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PERSPECTIVE

BLOCKCHAIN AND THE LAW

Future of cryptocurrency insurance is tough to predict

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The insurance industry has found it challenging to insure cyber data. Cryptocurrencies present even more challenges. Insurance is not yet readily available in the cryptocurrency market, nor is it likely to appear anytime soon in the legislative framework.

While it may seem that cyber-related fraud, embezzlement and theft should fall within standard coverages, the digital world presents special challenges. For instance, how does one even know if a loss has actually occurred, or if it has, how does one know how, when or why? In addition, who is actually insured, the individual, the cryptocurrency trading company or the companies "storing" the cryptocurrencies or "coins."

Cryptocurrencies are basically just data since there are no coins you can touch or carry in your pocket. Cyber insurance, whether of data or cryptocurrencies, raises issues including: the legal liability to others for privacy breaches of confidential information, cyber extortion (aka "ransomware"), cyber terrorism, loss or damage to data/information, and extra expense to recover/respond to a computer attack.

Key Considerations

Cyber Liability Coverage: Because cryptocurrencies are just data they are subject to "hacking." The idea that cryptocurrencies are not subject to hacking and cannot be altered, has already been proven inaccurate. For instance, in February 2018, Coincheck, a Bitcoin wallet and exchange service company in Tokyo, was the victim of hacking. Coins worth $534 million were stolen. To date, there have been few such hacks. However, hacking is likely to increase as cryptocurrency use grows, and hackers become more sophisticated.

The cyber policies presently offered have several limitations. For instance, insurance companies are still uncertain of the complete scope of security measures necessary for cryptocurrency insurance coverage. So far, insurance companies that provide coverage for cryptocurrencies only provide it for storage of coins offline, or in "cold storage." This is because coins stored online, or in "hot storage" (e.g. online wallets), are more susceptible to hacking and theft. For instance, in April 2018, Insurance Market, an online insurance broker based in Singapore, released an insurance policy covering the storage of cryptocurrencies as long as they are stored with a major storage and safekeeping facility.

Crime Coverage: Other insurers are considering theft insurance coverage for companies that handle cryptocurrencies like Bitcoin, Litecoin, and Ethereum. For example, Great American Insurance Group offers a Bitcoin coverage through an endorsement to its crime policy. The protection is offered to commercial or governmental entities that accept Bitcoin payments. However, protection is limited to claims arising from Employee's Dishonesty, Money and Securities Forgery, or Computer Fraud, with some other specialized coverages available as endorsements.

Insurers also face challenges regarding how to cover risks for customers they know little about. For instance, if the trades are done anonymously (a trademark of blockchain usage) insurers have no idea how to insure the purchasers of the coins since little is actually known about them — even by the Storage Companies.

In the cyber world, insurers focus on data security, storage procedures, the scale of the Storage Companies' operations, and the people involved. The potential insurer's examination of the Storage Company involved with cryptocurrencies can take several months. The insurance company's examination process includes providing checklists and consulting to the insureds to help them maintain appropriate security measures.

Volatility Coverage: Additionally, with the growing cryptocurrency market comes a need to hedge against the risks of exchange rate volatility. Considering the market's high volatility, investors wish to insure their assets against rate fluctuations. Several new insurance products fill this need. Bitrust, a cryptocurrency insurance platform, offers a peer to peer insurance coverage against sharp price drops. Additionally since the beginning of the year, ODUWA Coin, a Nextgen cryptocurrency, has offered "insurance and indemnity against cryptocurrency volatility by combining insurance and blockchain technology to provide investors with a way to protect themselves from losses in the cryptocurrency market." (The Currency Analytics, April 11, 2018).

D&O: Perhaps the most difficult form of coverage to obtain in the cryptocurrency arena is directors and officers insurance. This liability insurance covers directors and officers for claims made against them while serving on a board of directors and/or as an officer. In the cryptocurrency environment, initial coin offerings (ICOs) may give rise to a claim by disgruntled coin purchasers. Additionally, federal and state regulators have scrutinized ICOs, issuing several public warnings, and even starting regulatory enforcement actions. Whether such claims will trigger coverage under a traditional D&O policy is being debated. Given such concerns, securing D&O insurance can be a challenge. However, insurers have recently discussed policies that "integrate the technology risks to include private, technology errors and omissions (E&O) and cyber all in one form." (Elizabeth Blosfield, "Insurers May Not be Able to Avoid Blockchain, Virtual Currencies 'Sweeping Through Industry,'" Insurance Journal, Feb. 14, 2018).

The cryptocurrency insurance market is growing rapidly. At the end of 2016 Mitsui Sumitomo insurance started offering cryptocurrency insurance coverage to cryptocurrency exchanges. Its policy offers protection from both internal and external risks like employee- or third-party theft, or even hacking. This type of insurance can help this new industry mature while creating new opportunities for insurers.

The insurance products available for the cryptocurrency market are expensive for most companies since they cost much more than what the company pays for traditional (non-cyber) coverages. Many insurers are not convinced the cryptocurrency business is large enough for premiums to cover possible losses. Another blockade is the lack of governmental recognition of the cryptocurrency.

The future of insurance for virtual coins is difficult to predict. However, if regulators begin to exercise control over the area, insurance should become more available since the regulatory authorities will seek to provide guardrails for the public.

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