Investigation and Campaign: a call for regulation and transparency in the auctions art market.

A healthy and fair art economy depends upon ethical rules. Transparency and regulation of art auction houses can reestablish confidence in the art trade, boost the market and make it just for all.

Financial secrecy and manipulation of prices by auction houses mislead and monopolize the market at the expense of the whole art industry.[1] Lack of transparency, murky financialization, and collusion in the art auctions harm most traders, artists, and galleries. Despite conducting billions of dollars in trade, auction houses are still unregulated, since they are not publicly listed companies nor are they considered financial firms. As a result they often cause what is essentially fraud, losses to investors, and social inequality in the art world. They also infect cultural values and public institutions, making the need for regulations a serious social matter.

The artist Paolo Cirio has investigated the art market to assemble a list of key practices by auction houses that must be regulated. Cirio's regulation campaign focuses on addressing secrecy and calls for transparency in the market in order to reveal identities of owners and traders of artworks as well as accurate prices and financial arrangements set at auctions.

Third-party guarantees

Also called "Irrevocable Bids", third-party guarantees involve undisclosed individuals or companies who agree to purchase artworks ahead of an auction for a secret amount.[2]

Auction houses third-party guarantees are the most controversial practices because they increase financialization and secrecy. The identities of guarantors and their agreements with the house are undisclosed, giving them advantages that the other bidders do not have. Third-party guarantors can also bid anonymously during auctions and thereby manipulate prices to their advantage. They will profit if buyers win with bids above the price prearranged and, if the third-party guarantors place winning bids themselves they effectively receive a discount on the artworks via their cut of the sale's proceeds. In these cases, the actual price realized for such works is obscured since the third-party guarantor pays less than the final publicly listed price. Presale negotiations are also undisclosed and the prices reported by the auction houses include only the new values of the works and not the actual amounts from financial transactions.[3]

Beyond the identities of third-party guarantors not being disclosed by auction houses, the fact that specific works are subject to pre-arrangements with third-party guarantors is only announced at the start of an auction. Because of such increased opacity, everyone outside of a small group of insiders is left in the dark about these agreements made before the auction and most of the attendees and bidders are thus intentionally misled.[4] Third-party guarantees shift market risk and volatility onto honest buyers and sellers, instead of spreading and diversifying the risk across multiple parties.[5]

It's estimated that over 70% of the artworks sold at the auctions are backed by third-party guarantors,[6] with a total trade of over $2.5bn in 2018, and an overall value of guarantees increased by 50% in one year.[7]

Shadow Banking

Art auction houses can operate like a bank by lending money against the value of artworks. The terms on the loans are not disclosed and are customized for clients. These opaque deals inflate prices and muddy financial flows outside of banking regulations. Since the auction houses are not considered financial institutions, there is little to no scrutiny over them. The customized terms of these loans are designed to appeal to the auction's clients and to encourage them to make consignments they may not have made otherwise,[8] while charging high interest on the loans. Borrowers can use the same loans to buy at art auctions, hedging on prices,[9] and concealing the source of assets.[10]

Sotheby's Financial Services was established in 1988. Since then, lending by Sotheby's has tripled to $682 million in the recent years.[11] It's estimated that the outstanding value of loans against art in America reached $17bn-20bn in 2017, up 13% from the previous year. Such lending has continued to grow at double-digit rates since then.[12]

Private Sales

Art auction houses sell art in secrecy for consignors who don't want to sell at public auctions. In private sales the identities of buyers and sellers are not disclosed, and the auction houses work in confidentiality with clients, conducting the buying and selling process in a secretive setting. Art auction houses have dedicated galleries for private sales and operate as secondary market galleries.

Sotheby's reported $513 million in private sales in the first half of 2012, making commission revenues of $41.5 million.[13] As of 2016 private sales represented 10 percent of Sotheby's total sales[14] and the company aggressively expanded its private sale business.[15] In 2018 Sotheby's private sales topped $1 Billion.[16]

Money Laundering

Secretive financing arrangements by auction houses can be used to launder money through art as security for loans. The Bank Secrecy Act and other federal banking regulations do not apply to art auctions and they are therefore not supervised the way the banks are.[17] Also loans and payments in cash are accepted[18] at art auctions and artworks can be used as collateral to borrow money which can be later used to repay the loan, cleaning the source of the money within art auction houses.[19]

Auction houses allow transfer of assets across borders by shipping art to freeports, or in other disguising manners[20]. The ownership and the value of these artworks change when they are moved between countries around the world.[21] The mispricing and portability of artworks combined with the lack of regulations and coordination between jurisdictions generates a high volume of untraceable money laundering transactions.[22] On top of that, secrecy around the names of buyers and sellers, often indicated just as "private collection" by auction houses, can disguise the source and destination of money and artworks.[23] These subterfuges are often used to launder drug money[24] and they are also used to avoid taxes and financial regulations.[25] For instance Sotheby's was the first western art auction house licensed in China, and its trade has been used to transfer assets out of China which otherwise would be regulated by strict capital control.[26]

In order to avoid anti-money laundering compliance, the art market proposes self-regulation. In 2017 the Responsible Art Market Initiative in Geneva established a set of guidelines designed to help art businesses comply with anti-money laundering and terrorism financing regulations. Early attempts at self-regulation were already made at the Basel Institute on Governance 2012.[27] However intrinsic secrecy and lack of scrutiny still make the art market one of the main financial vehicles for money laundering.

Untraceable Transactions

The art auctions avoid documenting the terms of transactions and deals.[28] This lack of bookkeeping makes it difficult to scrutinize secrecy and manipulation in the market, effectively impeding regulation and accountability. Art market contracts, invoices, and transactions often have no name of individuals, signatures, inventory numbers, or legal terms indicated.[29] Also the country of provenance is not declared and the buyers, sellers, and owners of artworks can be anonymous offshore firms and trusts, or completely obscured.[30]

At art auctions ownership is disguised by designations such "From a distinguished collection" and other such general nomenclatures. In addition, art auction catalogues omit suspicious provenances or previous failures at auction, and there is no agreed standard for condition reports on the artworks. [31]

Insider Trading

Within this climate of secrecy privileged information circulates among a few insiders who use it to orchestrate speculations and secure high earnings in the art auctions market.[32]

Bidders that are informed regarding the state of affairs concerning consignors, estimates, reserve prices, financing arrangements, and guarantees can use such information to artificially inflate prices or bid against clients to manipulate the final values.[33] This information can be transferred from the art auction houses to bidders in secrecy to secure sales and prices of artworks.[34]

Besides this, inside knowledge about future museum exhibitions circulate between curators, dealers, collectors, and trustees. Often, exhibitions in major public art intuitions are funded by the dealers and collectors themselves shortly before they consign artworks of the same artists at auctions. This allows them to boost prices with the auction house complicity.[35] Curators and critics can receive monetary benefits by channeling this kind of information among dealers and collectors marketing their artists.[36]

Misleading Pricing

The auction houses conceal the actual value of artworks through various means. The prices recorded and announced publicly are often significantly higher than the sum actually paid by the buyers.[37]

Financial deals between auction houses, consignors, and buyers are secretly negotiated before auctions. These deals can include payments that are financed by the auction houses themselves,[38] third party guarantees paying only the prices prearranged,[39] and resale agreements.[40] Buyers and sellers can also work together to form rings that bid on particular artworks or artists in order to increase their value with prices recorded at auctions.[41] This so-called "Bidding up" practice involves getting an accomplice to bid on behalf of someone or anonymously make bids over the phone.

Also the art auction houses themselves can inflate estimates of artworks.[42] Such price fixing practices can lead to collectors buying work worth much less than they are priced.[43] Further, once the art auction house determines an arbitrary value as an estimate or reserve price, they alert representatives of the artists, inferring they may need to bid or buy back artworks at the auction to keep the value inflated. In the same fashion the auction houses select only a few artists and artworks[44] for the auctions where they can orchestrate or anticipate bidders willing to register new values[45] or buy it from themselves.[46] This practice called "Buying In" is not recorded and it's also used to keep stable market values. Furthermore, the initial estimate and reserve of prices set by the art auction houses are reinforced through a phony bidding performance by the auctioneer at the beginning of the auction to justify the estimates and create the appearance of demand.[47] This so-called "Chandelier bidding" is deceptive and distorts the true level of interest for a particular lot.[48]

Flipping Prices

The quick buying and resale of artworks in auctions by traders can raise prices exponentially in just a few months.[49] Dealers, critics, and auction houses can plan in secrecy to use publicity and targeted bidding to make some artists become very expensive.[50] Prices can be inflated before an auction using estimates based on hype created by paid press coverage and reviews, or during the auctions when secretive rings of bidders collude to bid the price up.[51]

Young artists are often subject to flipping; they are aggressively promoted in the market to flip the values of new inexpensive commissioned works at art auctions.[52] Earning margins rise very high once naïve collectors start to buy at the flipped prices.[53] However, these speculative operations always need new artists, since profitable margins decline quickly with young artists being unable to justify higher prices in the long run.[54] These cycles of flipping young artists result in losses for the collectors who overpaid for hyped artists and the ruining of the artists themselves not being able to ever sell again for the inflated prices and damaged reputation.

Anti-regulation Lobbies

Art auctions houses have been hiring lobby firms to avoid regulations and aggressively fight legal attempts by clients and artists taking action for fair business practice and rights. For instance, this is the case with the resale royalties law in the U.S.[55], which would conform with the E.U. directive for artists to receive royalties on their works when they are resold at auctions. Such right has been successfully fought by the art auction houses for years with political lobby.[56]

Another relevant case of opposing regulations concerns the "chandelier bidding" practice. Former democrat assemblyman Richard Brodsky spent 19 years attempting to ban "chandelier bidding".[57] In order to increase transparency in the practice, even the republican Senator John Flanagan attempted to pass another companion bill which failed under the strong opposition of the auction houses.[58]

Monopoly

The powerful auction houses and a handful of wealthy collectors control a largely unregulated market. This art auction market is, essentially, an elite club that controls who gets in, what the prices will be, who can buy and who can sell—and therefore, who can succeed and what they must create, in order to do so.[59] Such control is well demonstrated in the very limited number of artists and artworks traded at auctions.[60] Consequently, collectors and investors would rather trade only those artists instead of supporting others in the primary market. With the increasing number of new artists the primary market became flooded with supply of artworks, thus collectors became increasingly dependent upon the auction houses' gatekeeping control of the market and its demands.

Most recently art auctions have begun to promote new artists and artworks themselves,[61] instead of acquiring them from collectors and galleries devoted to supporting and developing artist careers.[62] When art auction houses become themselves art galleries and flippers they damage confidence in the primary market and usurp the role of art galleries thus monopolizing the entire art market.

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