.

Meanwhile, Sotheby's moved deeper into the online decorative arts business, acquiring Viyet.com—an online marketplace for vintage and antique furniture and decorative objects.

According to the Hiscox research, 41 percent of online platforms believe the online art market will converge towards one or a few global platforms (this view has not changed since 2018); however, the low level of merger and acquisition activity over the last 12 months might suggest that this scenario is some distance away.

Another 41 percent of online platforms believe the online art market will remain category-specific (up from 32 percent in 2018), with certain platforms dominating specific collecting segments (such as photography, prints, furniture, design, and contemporary art).

Part 05
Digital Art
and its market



El Silencio del Color © Lina Sinisterra (2016)



Powered by rapid enhancements in new technology and supported by adoption within mainstream cultural institutions, digital art is increasingly becoming one of the key focal points on the international art market scene.

Elena Zavelev
Founder, New Art Academy
and CADAF (Contemporary And Digital Art Fair)

The past five years have seen significant market growth. In 2013, Philips hosted the world's first auction dedicated entirely to digital art. The project succeeded in selling 16 of the 20 works offered, achieving a total of US$90,600[64]. The market has grown exponentially since, highlighted through the infamous sale of an AI artwork for US$432,500 at Christie's in October 2018[65].

What is digital art?
The term "digital art" can be used to refer to any artwork created using digital technology. This art is known to evolve alongside new developments in emerging technology and loosely falls into four main categories. "Time-based media" involves artworks that unfold over time, or specifically, use timing and the duration of the piece as an important dimension of the work. This can be compared to "static digital imagery" which refers to any still image generated through the use of digital technology. "Digital art installations" involve physical, often interactive pieces requiring audience participation and using digital technology. "XR", also referred to as "cross reality", art includes works that consist entirely of virtual reality (VR), augmented reality (AR) and mixed reality (MR) experiences.

Digital art as an investment
Digitalization of the traditional art marketplace has produced a new generation of collectors accustomed to sourcing pieces and artists online through the likes of Artsy and Instagram as well as having access to transparent pricing data.

Blockchain technology has been a game-changer for the proliferation of the digital art market, creating opportunities to register copyright and provenance information, supporting authenticity, and ensuring the scarcity of digital editions[66]. The ability to produce and verify the number of limited editions, in particular, has become crucial to the adoption of digital art collecting ensuring protection of the value of digital art pieces that are easy to copy.

Interest in the sharing economy and the opportunity to own or lease the fraction of the work of art supported by the records in the blockchain database offer another exciting catalyst for the growth of digital art as an investment class.

64 https://www.forbes.com/sites/katherynthayer/2013/10/22/going-once-going-twice-phillips-puts-gifs-on-auction/#30ed122f2c97

65 https://www.christies.com/features/A-collaboration-between-two-artists-one-human-one-a-machine-9332-1.aspx

66 https://www.forbes.com/sites/elenazavelev/2018/11/07/how-blockchain-empowers-the-digital-art-market

Potential for growth and **opportunities for the trade**

What do art market professionals stand to gain?

For art market professionals, this creates many opportunities in the area of digital art acquisition, display, digital collection management, and conservation. As the digital art market is relatively new, the business development potential is almost unlimited. This includes new platforms for fractional ownership of high-quality digital art, subscription services for digital art leasing, digital art insurance, and so on.

What are the benefits for art collectors and why should collectors buy digital art now?

There are also myriad benefits for art collectors. First of all, the current prices even for established artists are low relative to traditional art. The novelty factor plays an important role as contemporary digital art provides unprecedented new experiences for the audience.

A strong public example is the Louvre's recent foray into VR in their collaboration with HTC Vive Arts to create "Mona Lisa: Beyond the Glass". The partnership has resulted in a VR experience where visitors to the Louvre have a more personal interaction with the museum's most famous painting, circumventing the usually overcrowded viewing experience.

As for the liquidity of digital art, in many cases, especially with crypto-collectibles, it is significantly higher than that of the traditional art as digital art is easier to trade, own, and maintain. There are also unique social and transactional aspects to owning digital art as often there is an existing global community of artists, buyers, and sellers behind the marketplace it trades on.

Finally, the pricing models for digital art, especially for emerging artists, are still in development and are hugely driven by the community of artists and early collectors. This may result in a more dynamic market in future.

2001
Launch of Artport: Whitney Museum's portal to internet art and an online gallery space for commissions of net art and new media art

2011
Launch of Sedition Art: the online platform for selling and collecting editioned digital art

October 2013
First auction dedicated exclusively to digital art held by Phillips in collaboration with Tumblr. Project succeeded in selling 16 of the 20 works offered, achieving a total of US$90,600

March 2016
A group of 29 paintings made by Google's Artificial Intelligence algorithms sold at a charity auction in San Francisco.

May 2016
Pace Gallery opened a permanent gallery space in Palo Alto, following an inaugural Art + Technology exhibition with teamLab

April 2018
Artists and Robots show focusing on art produced with the help of robots premiered at Grand Palais in Paris
First digital art center L'Atelier des Lumières opened in Paris

June 2018
Digital Art Museum by teamLab opened in Tokyo

September 2018
CryptoKitty Dragon sells for US$170,000

October 2018
AI artwork sold at an auction at Christie's New York with "Portrait of Edmond Belamy" by GAN (Generative Adversarial Network) achieving 45 times its high estimate at US$432,500

February 2019
Phillips announced a collaboration with Daata Editions to commission two works from digital artists
First mixed-reality art experience "The Life" by Marina Abromovic exhibited at The Serpentine Galleries

March 2019
AI work "Memories of Passersby I" by Mario Klingemann sells at Sotheby's Contemporary Art Day Auction

May 2019
CADAF launched its first digital art fair



Major institutions in support of digital and new media art

- Ars Electronica
- CADAF (Contemporary And Digital Art Fair)
- Christie's Art+Tech Summit
- DIGITAL ART MUSEUM: teamLab Borderless
- Eyebeam
- Gray Area Foundation for the Arts
- HeK - House of Electronic Arts Basel
- iDAF (International Digital Art Festival)
- MoMA - Digital Art and Culture Symposium
- New Art Academy
- New Museum/Rhizome/Net Art Anthology
- Whitney Museum, Artport
- ZKM Center for Art and Media (Karlsruhe, Germany)



US$90,600

Phillips hosted the world's first auction dedicated entirely to digital art in 2013: 16 of the 20 works offered were sold, achieving a total of US$90,600 (averages to US$5,662.2 per work)

US$118,750

In 2015, Rafael Lozano-Hemmer sold a software-based sculpture for US$118,750 at Phillips

US$240,000

A digital work by TeamLab made by custom-built software sold for $240,000 at Phillips in 2017[67]

US$240,000

In 2017, a digital work by teamLab complete with custom software sold for US$240,000 at Phillips

US$600,000

In 2018, "In private sales", algorithmic art by Philippe Parreno was priced at around US$600,000 by his London dealer Pilar Corrias[68]

US$432,500

"*Portrait of Edmond Belamy*" by GAN (Generative Adversarial Network). The piece went to auction in October 2018 at Christie's New York in a Prints and Multiples sale, achieving 45 times its high estimate at US$432,500[69]

£40,000

March 2019, Sotheby's Contemporary Art Day Auction with "Memories of Passersby I" by Mario Klingemann. The work achieved its high estimate of £40,000

67 https://www.theartnewspaper.com/analysis/will-the-market-for-ai-art-take-off
68 https://www.theartnewspaper.com/analysis/will-the-market-for-ai-art-take-off
69 https://www.christies.com/features/A-collaboration-between-two-artists-one-human-one-a-machine-9332-1.aspx

El Silencio del Color © Lina Sinisterra (2016)



Section 6

Risk Management & Regulation

Pervivencias © Lina Sinisterra (2011)

Highlights

RISK MANAGEMENT

Perception of risk heightened across all aspects of the art market

- **Authenticity, provenance, forgery and attribution remain key concerns**
  84 percent of wealth managers said that this was the greatest area of risk and posed a threat to the reputation of the art market (up from 83 percent in 2017).

- **Price manipulation and other anti-competitive behavior**
  79 percent of wealth managers said that the risk of price manipulation and anti-competitive behavior was the main risk to the reputation of the art market (up from 76 percent in 2017).

- **Lack of title register/unique identifier for objects**
  The lack of infrastructure (e.g., a title register) enabling stakeholders to track and uniquely identify the ownership and provenance of works of art is seen as a key problem by 72 percent of wealth managers (up from 69 percent in 2017).

- **Undisclosed conflicts of interest**
  76 percent of wealth managers felt that conflicts of interest were the greatest threat to the reputation of the art market (up from 65 percent in 2017).

- **Money laundering concerns**
  76 percent of wealth managers said that money laundering was a key concern (up from 65 percent in 2017).

76 percent of wealth managers said that money laundering was a key concern.

REGULATION

- **More wealth managers in Europe believe the art market needs government regulation**
  In 2017, 60 percent of wealth managers said that they thought self-regulation would be the best way to regulate the art market. However, among European wealth managers this has changed: 54 percent of those surveyed stated that they thought the art market should be facing more government regulation and only 46 percent said that self-regulation would be the right approach.

- **Increasing calls to modernize business practices in the art market**
  In this year's survey, all stakeholders call for the modernization of current business practices, with 80 percent of art professionals (up from 74 percent in 2017), 81 percent of collectors (up from 64 percent in 2017), and 76 percent of wealth managers (up from 73 percent in 2017) expressing this opinion. The entry into force of the EU's fifth AML directive in January 2020 may be a motivation and catalyst for much-needed change.

- **The fight against money laundering broadens to include the art trade**
  The scope of EU anti-money laundering regulations is being extended to include the art trade as of January 2020. The global trend has been to increase the number of industries required to help in the fight against financial crime in response to the emergence of innovative money laundering schemes and a mounting threat of terrorism. This means that under the new regulation, dealers, auction houses, and other art traders fall are covered by the rules that apply to other "gatekeepers", such as banks, accountants, and lawyers.

- **The low threshold means that a large proportion of the current art trade will be covered by the new regulation**
  The new AML directive extends its scope to "persons trading or acting as intermediaries in the trade of works of art, including when this is carried out by art galleries and auction houses, where the value of the transactions amounts to EUR 10,000 or more".

- **Implementation of a financial crime risk program**
  The new AML regulation compels the art trade to implement a financial crime risk program. However, there is no one-size-fits-all approach, and this program will differ depending on the inherent

risks posed by various products and services, customers, geographies, and sales channels. The new requirements will oblige dealers and intermediaries to adopt a risk-based approach to transactions and customer relationships and establish policies and procedures relating to: i) customer risk assessments; ii) customer due diligence; iii) ongoing monitoring; iv) implementing adequate governance; and v) cooperating with the authorities.

Art professionals have a duty to file suspicious activity reports

Art professionals that fall under the new AML regulation must cooperate fully with authorities, which means not only reacting to requests, but also, on their own initiative, filing suspicious activity or transaction reports to the Financial Intelligence Unit (FIU) when they suspect or have reasonable grounds to suspect that money laundering or terrorist financing has been committed or is being committed.

Panama Papers shine a spotlight on the challenges around establishing beneficial ownership

Whilst few art-related money laundering lawsuits have been brought as a result of the Panama Papers, the documents reveal how the true owner of works of art can hide behind a veil of offshore shell companies.

Identifying beneficial owners

Art professionals (including auction houses, dealers, and galleries) must perform due diligence checks and identify the beneficial owner of each transaction under the new EU anti-money laundering regulation. However, transactions in the art market typically involve one or several intermediaries, and this makes it difficult to distinguish the intermediary from the actual beneficiary of the transaction. It is clear that it is important to establish whether the client is acting on its own behalf or as an agent. However, the legal framework has not provided a clear definition of the term "intermediaries", which is a significant legal omission.

Museums need to know their patrons

In light of the controversy around the Sackler family and their support for the art world, there is likely to be enhanced scrutiny around corporate and private financial support and donations to museums. The practical implications of this for the cultural sector could be significant, as the cost and resources required to pre-emptively assess the risk associated with external donors or supporters could be excessive.

Again, the fifth AML directive may result in the creation of a common tool for the art industry to share in terms of carrying out due diligence.

Challenges posed by the online art market and non-face-to-face transactions

With an estimated US$4.64 billion in online art transactions in 2018[70], it is clear that the art industry faces immense challenges in terms of identifying beneficial owners prior to transactions. Furthermore, this could hinder the application of anti-money laundering regulations, especially as regards transactions between private individuals.

Responsible Art Market (RAM) initiative

The objective of the RAM initiative is to raise awareness among art businesses of the risks facing the art industry and to provide practical guidance and a platform for sharing best practice as regards addressing such risks. RAM's founding members span the entire spectrum of the art market to include art businesses, academic institutions, and attorneys.

To date, RAM has published two sets of practical guidelines and checklists that are increasingly used and referred to: the Guidelines on Combatting Money Laundering and Terrorist Financing and the Art Transaction Due Diligence Toolkit. RAM holds an annual conference in Geneva during the art genève art fair. This provides an opportunity for art market professionals to meet and exchange ideas on market practices, challenges, and new initiatives.

Lessons to be learned from the diamond industry

Antwerp World Diamond Centre (AWDC) invested substantially in raising awareness of AML and providing guidance and support to diamond dealers on how to apply AML principles in practice. It did so through helplines, courses, and seminars as well as tools, such as a software tool through which diamond traders could screen their clients and assess the potential risks. Since these tools were too expensive for a sole trader, AWDC, as the sector body, funds this and provides free access to traders.

70 Hiscox Online Art Trade Report 2019

EU regulation on importing non-EU cultural goods
On 7 June 2019, a new EU regulation aimed at controlling the trade and introduction of cultural goods into the EU was published and passed by the European Parliament for the purposes of fighting the illicit trade in cultural goods. The regulation will be fully operational by mid-2025 at the latest. Antiques dealers have expressed concern about the added administrative burden, which they feel could harm their legitimate business activities. See p.226 for more information on the compliance requirements set out in the new regulation.

The fifth AML directive includes free ports but not customs warehouses
The fifth AML directive formally includes "persons storing, trading or acting as intermediaries in the trade of works of art when this is carried out by free ports, where the value of the transaction or a series of linked transactions amounts to EUR 10 000 or more" as new obliged entities. However, operators of customs warehouses or other storage provides are not included.

The final report of the TAX3 committee did note this oversight by recommending that at least customs warehouses "be put on an equal footing with free ports under legal measures aimed at mitigating money laundering and tax evasion risks therein, such as AMLD5".

Money laundering and tax evasion risk in free zones
A study by the European Parliamentary Research Service (EPRS) identified the risk associated with the increasing use of non-financial assets as substitute assets for the storage and transfer of wealth, particularly with the end of banking secrecy, which they claimed contributed to the rapid growth of the art market in recent years. However, art storage and logistics providers are not required to participate in any automatic data exchanges under the OECD's common reporting standard (CRS) or the EU's reporting agreements between tax authorities.

The fifth anti-money laundering directive represents an evolution rather than a revolution for art market professionals in France.

COUNTRY PERSPECTIVES

France
The fifth anti-money laundering directive represents an evolution rather than a revolution for art market professionals in France, as art market professionals in France have been subject to AML regulation since 2001. Art professionals in France have expressed concerns about the complexity of the regulation and the cost of compliance.

United Kingdom
Despite Brexit, all indications suggest that the UK government will implement AMLD 5. The UK government's consultation paper names HMRC as the preferred supervisor for art intermediaries. Although the regulator's enforcement approach is not yet known, data shows that fines imposed on high-value dealers have increased in recent years.

Switzerland
Art dealers already fall under the scope of existing money laundering regulations in Switzerland, such as the Swiss Anti-Money Laundering Act (AMLA). The latter also covers persons and legal entities that deal in goods commercially and in doing so accept cash. The current threshold is 100,000 Swiss francs, however, certain dealers (in precious metals and stones) will have to carry out due diligence for transactions above 15,000 Swiss francs. The threshold for all other dealers covered by the AMLA definition remains unchanged at 100,000 Swiss francs.



Introduction

Despite the increase in data volumes and technological advances, concern about transparency has increased in the last two years. This implies a perception that the art market is becoming a more un-democratic and less open marketplace, plagued by price manipulation, insider information, and conflicts of interest. In this year's survey, all stakeholders call for the modernization of current business practices in the art market, with 80 percent of art professionals (up from 74 percent in 2017), 81 percent of collectors (up from 64 percent in 2017), and 76 percent of wealth managers (up from 73 percent in 2017) expressing this opinion. In order to restore trust in the art market, these issues need to be addressed.

In this year's risk management and regulation section, we will predominantly focus on the fifth EU anti-money laundering directive coming into force in January 2020, and its possible impact on the art trade and the art industry as a whole.

Despite the challenges that this regulation will have for the art industry, lessons from other sectors and industries suggest that the reputational benefits of a better and more professional compliance environment will ultimately create more trust and opportunities for the market to expand beyond its current limits.

In this year's report, we have divided the risk management and regulation section into the following two parts:

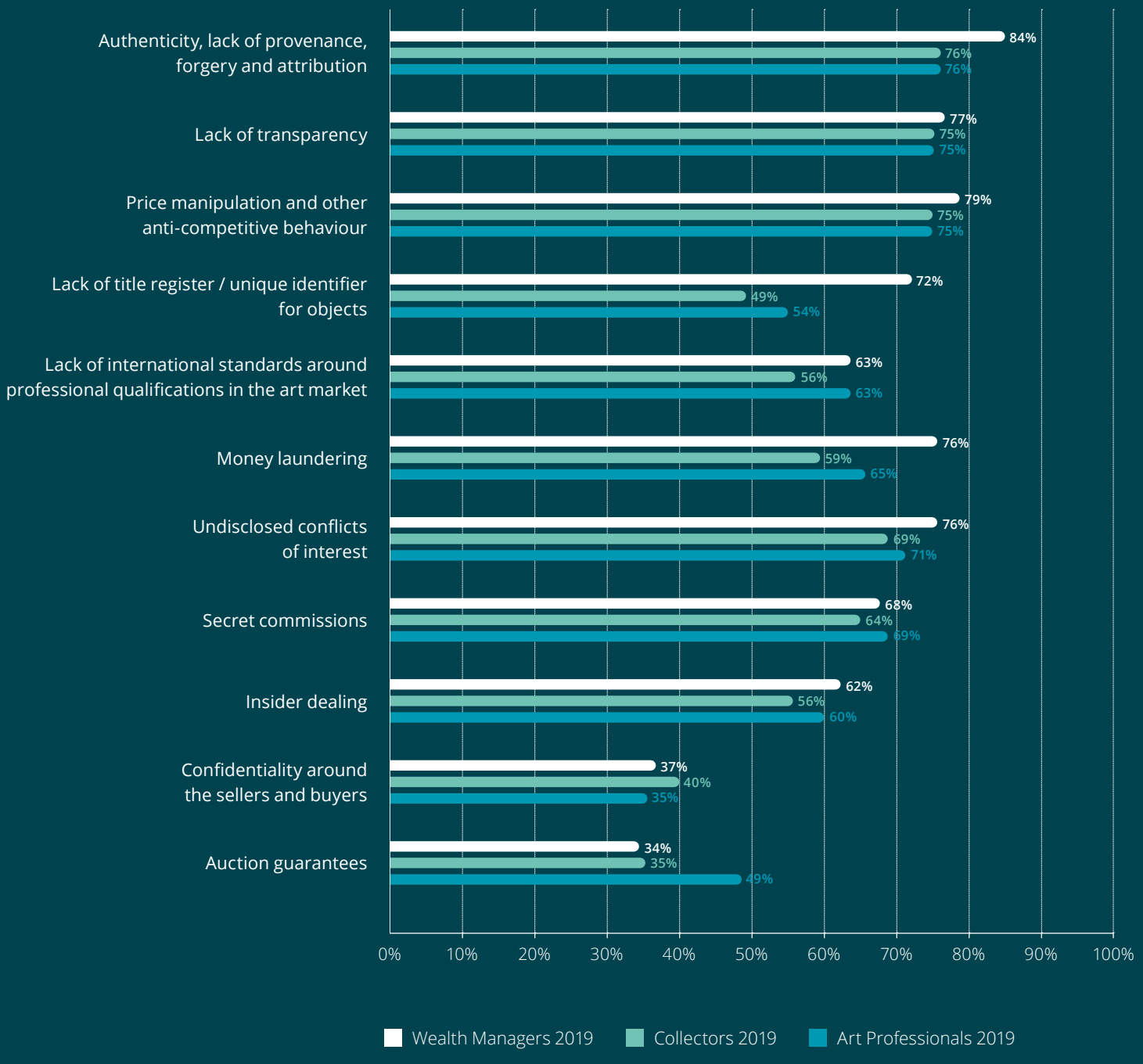
01. Survey findings 2019
This looks at how Art & Finance stakeholders (wealth managers, art professionals, and collectors) view regulation and the related theme of risk management in the art world.

02. Regulation: a focus on anti-money laundering efforts
In this section, professional from the Deloitte global network have teamed up to share technical knowledge in relation to the requirements to combat financial crime.

Pervivencias © Lina Sinisterra (2011)

Part 1
Survey findings 2019

Figure 50. Which of the following issues do you feel are the most threatening/damaging to the reputation of the art market?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Stakeholder analysis: current threats to the art market's reputation

Lack of transparency

This year's findings show that 77 percent of wealth managers said that a lack of transparency was the key threat (down from 79 percent in 2017). Among the collectors surveyed, 75 percent said transparency was a key issue (up from 62 percent in 2017), and 75 percent of art professionals also said this was a major concern (up from 69 percent in 2016).

Authenticity, provenance, forgery and attribution

84 percent of wealth managers said that this was the greatest area of risk and that it posed a threat to the reputation of the art market (up from 83 percent in 2017). With art values reaching astronomical levels, these issues will continue to haunt the art market going forward. The media coverage around the US$450 million sale of Leonardo da Vinci's Salvatore Mundi and the uncertainty around its attribution have come to exemplify the complexity and challenges associated with buying and selling high-value art. 76 percent of collectors and art professionals also rate this as one of the most important challenges in today's art market.

Price manipulation and other anti-competitive behavior

79 percent of wealth managers said that price manipulation and anti-competitive behaviors were among the major risks to the reputation to the art market (up from 76 percent in 2017). A further 75 percent of collectors and art professionals said the same.

Lack of title register/unique identifier for objects

The lack of infrastructure (e.g., a title register) enabling stakeholders to track and uniquely identify the owner and provenance of artworks was seen as a key problem by 72 percent of wealth managers (up from 69 percent in 2017). However, this issue was viewed as being of less concern by art professionals, 54 percent of whom said this was a major threat to the art market, compared with 49 percent of collectors.

Money laundering concerns

Of the three stakeholder groups surveyed, the wealth management community is the group that expressed strongest concern about money laundering risks in the art world, with 76 percent of wealth managers saying that money laundering was a key concern (up from 65 percent in 2017). It is still to be seen if the fifth EU money laundering directive (entering into force in January 2020), which requires auction houses, art dealers, and other art intermediaries to undertake anti-money laundering checks on customers, will change the perception of money laundering risk in the art market. In this year's survey, 65 percent of art professionals (up from 61 percent in 2017) and 59 percent of collectors (up from 49 percent in 2017) viewed money laundering risk as a major threat to the reputation of the art market. So, although many art market insiders are partly numb to these risks, it is clear that the wider world sees the situation differently.

Undisclosed conflicts of interest

76 percent of wealth managers felt that conflicts of interest were the greatest threat to the reputation of the art market (up from 65 percent in 2017). Without a clear division between art market roles (advisor or dealer? Broker or valuer?), conflicts of interest will continue to arise.

The lack of infrastructure enabling stakeholders to track and uniquely identify the owner and provenance of artworks was seen as a key problem by 72 percent of wealth managers.

Data & trust

Lack of trust in art market data

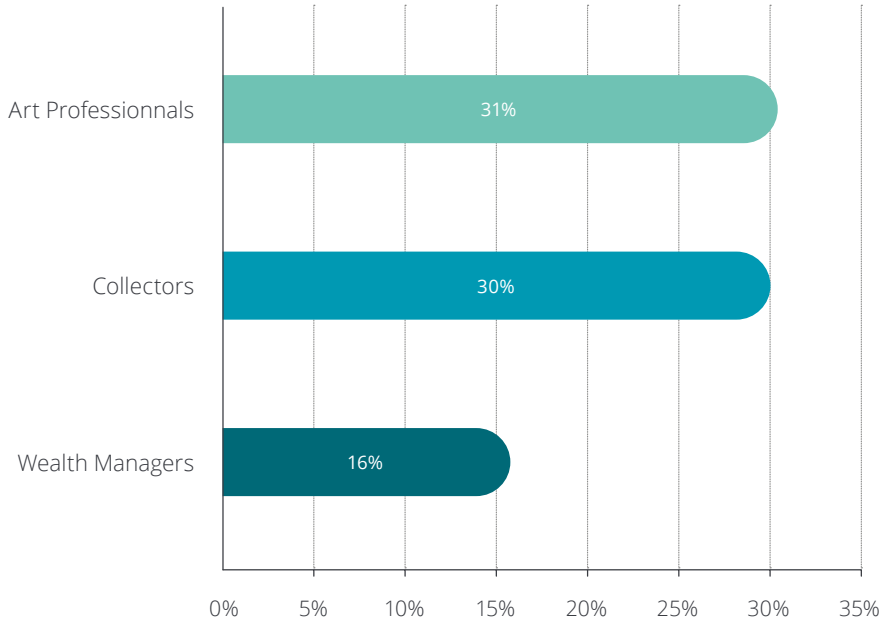
Technology has become part of our lives. Data and analytics are increasingly determining how we run our private lives as well as our businesses. However, the growing reliance on data, analytics, and artificial intelligence raises an important question: how do we know whether we can trust the outcome? An increasing focus on trust is emerging as algorithms begin to make more decisions on our behalf. Also, data and analytics are becoming increasingly complex and opaque, and the risks associated with poor design, errors, and unintended consequences are mounting.

This year's survey findings show that there is a deficit in trust when it comes to art market data. The fact that more wealth managers are concerned about price manipulation in the art market is of genuine concern as it could undermine confidence in art prices and transactional data used for valuation, art-secured lending decisions, risk management, and so on. Only 16 percent of the wealth managers surveyed said they had a high level of trust in art market data, and with none of the family offices expressing this view. Among art professionals, 31 percent said they had a high level of trust, leaving the remaining 61 percent with a medium to low level of trust in art market data.

This is an important issue, as current and future decision-making tools for valuation and risk models will depend heavily on this data and the trust in the data. Are big data and artificial intelligence (AI) the solution? Or might there be a risk that analytics and AI could amplify the problem by using data that the art market does not trust? The well-known expression "garbage in, garbage out" rings true in this context. The art industry needs to invest in getting the best-quality input for these new tools, as analytics and forecasting systems are only as good as the data you feed them. How do we achieve this? Should we move towards a neutral custodian of art data: maybe a regulated entity, such as a bank? Or do we want to move towards a decentralized structure using blockchain technology, which could verify and track the provenance of art market data, i.e., verify the history of the data from its origin throughout its life cycle, addressing the critical question: where does this data come from – and can we trust it? There is no doubt that trust in data has value, and that there is a clear commercial case for ethical conduct around data.

Figure 51. What level of trust do you have in the art market data (qualitative & quantitative) currently available? (Percentage respondents saying 4 or 5)

Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



Only 16 percent of the wealth managers surveyed said they had a high level of trust in art market data.

What can be done to increase trust in art market data? Based on qualitative responses from the three stakeholder groups, here is a list of suggestions for how to increase trust in art market data.

More transparency around transactions, including buyer information, pricing data, and valuations. A large number of stakeholders raised concerns about the asymmetric information that exists in the art market, where one part of the transaction always seems to have more information and knowledge than the other. To achieve increasing transparency, the following suggestions were put forward:

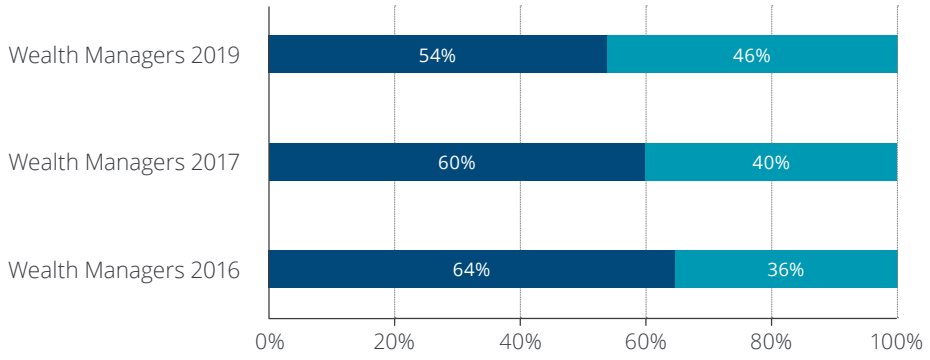
- **Ownership and provenance**
  Create a mandatory register and force greater transparency in relation to ownership and provenance. This will ensure greater transparency as regards who is the underlying buyer of the art (ownership provenance).
- **Access to more data sources**
  Increase the number of data sources: i.e., through access to primary market and private treaty sales.
- **More analytical tools**
  There is a need for an art market index benchmark that is publicly available; without such a benchmark it would be hard for art to become a true asset class.
- **Research endorsement**
  Research backed by big trusted brands, such as companies in the financial, legal, and insurance businesses.
- **Research methodology**
  More transparency around research methodology, plus greater clarity about the assumptions used.
- **Education and data literacy**
  Invest more resources in educating consumers and the art world about data and its limitations. With broader awareness of what data is and is not and what it can and cannot do, some of the current concerns might be addressed.
- **Standards and quality control**
  Establish a type of standardization/ rating agency like Moody's and S&P for the art world and the companies working within it. The potential need for a "certification" body in the art world is also raised by Justine Ferland, researcher at the University of Geneva's Art-Law Centre, attorney-at-law (Quebec, Canada), and member of RAM's Task Force and Sandrine Giroud, Partner with LALIVE, Switzerland, board member of the Art Law Foundation, and member of RAM's Task Force on p.244.

REGULATION:
Government vs self-regulation

Self-Regulation

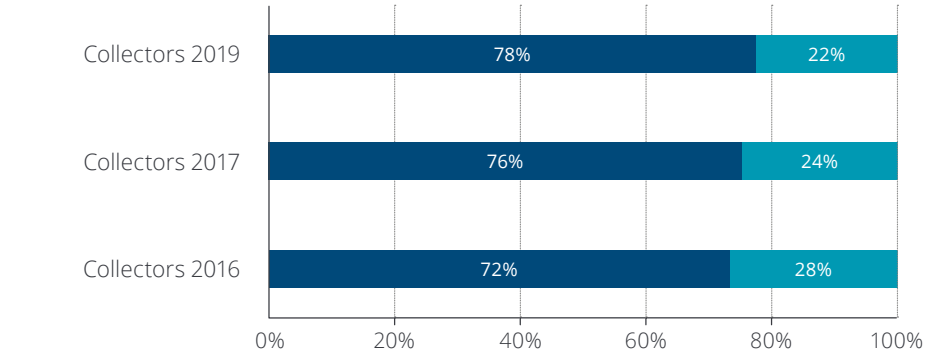
Government Regulation

Figure 52. Wealth managers: which regulatory approach do you favor when it comes to establishing trust and credibility in the art market?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



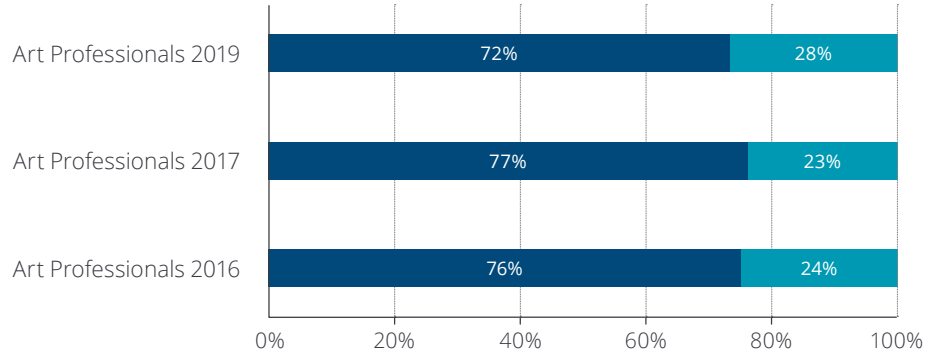
It is interesting to note that there has been a significant shift in perception among wealth managers about how to best regulate the art market. Whilst in 2017 60 percent of wealth managers said that they thought self-regulation would be the most appropriate way to regulate the art market, this has shifted this year to 54 percent of European wealth managers surveyed stating that they think the art market should face more government regulation and only 46 percent saying that self-regulation would be the right approach.

Figure 53. Collectors: which regulatory approach do you favor when it comes to establishing trust and credibility in the art market?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019



In contrast, US wealth managers favor a self-regulation approach, with 73 percent of those surveyed expressing this view. There has also been a slight increase among art professionals, 28 percent (up from 23 percent in 2017) of whom feel that government regulation might be a more appropriate approach to the art market. In the European context, this change in sentiment could be significant, as it could signal that the European wealth management industry thinks that the art market is not doing enough to change its current practices, and that self-regulation is hard to achieve in a globally fragmented art market.

Figure 54. Art professionals: which regulatory approach do you favor when it comes to establishing trust and credibility in the art market?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2019





From the series: "Comer del Arte Quiero" © Lina Sinisterra (2011)

It is interesting to note that there has been a significant shift in perception among wealth managers about how to best regulate the art market.

Part 2
REGULATION:
A focus on anti-money laundering efforts

In the context of the upcoming implementation of important regulations, notably in the field of money laundering, many market players have voiced their concerns in terms of understanding the new rules. In this section, passionate professionals from Deloitte's global network have teamed up to provide technical knowledge that readers will hopefully find instructive. Their contribution reflects the research they have carried out and aims to demystify certain beliefs so that art professionals can feel more confident in the runup to the entry into force of these regulations.

Our professionals have strived to gather insights on the following topics:

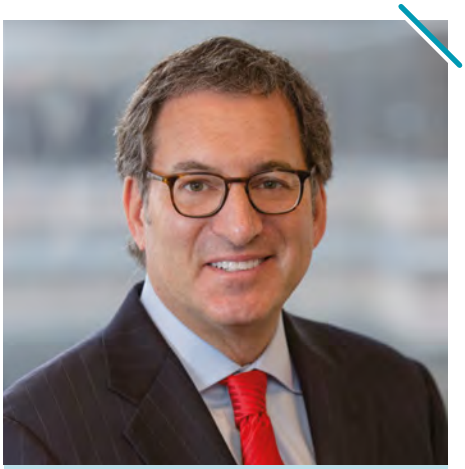
- Michael Shepard, Deloitte Global Financial Crime Leader has been interviewed to provide his view on the global trends in the fight against money laundering
- Our experts lay out the ground rules pertaining to EU anti-money laundering obligations and how they will potentially affect art traders and intermediaries
- Because anti-money laundering rules can be complex to understand, we provide an in-depth exploration of the concept of the ultimate beneficial owner. This is one of the most difficult concepts to fully comprehend under anti-money laundering rules. This concept will be illustrated by case studies
- We will also illustrate the thought process to be conducted when considering and responding to the EU regulation on the introduction and import of cultural goods
- Each local market has its own specific characteristics that make it more or less easy for local players to deal with regulations. We will consider:
  - France
  - United Kingdom
  - Netherlands
  - China (Mainland)
  - Switzerland
  - Russia

Additionally, we felt that it was important for market insiders to share their insights on regulation and its impact in their respective market segments:

- The diamond industry had to implement anti-money laundering regulations several years ago. In hindsight, how did it work and how could this experience benefit the art market?
- Market-led initiatives such as the Responsible Art Market initiative have been pioneers on the field of market self-regulation and we will share an update on their activities.
- The potential impact of these regulations on cultural institutions will be approached.
- Money laundering risks associated with freeports were raised by the EU commission several years ago. At the dawn of AMLD5 enforcement, it is understood that storage facilities as a whole will weigh in the balance when fighting money laundering and terrorist financing. Operators from the Luxembourg Freeport will explain how they dealt with stringent local regulations ahead of AMLD5.

Expert voices

INTERVIEW WITH MICHAEL SHEPARD, GLOBAL FINANCIAL CRIME LEADER, DELOITTE RISK AND FINANCIAL ADVISORY



Michael Shepard
Global Financial Crime Leader,
Risk and Financial Advisory
Deloitte Transactions and Business Analytics LLP

Hi Michael, you are the Global Financial Crime Leader at Deloitte. Could you please give us an overview of the global regulatory trends in the fight against financial crime? What trends affect the art market specifically?
Although general regulatory enforcement actions in the financial services industry appear to have slowed down somewhat, prosecutions, enforcement actions, and regulatory scrutiny around financial crime remain intense. In addition, regulators charged with anti-money laundering obligations are broadening their focus beyond the financial services sector in the fight against financial crime. In the US, for instance, we are seeing this happen in the real estate industry. The Financial Crimes Enforcement Network, which is the administrator of the Bank Secrecy Act, has issued Geographic Targeting Orders to obtain more data and information on real estate deals that do not involve loans from financial institutions. There is a lot of press coming out of British Columbia in Canada about money laundering in real estate. In the EU, regulators continue to be interested in gatekeepers (e.g., accountancy firms and lawyers) and their compliance with anti-money laundering laws. The scope of EU AML regulations is also being extended to include the art trade. The trend is to broaden the scope of industries required to help in the fight against financial crime and this is essential if we are serious about addressing the problem. Everyone has to be a player and we cannot solely rely on financial institutions to track money flows and report suspicious activity to law enforcement. The broader business community must take responsibility to prevent, detect, and mitigate the risks of financial crime.

Many art professionals do not believe it is their responsibility to implement anti-money laundering rules; instead, they argue that this should fall to banks and other financiers. What can we say to them?
Why should fighting financial crime be solely the banks' responsibility? Say a car dealer is selling an expensive vehicle to a drug dealer for cash. The car dealer may not deposit the money at a bank, or may do so in a manner that would not indicate that the



"Dad" - Series: Pervivencias © Lina Sinisterra (2011)

funds were the proceeds of crime. The car dealership must be held accountable for its knowledge of its customers just as a bank is in order to fight financial crime. The same is true in the art world. Dealers, auction houses, and other artwork traders should know their customer and understand the financial crime risks they pose. After gathering customer due diligence information, the art dealer should be able to identify any red flags that indicate possible suspicious activities or money laundering. Again, the fight against financial crime must be an industry-wide effort.

Additionally, a significant portion of art dealers say they do not have sufficient financial and human resources to implement these rules. How can they overcome these difficulties?

They are permitted to implement a financial crime risk management program. There is no one-size-fits-all approach. Such programs may differ depending on the size of the dealer, the countries they deal in, the types of customers they have, and the available distribution channels (e.g., face-to-face, online, telephone).

The key to developing a financial crime risk management program is to first conduct a money laundering risk assessment to determine the level of inherent risk faced across products and services offered, customers, geographies, and channels. From that, dealers can determine what controls are in place or need to be implemented to mitigate the identified risks. Regulators do not require art dealers to bankrupt themselves developing and implementing a risk-based program. For instance, in a smaller gallery, one person may have to perform multiple roles, including overseeing the program. This is actually similar to what we see in some of the smallest financial institutions. There are multiple ways to put such a program together but, as I said, I think that the key step is performing a financial crime risk assessment in advance.

AML efforts have been criticized on the basis that money laundering cases in the art market are rare and, as such, the whole industry is the wrong target. How can we explain this phenomenon?
To answer this question, I think it is important to understand some of the ways in which money is laundered in this industry. Art is comparable to a commodity, and as such it can be used in trade-based money laundering to transfer value to others or across borders. In this manner, proceeds of crime can be moved or transferred without using a bank to simply transfer funds that criminals know are monitored for suspicious activity. Here is an example of how art is used for trade-based money laundering: Criminal A sells an inexpensive piece of art to Criminal B but issues an invoice to B for US$1 million. B then wires US$1 million to A and both can then legitimize the money transfer using the invoice.

Furthermore, criminals typically enjoy luxury possessions, which can include artwork. This is why the EU has recognized that the art industry is exposed to money laundering risk. EU officials have not concluded that the art market is fraught or riddled with money laundering: they are simply saying that there is an existing financial crime risk that must be mitigated by the art industry itself.

Finally, there are some well-publicized cases involving art being used to launder the proceeds of white-collar crimes such as stock price manipulation. Basically, money laundering in the art market is designed to move the proceeds of crime away from their tainted source. Buying a piece of art and later selling it helps to mask the source of the proceeds and thereby legitimize them.

Do you foresee any benefits for art professionals once they comply with these rules?
The first benefit is that if there is a problem, the government and prosecutors generally look more favorably upon companies that have a financial crime risk mitigation program. If the company made good-faith efforts to mitigate risk by implementing the program and controls, prosecutors can better understand the one-off instance where maybe a rogue employee did something illegal.

Secondly, it is about being a good corporate citizen. If an art dealer is ever known for being complicit in money laundering—wittingly or unwittingly—it can have serious reputational repercussions. Based on my understanding, reputation and trust play a significant role in the art market and as such it is clearly beneficial to have a financial crime risk management program. Lastly, by meeting these obligations, art dealers may find themselves in a position to know their customers better. This may be helpful to dealers as they seek to market and sell additional products and services.

What lessons from other industries could be learnt and applied by art professionals as they tackle these regulatory challenges?
Art professionals should educate themselves on the applicable regulations and perhaps attend industry events for this purpose. It is important to understand the kinds of financial crime risk faced by the art trade, first from an industry perspective and then from the perspective of the individual company. It is not enough to say that there are no risks at all.

There are some examples of galleries being used for illicit purposes. Art professionals should read the literature about these publicized cases. I also suggest that they reach out to professionals who have had experience in performing financial crime risk assessments and developing and implementing risk-based AML programs in other industries. Art dealers may find it useful to leverage their prior experience as they seek to develop a risk-based program for their own company.

Again, it does not have to be expensive. Additionally, some of the procedures are likely to already be in place for certain art professionals or may just need to be enhanced.

Are there any technological trends that will disrupt the performance of AML/KYC obligations?
Technology is an enabler of both financial crime and financial crime risk management. It is just a matter of trying to stay one step ahead of the criminals. There is the potential that cloud technology can be used to enhance financial crime risk management controls, both to mitigate and detect financial crime. Now, as regards the art market, companies with more sophisticated technology will be in a position to leverage technology to fulfil their AML obligations. For example, every business is subject to certain economic trade sanctions depending on jurisdiction. If customer data is digital, technology is available that can be used for name and country screening instead of checking sanctions lists manually.

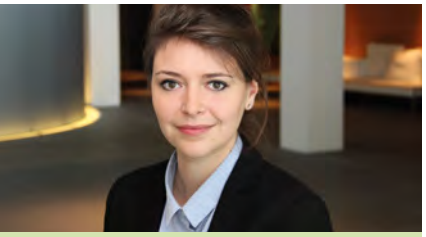
How do you think Deloitte can help to support art professionals facing these challenges?
Deloitte is a leading financial crime professional services firm and we can leverage our experiences with other industries that are subject to money laundering regulations. I see our role as being similar to what we do for financial services companies. On a global basis, we have extensive anti-money laundering subject-matter expertise and the capability to assist with risk assessments and the development of appropriate risk-based controls and training. We can assist with testing these controls when they have been running for some time. If there is a major issue, our forensic financial crime practice could then work with the art company's lawyers to perform forensic investigations. Thus, we have the experience and capability to assist with all aspects of financial crime risk management.



Expert voices



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Astrid Brandy
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ANTI-MONEY LAUNDERING OBLIGATIONS AND SOLUTIONS

By January 2020, all EU member states are due to transpose Directive 2018/843 (also referred to as the fifth anti-money laundering directive, or AMLD5) into national law. The first of its kind (Directive 91/308/EEC) was issued in 1991 and only covered financial and credit institutions.

The constant emergence of new money laundering schemes, coupled with the increasing terrorist threat, has prompted EU lawmakers to strengthen Anti-Money Laundering (AML) obligations and expand the scope of obliged entities: first to professions on the fringes of finance, such as accountancy and real estate, and now to the world of art.

To prepare themselves, buyers and sellers of artworks (e.g., dealers, galleries, and auction houses) and intermediaries must start familiarizing themselves with AML concepts and with the solutions available on the market that may help them to optimize their efforts to reach full compliance. To demystify AMLD5, this section provides a broad overview of the most significant AML obligations.

Background

Anti-money laundering rules are typically defined through a waterfall process. Global inter-governmental organizations such as the Financial Action Task Force (FATF) regularly issue guidance. In turn, this guidance is considered by governing bodies, such as the European Commission, which sets its own rules by means of directives. The FATF initially defined money laundering as the process of disguising the illegal origin of the proceeds of criminal activities and the definition has not changed much over time. However, it is important to note that with the fourth EU AML directive, the meaning of "criminal activities" was broadened to include tax crimes[71].

The recently introduced AMLD5 does not represent a radical departure from existing law; instead, it fine-tunes the principles set out in AMLD4. Whilst the fifth directive extends its scope to "*persons trading or acting as intermediaries in the trade of works of art, including when this is carried out by art galleries and auction houses, where the value of the transaction or a series of linked transactions amounts to EUR 10 000 or more*"[72], certain countries, including France and the Netherlands, proactively extended the rules to include art professions when enacting previous directives into national law.

In general, these directives require obliged entities to:

01. Adopt a risk-based approach

02. Perform customer due diligence

03. Monitor the business relationship

04. Implement an adequate governance and operating model

05. Cooperate with authorities

These obligations are often referred to as the "AML framework".

01. Risk-based approach

Concept

A risk-based approach consists, firstly, in identifying the sources of money-laundering/terrorist financing (ML/TF) risks within the organization and assessing these risks. The nature and frequency of processes to monitor each area of risk depend on the severity of the ML/TF risk in question.

The EU provides a non-exhaustive list of risk factors[73] that can be considered when rating each business relationship from a money-laundering risk standpoint. The risk level may vary according to:

- The types of customer considered, e.g., is the customer an individual, a company, a trust, etc., an existing or a new customer, well-known on the art market or not, politically exposed or not?
- The distribution channel used e.g., did the entity meet the customer face-to-face, at an art fair, through a web platform or intermediary?
- The types of goods and transaction in question e.g., is the origin of the artwork known and documented, what is its value, is the initiated transaction a sale, a loan, a donation, etc.?
- The countries involved e.g., is the customer domiciled in a country with equivalent AML/CTF laws, is the artwork coming from a country that is subject to trade sanctions, etc.?

An efficient AML framework must be tailored to each obliged entity.

What this means for art professionals

Art professionals will have to determine and assess which risk factors apply to their business holistically; this assessment will need to be performed on a regular basis. This risk assessment will serve as a reference grid against which each business relationship will be rated and monitored. Therefore, depending on the risk associated with the customer in question, the customer's AML/CTF risk will be classed as low, normal or high.

02. Customer due diligence

Concept

The scope of customer due diligence is to some extent discretionary, i.e., relying on the risk-based approach, the professional can decide which checks to perform and when. However, a few universal rules prevail when performing due diligence in relation to a customer:

- It must be performed as soon as the business relationship starts (i.e., prior to the conversion of a prospect into a client)
- It must be tailored to the customer's risk level, according to the risk-based approach discussed above
- It must be performed on an ongoing basis
- It must leave a documented audit trail

Hence, the information and documentation collected, as well as the nature and results of the checks carried out, must be documented. Evidence must be kept and stored until the end of the business relationship, and maybe for some time afterwards, according to the legal retention requirements in force locally.

71 *AMLD4, Directive (EU) 2015/849, chapter 1, Section 1, Article 3 § 4 (f) – each member state transposing the directive provides its own definition of "tax crimes".*

72 *AMLD5, Directive (EU) 2018/843, Article 1 §1 (i)*

73 *AMLD4, Directive (EU) 2018/843, annex III, amended by AMLD5, Directive (EU) 2018/843, Article 44*

What this means for art professionals
When entering into business relationships, professionals will need to attribute a risk score to the customer. This will determine the nature of initial due diligence checks. Professionals must carry out key due diligence checks to ensure that they know their customers and their beneficial owners[74]. These due diligence measures are also referred to as "know-your-customer" or KYC. Professionals must carry out the following KYC measures[75]:

- Identify the customer (legal name, date of birth/registration, legal address) and verify this identity (check documents such as passports or trade register extracts)
- Identify the beneficial owner of transactions
- Obtain and assess information about the purpose and intended nature of the business relationship
- Carry out appropriate risk-based procedures to determine whether the customer and/or its beneficial owner(s) is/are politically exposed persons (PEPs) and/or "listed" for another AML/CTF purpose[76]

Several situations can warrant the performance of enhanced due diligence checks. For instance, when dealing with a customer located in a high-risk[77] country, professionals must increase the number and timing of transaction checks and apply the following measures, obtaining additional information and/or document(s) on[78]:

- The customer and beneficial owner(s)
- The reasons for and intended nature of the business relationship
- The source of funds for the transaction and source of wealth of the customer and beneficial owner(s)
- Approval of senior management to accept or continue the business relationship

Local laws usually require professionals to use systems for the purposes of checking counterparties (individuals and legal entities) against sanction lists, watchlists, etc. This first line of defense is valuable not only at the inception of the business relationship, but also on an ongoing basis to prevent the reputational damage that a company could suffer if it does business with dubious counterparties.

03.
Monitoring of the business relationship

Concept
This obligation derives from the fact that customers' circumstances are likely to change during the course of the business relationship; they may potentially move house, or even change occupation for instance. Such changes may affect the customer's risk score and therefore the due diligence checks that must be carried out. For this reason, it is crucial to keep the customer's information up to date (along with the relevant documentation).

In addition to keeping the KYC files up to date, ongoing monitoring of the relationship relies on the automated identification of potential PEPs or sanctioned customers and beneficial owners (i.e., name screening), and the automated detection of forbidden or risky transactions.

Common pitfalls to exercising constant monitoring arise when the screening is not performed frequently enough (or against outdated watchlists). For example, the professional may realize that the customer became a PEP months ago leading to an obsolete risk score.

What it means for art professionals
Art professionals should maintain evidence of every interaction they have with their customer in order to identify changes in their customer's behavior or characteristics. Failure to do so can result in questions from regulators as to what the professional did to track any relevant changes affecting the customer's risk profile. Furthermore, obliged entities will need to exercise a thorough level of scrutiny over each transaction with their customers to determine whether it exhibits features that indicate a risk of money laundering or terrorist financing.

While there is a certain degree of leeway in the regulations in this regard, there are a few best practices available such as the Responsible Art Market (RAM) checklists. When carrying out a transaction with a customer, art professionals will now have to identify AML/CTF red flags such as:

- Does the transaction involve large volumes of cash?
- Is the transaction settled through several payments of small amounts?
- Does the trade involve jurisdictions with low AML/CTF standards?
- Is the rationale behind the transaction in line with the intended purpose of the business relationship with this customer?
- Are third parties involved?
- Potential red flags must be identified in the course of the entity's initial risk assessment and considered as part of the due diligence process.

74 In the art market, a "beneficial owner" is a natural person who ultimately owns or controls the customer and/or the natural person(s) on whose behalf a transaction or activity is being conducted. For more information on this topic, refer to the article "Ultimate beneficial owners and why you need to know about them" by Hajar Ouardi on page 221).

75 These are just a few examples and although EU directives set rules, local national laws can be more stringent than directives.

76 Under AMLD5, the EU specifically requires each member state to issue a list of precise public prominent functions qualifying a person as a PEP locally. For that matter, relatives and close associates of PEPs are treated as Politically Exposed Persons themselves.

77 The European Commission publishes and regularly maintains the list of high-risk countries, available at https://ec.europa.eu/info/policies/justice-and-fundamental-rights/criminal-justice/anti-money-laundering-and-counter-terrorist-financing/eu-policy-high-risk-third-countries_en

78 When dealing with a customer located in a high-risk country, one or more enhanced due diligence measures must be performed on top of these, based on guidelines provided by each respective member state.

04.
Adequate internal organization

Concept

The effective deployment of the AML risk management setup outlined above relies heavily on the design and implementation of adequate internal AML processes. Concretely, this set of requirements implies that obliged professionals will:

- Develop internal policies, controls, and procedures to monitor, document, and control all the steps and aspects of the AML process
- Appoint a compliance officer[79] at management level where appropriate with regard to the size and nature of the business
- Train their staff[80] to assess AML risk and ensure that staff have a good level of awareness so as to understand and spot money laundering risk indicia
- Keep track of the risks identified and any action that was taken in order to be able to respond diligently to authorities' enquiries

A key element of the setup lies in the professionals' ability to prove, at all times, that they have collected and recorded the necessary information and documents (via communications, identification documents, public sources, etc.), performed the appropriate level of due diligence, and effectively implemented the required controls. It is important to remember that if the authorities carry out an audit, any check that has not been documented is deemed to not have been performed at all.

What it means for art professionals

Art professionals will need to set up internal systems to ensure the appropriate level of monitoring. They will need to adjust their processes in light of AML requirements. Their whole AML framework will need to be documented in general policies and operational procedures whose implementation will need to be continuously monitored.

Members of staff involved in activities that give rise to AML risk will need regular training on the topic so that they are in a position to recognize operations that may or may not be related to money laundering or terrorist financing activities, and they will also need to record the relevant information and documentation at each step of the process.

Successful implementation of AML/CTF obligations will enable art professionals to detect and document suspicious activities.

05.
Cooperation with the authorities

Concept

Professionals who fall within the scope of AML/CTF regulations must cooperate fully with the authorities. This entails responding to requests for information from the competent authorities in a timely manner, as well as filing, without delay, suspicious activity/transaction reports to the Financial Intelligence Unit (FIU) on their own initiative. The right time to do so is when the professional knows, suspects or has reasonable grounds to infer that money laundering or terrorist financing has been committed, is being committed or is being/has been attempted.

What it means for art professionals

Successful implementation of AML/CTF obligations will enable art professionals to detect and document suspicious activities at the on-boarding stage or during the relationship. For instance, this may be the case if the actual source of the funds used for the transaction does not seem consistent with the information provided by the client or cannot be proven upon request, or if a client is reluctant to provide the requested information. These are just a few situations in which the authorities would need to be notified.

79 *AMLD4, Directive (EU) 2015/849, chapter 1, Section 1, Article 8 § 4 (a)*

80 *AMLD4, Directive (EU) 2015/849, chapter 6, Section 1, Article 46 § 1 – when transposing the Directive, the member state shall require that the obliged entities take measures proportionate to their risks, nature and size, including ongoing training programs, so that their employees are aware of the provisions adopted pursuant to the Directive.*

How can Deloitte help?

With the entry into force of AMLD5, art professionals are likely to find Deloitte's expertise and ready-made tools highly beneficial. These will evidently help professionals to rise to the challenge of understanding and ensuring compliance with AML/CTF regulations while building a cost-efficient, effective, and easily maintainable system.



Deloitte can help you to:

- Perform a company-wide risk assessment
- Embed your tailored risk assessment into an all-in-one KYC system: D.KYC



D.KYC is Deloitte's KYC solution covering the entire KYC value chain. It encompasses the onboarding process, automated risk scoring, document management, and name screening against sanction lists, PEP lists and adverse media lists. This solution is highly customizable and provides a user-friendly and streamlined way to fulfill KYC obligations.



Our solution helps you to perform review your KYC files on a regular basis and tells you when it is best to take a look and update risk levels. D.KYC also provides a document management system triggering alerts whenever a document is due to expire.

With the entry into force of AMLD5, art professionals are likely to find Deloitte's expertise and ready-made tools highly beneficial.



- Deloitte can provide AML consultancy services that help you to define the adequate target system, set up efficient processes and technologies, and devise tailor-made policies, procedures, control plans, and work materials in order to document and streamline the day-to-day delivery.
- In order to meet training requirements, generic and customized AML training sessions are delivered by our AML experts either in a classroom or online.
- D.KYC embeds a fully flexible workflow management engine, an extensive case management interface, and an exhaustive audit trail, which can be a key support to the implementation of the designed processes.

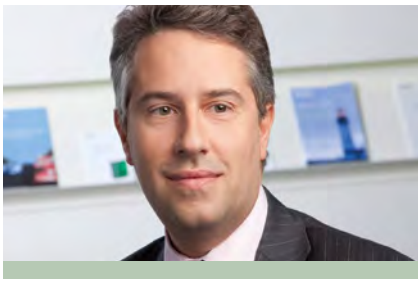


The transmission of the relevant information, either on the art professional's initiative or upon request form the authorities can be significantly eased by D.KYC embedded features such as the documentation of the due diligence performed and of the monitoring of the relationship within the D.KYC workflow management, case management interface, and audit trail.

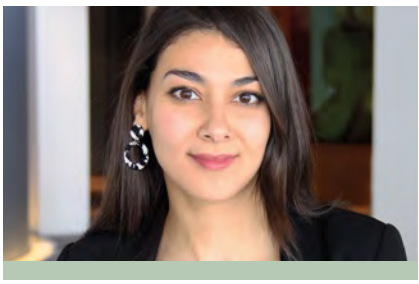


Expert voices

ULTIMATE BENEFICIAL OWNERS AND WHY YOU NEED TO KNOW ABOUT THEM



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In the context of combatting financial crime, EU anti-money laundering regulations entering into force in January 2020 establish an obligation for art dealers and intermediaries to identify the natural person who stands to benefit from the art transaction in question. This person is known as the "beneficial owner". Transactions in the art market typically involve one or more intermediaries; as a result, it can sometimes be difficult to distinguish the intermediary from the actual beneficiary of the transaction.

Art professionals classed as "obliged entities" under the new EU regulation (including auction houses, dealers, and galleries), must perform due diligence checks on all their clients and identify the ultimate beneficial owner(s) of each art transaction.

Definition of the term "beneficial owner"

A "beneficial owner" is the natural person(s) who ultimately own(s) or control(s) the customer, and/or the natural person(s) on whose behalf a transaction or activity is being conducted. As such, a legal entity cannot be identified as a beneficial owner.

The notion of control

Pursuant to this definition, the beneficial owner may be the person who ultimately "controls" the structure. In fact, there is a clear distinction between the concepts of "legal ownership" and "effective control". "Control" is a difficult concept to grasp in relation to the art trade.
A beneficial owner can exercise beneficial ownership or control over a company in numerous ways, both direct and indirect[81]:

- Direct control is exercised when a person owns a significant proportion of the shares or voting rights in a company[82]
- Indirect control covers control through other ownership arrangements

Specificities of non-face-to-face transactions

The phrase "non-face-to-face transactions" refers to business relationships that are conducted via the internet, telephone or similar technology[83]. In 2018, the online market grew by 9.8 percent, making it worth US$4.64 billion[84]. Each non-face-to-face transaction will need to be assessed by the art professional prior to execution. Non-face–to-face transactions typically entail a higher level of risk[85] in terms of the identification of the beneficial owner

81 A Beneficial ownership implementation Toolkit, OECD, March 2019

82 Percentages of direct/indirect interest may vary under the national laws of each member state

83 Basel Art Trade Anti-money laundering Principles, January 2018 (vi), page 8

84 Hiscox Online Art Trade Report 2019

85 FATF (2012), Interpretive Note to Recommendation 10

and enhanced due diligence processes may be required in certain circumstances.

In this context, deciding which due diligence processes to perform on the client and beneficial owner can pose challenges for art operators. The key risk is that certain types of platform and website allow anonymity as there are no checks on the buyer[86]. This makes the beneficial owner impossible to track. It also hinders the application of anti-money laundering regulations, especially in cases of transactions between private individuals. The risk lies in confirming the identity of the artwork's beneficial owner.

Identification and verification of the beneficial owner

To identify an individual, professionals require a range of fundamental and basic information: their name, date of birth, address, etc.

The identity of the beneficial owner must be verified through supporting evidence that demonstrates the person's supposed identity. The process for verifying the counterparty's identity will depend on the type of counterparty in question (whether they are a natural person, legal entity, trust, foundation, etc.).

If the counterparty is a natural person, the documentary evidence used for the purposes of verifying the beneficial owner's identity typically includes government-issued identity cards and passports. If the counterparty is a legal entity, documentary evidence includes extracts from the trade and companies register, articles of association, share registers, etc.

What happens when there is no beneficial owner

There may be cases where no natural person is identifiable as the beneficial owner who ultimately owns or exerts control over a legal entity. In such exceptional cases, the art professional, having exhausted all other means of identification, and provided that there are no grounds for suspicion, may consider the senior managing official(s) as the beneficial owner(s)[87].

What happens when there are multiple intermediaries

One of the characteristic features of an art transaction is that the beneficial owner is not necessarily the client of the art operator. The client is the person or entity with whom a contractual relationship is formed and refers to the buyer as well as the seller. The due diligence process should go beyond the basic information on the buyer and seller that would appear in any contract between them. It should cover any natural person who, as the ultimate beneficial owner, may operate through another natural person or a corporate structure as an intermediary.

This is vital in order to clarify whether the client is acting on its own behalf or as an agent. Intermediaries include art galleries, auction houses, art-secured lenders, logistics operators, and more. However, the legal framework does not provide a clear definition of the term "intermediaries", which is a significant legal omission.

The due diligence process should go beyond the basic information on the buyer and seller that would appear in any contract between them.

86 TRACFIN, Tendances et Analyses des risques de blanchiment de capitaux et de financement du terrorisme 2017-2018, page 72

87 AMLD4, Directive (EU) 2018/843, Article 3, (12)

Case studies

Case Study 1

Imagine that art operator A (an auction house) is making a sale to art operator B (an art gallery or professional art dealer), which is acting on behalf of a specific client who is a private collector (C). Who is subject to the anti-money laundering regulations?

As "persons trading or acting as intermediaries in the trade of works of art", both the auction house and art gallery/ professional art dealer must perform due diligence on the beneficial owner of the transaction.

Due diligence to be performed by art operator A: the auction house

- *Identification of the beneficial owner*
  The auction house (A) must identify the beneficial owner(s) of the transaction: the natural person(s) who will ultimately benefit from the transaction. Identification involves collecting the following information: name, address, date of birth, and nationality. In this case, it is the private collector (C).

- *Check on the role of the "client" in the transaction*
  The next step is to check the client's role in the transaction. The auction house must establish if the client is the principal owner, or a buyer/seller representing the client.

- *Establish a clear link between the client and the ultimate beneficial owner of the transaction*
  If the client is an agent, advisor or intermediary (as is the case here), the auction house must establish the link between the ultimate beneficial owner (C) and the intermediary (B) as the intermediary does not own the artwork.

- *Ascertain the role of the client*
  The auction house should check in what capacity that intermediary is acting and the extent of its authority to act on behalf of the beneficial owner.

- Check *for potential red flags in relation to the benef*icial owner and the transaction
  In order to complete its due diligence, the auction house must verify whether there are any red flags regarding the beneficial owner or the transaction. If red flags are detected, an enhanced due diligence process must be followed.

Due diligence to be performed by art operator B: the professional art dealer

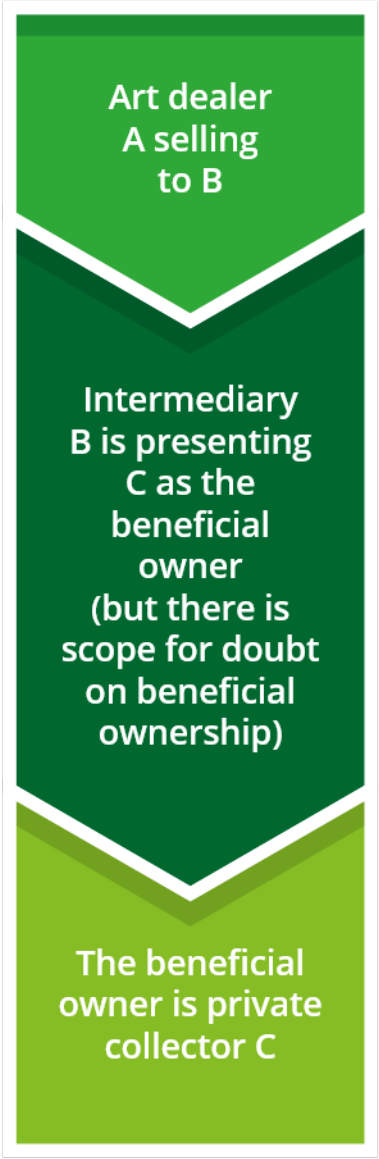
- *Identification of the beneficial owner*
  The intermediary (B) must also identify and verify the beneficial owner (C) of the transaction (as explained above).

In this situation, a key question should be asked: can operator A rely on the due diligence performed on the beneficial owner by art operator B as they are both obliged entities? As the art world is still in the process of implementing the regulation, there is no clear answer.

In fact, there are no decisive factors that can be used to confirm that the two obliged entities have an equivalent level of due diligence as regards anti-money laundering regulations.



If red flags are detected, an enhanced due diligence process must be followed.



Case Study 2

Imagine an art transaction involving an art dealer (A) that met an intermediary (B) who represents a potential client—presented as the beneficial owner (C) of the transaction. What due diligence checks should be carried out?

Firstly, the art dealer (A) must identify the client (in this case, intermediary B) and then identify the presented beneficial owner (C) as per the rules indicated above[88]. The key question to ask is whether the supposed beneficial owner is the true beneficial owner of the art transaction. In many cases, the intermediary is the true beneficial owner but they are relying on a "front man[89]" pretending to be the beneficial owner in order to avoid the due diligence process. A front man acts informally and usually has the same traits as the beneficial owner.

To prevent this type of situation, art dealer A must be careful and ensure that they fully understand the rationale behind the art transaction. The art dealer must check for the following red flags:

- The supposed beneficial owner has no involvement in the art world
- The supposed beneficial owner has no corroborating evidence to prove their ownership of the artwork
- The supposed beneficial owner is evasive or reluctant to provide adequate information relating to their identity or they provide information that appears to be false
- The supposed beneficial owner has no established and documented business relationship with the intermediary
- The price of the transaction is inconsistent with what is known about the buyer (lifestyle, assets, revenue, etc.)
- The beneficiary/account holder of the transaction cannot be verified

If such red flags are raised, art dealer A may suspect that intermediary B is the actual ultimate beneficial owner and must perform all the required due diligence focusing on B rather than C.

88 See the paragraph entitled "identification of the beneficial owner" in case study 1

89 The puppet master: How to corrupt use legal structures to hide stolen assets and what to do about it, Van Der Does de Willebois (2011)

Beneficial owner registry

The new EU AML/CTF Directive 2018/843 (AMLD5) was published on 19 June 2018 and entered into force on 9 July 2018 with effective application from 10 January 2020.

AMLD5 seeks to reduce criminals' ability to make use of existing legal loopholes. It does so by, in particular, increasing transparency as regards who really owns legal entities and trusts and the identity of the beneficial owner.

The key measures implemented by AMLD5 to improve transparency as regards the beneficial owners are as follows:

- BO registries of legal entities are publicly accessible for specific types of information gathered on the beneficial owner(s)
- BO registries of trusts and similar legal arrangements are now accessible to competent authorities, FIUs, and obliged entities in the context of their due diligence measures, and to any person who can demonstrate a legitimate interest (although the directive does not define "legitimate interest")

AMLD5 provides for the pooling of information among of all national registers (via the European Central Platform) to promote cooperation between EU member states.



Expert voices

SAFEGUARDING CULTURAL ARTIFACT

Shedding light on the EU regulation surrounding the introduction and the import of cultural goods.

On 7 June 2019, Regulation (EU) 2019/880 aimed at controlling the introduction of cultural goods into the EU was published in the Official Journal. This regulation was passed by the European Parliament for the purposes of fighting the illicit trade in cultural goods. A political agreement having now been reached at EU level, the regulation is ready for implementation and shall be fully operational by mid-2025 at the latest.

Art professionals (mainly antiquities dealers) have expressed concern that the new regulation may present a significant administrative burden that could harm their legitimate business activities. The European Commission is expected to set out further details regarding the practical application of the regulation. The principles guiding the introduction and import of cultural goods into the EU have been laid down in the regulation. It is thus the right time to take a look at these principles, which will soon shape the rationale behind how non-EU antiquities are traded in the EU.

The new regulation starts from the fundamental premise that the introduction of cultural goods into the EU that have been removed from the territory of the country in which they were created or discovered in breach of the laws and regulations of that country should be prohibited. Compliance requirements are imposed to ensure that adherence to these laws and regulations is verified.

Compliance requirements

To import a non-EU cultural good listed in the regulation, the importer will have to provide an import license or an importer statement. In exceptional cases, or for specific cultural goods, no additional compliance requirements will be imposed on the importer. This future enhanced administrative importation process will have an impact on the introduction of goods into the EU. Nonetheless, the compliance requirements under the new regulation are not all-encompassing. Other rules and regulations may apply (e.g., AML and CITES).



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Compliance requirements relating to the introduction and importation of cultural goods will affect trade flows in cultural goods. Non-compliance with the requirements of the cultural goods regulation may have a profound impact on the import process because customs authorities may stop goods at border checkpoints. Fines and other penalties (imprisonment, permit revocation, etc.) will be imposed in the event of non-compliance, but these differ between the various Member States.

The applicability of the cultural goods regulation depends on two factors:

- The nature of the good itself, including its value and age
- The import purpose

The nature of the good

The nature of the goods falling within the scope of this regulation is clearly defined in Part A of the Annex:

A. rare collections and specimens of fauna, flora, minerals and anatomy, and objects of paleontological interest;
B. property relating to history, including the history of science and technology and military and social history, to the life of national leaders, thinkers, scientists and artists and to events of national importance;
C. products of archaeological excavations (including regular and clandestine) or of archaeological discoveries on land or underwater;
D. elements of artistic or historical monuments or archaeological sites which have been dismembered;
E. antiquities more than one hundred years old, such as inscriptions, coins and engraved seals;
F. objects of ethnological interest;
G. objects of artistic interest, such as:
    i. Pictures, paintings and drawings produced entirely by hand on any support and in any material (excluding industrial designs and manufactured articles decorated by hand);
    ii. Original works of statuary art and sculpture in any material;
    iii. Original engravings, prints and lithographs;
    iv. Original artistic assemblages and montages in any material;
H. Rare manuscripts and incunabula;
I. Old books, documents and publications of special interest (historical, artistic, scientific, literary, etc.) singly or in collections;
J. Postage, revenue and similar stamps, singly or in collections;
K. Archives, including sound, photographic and cinematographic archives;
L. Articles of furniture more than one hundred years old and old musical instruments.

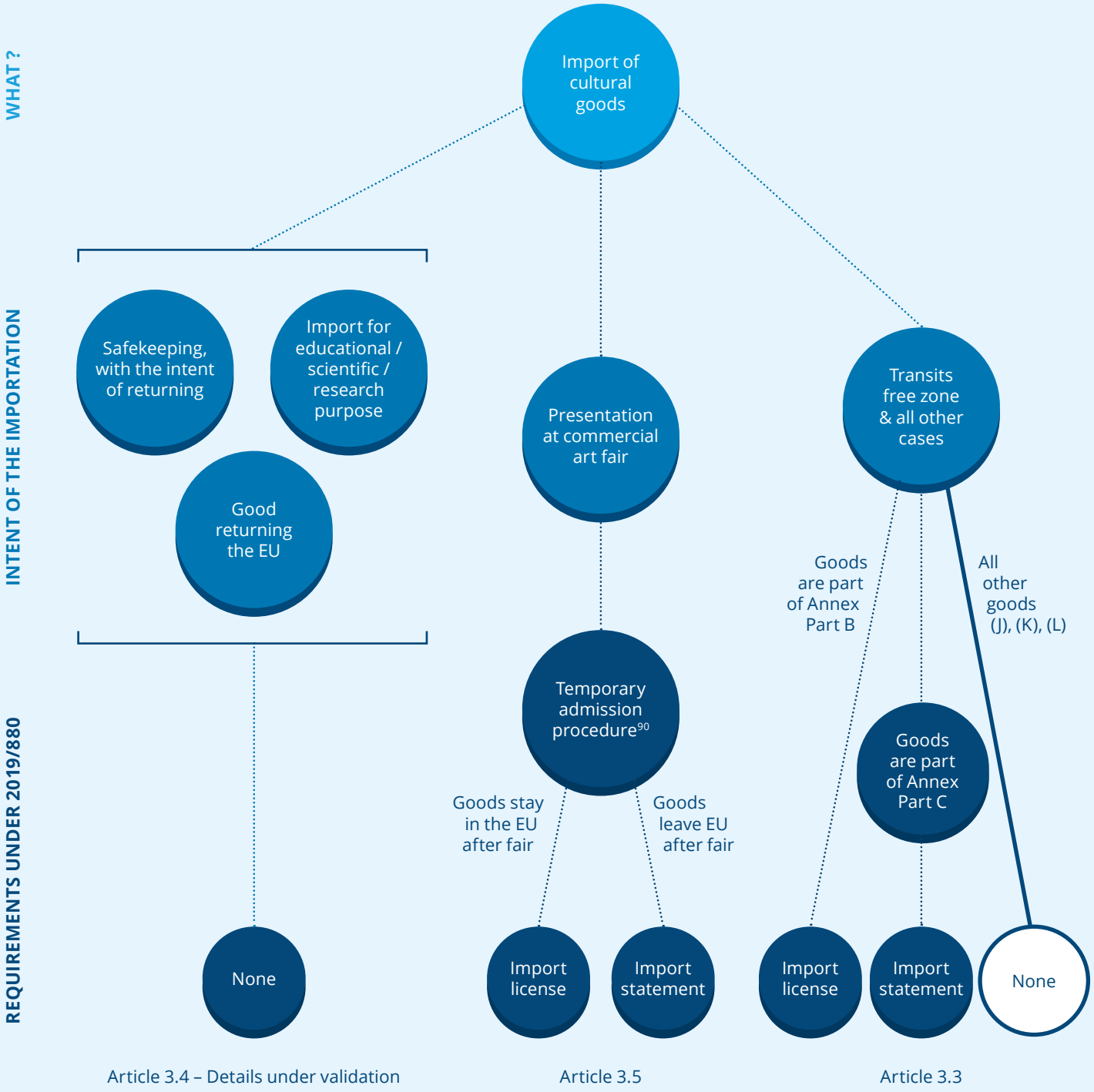
This list is then segregated into two sub lists, which will affect the decision-making process:

- If the goods are in category (c) or (d) and are greater than 250 years old, then they are on list A
- If the goods are in any other category, exclusive of (j), (k), (l), and both greater than 200 years old and €18,000 in value, then they are part of list B

The import purpose

Whereas the regulation conceptually applies to cultural goods that are defined in the regulation, the compliance requirements differ depending on the nature of the goods and the purpose of the import. Conceptually, the purpose of the import may be illustrated by the chart on the right :

The new regulation stems from the fundamental premise that the introduction of cultural goods into the EU that have been removed from the territory of the country in which they were created or discovered in breach of the laws and regulations of that country should be prohibited.



Who needs to provide an import license/statement?
As illustrated in the figure, in some instances, the regulation requires the "holder of the goods" to present an import license or an import statement. This term is defined by the EU customs code (Regulation (EU) 952/2013) as follows: "the person who is the owner of the goods or who has a similar right of disposal over them or who has physical control of them" (Art. 5, §34).

Where to apply for an import license?
Whilst the details of the electronic import license application procedure still need to be outlined in implementing acts, it is worth knowing where it needs to be obtained. Article 4, §1&2 of the proposed regulation indicates that the holder of the goods should submit the application to the customs authorities of the Member State that serves as the EU entry point. Once the importation is complete, the item can be moved to another Member State without the need to request a new license.

90 As laid out in Article 250 of Regulation (EU) 952/2013



Expert voices

THE FIFTH ANTI-MONEY LAUNDERING DIRECTIVE: A EUROPEAN EVOLUTION, NOT REVOLUTION, FOR ART MARKET PROFESSIONALS IN FRANCE



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Art market professionals in France have been subject to Anti-Money Laundering (AML) regulations since 2001. As such, the obligations imposed by AMLD5 are not new for professionals operating in the fourth-largest art market in the world[91]. However, as the art market comes under increased scrutiny, notably as regards the evaluation of France's compliance with global standards, art market professionals are pointing to the unique challenges they face in complying with AML obligations and the potential impact of these obligations on France's competitiveness.

In France, art market professionals are represented by the French National Council of the Art Market (*Conseil National du Marché de l'Art*, or CNMA), an apex body comprising professional associations of antiques dealers, art galleries, and auction houses, among others. In January 2019, the CNMA wrote to the president of the French Republic to draw attention to, inter alia, growing regulatory complexity and the cost of compliance. This letter was written in the context of Brexit uncertainty, including the prospect that the United Kingdom could potentially free itself from certain European obligations. The letter also addressed a number of related topics, including proposals to apply import checks on cultural property and amendments to the VAT directive. Echoing the frustrations of entities large and small facing new obligations, the CNMA drew attention to the growing burden of compliance for an art market that is composed of small firms (i.e., often with fewer than five employees) as well as the singularity of the art market, where trust and discretion are watchwords. Clinical requirements to verify the identity of customers, their source of funds and wealth, and to report suspicious transactions, introduce friction in an already delicate sales process.

Deloitte welcomed the opportunity to share best practice and perspectives on financial crime compliance with the CNMA and its members in June 2019 in the offices of Beaux Arts & Cie. The exchange drew on our experience assisting non-bank financial institutions as well as non-financial businesses to strengthen their compliance programs. Among the trends highlighted was the growing regulatory acceptance of collaborative arrangements to manage AML obligations more efficiently and effectively. Such arrangements, including pooling staff, technology, or other resources, could be especially relevant to art market professionals, providing operational efficiencies as well as increased risk intelligence.

Deloitte will be conducting a survey of French art market participants to gauge their level of compliance with AML regulations and operational challenges. The results of this survey are expected to support industry bodies in their continued engagements with the Directorate General of Customs and Indirect Taxes (i.e., the sectoral regulator), in particular, as regards the development of practical guidelines for art market professionals as well as high-value dealers. The findings will also inform the development of Deloitte's Art & Finance offerings in France from ongoing compliance training to forensic and business intelligence services and managed services.

91 Art Basel and UBS 2019 Art Market Report

Case study

How Deloitte Netherlands interacts with the art community to comply with **the fifth AML directive**



Duco Wildeboer
Senior Manager, Financial Advisory
IPO & Governance Services
Deloitte Netherlands

A short series of articles in Dutch newspaper *NRC Handelsblad* in April 2018 alerted the wider audience to a fundamental change in the traditional and highly confidential art market: the introduction of the fifth EU Anti-Money Laundering Directive. From January 2020, the art trade will be obliged to perform a customer due diligence investigation (CDD) ahead of transactions. This new process represents a steep change for a discreet trade that relies on trust, business cards, and a handshake. Performing CDD ahead of the transaction and asking for a customer's source of wealth (among other details) will be something of a shock to the art community.

The Netherlands art trade and Paris-based CINOA expressed surprise and said that they were not consulted and certainly not in agreement with the reasoning behind the inclusion of the art trade in the fifth EU AMLD. The EU Parliament shrugged off both arguments; sleeping lobbyists and some high-profile cases of tax evasion were mentioned.

As part of the Deloitte Art & Finance initiative, we took it upon ourselves to provide the art trade in the Netherlands with further information by organizing the first mini-seminar on this subject together with the Ministry of Finance in November 2018. The date was chosen to coincide with the PAN Amsterdam Art Fair and was held only one metro stop away from the RAI in Deloitte's Edge building. Paul van Gelderen (Manager Tax, Private Clients) and Duco Wildeboer (Senior Manager, Financial Advisory) from our Amsterdam office introduced the subject and Adrien Chiariello from our Luxembourg office presented the solution designed for the art trade: DKYC. This seminar, the first of its kind in the Netherlands, was followed up by two further conferences organized by Russell Advocaten in Amstelveen and were aimed at art trade professionals. Duco Wildeboer led the audience into the matter and suggested our DKYC tool as the solution to the administrative burden. Clients can choose from a variety of solutions, from simple screening to a fully serviced platform. The three events brought together over 80 Dutch art dealers, gallerists, lobbyists, and auctioneers.

Following our efforts to educate the trade, the TEFAF Maastricht organization invited Mrs. Karin de Jong, partner Risk Advisory in our Amsterdam office, to be a panelist at the dealer's seminar held in the run-up to the opening of TEFAF 2019. Close to 90 international art dealers and exhibitors attended this session.

In addition to reaching out to TEFAF/PAN, we engaged with organizations such as the KVHOK, the Dutch Gallery Association, and the Dutch Federation of Valuers, Real Estate Agents and Auctioneers and offered our assistance in setting up the Deloitte KYC solution at branch organization level. Compliance with and enforcement of the earlier AML directives have been fairly relaxed in the Netherlands and the competent authorities have not yet published their approach to the matter. Recent inquiries with some Dutch auction houses have, however, sparked enthusiasm for enhancing their existing extensive CDD practices.

Deloitte's most recent effort was a speaking engagement at the first International PAIAM Conference outside the UK/US. PAIAM (Professional Advisors in the International Art Market) is an organization with over 250 vetted members from Europe and the Americas. Craig Davies (Rawlinson-Hunter UK) and Duco Wildeboer introduced the subject from both a UK and a Continental EU perspective, and Duco presented the DKYC solution that has been developed leveraging our experience in KYC/CDD for international banks.

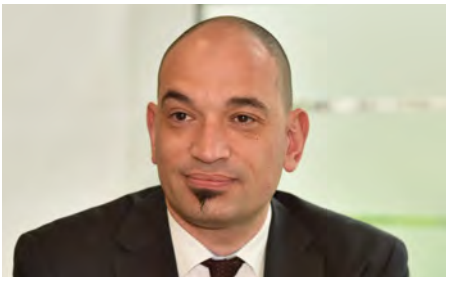
Deloitte will continue its commitment to assisting the art community with solutions like DKYC and has also developed blockchain solutions to help smaller companies cope with their administrative burdens.



Expert voices

TRANSPOSITION OF THE FIFTH ANTI-MONEY LAUNDERING DIRECTIVE INTO UK LAW: LEGISLATIVE AND PRACTICAL CHALLENGES







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The UK art market is currently the second largest globally, accounting for 21 percent of global sales after the US (44 percent), and before China (19 percent)[92]. Key to maintaining investor confidence and eminence in the market, as for any asset class, is a robust legal framework protecting it against illicit activity.

From January 2020, the UK art market will be subject to tighter anti-money laundering (AML) regulations as a result of a new European Union directive, the fifth anti-money laundering directive (AMLD 5)[93]. The new directive was issued in response to, among other things, the vast financial dealings uncovered by the "Panama Papers"[94]: a leak of 11.5 million files from the Panamanian law firm Mossack Fonseca, which exposed the use of offshore companies by some of the world's most prominent figures to hide their wealth, evade taxes, and commit fraud.

Whilst few art-related money laundering cases have been brought as a result of the Panama Papers, the documents reveal how true ownership of artwork can be hidden behind a veil of offshore shell companies[95]. A lack of transparency with regard to beneficial ownership, together with art's transportability, high value, and inconsistent and seemingly arbitrary pricing mechanisms[96], may have

92 *The Art Market 2019 – An Art Basel and UBS Report (https://www.artbasel.com/news/art-market-report), pg. 37 – fig. 1.4*

93 *European Parliament and Council Directive (EU) 2018/843 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (2018), Official Journal of the European Union, L156*

94 *http://europa.eu/rapid/press-release_STATEMENT-18-3429_en.htm*

95 *https://www.nytimes.com/2016/04/12/arts/design/what-the-panama-papers-reveal-about-the-art-market.html*

96 *Shea, A., 2018, "Shooting Fish in A Bliss Bucket: Targeting Money Launderers in the Art Market", Columbia Journal of Law & The Arts, Vol. 41, no.4, pg. 667*

Art's transportability, high value, and inconsistent and seemingly arbitrary pricing mechanisms, may have led authorities to conclude that art is, or has the potential to be, used as an asset to evade taxes and launder money.

led authorities to conclude that art is, or has the potential to be, used as an asset to evade taxes and launder money[97]. This hypothesis is currently being tested by US authorities who have seized art, including a Monet, Picasso, and Basquiat, as part of an operation to forfeit assets allegedly purchased in an effort to launder funds misappropriated from Malaysia's 1Malaysia Development Berhad fund.

The new requirements will pose operational and commercial challenges for art dealers and intermediaries who must establish the infrastructure required to conduct customer due diligence (CDD) and report suspicious transactions. Industry groups such as The British Art Market Federation have voiced concerns around the introduction of AMLD 5, especially for smaller art businesses[98]. In this article, we explore some of the practical and legislative challenges posed by the new directive.

97 *https://www.law.com/newyorklawjournal/2019/03/29/art-market-may-be-asked-to-reveal-whats-behind-the-curtain-with-proposed-legislation/*

98 *https://www.artatlaw.com/archives/new-anti-money-laundering-regulations-target-art-market*

99 *whether the transaction is carried out in a single operation or in several operations which appear to be linked*

100 *UK Government (2019) "Transposition of the Fifth Money Laundering Directive: Consultation", London: HM Treasury, pg.22*

101 *Value Added Tax Act 1994, s.21. Available at: http://www.legislation.gov.uk/ukpga/1994/23/section/21*

Current UK regulations

Under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (Money Laundering Regulations), individuals or entities in the art market are only required to register with Her Majesty's Revenue and Customs (HMRC) for AML purposes if they fall under the definition of a high value dealer: "*persons trading in goods to the extent that payments are made or received in cash in an amount of EUR 10 000 or more*"[99]. Therefore, art dealers in the UK can avoid the obligations under the Money Laundering Regulations if a customer pays for goods worth €10,000 or more through non-cash payment methods. For example, an art dealer would be exempt from conducting CDD if a customer paid €9,999 in cash and the remainder via electronic bank transfer.

Future regulations

AMLD 5 was published on 19 June 2018 and must be transposed into national law by 10 January 2020. For the art market, the new legislation represents a significant departure from the previous regulatory regime. It explicitly names the art market in the list of obliged entities that must comply with the directive. Art dealers and intermediaries involved in the trade of works of art, including art galleries and auction houses, will have to perform CDD in relation to transactions, or a series of linked transactions, amounting to €10,000 or more regardless of the means of payment. They will also have to report suspicious transactions to the local Financial Intelligence Unit. Furthermore, free ports, an area within a customs territory where import duties and taxes do not apply to the goods introduced, and free port operators will also become obliged entities.

Challenges for the UK market

Regardless of whether the UK leaves the EU, all indications suggest that the UK government will implement AMLD 5. On 15 April 2019, it published a consultation paper that highlights a number of legislative challenges involved in implementing the requirements of AMLD 5. Two broad categories are identified:
01. definition of terms outlined in AMLD 5
02. practical challenges.

With regards to defined terms, the consultation paper identifies the following challenges:

01. Businesses falling within the scope of the term "art intermediaries" need to be defined. "A person or company that buys and sells works of art by way of business", such as a gallery owner, private dealer or auctioneer, is generally understood to be included in the term "art intermediaries". However, it is unclear whether businesses that are not involved in making or receiving the payment, such as art curators, consultants or specialists in art storage and shipment, would also fall within the scope[100]. If these entities do fall within the scope, the party on whom the intermediary must carry out CDD—buyer, seller or both—will also need to be clarified.

02. Clarification around the term "works of art" also needs to be provided. Within existing legislation, there are a number of definitions; for example, the VAT Act 1994 describes works of art as objects that can be executed entirely by hand and do not encompass antiques or collectors' items[101]. The paper questions whether the art industry can agree on a single definition, such as the one above, and whether it is suitable for AML purposes.



Comer del Arte Quiero © Lina Sinisterra (2010)

03. The paper queries how free ports should be defined in UK money laundering legislation given that none currently operate within the UK. Customs warehouses, which offer the same advantages as free ports, may also need to be included. A paper published in October 2018 by the European Parliament on money laundering and tax evasion risks in free ports suggests that the common advantages of tax-deferral and secrecy offered by both free ports and customs warehouses result in similar AML and tax evasion risk[102].

With regards to practical challenges, the consultation paper considers the following:

01. The challenges around timing of CDD for art intermediaries (described above) that are acting in relation to a transaction worth €10,000 or more but not executing the transaction themselves. CDD should be conducted prior to exchange of funds; however, the intermediary may not be privy to the exact date of the transaction or have time to complete CDD prior to the transaction taking place. Timing of CDD is particularly challenging for auction houses as the sale may conclude before the buyer's identity is known. The government posits that, as a result, art intermediaries may be required to conduct CDD on all potential buyers and sellers, in cases where there is a realistic possibility that the final price of one artwork will be above €10,000. However, the government acknowledges difficulties connected to the variable pricing of works of art, where two similar pieces can fetch hugely different sums. CDD carried out on the basis of estimated value may pose greater administrative and commercial challenges, particularly to smaller industry operators.

02. Finally, there are challenges in determining what constitutes a series of linked transactions equivalent to €10,000. The government points to the definition contained in HMRC's guidance for high-value dealers as a potential approach: "multiple… payments against a single invoice, which together exceed the EUR 10,000 threshold, regardless of how long it takes to make the payment"[103]. If adopted, this will require art intermediaries to establish a transaction monitoring system that sends an alert when the total sum of multiple payments reaches the €10,000 threshold.

Conclusion

While the outcome of the UK Government's consultation on the implementation of AMLD 5 is imminent and expected to resolve some of the legislative challenges outlined above, art dealers and intermediaries must nevertheless prepare to adopt a risk-based approach to managing the money laundering risk associated with transactions and customer relationships.

A risk-based approach will entail drafting and implementation of policies and procedures which address: 1) enterprise-wide risk assessments; 2) customer risk assessments; 3) customer due diligence; 4) ongoing monitoring; 5) screening; and 6) reporting suspicious activity and maintaining records. Furthermore, staff will require AML training to ensure the effective embedding of these controls. For more information on this topic, refer to "Anti-Money Laundering Obligations and Solutions" on p.216. While larger businesses are more likely to have funds enabling them to adapt to the new requirements, smaller businesses may find compliance a significant burden on their operations and finances.

102 European Parliament, 2018, "Money Laundering and Tax Evasion Risks in Free Ports", Brussels: European Parliamentary Research Service, p.13

103 HMRC. (2010). Anti-money laundering supervision: guidance for high value dealers, p.22. - Available at: https://www.gov.uk/government/publications/anti-money-laundering-guidance-for-high-value-dealers

While larger businesses are more likely to have funds enabling them to adapt to the new requirements, smaller businesses may find compliance a significant burden on their operations and finances.



Expert voices

ANALYSIS OF ANTI-MONEY LAUNDERING FOR ART TRADE IN CHINA



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In the spring of 2019, the second plenary meeting of the Financial Action Task Force (FATF) evaluated and adopted the Mutual Evaluation Report on Anti-money Laundering and Counter-terrorist Financing (AML/CFT) System of the People's Republic of China (China). The report commented that China has established a multi-dimensional national ML/TF risk assessment framework and is operating the Joint Inter-ministerial Conference for AML effectively, specifically for the Financial Institutions (FI) and non-bank payment institutions. However, it also pointed out that China's AML supervision of Designated Non-Financial Businesses and Professions (DNFBP) called for a strengthening of the risk assessment and compliance standard of DNFBPs.

At the 6th China Anti-Money Laundering Summit Forum held in December 2016, the Deputy Governor of the People's Bank of China (PBC) mentioned that while AML compliance has generally developed in the financial industry, money laundering activities in China have begun to penetrate the DNFBPs sector.

Globally as well, high-value goods dealing (including the sale of real estate, precious metals trading, art auctioning and pawn stores) has been highlighted as a higher risk sector in a number of FATF mutual evaluation reports.
For example:

01. The Portugal Fourth Round FATF ME Report pointed out the high-value goods dealers of the jurisdiction should enhance their AML/CFT work participation.
02. The Austria Fourth Round FATF ME Follow-up Report issued in 2018 pointed out there had been no requirement for high-value goods dealers in the jurisdictions to identify the customer identity of legal persons and arrangements.

Some of the key features of this industry that have made it susceptible to money laundering (not just in China, but globally) include (non-exhaustive):

01. No transparency in the price of artwork, as there is no authoritative institution or evaluation standard to determine the value of art
02. Difficulty in determining the authenticity of cultural relics
03. Lack of transparency in the end to end transaction owing to the very nature of the auction rules, which protect the privacy and identity of both buyer and seller
04. The broader concept of 'money' in the art trading industry (traveler's checks, bank drafts, securities, jewelry, antiques, real estate, and so on).

New business models have developed, including art finance, online art trading and art shares trading, which have attracted a number of social funds.

With the growth of China's economy in recent years, art trade has ushered in a phase of prosperous development. In this regard, China has taken active measures to strengthen the AML/CFT framework specifically focused on this sector.

One of the priorities for the Chinese presidency for the FATF includes developing best practices for fighting the laundering of money via illegal trafficking in wildlife[104]. A practical example is the recent case in which a record 8.8 tons of ivory were seized by Singaporean customs owing to accurate intelligence provided by Chinese customs. The director of Nanning Customs was said to have remarked that the case was the first joint cross-border crackdown by the customs of China and

104 Objectives for FATF – XXXI (2019-2020)
https://www.fatf-gafi.org/media/fatf/content/images/Objectives-FATF-XXXI(2019-2020).pdf

New business models have developed, including art finance, online art trading and art shares trading, which have attracted a number of social funds.

Singapore through international law enforcement cooperation, which wiped out the transnational smuggling network[105].

Additionally, the Notice of the General Office of the People's Bank of China on Strengthening the AML Supervision Work on DNFBPs (No. 120 [2018] of the General Office of the PBC, or the Notice) published in July 2018 stressed that DNFBPs should abide by the laws and regulations and should work to mitigate AML/CFT risks.

The Ministry of Culture of China has also issued the Administrative Measures for Operation of Art Businesses (No. 56 of the Order of the Ministry of Culture, or the Measures). These Measures clearly define the objects under administration, have facilitated an industry census and have prohibited the operation of art businesses for the purpose of raising funds or by means of illegal pyramid selling. The Measures define a number of prohibitions including trading artworks from illegal sources, impersonating others, and trading artworks made from animals and plants that are prohibited from trading.

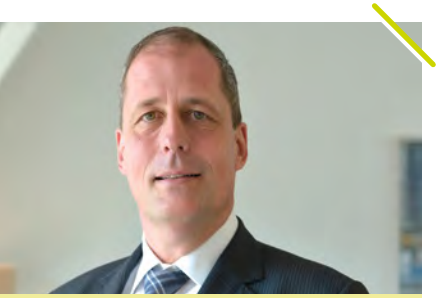
The Basel Institute on Governance also recently published the Basel Art Trade AML Principle (the Principle). The Principle clearly defines the AML standard for art dealers: the use of a risk-based approach to address three major types of risks; i.e. customer identification, the source of artworks, and the source of funds for buyers involved in the transaction.

Some best practices to consider when implementing such an approach include:

01. Providing regular training for employees covering their roles and responsibilities in preventing, detecting and reporting suspicious transactions, as well as the process of escalating such suspicious transactions
02. Identifying and verifying the source of artworks, establishing a process to ascertain the authenticity of artworks and ensuring that sufficient, legitimate instructions are provided for selling the artworks
03. When confirming the source of funds, defining policies on the countries from which payments are accepted (for example, those that have taken reasonable measures to implement AML/CFT and anti-tax evasion controls, financial institutions with good reputation, etc.)
04. Implementing controls on third party payments and high-value transactions that use cash
05. Defining typical red flags and establishing escalation protocols for transactions which display such characteristics–for example, unwillingness to provide sufficient information about customer identity or assets; payment by cash, anonymous credit card or stored value card; intentionally targeting for sales by reducing or raising prices; providing multiple low-value cash payments; if an entity used for purchasing or selling artwork has a complex structure; close connections with politically exposed persons/persons who are known (or said) to have been subjected to criminal or regulatory investigation, prosecution or conviction; and residing or operating in high-risk jurisdictions
06. Defining records retention requirements.

In summary, the current AML control framework in China's art market is improving, and efforts to further define policy and regulations in this sector are ongoing.

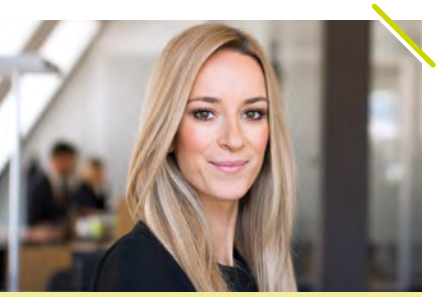
105 XinhuaNet - http://www.xinhuanet.com/english/2019-07/23/c_138251392.htm



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Expert voices

MONEY LAUNDERING IN ARTS, A SWISS PERSPECTIVE

Legal framework

Like everybody else in Switzerland, art dealers fall under the scope of the general criminal law provision of Art. 305bis of the Swiss Criminal Code (SCC)[106], which defines money laundering as a criminal offence. Furthermore, the Swiss Anti-Money Laundering Act[107] (AMLA) applies to, inter alia, natural persons and legal entities that deal in goods commercially and in doing so accept cash (i.e., dealers)[108]. Art dealers who meet this definition and accept more than 100,000 Swiss francs in cash—even in instalments—in the course of a commercial transaction must (1) verify the identity of the customer, (2) establish the identity of the beneficial owner, and (3) keep records. They are exempt from these requirements if payments are made through a financial intermediary (e.g., a bank)[109]. Where a transaction appears suspicious, they must immediately file a suspicious activity report (SAR) with the Swiss Money Laundering Reporting Office (MROS)[110], and the Swiss Financial Intelligence Unit (FIU). Art dealers covered by the AMLA must also appoint an auditor to verify their compliance with the specific requirements and file a SAR with the MROS if there are reasonable grounds for suspicion[111]. Apart from that, they are not subject to any specific supervision.

Under the Cultural Property Transfer Act, art dealers are required to establish the identity of sellers and request a declaration in writing confirming their right to dispose of the cultural property[112]. If an art dealer fails to fulfil this duty and in doing so accepts compensation from an illegitimate source, they could possibly be guilty of committing money laundering under the SCC.

Since the introduction of dealers' reporting requirements in 2016, the MROS has not received any SARs for the art dealer category[113]. However, the number of SARs filed by financial intermediaries that in some way involve art dealing is noteworthy, for example (1) the renowned painting at the center of an advanced fee scam[114], (2) the art dealing case

106 Swiss Criminal Code of 21 December 1937 (status as of 1 March 2019).

107 Federal Act on Combating Money Laundering and Terrorist Financing of 10 October 1997 (status as of 1 January 2019).

108 Art. 2 (1) (b) AMLA.

109 Art. 8a AMLA.

110 Art. 9 (1bis) AMLA.

111 Art. 15 AMLA. Further details are provided the Federal Ordinance on Combating Money Laundering and Terrorist Financing of 11 November 2015 (status as of 1 January 2016).

112 Federal Act on International Transfer of Cultural Property of 20 June 2003 (in accordance with the UNESCO Convention of 14 November 1970), Art. 16.

113 MROS, Annual Report 2018, April 2019.

114 See: https://www.fedpol.admin.ch/dam/data/fedpol/kriminalitaet/geldwaescherei/jabe/jb-mros-2016-e.pdf (para. 3.17).

involving an alleged sale of a painting by Marc Chagall[115], and (3) works of art and a criminal organization case[116].

FATF Mutual Evaluation Report

The FATF noted in its 2016 Mutual Evaluation Report for Switzerland that "[t]he threshold of CHF 100 000 (approximately USD 101 296 /EUR 91 340) seems very high, even for Switzerland, for ensuring transparency and limiting the use of cash usually associated with this type of measure"[117]. However, it made no specific recommendations for the sector. The planned changes, which are expected to enter into force on 1 January 2020, will thus only extend the due diligence requirement to dealers in precious metals and stones by lowering the threshold to 15,000 Swiss francs in accordance with FATF Recommendation 22[118]. The threshold for all other dealers covered by the AMLA definition remains unchanged at 100,000 Swiss francs.

Free ports

Although Switzerland accounts for only 2 percent of the global art market[119], it is regarded as a major player. This is because it hosts the Art Basel fair and has a network of free ports, including the one in Geneva (GFPW), which is the largest tax-free storage site for art in the world and has been described as "the greatest art collection no one can see"[120]. It is estimated to store at least US$80 to US$100 billion in assets. Increasingly, over recent years, free ports have been the subject of political debate, as such warehouses could be misused for the storage of illicit goods and for the purposes of money laundering and tax evasion. During their stay inside the free port—that in practice can last for decades—objects go untaxed, and once inside the free port, art can be sold privately and anonymously to other buyers, without necessarily leaving the warehouse after the transaction[121].

Following the strategy of the Federal Council, as recommended by the Federal Audit Office, the Customs Ordinance was amended and has stipulated since 1 January 2016 that the name and address of the owner of the goods must be listed in the inventory[122]. The measures adopted by the GFPW go beyond the minimal legal framework: tenants must disclose their beneficial owners and the identities of subtenants and their activities are also required. Names and ownership are cross-checked against SECO[123], FINMA[124], and Interpol databases. Swiss free ports are neither financial intermediaries nor dealers in the sense of the AMLA definition; their control is exercised rather indirectly through the due diligence obligations incumbent upon the financial intermediaries and dealers that meet the threshold requirement outlined above. Nevertheless, the fact that there is no verification that the settlement of a transaction in the free ports was carried out by a financial intermediary remains problematic despite the regulatory changes[125].

Self-regulation

The Basel Institute of Governance concluded in its 2012 working paper on the draft Basel Art Trade Guidelines that "the art trade has shown a pronounced lack of interest in constructively dealing with the proposed guidelines" and "reactions to a letter sent to key representative of the art trade industry [...] were met with reservation and outright refusal to engage."[126] The institute issued the Basel Art Trade Anti-Money Laundering Principles in 2018, seeking to complement and set out in more detail the AML aspects of the 2012/2018[127] guidelines[128].

In light of the above, a group of significant market participants established the Responsible Art Market (RAM) Initiative, a non-profit, cross-market initiative formed in Geneva in 2015, aiming to raise awareness amongst art businesses of the risks faced by the art industry in Switzerland and abroad, and to provide practical guidance and a platform for sharing best practice. More can be learnt about this initiative later in this section.

As Switzerland is heavily engaged in distributed ledger technologies such as Blockchain, diverse market players are looking into using these new technologies to track and trace art. Supported by internet of things (IoT) solutions, these offerings have the potential to further improve reliability and transparency in the art market.

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115 See: https://www.fedpol.admin.ch/dam/data/fedpol/kriminalitaet/geldwaescherei/jabe/jb-mros-2015-e.pdf (para. 3.2.1).

116 See: https://www.fedpol.admin.ch/dam/data/fedpol/kriminalitaet/geldwaescherei/jabe/jb-mros-2013-e.pdf (para. 3.17).

117 FATF, Mutual Evaluation Report, Switzerland, December 2016, para 303.

118 FATF, The FATF Recommendations. Recommendation 22 focuses solely on the following designated non-financial businesses and professions: casinos, real estate agents, dealers in precious metals and dealers in precious stones, lawyers, notaries, other independent legal professionals and accountants, trust and company service providers. Major luxury sectors such as personal luxury items, art, and luxury transport fall outside the scope.

119 Art Basel & UBS Report, The Art Market 2019.

120 BBC, Geneva Free Port: The greatest art collection no-one can see, 1 December 2016 https://www.bbc.com/news/entertainment-arts-38167501.

121 The Globe and Mail, The link between art and money laundering, 15 May 2018 https://www.theglobeandmail.com/report-on-business/international-business/european-business/economists-urge-tighter-regulations-to-curb-money-laundering-in-art-market/article26217852/. See also https://www.fedpol.admin.ch/dam/data/fedpol/kriminalitaet/geldwaescherei/jabe/jb-mros-2015-e.pdf (para. 3.2.11) for an example of a SAR relating to contraband watches in a Swiss free port.

122 Federal Ordinance on Customs as of 1 November 2006 (status as of 1 January 2019), Art. 184 (1) (c). Detailed requirements are listed in Guidance 10-30 of the Federal Customs Administration, Customs Warehousing Procedure for Open Bonded Warehouses as of 1 June 2019.

123 State Secretariat for Economic Affairs.

124 Swiss Financial Market Supervisory Authority.

125 GFPW, Press Conference of Free Ports and Warehouses SA Geneva – 8 June, 2016 https://geneva-freeports.ch/files/8714/7392/8901/dossier_presse_uk.pdf.

126 Basel Institute of Governance, Basel Art Trade Guidelines, Intermediary report of a self-regulation initiative, 2012 https://www.baselgovernance.org/sites/default/files/2018-12/biog_working_paper_12.pdf.

127 The 2012 Guidelines had been reissued in 2018 without any material changes.

128 Basel Institute of Governance, Basel Art Trade Anti-Money Laundering Principles, 2018 https://www.baselgovernance.org/sites/default/files/2019-01/Basel%20Art%20Trade%20AML%20Principles%202018.pdf.



Expert voices

AML AND THE ART MARKET IN RUSSIA

Anti-Money Laundering ("AML") legislation in the Russian Federation is mainly based on Federal Law No. 115-FZ dated 1 August 2001 "On Prevention of Laundering Criminal Proceeds and Terrorist Financing" (the "AML Law").



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Neither the AML Law nor any other Russian law expressly requires art market professionals to follow the rules and obligatory procedures set out in the AML Law.

AML compliance is monitored by the Federal Service for Financial Monitoring ("**Rosfinmonitoring**"). Rosfinmonitoring issued recommendations on the implementation of non-typical transactions (the "**Recommendations**") in 2009 (and amended them in 2014). The Recommendations are aimed at creating a mechanism to counter the laundering of criminal proceeds and terrorist financing. The Recommendations provide a list of "red flags" for suspicious transactions; transactions in artworks were one such red flag.

On 1 March 2019, Rosfinmonitoring issued Information Letter No. 59, containing recommendations on AML risk assessments. One of the client risks mentioned is "*sale of artworks, antiques, and luxury goods*". This does not mean that all transactions in artworks trigger AML compliance measures. Instead, the Recommendations are intended as guidance for entities that fall under the mandatory AML compliance requirements (e.g., banks, insurance companies, etc.), helping them to mitigate the associated risks.

"Right to follow" and AML in Russia

A recent law expanded the powers of the Copyright Holders Association (the "Association"). Accredited by the Russian Ministry of Culture, the Association is responsible for protecting the artists' and their successors' "right to follow" (the right to receive a fee on each resale of an artwork). Now the Association is entitled to request financial data when art assets change hands.

In December 2018, two Russian art auction houses underwent a prosecutor's inspection over an alleged violation of the "'right to follow" (based on a request made by the Association). Auction houses were obliged to disclose the financial documents relating to the sale of certain pieces of art to clients. This measure is not primarily aimed at combatting money laundering; however, it may prove to be an effective instrument to bring transparency to the Russian art market.

We have asked market players to comment on 5AMLD and its potential impact on the Russian art market. We also talked with them about their art-related activities and initiatives to promote and develop the market.



Inna Bazhenova
Publisher of The Art Newspaper international network, founder of the IN ARTIBUS cultural foundation, co-publisher of The Russian Art Focus, art collector



Ksenia Podoynitsyna
Russian contemporary art-market expert and founder of InArt a project that provides Russian contemporary art analytics

The implications of 5AMLD for the European market are still difficult to assess.

Inna Bazhenova:
"The statement that art sellers 'should request information on the source of funds and the source of their clients' funds in general when the client comes from a third country with a high risk level', in my understanding, directly concerns Russian art buyers. If this requirement is followed to the letter, it will undoubtedly affect the Russian art market. In my experience, the art market in Russia is not involved in money laundering, at least in a broad way. However, as a rule, collectors do not like to disclose their acquisitions in full. The market is already suffering because of its considerable isolation from European and global markets. Moreover, an additional barrier on the side of auction houses and other art sellers will reduce the activity of Russian buyers and further separate the local market from Europe and the rest of the world.

Personally, as a collector, I do not see any problems resulting from 5AMLD, since I always represent myself at auctions when I buy art. I stand for transparency on the art market and reject any manipulations that distort our picture of the market.

As for the Russian art market, it depends on the general economic situation and the political climate of the country. One of the significant factors limiting the Russian art market is its isolation within the country. There are numerous other objective reasons: the quality of artworks, national legislation, lack of information, and so on. As a publisher, I consider it my goal to integrate the Russian market into the international context. We publish all sorts of information on the international art market in Russian and for the Russian-speaking audience and share Russia-related information across the entire global network of our publications. In partnership with the Aksenov Family Foundation, we have launched a new product—the Russian Art Focus edition—which informs and educates our readers on Russian art and is in English. I hope that it will attract additional attention to Russian art in general and modern Russian art in particular."

Ksenia Podoynitsyna, InArt founder and CEO:
"5AMLD will not have direct implications for the Russian or EU art markets. However, since it increases market transparency requirements, including as regards asset diversification, the resulting restructuring of portfolios may spark more interest in alternative investments, including works of art. This will directly stimulate interest in alternative asset classes and may eventually affect the size of the art market in Russia.

At present, 5AMLD is not having a major impact on the Russian art market. The number of transactions involving EU-based trusts buying artwork from Russia is small, and Russians rarely use this tool to make purchases. Information about art trusts operating in Russia is currently unavailable. The implications of 5AMLD for the European market are still difficult to assess. Most transactions are transparent, and those that look suspicious to financial authorities are investigated on a case-by-case basis.

Details about such transactions are published and used to promote enhanced transparency and a better understanding of the market rules. The directive may also affect projects that use digital currencies, such as Bitcoin".



Denis Belkevich
Co-founder at FUELARTS, art analyst and economist, professional manager of cultural projects, art investment & collection management consultant

Denis Belkevich comments on 5AMLD:
"It all depends on whether the UK will remain in the EU. With the UK, the European art market accounts for up to 32 percent of global turnover; without it, only 11 percent. Traditionally, the most expensive purchases are made in the UK (through London auction houses). If Brexit happens, the balance of power will remain virtually unchanged: London will remain the place for trading the 'blue chips' and a slow decline that began in 2009 (about -1 percent per year) will continue in the remaining EU countries. If the disclosure of information on purchases above €10,000 eventually does affect the UK, many buyers are expected to move over to New York, Hong Kong, and Geneva (Switzerland, we recall, is not in the European Union). On the other hand, the average cost of artworks sold at international fairs—the main sales channel of the gallery market—in recent years amounted to slightly less than €6,000. Thus, such transactions do not fall under the regulations anyway.

In Russia, the picture is reversed. Let's say the European Parliament's 5AMLD affects the domestic Russian art market. This would signify that the market does exist and has a tendency of becoming more transparent. While it is still at the formation stage, the European turbulence will not affect it at all. If 5AMLD affects the international purchases of Russian collectors (who, according to various sources, acquire US$1 billion to US$1.5 billion of Western art a year, while Russian art purchases add up to only US$200 million), it might affect the Russian market, too. Should collectors' attention and capital be drawn to our internal art market and should they receive social and status returns on their spending, this may prove a positive outcome for the Russian art market."

If 5AMLD affects the international purchases of Russian collectors (who, according to various sources, acquire US$1 billion to US$1.5 billion of Western art a year, while Russian art purchases add up to only US$200 million), it might affect the Russian market, too.

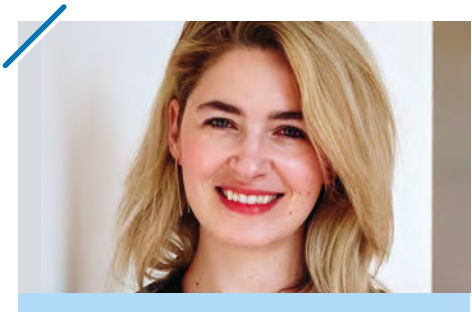


Pervivencias © Lina Sinisterra (2011)

Expert voices

EXPERIENCES FROM **THE DIAMOND INDUSTRY**

The art trade is not the first non-financial sector to face Anti-Money Laundering (AML) regulations. Industries sharing analogous characteristics, such as the diamond trade, have already had to adjust and the art industry could learn a lot from their experiences.



Trisevgeni Stavropoulos
Head of Compliance at the Antwerp World Diamond Center (AWDC)



Sarah Philips
Director
Risk Advisory – Financial crime
Deloitte Belgium



Inneke Geyskens-Borgions
Senior Manager
Risk Advisory – Financial crime
Deloitte Belgium

Interview with Trisevgeni Stavropoulos, Head of Compliance at the Antwerp World Diamond Center (AWDC), which is one of the world's largest hubs for diamond trading.

When was the diamond industry first obliged to follow AML regulations and what was the industry's initial reaction?
AML regulations were imposed on the Belgian diamond industry for the first time in 2004. The initial reactions of diamond traders were very negative. The legislation seemed highly complex, written for the financial sector, and not tailored to Designated Non-Financial Businesses and Professions' (DNFBPs') business model and resources. In the early years, traders tried to comply with the legislation as nothing but a box-ticking exercise, without understanding the goal of Anti-Money Laundering Laws (AMLL).

Were any initiatives led by the Belgian industry itself to make the transition easier (e.g., any efforts by a professional association to mutualize the cost of compliance, industry-led training, sharing of procedures etc.)?
As a sector body, AWDC has invested substantially in raising awareness of AMLL and providing guidance and support for its practical implementation. We have an AML & Compliance Helpdesk that supports Belgian traders with all of their compliance questions and issues, be they related to AML or to other legal frameworks. Our main initiative to ease the diamond sector's transition to AML compliance has been our AML & Compliance seminars, organized in cooperation with the

supervisory authority of the diamond sector. These seminars, held on both a basic and an advanced level, familiarize traders with the legislation, explain why it is as it is, and describe what it entails for their business.

Initially, these seminars were often attended by traders who came to vent their frustrations regarding the AMLL and its implications. Clearly, there was significant resistance to compliance with this legal framework in the first instance. However, we have made it our mission to work through this phase and to support traders where possible, in order to lower the threshold for compliance in practice (e.g., we drafted templates for Know Your Customer (KYC) forms that traders could send to their clients, we developed guidelines for client acceptance, etc.). This eventually resulted in a noticeable shift in attitudes.

Today, the majority of industry players attend these seminars on an annual basis, to be informed about any AMLL/compliance updates and get the latest information. It is not only diamond traders who attend, though. Even financial institutions, insurance companies, and AML inspectors join these seminars to understand how AMLL is being implemented in the diamond industry.

Aside from raising awareness, a lot of energy has also been invested in providing the sector with the right tools and documents. Our aim in this regard is to help traders assess what they should do to be compliant and to assist them in their compliance efforts. For example, in collaboration with a major publisher of business information, we have created a customized software tool[129] through which Belgian traders can screen their clients and assess the potential risks related to the client before entering into a business relationship. This not only strengthens the quality of traders' KYC work and risk assessments, but also enhances transparency and vigilance practices in the sector. Since these tools are too expensive for a sole trader to purchase alone, we as the sector body fund this and provide the trader with free use.

What were the biggest challenges faced when implementing obligations? Think about specific obligations with practical implications, e.g., identification of the beneficial owner, definition of risk-based approach, documentation of all actions with an audit trail, documentation of source of funds, etc.

How to collect clients' identification documents (ID cards, company bylaws, etc.) was easy to explain and quite quickly understood and implemented by traders. The concept of a risk-based approach was more of a challenge. This requires a thorough understanding of the risks related to the industry, client, and/or supplier. The 2017 Belgian diamond industry risk assessment, which we carried out in cooperation with our supervisory authority and the banking industry, identified specific potential AML risks in the Belgian sector. This document has proved to be an important foundation to help the industry understand what the risks are, and to allow players to develop an adequate risk-based approach in their own businesses.

Another practical challenge is the identification of UBOs. This remains particularly difficult when handling international transactions with clients located in countries without AMLL: some can be unwilling to give their identification data, especially in relation to their UBOs. The database in our custom software tool does help traders to some extent as it allows them to access additional UBO information.

Lastly, the submission of STR and SAR notifications to the FIU remains a sensitive issue. However, since a reporting point within AWDC was established in cooperation with the Belgian FIU, the number of qualitative STR and SAR notifications has increased significantly.

We have noticed that enabling traders to submit notifications to the sector body, which then passes the information on to the FIU, has lowered the threshold at which traders decide to send notifications of suspicious activities.

How did diamond industry clients first react when they were told by professionals that they had to provide more information?

Clients living abroad in countries without AMLL or where the diamond sector is not subject to AMLL were particularly hesitant to provide identification documents. AWDC has addressed this by drafting standard letters for clients explaining the Belgian AMLL, how Belgian suppliers fall under its scope, which information needs to be provided to them and why. These letters were considered a game changer by many Belgian diamond traders, making it much easier to obtain the necessary documents from their counterparties, as they were now better informed about the legislation and its implications. A standard letter from a sector body gives the foreign counterparty confidence that the reason why the Belgian diamond trader is asking for identification documents is not because they distrust the counterparty but simply because they are required to do so by law.

129 Database on the AWDC website: https://www.awdc.be/en/KYC

The better the perception of the sector, the more traders are encouraged to take compliance to the next level, as they notice that it really does pay off.

Was there a significant downturn in sales after the regulation passed? For example, were clients so scared of providing more documentation that they refused to do business?
We do not have any real proof of a downturn in sales because of AMLL, although some traders do claim that they lost business when the legislation first applied to them. Over the past five years, more diamond centers (outside of Europe) have implemented AMLL and this has created more of a level playing field and made it easier for Belgian traders to comply with their obligations.

Did the regulations have any positive outcomes for the diamond industry? For example, did it restore trust with external players, such as financial institutions, etc.?
The better the perception of the sector, the more traders are encouraged to take compliance to the next level, as they notice that it really does pay off. The ultimate demonstration of that from a diamond trader's perspective is that banks—many of which had stepped out of the sector as they took a "better safe than sorry" approach and viewed the diamond sector as high risk—are slowly but surely opening up to the sector again thanks to its firm focus on compliance and transparency.

Is there any advice you would provide to professionals that will have to implement these regulations soon?
I think it is important to understand that compliance with AMLL in your company is not something you should adhere to out of fear of sanctions. Instead, try to embrace the objectives of the legislation: it is necessary to keep your sector clean and to help the government fight money laundering. In short, it is the right thing to do. No sector benefits from a bad reputation such as being a money laundering hub. In the short term, this might require some work, and you might even lose some business, but in the long term, this attitude will bring more commercial benefits and it secures your company's own business as well (understanding who you are trading with and what any potential risks could be).

In addition to that, professionals should definitely turn to their sector body and ask for support through education and tools. Sector bodies can seek inspiration and advice from other bodies that serve other sectors but fall under the same legal framework. This will ensure professionals have access to the best practices available. The sector body should in turn cooperate with its supervisory authority to implement AMLL in the sector. As such, the full range of AMLL objectives—to prevent and combat money laundering in different sectors—will be achieved through the cooperation of the various entities at different levels.



Expert voices

PROMOTING RESPONSIBLE PRACTICES: LESSONS LEARNT FROM THE RESPONSIBLE ART MARKET INITIATIVE



Justine Ferland
Researcher at the University of Geneva's Art-Law Centre, attorney-at-law (Quebec, Canada), and member of RAM's Task Force



Sandrine Giroud
Partner at LALIVE, Switzerland, board member of the Art Law Foundation, and member of RAM's Task Force

Should the art industry be subject to stricter regulations?
The question remains a key concern for many of those working in the art trade: some argue in favor of greater transparency and accountability, whereas others warn of the added costs and barriers that would be created by further regulation. People with a wide range of viewpoints are slowly but surely coming to accept the importance of an industry worth over US$60 billion, its financialization and associated risks, and the need for more sustainable practices. Maintaining trust and credibility in a market that has discretion at its core without undermining the commercial interests of the industry while also promoting fair and efficient competition for future growth: this is the challenge still facing the art market today. The Responsible Art Market Initiative (RAM) is a direct response to this challenge.

An initiative by the market for the market
RAM is the first of its kind: a non-profit, cross-market initiative launched in Geneva (Switzerland) in 2015, under the auspices of the Geneva-based Art Law Foundation (ALF) and the University of Geneva's Art-Law Centre (ALC). Its mission is to raise awareness among art businesses of the risks facing the art industry and to provide practical guidance and a platform for sharing best practice to address those risks. RAM's founding members span the entire spectrum of the art market and include art businesses, academic institutions, and attorneys.

To date, RAM has published two sets of practical guidelines and checklists that are increasingly used and referred to: the *Guidelines on Combatting Money Laundering and Terrorist Financing*[130] and the *Art Transaction Due Diligence Toolkit*[131]. RAM holds an annual conference in Geneva during the Art Genève art fair. This provides an opportunity for art market professionals to meet and exchange ideas on market practices, challenges, and new initiatives.

From the outset, RAM has endeavored to go beyond the question of whether the art market should self-regulate. Instead, its work involves: (1) gathering industry knowledge and practices through dedicated working groups composed of a diverse array of professionals, (2) synthetizing and structuring the information into practical take-aways and best practice, (3) testing findings through surveys and bilateral discussions with industry stakeholders, and (4) holding public discussions and debates at RAM's numerous events to discuss the latest ideas. As such, these responsible practices are not exhaustive and are bound to evolve and need to be adapted to the specific context of particular art businesses or industry sectors. They do not purport to set a standard to be applied in all situations; rather, RAM advocates for a risk-based approach to determine the degree of due diligence required in relation to a specific issue.

Lessons learned
Almost five years into the project, RAM is going from strength to strength and its message is resonating more widely. Here are some of the lessons learned so far:

There is a real and sustained appetite for practical guidance on risks in the art market and responsible practices to address them. One of the measures of RAM's success is the growing number of people attending its annual event and the fact that the audience includes very diverse and international art market professionals such as art dealers, gallery representatives, academics, service

130 *Guidelines on combatting Money Laundering and Terrorist Financing available at http://responsibleartmarket.org/guidelines/guidelines-on-combatting-money-laundering-and-terrorist-financing/*

131 *Art Transaction Due Diligence Toolkit available at http://responsibleartmarket.org/guidelines/art-transaction-due-diligence-toolkit/*

providers, and government agencies. This indicates a real interest in the initiative's mission described above and consolidates RAM's position as an initiative by the art market, for the art market. RAM is clearly viewed as able to address the risks faced by the industry from a practical, holistic standpoint and suggest the best practice that should be adopted in response. In addition, RAM has been able to further its mission by submitting its draft guidelines and checklists for public consultations. It has reached out to key stakeholders for suggestions on how to improve, simplify, and enhance them prior to their public launch, and thereby ensured that the published documents are applicable in practice. The growing number of art dealers, individuals, and collectors who use or have adapted the RAM guidelines and checklists in their businesses indicates that the initiative has become a key point of reference for responsible conduct in the art market. It has succeeded in remaining accessible and useful for all art trade players, including smaller organizations without large compliance or legal departments.

The art market needs a platform for dialogue and exchange on best practice. RAM's goal of fostering a culture of dialogue has proven effective in creating a space where practices can be discussed freely and in a constructive manner. Through numerous international events, the initiative has brought together unlikely groups of panelists that have or represent diverse—and sometimes opposed—interests. These panelists, whose varied backgrounds included the art business, finance, legal compliance, art history, and scientific expertise, participated heartily in frank exchanges on topics such as the need (or not) for further regulation in the art market, the usefulness of new technologies, and the practicalities and limits of risk management procedures. Some panelists also agreed to touch upon sensitive topics about which they usually prefer not to speak in public, strengthening RAM's position as an independent and open discussion forum that welcomes all art businesses and their employees to discuss art market practices.

Independence is crucial to RAM's success—but other certification initiatives may be helpful in the long term. Throughout its expansion, RAM has endeavored to remain fully independent and to avoid all actual or perceived conflicts of interests. It has done so by aiming for equal representation of all art market stakeholders in its working group—now renamed the Advisory Board. This includes large and small galleries, auction houses, dealers, freeports, lawyers, law enforcement officers, art experts, appraisers, insurance companies, insurance brokers, compliance experts, and academics. From the outset, RAM has also clearly held that it is not, and will not become, a certification body for "diligent" or "responsible" art businesses. However, the fact that this question recurs again and again at RAM events and bilateral discussions with art market stakeholders raises the question of whether some form of certification by an independent body may indeed be helpful in the future to further increase transparency and trust in the market.

The future

Although RAM's activities have generated positive responses and global interest, more work has yet to be done to ensure that the initiative remains a useful point of reference in the ever-evolving art market. With stricter anti-money laundering and terrorist financing regulations having recently come into force (or coming into force in the near future), RAM will be reviewing its Guidelines on Combatting Money Laundering and Terrorist Financing and especially the various country guides summarizing the anti-money laundering regimes that apply in different jurisdictions[132] to ensure that all its materials remain up to date.

Moreover, having organized events in Geneva, London, and New York so far, and with Advisory Board members coming from all across Europe and the United States, RAM has long since transcended the Swiss borders of its two founding institutions to become an international point of reference in responsible art market practices. This is excellent news but also sometimes complicates discussions and working sessions between the stakeholders involved.

To facilitate smaller group conversations and ensure that national issues and particularities are adequately addressed, RAM is currently working on the creation of regional committees. For the moment, these efforts are focused on the United States and the United Kingdom (in addition to Switzerland). These regional committees will allow smaller groups of interested professionals to organize local awareness-raising events and discuss topics that are especially relevant to their jurisdictions and areas of practice.

In addition, the growing interest expressed by various art market players in getting involved in the initiative has prompted RAM to reflect on ways to further develop and encourage dialogue on a daily basis, outside of its various events and public consultations. In that regard, RAM is currently working on an updated, more interactive website, which it hopes will become a truly interactive platform where all interested stakeholders can engage in further discussion of risk and best practice in the market. Although the exact form is still to be determined, RAM hopes to share as many relevant resources as possible, link to other initiatives and organizations who are playing a role in creating a more responsible art market, invite further comments on the existing guidelines and checklists, and, in the long term, foster online dialogue between all members of the "RAM Community".

Last but not least, RAM is also working on a new set of guidelines aimed at summarizing best practice for authentications of fine art, in the specific and practical spirit of the two previous publications. These guidelines will be launched at RAM's next annual conference, which will be held in Geneva, Switzerland, at the beginning of 2020.

The RAM experience shows that the art market needs and wants more dialogue on best practice. Whatever the direction taken as regards (self-) regulation of the art market, dialogue must be the first step to ensure that the relevant information is shared and considered to lay the foundation for a sustainable art market.

For more information:
http://responsibleartmarket.org

132 These country guides were drafted by legal professionals from various jurisdictions on a voluntary basis and are available at http://responsibleartmarket.org/guidelines/guidelines-on-combatting-money-laundering-and-terrorist-financing/



Expert voices

KNOW YOUR PATRON:
THE IMPLICATIONS OF THE NEW 5AMLD ON MUSEUMS IN THE EU AND BEYOND

The views expressed in this article are the personal views of the author and not those of Deloitte.

At first glance, the fifth Anti-Money Laundering directive ("5AMLD"), due to be implemented in January 2020, has nothing to do with cultural institutions or museums. However, the art market in general must pay close attention, as the legislation calls out "intermediaries" involved in art-market "transactions" and/or the "trade of works of art", for any transaction or linked transactions amounting to €10,000 or more[133]. Most art-market professionals will need to conduct risk-based due diligence checks on the ultimate beneficiaries of any major art transaction.

Luckily, in most cases, museums have little to do with transactions, and do not have a role as an intermediary in the market. This means that the rules set out in 5AMLD do not extend to these institutions directly. Most of the lawyers interviewed for this article agreed that the new legislation has no direct impact on the work of cultural institutions in the EU and worldwide today.

The only instance where museums should be directly aware of the legislation is if they are actively acquiring or deaccessioning works. For any work acquired for more than €10,000, additional checks would need to be conducted to ensure that they know the ultimate beneficiary of the museum's purchase, that there is nothing suspicious about the source of funds, and that the work's provenance makes sense. Similarly, for deaccessioned works, the buyer's source of funds should not be suspicious, and a beneficiary should be identified.

Most museums work with intermediaries such as gallerists and auction houses for these transactions, so their trusted advisors will presumably be able to assist in these matters.

Despite the presumed lack of direct implications for the museum industry, the new laws have an indirect impact and raise important questions about current

133 *Article 1 Amendments to Directive (EU) 2015/849 point (3) of Article 2(1) is amended as follows: (i) persons trading or acting as intermediaries in the trade of works of art, including when this is carried out by art galleries and auction houses, where the value of the transaction or a series of linked transactions amounts to EUR 10 000 or more; (j) persons storing, trading or acting as intermediaries in the trade of works of art when this is carried out by free ports, where the value of the transaction or a series of linked transactions amounts to EUR 10 000 or more.*

practices. In particular, museums should bear in mind that any unscrupulous behavior, or links to such behavior, involve risks that could ultimately affect the institution adversely.

This article will outline a few of the points to bear in mind in relation to knowing your patron—whether they are helping purchase a work for the museum, funding an exhibition, or paying to be a part of the museum's inner circle of sponsors.

There are three main reasons why financial institutions conduct Know Your Customer (KYC) practices as part of due diligence: to avoid accepting proceeds of crime, to avoid being involved with those who are avoiding fiscal duties such as paying taxes, and to avoid being connected with individuals on sanctions lists. Proceeds of crime may be linked to terrorism financing, dealing in illicit goods, or funding gained through bribery and they are generally a police matter. Tax avoidance is a completely different issue, with different government bodies' regulations in each jurisdiction. But it is a serious threat: those convicted of being directly or indirectly linked to money laundering face up to 14 years in jail.

In all instances, culprits are trying to bring funds into circulation from a less reputable original source and they use the confidentiality and opacity of the art market to their advantage. The authorities have clearly identified this market as a place where this type of misdeed occurs, otherwise they would not have added art to the 5AMLD so explicitly. Museums should be conscious of this in their daily work.

Pre-emptive measures

To this day, most museums in the UK interviewed for this article look at the guidance provided by the Woolf Inquiry into LSE's links with Libya from 2011. Going forward, one could read this enquiry's advice alongside the wording of 5AMLD. The conclusions from the enquiry state that institutions "should adopt [...] an up-to-date policy on donations [...including an additional] document on ethical and reputational risk."[134] The policy is really about enforcing pre-emptive behaviors to ensure that the source of funds and its use is scrutinized; in this sense, both the enquiry and 5AMLD advocate a similar approach.

There are two main setbacks to these pre-emptive measures, which are covered in the 5AMLD but can be difficult to apply to the world of museums. Firstly, the process of understanding the ultimate beneficial owner can be complex and involve both criminal risk and reputational risk, and secondly, the administrative costs of all of these pre-emptive measures can be prohibitive for museums.

Know your patron

The Sackler family, long-standing supporters of the art world, were targeted in 2019 for the fact that Perdue Pharma, the company they own, sells Oxycontin (a drug that has been singled out as a potential key driver of the opioid crisis)[135]. Photographer Nan Goldin, who has personal ties to the opioid crisis, refused to work with museums with ties to funding from the Sackler family, and has even continued her campaign in Europe in July 2019[136].

What is unclear in this regard is how the institutions in question could pre-emptively assess that this family, who earned their money in a legal (though some may argue unethical) way, could have posed a reputational risk to museums.

In a statement, a family spokesperson said, "our goal has always been to support the valuable work of [...] outstanding organizations, and we remain committed to do so".[137] But, despite their good intentions, the family ended up doing a lot of harm for the museums they patronized, leading to adverse reactions among visitors, and affecting museums' relationships with other sponsors, as it was widely publicized in the press. The relationships might be mended with the institutions in the long run, but the damage in the press and public opinion has been done. It is a thorny issue. The Economist put it clearly: "*Does it benefit humanity more to return a sack of cash to the Sacklers, or to spend it on bringing culture to multitudes?*"[138]



Bernadine Bröcker Wieder
CEO/Co-Founder
Vastari Group

Most art-market professionals will need to conduct risk-based due diligence checks on the ultimate beneficiaries of any major art transaction.

134 *Woolf Inquiry Report, page 143. "Donations 8"*

135 *"The Opioid Timebomb: the Sackler family and how their painkiller fortune helps bankroll London arts" London Evening Standard 19 March 2018 https://www.standard.co.uk/news/health/the-opioid-timebomb-the-sackler-family-and-how-their-painkiller-fortune-helps-bankroll-london-arts-a3793651.html*

136 *"Nan Goldin and Anti-Sackler Opioid Activitsts Swarm the Louvre, Marking their First Action in Europe" 1 July 2019, Artnet News https://news.artnet.com/art-world/nan-goldin-sacker-louvre-1588336*

137 *CNBC, 31 May 2019*

138 *"Culture Vultures: The Moral Maze of Museum Management", The Economist, 28 March 2019. https://www.economist.com/leaders/2019/03/28/the-moral-maze-of-museum-management*

The 5AMLD practices for identifying the UBO (ultimate beneficial owner) of a company will make asking required questions easier to a certain extent.

"Culture-washing"

Participating in the art world, especially with museums, provides a certain kind of kudos that one cannot achieve anywhere else. The general public reportedly trusts museums more than newspapers and NGOs[139]. Therefore, museums may attract financial supporters who wish to achieve a moral uplift in their public personas. Attaching a name to a museum gallery, helping to purchase an artwork, donating a collection or contributing to popular exhibitions can be very beneficial to a person's reputation.

This is not as straightforward as identifying the source of the funds that are supporting the institution. What kind of research would an institution need to do to understand all of the potential links of connected persons resulting from an act of patronage? Another example helps to illustrate this issue. In 2019, a well-known arts institution decided to withdraw from sponsorship from a company, because its director was linked to anti-gay legislation.[140] To flag up this potential issue pre-emptively, a member of staff at a museum would have had to go beyond due diligence on the source of funds, to check the political and moral leanings of the ultimate beneficiary behind a corporation!

Conducting due diligence checks is no simple task. The institution needs to create systems that help employees and other connected individuals understand what is required of them to perform in an ethical way and avoid reputational backlashes or individuals taking advantage of the good reputation of the culture sector. As mentioned in a report called *Ethics Matters*, "statements of commitment mean little without policies and procedures to translate aims into action"[141].

The 5AMLD practices for identifying the UBO (ultimate beneficial owner) of a company will make asking required questions easier to a certain extent. If these corporations, trusts, and foundations are being routinely asked for more information about their ultimate beneficial owners due to EU legislation, it will be less awkward for museums to do so as well.

Administrative costs

Keeping all of these risks in mind, 5AMLD will benefit museums in another way. Today, a subscription to a database of Politically Exposed Persons (PEPs) can be prohibitively expensive. Research for this article indicated that although major national institutions subscribe, many smaller and regional museums are priced out of that kind of research database.

Though it will not be possible to search for people by name, with 5AMLD governments will now have to publish a non-subscription-based database of roles/positions that are considered politically exposed[142]. It will be interesting to see if culture ministers, museum directors, and other cultural offices will be included in the list. What this would mean is that for any partnership or donation, PEPs will need to provide ID, proof of address, and an explanation of the source of their funds. It is not a red flag, but simply an indication that further due diligence is required. Museums will need to keep track of this information - but the cost of subscribing to a database will no longer be a barrier. One could argue that it would be worthwhile for international institutional associations to provide direct advice to museums, and potentially assist in collaborative databases to share knowledge between larger, national museums and smaller, regional ones.

Across the board, museum staff are already bogged down with bureaucratic and administrative tasks. Public funding for museums is decreasing every year, resulting in an increased reliance on funds from the private sector. I do not envy those who now need to think about these issues, but if one can learn one thing from the above, it is that foresight and pre-emption, awareness and knowledge-sharing are key to preventing risky situations of all kinds.

139 *"People Trust Museums More Than Newspapers. Here Is Why That Matters Right Now (DATA)" https://www.colleendilen.com/2017/04/26/people-trust-museums-more-than-newspapers-here-is-why-that-matters-right-now-data/*

140 *"Stagecoach's sponsorship of Turner prize ends over LGBT rights row" (MSN Money Online, powered by Microsoft News) https://www.msn.com/en-gb/money/business/stagecoachs-sponsorship-of-turner-prize-ends-over-lgbt-rights-row/ar-AAAOBKn*

141 *"Ethics Matters", Institute of Business Ethics and the Council for Industry and Higher Education: paragraph 1.3. https://www.ibe.org.uk/userfiles/ibe_cihe_ethicsmatters.pdf*

142 *"Politically Exposed Persons", Comply Advantage https://complyadvantage.com/knowledgebase/regulation/5amld-politically-exposed-persons-peps/*

Case study

The role of free zones in the compliance chain

The fifth AML directive[143] adds storage providers in free zones in the EU to the list of obliged entities. This article will look at the risks associated with these free zones, the broader context of risk in art storage, and the lessons that can be learnt from the experience in Luxembourg, where the Freeport has been subject to national AML rules since 2015.



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Money laundering and tax evasion risks in free zones

In 2010, an FATF/OECD report entitled *Money laundering vulnerabilities of free trade zones*[144] identified free zones as tools for money laundering and criticized a lack of oversight, non-existent, or outdated AML/CFT procedures, and a lack of transparency. These findings were later confirmed by two special European Parliament committees: in 2017 by the PANA committee related to the discoveries in the "Panama papers"[145], and in 2018 by the TAX3 committee on financial crimes, tax evasion, and tax avoidance[146]. They concluded that "'freeports may constitute offshore storage facilities, enabling money laundering and untaxed trade in valuables", "must not be used for the purposes of tax evasion or to achieve the same effects as tax havens", and that "money laundering risks in free ports are directly associated with money laundering risks in the substitute assets market", which meant art and other high-value collection objects. This opinion is partially shared by the European Commission[147], which views free zones as attractive places for money laundering and terrorism financing, despite having found no evidence of systematic use of free zones in the EU to commit fraud.

The most recent risk analysis of free zones is the study titled *Money laundering and tax evasion risks in free ports*[148], produced by the European Parliamentary Research Service (EPRS) for the TAX3 committee. It confirmed previous criticism, for example that free zones could be havens of secrecy.

143 *5th AML Directive, Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018L0843*

144 *FATF/OECD, Money Laundering vulnerabilities of Free Trade Zones, March 2010, https://www.fatf-gafi.org/publications/methodsandtrends/documents/moneylaunderingvulnerabilitiesoffreetradezones.html*

145 *PANA Final Inquiry Report A8-0357/2017, http://www.europarl.europa.eu/cmsdata/134368/A8-0357_2017_EN.pdf*

146 *TAX3 report as adopted by the Plenary on 26 March 2019 (P8_TA-PROV(2019)0240), http://www.europarl.europa.eu/cmsdata/162244/P8_TA-PROV(2019)0240.pdf*

147 *Letter from Pierre Moscovici to Dr. Wolf Klinz, Brussels 28.02.2019, Ref.Ares(2019)1375924-28/08/2019*

148 *Money laundering and tax evasion risks in free ports, http://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_STU(2018)627114*

Money could be laundered through transactions happening while artworks were in storage, without the knowledge of any public authority. Free zones could also serve as storage facilities for artworks purchased with proceeds from predicate offences for money laundering. Since free zones and their actors were not subject to any AML/CFT laws and did not have to perform customer due diligence, the ultimate beneficial owners of substitute assets in storage, such as art, wine, or precious metals, would not be properly identified.

The EPRS study added a new element of risk resulting from the increasing use of non-financial assets as substitute assets for the storage and transfer of wealth. With the end of banking secrecy, investment in new assets such as art has increased massively, which (at least in the eyes of the European Parliament) has contributed to the rapid growth of the art market in recent years. Art storage and logistics providers are, however, not required to participate in any automatic data exchanges under FATCA, the OECD's Common Reporting Standard (CRS) or the EU's reporting agreements between tax authorities as set out in the directive on administrative cooperation.

This means that direct tax authorities have no immediate access to information on wealth stored in the form of non-financial assets, transactions, or beneficial owners, and therefore can neither tax these locally nor inform the relevant authorities in the country of residence of the beneficial owner. Since artworks can remain in storage in free zones for an indefinite time and benefit from the suspension of VAT and taxes, they are an ideal means of transferring large amounts of wealth from one person to another in a tax efficient way.

Free zones play only a marginal role for art storage in the EU

Despite the implications of the title of the EPRS study, however, these risks are not limited to free zones. Free zones, originally intended as spaces to temporarily store merchandise in transit, provide temporary relief from import customs duty and import VAT, though typically not from other forms of taxation such as wealth tax, inheritance tax or capital gains tax. It is undisputed that alternative assets are now often stored in free zones on a permanent basis. Customs warehouses, which are mostly unknown to the general public, can offer the same advantages in terms of security, storage conditions, and the suspension of import VAT and customs duties as free zones in the European Union. They are also much more important for the art world than free zones in the EU. In the UK, France, and Germany, which according to recent figures from the Art Basel and UBS *Global Art Market Report 2019*[149] together make up as much as 89 percent of the European art market, there is not a single free zone that focuses on art or other alternative assets. The demand for tax efficient storage in these markets is exclusively met through customs warehouses.

The number of free zones and customs warehouses pales into insignificance in comparison with the number of free warehouses, such as self-storage, storage at logistics or removals companies, and even safety deposit boxes. While free zones and customs warehouses are subject to approval and regular control by customs authorities in their respective jurisdictions and need to be able to produce inventory lists (with more or less detail, depending on their location), free warehouses have no formal obligations towards public authorities.

The fifth AML directive formally includes "persons storing, trading or acting as intermediaries in the trade of works of art when this is carried out by free ports, where the value of the transaction or a series of linked transactions amounts to €10 000 or more" as new obliged entities. However, operators of customs warehouses or other storage providers are not included. The final report of the TAX3 committee did take note of this oversight by recommending that at least customs warehouses "be put on an equal footing with free ports under legal measures aimed at mitigating money laundering and tax evasion risks therein, such as AMLD5".

Compliance at the Luxembourg Freeport

The EU member country most exposed to risks inherent to free zones is Luxembourg. In September 2014, it became the first EU country to house a free zone dedicated to high-value alternative assets when Le Freeport Luxembourg opened for business. In the 2015 revision to its national AML law, Luxembourg included the logistics providers at the Freeport in the list of obliged entities, without the transaction limit that is now present in the fifth AML directive.

Luxembourg also took preemptive action on the potential risks resulting from a lack of traceability and information and required Freeport operators to provide documentation on all objects to be stored for their clients as well as to communicate in real time any movement or transaction that clients requested from the operator. This made secrecy regarding the objects in storage a thing of the past. To this day, 100 percent of all inbound shipments are physically inspected by customs agents together with art handlers.

In 2016, when operator licenses first came up for renewal, the Luxembourgish Customs Administration further strengthened the documentation requirements by requiring commercial invoices or other documentary proof of ownership as part of the documentation package for any inbound shipment or change of ownership at the Freeport. This enables customs to not only have 100 percent accurate information on all objects stored in the Freeport, but

149 The Art Market 2019, An Art Basel & UBS Report, Prepared by Dr. Clare McAndrew Founder of Arts Economics, https://www.artbasel.com/news/art-market-report

also up-to-date documentation on the ownership of each piece.

The final step from ownership to the UBO is ensured through the full customer due diligence process, performed by licensed operators that are audited by the Indirect Tax Administration on a yearly basis. This strong regulatory environment, together with effective oversight by two public authorities, led the Luxembourg government to reassess the risk of the Freeport in the National Risk Assessment for the upcoming FATF review. While the inherent risk of the Freeport is still high, the actual risk, accounting for the mentioned mitigation factors, could be lowered to a moderate level.

The change in national legislation created a very unique set of challenges for licensed operators. The lack of compliance solutions tailor-made for their special situation meant that they had to find the best solutions for similar-sized entities and adapt them to their specific use case. Their business case was also affected, given compliance costs resulting from the need for external expertise, software, processes, and time to create and implement the changes and perform ongoing due diligence. Becoming compliant also resulted in loss of revenue caused by the departure of existing clients that were either unwilling to cooperate or not in line with the new standards.

On the upside, compliance has enabled licensed operators to better understand their clients and their background, which helps with managing reputational risk (among other forms of risk). Client profiles that are incompatible with a fully AML-compliant operation can be identified at a much earlier stage. In a market that for the most part is lacking in structure and organization, the filter of AML compliance resulted in a list of clients that are better organized than the rest, which has advantages ranging from improved flow of information for operational matters to improved handling of invoices.

Compliance is also a key ingredient when working with banks, funds, and other institutional clients and obliged entities, which require their counterparts to uphold the same standards of customer due diligence. Inversely, working with these obliged entities means that the clients they refer to licensed operators are themselves already previously vetted and approved.

The compliance procedures at the Freeport further strengthened the international recognition obtained from the World Free Zones Organization (WFZO) and other institutions. Free zones currently represent 30 percent of international trade and many are members of the WFZO, which is recognized by the UN, WTO, WCO, and OECD. In June 2019, the Freeport obtained the Safe Zone Platinum certificate from the WFZO based on international standards for compliance management, integrity, safety, and security developed by the OECD. This certificate reflects the high security, safety, and compliance procedures already in place since the opening of the Freeport in 2014 and developed further over the intervening years through the obtention of the ISO 9001 and ISO 45001 certificates.

Advice for the art market on the road to compliance

The fifth AML directive will focus the burden of compliance on the actual market-makers in the art world: the galleries, dealers, intermediaries, and other consultants that interact with buyers and sellers. Because many of them do not accept cash payments over €10,000, they did not fall under the high-value dealer provision of previous iterations of the AML directives and had little incentive for compliance in the past.

For those art professionals now faced with getting their business AML compliant, the most important advice is to start preparing right away. It would be dangerous to count on a lack of preparedness in their country of establishment and the difficulties associated with enforcing the new rules starting in January 2020. While money is certainly a factor, every entity in the market is concerned and this fact should ensure a level playing field, at least in the EU.

Furthermore, the AML law contains a best-effort obligation rather than an obligation to achieve a specific result, which should mean that larger and more potent organizations in the art market will be held to higher standards than smaller operations, provided they can supply material proof of their compliance efforts. The cost to become fully compliant should also be put in perspective against the potential for high fines to be paid by non-compliant obliged entities and the possible publication of their names by national authorities.

The upsides of compliance, of which there are many, should be of particular benefit to the art market which—not without reason—is still described as one of the last "unregulated markets". Many of the deals that currently happen in a more or less improvised manner will tomorrow benefit from better organization in a compliant environment. The parties will (have to) know each other much better than they do today, whether the deal involves professionals or end clients. Better knowledge of the origin of funds and the financial situation of the client might even lead to fewer outstanding invoices.

At the very least compliance will bring some much-needed transparency into the market, given that it will be almost impossible to hide behind intermediaries and shell companies and continue to do business on the art market under the fifth AML directive.

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Comer del Arte Quiero © Lina Sinisterra (2010)

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