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Protecting Your Investment in Fine Art

BY MATTHEW HEALY, WEALTH PLANNER & RISK MANAGEMENT, CENTER FOR WEALTH IMPACT

For centuries, people of means have acquired fine art and other collectibles. Sometimes the buyer impulsively purchases a painting or sculpture after falling in love with it. Other times the acquisition is quite deliberate following an extensive search for the perfect piece to complement a carefully constructed collection. Increasingly, fine art is viewed by some as an alternative asset class for investment purposes. Though generally considered an illiquid asset, art and collectibles may provide portfolio diversification and, under certain economic conditions, may have the potential to outperform equities and other investments.

What used to be a fairly small and closed circle of knowledgeable art collectors and dealers has grown in recent years to a much broader, robust market. In addition to the traditional purchase and sale of art through galleries, dealers, and auction houses such as Sotheby’s and Christie’s, Internet technology has enabled online art auction organizations such as Artnet Auctions® to connect buyers and sellers worldwide, 365 days a year. The art market in 2014 broke all existing sales records, according to the annual TEFAF Art Market Report by Art Economics founder Clare McAndrew, with annual sales topping $53.9 billion.

With more people investing more money in art and fine collectibles, whether for purely aesthetic or for strategic financial purposes, awareness of the risks associated with these investments and the ways to protect these assets is vital.

“We encourage our clients to approach their collections with a healthy dose of pragmatism, just like any other business or investment transaction,” says Matt Healy, Managing Director of Client Risk Management for Ascent Private Capital Management of U.S. Bank. “From the purchase of a piece to its protection in transit, on display or in storage, and through its eventual transfer to another owner, we encourage clients to take steps to protect against potential loss should something happen to the piece.”

Collectors should pay particular attention to confirming ownership, obtaining proper insurance and planning ahead for the eventual transfer of individual pieces or collections to family members, museums or other beneficiaries.

Scott Winget, Senior Managing Director of Center for Wealth Impact in Denver, agrees. “Collectors should consider the importance of risk management for their art collections just as for other assets. Consulting with an insurance advisor who specializes in collectibles is highly recommended. When artwork is used as loan collateral, or donated as a charitable
“Compared to other investment classes, the art market is not regulated and not transparent. Buyers and their advisors routinely cannot find out who owns the art offered for sale.”

Judith Pearson
President of ARIS Corporation

contribution, or otherwise is part of a comprehensive trust or estate planning strategy, careful attention should be paid to who owns it now and who it goes to in the future. Otherwise, there can be significant legal liability and tax consequences, not to mention personal disappointment within families.”

WHO REALLY OWNS IT?

Ownership challenges have always been part of the art-collecting world, particularly for works of art created prior to World War II, when thousands of pieces throughout Europe were stolen. Furthermore, the availability of information online today has spurred an increasing number of contested ownership and provenance issues, according to Pierre Valentin, a U.K. attorney whose international practice focuses on dispute resolution involving art, antiques and design.¹

In order to help mitigate the risk of future title claims, Valentin recommends that when purchasing art, buyers take two important precautions: (1) Research the art’s provenance through the Art Loss Register. If the piece is listed, it may be lost or stolen, and a prudent buyer may decide not to go forward with the purchase. (2) Sign only purchase agreements or bills of sale that include robust warranties and representations with regard to ownership. While a purchase agreement may not provide a guarantee against fraud or possession of stolen property, it may equip the buyer with some legal protection by making the seller responsible for damages should an ownership claim arise.

“Because art can appreciate so much in value, the stakes are higher, and with information now so accessible, it is easier for people to become aware of the movement of art that may be subject to a claim,” says Healy. “We advise collectors to take advantage of as many precautions as are available.”

Ascent works with a variety of professionals to assist clients who want help acquiring, managing and divesting fine art and other collectibles. Judith Pearson, President of ARIS Corporation, is one of them. ARIS is the world’s first underwriter of title insurance for fine art and other precious collectibles. She co-founded the company in 2006 with partner Lawrence Shindell to address a critical gap in fine art collecting for individuals and institutions – insurance to help protect a collector from ownership claims.

“In the art world, just because you paid for it doesn’t mean you own it,” says Pearson. “Compared to other investment classes, the art market is not regulated and not transparent. Buyers and their advisors routinely cannot find out who owns the art offered for sale. Historically, the art market has considered this information to be confidential, unlike the market for real estate, where for more than 125 years there have been regulated repositories of local records and title insurance in virtually every state.”

CONSIDER TITLE INSURANCE

According to Pearson, most people think of risks in the art world in terms of theft – either contemporary theft or reclamation by historical owners, such as works stolen during World War II. Actually, Pearson says, 75 percent of disputes relate not to theft but to liens due to divorce, judgments, taxes or bank loans, or to questions of who has the authority to sell a piece, consignment issues, fractional ownership and other disputes. Prudent buyers may want to work with an experienced insurance advisor and consider obtaining a policy from carriers like ARIS that insure clear legal title, provide coverage against disputes and cover attorney fees.

Why does Pearson believe title insurance for art is so important?

“It comes down to asset liquidity and value,” explains Pearson. “If you don’t have clear title to a piece of art, you can’t sell it, donate it or gift it to a relative or friend without the potential for substantial risk of legal liability and financial loss. You would never dream of buying a home without the assurance that you have clear legal title, and you would never expect to have to give it back. Why would you buy fine art without that same assurance?”

Winget notes that an inability to prove ownership can be particularly damaging if a family had planned to use proceeds from the sale of art to help pay estate taxes or otherwise offset future financial obligations. Without a legal market for the art, the carefully laid estate plan could falter. The same is true if the estate plan includes a donation of art in return for a charitable deduction or to remove a significant asset from the taxable estate. If a museum isn’t willing to accept the gift without confirmation of legal title, the estate may be left holding an asset and a tax liability that was not part of the plan.

DON’T OVERLOOK OTHER INSURANCE

In addition to confirming the provenance and ownership of fine art pieces, collectors are encouraged to verify their works are properly insured against loss in the event of theft, fire or other damage.

“Traditional mass market homeowner insurance policies and riders may not provide adequate coverage for high-value collectibles,” says Healy. “We suggest clients work with experienced property and casualty brokers to identify appropriate insurance coverage that is specifically designed to cover damage and loss wherever that art may be. For example, families will sometimes loan a piece to a museum or transport it from one residence to another. A comprehensive policy from a carrier specializing in the high net worth market should cover the artwork under all of these situations.”
“Plan for the Future

Sometimes families are diligent about protecting their investments in fine art but fail to give equal consideration to another very important aspect of ownership – determining who will inherit these specialty assets and communicating the decisions to family members.

“The disposition of art, whether one special piece or a whole collection, can trigger a range of wealth and family dynamics issues including entitlement, resentment, and dissention,” says Healy. “How do you effectively pass an asset like art – which often is loaded with very personal feelings – through to the next generation? Does it make sense to give your children shared, equal ownership or do you divvy up a collection based on roughly equal value or on personal preferences? What if some family members really care about the same piece of art, or none at all? With so much at stake, not the least of which being family harmony, it is essential to discuss these questions before an event that leads to the disposition or transfer of a collection.”

Ascent’s unique Wealth Impact Planning practice includes Strategic Wealth Coaching services that provide families a framework to help address these questions in a manner that may create harmony rather than discord.

“As in so many other areas of family wealth management, communication and trust are critical when it comes to deciding what to do with an asset as personal as art,” says Healy. “Strategic Wealth Coaches can help facilitate productive conversations among family members to identify and resolve how to appropriately handle the transfer of ownership of these assets.”

Ascent Offers Solutions

“Ascent offices are adorned with revolving displays of fine art created by local artisans,” says Ascent President Michael Cole. “We appreciate the excitement and pleasure our clients express about collecting fine art, and we can help them find resources to manage the risks associated with owning such unique, high-value assets. We welcome questions about this and other aspects of holding alternative asset classes.”
IMPORTANT DISCLOSURES

There are special risks associated with an investment in tangible assets, such as wine or artwork, including market price fluctuations, liquidity risks, and impact of political, environmental, and financial changes. In addition, unique expenses associated with these investments (i.e., purchase and sale, appraisal costs, storage, insurance) may adversely impact investment returns. Investing in alternative assets involves higher risks than traditional investments and is suitable only for the long-term. They are not tax efficient and have higher fees than traditional investments. They may also be highly leveraged and engage in speculative investment techniques, which can magnify the potential for investment loss or gain.

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Matthew Healy has over 22 years of previous experience as an attorney and specialist in insurance planning, succession planning and executive benefits. He focuses on the analysis, consultation and mitigation of a broad spectrum of personal, financial and business risks faced by families of wealth. He serves as wealth planner and risk management for Center for Wealth Impact at Ascent Private Capital Management of U.S. Bank.