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The Wave of the Future?
Canada needs to develop industry-standard appraisals of fine art and antiques
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Like most Canadians in business, appraisers spend a good deal of time looking at what goes on in the United States. There is always a strong sense of looking into the future. Eventually, it seems, many of the trends and changes emerging in the US seep into Canada. For years now, Canadian appraisers have noted the continuing development of generally accepted appraisal standards and report-writing conventions in the USA. Starting with the codified practice guidelines and ethical standards of well-respected organizations such as the American Society of Appraisers (ASA), and continuing with The Appraisal Foundation's creation and development of the *Uniform Standards of Professional Appraisal Practice* (USPAP), the trend in the States is obvious. Appraisal standards are gaining more and more professional and public acceptance.

The first real impact of the *Uniform Standards* on Canadian personal property valuation practices took place a number of years ago when the Canadian Cultural Property Export Review Board re-tooled its appraisal guidelines to deal with widespread donation-related valuation problems. Looking to an existing model, the Review Board appears to have used significant portions of the *Uniform Standards* in the development of their own appraisal parameters. And, as the re-tooling process continues, the Canadian appraisal guidelines are beginning to look more and more like the *Uniform Standards*.

Up until relatively recently, the insurance industry in both countries did not see personal property appraisal standards as a particular issue. Sub-standard or inflated appraisals involved in claims were dealt with on an *ad hoc* basis by adjusters. Little energy was expended, however, on the front end of the problem – the underwriting stage.

This point of weakness has been addressed in the US by the Inland Marine Underwriters Association (IMUA) through the publication of a guide focused on the way the insurance industry deals with appreciable personal property. The *Underwriter's Guide to the Valuation of Art, Antiques & Collectibles* breaks new, proactive ground by looking at the advantages of utilizing professionally prepared appraisal reports for insurance purposes. The document takes a comprehensive approach to the valuation of art and antiques, dealing with the following key areas of concern to the insurance industry:

- Why and when an underwriter should request an appraisal and when is an appraisal *not* necessary
- The specific elements that constitute a complete appraisal
- Object identification issues
- Additional areas of interest and concern such as clear title, volatile markers, etc.

Why and When

The question of why an underwriter should want to request an appraisal report seems obvious to most professional appraisers. We have always argued that it is beneficial for the insured to know exactly what he or she owns, have it described accurately, and finally, have a supportable, defined estimate of the appropriate value placed on the object in the event of a loss.

From the underwriter's perspective, however, there is an excellent business reason behind asking for an appraisal: It allows the insurance company to know exactly what level of financial risk it is exposed to when covering a high value object or collection. Personal property appraisers are more than pleased to deal with valuations after a
loss -- but the cost is borne by the insurance company rather than the insured in most cases. And, if the items are either destroyed or stolen, there is always an element of conjecture on the appraiser's part. The *Underwriter's Guide to the Valuation of Art, Antiques & Collectibles* points out that the only sure way to determine the amount subject to risk is to have an appraisal done in advance.

The IMUA brings up two further business reasons for requesting an appraisal -- mitigation of moral hazard and to establish the exact location of the objects being insured. Insuring an object for more than its actual worth is obviously something an insurance company does not want to do and according to the *Underwriter's Guide to the Valuation of Art, Antiques & Collectibles*, knowing where an object is located can "assist the underwriter in determining PML at a location or concentration of exposure".

As well as establishing value, a professionally prepared appraisal report documents condition – a key characteristic of value with art and antiques. Most non-appraisers have a vague notion that condition impacts on value, but probably are not clear to what degree. With certain property types -- such as Old Master paintings, antique ceramics, and other delicate, high end objects -- obvious poor condition can devalue by 75% or more. Clearly, a professional assessment of the condition of a valuable object by an appraiser is vitally important to the underwriter looking to quantify the degree of exposure to risk. The relationship of condition to value is just too important to ignore.

The final reason the underwriter should request an appraisal is an obvious one. An agreed value will reduce the costs of adjustment and allow supported claims to be paid to the insured quickly. Both the industry and its clients benefit from this.

The IMUA suggests there are three points in time an underwriter should ask for an appraisal from a private or corporate collector - at the inception of the policy, when the collection has changed over time (due to additions or restoration of objects), and every three to five years to account for changes in the market and volatility factors. They also suggest a new appraisal if the object has been involved in a loss and is damaged.

The flip side to knowing when an appraisal is required is knowing when *not* to ask for one. The IMUA notes that independent appraisals usually are not required of public art museums or commercial art dealers. In the case of public art museums, the vast size of collections make individual appraisals out of the question due to cost. There are instances, however, such as when objects are lent to other institutions or toured, when asking for appraisals may be prudent.

As for art dealers, coverage usually is based on either purchase price or selling price. These prices can be confirmed through the dealer's records. Collectors, on the other hand, are handled differently. Experienced appraisers will often advise new client collectors to consult with their insurance professional to establish a dollar value cut-off point. In most cases, lower value works of art or antiques probably will not need individual appraisals -- unless there is a large number of articles in a collection.

Key Elements
Once established that an appraisal is needed by the underwriter, the question arises: What constitutes a complete and professional appraisal report? As mentioned above, formal guidelines do exist within the profession, delineated by organizations such as the American Society of Appraisers (ASA). But to the insurance professional, the most useful guidelines are the *Uniform Standards of Professional Appraisal Practice* – the valuation benchmark document in North America. Copies of this rather lengthy and evolving set of standards can be obtained through The Appraisal Foundation at http://www.appraisalfoundation.org/.

In an effort to distill these accepted appraisal standards down to their most basic level, the *Underwriter's Guide to the Valuation of Art, Antiques & Collectibles* lists and discusses the key parts of the document. They point out that the following should be included in an appraisal document:
- The name and address of the client / insured
- The purpose of the document (typically in appraisal lingo this is identified as the "intended use" of the appraisal). The intended uses for an insurance related appraisal might be for insurance coverage, or for loss/claim in a case of a loss
- A discussion of the valuation approach used – either market comparison, cost, or income. (In insurance related valuations, the most common approaches to value are market comparison and cost)
- A discussion of the "most common market" for the object or objects valued. For example, the retail level market usually is the marketplace an object will be replaced in
- A general market analysis indicating the stability or volatility of the marketplace
- The "acquisition history" of the object or objects. The provenance or history of ownership of an object can impact on value. Additionally, the identification of past vendors may alert an insurance underwriter to potential conflicts of interest (e.g. an appraisal by a vendor may not be viewed as being entirely free from bias)
- A statement of the professional qualifications of the appraiser
- The effective date of the valuation, including a statement of the date of inspection and the date the report is issued
- An indication whether the subject property was physically inspected or not. (Valuations can be issued on the basis of an examination of a photograph, or a good physical description)

- An indication of the basis of the fee structure. (Most appraisal societies view fees based on a percentage of end value or on a contingency basis as unethical Professional appraisers usually bill clients on an hourly rate, on a per object basis, or on a flat fee basis)
- A complete description of the subject property. Objects usually are identified the way they are described in the marketplace, or using museum nomenclature
- When required, a discussion of sales of comparable object in the marketplace (usually for higher value objects or when challenges or litigation is anticipated)
- A specific dollar value rather than a range of values
- An indication of the total number of pages in the appraisal document (preventing use of a part of the appraisal removed from the whole)

In addition to these important elements identified by the IMUA, most professional appraisal societies suggest the following should be included in a professional appraisal document:

- A signed letter of transmittal (on letterhead) summarizing the appraisal assignment and the value conclusion
- A listing of any basis assumptions and limiting conditions that may affect the appraisal document
- A listing of any exhibition history or literature citations that may impact on value
- A complete description of the condition of a subject property, including any old repairs or changes. This should go beyond the concepts of poor, fair, good, very good, or excellent and documents specific condition flaws
- A signed certification indicating compliance with the *Uniform Standards of Professional Appraisal Practice* and the report writing standards of the appraisal society the appraiser is accredited through
- If required, photographs of the subject properties

As suggested, an accurate description of a subject property is an essential part of a useful appraisal document. The IMUA wisely has chosen to promulgate the Getty Information Institute's *Object ID* system. Developed by the world famous Getty Museum in California in conjunction with the input of curators, appraisers, dealers and other cultural property specialists, the Object ID system sets a series of basic parameters that can be used to describe all physical objects.

These include: type of object (e.g. painting, chair, vase, etc.); materials and techniques used in the object (e.g. oil on canvas); measurements (e.g. size, weight, etc.); inscriptions or markings (signatures, dates, etc.); distinguishing features; title; subject matter; date or period; maker or manufactory.

All complete appraisal documents should cover these elements in a physical description of an object valued for insurance coverage, or for any other intended use.

Other Concerns

Rounding out the *Underwriter's Guide to the Valuation of Art, Antiques & Collectibles* are a number of issues that may be of particular concern to the insurance industry: the question of on-line valuations, authenticity issues, provenance and title, volatile markets, and finally the use of sale receipts in place of appraisals.

Briefly, the document notes that online appraisals are most useful in providing initial indications of worth, and may not be accepted by US tax authorities if dealing with objects over $5,000 (US) in potential value. In the case of an audit, the document indicates that a formal written appraisal may be required. Though not entirely dismissive of this type of "appraisal", their limitations to an underwriter are pointed out. As a matter of record, most professional appraisal organizations are circumspect about this type of valuation as they rarely comply with the Uniform Standards.

Issues of authenticity obviously have a significant impact upon value – and by extension on insurance replacement value. The *Underwriter's Guide* rightly points out that appraisers do not explicitly authenticate; that is the purview of curators and other museum world experts. It is noted, however, that appraisers implicitly make a statement of authenticity through their value conclusions. An artwork or antique object assumed to be authentic will be valued at the level of other authentic works. When difficult issues of authenticity arise, most professional appraisers will consult the appropriate experts and proceed with caution.

Provenance and title are interesting in light of issues like Nazi war booty and the recent thefts from museums in Iraq. Artworks and antiquities with murky backgrounds can get entangled in protracted court battles to establish title. The IMUA points out that appraisers do not pass judgment on contentious title claims but do have a responsibility to note them in appraisal reports, if known. Additionally, title disputes do have an impact on value.

Volatile markets should always be addressed by an appraiser if an issue. During the late 1980s and early 1990s a significant "correction" occurred in many areas of the fine art market, while other areas remained more or less stable. Appraisers must be cognizant of the fact that the market cannot be characterized as a whole in most cases. It is the appraiser's responsibility to be aware of the market conditions as they apply to specific property types or categories. The IMUA's guide suggests that underwriters should be prepared to ask for more frequent updates or re-appraisals if a high value object is valued within the context of a market identified as volatile or potentially unsustainable.

The *Underwriter's Guide* cautions insurance professionals about the use of sales receipts as indicators of value. While a receipt documents a purchase, it is not the same as an unbiased and researched estimate of value. The guide correctly points out that receipts are invaluable to the appraiser, and form part of the object's provenance, but that they should not be viewed as definitive evidence of value. It is always possible the object in question was purchased for too much or too little.

Promising Framework

From a professional appraiser's perspective, the *to the Valuation of Art, Antiques & Collectibles* is an excellent framework for dealing with valuable property in an insurance context. It provides both an overview of broad issues associated with the valuation of art, antiques and collectibles, and specific details on the required elements in a professionally prepared appraisal report. The guide is well written and succinct, with little in the way of confusing appraisal jargon and "artspeak". Clearly, this document has been put together for the insurance professional, addressing the concerns and issues of the insurance industry.

Keeping in mind the powerful influence of the United States on Canadian business practices, it is reasonable to speculate that this document could have some positive influence in Canada. If not, it should. There are very few specifically American distinctions in the *Underwriter's Guide to the Valuation of Art, Antiques & Collectibles* and it easily could be adapted to Canada.

Additionally, the global nature of the art and antiques marketplace means that American issues are in many cases paralleled in Canada. But the most convincing argument for using this guide is that it makes good business sense. It doesn't take an MBA to identify that dealing with problems proactively will satisfy clients and generate more profit. And those are the hallmarks of any successful business.