

## **Winds of Change**

### **Specialist fine art insurance looks to the future following Hurricane**

#### **Katrina**

**It may not have wreaked the devastation that Katrina brought to the Gulf of Mexico, but Hurricane Wilma that raged off the Yucatan Peninsula in mid-October 2005 was the most powerful Atlantic hurricane ever recorded. Furthermore, as the 12th hurricane of the season — only the second time that number has been reached since record-keeping began in 1851 — Wilma exhausted the annual allocation of hurricane names, thereafter necessitating reversion to the Greek alphabet.**

This meteorological preamble might seem irrelevant in the context of the Maastricht Fine Art & Antiques Fair. After all, Europe's most prestigious fair is located, one might assume, safely beyond the reach of tropical storms. But sadly art is not entirely immune from the forces of nature. The art market, along with every other area of the global economy, is certain to feel Katrina's reverberations in the form of higher insurance premiums going forward.

With total insured losses provisionally estimated at between \$40-\$60 billion, Katrina remains the most critical single event sustained by the international insurance industry to date, surpassing Hurricane Andrew in 1992 (US\$22 billion in losses) and the Twin Towers attack in September 2001 (\$40 billion). Even the world's largest re-insurers have had some difficulty computing the total cost of recent catastrophes. Swiss Re, the world's second largest re-insurance company, upgraded its own estimated Katrina losses from \$500 million in August to \$1.2 billion a month later. Some experts have suggested that 25-40% of re-insurance capital was wiped out as a result of last year's climate events. Clearly it will be some time before the market fully recovers.

Re-insurance, which every insurer buys, can be thought of as a single worldwide pool of resources, the logic of which dictates that everyone pays for everyone else's losses. Hence events such as Wilma and Katrina could have a noticeable, albeit indirect, impact on the art trade.

In their very unpredictability, climate change and terrorism constitute the most serious challenges to the insurance sector. Terrorism cover has now become an almost essential requirement in the insurance of exhibitions, but invariably presents a major capacity problem. Few insurers have the capacity to underwrite terrorism risk and as capacity diminishes, so cover becomes disproportionately expensive, often bearing little or no relation to the actual exposure. Nevertheless, although museums increasingly insist on such cover, its cost is not always easy for brokers to explain. Meanwhile, more and more collectors are also requiring terrorism cover as a condition of loans.

### **Market capacity**

Despite a popular misconception, the international insurance market is not a monolithic structure, and nor is the fine art component of that market. The bulk of US insurance business now stays within the American market — largely because terrorism has become a critical issue in risk management — but the specialist fine art insurance market is more internationally dispersed. For example, most major international fine art exhibitions are underwritten through a combination of the Company market and Lloyd's, which continues to have very significant capacity for the larger fine art risks.

It has been estimated that Lloyd's currently insures around 50% of global fine art business, including 20-30% of the US market and around 70% of the European market. In 2004, this amounted to £80 million in gross fine art premium. But while in general Lloyd's continues to look very favourably on fine art as a risk, Lloyd's remains only one brand — albeit the most prestigious one — in the global insurance marketplace.

At any given time, different parts of the global industry might respond in contrasting ways to the same events. Recently the US and London markets appear to have been pulling in opposite directions. At the time of writing, certain US insurance brokers were indicating a desire to reduce their rates in a bid to retain business following this year's storms, while the London markets seemed concerned to do the opposite by increasing their rates to recoup losses, create surplus and enhance financial stability ahead of next year's re-insurance renewals.

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Underpinning these contrasting approaches is a widespread industry sense that the market is hardening.

- Fine art in general has always been seen as an attractive prospect for the insurance industry — particularly museums and exhibitions — but art and antique dealers are now being looked at more critically. Indeed some insurance carriers view the art and antiques trade as singularly unprofitable and argue that nothing short of a doubling of prices could make it a viable business.

Against this background, competition is intensifying, with new carriers entering the market all the time, while XL and AIG are currently in the process of boosting their fine art portfolios as part of a long-term business development plan. AXA Art, however, remain the only company in this sector dedicated solely to art insurance; all other specialists offer art cover as an addition to other insurance packages and specie books.

### **Sharing risk**

While competition, expertise and knowledge are increasing, stability in the insurance industry is also dependent on other factors. The recent renewal by the US government of the Terrorism Risk Insurance Act (TRIA) of 2002 has offered welcome reassurance to the US insurance market. Passed by Congress following 9/11, TRIA represents a government commitment to underwrite a proportion of the financial losses to companies in the event of a terrorist attack. Although the Act was designed for the company sector rather than private collections, confusion among consumers led some brokers to provide TRIA to private clients where it did not apply. The Act expired in 2005 but was recently extended following determined lobbying by the US insurance industry. Insurers successfully argued that private capital alone cannot absorb exposure to acts of terrorism and requires support in order to spread risk and build stability.

In such uncertain times, stability and continuity have become precious commodities. By and large, those seeking bespoke fine art insurance — be they private collectors, museums or dealers — have enjoyed a reassuring share of both in recent years. That said, there is now a broad consensus across the international insurance market that specialist all risks fine art cover has traditionally been too cheap. This is almost certain to change following this year's natural catastrophes, as the larger clients among the trade, museums and exhibitions see their premiums rise. To what extent, however, remains as unpredictable as a tropical cyclone. More broadly, there is already speculation that capacity in the fine art insurance market could decrease as underwriters seek more profitable lines elsewhere. Another possible scenario is that those companies offering specialist art cover as a peripheral service might choose to return to their core business. Time will tell.

### **Key drivers**

At present the fine art insurance market may not be growing to any marked degree — there is, after all, only so much fine art requiring insurance at any one time — but the art market itself is changing in response to a range of factors and inevitably this is having an effect on the insurance industry.

These factors might be summarised thus:

- \* **Values for certain types of fine art have risen exponentially over the past decade.**
  - \* **New collectors are entering the market every year as new wealth is created in both emerging and established economies.**
  - \* **Fairs are growing in number and quality as dealers acknowledge the need to take their goods to buyers rather than wait for buyers to travel to them.**
  - \* **Contemporary art is enjoying a bull market and the nature of much of today's contemporary art presents particular challenges for insurers.**
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Inevitably, the continuing rise in fine art values is having an impact on the insurance industry. Higher auction prices invite reappraisal of insured collections, although not all collectors update their insurance schedules with the regularity that insurers recommend. It will come as no surprise following the sale of Picasso's *Garçon à la pipe* for \$104 million, that there are now private collections that contain individual works of art with an insured value of between \$120-150 million. That represents more than the entire London annual fine art premium income.

Such values require commensurate levels of risk management, particularly when the insured works are loaned to exhibitions or shown at fine art fairs. Most of the trade showing at important international fairs such as TEFAF Maastricht will factor the added costs of due diligence into their business and will take the extra duty of care when transporting goods to market. This makes them a more attractive insurance prospect. Security at major fairs is also much tighter and as a result of these two factors losses are comparatively rare. Claims are by no means uncommon, but they tend to be damage-related, often occurring in transit — an increasingly critical issue in art insurance.

#### **Accumulated risk**

Unsurprisingly, with fine art prices rising as they are, international fine art fairs remain an important area of business to the insurance industry. However, fairs also bring challenges. Maastricht represents hundreds of millions of Euros at risk in one location, not to mention the transport of works to and from the fair. Such huge accumulations of risk at certain times of the year and at certain geographical points are notoriously hard to monitor and manage and are so difficult for insurance companies to assess when renewing their re-insurance charters.

The issue of accumulation was thrown into sharp focus following the Momart fire in East London in May 2004. Although representing only 5-10% of Momart's total storage capacity, the loss to the insurance industry as a result of the warehouse fire was estimated at around £60 million — a significant proportion of London's total annual premium income for fine art.

The combination of rising art values and the growing popularity of fairs suggests that the issue of accumulation is likely to become more critical for fine art insurers in the years to come. This will become more noticeable as Russia, China and other emergent economies participate more actively in the annual fairs and exhibitions calendar and as loans between museums become more frequent. Furthermore, although it is not a subject many people like to ponder, the risk of terrorism continues to lurk in the background.

### **Increased globalisation**

Russia and China are acutely aware of the value of visual culture, not only in helping to develop a sense of national identity, but as a powerful generator of economic activity. Ten years ago, Russians bought almost no fine art insurance cover, but today it is a growing market as more wealth is created and as Russian entrepreneurs look to increase their investment in cultural goods and other non-financial assets.

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Until relatively recently, Russian museums were so chronically impoverished that most were entirely uninsured. Whenever an object was loaned to an overseas institution, the receiving museum would insure it. However, in June 2000, the Russian Culture Ministry signed an agreement with six leading Russian insurers to cover state-run museums, although the Ministry still only covers a small percentage of the risk when objects travel abroad, with Lloyd's often underwriting the remainder.

Meanwhile, Russian buyers are becoming an ever more powerful force in the international art market. For example, Russian collectors bought six of the top ten most expensive lots at Christie's London sale of important Russian works of art in November 2005, five of which were new world auction records.

China too will continue to make its presence felt in the market for fine art insurance as newly wealthy mainland collectors seek to reconstitute their cultural heritage. In 2005, Lloyd's won accreditation to operate in China and in the coming decade its Asian business is likely to see significant growth as a consequence. It is too early to speculate to what extent fine art insurance will benefit from developments in that region but industry specialists are quietly confident that ultimately it could bring more business into the market.

### **Contemporary trends**

Another notable trend in the art market over the last three years has been the soaring demand for contemporary art. This has been visible across all sectors: at auction, on the fairs circuit and in museum exhibitions. The insurance market has been a quiet beneficiary of that swelling interest. Sale totals at auctions of contemporary art now regularly outstrip the traditionally dominant Impressionist and Modern category, while the success of Art Basel, Art Basel Miami, and London's annual Frieze fair — the capital's first truly international contemporary art fair, now in its fourth year — are among many reliable indices in the fairs calendar of the seemingly insatiable demand for contemporary art among both novice and established collectors.

In the US, spiralling prices for contemporary art and for classic American modernism have been fuelled in no small measure by the emergence of a new generation of hedge fund millionaires, many of whom see art collecting as an enjoyable and fashionable means of diversifying their investment portfolios. Not all new collectors are aware of the need for bespoke insurance, however, and many require educating about the care and preservation of works of art, about what to be aware of when buying and selling, about how a loan agreement ought to be constructed, and so on. Hence it is increasingly important for insurance professionals to be ready and able to enlighten clients on the potential pitfalls that underpin the pleasures of collecting and the benefits accruing to flexible cover.

Conversely, experienced collectors are becoming more discerning about the services they are offered and more concerned about the financial stability of the companies that are insuring them. Increasingly in the niche area of fine art cover, clients expect not only the financial peace of mind and a problem-free pay-out in the event of a loss, but a range of tailored peripherals to boot — a pre-risk survey, a disaster-recovery plan, expert advice on protection against fire, burglary, natural hazards, etc. A more comprehensive service of this kind has to be paid for, however.

### **Material concerns**

The New York Times's art market columnist Carol Vogel recently asked the timely question, "Where do you turn when the 1960's fluorescent cherry-red bulb in a Dan Flavin installation burns out? What's to be done when the rubber used in an Eva Hesse construction begins to crumble? How do you restore an all-black Ad Reinhardt painting damaged so badly that it has visible blotches and scratches?"

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As this suggests, a good deal of modern and contemporary art provides greater challenges to museums, collectors and insurers than many other classes of art object, largely because of the fragility of the materials in which much contemporary art is constructed. Damage to an Old Master painting can often be restored with minimum diminution of value, but even seemingly minor damage to a contemporary work often results in a claim for a total loss. Furthermore, many contemporary artists today seem less prepared than their forebears to restore a work made earlier in their career and such factors tend to make contemporary art a more volatile prospect for insurers.

For this reason some specialist fine art insurers see significant long-term benefit in promoting awareness of the importance of conservation. AXA Art has just completed a three-year project with Germany's Vitra Design Museum looking into revolutionary techniques for conserving plastics in design objects and are about to embark upon a three-year project with Tate to investigate the conservation of acrylics and other artists' paints. Meanwhile, AXA Art also recently donated one of Ad Reinhardt's signature black canvases from the 1960s to the Guggenheim Museum Study Collection, which is exploring new laser technologies for conserving monochromatic surfaces. Having sustained a certain amount of damaged in transit some years ago, the Reinhardt painting has some unsightly scratches, blemishes and blooms, which make it an ideal object for applied research.

#### **The Spitzer crusade**

Elsewhere, although it barely registered beyond the professional confines of the business world, the zealous crusade for more honest corporate governance undertaken over the past three years by New York Attorney General Eliot Spitzer may ultimately result in a more transparent insurance industry.

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Spitzer exposed an embedded culture of 'contingent commission' payments in the US insurance market in which brokers were receiving, on top of their normal commission, a 'contingent commission' paid by the insurer based on the volume of business placed with that insurance company. Spitzer reminded Marsh McLennan, Aon and Willis Group Holdings, amongst others, that a broker's responsibility should be towards finding the best value cover for his clients rather than seeking the company that paid the most generous rewards for business flow. Swingeing fines were levied and promises of deep-rooted business reform elicited from those found culpable. Although these malfeasances were not revealed as extending into the specialist fine art sector, some professionals believe the resulting reforms could bring broader benefits across the industry.

In the short term, Spitzer's push for a more level playing field has led to closer industry monitoring by the Financial Services Authority. This additional layer of management cost and bureaucratic scrutiny is one of the prices to be paid for greater business transparency.

Finally, the insurance industry remains divided as to the possible impact that the introduction of *droit de suite* — the artist's re-sale rights levy — might have on the specialist fine art insurance market. One school of thought holds that any deterioration in London's preeminent status in the world art market could have a knock-on effect on the levels of fine art insurance business written in London. Others maintain that the location of the trade is immaterial and the capacity of the London insurance market so unassailable that there is no cause for concern. Above all, it is the lingering uncertainty surrounding the precise details of its imposition that is breeding nervousness in the market.

Like a tropical wind, *droit de suite* could still prove a force to be reckoned with.

**Tom Flynn**  
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