INDUSTRY INSIGHTS_

Bridging industries and the road to optimizing art as a financial asset

Leveraging art as a financial asset has grown in sophistication in recent years. From existing collectors using art as collateral to the emergence of art tokenization providing access to the wider public, the innovation potential is significant.

In this article, we at Overstone, an art analytics and finance company, **provide an overview of art's unique features as a financial asset and the necessary tools to extract and protect its value.** We also consider the challenges and barriers that may impede its further integration within the wider financial and insurance ecosystem.

Unlike more traditional classes of financial assets, the art market is influenced by its underlying assets' physical indivisibility. Additionally, asymmetric information, substantial transaction costs, and liquidity issues significantly impact its efficiency. This combination of factors poses a considerable challenge for the art lending market and art's other financial applications.

This market's future growth depends on addressing key challenges, such as establishing robust risk management practices with a particular emphasis on valuation, regulation and liquidity, with the latter being one of the most critical risks of owning art. There are three crucial hurdles in this journey.

The first challenge is the inability to value and monitor art in a universally accepted manner across industries. Art, being the product of human creativity, is a heterogenous good and inherently unique. This uniqueness poses a singular challenge when considering it as a financial asset, from valuation to performance tracking to how it is sold.

Although art is not immune to factors affecting the value of more traditional financial assets, we find that even during global political volatility, other factors can promote a more favorable sales environment. These include its unique supply and scarcity driven market, the complexities around the pricing of art, and its singular positioning as an object not always acquired for financial reasons.

Unfortunately, the valuation of traditional art often appears as a closed shop, with limited transparency outside the industry. To standardize this process, we need to challenge the existing status quo.

One way is through technology and data science. While technology cannot replace art valuation's traditional approaches, the industry can make headway in its standardization journey by using high-frequency data, analyzing data patterns and developing analysis and metrics. This, in turn, enhances transparency and reduces friction within the art market.

A second challenge is that art research lacks a universally accepted methodology. There is still no agreed-upon protocol that ensures the accurate identification of specific artworks' risks, such as authenticity, provenance or condition. This creates an "unknown unknown" for potential participants unfamiliar with the art world.

Standardization is again the crucial first step in this challenge. By establishing a set of structured questions and adopting a systematic approach to answering them, industry stakeholders can receive technology-enabled clarity and direction. Only recently have we seen the emergence of art-tech companies tackling the industry's particular pain points, such as the intricacies of due diligence research. These companies focus on addressing the industry's critical "plumbing," rather than the previous emphasis on sales channel innovations, such as online sales or tokenization.

These innovative solutions comprise a range of applications, such as micro-imaging for verifying the identity of artworks and companies tackling the challenges of material and authenticity risks. However, to be truly effective and gain trust, these solutions must incorporate the art world's deep knowledge, rather than aiming to entirely replace this expertise with technology. Similarly, while there are a myriad of



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collection management systems designed for collectors, commercial galleries, museums and artists, their fragmentation and the lack of standardization act as barriers to growth and more systemic solutions. This can be partially addressed by clear data structuring and standardizing systems to allow for application programming interfaces (APIs). These tools can ease integration, safeguard art, monitor its value, and enable its physical and financial management as part of a collector's or institution's overall assets and risk assessment.

The third and final challenge is a lack of connectivity between art and the wider financial and insurance ecosystem, primarily due to the uncertainty of an artwork's agreed attributes, dynamic value and risks. Connectivity is highly dependent on transparency and data exchange. Therefore, to be effectively connected to the wider financial ecosystem, the exclusive art market must open up and develop coordination mechanisms.

With such a fragmented market, regulation would enhance transparency and elevate the sector's wealth creation. Disclosure and transparency rules are synonymous with responsibility, creating a safer investment environment. However, unlike other markets, the art market does not currently benefit from dedicated external regulation.

These challenges significantly impact not only art collectors seeking loans or insurance coverage, but also museums, galleries and artists. The finance and insurance industries struggle to assess these entities' assets, hindering their ability to offer suitable financing solutions and insurance coverage for the assets themselves and the associated transactions.

With the substantial volume of liquid capital circulating in global markets, there is a clear opportunity to enhance the appeal of art as a financial asset class. Art collateralization and securitization are increasingly being applied to the art as an asset class. We believe that the transition of art to a tradable asset is inevitable, and mirrors the evolution of other asset classes seen across the financial markets.

However, to successfully achieve the art market's financialization, the industry must address the aforementioned issues from a legal, technological, and financial standpoint. To bridge industries and optimize art as a financial asset, we need to harness augmented views of value through data integration, technological innovations, and traditional art expertise. This will undoubtedly enhance the liquidity of art as a financial asset, leading to increased demand and subsequent supply that, in turn, should encourage further innovation.

Art as an investment offers real economic and non-economic returns. While technology and standardization could generate even more meaningful returns, their adoption by the art market has been sluggish for the reasons explored in this article. However, market players are beginning to take a deeper interest in these solutions.