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Brian L. Frye

*University of Kentucky School of Law*

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## NEW ART FOR THE PEOPLE: ART FUNDS & FINANCIAL TECHNOLOGY

BRIAN L. FRYE<sup>1</sup>

### INTRODUCTION

“[M]aking money is art, and working is art, and good business is the best art.”<sup>2</sup>

Wealthy people have invested in art since time immemorial. But the modern art market emerged only in the late nineteenth century, as private wealth gradually spread to the bourgeoisie.<sup>3</sup> As the art market grew and the most desirable artworks became extremely valuable, individuals and institutions began to form “art funds” to invest in this promising new asset class. In 1904, a group of Parisian art collectors formed *La Peau d’Ours*, the first private art investment club. Between 1974 and 1980, the British Rail Pension Fund invested £40 million in art. And in the 2000s, many private investment companies created art funds. While some of those art funds were successful, many were not.<sup>4</sup>

The art market is notoriously opaque and insular. On the primary market, only insiders have access to desirable works, and even basic information like price is typically confidential. And even on the secondary market, access is limited, and information remains scarce and unreliable. This cartelization and inefficiency often provides lucrative arbitrage opportunities to insiders with access and reliable information, even as they make it difficult for outsiders to profitably invest in the secondary market.

Financial technology (“fintech”) promises to transform the art market by providing access and information to retail investors. In theory, art funds could provide access to the art market by using crowdfunding platforms to

1. Spears-Gilbert Associate Professor of Law, University of Kentucky School of Law. J.D., New York University School of Law, 2005; M.F.A., San Francisco Art Institute, 1997; B.A., University of California, Berkeley, 1995. Thanks to Tim Schneider and Christopher G. Bradley for their helpful comments.

2. ANDY WARHOL, *THE PHILOSOPHY OF ANDY WARHOL: (FROM A TO B AND BACK AGAIN)* 92 (1975).

3. NOAH HOROWITZ, *ART OF THE DEAL: CONTEMPORARY ART IN A GLOBAL FINANCIAL MARKET* 152 (2011).

4. *Id.*

sell shares in art portfolios, and use data analytics to identify promising art investments. Perhaps they could even create an “art index fund,” and enable retail investors to invest in the art market as a whole, rather than a particular artist or portfolio.

But in practice, fintech is unlikely to make art funds a wise choice for retail investors or most institutional investors. The promise of access and information is a chimera. Art world insiders typically have no incentive to give art funds access to the primary market, because plenty of private capital is available. Data analytics are useless without accurate information. And an “art index fund” would be like investing in lottery tickets, because only a vanishingly small number of works have any value on the secondary market, and even fewer increase in value. Unless the art market becomes more transparent, fintech probably has little to offer potential art fund investors.

### I. THE ART MARKET

The so-called “art market” is the rarefied market for high-value artworks. Every year, the ultra-rich exchange untold billions of dollars buying and selling artworks in the art market. Actually, there are really two art markets: the primary art market and the secondary art market. The primary art market comprises the initial sale of artworks, primarily by art galleries. The secondary art market comprises any subsequent sale of artworks, including both private sales and sales at auction.<sup>5</sup>

The primary art market is both exclusive and opaque. Unlike most markets, money alone isn’t enough. Only insiders have access to the most desirable artworks on the primary market. Galleries routinely refuse to sell desirable artworks to outsiders. Among other things, galleries expect art collectors to keep artworks for an extended period of time before selling them, and ostracize art collectors who quickly resell artworks, who are known as “collectors only in name” or COINs. And galleries provide almost no reliable information about the sale of artwork on the primary market. Everything about the primary market is confidential. Galleries only selectively disclose which artworks are available, rarely disclose prices, and quote different prices to different people.

The secondary art market is considerably less exclusive and opaque. Anyone can buy an artwork at auction, if they can afford it, and auction results are publicly available. However, galleries also sell many works on

5. See generally TIM SCHNEIDER, *THE GREAT REFRAMING: HOW TECHNOLOGY WILL—AND WON’T—CHANGE THE GALLERY SYSTEM FOREVER* (2017).

the secondary market, and auction houses provide only limited and highly selective data about auction results. As a consequence, the secondary market appears considerably more transparent than it actually is.

The two leading sources of information about the art market are the annual reports produced by The European Fine Arts Foundation (TEFAF) and Art Basel/UBS. The TEFAF Art Market Report 2017 reported total art market sales of \$45 billion in 2016, with \$26 billion attributed to dealers, \$17 billion attributed to public auctions, and \$2 billion attributed to private auctions.<sup>6</sup> By contrast, the Art Basel/UBS authored by Clare McAndrew reported total art market sales of \$56.6 billion, with \$32.5 billion attributed to dealers, \$22.1 billion attributed to public auctions, and \$2 billion attributed to private auctions.<sup>7</sup>

Both reports provide important and valuable information. But neither is comprehensive or reliable, because information about art market transactions is limited and unreliable. For one thing, the available data forces both reports to conflate the art market and the antiques market, even though they are largely unrelated to each other. Both reports only provide reasonably reliable information about public auction results, which are only part of the secondary market. And neither report provides reliable information about the primary market, because reliable information simply does not exist. In other words, the best information available on the art market is still largely guesswork and speculation.<sup>8</sup>

## II. AN ECLECTIC HISTORY OF ART FUNDS

An art fund is simply an investment fund intended to generate a positive return on investment by buying and selling artwork. Historically, art funds have taken many forms, from informal syndicates, to institutional investors, to private investment companies. The premise of art investment is canonical: buy low and sell high. Typically, the manager of an art fund decides which artworks to buy and sell and receives a management fee, as well as a percentage of any positive return.

In theory, art funds could increase the efficiency of the art market by facilitating investment in art and increasing the liquidity of the art market. Some investors may consider art a potentially attractive asset class, but not

6. See RACHEL A.J. POWNALL, THE EUR. FINE ART FOUND., TEFAF ART MARKET REPORT 2017, at 11 (2017), <http://made2measure.org/tefaf/amr2017/market> [<https://perma.cc/BJD6-PA8V>].

7. CLARE MCANDREW, ART BASEL & UBS, THE ART MARKET 14–16 (2017), [https://d33ipftjqr91.cloudfront.net/asset/cms/Art\\_Basel\\_and\\_UBS\\_The\\_Art\\_Market\\_2017.pdf](https://d33ipftjqr91.cloudfront.net/asset/cms/Art_Basel_and_UBS_The_Art_Market_2017.pdf) [<https://perma.cc/9WK9-J5S9>].

8. SCHNEIDER, *supra* note 5.

want to deal with the burdens of actual art ownership, like storage, insurance, and management. Others may lack the capital to invest in art independently, but desire to purchase a share in an art investment. Art funds could enable these investors to participate in the art market, by enabling them to invest smaller amounts of capital at a reduced carrying cost. In addition, art funds could gather information about the art market more efficiently than individual investors.

But in practice, art funds have had little or no impact on the art market. While the first art fund was created in 1904, and was reasonably successful, no further art funds were created until the 1970s. And few have been successful. Apparently, the advantages theoretically associated with art funds may be outweighed by practical liabilities.



Gustave Doré, *L'ours et les deux compagnons* (1868)

#### *A. La Peau de l'Ours*

The first art fund was *La Peau de l'Ours*, a syndicate created in 1904 by André Level, a Parisian art collector born in 1863. As a young man, he collected rare books, but in 1895, he began collecting modern art. In 1903, Level decided to create an art fund to invest in modern art, possibly inspired by Henri Matisse's failed attempt to sell his paintings by subscription.<sup>9</sup>

Level invited his family and friends to invest in his fund, which he created on February 24, 1904. There were thirteen members, including

9. MICHAEL C. FITZGERALD, MAKING MODERNISM: PICASSO AND THE CREATION OF THE MARKET FOR TWENTIETH-CENTURY ART 21 (1995) (citing ANDRÉ LEVEL, SOUVENIRS D'UN COLLECTIONNEUR 17 (1959) (Level sent his brother Emile a letter describing the art fund on November 30, 1903, and a draft agreement on December 2, 1903)).

Level, his three brothers, and his cousin, and eleven voting shares, two of which were shared by two members.<sup>10</sup> The owners of each voting share agreed to invest 250 francs per year for ten years, which the fund would use to buy artworks. Only Level could propose purchases, which had to be seconded by a representative of the members and approved by a majority of the members. Members could display the artworks owned by the fund in their homes. After ten years, the fund would sell all of the artworks and dissolve the fund. The investors would receive 3.5% interest per year, and any additional profits on the sale of each painting would be distributed as follows: 60% to the investors; 20% to the artist, and 20% to Level.<sup>11</sup>

Level named his art fund *La Peau de l'Ours*, or “*The Bearskin*,” after Jean de La Fontaine’s fable *L’ours et les deux compagnons*, or “*The Bear and the Two Companions*.”<sup>12</sup> In the fable, two men promise to sell a bearskin, then set out to kill a bear. While they are hunting, a bear surprises them. The first hunter climbs a tree and the second plays dead. The bear sniffs the second hunter, and then leaves. When the first hunter asks the second what the bear said, he responds: “*Il ne faut jamais vendre la peau de l’ours qu’on ne l’ait mis par terre*” (“Never sell a bearskin before you’ve killed the bear.”)<sup>13</sup> The moral of the fable is not to assume success until it is actually achieved. Presumably, the name of the fund was intended to suggest prudence.

Over the course of ten years, the members of *La Peau de l'Ours* invested a total of 27,500 francs, which Level used to buy 145 paintings, including works by Vincent Van Gogh, Paul Gauguin, Henri Matisse, Pablo Picasso, Odilon Redon, Constantin Guys, Jean-Édouard Vuillard, Pierre Laprade, Albert Marquet, Henri Charles Manguin, Maurice Denis, Jean Puy, Jean-Louis Forain, Ker-Xavier Roussel, and Cornelis Theodorus Maria “Kees” van Dongen, among others.<sup>14</sup> Level focused on twentieth century art, and most of the works purchased by the fund were in the Fauve and Nabis styles.<sup>15</sup>

Level bought many iconic works at bargain prices, especially during the early years of the fund. Many modern artists struggled to sell their paintings, so Level’s interest was very welcome. He often bought paintings directly from the artists, rather than through galleries, in order to get lower prices. For example, in 1904, Matisse was delighted to sell Level his *Still Life With Eggs* (1896) for the then-extravagant sum of 400 francs.<sup>16</sup> And in

10. According to Matisse, the members of the fund were Level’s poker buddies. See HILARY SPURLING, *THE UNKNOWN MATISSE: A LIFE OF HENRI MATISSE: THE EARLY YEARS, 1869–1908*, at 273 (1998).

11. FITZGERALD, *supra* note 9, at 21–22.

12. Jori Finkel, *The Story of the Original and Greatest Art Fund*, *THE ART NEWSPAPER* (July 31, 2014), <http://ec2-79-125-124-178.eu-west-1.compute.amazonaws.com/articles/The-story-of-the-original-and-greatest-art-fund/33141> [https://perma.cc/28ZM-F3WR].

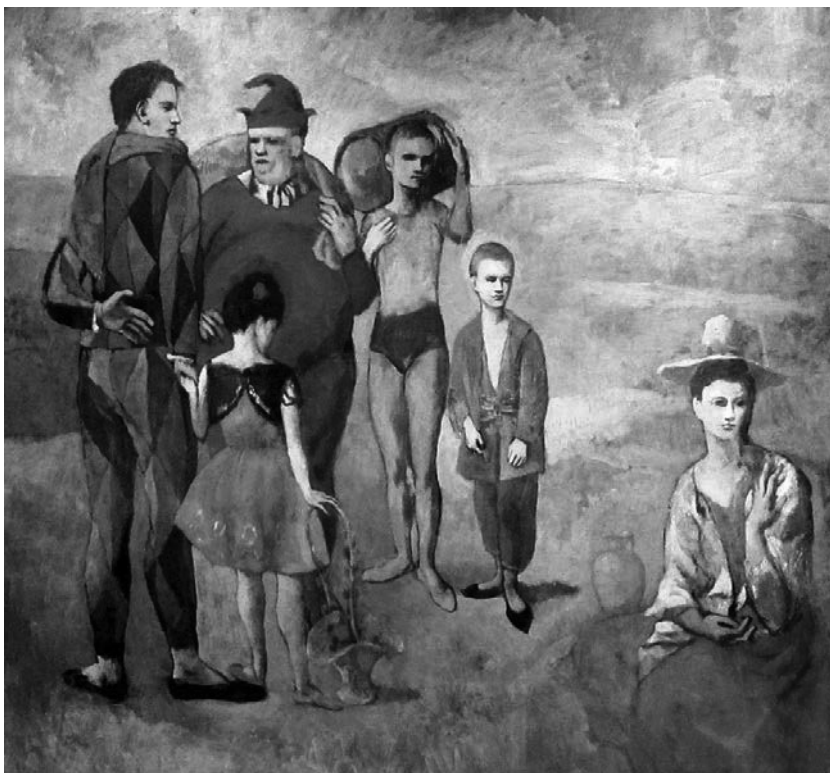
13. JEAN DE LA FONTAINE, *L’Ours & Les Deux Compagnons* [*The Bear and the Two Companions*], in *FABLES CHOISIES* [SELECTED FABLES] 189, 191 (1668).

14. Robert Dell, *Paris Letter*, *AM. ART NEWS*, Mar. 21, 1914, at 5.

15. FITZGERALD, *supra* note 9, at 15.

16. See SPURLING, *supra* note 10.

1908, Level purchased Picasso's already celebrated painting *La Famille de Saltimbanques* (Family of Saltimbanques) (1905) for 1000 francs, even though Picasso had hoped to get more. Level offered a 300 franc deposit, and Picasso sold him the painting two weeks later.<sup>17</sup>



Pablo Picasso, *La Famille de Saltimbanques* (1905)

Artists probably also appreciated the fund's promise to pay 20% of the net profit from the eventual resale. At the time, many artists were pushing for a *droit de suite*, or "resale royalty right," which the fund effectively offered, at least for the first resale.<sup>18</sup> Perhaps some artists gave Level a better price in exchange for the possibility of future profit.

But as the demand for modern art gradually increased, the fund was eventually priced out of the market. By 1910, Level could no longer afford to purchase major new works. His fund was a victim of its own success.

17. Finkel, *supra* note 12.

18. See Brian L. Frye, *Equitable Resale Royalties*, 24 J. INTELL. PROP. L. 1, 5-7 (2017). In 1920, France created a resale royalty right to 1% of the sale price of an artwork from 1,000 to 10,000 francs; 1.5% of the sale price from 10,000 to 20,000 francs; 2% of the sale price from 20,000 to 50,000 francs; and 3% of the sale price over 50,000 francs. *Id.* at 7.



Hermann-Paul, *La Peau de L'Ours* (1914)

[“We cannot give her a dowry, but she has a nice futuristic collection!”]

On March 2, 1914, Level sold the *La Peau de l'Ours* collection in an auction at the Hôtel Drouot for a total of 116,545 francs.<sup>19</sup> Picasso's *Les Bateleurs* alone sold for 12,650 francs. After expenses, the auction generated a net profit of 63,207 francs, which Level distributed to the investors, the artists, and himself, according to the terms of the agreement. Everyone was happy. The investors received a healthy return, and the artists received

19. James Surowiecki, *Cash for Canvas*, NEW YORKER (Oct. 17, 2005), <http://www.newyorker.com/magazine/2005/10/17/cash-for-canvas> [https://perma.cc/DRH9-4DD3].



a dividend, which they deeply appreciated. Picasso received 3,978.85 francs, about 20% of his income for the year, and artists who received less still expressed their gratitude.<sup>20</sup> Level had killed the bear, and then some.

And yet, Level's fund was *sui generis*. It was unclear whether its success reflected the wisdom of investing in art, or the kismet of Level's own genius and luck. In any case, Level's fund had no successors until the 1970s.

### B. The Second Wave of Art Funds

After World War II, investment in the art market gradually increased, especially in the United States. In 1961, the economist and art historian Gerald Reitlinger suggested that artwork was effectively a "hard asset," like gold or real estate, negatively correlated to stocks and bonds, and therefore a potential hedge against inflation.<sup>21</sup> As art became an increasingly promising investment, interest in art funds gradually grew.

In the early 1970s, several private investors created art funds, but none were successful. For example, in 1970, Baron Leon Lambert founded the Artemis Fund, an "art investment banking firm" in Luxembourg, but almost immediately converted it into a dealership. And in 1971, Ephraim Ilin founded the art fund Modern Art Collection, S.A. (Modarco) in Panama, which folded in 1977.<sup>22</sup> Despite their apparent promise, art funds proved more difficult to operate at a profit than expected.

### C. The British Rail Pension Fund's Art Fund

In 1974, the £1 billion British Rail Pension Fund (BRPF) decided to diversify its portfolio by investing in art.<sup>23</sup> At the time, British Rail was a state-owned company, and BRPF was a private pension fund owned by British Rail employees and retirees.<sup>24</sup> Inflation was extremely high: about 30% in the United Kingdom and 12% in the United States. BRPF wanted to hedge against inflation by investing in "hard assets," and identified art as an appropriate alternative to gold.<sup>25</sup>

Initially, BRPF decided to invest up to 6% of its annual cash flow—about £3 million—in art, depending on the availability of suitable investments. It retained Sotheby's as an art advisor, and began buying art in late

20. FITZGERALD, *supra* note 9, at 40. Notably, Picasso incorporated Level's calling card into his collage, *Bottle of Bass, Wine Glass, Packet of Tobacco, and Calling Card* (1914).

21. See generally GERARD REITLINGER, *THE ECONOMICS OF TASTE* (1961).

22. HOROWITZ, *supra* note 3, at 153.

23. Jeremy Eckstein, *Art Funds as Asset Class*, in *FINE ART AND HIGH FINANCE: EXPERT ADVICE ON THE ECONOMICS OF OWNERSHIP* 135, 138 (Clare McAndrew ed., 2010). Eckstein was one of BRPF's art advisors.

24. British Rail operated most rail transport in Great Britain from 1948 to 1997, when it was privatized.

25. HOROWITZ, *supra* note 3, at 154.

1974.<sup>26</sup> BRPF purchased artwork primarily at auction. Sotheby's prepared reports before each auction, identifying promising works and providing suggested maximum bids.<sup>27</sup> BRPF invested in many different kinds of art, including Old Master paintings, drawings, and prints; Impressionist paintings; Chinese art; books and manuscripts; antiquities; Medieval and Renaissance art; Japanese Art; 19th century decorative art; Victorian photographs; vertu; and English silver. However, it decided not to invest in contemporary art, based on the risk and volatility of the contemporary art market.<sup>28</sup>

By 1978, BRPF had invested about £27 million in art, and it decided to cap its total investment at £40 million. It stopped buying art in 1980, at which point it had purchased about 2,400 artworks. The carrying costs associated with BRPF's art collection—primarily storage and insurance—were substantial. It mitigated those costs by lending works to museums, much as *La Peau d'Ours* lent the works in its collection to its members. Lending the works for exhibition may also have increased their resale value.<sup>29</sup>

In 1987, BRPF came under new management, and decided to sell its art collection. It was a timely decision, as the art market was booming, but BRPF was also under political pressure to sell, as many people considered art an inappropriate investment for a pension fund. In June 1987, BRPF auctioned its collection of Old Master prints. The original cost of the collection was £607,000 and the auction realized about £2 million, for an inflation-adjusted rate of return of 2.5%.<sup>30</sup>

Between June 1987 and June 1990, BRPF auctioned fifteen of its art collections. The most profitable was its April 1989 auction of its collection of Impressionist paintings, which generated an inflation adjusted return of 12.9%. But its other auctions were considerably less successful, and several lost money. In 1990, the art market collapsed, and BRPF stopped selling until 1994. In December 2000, BRPF auctioned the last of its artwork and liquidated its art fund. The total profit from BRPF's art fund was about £168 million, for an inflation-adjusted return of about 4%.

26. Peter Cannon-Brookes, *Art Investment and the British Rail Pension Fund*, 15 MUSEUM MGMT. & CURATORSHIP 406, 406 (1996). Sotheby's created an independent intermediary company to advise BRPF, in order to avoid conflicts of interest. Eckstein, *supra* note 23, at 143. However, some observers have alleged that Sotheby's still intentionally recommended poor-quality works to BRPF. HOROWITZ, *supra* note 3, at 155.

27. Cannon-Brookes, *supra* note 26.

28. Eckstein, *supra* note 23, at 140. "Vertu" is a category of art objects that appeal to curiosity and the Western classical era. Examples of vertu include, *inter alia*, Greek and Roman antiquities, classical sculpture, and scientific curiosities. The collection of vertu into *Wunderkammer* or "Cabinets of Curiosities" was popular in the 18th century.

29. See Eckstein, *supra* note 23, at 140; J.H. Farrar, *In Britain, Railway Pensioners Own Rare Books and Monets. A Glimpse at the British Rail Pension Fund's Distinguished and Varied Art Collection*, CHRISTIAN SCI. MONITOR (Oct. 6, 1986), <https://www.csmonitor.com/1986/1006/irail1.html> [<https://perma.cc/FJ3V-RZ3Z>].

30. See Eckstein, *supra* note 23, at 144–45; Terry Trucco, *British Pension Fund Sells \$65.6 Million in Artworks*, N.Y. TIMES (Apr. 5, 1989), <http://www.nytimes.com/1989/04/05/arts/british-pension-fund-sells-65.6-million-in-artworks.html> [<https://perma.cc/DK6R-BEJJ>].

The managers and advisors of the BRPF art fund declared it a success. After all, the fund was profitable, and handily achieved its stated goal of beating inflation. But detractors observed that the United Kingdom equity index increased 1,700% over the life of the art fund, a considerably larger gain. In fact, simply placing the funds in a British Postal Savings Account would have produced a larger return.<sup>31</sup>

Moreover, the success of the BRPF art fund depended substantially on good luck. The art market boomed after BRPF purchased its collection, and BRPF fortuitously sold many of its works at the top of the market. In addition, the overwhelming majority of the fund's profits derived from a small number of high-value works. The BRPF's collection of twenty-five Impressionist paintings accounted for about 25% of the art fund's total value and were its most successful investment by a long shot. Many of its other collections were unprofitable.<sup>32</sup>

As BRPF finished selling its art collection, several other institutional investors created or tried to create art funds with varying degrees of success. For example, in 1989, Banque Nationale de Paris (BNP) created an art fund and invested \$22 million in artwork, which it sold in 1999 at a loss of more than \$8 million. Chase Manhattan Bank also tried to create an art fund, but failed to attract enough investors.<sup>33</sup>

#### *D. The Third Wave of Art Funds*

Gradually, private investment companies began creating art funds and attracting private investors. They argued that investors could diversify their investment portfolios by investing in art, and that the opacity of the art market created arbitrage opportunities that art funds could exploit in order to generate above-market returns.<sup>34</sup>

These private art funds are essentially hedge funds that invest in artwork and sell shares to investors. Art funds are inevitably private offerings open only to accredited investors in order to avoid registration under the Securities Act of 1933.<sup>35</sup> They typically require a minimum investment of \$100,000 to \$250,000, and are "closed-end" investments with a five- to ten-year term, meaning that they issue a fixed number of shares that can only be redeemed at specified times or when their term ends. Art funds also

31. Cannon-Brookes, *supra* note 26, at 407.

32. Trucco, *supra* note 30.

33. Ivan Lindsay, *Go Figure*, SPEAR'S (Jan. 21, 2011), <http://www.spearswms.com/go-figure/> [<https://perma.cc/R8UE-L622>].

34. Shelly K. Schwartz, *Wealthy Investors Dabble In Art Investment Funds*, CNBC (May 29, 2015, 10:32 AM), <http://www.cnbc.com/2015/05/29/wealthy-investors-dabble-in-art-investment-funds.html> [<https://perma.cc/KM4T-QVRQ>] ("Now we're in cycle 3.0," said Beard, noting art funds have evolved into private equity structures that are either closely held or private syndicates that allow a small group of investors to build a collection with tax efficiency in mind.").

35. See 15 U.S.C. § 77d(a)(2) (2015) (exempting from registration "transactions by an issuer not involving any public offering"); 17 C.F.R. §§ 230.501–508 (2017) (defining the term "accredited investor" and providing exceptions to the registration requirements).

charge fees, typically a “2 and 20” fee of 2% per year and 20% of profits in excess of a 6–8% benchmark.<sup>36</sup>

Art funds range in nominal size from about \$10 million to \$500 million, but most are relatively small. They typically seek to provide a return on investment of 10–15% per year, net of fees, using three different strategies: diversification, focus, and opportunism. Diversified art funds aim to create the equivalent of an “art index fund” by investing in a wide range of artworks. Focused art funds aim to arbitrage information costs by investing in one kind of artwork, often a particular region, style, or artist. And opportunistic funds aim to arbitrage transaction costs by investing in undervalued artworks, often looking for distressed sales.<sup>37</sup> Notably, art funds typically buy works on the secondary market, and rarely buy works on the primary market.

### *E. The Fine Art Fund*

The paradigmatic private art fund is the Fine Art Fund, which was founded by Philip Hoffman in 2001, and launched in 2004.<sup>38</sup> The Fine Art Fund’s first art fund required a minimum investment of \$250,000, and adopted a diversified strategy, investing in five art market sectors: Old Masters (25–30%); Impressionist (30%); Modern (20%); Contemporary I: 1960–85 (15–20%); and Contemporary II: 1985–2010 (0–5%). It hired professional art advisors to identify promising investments and make investment recommendations to its managers. No single investment could use more than 15% of the fund’s total capital, and investments using more than 7% of the fund’s total capital required the approval of the fund’s board of directors.<sup>39</sup>

The Fine Art Fund’s first art fund purchased a total of 80 artworks. When it was fully subscribed, the Fine Art Fund began opening additional funds, and adopting different strategies. Among other things, it created funds focused on particular regions and genres and began looking for distressed sales.<sup>40</sup>

The near-collapse of the banking system at the end of 2008, for instance, offered the opportunity to purchase artworks “at some very attractive prices.” Hoffman tells of a collector who had hesitated to sell at \$5.2 million in 2003, but who in 2008 “needed cash urgently” and “within forty-eight hours” parted with the work for \$750,000. Hoffman likes “stressed sales.” He haunts the auction houses, watching for lots that fail

36. HOROWITZ, *supra* note 3, at 149.

37. *Id.* at 151.

38. See THE FINE ART GROUP, <https://www.fineartgroup.com/about/> [<https://perma.cc/Z3RZ-LCDD>].

39. HOROWITZ, *supra* note 3, at 151.

40. Anny Shaw, *The Problem with Art Funds*, ARTSY (Jan. 9, 2017), <https://www.artsy.net/article/artsy-editorial-the-problem-art-funds> [<https://perma.cc/YJ2S-ZFHN>]; Daniel Grant, *Secrets of the Fine Art Funds*, ARTNET (Nov. 22, 2011), <http://www.artnet.com/magazineus/features/grant/fine-art-funds-11-22-11.asp> [<https://perma.cc/RN6U-QTYW>].

to find buyers, and which thus might be had after the auction for a bargain price.<sup>41</sup>

Each fund typically has about thirty or forty investors, who have invested between \$250,000 and \$7 million.

The Fine Art Fund began distributing profits from its first art fund in 2009, and finished winding down the fund in 2015, generating a net annual return of about 5%. In 2016, the Fine Art Fund rebranded itself as the Fine Art Group. It currently manages eight art funds managing more than \$500 million in investments, but the profitability of those funds is unclear.<sup>42</sup>

#### F. Other Private Art Funds

The success of the Fine Art Fund encouraged other private investment companies to create art funds. The trend reached its peak in 2012, when there were about 115 art funds managing about \$2 billion in investments. But the overwhelming majority of those art funds were based in China, and many may have reflected investment incentives unrelated to the performance of the art market. In any case, many of the Chinese art funds quickly folded, and the number of American and European art funds has remained relatively stable at about twenty.<sup>43</sup>

The roster of existing private art funds is remarkably eclectic. Most are quite small, and in most cases it is difficult to evaluate their success with any confidence. While they all intend to produce a positive return on investment, some also have a social goal, which may influence their investors and their investment strategy. In addition, art funds typically provide limited information about their assets and performance. Often, it is difficult to determine whether they even still exist. Here is a selection of art funds, with brief descriptions of their investment strategies and performance, to the extent information is available:

- Artfonds 21 is based in Germany.<sup>44</sup> It launched in 2007, and raised about \$440,000 from twenty investors, which it invested in about fifty artworks. It encourages museums to borrow the works in its collection, and produces limited edition prints for sale, sharing any profits with the artists.<sup>45</sup>

41. Grant, *supra* note 40.

42. Shaw, *supra* note 40.

43. DELOITTE LUX. & ARTTACTIC, ART & FINANCE REPORT 2014, at 94 (2014), <https://www2.deloitte.com/content/dam/Deloitte/lu/Documents/financial-services/artandfinance/lu-en-artandfinancereport-08092014.pdf> [<https://perma.cc/ALM3-QGFH>]; see also Alasdair Whyte, *Does Investing In Art Funds Make Sense?*, PRIV. ART INV. (Nov. 5, 2014), <http://www.privateartinvestor.com/art-finance/does-investing-in-art-funds-make-sense/> [<https://perma.cc/KD3J-E8YY>]; Crystal Kim, *Art Funds Take a Dive*, BARRON'S (Oct. 11, 2014), <http://www.barrons.com/articles/art-funds-take-a-dive-1413000117> [<https://perma.cc/B2LC-L6EM>].

44. ARTFONDS 21, [artfonds-21.com](http://artfonds-21.com) [<https://perma.cc/NEP9-PR2N>].

45. Alasdair Whyte, *Artfonds 21 – A Very Different Art Fund*, PRIV. ART INV. (Nov. 12, 2014), <http://www.privateartinvestor.com/art-finance/artfonds-21-a-very-different-art-fund/> [<https://perma.cc/83VG-6X7A>].

- Anthea is based in Zug, Switzerland.<sup>46</sup> It launched in 2013, and focuses on contemporary art. In 2015, it reported a total return on investment of 28%.<sup>47</sup>
- Artemundi Global Fund was based in the Cayman Islands. It launched in 2010, and focused on Old Masters, Modern, and Modern Latin American art. The minimum investment was \$250,000 for individuals and \$1 million for institutions, and it raised about \$150 million.<sup>48</sup> Artemundi closed on April 31, 2015, reporting a net annual return of 17%.<sup>49</sup>
- Art Partners is based in Tel Aviv, Israel. It launched in 2007, and focuses on Post-War and Contemporary art. In 2013, it stated that it “has thus far returned to its investors approximately 50% of their committed capital,” and that it planned to launch a second fund. It has not posted any further updates.<sup>50</sup>
- Brazil Golden Art is based in Rio de Janeiro, Brazil.<sup>51</sup> It launched in 2011, and initially focused on Brazilian art, but later began offering financing to art galleries. In 2015, it sold a group of artworks from its collection at Sotheby’s.<sup>52</sup> It has reported a negative return on investment since inception.<sup>53</sup>
- The Collectors Fund is based in Kansas City, Missouri.<sup>54</sup> It launched in 2007, and focuses on Post-War and Contemporary art. The minimum investment was \$100,000, and by December 2010, it had raised about \$30 million from about 100 investors. In 2011, it had sold 13% of its

46. *Location*, ANTHEA ART INVS. AG, <http://www.anthea.art/location/1/11> [https://perma.cc/9JG5-4TYH].

47. *See* ANTHEA ART INVS. AG, ANTHEA CAIF MARCH 2015 SNAPSHOT (2015), [http://www.anthea.art/public/pdf/pdf\\_44.pdf](http://www.anthea.art/public/pdf/pdf_44.pdf) [https://perma.cc/69JR-D7F4]; ANTHEA ART INVS. AG, ANTHEA CONTEMPORARY ART INVESTMENT OPPORTUNITIES CLP SEPTEMBER 2015 SNAPSHOT (2015), [http://www.anthea.art/public/pdf/pdf\\_45.pdf](http://www.anthea.art/public/pdf/pdf_45.pdf) [https://perma.cc/7QMG-V88K].

48. *See* Jenny White, *Art Funds: An Inside View from Artemundi*, PRIV. ART INV. (Sept. 1, 2014), <http://www.privateartinvestor.com/art-finance/art-funds-artemundi-global-fund/> [https://perma.cc/6F3M-JPVM].

49. *See Artemundi Global Fund’s Up-To-Date Information (2010–2015) Final Financial Results*, ARTEMUNDI GLOB. FUND, <http://artemundiglobalfund.com/financials/> [https://perma.cc/N5CR-9TTB]; *see also* ARTEMUNDI GLOB. FUND, <http://artemundiglobalfund.com/> [https://perma.cc/MVR8-ANSE].

50. *Overview*, ART PARTNERS, <http://www.artfunds.com/about.html> [https://perma.cc/S55Y-PBW6].

51. BRAZ. GOLDEN ART, <http://www.brazilgoldenart.com.br/Site/Institucional> [https://perma.cc/2BJ6-T7WM].

52. *The Brazil Golden Art Collection*, CHRISTIE’S (Nov. 10, 2015), <http://www.christies.com/features/The-Brazil-Golden-Art-Collection-6785-3.aspx> [https://perma.cc/P4NE-8NQR].

53. *Brazil Golden Art BGA FIP Quote*, BLOOMBERG MKTS. (Sept. 15, 2017), <https://www.bloomberg.com/quote/PEF4173:BZ> [https://perma.cc/DS58-UFVS] (last visited

54. *About Us*, THE COLLECTORS FUND, <http://thecollectorsfund.com/visitors/entry/?#/visitors/about-us/> [https://perma.cc/6FEJ-4MRA].

collection, and reported a net annual return of 28.5%.<sup>55</sup> Its website was last updated in 2014.

- The Day Star Fund is based in Malta.<sup>56</sup> It launched in 2012, and invested in a wide range of established artists. In 2015, it had raised about \$60 million from an unknown number of investors, and reported a return of over 20% for 2014.<sup>57</sup> Its current status is unknown, but its website is inactive.<sup>58</sup>
- The Fine Art Invest Fund is based in Zurich, Switzerland.<sup>59</sup> It launched in 2010, and focuses primarily on contemporary photography. Unlike most art funds, the Fine Art Invest Fund often purchases works directly from artists. It is jointly managed by KMS Fine Art Group and PMG Funds Management. In 2015, it had raised about \$17 million from an unknown number of investors, and reported a total return on investment of about 33%. It is an open-ended fund, and allows investors to withdraw their investment on a quarterly basis.<sup>60</sup>
- The Scheryn Art Collectors' Fund is based in South Africa.<sup>61</sup> It launched in 2015, and focuses exclusively on contemporary African art. It was founded by South African art collectors Herman Steyn and Dabing Chen, who provided an initial investment of about \$1.6 million. The minimum investment is about \$40,500 and the fund hopes to raise about \$40.5 million. The primary purpose of the fund is to promote African art, rather than generate a return, and it accepts investments in the form of cash or artworks.<sup>62</sup>

55. David E. Adler, *Art Funds Bidding to be Considered a Real Asset Class*, INST. INV. (Nov. 29, 2011), <http://www.institutionalinvestor.com/Article/2941263/Art-Funds-Bidding-to-be-Considered-a-Real-Asset-Class.html#.WbvUCVeiPdk> [<https://perma.cc/8DP3-UYEH>]; Grant, *supra* note 40.

56. Rebecca Hawkins, *Art Funds Survey 2015*, PRIV. ART INV. (Apr. 12, 2015), <http://www.privateartinvestor.com/art-finance/art-funds-survey-2015/> [<https://perma.cc/A2WT-4QF7>].

57. Rebecca Hawkins, *Profile: Day Star Fund*, PRIV. ART INV. (Nov. 13, 2015), <http://www.privateartinvestor.com/art-finance/art-funds-art-finance/profile-day-star-fund/> [<https://perma.cc/GT2V-MCN4>].

58. See DAY STAR FUND, <http://www.daystarfund.com/> [<https://perma.cc/LB5F-JWMN>]; DAY STAR FUND (Switz.), <https://www.daystar.ch/> [<https://perma.cc/H37V-SD2L>]. But see *Day Star Private Fund Limited*, GIB. FED. SERV. COMM'N, <http://www.fsc.gi/regulated-entity/day-star-private-fund-limited-17588> [<https://perma.cc/29K9-R7FB>].

59. *Disclaimer*, FINE ART INVEST FUND, <http://www.faiif.ch/de/disclaimer.htm> [<https://perma.cc/5879-J4XN>].

60. Rebecca Hawkins, *The Fine Art Invest Fund: The Photography Fund*, PRIV. ART INV. (Apr. 30, 2015), <http://www.privateartinvestor.com/art-finance/the-fine-art-invest-fund-the-photography-fund/> [<https://perma.cc/HSZ2-SP2R>].

61. *Scheryn Art Collection*, THE CLARION LIST, <https://www.clarionlist.com/listing/scheryn.html> [<https://perma.cc/94V2-BXG3>].

62. Cristina Ruiz, *Africa Is the New China, so It Must Be Time for a Dedicated Art Fund*, ART NEWSPAPER (Apr. 10, 2015), <http://theartnewspaper.com/news/art-market/africa-is-the-new-china-so-it-must-be-time-for-a-dedicated-art-fund/> [<https://perma.cc/4W2H-SUB5>]; Jenny White, *Herman Steyn: Why I Launched the World's First Contemporary African Art Fund*, PRIV. ART INV. (May 12, 2015), <http://www.privateartinvestor.com/art-finance/art-funds-art-finance/herman-steyn-why-i-launched-the-worlds-first-contemporary-african-art-fund/> [<https://perma.cc/2MNK-CWES?type=image>].

- The Tiroche DeLeon Collection is based in Israel.<sup>63</sup> It launched in 2012 when art collectors Serge Tiroche and Russ DeLeon sold a collection of 230 works to Art Vantage PCC Limited Gibraltar. The fund focuses on artists from developing countries. The minimum investment is \$500,000. The fund will close in 2017 and has a ten year term.<sup>64</sup>

As this survey suggests, enthusiasm for art funds is on the decline. In 2004, the Dutch bank ABN-AMRO announced its intention to create a “fund of funds” for art funds, but soon dropped the plan, concluding that there were too few viable art funds.<sup>65</sup> It would probably reach the same result today. Many art funds have folded, many others report tepid or negative returns, and many others report nothing at all, which is tantamount to the same. Perhaps reflecting the state of the market, the Art Fund Association was formed in 2011 as a trade association for art funds, but its website shows no evidence of any activity since 2013.<sup>66</sup>

### III. THE VIABILITY OF ART FUNDS

Of course, artwork can be a good investment. The art market is enormous, with at least \$50 billion in sales per year.<sup>67</sup> A significant percentage of investments in artwork generate a positive return on investment, and a few are wildly profitable. Many sophisticated investors consider artwork a potentially appropriate element of a diversified investment strategy, and some invest heavily in artwork. While art collectors may also have alternative motives, including the social capital associated with the ownership of desirable artwork, prudent investment is at least a factor.<sup>68</sup>

But is artwork a viable asset class for an investment fund? The typical arguments in favor of art funds are: 1) art is a “hard asset” that investors can use to hedge against inflation; 2) inefficiencies in the art market create arbitrage opportunities; and 3) art funds reduce transaction costs for investors.<sup>69</sup> In theory, art funds could enable investors to hedge against inflation and generate above market returns at lower cost.

63. *Contact*, TIROCHE DELEON, <http://www.tirochedeleon.com/contact/> [<https://perma.cc/F7L4-V5TZ>].

64. Hawkins, *supra* note 56. *See generally* Anna Dickie, *A Conversation with Serge Tiroche: Co-Founder, the Tiroche DeLeon Collection*, OCUA (July 7, 2015), <https://ocula.com/magazine/conversations/serge-tiroche/> [<https://perma.cc/RX6V-FXQP>].

65. Georgina Adam & Brook S. Mason, *Art Funds Struggling*, FORBES (Sept. 20, 2005, 12:01 AM), [https://www.forbes.com/2005/09/19/abn-armo-artfunds-cx\\_0920hot\\_ls.html](https://www.forbes.com/2005/09/19/abn-armo-artfunds-cx_0920hot_ls.html) [<https://perma.cc/E43T-2XVC>].

66. THE ART FUND ASS’N LLC, <http://www.artfundassociation.com/index.html> [<https://perma.cc/4NXF-9L3C>].

67. MCANDREW, *supra* note 7, at 14.

68. *See generally* SCHNEIDER, *supra* note 5.

69. *See, e.g.*, Whyte, *supra* note 43.



### A. Art Hedges

Art funds typically argue that art is a “hard asset” that can be used to hedge against inflation based on evidence suggesting that the art market is not correlated with the equity or bond markets. In other words, when the equity and bond markets decline, the art market does not. When Reitlinger first made that observation in 1961, it encouraged BRPF to create its pioneering art fund.<sup>70</sup>

Interest in the art market as a hedge against inflation spiked when economists Michael Moses and Jianping Mei published the article *Art as Investment and the Underperformance of Masterpieces* in 2002.<sup>71</sup> Their study applied a “repeat sales regression” methodology, measuring investment returns on assets sold more than once. They found that historical average annual returns on art were between equities and bonds, and had lower volatility and correlation than expected, which suggested that art could be used to hedge against equities and bonds.<sup>72</sup>

However, using a similar methodology, William Goetzmann had previously found that historical real returns on art were both highly volatile and highly correlated to the equity and bond markets.<sup>73</sup> And Goetzmann observed that the “repeat sales regression” methodology is vulnerable to a positive bias, because it only measures returns on works resold in the secondary market. The overwhelming majority of artworks sold on the primary market have no value on the secondary market, and most artworks are resold only if they have increased in value.<sup>74</sup>

Ultimately, it is unclear whether and to what extent the art market is correlated to the equity and bond markets. The evidence is inconclusive, because art investors rarely limit themselves to a hedging strategy, with the notable exception of the BRPF art fund. Arguably, the BRPF example supports the hedging theory, as BRPF’s art fund generated only modest returns, while the equity and bond markets generated enormous returns over the same period, suggesting a lack of correlation. However, investors may not find evidence of poor performance in a booming market a particularly compelling endorsement.

And in any case, while the relatively poor performance of the BRPF art fund is consistent with a lack of correlation, it is also consistent with correlation. Perhaps it underperformed the market only because art is typically an underperforming asset. After all, only a tiny fraction of artworks

70. See generally REITLINGER, *supra* note 21.

71. Jianping Mei & Michael Moses, *Art as an Investment and the Underperformance of Masterpieces*, 92 AM. ECON. REV. 1656, 1666 (2002); see also Surowiecki, *supra* note 19.

72. See also Rachel Campbell, *Art as a Financial Investment*, 10 J. ALTERNATIVE INV. 64, 66 (2008).

73. See William Goetzmann, *Accounting for Taste: Art and the Financial Markets over Three Centuries*, 83 AM. ECON. REV. 1370, 1374 (1993).

74. See William Goetzmann & Liang Peng, *The Bias of the RSR Estimator and the Accuracy of Some Alternatives*, 30 REAL EST. ECON. 13, 37 (2002).

sold on the primary market ever have any resale value, and only a minority of those works increase in value.

In any case, if art is uncorrelated to other assets only because it almost always declines in value, while alternatives almost always increase in value, that is hardly a recommendation. Of course, some artworks are purchased for a pittance and become incredibly valuable. But the same is true of lottery tickets, and only a lunatic would suggest investing in the lottery.<sup>75</sup>

Perhaps it is possible to hedge against inflation by investing in art. But the jury is still out as to whether it is likely to work. While many art funds and their promoters talk about hedging, BRPF is the only example of an art fund actually using a hedging strategy. In practice, art funds sell the prospect of above-market returns. Or try to, anyway.

### *B. Art Arbitrage*

Art funds also argue that inefficiencies in the art market create potentially lucrative arbitrage opportunities. The opacity of the art market creates information costs, which cause market failures. Investors with accurate information about the art market can arbitrage those market failures and generate above market returns. Art funds with accurate information could do the same for their shareholders.

But information about the art market is unreliable and difficult to acquire. Public auction results provide some information about part of the secondary market, but are still unreliable, because auction houses only release limited data. Almost all other transactions on the secondary market are private and confidential. And almost no information about the primary market is publicly available. Parties sometime disclose information about private transactions, but there is no reason to believe that information is accurate or representative.

Effectively, accurate information about the art market is synonymous with insider information. If you want information about an art market transaction, you have to get it from a party to that transaction. As a consequence, market-makers typically have the most information and are in the best position to arbitrage the art market.

And in most cases, arbitraging the art market actually requires insider access. As a practical matter, the primary art market is almost entirely closed to outsiders. Works created by blue chip artists are only offered for sale to insiders, who must agree to and observe conditions set by the galleries selling the work. In order to obtain the most desirable works, collectors must cultivate their relationship with a gallery over a period of years. In addition, galleries may offer to sell a work to a collector only if the collector agrees to purchase additional works and donate them to a museum. And

75. See generally Aaron Abrams & Skip Garibaldi, *Finding Good Bets in the Lottery, and Why You Shouldn't Take Them*, 117 AM. MATHEMATICAL MONTHLY 3 (2010).

galleries typically expect collectors not to resell works for a substantial period of time, limiting the liquidity of an art collection.

While outsiders do have access to the primary market via mid-range and low-end galleries, it offers them few arbitrage opportunities. The overwhelming majority of works sold on the primary market will never have any value on the secondary market. While some works sold by mid-range and low-range galleries will eventually increase in value on the secondary market, and a vanishingly small number will become extremely valuable, it is impossible to predict which works will be valuable, and which will not. As William Baumol observed, art investment is always a gamble, and outsiders are the biggest suckers.<sup>76</sup>

Outsiders even have limited access to the secondary market. While anyone can participate in a public auction, the majority of works on the secondary market are offered in private sales. Often, those sales are limited to insiders, and galleries may quote different prices to different buyers.<sup>77</sup>

Art funds are outsiders, with neither insider information nor insider access, which are both sensitive and valuable. Insiders provide information and access only to trusted parties who are willing to pay for them. Art funds have duties to their investors and cannot obtain or utilize information and access as easily or effectively as private individuals. As a consequence, art funds typically purchase works on the secondary market in public auctions.<sup>78</sup> Without insider information or access, their ability to arbitrage the art market is practically nil.

Of course, even a small amount of information can create arbitrage opportunities, especially at scale. Real estate investment trusts generate significant returns in a heterogenous market by leveraging limited information and data analytics.<sup>79</sup> But the art market makes the real estate market look efficient. REITs have access to lots of reliable data about real estate transactions. Art funds have access to almost no reliable data about art transactions. And when real estate declines in value, it almost always still has some value. When artwork declines in value, more often than not, it is effectively worth nothing. While it may be possible for outsiders to identify arbitrage opportunities in the art market, the odds are daunting.

76. William J. Baumol, *Unnatural Value: Or Art Investment as Floating Crap Game*, 76 AM. ECON. REV. (PAPERS & PROC. 98TH ANN. MEETING AM. ECON. ASS'N) 10, 10–14 (1986); see also Arthur G. Korteweg et al., *Does it Pay to Invest in Art? A Selection-Corrected Returns Perspective*, 29 REV. FIN. STUD. 1, 2–4 (2016), <https://ssrn.com/abstract=2280099> [<https://perma.cc/58ZP-PSC7>]. But see Nathalie Buelens & Victor Ginsburgh, *Revisiting Baumol's 'Art as Floating Crap Game'*, 37 EUR. ECON. REV. 1351 (1993).

77. See generally SCHNEIDER, *supra* note 5.

78. HOROWITZ, *supra* note 3, at 146 (“Art funds tend to operate in the retail sector, where values are more established and works can be traded more seamlessly and discreetly.”).

79. Thanks to Christopher G. Bradley for this observation.

### C. Art Transaction Costs

Finally, art funds argue that they can make art investment more efficient by reducing transaction costs, including market research, insurance, and storage. In theory, art funds enable investors to share the costs and obtain volume discounts. In addition, art funds can eliminate insurance and storage costs entirely by lending or renting the works in their collections to museums or private parties. But in practice, the savings are largely illusory, and more than offset by the inability of art funds to take advantage of benefits that are highly salient to private art collectors.

When private investors invest in an artwork, they typically display it in their homes. Moreover, private investors can limit their investment risk by donating works that decline in value to an art museum and taking a charitable contribution deduction for the purchase price of the work. Private investors can also use art investments to defer capital gains taxation, by reinvesting the proceeds of a sale in the purchase of another work.<sup>80</sup> And some unscrupulous private investors may use the opacity of the art market to facilitate tax fraud or launder money.

None of these incentives are available to art funds. When an art fund purchases works, they typically sit in a storage facility at considerable expense until they are sold.<sup>81</sup> Occasionally, museums will borrow notable works and enable the fund to avoid fees, but it is rare. And private parties rarely, if ever, borrow works from art funds.<sup>82</sup> In addition, while the investors in an art fund may reduce some of the expenses associated with acquiring and owning art, they do so at the cost of all of the social benefits of personal ownership. The social capital associated with artwork is highly salient to art collectors. They want to own a Picasso, not be a passive investor in a Picasso.<sup>83</sup>

### D. Access to Capital

The only real advantage associated with art funds is access to capital. BRPF was reasonably successful in large part because it had access to effectively unlimited capital and time, which enabled it to acquire high-value works with limited competition and hold them as long as necessary.<sup>84</sup> But lack of capital is no longer a problem for private investors. Many different parties with effectively unlimited capital are now investing in the art mar-

80. Doug Woodham, *The Tax Strategy That Fuels the Art Market—and That May Be about to End*, ARTSY (Nov. 7, 2017, 4:03 PM), [https://www.artsy.net/article/artsy-editorial-tax-strategy-fuels-art-market?utm\\_source=twitter&utm\\_medium=social&utm\\_campaign=sm-editorial-news&utm\\_content=tw-1-1031-explainer](https://www.artsy.net/article/artsy-editorial-tax-strategy-fuels-art-market?utm_source=twitter&utm_medium=social&utm_campaign=sm-editorial-news&utm_content=tw-1-1031-explainer) [https://perma.cc/98TF-YZ24]

81. Shaw, *supra* note 40.

82. HOROWITZ, *supra* note 3, at 151 (2011).

83. In theory, membership in an art fund could also be prestigious. Perhaps La Peau d'Ours owed its success in part to the prestige or camaraderie of membership. Thanks to Christopher G. Bradley for this observation.

84. Lindsay, *supra* note 33.

ket. And insiders are likely to find private parties more attractive business partners than art funds.

Moreover, the “mutual funds” of the art world are effectively art museums. Institutions like the Metropolitan Museum of Art, the Museum of Modern Art, and the Louvre hold collections vastly larger and more valuable than any private collector. But art museums are uniformly charitable organizations, which cannot have investors.<sup>85</sup>

#### IV. FINTECH ART FUNDS

Fintech is typically defined as “a new financial industry that applies technology to improve financial activities.”<sup>86</sup> Essentially, fintech companies use technology to provide higher quality, less expensive, and more convenient financial services to businesses and consumers, typically via the internet. Among other things, fintech uses data analytics to help market participants make more economically efficient decisions. Fintech firms have already transformed the insurance, investment, and lending markets, and are poised to enter many other markets, pending regulatory approval.

The idea of applying fintech tools to the art market has been floating around for years. In 1970, the German business magazine *Capital* created an artist ranking called *Kunstkompass*, which was intended to rank artists by reputation, an implicit measure of value. And when investment banker Bruce Taub launched the art fund Fernwood Art Investments in 2003, he claimed:

We are the first independent firm to develop a comprehensive suite of art-focused investment research, advice, financial products and services for sophisticated investors and collectors. Our work generates new ways to participate in the art market and, in the process, brings significant new capital to the art economy. In short, Fernwood is employing rigorous portfolio management techniques traditionally applied to equities, bonds and commodities, in combination with academic and art trade expertise, to derive investable art insight... The difference between art collecting and art investing is Fernwood.<sup>87</sup>

Essentially, Fernwood’s business model was to apply an early version of fintech to generate information about the art market and provide investment opportunities to accredited investors. But Taub predicted that fintech

85. With the notable exception of private museums, like the 21c Museum Hotel chain. See 21c MUSEUM HOTELS, <https://www.21cmuseumhotels.com> [<https://perma.cc/P2WT-F26Z>]

86. See, e.g., Patrick Schueffel, *Taming the Beast: A Scientific Definition of Fintech*, 4 J. INNOVATION MGMT. 32, 46 (2016); see also George Walker, *Financial Technology Law—A New Beginning and A New Future*, 50 INT’L LAW. 137, 145–46 (2017). But see Douglas W. Arner et. al., *The Evolution of Fintech: A New Post-Crisis Paradigm?*, 47 GEO. J. INT’L L. 1271, 1277–78 (2016) (arguing that the interlinkage of finance and technology has a long history dating to the mid-nineteenth century).

87. HOROWITZ, *supra* note 3, at 143.

would eventually enable art funds to provide access to the art market to retail investors as well:

The securitization (perhaps a better term would be “democratization”) of previously illiquid investment categories is a steady, ongoing trend that has gained momentum with the spread of global capitalism, to the benefit of increasingly wider groups of investors. These benefits are typically enjoyed first by a small, privileged group of insiders, then by a wider group of sophisticated investors, and finally become retail investment opportunities available to all. Equities and bonds made this journey over the last century, and funds-of-funds are now making more non-traditional investment categories (such as hedge funds and private equity investing) accessible to individuals with smaller and smaller amounts of capital to invest. I believe that art is heading down the same road, to the eventual benefit of all investors.<sup>88</sup>

When Taub launched Fernwood, his goal was to raise \$150 million for two art funds: the “Senior Allocation Fund,” essentially an art market index fund, and the Opportunity Fund, essentially a hedge fund. But he only raised about \$8 million, and Fernwood folded in 2006.<sup>89</sup>

In theory, fintech could increase the efficiency of art funds, and even make them accessible to retail investors. Art funds could apply fintech tools to art market data, and enable retail investors to make efficient investments in art. But in practice, fintech probably has little to offer the art market. Indeed, the utopian premise of fintech is fundamentally incompatible with the dystopian reality of the art market.

The purpose of fintech is to make markets more transparent and efficient. But the last thing the art market wants is transparency or efficiency. On the contrary, the art market depends on opacity and inefficiency. Participants in the art market disclose as little information as possible. And when they do disclose information, there is rarely any reason to believe it is accurate.<sup>90</sup> As a consequence, the art market is largely a black box. The only semi-reliable information is auction results, and even those are compromised by withdrawals, guarantees, and buy-backs. Without access to accurate data, fintech is largely useless. You can’t analyze data you don’t have, and analyzing inaccurate data can only produce meaningless results. As computer scientists are wont to observe, “Garbage in, garbage out.”

Nevertheless, several different companies are trying to use fintech tools to analyze or arbitrage the art market, with varying degrees of success. ArtRank uses proprietary data and algorithms to predict the market

88. *Id.* at 160–61 (quoting Bruce Taub, *New Choices for Sophisticated Investors*, FIN. MAG., Apr. 2005).

89. Daniel Grant, *\$8M Embezzlement Suit Targets Fernwood CEO*, ARTNEWS (Apr. 17, 2007), <http://www.artnews.com/2007/04/17/8m-embezzlement-suit-targets-fernwood-ceo/> [<https://perma.cc/4BMN-ECT8>].

90. SCHNEIDER, *supra* note 5, at 12–13.

performance of contemporary artists.<sup>91</sup> Similarly, ARTSTAQ uses proprietary data and algorithms to create the equivalent of a stock exchange for art.<sup>92</sup> And Arthena uses fintech tools to market art funds to accredited investors.<sup>93</sup>

#### A. *Sell You Later / ArtRank*

The most effective use of fintech in the art market is probably Carlos Rivera's ArtRank, which purports to provide the equivalent of financial reports on the art market.<sup>94</sup> Rivera graduated from USC in 2009 and opened a gallery in downtown Los Angeles.<sup>95</sup> The gallery was a commercial success, but he closed it in 2011 to run a single-investor art fund. Unlike other art fund managers, Rivera didn't rely on art experts, but hired a "data scientist" and a "financial engineer."<sup>96</sup> Essentially, Rivera developed an algorithm that told him when particular works of art were likely to increase or decrease in value. According to Rivera, his first art fund generated a "4200% return on investment in 16 months," turning a \$700,000 investment into \$12 million, and he ran "a few" more funds using the algorithm, with similar results.<sup>97</sup>

On February 8, 2014, Rivera launched the iconoclastic website SellYouLater.com, which provided a rudimentary ranking of emerging artists and recommendations on whether to buy or sell their work. And the SellYouLater website explained:

SellYouLater™ ranks emerging artists using qualitatively-weighted metrics, including web presence (verified social media counts, inbound links), studio capacity and output, market maker contracts and acquisitions, major collector and museum support, gallery representation, and auction results.<sup>98</sup>

Essentially, SellYouLater used Rivera's algorithm to track and predict the market performance of selected artists, and placed them into one of five categories: "BUY NOW <\$10,000"; "BUY NOW <\$100,000"; "SELL

91. ARTRANK, <https://artrank.com/index.php> [<https://perma.cc/E9UL-82PW>].

92. ARTSTAQ, <https://www.artstaq.com/> [<https://perma.cc/U9Q9-EB64>].

93. ARTHENA, <https://arthena.com/> [<https://perma.cc/E9EE-M8RL>].

94. See generally Andrew M. Goldstein, *Art Rank Founder Carlos Rivera on Why He's Leading the Flipper Revolution—and Why It Can't Be Stopped*, ARTSPACE (June 11, 2015), [http://www.artspace.com/magazine/interviews\\_features/expert\\_eye/carlos-rivera-art-rank-interview-52904](http://www.artspace.com/magazine/interviews_features/expert_eye/carlos-rivera-art-rank-interview-52904) [<https://perma.cc/3DER-HK65>]; Eric Bryant, *Behind the Anarchist Art-Market Predictors SellYouLater.com*, ARTSPACE (Feb. 13, 2014), [http://www.artspace.com/magazine/news\\_events/art\\_market/sellyoulater-52048](http://www.artspace.com/magazine/news_events/art_market/sellyoulater-52048) [<https://perma.cc/XBJ7-RC45>].

95. Goldstein, *supra* note 94.

96. *Id.*

97. Bryant, *supra* note 94; see also Goldstein, *supra* note 94. Rivera's claims are not substantiated. A cynic might wonder why anyone would share such profitable information with the public.

98. Bryant, *supra* note 94.

NOW (peaking)”; “LIQUIDATE (trending down)”; and “PURGATORY.”<sup>99</sup>

Typically, art market analysts review auction results, observe the price trends for particular artists, and assume those trends will continue. Needless to say, that is not a particularly sophisticated or reliable methodology.<sup>100</sup> As investment advisors have long observed, past performance is no guarantee of future results. By contrast, SellYouLater claims to predict the likely market performance of an artist’s work based on data other than past performance.

Sell You Later sent a shockwave through the art world. While it flouted art market norms by treating art as a commodity, everyone wanted the information it provided. According to Rivera, SellYouLater gathered data from about twenty-five art world professionals in exchange for advance notice of its predictions, which were then made publicly available on the Internet.<sup>101</sup>

Initially, Rivera ran SellYouLater anonymously, using the pseudonym “S. Lysell.”<sup>102</sup> But he soon dropped the pseudonym and rebranded SellYouLater as ArtRank,<sup>103</sup> which operates on a “freemium” model. In other words, ArtRank’s quarterly “Public Index” is published on its website, but members get access before publication. A basic membership is free and provides access to the Public Index ten days before publication, but a premium membership is expensive and available only to a limited number of people. For example, early access to the fourth quarter 2017 ArtRank Public Index provided access 21 days before publication, but cost \$10,000 and was only available to 10 people. It is unclear how many premium memberships ArtRank sold, if any.<sup>104</sup> Notably, ArtRank does not currently publish a quarterly Public Index. The ArtRank website currently features its 2016 Public Index, but promises publication of its 2017 Public Index on September 9, 2017, which has come and gone.<sup>105</sup>

ArtRank claims to use fintech tools to analyze the art market. Of course, ArtRank’s methodology is proprietary, but according to Rivera, it gathers data related to six factors:

1. Presence
2. Auction results
3. Market saturation

99. *Id.* (Q: “In the rankings, what do you mean by ‘purgatory?’” A: “These artists’ market relevance has either subsided or gathered insufficient momentum to belong in the actionable categories. We do not intend a negative connotation, but we do not believe the artists of this cohort to be timely investments.”).

100. SCHNEIDER, *supra* note 5, at 54–55.

101. Bryant, *supra* note 94.

102. *Id.*

103. ARTRANK, *supra* note 91.

104. 2017 ArtRank Public Index: Early Access, ARTRANK, <https://artrank.com/products/artrank-q4-2016-index-early-access> [<https://perma.cc/78NP-GSJ7>].

105. *Collect Smarter*, ARTRANK, <https://artrank.com/index.php> [<https://perma.cc/K86H-6444>].



4. Market support
5. Representation
6. Social mapping

It then uses its proprietary algorithm to make a prediction about the performance of an artist's work based on those factors, slotting artists into one of six categories: "BUY UNDER \$10,000"; "BUY UNDER \$30,000"; "BUY UNDER \$100,000"; "EARLY BLUE CHIP"; "SELL / PEAKING"; and "UNDERVALUED BLUE CHIP."<sup>106</sup> ArtRank publishes quarterly projections, and currently sells early access to a limited number of people for \$10,000.

Obviously, the actual content of the factors ArtRank measures is unclear. And Rivera provides little information about what kind of data each factor actually measures. But ArtRank claims to rely on a dataset of "more than three million historical [art market] data points."<sup>107</sup> Rivera has explained that ArtRank relies heavily on data relating to which artists and works selected Instagram users like and repost.<sup>108</sup> The methodology behind the ArtRank algorithm is also unclear, but apparently relies on "weighted qualitative metrics," which sounds suspiciously like a synonym for "opinion."<sup>109</sup>

Surely, it is possible to gather additional data and use fintech tools to improve analysis of the art market. While the factors ArtRank measures and analyses are vague, they sound at least plausibly relevant to performance. For example, an artist's popularity on social media is a plausible indication of demand or the lack thereof. As Oscar Wilde observed, "There is only one thing in life worse than being talked about, and that is not being talked about." Mentions on social media are at least evidence that people are paying attention.

It is certainly possible that ArtRank's algorithm actually provides more accurate predictions than alternative approaches. While its predictions were not obviously wrong, it remains unclear whether ArtRank predicted performance or helped to cause it. The more the art market pays attention to ArtRank's predictions, the more they become a self-fulfilling prophecy, much as investment reports can influence stock prices. And in an illiquid and opaque market like the art market, the feedback loop between prediction and performance is probably even stronger.

Indeed, ArtRank's freemium business model is premised on selling first-mover advantage. Even if ArtRank can't predict the long, medium, or even short-term performance of an artist's work, maybe it can predict ultra-short-term performance, if the release of its Public Index causes a momentary increase or decrease in demand for an artist's work. In theory, even

106. *Id.*

107. *Frequently Asked Questions*, ARTRANK, <https://artrank.com/pages/faq> [<https://perma.cc/4N9S-YJDS>]; Bryant, *supra* note 94.

108. *See Frequently Asked Questions*, *supra* note 107 (discussing how ArtRank codes the number of an artist's "followers").

109. *Id.*

this brief arbitrage opportunity could interest COINs. But ArtRank's failure to publish a 2017 Public Index suggests that no one purchased a premium membership, as they would surely insist on its timely publication in order to profit from its expected market effects. In practice, the art market is probably far too illiquid for an ultra-short-term trading strategy to be effective.

### B. ARTSTAQ

The goal of ARTSTAQ is to use fintech tools to transform artworks into pure investments, essentially creating a "stock market" for artwork.<sup>110</sup> ARTSTAQ was founded by Roman Komárek, a former NASDAQ trader and art collector, and launched in 2015. In many respects it is similar to ArtRank. It gathers public data about art auctions, as well as private data from about 50 art world experts, and uses a proprietary algorithm to generate a numerical rating from one to ten for each artist in its database, which it refers to as the "Art Quotient." According to ARTSTAQ, the higher an artist's Art Quotient, the less risk is associated with investing in that artist's work.

ARTSTAQ lists all of the artists in its database, along with the Art Quotients and trends. Users can buy works by those artists on the site, leave the works in storage, and resell them at any time. ARTSTAQ rates almost 300,000 artists, and ranks them by Art Quotient. Its highest ranked artist is Pablo Picasso, with an Art Quotient of ten.<sup>111</sup> However, ARTSTAQ currently only offers works by "emerging artists," a particularly volatile segment of the art market, and has a total of 711 works available for sale, overwhelmingly in the "low-end" of the market, with prices under \$5,000.

ARTSTAQ allows buyers to choose either home delivery or storage of their art purchases. It charges buyers a commission of from 3–15% of the sale price of the work, with the commission decreasing as the price increases.<sup>112</sup> ARTSTAQ insures all of the works it stores, and promises to authenticate works, with varying degrees of scrutiny, depending on their price.

In theory, ARTSTAQ enables retail investors to easily invest in artwork. It provides information, a marketplace, transaction clearing services, and storage. In practice, it is not yet clear whether there is consumer demand for the services that ARTSTAQ is providing. Its market appears to be quite thin, and it is unclear whether anyone is actually buying any of the

110. See ARTSTAQ, *supra* note 92; see also Robin Scher, *ARTSTAQ Wants to Transform the Art Market into a Stock Market*, ARTNEWS (May 12, 2017), <http://www.artnews.com/2017/05/12/artstaq-wants-to-transform-the-art-market-into-a-stock-market/> [<https://perma.cc/GN7D-7KBS>].

111. *Rating*, ARTSTAQ, <https://www.artstaq.com/rating/artist-list?order=DESC&sort=artisticQuotient> [<https://perma.cc/DBT4-2DX4>].

112. ARTSTAQ's current buyer's commission percentage model is: 15% of the Trading Price if the Trading Price is below \$9,999, 10% of the Trading Price if the Trading Price is between \$10,000 and \$49,999, 7% of the Trading Price if the Trading Price is between \$50,000 and \$99,999, 5% of the Trading Price if the Trading Price is between \$100,000 and \$999,999, 3% of the Trading Price if the Trading Price is higher than \$1,000,000.

works available for purchase. It remains to be seen whether ARTSTAQ's business model is viable, but it is certainly interesting.

### C. Arthena

Arthena uses fintech tools to make it easy to invest in art funds.<sup>113</sup> It was founded in 2013 by Madelaine D'Angelo, an art appraiser and former academic, and hires advisors to create themed collections, which it offers to accredited investors. Representative themes include: The New, Now: Notable Emerging Art; Modern Masters: Invention of the 20th Century; On the Rise: Leading Figures in Contemporary Art; and Emerging New York: From Bushwick to Chelsea.<sup>114</sup> Minimum investments range from \$10,000 to \$250,000, and most of the funds have an offering size of \$1 million, with a five-year term.<sup>115</sup> Currently, Arthena has four open funds and six closed funds, suggesting that it has raised about \$10 million.<sup>116</sup> The target return on investment for the funds ranges from about 10–15%.<sup>117</sup>

In most respects, Arthena resembles the art funds of the previous era. Indeed, in many respects it is almost indistinguishable from Fernwood. It appears to rely primarily on expert judgment, rather than data analysis. Its primary innovation is to use crowdfunding technology to make investing easier. Clearly, there is at least some demand for the services that Arthena is providing. But it is not yet clear whether it is attracting sufficient investment to create viable funds and whether its funds will ultimately generate above-market returns.

There is every reason to be skeptical on both counts. After four years, several funds are still open, and Arthena does not appear to be creating new funds. The stated investment strategy is to buy works at auction based on expert opinion, which is unlikely to generate arbitrage opportunities. And Arthena has not announced any results, even though the five-year term of the funds is about to end.

## V. CONCLUSION

While the history of art funds is long, it is also checkered. Art funds have occasionally provided a reasonable or even substantial return on investment, but often their performance is quite poor. The viability of art funds investing in the secondary market is questionable, given their outsider status. It is possible that fintech tools will enable art funds to identify

113. ARTHENA, *supra* note 93; *see also* Rebecca Hawkins, *Arthena: Crowd Funding in the Art World*, PRIV. ART. INV. (Sept. 16, 2015), <http://www.privateartinvestor.com/news/arthena-crowd-funding-in-the-art-world/> [<https://perma.cc/Z5MW-P6F9>].

114. *Invest in Our Funds*, ARTHENA, <https://arthena.com/funds> [<https://perma.cc/C5DQ-2E88>].

115. *E.g.*, *Blue Chip Artists*, ARTHENA, <https://arthena.com/fund/blue-chip-artists> [<https://perma.cc/6QF2-M699>]; *Established Masters*, ARTHENA, <https://arthena.com/fund/established-masters> [<https://perma.cc/U7YY-SQJ6>]; *Rising Emerging*, ARTHENA, <https://arthena.com/fund/rising-emerging> [<https://perma.cc/A7CG-9BP3>].

116. *Invest in Our Funds*, *supra* note 114.

117. *See supra* note 115 and accompanying text.

arbitrage opportunities and enable retail investors to efficiently invest in the art market. But I wouldn't hold my breath.