Cryptocurrency Risk Exposures

An increasing number of companies are introducing cryptocurrency into their business models, creating elevated risks more misunderstood than ever before. As a result of the utilisation of cryptocurrency, firms may be not have reconsidered whether their insurance requirements need adjusting, leaving them potentially under-insured or uninsured by today's market standard. Many of these new business activities require a re-examination of the way current insurance policies react and exploration of how new emerging polices can mitigate the risks associated with business activity in cryptocurrency.

As underwriters look to familiarize themselves with the new exposures arising from cryptocurrencies, here are some of the risks to be aware of:

Unclear Regulation - Industry growth has been highly reliant upon unregulated companies, which underwriters can translate to a lack of oversight and proper internal controls. Such risks have been overcome before – ex: lack of a single AML approach in payment and alternative remittance companies. Several insurers are declining to write any client engaging in cryptocurrency or related business until regulatory standards are confirmed.

Custody – As firms increasingly engage with cryptocurrency as a commodity, third party custodian operations are becoming more prevalent. Although best practices for crypto custodianship are still being written, those firms that have clear and defined risk management protocols are being perceived as having a more favorable risk profile and can currently find the most readily available coverage in the marketplace. Underwriters are attempting to standardized cold storage placements due to the high volume of requests they are seeing, designing coverage to protect against loss or damage caused by employee theft, collusion and extortion events.

Cyber Security – Cryptocurrency firms often operate in a centralized manner like most of the traditional firms do, taking away the main security feature offered by blockchain technology. Businesses and individual investors alike are dealing with large disappearances, complex ransomware, extortion events and artificial intelligence powered bots scouring the internet looking for weak links. Similar to cyber threats on different industries, hackers are finding the people, servicing function and storage areas to be easy prey.

Volatility & illiquidity – Not backed by a central bank, insures are concerned about systemic risk of the cryptocurrency industry, currency inconvertibility, the ability for participants to exit the market, and more. In particular, cryptocurrency exchanges that pay customers out of their own funds upon transaction request and then approach the market to sell are seen as having higher risk profiles due to potential market runs and little to no access to credit.

Business & reputational risks – Although established financial institutions engaging in cryptocurrency related activities may be attracting a new customer base, current clients may be frightened or dismayed by the divergence from traditional services. Any negative or adverse regulatory event could trigger a further loss of confidence in the cryptocurrency industry.

As the cryptocurrency industry continues to develop and mature, it is only natural that insurer appetite for cryptocurrency and other digital asset related risks will continue to broaden as underwriters become more familiar and comfortable with these evolving exposures. The risks outlined above associated with this evolving industry do not fit neatly into traditional insurances, calling all participants in the insurance value chain to work in collaboration to develop and tailor new products to fit this growing need. True value will be brought to companies in the cryptocurrency industry by brokers with the right combination of technology experts and experienced insurance professionals.

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