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RISK MANAGEMENT  
FIDUCIARIES & WEALTH ADVISORS



## Risk Management

for Fiduciaries and Wealth Advisors\*

Fiduciaries and other advisors are charged with a duty to use their best professional efforts to protect client assets. This includes protecting clients, their trusts, their estates and their beneficiaries from foreseeable risk of loss when it comes to fine art and other important collectibles. The paramount risk in the art world today is the risk of defective legal title, that is, that the client does not actually own the work of art or other important collectible in their possession. The resulting financial loss to clients, their families and third-party beneficiaries due to the failure of tax, trust, estate and other philanthropic plans can be substantial. If fiduciaries or other advisors do not understand and protect against the risks, then the client can look to the fiduciary or advisor for recourse.

\* This brochure is intended to assist fiduciaries and the broader category of legal, tax, financial, wealth management and other professionals who advise individual clients and trusts, estates and related legal entities around art and other important collectible assets. A fiduciary is a person who is legally required to act for the benefit of another on all matters within the scope of the fiduciary relationship and with a high degree of care, good faith, trust, confidence and candor. Certain fiduciary duties carry specific standards of care, but the general standards of care applicable to fiduciaries equally apply to the broader category of professionals addressed in this brochure.



### *Appreciating Fine Art and Other Collectibles as an Alternative Asset Class*

Fine art and other important collectibles are increasingly viewed as an asset class. Over time, art has proved to be a solid investment-hedge against inflation and the volatility of the equity markets. Banks are devoting more resources to assist clients in building their art collections for investment purposes and to facilitate clients borrowing against their art.

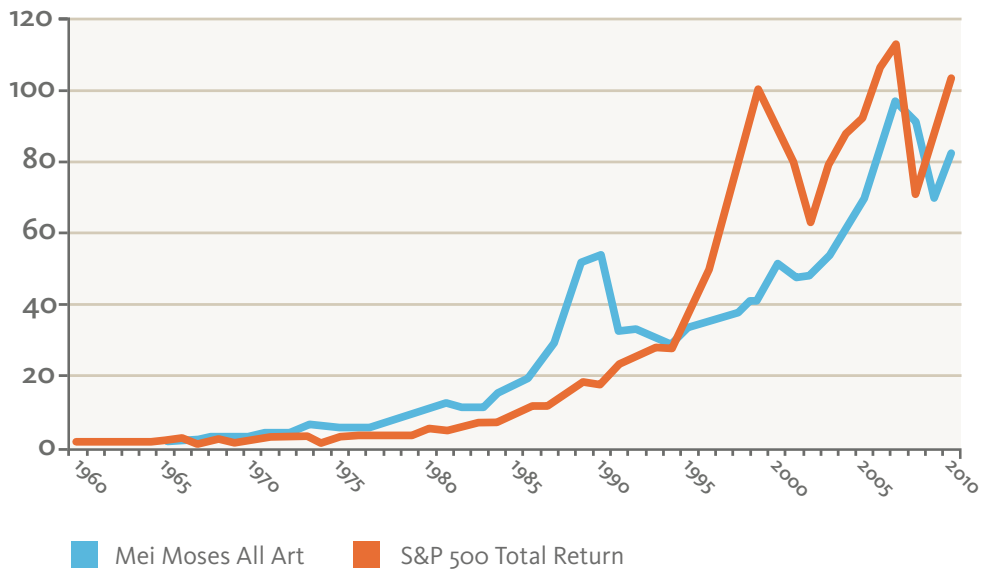
As the art market continues its global reach into China, Russia and emerging markets and through burgeoning on-line website art sales to seasoned and first-time collectors, fine art and important collectibles remain a stable alternative to traditional financial investment vehicles.

New art investment funds have launched in the U.S., U.K., Brazil, China, France and Russia, and art funds are estimated to reach the \$1 billion mark by the end of 2011. High and ultra high net worth individuals and family offices are increasingly investing in art funds to diversify their portfolios and asset allocations.

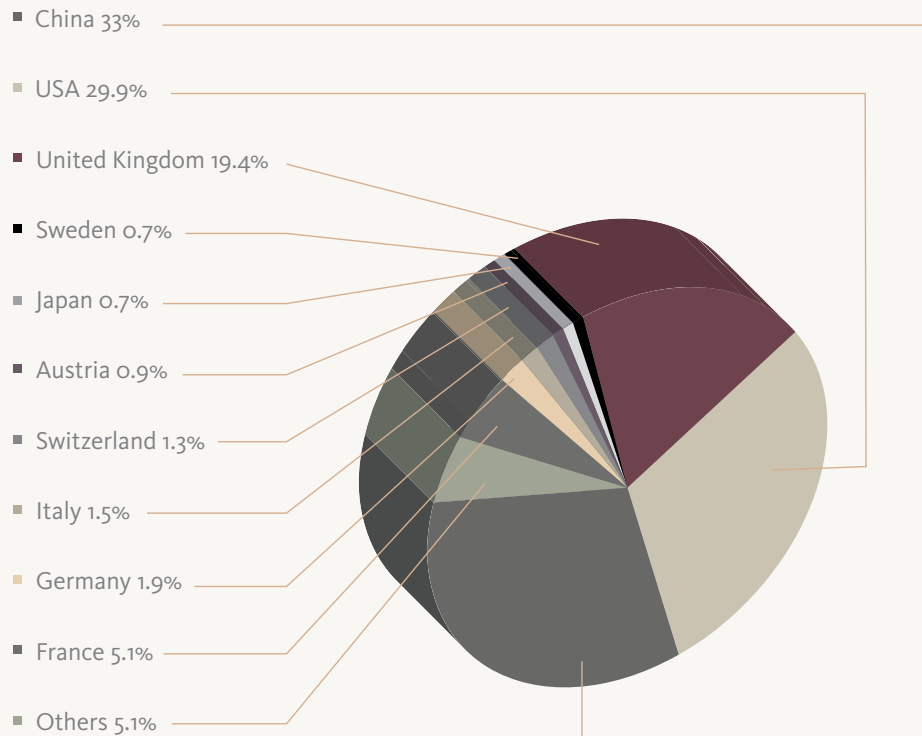
In the U.S., the IRS is more focused than ever before on collecting tax revenue from taxpayers who generate income from their art, which has created new issues around asset valuation and estate tax calculation.

Wealth management advisors are applying the same tax and estate strategies around art objects and other precious collectibles that they have traditionally applied to other assets, requiring implementation of the same risk management tools for their clients' art objects that they apply to their clients' other valuable assets.

### Mei Moses® Annual Art Index and S&P 500 Total Return Index (1960-2010) Year End 2010®

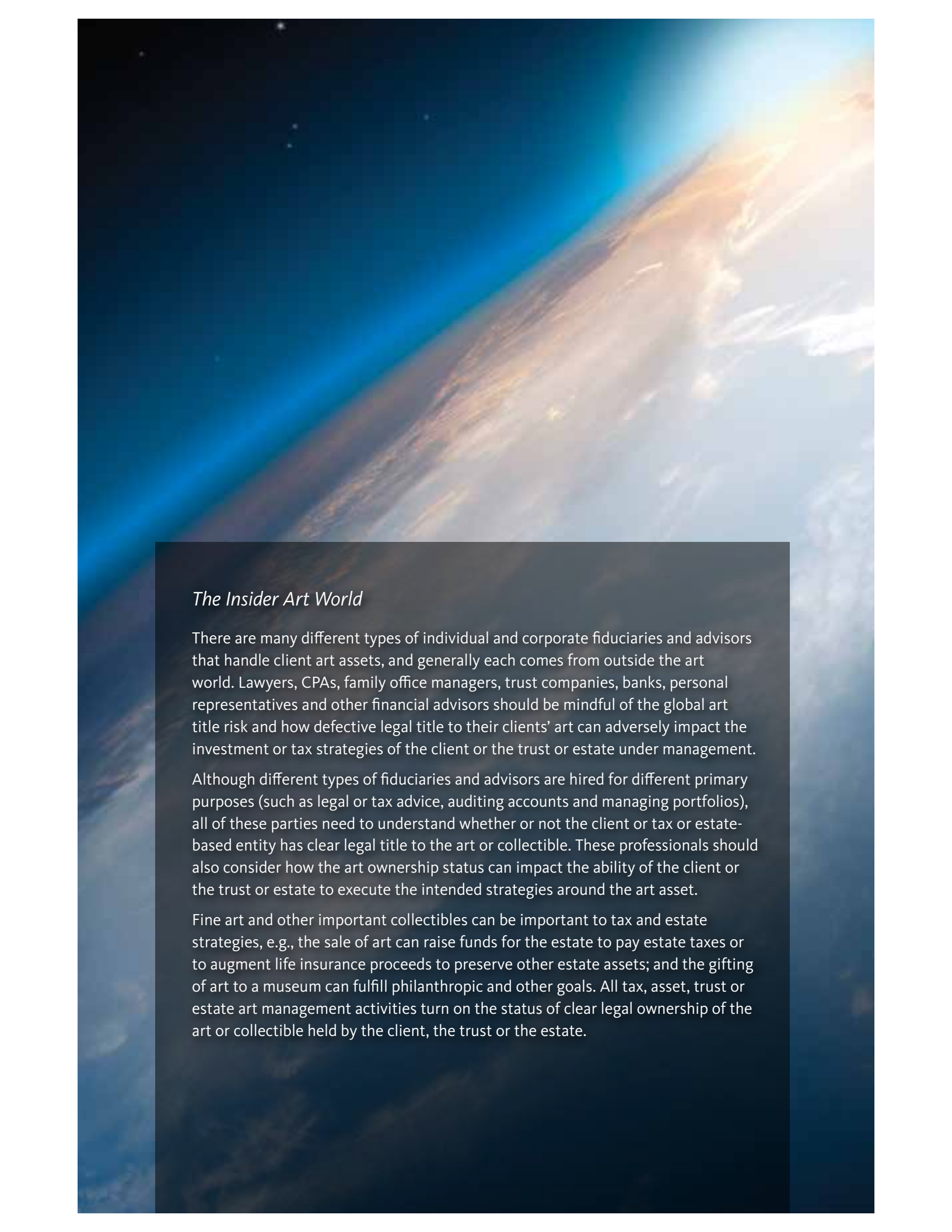


### Fine Art Auction Sales Turnover



artprice: Art Market Trends 2010: Fine Art Auction Sales Turnover Breakdown by Country, pg 14





### *The Insider Art World*

There are many different types of individual and corporate fiduciaries and advisors that handle client art assets, and generally each comes from outside the art world. Lawyers, CPAs, family office managers, trust companies, banks, personal representatives and other financial advisors should be mindful of the global art title risk and how defective legal title to their clients' art can adversely impact the investment or tax strategies of the client or the trust or estate under management.

Although different types of fiduciaries and advisors are hired for different primary purposes (such as legal or tax advice, auditing accounts and managing portfolios), all of these parties need to understand whether or not the client or tax or estate-based entity has clear legal title to the art or collectible. These professionals should also consider how the art ownership status can impact the ability of the client or the trust or estate to execute the intended strategies around the art asset.

Fine art and other important collectibles can be important to tax and estate strategies, e.g., the sale of art can raise funds for the estate to pay estate taxes or to augment life insurance proceeds to preserve other estate assets; and the gifting of art to a museum can fulfill philanthropic and other goals. All tax, asset, trust or estate art management activities turn on the status of clear legal ownership of the art or collectible held by the client, the trust or the estate.



### *Representing Unknowable Information*

In every art sales transaction, whether a private sale through a dealer or gallery or a public auction sale, the seller – i.e., the trustee, executor or other fiduciary acting for the owner, such as the trust or estate – must represent and warrant in the sales or consignment document that the entity has clear legal title to the offered work. The same requirement applies when a trust or foundation gifts a work (or lends a work for exhibition purposes) to a charitable institution as part of fulfilling a trust or foundation objective. After the transaction, if an actual or alleged title defect or challenge arises, the trust, estate and beneficiaries can be liable for indemnity to the buyer or recipient under the contractual guarantee of clear legal title to the art.

Traditionally, fiduciaries have relied on public auction sales as a neutral means to sell art from a trust or estate and to achieve the highest price by competitive bidding. The unrecognized variable in auction sales is that auction houses retain the right to unwind the auction transaction if the auction house later believes that there might be an issue of clear legal title to the sold artwork. Rescission of the sale of trust or estate property years after the sale prevents the trust or estate from achieving finality in the sale because of the risk that it may later have to disgorge the auction proceeds.

### *Taxing Questions in Art Valuation*

When using art objects or other important collectibles to secure tax advantages for charitable gift deductions, deferring capital gain tax payments through “like kind” exchanges and for other tax strategies, fiduciaries and other wealth or professional advisors should be aware that defective title can have significant adverse consequences to the client’s tax strategy.

Often there is some uncertainty about the ownership of art and other important collectibles, and this uncertainty decreases the value of the object. If an appraisal report that complies with the now mandated Uniform Standards of Professional Appraisal Practice (“USPAP”) appraisal standards does not identify the uncertainty of ownership as an economic restriction, encumbrance, assumption or hypothetical condition surrounding the valuation of the appraised art, then the trust or estate can be liable to the IRS for misstating the value.

A fiduciary or other advisor must confirm whether the individual client, or the trust, estate or foundation, has clear legal title to the art or other collectible asset for many reasons. If, for example, the fiduciary or an expert which the fiduciary hires on behalf of the trust, estate or foundation for art title due diligence review discovers a defective title issue surrounding the subject art or other collectible at the eleventh-hour, then it could be too late properly to address the art ownership issue and to achieve the client’s intended, and the advisor’s stated, tax strategies given strict IRS filing deadlines.



### *The Evolving “Duty of Care” for the Art World*

The fiduciary must manage their client’s art assets and render advice with respect to these assets with the highest degree of skill, good faith and prudence even if the fiduciary is unfamiliar with the art industry. In the case of trusts, estates and foundations, this duty extends to protecting and preserving the trust and estate art holdings against damage, loss and liability; and it applies whenever the fiduciary executes the trust, estate or foundation plan – activities which often include buying, selling, gifting or otherwise transferring the fine art and important collectibles.

For wealth advisors and legal, tax, banking or other professionals who do not necessarily fit within the legal definition of a fiduciary, there is a growing trend in the legal landscape of the art industry to establish a heightened duty of care and a corresponding liability for advisors who do not adequately protect their client’s art and other important collectibles from loss including loss due to defective legal title.

Liability claims can be brought against the fiduciary or advisor where, for instance, the fiduciary provides representations and warranties about clear title to the work offered for consignment; the trustee makes arrangements to exhibit the artwork to increase the value of the object and exposes the art to an unknown title claim; or an accountant obtains an appraisal for an artwork that is the subject of a charitable gift and tax deduction and the appraisal does not satisfy disclosure requirements of the IRS with respect to title liens and encumbrances or other conditions affecting an assumption supporting the appraisal.

At all events, trusts and estates can suffer substantial financial losses by relying on the fiduciary’s or advisor’s adherence to the art industry’s traditional due diligence practices, which cannot eliminate the title risk altogether and are highly variable when it comes to identifying classic liens and encumbrances. Losses can be the financial loss of money damages owed to claimants, litigation defense costs, IRS penalties, loss of tax deduction, the physical loss of the art, as well as the reputational loss of the owner, for instance, if associated with WWII stolen art.



### *Avoiding Client Clashes*

One of a fiduciary's most critical duties is the duty to avoid conflicts of interest with the trust and estate beneficiaries when carrying out the wishes of the grantor or person who created the trust or estate. When a fiduciary manages art assets, the fiduciary's interests can be in conflict with the client's interests.

If the fiduciary represents (without the requisite, supporting knowledge or information) clear legal title to trust art that is charitably gifted, the fiduciary can be liable for making a false warranty of title and ultimately can be held responsible for the trust's losses due to the defective title claim. However, if the fiduciary declines to make such a representation about the ownership status of the art, then the fiduciary will prevent the estate from achieving its intended philanthropic goal.

The best-in-class solution to avoiding the dilemma of pitting the fiduciary against the client is to acquire title insurance for the art or other important collectible. This dually benefits the fiduciary and the trust, estate or foundation. The policy replaces the representation and warranty of the fiduciary or advisor and transfers the risk of defective title to a third-party insurer so that in the event of a future ownership challenge, all parties can look to the third-party title insurer for recourse rather than to the fiduciary.



### *“Fiduciary Exception” to Attorney-Client Privilege*

In 2011, the U.S. Supreme Court affirmed that the “fiduciary-exception” to the attorney-client privilege is alive and well. From a liability perspective in the context of trust, estate and foundation administration, this means that when the fiduciary’s actions surrounding the art ownership risk are challenged by a beneficiary, the fiduciary will likely have to disclose to that beneficiary the communications with or advice the fiduciary obtained from the legal counsel about management of the art title risk. As a result, legal advice about the art title risk which fiduciaries secure for the benefit of the entity and its beneficiaries can be watered down to the point of providing little or no effective guidance to fiduciaries, who are charged with the job of handling the art market title risk for the trust, estate or foundation beneficiaries. And, at all events, this type of legal advice, which requires separate expert research on the title risk and is costly and time-consuming, unlike title insurance, provides no financial guarantee to support the fiduciary’s actions.





### *Deducting Premium Costs*

There can be cost-effective ways for a trust and estate or other tax-based entity to pay for title insurance that manages the title risks for art and other important collectibles. The premium can be split among transacting parties including the buyer, seller and dealer or gallery and can be a negotiated, shared cost in the sales agreement. The cost of title insurance generally goes to the tax basis in the art or collectible for capital gain tax purposes. The insurance can be part of a charitable gift for charitable gift deduction purposes. The cost is reduced on a net after-estate-tax basis as a deductible estate administration expense when an estate purchases title insurance as part of selling estate assets. Other added tax efficiencies may apply to the title insurance cost based on the particular circumstances of the taxpayer.<sup>1</sup>

<sup>1</sup> To the extent that this brochure discusses tax matters, it is not intended and should not be used to avoid tax penalties that may be imposed by the law. Taxpayers should seek specific tax advice from independent tax attorneys or accountants based on their particular circumstances. See IRS circular 230. Some deductions can be limited by the 2% exclusion rule, which provides that only amounts greater than 2% of a taxpayer's adjusted gross income can be deducted.

## *Mechanics of Acquiring Art Title Insurance*

The process of acquiring art title insurance is straight-forward. Policies can be acquired at any time for all or part of an existing art collection owned by an individual client or the trust, estate or foundation. Policies are often acquired when parties transfer art out of or into a trust or foundation; before a sale at auction (including for estate settlement); before consigning art to a gallery or dealer; at the time of purchase from public auction or private sale; before lending art for exhibition; or when gifting art to an individual or institution.

Underwriting is based on the applicant's and their advisor's actual knowledge of the status of the work or collectible, not what they "should" or "could" have known about the chain of title. Applicants are asked to complete a standard application form and to provide information and documentation about the art or collectible including the provenance and exhibition history, images of the front and back of the work, the value and past or pending transaction details.

All information and documentation provided to, as well as communications with, ARIS by applicants and their advisors during the application and underwriting process are kept strictly confidential to the extent legally permitted and pursuant to ARIS's standard terms and conditions.





## Argo Group Financials

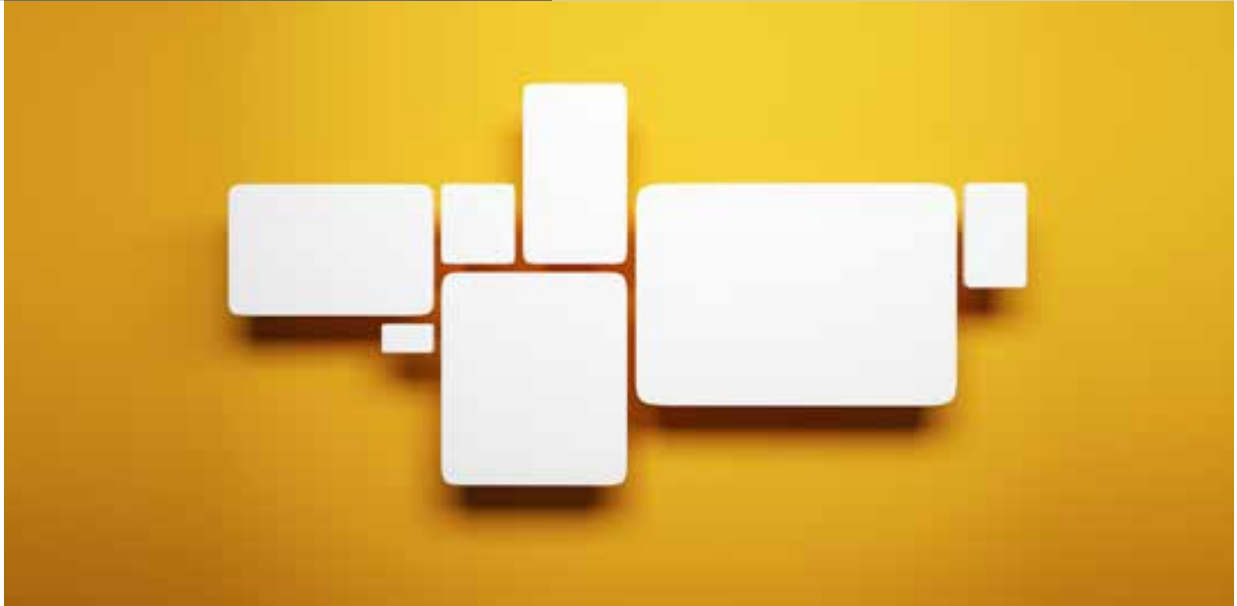
### Balance Sheet

(in millions, except per share data)	12/31/13	12/31/12
Investments & Cash .....	\$4,236.6	\$4,296.5
Receivables.....	1,611.9	1,681.9
Other Assets .....	742.5	710.5
<b>Total Assets .....</b>	<b>\$6,591.0</b>	<b>\$6,688.9</b>
<b>Total Shareholders' Equity .....</b>	<b>\$1,563.0</b>	<b>\$1,514.1</b>
<b>Debt to Total Capital Ratio .....</b>	<b>20.5%</b>	<b>20.9%</b>
<b>Book Value per Share.....</b>	<b>\$58.96</b>	<b>\$60.75</b>

### Financial Strength Rating

A.M. Best.....	A (Excellent)
S&P .....	A- (Strong)

RATING INFORMATION: Argo Group is a publicly-traded company whose principal underwriting subsidiaries are each A.M. Best-rated 'A' (Excellent) (third highest rating out of a 16 rating classifications) with a stable outlook, and Standard and Poor's-rated 'A-' (Strong) with a stable outlook. As a member of Argo Group, ARIS Title Insurance Corporation operates as a separate statutory insurance company and mono-line title insurance underwriter in tandem with Argo Group's full line of products and services.



ARIS Title Insurance Corporation is the recognized global authority on the subject of legal title risks impacting the global fine art market. ARIS is the only insurer that underwrites title insurance for fine art and other important collectibles. ARIS manages art market title risks utilizing underwriting protocols and proprietary tools based on assuming the financial risk of defective legal title, which is in contrast to the traditional art industry practices where the risk is not assumed. ARIS's tools include the only art title plant in the industry, ownership of or access to which is required by law in the U.S. in order to be a licensed title insurance company. ARIS Title Insurance Corporation is a member of Argo Group International Holdings, Ltd. (Nasdaq:AGII).

ARIS Title Insurance Corporation is based in New York, New York, and Denver, Colorado.

Argo Group is an international underwriter of specialty insurance and reinsurance products in the property and casualty market. Argo Group offers a full line of products and services designed to meet the unique coverage and claims handling needs of businesses in four primary segments: Excess & Surplus Lines, Commercial Specialty, International Specialty and Syndicate 1200. Argo Group's insurance subsidiaries are A. M. Best-rated "A" (Excellent).

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