

GENERAL ARTICLES

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Art-Secured Lending: Obstacles and Proposed Solutions

Abstract: Taking up the appeal of lenders around the world, this article shows that there is an opportunity to internationally and uniformly regulate art-financing. The research contributes to the debate by presenting recent evolutions of the art-financing industry from both the financial and legal perspectives. The article provides an overview of the art-secured lending market, focusing firstly on financial issues that hinder the practice and the proposed solutions to them; and secondly on legal issues. Despite the financial difficulties faced by service providers, including determining the estimated return of a work of art after two years from the issuance of the loan, scholars and market players have successfully teamed up to solve some urgent financial issues. Departing from recent literature that analyses art-financing exclusively from a financial standpoint, this paper also considers art-financing from a legal perspective, presenting two case studies and two different legal systems. The jurisprudence of both U.S. and selected European courts on point is employed to highlight the advantages and drawbacks of art-secured lending. Finally, the article advocates the creation of an international register of collateralized art goods to encourage international secured transactions involving art works.

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Introduction

In Shakespeare's *Merchant of Venice*, a pound of Antonio's flesh collateralized Shylock's loan. The play demonstrates two important things regarding the study of collateral: first it shows that collateral – the contractual device used by borrowers and lenders around the world to secure loans¹ – has been around for a long time; and second that both lenders and borrowers are always searching for more creative and non-traditional ways to facilitate cash flow. Anything that has a revenue or a potential future earnings stream and gives lenders a sufficient level of reassurance against the risk of a borrowers' default can be used as collateral. In addition to classic types of collateral convertible to cash, namely hard collateral (e.g. houses and automobiles) or paper collateral (stocks and bonds), the "very imaginative" category of collateral assets includes antique furniture, artworks, and entire art collections.² Unfortunately, art-backed loans are not as popular as real estate, home equity, specialized equipment, or machinery loans. The most evident reason is that playing with the art market is not an easy "game". In the past, institutional investment houses have avoided the art market, considering it as a quasi-deregulated, not-highly-liquid trading market. Opacity, volatility, high transaction costs, cyclical trading patterns, and its relatively small scale were among the reasons to distrust this market in terms of its ability to provide reliable collateral. More recently however, some scholars have concluded that significant diversification benefits can indeed be achieved by adding artworks to an investment portfolio.³ Increasing record prices at auctions may have contributed to creating a conventional wisdom that artworks in general are worthwhile investments.⁴ Art as an asset class has suddenly become a valuable collateral. The second section of the article provides an overview of the art-secured lending market, including brief descriptions of service providers such as private banks, auction houses, and art funds, as well as explaining their market positions.

¹ A loan agreement or a secured transaction is a business arrangement in which the lender acquires a security interest in collateral owned by the borrower. In this article, the terms "art-secured loans" or "art-backed loans" are used to differentiate loans backed by art assets from loans backed by hard or paper collaterals.

² C.S. Guyer, *Creative Collateral*, "The RMA Journal" 2006, Vol. 88(10).

³ R. Campbell, *Art as a Financial Investment*, "The Journal of Alternative Investments" 2008, Vol. 10(4), <https://doi.org/10.3905/jai.2008.705533> [accessed: 11.12.2021], mentioned in L. Pollmann, *Art: A Purely Emotional Asset? Diversification Potential of Art in an Equity Setting*, MA thesis, Luiss GuidoCarli, Department of Economics and Finance, 2019, p. 5, <https://tesi.luiss.it/25092/> [accessed: 11.12.2021].

⁴ D. MacDonald-Korth, V. Lehdonvirta, E.T. Meyer, *The Art Market 2.0: Blockchain and Financialisation in Visual Arts*, May 2018, <https://www.dacs.org.uk/DACSO/media/DACSDocs/Press%20releases/The-Art-Market-2-0-Blockchain-and-Financialisation-in-Visual-Arts-2018.pdf> [accessed: 25.10.2021]. DACS is a British organization that manages the rights of leading artists.

The euphoria for the “financialization of art” partially evaporated when investors, who thought they could turn to art as they would turn to any other financial asset, were proven wrong.⁵ Truly successful art investors not only understand the market, but they recognize the artistic idea of the artist, which is the real value of art.⁶ The evaluation of art is inherently subjective because it is sometimes driven by passion and enthusiasm, and other times by profit, thus the realizable value significantly fluctuates over time. The third section of the present article tries to answer the question whether the financial obstacles alone hinder the use of art-financing. The fourth section shows that despite the financial difficulties faced by service providers, including determining the estimated return on a work of art after two years from the issuance of a loan, scholars and market players have teamed up to solve urgent and difficult financial issues. This has led to an expansion of the art-secured lending market, which in the United States reached an estimated US\$17-20 billion in 2017.⁷ In Europe, art-secured lending is less developed, but *slowly* expanding.⁸

The unequal distribution of art-financing services all over the world reflects institutional lenders’ fear of a practice that is still perceived as risky and not uniformly regulated. In 2019, 64% of wealth managers in banks, auction houses, and art funds interviewed by Deloitte all around the world offered art-secured lending services.⁹ At the same time however, service providers call for more regulations to “create new opportunities to expand and democratize the art market”.¹⁰ Therefore, in addition to financial issues, legal obstacles, including the absence of uniform international rules, keep lenders from expanding their art-financing business. This gives rise to the question: How can we better regulate art-financing?

“Art-secured lending, except for a few efforts, has not received a lot of attention in the academic literature” states Dr. Ventura Charlin, Strategy, Business Analytics and Applied Statistics Consultant.¹¹ To add to that, the majority of the small number of scholars who approach the subject come from the financial world. This article aims to contribute to the debate by presenting recent evolutions in the art-financing industry from both a financial and legal perspective. The financial issues

⁵ Ibidem.

⁶ W. Wilke, *Kunstvoll Investieren*, Dresdner Bank, Frankfurt am Main 1999, as referenced in L. Pollmann, op. cit., p. 4.

⁷ Deloitte, ArtTactic, *Art & Finance Report 2017*, <https://www2.deloitte.com/content/dam/Deloitte/at/Documents/finance/art-and-finance-report-2017.pdf> [accessed: 11.12.2021]. No studies or reports on point were issued between 2020 and 2021 due to the impact that Covid-19 had on consumers’ lending.

⁸ Ibidem.

⁹ Deloitte, ArtTactic, *Art & Finance Report 2019*, p. 10, <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/artandfinance/lu-art-and-finance-report-2019.pdf> [accessed: 11.12.2021].

¹⁰ Deloitte, ArtTactic, *Art & Finance Report 2017*, p. 154.

¹¹ Clare McAndrew and Rex Thompson, in *The Collateral Value of Fine Art*, “Journal of Banking & Finance” 2007, Vol. 31(3), seem to be the first authors who looked into this market segment. V. Charlin, A. Cifuentes, *A Risk-Assessment Framework for Art-Secured Lending*, working paper, February 2019, p. 5.

and proposed solutions, illustrated in the third and fourth sections respectively, serve only a compositor purpose, i.e. to illustrate the state of the art. The present study departs somewhat from the recent literature by taking a legal approach to the subject matter. In the fifth and sixth sections, the vicissitudes of existing practice give rise to reflections on the market's need for regulations. U.S. and European case law on point is employed to highlight both the advantages and drawbacks of art-secured lending in one system or the other. Finally, taking up the appeal of art lenders the present article aims at suggesting policy and regulatory changes to resolve the legal issues that are impairing the enhancement of art-financing, and thus limiting their market potential. The article advocates the creation of an international register of collateralized art goods that may bring more certainty to international secured transactions involving works of art as collateral.

The Art-Secured Lending Service

The art-lending practice has been around for quite some time. Collateral lending – or pawnbroking – is one of the world's oldest juridical institutions. Its origin dates back to old Mesopotamia, where the loans took the form of seeds. In *Ab Urbe Condita* (I.53), Livy refers to the statue inside of the temple of Vesta as being “a symbolic *pignus* [pledge] of Roman power”.¹² In Florence, during the Renaissance period the Medici bank lent 95,000 florins against a jewel-encrusted mitre belonging to the Antipope John XXIII, who needed money to pay off the King of Naples. In Lombardy in the 16th century the sister of Salaino, a pupil of Leonardo da Vinci, took out a loan of twenty-six *scudi*¹³ using nine paintings made by her brother as collateral. However, apart from a few exceptions, in the past, banks and other financial institutions accepted artworks as collateral only among other assets, as they did not have access to reliable information on the art market nor the wherewithal to efficiently monetize art-collateral.

Today, a growing number of private banks have developed the necessary expertise to understand and operate in both the primary and secondary art markets. In the United States, Citibank, UBS, J.P. Morgan, Bank of America, and Emigrant Bank offer art-secured loans. Private banks typically offer recourse loans, where artwork serves as collateral in addition to the borrower's personal guarantee of repayment. This means that if the borrower defaults and the bank cannot recover the amount lent by selling the artwork, the lender has a claim on other property belonging to the borrower.¹⁴ The creditworthiness of the client is thus more important than the pledged artworks. Banks typically provide art-backed loans to clients with substantial amounts of assets under management in order to generate reve-

¹² Titus Livius, *The History of Rome*, transl. by D. Spillan, Henry G. Bohn, London 1853, <http://www.gutenberg.org/files/19725/19725-h/19725-h.htm> [accessed: 25.10.2021].

¹³ Milanese silver coins in use during Visconti's time.

¹⁴ A. Blackman, *Art Plays a Growing Role as Collateral*, “The Wall Street Journal”, 15 June 2015.

nues from wealth management services. The multinational investment bank and financial services holding company J.P. Morgan Chase & Co. offers art-financing services and provides customized lending solutions. When a collector with a wealth made up of private equity investment turns to the bank with a plan to make a substantial commercial real estate investment, rather than selling the client's portfolio of financial assets to meet the resulting capital demands the bank advises the client to establish a line of credit secured by their art collection. By using a line of credit to access the equity of the collection, the client will be able to maintain the financial market investments, as well as to defer taxable gains that would have otherwise been triggered had the client liquidated the investment portfolio.

Major auction houses and some galleries also offer art-financing services to their clients. Auction houses typically offer two types of loans: a loan to consignors who are selling their art both in private or public auction sales; and a standard loan where no sale of art is contemplated. In both cases the work is appraised and the amount of the loan is based on between 40% and 50% of the artwork's lowest estimate. Auction houses offer art-financing services to allow collectors to acquire new or additional art or to leverage their currently-owned art. To better serve this purpose, interest-free consignor advances are offered to certain borrowers as an incentive to consign the collateral with the auction house.

Sotheby's, for instance, organizes its lending operations around two segments: the Agency segment, and the Finance segment. The Agency segment sells works owned by the auction houses itself or earns commissions and fees acting as an agent for clients wishing to sell their artworks through the auction or via private sale process.¹⁵ The Finance segment does business as Sotheby's Financial Service (SFS).¹⁶ SFS is a proper financing company that earns interest income and associated fees through art-related financing activities by issuing loans that are secured by works of art.¹⁷ SFS specializes in loans against consigned works and term loans,¹⁸ which offer clients immediate access to liquidity from their assets. Two thirds of the loans provided by SFS are term loans, with no commitment to sell the pledged artworks. Term loans may also generate future public or private sale consignments through the sale of the collateral at the conclusion of the loan or through future purchases of new property by the borrower.¹⁹ To a much lesser extent, SFS also makes consignor advances secured by artworks that are contractually committed to be offered for sale through the Agency segment. The procedure applied before

¹⁵ In the United States, agency services are regulated by the *Restatement of the Law of Agency* (3rd ed., 2006).

¹⁶ In addition to the two segments, Sotheby's offers art advisory services through Art Agency Partners, acquired on 11 January 2016.

¹⁷ The category of assets accepted as collateral against money loans include paintings, photographs, jewelry, sculptures and other works of art, including furniture, books, and classic cars.

¹⁸ A loan repaid in instalments over a certain period of time.

¹⁹ A.K.H. Chan, *Art as Collateral: Seeking Returns from Lending vs. Owning*, MA thesis, Sotheby's Institute of Art, 2014, p. 9.

issuing a loan secured by art objects is similar to the three-step procedure that Sotheby's carries out when accepting future lots to include in their inventory: the evaluation phase;²⁰ the personal and corporate due diligence phase; and the due diligence of the pledged artwork. After the last due diligence, Sotheby's either rejects the application or issues the requested loan. The loan amount is determined as a percentage of the total lowest auction estimate of the collateral, upon the advice of relevant Sotheby's specialists. Even for Sotheby's, which holds a very good position – probably the best – in the market, it is difficult to determine the future value of an artwork. The volatility of less consolidated artists remains an issue and there is no recognized formula to rely upon, which explains the low percentage of the loan to value (LTV)²¹ ratio when compared to other categories of assets. Immediately after the loan is granted, the return risk shifts to Sotheby's. According to Vladimir Kleyman, Director of Transactions and Senior Counsel of SFS, even with consolidated artists, due diligence mistakes are always possible.²²

Recently, private equity firms have joined forces with banks to serve their clients' requests for art-secured lending services. Athena Art Finance (AAF) is a specialized art lender backed by the private equity firm the Carlyle Group and investors from the Pictet Group. In 2019, AAF was acquired by Yieldstreet. Part of the lending service provided by AAF includes additional trimmings, such as helping to vet and document the pledged works' ownership history, provenance, and title. Loan rates offered by AAF vary according to the artworks, with the average LTV ratio being 50%. AAF's clients include gallerists and dealers who are constantly in pursuit of new, valuable inventory, as well as investors and others who need liquidity for more general business purposes. The Fine Art Group, for its part, offers art advisory and financial services. They offer loans with one to three year maturities, secured by art as the only security: their art finance product is purely asset-backed. The Fine Art Group's clients are art dealers, collectors, and galleries, who borrow against their art to free up capital to expand their existing collections; as well as family offices and trusts with a similar strategy for the acquisition of more art. Recently, Freya Stewart, CEO of the Fine Art Group, reported that in 2020 requests for art-backed loans surged by 30% compared to 2019 as collectors sought to borrow against their collections to invest in more art or in other businesses.²³

²⁰ Due to the inherent subjectivity involved in estimating the realizable value of art pledged as collateral for SFS loans, the estimates of realizable value may prove to be different than the amount ultimately realized upon sale.

²¹ The LTV determines the ratio assessment of the lending risk; it measures the maximum amount of a secured loan based on the market value (and the liquidity) of the collateral. Financial institutions and other lenders examine it before approving money loans and mortgages.

²² Stated during an interview in New York in May 2019.

²³ R. Frank, *The Wealthy Are Borrowing Against Their Art Collections and Lenders Are Reselling the Debt*, CNBC, 25 February 2021, <https://www.cnbc.com/2021/02/25/the-wealthy-are-borrowing-billions-against-their-art-collections-.html> [accessed: 25.10.2021].

Despite the general enthusiasm surrounding art-financing, lenders are holding back on two grounds: the financial and the legal ones. While the financial issues that preoccupy lenders revolve around the employment of art as an asset class, its evaluation, and estimated return; legal problems relate to the international regulation of the phenomenon. Every time art is used as collateral, any of the lenders singled out in the present section has to face three unknowns: the true value of the artwork offered as collateral at the time of the loan; the value of the artwork after two years;²⁴ and the likelihood that the borrower will default, i.e. will lose either the ability or willingness to repay the loan. Determining the true value of art for lending purposes is the subject of the next section, while the second and third unknowns will be addressed later in the article.

Financial Issues and Solutions

The starting point of any discussion on the value of art revolves around the art market, which arbitrarily dictates the value of any work that exchanges hands. In 2020, the year most affected by Covid-19, global sales of art and antiquities reached an estimated \$50.1 billion, down 22% from 2019 and 27% from 2018.²⁵ The year 2021 has seen both highs and lows in the art market. While in-person sales suffered, confidence levels lowered, and no Bansky's was shredded at a live auction, online sales broke records²⁶ and NFTs invaded the market. Market observers find it difficult to predict prices as art is – for the most part – traded and owned by the rich and ultra-rich. As a result, “the price development of art works is decoupled from the general economic situation – since in times of crisis, the rich and ultra-rich are the ones least affected”.²⁷ To understand the dynamics of the art market, economists have broken down the fundamentals of the value of art that function as quality-dependent pricing anchors. They soon found out that the fundamentals alone are not sufficient to determine the value of art. The value is made of fashionable trends that are quality-independent pricing anchors.²⁸ Different schools of thought explain art value and pricing factors differently. Art dealer and author Michael Findlay uses the names of the three Charities to illustrate the three

²⁴ Two years is the estimated average time considered by financial studies.

²⁵ In 2021, the top three markets – United States, United Kingdom, and China – further cemented their position, accounting for 82% of global sales by value. Despite the escalation of the Brexit crisis and widespread uncertainty regarding its future, the United Kingdom had a relatively strong year. C. McAndrew, *The Art Market 2021. An Art Basel & UBS Report*, March 2021, <https://www.ubs.com/global/en/our-firm/art/collecting/art-market-survey.html> [accessed: 25.10.2021].

²⁶ Based on the Art Basel & UBS Report, online sales of antiquities and fine art reached a record of \$12.4 billion doubling in value from the previous year and accounting for a record share of 25% of the market's value. *Ibidem*.

²⁷ L. Pollmann, *op. cit.*, p. 2.

²⁸ *Ibidem*, pp. 17-18.

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components of the value of art: Thalia, the goddess of fruitfulness and abundance, represents commerce, while Euphrosyne, goddess of joy, represents the society, and Aglaea, the goddess of beauty in the eye of the beholder, is the essential, intrinsic value of art.²⁹ When art is used against a money loan, the lender has to evaluate and price the pledged artwork, but determining the value of an antiquity or a painting is not as simple as evaluating shares of stock or bonds. To give a sense of the complexity, the present section provides a brief overview of the art evaluation process, breaking down the main components of the value of a work of art, being: the commercial value; the social value; and individual taste.

Today, with some exceptions,³⁰ the commercial value of art is not correlated to the cost of the materials used in the production borne by the first buyer in the primary market. Whether it is real estate, stock in a closely held business, a plane, a yacht, or art, today banks routinely obtain appraisals and establish advance rates (which are percentages of the appraised value against which they will extend credit), and then determine the amount they are prepared to lend against a particular pool of collateral. U.S. Federal law requires that independent appraisers make real estate appraisals for loan collateral purposes no more than one year prior to the date of the loan (and that the LTV ratio be less than 85%). Banks' credit policies for other types of collateral, including artworks, follow similar guidelines. For U.S. appraisers the fair market value of a work of art is represented by the price at which "the property would change hands between a willing buyer and a willing seller, neither being under the compulsion to buy or sell and both having reasonable knowledge of all relevant facts".³¹ "The fair market value cannot be determined on forced sales, nor can it be determined by a sale within a marketplace other than that which at the time it would be most commonly sold to the public".³² To establish the value of an artwork, art appraisers rely on the sales comparison approach. This method of evaluation involves comparison of property with similar items which have been sold within the common market for objects of that kind. In general, the most common market for fine arts is the market consisting of sales to members of the public through art fairs, specialist dealers, and specialist auctions. Accordingly, the markets considered and the sale prices reviewed for items comparable to the listed items include dealer sales, art fairs, as well as in-house exhibition and international auction house sale results. In appraisals, values are based upon the whole interest and possessory interest of the client, undiminished by any liens, fractional interests, and any other form of encumbrance or alienation.

²⁹ M. Findlay, *The Value of Art: Money, Power, Beauty*, rev. ebook ed., Prestel, Munich 2014.

³⁰ In the case of Damien Hirst's *Physical Impossibility of Death in the Mind of Someone Living*, the delivery from Australia to England, the taxidermy, and the montage in a giant glass vitrine of a 15-foot tiger shark "sculpture" might have weighted in the final price of \$50,000 paid by Saatchi to Hirst in 2005.

³¹ Fair market value is defined in *Treasury Regulation* §1.170A-1(c)(2). International Society of Appraisers, *Core Course Manual*, 12-20 (2018-2019 ed.).

³² *Treasury Regulation* §20.2031-1(b) expands upon the definition of §1.170A-1(c)(2). *Ibidem*.

While the auction price of a given artwork – as an instant evaluation – represents a consensus opinion on the value of said artwork, this value is in turn determined by a complex and subjective set of components and “beliefs based on past, present and future prices, individual tastes and changing fashion”.³³ However, “the uniqueness of each artwork adds to the complications since prices must be estimated based on sales of similar but not identical items”.³⁴

Another distinctive feature of the art market which needs to be considered when appraising a work of art is its unpredictability. An artwork believed to be authentic and traded as such could, later on, be declared to be a fake by the artist’s major expert, scholars, connoisseurs, scientific experts etc., or it can be attributed to the artist’s school, workshop, or followers. In the first scenario, the artwork immediately loses all its commercial value, while in the second scenario the commercial value is considerably affected and a new artistic and commercial appraisal would be required. The market value of art thus breaks down into different components that lenders must carefully consider. When assigning prices to luxury assets, SFS considers 10 criteria: authenticity, provenance, condition, rarity, historical importance, size, fashion, subject matter, medium, and quality; some scholars add colors and exposure to the equation.³⁵ If the fundamentals determining the commercial value of art were solely to be considered, prices could be more predictable and the volatility not be so high. However, there are two other aspects of the value of art that lenders have to take into account: the social value of art, and individual taste.

“The value of the artwork is intrinsically related to a series of immaterial factors”, postulated Kleyman.³⁶ The reputation and the production of an artist are key to determining the market value of a piece, and popular feelings towards a particular artwork may result in a change of value.³⁷ While “economists [and auction houses’ specialists] have developed sophisticated techniques of measuring [the commercial value of art]”, the social or cultural value proves difficult to determine. Neil Brodie concludes that “the value of an antiquity [but the same logic applies to contemporary artworks] can be measured directly in financial terms and indirectly by contingent valuation methodologies designed to measure public

³³ A.C. Worthington, H. Higgs, *Art as an Investment: Risk, Return and Portfolio Diversification in Major Painting Markets*, “Accounting and Finance” 2004, Vol. 44(2), pp. 257-272, <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.532.3589&rep=rep1&type=pdf> [accessed: 25.10.2021].

³⁴ L. Pollmann, op. cit., p. 5.

³⁵ Ventura Charlin and Arturo Cifuentes studied the relationship between the price of a painting, its color, and related attributes. The scholars based their research on Mark Rothko’s post-1950 paintings. V. Charlin, A. Cifuentes, *The Price of Color in Mark Rothko’s Paintings*, 16 January 2020, <https://ssrn.com/abstract=3262314> [accessed: 20.12.2021].

³⁶ See footnote 22.

³⁷ When a rumor goes around that an artwork is a fake or there are a lot of forged works of the same artist around, or if another work by the same artist gets “burnt” at auction, all these events can depress the entire artist’s production, not just a single work. S. Thornton, *Seven Days in the Art World*, Kindle ed., Granta Publications, London 2012, pp. 15-16.

‘willingness-to-pay’³⁸. The social value of art is comprised of the many purposes that art “serves”.³⁹ Art – here intended as cultural heritage – represents the identity of a given group of individuals. This aspect might change over time. The fact that a given artwork has a given social value leads to restrictions on its circulation and a drop in value of the piece. In Italy, for instance, as a general rule objects with a cultural interest made by non-living authors more than 70 years ago may be declared to be of national cultural interest. When an object is declared to be of national cultural interest (Articles 12 and 13 of the Italian Code of Cultural Heritage and Landscape, CCHL⁴⁰), the owner is entitled to sell or donate it, but with the obligation to notify the contract to the Italian State within 30 days of the date of the transaction (Article 59 CCHL). In case of a sale, the State has the right of first refusal, which may be exercised within 60 days of the date of receipt of the sale notice (Article 60 CCHL). In general, classified objects may be moved within the Italian territory, but their movement must be authorized by the Ministry of Culture (Article 21 CCHL). Italian economists have established that every time a painting or an antiquity is declared to be of national cultural interest, the value of the work drops by 40-50%.⁴¹ The social value of a work of art thus becomes a key factor in the case of international art-secured lending. When Italian artworks are used as collateral against money-loans provided by foreign financial institutions, the fact that the artwork may potentially be unable to leave the Italian territory becomes a serious problem. The issue no longer pertains solely to the sphere of value, but it also becomes a question of the suitability of classified objects for art-secured lending services. The complexity of the subject matter explains why financial institutions stayed away from art-secured loans for such a long time; not just because of the extreme price volatility and the opacity of the market, but also because of the uncertainty derived from the application of parochial rules.

To briefly explain the third component of the value of art, one should take a look inside the auction saleroom. Every bidder enters that room with an object and a maximum price in mind, thinking “this high and no higher”.⁴² The maximum price represents the ideal allocation of the bidder’s funds, which meets both the

³⁸ N. Brodie, *Archaeological Looting and Economic Justice*, in: P.M. Messenger, G.S. Smith (eds.), *Cultural Heritage Management: A Global Perspective*, University Press of Florida, Gainesville 2010. See also R. Mason, *Assessing Values in Conservation Planning: Methodological Issues and Choices*, in: M. de la Torre (ed.), *Assessing the Values of Cultural Heritage*, Getty Conservation Institute, Los Angeles 2002, pp. 5-30; and T. Darvill, *Value Systems in Archaeology*, in: M.A. Cooper et al. (eds.), *Managing Archaeology*, Routledge, London 1995, pp. 40-50.

³⁹ A. Klamer (ed.), *The Value of Culture: On the Relationship between Economics and Arts*, Amsterdam University Press, Amsterdam 1996, p. 243.

⁴⁰ *Decreto Legislativo 22 gennaio 2004, n. 42: Codice dei beni culturali e del paesaggio*, Gazzetta Ufficiale No. 45.

⁴¹ S. Famularo, P. Ripa, *Quanto la notifica penalizza il mercato dell’arte italiano?*, “Il Giornale delle Fondazioni”, 27 July 2012. The article is based on a report issued by the Osservatorio sui Beni Artistici of the Monte dei Paschi Bank in 2012.

⁴² D. Thompson, *\$12 Million Dollar Stuffed Shark: The Curious Economics of Contemporary Art and Auction Houses*, Kindle ed., Aurum Press, London 2010.

buyer's expectations and his or her financial possibilities. "Few [bidders] stick to this once bidding starts. A bidder will say to himself 'just one bid over', almost simultaneously, in that same showroom a dealer bidding for a client via mobile phone will say: 'we have reached your limit but this is a great work [of art], I think we should go higher'".⁴³ "The one bid over" or the "we should go higher" kind of feelings – halfway between logic and passion – corresponds to the essential value of art. Art moves people because it provokes the most difficult to define feelings: art might push a bidder to pay more than originally planned, or encourage a thief to steal a Mona Lisa.⁴⁴

The third component of the value of art is subjective and depends on individual experiences,⁴⁵ which is what makes the art market so unpredictable. In economics, the essential value of art is explained by the term "aesthetic dividend". Paintings, sculptures, and drawings are valuable financial assets,⁴⁶ therefore, art is added to portfolios to diversify the contents or mitigate the overall risk.⁴⁷ Having old masters' paintings in a portfolio is a low-risk, low-revenue choice, while not-consolidated or emerging artists represent a riskier choice, but the potential return is higher because they might be subject to a future increase in value. Although art is unmistakably below the efficiency frontier, its presence in financial portfolios – if motivated by a real passion for art – generates the so-called aesthetic dividend, namely an implicit, aesthetic share of profits. It is clear that the aesthetic dividend has no effect on the value of the pledged artwork. In many jurisdictions, the law prohibits the negotiation of forfeiture agreements, therefore, in the case of a borrower's default the lender can almost never acquire ownership over the asset used to secure the transaction.⁴⁸ Therefore, while the aesthetic dividend, determined on the basis of the lender's taste, has little account in this analysis, what could be considered is the loss caused to the borrower who collateralized a loan using an artwork of particular significance to him or her.

⁴³ Ibidem.

⁴⁴ In 1911, an Italian handyman named Vincenzo Peruggia stole the iconic Leonardo da Vinci's painting, the *Mona Lisa*, from the Louvre. The *Mona Lisa* had spent two years on the kitchen table of the plumber. From the jail, Peruggia declared: "I fell in love with her".

⁴⁵ A. Klamer (ed.), op. cit., p. 243.

⁴⁶ V. Charlin, A. Cifuentes, *The Art Market: What Do We Know About Returns?*, 2015, https://ssrn.com/abstract_id=2636269 [accessed: 25.10.2021].

⁴⁷ Markowitz portfolio theory might be used to construct an efficient frontier for the exclusive-art portfolio and the mixed-asset portfolio where art is included alongside short and long term government debt and corporate debt and equity.

⁴⁸ Article 2744 of the Italian Civil Code. *Regio Decreto 16 marzo 1942, n. 262: Codice Civile*, Gazzetta Ufficiale No. 79.

Fixing Financial Issues

Circling back to the three unknowns of art-secured lending practice; once we have established how to appraise an artwork, the value of the artwork after two years⁴⁹ and the likelihood (or not) that the borrower will default or lose the ability and/or willingness to repay the loan have to be determined. As explained in the previous section, pricing artworks is not impossible, appraisers do it every day. The real challenge for financial institutions is to determine the value of the work of art pledged by the borrower after two years, taking into consideration the myriad of variables that influence the art market and art market prices. According to Dr. Arturo Cifuentes, Senior Research Associate at Clapes UC (Santiago, Chile), the value of a painting after two years could be calculated considering the real return using the Monte Carlo simulation.⁵⁰ In finance, this simulation is used to solve problems when a specific formula is not available. There is already an extensive literature on the performance of art as an asset class and the movement of average art prices.⁵¹ Based on a survey conducted by Orley Ashenfelter and Kathryn Graddy, the real return on art ranges from 0.6% to 5.0% for paintings in general over the long term.⁵² The return on art is found to have much higher volatility than conventional financial investments such as corporate equity indices; the standard deviation of the real return on art is approximately 21.3% for the period from 1950 to 1999; 35% for the period from 1900 to 1999; and 42% for the period from 1875 to 1999.⁵³

As for the third unknown, i.e. the likelihood that the borrower will lose the ability to repay or default is determined by looking at the borrower’s current income and assets. Lenders may also consider the borrower’s expected income. Besides income, lenders consider a borrower’s current liabilities and other requirements according to the type of loan issued or service provided. In general, while the lender’s due diligence remains key, the borrower’s ability and willingness to repay the loan is less problematic in art-financing, where the LTV ratio is so low that it makes it more convenient to use artworks against money loans than other assets. In most cases, the lender ends up not losing money but making a profit. Loans backed by works of consolidated artists should be preferred by lenders. The probability of a loss for

⁴⁹ Two years is the estimated average time considered by financial studies.

⁵⁰ The Monte Carlo simulation, $Price(t=2\text{ years}) = Price(t=0) \times (1 + \text{return})$, is a legitimate and widely used method often used in mathematical finance for dealing with uncertainty in many aspects of business operations. The Monte Carlo Option Price is a solution applied to calculate the value of an option with multiple sources of uncertainties and random features, such as changing interest rates, stock prices, or exchange rates, etc. L. Bingqian, *Monte Carlo Simulations and Option Pricing*, Undergraduate Mathematics Department, Pennsylvania State University, 2011, <http://www.personal.psu.edu/alm24/students/bingqianMonteCarlo.pdf> [accessed: 10.01.2022].

⁵¹ L. Pollmann, op. cit. and footnote 11 above.

⁵² O. Ashenfelter, K. Graddy, *Auctions and the Price of Art*, “Journal of Economic Literature” 2003, Vol. 41(3).

⁵³ J. Mei, M. Moses, *Art as an Investment and the Underperformance of Masterpieces*, “American Economic Review” 2002, Vol. 92(5).

the lender in 90% of cases equals 0, and only in the 10% of cases is there a chance of experiencing a money loss.⁵⁴ Less-known artists suffer from greater price volatility, with the consequential risk of loss of income for investors and lenders.⁵⁵

Today, collectors perceive art-secured loans as an easy and inexpensive source of capital (whether they are using the funds to buy more art or invest in their own businesses)⁵⁶ while galleries pledge artworks to finance their company's growth. Similarly to asset-based lending, which splits into individual loans and loans to corporations,⁵⁷ financial institutions have differentiated loans to collectors and loans to galleries. In the latter case, the loan is secured with the merchant's inventory.⁵⁸ In 2017, 64% of art collectors interviewed by Deloitte Art & Finance service valued art for its potential for return and the opportunity to diversify liquid assets.⁵⁹ Collectors with a large collection can decide to rotate the artworks used as collateral.⁶⁰ Loans to collectors are made for a period ranging from 3-4 months up to 5 years,⁶¹ but the loan tenor generally does not exceed 2-3 years. Interest rates are normally high (15-25%), and the LTV ratios are in the 40-60% range, i.e. considerably lower than the typical 80-90% in the real estate and automobile markets. Loans to collectors are not amortized loans, i.e. loans that require periodic payments; they usually demand one payment at the end of the negotiated period of time. Collectors turn to art-financing when they need funds to purchase additional artworks, to bridge financing for artwork acquisitions or sales, or to make use of attractive interest rates based on the artwork and the collector's personal credit

⁵⁴ V. Charlin, A. Cifuentes, *An Investor-Oriented Metric for the Art Market*, "The Journal of Alternative Investments" 2014, Vol. 17(1), p. 5; R.A.J. Campbell, *Art as Collateral: Credit Default Swap Derivatives in Banking*, draft paper, Debt, Money and Finance in Integrated Global Markets, XIV International Tor Vergata Conference on Banking and Finance, December 2005.

⁵⁵ In finance, the credit risk refers to the uncertainty regarding a counterparty's ability and willingness to meet its contractual obligation. The credit risk is inextricably connected to the debtor and his or her capacity to maintain the credit quality. Financial loss is caused by a reduction in the credit quality, which will ultimately result in default risk or deterioration risk.

⁵⁶ S.D. Brodie, *The Risk Calculus of Art Loans: Lending Against Value in an Extraordinary Market*, <http://www.elementsinplay.com/wp-content/uploads/2013/02/Art-Avocacy-SpringSummer-2012.pdf> [accessed: 25.10.2021].

⁵⁷ Differentiated for the diverse motivations and opportunities faced by the two art market players when securing a transaction.

⁵⁸ Maecenas, a blockchain platform, helps galleries to get the liquidity necessary to expand their collection by pledging the artworks already in their possession, providing an alternative to the three-year art-secured loan with a 13.5% annual interest. Galleries can raise funds through investors on the Maecenas platform by listing their artworks at a 6% one-off fee. Maecenas website is available at: <https://blog.maecenas.co> [accessed: 25.10.2021].

⁵⁹ Deloitte, ArtTactic, *Art & Finance Report 2017*.

⁶⁰ In 2011, the billionaire Michael Steinhardt pledged 20 paintings and drawings, including five by Pablo Picasso and one by Jackson Pollock, as collateral for a loan from J.P. Morgan Chase Bank.

⁶¹ According to Dr. Cifuentes, the typical art-secured loan tenor is 2-3 years. Dr. Cifuentes is a former Columbia Business School's Finance Professor; he taught *Art as Collateral: Secured Lending* class, Term B class, Fall 2018, at Columbia Business School in New York.

profile. Art-financing gives collectors, investors, and galleries the ability to leverage the value in an artwork and defer capital gains, as well as liquidity and the flexibility to take advantage of investment opportunities while keeping the investment portfolio intact. It is thus not surprising that in 2019 art – interpreted as a valuable financial asset – has become one of High Net Worth Individuals (HNWIs)’ favorite investments of passion.⁶²

Despite the enthusiasm and the increasing number of institutions with art-based lending services, art-secured lending is still considered “a niche-credit service targeted to HNWIs who wish to unlock liquidity out of their collection or art assets for investment or personal finance purposes”.⁶³ More recently, the percentage of collectors buying art as a mere investment declined;⁶⁴ despite art is now accepted as a financial asset, it is still perceived as a questionable investment.⁶⁵ The figures reported by the Art Basel & UBS Report are a sign of the fear of European HNWIs when pledging part of their art collections. The unequal distribution of art-financing services all over the world reflects the market’s fear of a practice not uniformly regulated.

The same fear prevents art dealers from trusting art-financing. According to the TEFAF Art Market Report 2018, 15% of art dealers said that they had used artworks as a collateral for a loan, either exclusively (non-recourse) or as part of a broader pool of assets (recourse); only a small group of dealers (4%) say they regularly use loans to galleries as a way of financing different aspects of their business. However, as the drafters pointed out, once again the low figure might be affected by the nature of the TEFAF dealer sample, which is largely European.⁶⁶ The U.S. art-secured lending market is significantly more developed, so one would expect this percentage to be higher among U.S. dealers. Beyond all the economic reasons that can justify the low level of use of this service, one must take into account what the market and legislators have done. While the market and financial scholars continue to seek solutions to enhance art-financing services, the legislators have remained largely unmoved.

Legal Issues Concerning Art-Secured Lending

Probably the greatest issue preventing the widespread use of art-financing is the uncertainty created by the differing laws in force in different States aimed at regu-

⁶² In 2019, 9% of the available wealth of HNWIs was allocated in art assets; however, in 2020 Covid-19 caused a 20.2% drop in the number of paintings sold at auction and value, compared to the same period the previous year, according to analysis by Art Market Research Developments (AMRD).

⁶³ Deloitte, *ArtTactic, Art & Finance Report 2017*.

⁶⁴ C. McAndrew, *op. cit.*

⁶⁵ In 2017, Deloitte already calculated a 3% loss from 2016. See Deloitte, *ArtTactic, Art & Finance Report 2017*.

⁶⁶ TEFAF, *Art Dealer Finance 2018*, <https://2018.amr.tefaf.com/> [accessed: 20.12.2021].

lating art-secured lending. Different laws, imposing different requirements on borrowers and lenders, dampen the international demand for this service. While economists have tried to find innovative ways to facilitate the issuance of art-loans and banks as well as other financial institutions continue to offer art-financing services, national and international lawmakers are not keeping pace with the evolving reality.

Two key elements of secured transactions seem to vary according to the jurisdiction considered: perfection and priority. Perfection refers to the practice(s) used to put the world on notice of the existence of a lien. A security interest is perfected when attached, namely when value is given, provided that the debtor holds rights in the collateral or the power to transfer rights in the collateral to a secured party. When the security interest is attached, it becomes enforceable, unless the parties have specifically agreed to postpone the time for attachment, in which case the security interest will attach at the time specified in the agreement. When an asset is perfected it means that the lender gets a priority status, namely the right to satisfy the lien prior to other creditors. Priority is achieved by providing a public notice of an attached security interest. Perfection by filing or perfection by registration is an alternative to perfection by possession, which is the strongest way to secure collateral assets. Perfection by control (e.g. of shares) is only relevant for investment property. To perfect a security interest by possession, the secured party (the creditor or a third party) obtains actual or apparent possession of a property owned by the debtor. The absence of an internationally-enforced treaty dictating the rules of perfecting a security interest in movable property has resulted in great uncertainty for lenders, inasmuch as laws regulating secured transactions change from State to State.⁶⁷

In the United States, where liens on movable property can be perfected by voluntarily filing a U.C.C.-1 Financing Statement, banks and auction houses are often not content with just the registration alone, and they take possession of the collateral while the loan is outstanding. However, Sotheby's makes some exceptions for long-time U.S.-based trusted clients by letting them retain the possession of the pledged property. In a jurisdiction where filing is not an option, Sotheby's perfects the lien only by possession.⁶⁸ In case of default, in almost all jurisdictions perfection by possession trumps perfection by filing.

The analysis of U.S. case law demonstrates some serious faults in the system. In some cases, the consignee uses the artworks consigned (or even pledged) for the sale by the owner as collateral for a gallery loan. The absence of checks on the ownership rights over the pledged assets at the time of filing of the financial statement resulted in an arbitrary interference with the owners' enjoyment of their property rights.

⁶⁷ Deloitte, ArtTactic, *Art & Finance Report 2017*.

⁶⁸ Sotheby's Financial Service grants international loans to individuals and companies located everywhere in the world under the condition that they transfer their property to warehouses.

GENERAL ARTICLES

Giuditta Giardini

In Europe, in general perfection by possession seems to prevail over perfection by filing when dealing with movable property. However, foreign banks and financial institutions may not be subject to the provisions of national laws. A Dutch case, explained below, illustrates the difficulties for international lenders to provide services worldwide in the absence of harmonized international rules.

Troubles for borrowers

A great number of U.S. galleries offer art-financing services to their clients, since in the United States lending money against artworks has more pitfalls on the borrower's side than on the lender's. Problems arise when artworks – consigned to galleries to secure loans, or just for sale – are inventoried and taken by bankruptcy trustees to be sold to pay galleries' creditors. To prevent galleries from paying their debtors with consignors' property, the Uniform Commercial Code (U.C.C.)⁶⁹ amended its provisions to be more consignor-friendly. However, the amendment has resulted in general confusion and divergent court interpretations.

Prior to the 1999 revision to the U.C.C., consignment sales were governed under both Article 2 (on Sale) and Article 9 of the U.C.C. §2-326 (Sale on Approval, Sale on Return),⁷⁰ which provided most of the law on consignment and subordinated the consignor's interests to the right of the consignee's creditors, unless the consignor could satisfy at least one of three exceptions: (i) that the consignee was generally known by his creditors to be substantially engaged in selling works of others; (ii) to prove compliance with signage requirements; and (iii) to have formally filed a financing statement under Article 9. The last two requirements were not very popular, and consequently when a gallery (consignee) became insolvent and filed for bankruptcy, or pledged the consigned property as collateral for a loan, the collector-consignor was left with having to prove the "generally known" exception in order to get his or her property back. Since consumers were highly unsuccessful in their attempts to win back their property based on the three exceptions, in 1999 the revision of Articles 2 and 9 eliminated any mention of the U.C.C. §2-326.⁷¹ At the same time, a new definition of "consignment" was included in U.C.C. §9-102(a)(20) whereby, as set forth in *Haley Steele*,⁷² a consignment was defined as being a security interest (U.C.C. §1-201(37)).⁷³ Therefore, anytime the

⁶⁹ The Uniform Commercial Code is a set of laws governing all commercial transactions in the United States. It is not a federal law, but a uniformly adopted state law.

⁷⁰ Courts had to decide if a particular transaction was a "sale or return" to determine the priority between the consignor and the consignee's secured creditors.

⁷¹ J.J. White, R.S. Summers, *Uniform Commercial Code*, 6th ed., Hornbook Series, Kindle ed., West Academic, St. Paul 2010.

⁷² *In Matter of Haley Steele*, No. 051617BLS (Mass. Cmmw. Nov. 14, 2005).

⁷³ *In re Moransen*, 302 B.R. 784 (E.D.N.Y. 2003), *aff'd in part, remanded in part*, 2005 WL 2370856 (E.D.N.Y. 2005). "The law of the consignment is governed by [U.C.C. §9-102(a)(20)] and next U.C.C. § 2-326

transfer of a work of art falls within the definition of a consignment under U.C.C. §9-102(a)(20), the consignor has to file a U.C.C.-1 Financing Statement in the State where the consignee, gallerist, or dealer is located in order to protect his or her property. Today, the signature of the consignee is no longer necessary so long as the consignee agrees on the filing, which can be provided for in the requirement. The consignee has a duty to inform its secured creditors. A U.C.C. §9-102(a)(20) consignor who fails to file a financial statement is automatically subordinated to the consignee's lien creditors.

In instances where U.C.C. §9-102(a)(20) does not apply to the consignment, there is some confusion regarding “exactly where consignees of this – non Article 9 consignment – stand”.⁷⁴ Under U.C.C. §9-102(a)(20), when goods defined as “consumer goods”⁷⁵ are on consignment with dealers or auction houses, they fall outside of Article 9. However, when non-consumer goods are consigned to dealers they fall within the provisions of Article 9, but not when consigned to auction houses. Given the legal uncertainty lingering over the consequences for a non-Article 9 consignment, unless and until a State addresses the issue in detail a protective filing of a U.C.C.-1 Financing Statement is the best solution.

To protect consignors, States have implemented consignment statutes.⁷⁶ The *New York Consolidated Laws, Arts and Cultural Affairs Law – ACA § 12.01. Artist-art merchant relationships* were amended by a Bill passed in 2012 in reaction to a Court decision in the *Salander O'Reilly* case. *Salander O'Reilly* was a famous five-floor 5th Avenue gallery (Manhattan, N.Y.). The gallery represented many high profile artists and had wealthy clients. However, in 2005, the gallery started to show the first signs of insolvency, which led to the filing of an involuntary bankruptcy petition in October 2011, followed by a voluntary petition.⁷⁷ The gallery's debts exceeded its minimal remaining assets and creditors went after the consigned works of art in the gallery's possession (more than a hundred consigned works), using all possible legal arguments. The gallery's consignors had not filed any financing statements at the time of the consignment, and only when in court did they find out that their works had been used to secure loans, as they were the property of the *Salander O'Reilly Galleries*. Some of the artworks eventually went back to their rightful owners because the gallerist failed to include them in

amended [...] the standard approach is first to go to Section 9-102(a)(20), and if the transaction does not fit under this section, then go to next Section U.C.C. § 2-326, if the transaction does not fit [...] then the transaction falls entirely outside the [U.C.C.], and the Court must then fall back on the common law of bailment and other tradition practices”.

⁷⁴ J.J. White, R.S. Summers, *Uniform Commercial Code*, 5th ed., West Publ., St. Paul 2002.

⁷⁵ For the purpose of U.C.C. §9-102(a)(23), consumer goods are “goods that are used or bought for use primarily for personal, family, or household purposes”. In general, artworks should not be considered consumer goods.

⁷⁶ U.C.C. §9-102(a)(20).

⁷⁷ Chapter 11 of the U.S. Bankruptcy Law.

the loan agreement, but other artworks entrusted to the Salander O'Reilly Galleries were sold to pay off the Galleries' debts. Following the case, the New York statute was amended to include a new paragraph indicating that consigned artworks "[shall] be considered property held in statutory trust, and no such trust property or trust funds shall become the property of the consignee or be subject or subordinate to any claims, liens or security interest of any kind or nature whatsoever of the consignee's creditors".⁷⁸ Despite the change in the law, the consignment of art goods to galleries in financial difficulties is still troublesome. In *Overton v. Art Finance Partners*,⁷⁹ the plaintiff Stephanie Overton declared that after she delivered six artworks, including a Modigliani and a Chagall, to the U.K. and N.Y. fine art agent Timothy Sammons "[he] never filed U.C.C. statements, published periodical listings [or] otherwise provided notice" that Ms. Overton owned the paintings placed in the consignee's custody. In addition, the contract used for the loan was a sale and leaseback,⁸⁰ thus under the terms of the contract the artworks were actually sold, although this never occurred to the consignors, who believed they had signed a consignment agreement. The second interesting thing about this case is that when Sammons entered into a loan agreement with the art-financing service provider, Knickerbocker Funding LLC, he pledged Ms. Overton's Modigliani and Knickerbocker filed a U.C.C.-1 Financing Statement whereby he declared that Sammons' ownership right was "free and clear of any lien, security interest, charge or encumbrance or interest of any other person (including without limitation, any interest as consignor)". The U.C.C.-1 Financing Statement, filed on a voluntary basis, has many times proved its fallibility, especially because the statement is not supported by a register or an international database of artworks pledged as collateral against money loans. In the case under scrutiny there had been no objection to the filing of the statement, which shockingly proves how checks are lacking and could be improved.

Troubles for lenders

In September 2008, the State of the Netherlands⁸¹ acquired *The Bend in the Herengracht in Amsterdam, Seen from the Vijzelstraat* – a 17th century work by Dutch painter Gerrit Adriaensz Berckheyde – from Louis Reijtenbagh, a wealthy Dutch art collector, for the benefit of the Rijksmuseum based in Amsterdam. At the time

⁷⁸ *New York Consolidated Laws, Arts and Cultural Affairs Law – ACA § 12.01. Artist-art merchant relationships*, <https://codes.findlaw.com/ny/arts-and-cultural-affairs-law/aca-sect-12-01.html> [accessed: 25.10.2021].

⁷⁹ *Overton v. Art Finance Partners LLC*, 166 F. Supp. 3d 388 (S.D.N.Y. 2016).

⁸⁰ A transaction in which the owner of a property sells an asset, typically a real estate property, and then leases it back from the buyer.

⁸¹ The decision to choose a case taken from Dutch case law is due to the presence of the largest European art fair in the country: The European Fine Art Fair (TEFAF) based in Maastricht. TEFAF was established in 1988, by The European Fine Art Foundation, and attracts about 75,000 visitors.

of the sale, the painting already collateralized a \$50 million loan taken by Reijtenbagh from the New York-based bank J.P. Morgan Chase in 2006, but the State was not aware of any claim or contention that the painting had been pledged for any loan made to Mr. Reijtenbagh. When the collector defaulted, the bank tried to take possession of the property to satisfy its credit from the proceeds of the sale. However, the State of the Netherlands opposed the bank's claim as the true owner of the property. Since the sale transaction happened in the Netherlands, the Dutch Government claimed that it was subject to Dutch civil law. Under Article 3:84(1) of Dutch Civil Code (DCC),⁸² the transfer of ownership requires (i) a delivery (formality), pursuant to (ii) a valid title (*causa*) carried out by (iii) a person authorized to dispose of the property, generally the owner. If a non-owner transfers property, the transfer fails because of requirement (iii). This being the case, the transferee fails to acquire ownership and will be a *mere* possessor of the movable property. The transferee can, however, be protected – in cases of movable property – if it can prove that it acted in good faith at the time of the purchase and proves that it did not know – nor ought reasonably to have known – that the transferor was not authorized to sell the property (Article 3:86 DCC). The owner of the movable can claim back his or her property from the possessor only by proving his “stronger” right. However, the burden is very high. Under Dutch law, similarly to French and Italian law, some important processual presumptions of evidence exist, related to the principle of *possession vaut titre*. Namely, the factual holder of the movable is presumed to be the possessor (Article 3:109 DCC) and the possessor is presumed to be the owner (Article 3:119 DCC). When the possessor is in good faith (meaning she could reasonably assume herself as the owner) she will eventually become owner of the movable after the running of the acquisitive prescription period, which is three years (Article 3:99 DCC) – otherwise after 20 years if the possessor is in bad faith (Article 3:105 DCC).

In the absence of any documentation proving the use of the painting as collateral, the Dutch State was deemed a good faith purchaser and pursuant to Article 3:86 DCC, the Government could retain the property. The Dutch State became the lawful owner of the painting with no strings attached, and no security interests or liens whatsoever existed under Dutch law. Without a valid legal claim under Dutch law, in 2019 J.P. Morgan Chase decided to settle out of court. This case shows how the flight risk associated with the international use of art as collateral can only be mitigated – with the legal tools currently available – by lenders taking physical possession of the movable property, hence perfecting the lien by possession. In some civil law systems, such as Italy, money-lending against unregistered movable assets is possible only after the asset has been divested from the debtor and delivered to the creditor, or to any designated custodian. However, as the Dutch case proves,

⁸² *Burgerlijk Wetboek*, NLD-1992-L-91671.

this does not happen in all civil law countries. Despite clear evidence in favor of perfecting a lien by possession, surprisingly in 2018 Falcon Fine Art announced a new set of art-financing services to win over the sluggish European market. The service would allow collectors to keep a financed work at home rather than in storage, as is now the case. Equally, a collector would have the choice to loan a work to a museum while financing it, at the same time thus increasing the value of the artwork.⁸³

Another issue preventing art-financing in European countries is that of national patrimony and export licenses. It certainly is possible and easy for an Italian bank to make an art-secured loan to an Italian collector seeking to borrow money, assuming that the artwork in question is located in Italy. However, because major banks in the U.S. and Europe often make loans on a global scale, a U.S. or a U.K. bank would be unlikely to lend money to an Italian collector because it may prove impossible for the bank to get the artwork out of Italy in case of default on the loan, especially if the artwork is considered important for the Italian State under Articles 12 and 13 CCHL. Similarly, banks in Germany, Switzerland, and the U.K. would be just as unwilling to make that same collateralized loan to a French or Spanish collector because of the national patrimony laws in place protecting national artworks. There are fewer restrictions on cultural exports in the U.K. and Switzerland, and there are none in the United States, so fewer obstacles would exist to art-based lending in those countries. The differing regulations in force in different States create uncertainty, which hinders uniformity in worldwide services. Based on the research conducted by Deloitte, art-secured lending providers are calling for more uniform regulation. Art lenders suggest that such more uniform regulation would create new opportunities to expand and democratize the art market, as banks and wealth managers would be able to put their full weight into the market. Despite the need to internationally regulate the practice, as of now no feasibility study has ever yet been undertaken to meet the urgent needs of the market players.

Conclusions: Fixing Legal Issues

The third and fifth sections have demonstrated the main financial and legal obstacles preventing the enhanced use of art-financing worldwide. The first issue concerns the high volatility of prices in the art market, which makes art returns unpredictable for certain categories of art and artists. However, as discussed in the fourth section, the interplay between market players' willingness to meet clients' needs and scholars' interest in the issues has proved fruitful and successful.

The fifth section has shown that, from a legal perspective, what most hinders the expansion of art-secured lending is the idiosyncrasies of national laws and the

⁸³ *Art-backed Financing Grows in Sophistication*, 5 March 2018, <https://www.privateartinvestor.com/art-finance/art-backed-financing-grows-in-sophistication/> [accessed: 25.10.2021].

absence of uniform international rules, or even guidelines. This has resulted in stakeholders calling for the harmonization of national laws regulating art-financing.

Indeed, the transnational nature of the art markets imposes an obligation upon lawmakers and market players to work together to find a prompt and fair solution. Any services related to the art markets should be conceived in a space free from parochial, idiosyncratic, and national rules. The present situation urgently presses major art market players with a stake in the art-financing business to encourage the international community to find solutions outside of national boxes, boundaries, and regulations. In particular, the international community could still study ways to overcome the lenders' persistent uncertainty regarding questions of title over the pledged artwork, i.e.: (i) whether the borrower has pledged an artwork free and clear of any lien, security interest, charge or encumbrance, or interest on the part of any other person; and (ii) whether the borrower has a valid title over the artwork he or she intends to pledge. Since the harmonization of national laws is far from being achieved, lenders and borrowers could perhaps find different solutions.

Unlike other movable goods such as automobiles, art goods are not subject to mandatory registration. The attempt to change this negative trend and to meet the market's needs undertaken by the United States with the introduction of the U.C.C.-1 form has proven insufficient. The U.C.C.-1 Financing Statement model is a good idea in theory, but a voluntary affidavit has no teeth. However, there is room for improvement. A compulsory registration of art goods used to secure transactions in an international register would bring greater security to the art-financing business. While it is true that the art market (especially collectors) is hostile to any registration of art assets both for reasons of privacy and protection, lenders' financial security should prevail over any pro-deregulation argument. The idea underlying the present article is to suggest the creation of an international tool setting up an international register of artworks when used as a collateral.

The Cape Town Convention on International Interests in Mobile Equipment ("Cape Town Convention"),⁸⁴ adopted in 2001 under the auspices of the International Institute for the Unification of Private Law (UNIDROIT), is an international treaty intended to standardize transactions involving movable property with a specific focus on mobile equipment. The treaty offers international standards for the registration of contracts of sale, security interests, leases, conditional sales contracts, and legal remedies for default in financing agreements, including repossession and the effect of a particular States' bankruptcy law. The text of the Cape Town Convention is complemented by four Protocols specific to four types of movable equipment: aircraft equipment (2001), railway rolling stock (2007), and space assets (2012), and mining, agricultural, and construction (MAC) equipment (2019). Although artworks do not fit the scope of the Cape Town Convention, the treaty

⁸⁴ Adopted on 16 November 2001, entered into force on 1 March 2006, <https://www.unidroit.org/instruments/security-interests/cape-town-convention/> [accessed: 11.12.2021].

could inspire and guide the adoption of uniform rules on art-secured lending and the setting up of a register for artworks used to back up money loans.

This article thus suggests standardizing the procedures for the issuance of art-secured loan agreements so that every time a lender accepts an artwork as a collateral, the lender should file a mandatory form containing information regarding the parties and the artworks involved, the type of loan (i.e. recourse, non-recourse, term loan, etc.), the duration, the custody, and legal remedies available in case of the borrower's default.⁸⁵ The lender would file the relevant information concerning the loan with a designated entity in the territory of the State where the lender is based as the entry point through which the information for registration may be transmitted to, for instance, other States, including the State where the borrower is located, has domicile, or resides (Article 18.5 of the Cape Town Convention). The competent authority would have the task to control and ensure that the security interest derived from the art-secured loan is an "international interest" within the meaning of Article 7 of the Cape Town Convention or similar. At the time of the registration, the lender would have to comply with precise criteria for the identification of the object, including proving that the borrower has a valid title to the property, and provide additional information concerning the loan. Once the competent authority would make sure that the available remedies will be exercised in a commercially reasonable manner, namely in conformity with the provisions of the security agreement, the registration would end and a certificate would be issued. The entire process should safeguard the confidentiality of information and documents.

In order to avoid the occurrence of situations similar to those faced by Salander O'Reilly Galleries' consignors, in the case the lender decides to sell or lease the pledged property, any sum collected or received as a result of exercise of any of the remedies must be applied towards discharge of the amount of the secured obligations. If the sums collected exceed the amount secured by the security interest and any reasonable costs incurred in the exercise of any such remedy, the surplus will be distributed among holders of subsequently ranked interests which have been registered or of which the chargee has been given notice, in order of priority, and pay any remaining balance to the chargor.⁸⁶

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