Rates set to harden as crypto contagion spooks capacity providers

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Crypto Digital Assets Asia

The FTX collapse-induced crypto contagion is constricting capacity and forcing providers to enforce the restriction of coverage or complete reconsideration of their participation.

Jared Gdanski, CEO and founder of crypto-assets insurance specialist Evertas, warns of a global capacity crunch.

“If you added up every single insurance policy that you could get for crypto, you would have under a billion dollars, probably in the $800 million to $900 million range, at best. Realistically, a lot of the policies get closer to half a million or so”.

The problem, he says, is that there are few full-time providers of crypto insurance and there is a lack of expertise in the industry, for many, it is part of a wider portfolio or a natural transition after covering the cyber market.

“My suspicion is that as you see claims coming in, you’re going to see people get spooked and start to pull out of the market,” Gdanski said.

Joel Pridmore, managing director at MGA Frontier Global Underwriting, doubts that traditional insurers will dive into the crypto space or there will be an influx of capacity coming in the next 12 months.

“What will change as a result of FTX, some toe dippers will perhaps take their toes out now, and probably wait and see, because this will be a shock to them that they didn’t expect”, he said.

Pridmore foresees “jittery responses from certain insurers who didn’t have a very targeted approach to the space”.

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Joseph Ziolkowski, Relm

One of the carriers Evertas talked to has recently stopped doing crypto completely, letting their policies expire. “They were sending out cancellation notices, which is pretty dramatic. As much as drama you will have in the insurance industry”, Gdanski said.

Another problem, according to James Gadbury, divisional director at Costero Brokers, is that with the cyber insurance market hardening, carriers are not looking to write new types of exposure, instead looking more closely at how they can write more of their core business with established businesses.

Costero's Gadbury mentions the regulatory environment as one of the difficulties for underwriters.

"From conversations I've had with PI and D&O underwriters the regulatory environment is one of the biggest barriers to them providing capacity. There is concern that they might provide cover and regulation completely change within the policy period. Suddenly, they have exposure to something they haven't priced for and if you had that situation across a portfolio of business, you can see why they want a more mature regulatory framework to provide cover."

With fewer (re)insurers rushing to add more cyber risks to their books and the ones that are in pulling out as claims come in, it is fairly certain that the markets will harden, however, to what extent is the question.

Joseph Ziolkowski, CEO and co-founder at Bermudan specialist reinsurer Relm, said: "How things are developing is going to be dependent on what are the knock-on effects of the FTX collapse. We're only days into the domino effect. And if this is the extent of it, I think that's going to result in certain impacts on pricing…if there are additional significant downfalls, that is going to have a more negative effect."

Rates increasing with things like smart contracts, DeFi insurance and hot wallets, which are digital wallets that are connected to the internet, are likely to increase, but for cold storage (crypto assets held offline) rates are probably going to stay the same, with long-term cold storage becoming a bit less expensive, said Gdanski.

At the same time, coverages such as professional liability and D&O that historically have less capacity are expected to suffer the most from companies that lack adequate internal controls and governance.

Crypto insurance has been very pricey because of the limited capacity, noted Becky Tam, chief operating officer at Hong Kong-based crypto insurer OneInfinity. "Crypto insurance can cost 10x to 50x more than [conventional D&O and P&I] policies — depending on the risk," she said.

However, Frontier's Pridmore thinks rates have been in line with the risk.

"I don't think they [the rates] are exorbitant, out of line with where they need to be. We are charging the right premium for the risk and, you know, failures, like FTX will prove us right in that…the sector is still not in a space where it's stable or without volatility", he said.

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Product evolution

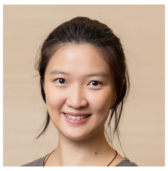
Gadbury sees insurance as "quite siloed" and predicts "we are some way off having crypto insurance as a class in itself". Instead, there may be products that encompass a few of the existing coverages under one policy, the development of such we can see already.

Frontier is offering PI and D&O insurance that Pridmore calls very important classes, allowing companies, projects and protocols to attract high-quality management and directors, leading to "greater governance" and "better behaviour".

Evertas, which has increased its capacity in terms of the total amount of risk policyholders willing to take on and the total number of policies, has been looking to expand to new coverages in the next six months, one of them being crypto-denominated policies, where the insured can pay their premiums and have claims paid in cryptocurrency.

Currently, Evertas is offering a variety of policies, such as theft and loss of crypto, fidelity, fiat crime, E&O and tech E&O, and some other limited coverages on a case-by-case basis.

Ziolkowski also mentioned that Relm is "already capitalising on the development of some innovative products that speak to some of the nuances of operations within the digital asset space".



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Becky Tam, OneInfinity

Asia Outlook

Market practitioners note some positive development regarding the availability of capacity in the Asian market in the last three years and regulators are keen on coming to a common landing on regulations but explain the hesitation of the companies providing more capacity by several reasons.

Asia is the third largest market for crypto adoption, with eight countries in the region making it to the world top-20: China, India, Nepal, Pakistan, Thailand, the Philippines, Indonesia and Vietnam, according to a report by a blockchain data platform Chainalysis.

About 40 % of bitcoin on-chain activity conducted in the top 50 exchanges originates in Asia Pacific. A growing market is noticeable in retail and institutional investors' activity in the region and regulators looking to provide licenses to exchanges and custodians.

"Asia Pacific is a crucial part of the whole conversation globally…and it just takes a commitment to people doing things right, both on the broking and underwriting side…to be able to grow that industry properly", said Pridmore, who has been writing crypto and blockchain policies in Asia Pacific for almost seven years.

He highlights Hong Kong, Singapore and Australia as important centres of crypto, but also draws attention to Thailand in the context of the Securities and exchange commission (SEC) activity.

Tam predicts Hong Kong cornering a bigger pie of the crypto business in the region in the light of recent regulatory developments but laments the lost opportunity due to policy ambiguity during the pandemic.

"A lot of players flew themselves and their money to Singapore, hope that we can gain them back again", Tam said.

The Monetary Authority of Singapore (MAS), meanwhile, has been tightening its stance, recently issuing a statement regarding the absence of insurance of FTX assets, calling dealing in cryptocurrency 'hazardous'.

Governance and regulations

The shift in Singapore's stance is telling from a regulatory and governance perspective.

Raymond Zenkich, president and founder at Evertas, sees FTX collapse as a wakeup call, making investors take more informed decisions. "Risk ultimately is global in nature… people want to know: are my assets safe? That's fundamentally the question they're asking themselves," he said.

Institutional focus may change, as larger holders of crypto will weigh their perspectives of collaboration with certain custodians and exchanges, aligning with an existing trend of large corporate treasuries buying insurance for their custodians, and lead to more demand for insurance and higher scrutiny.

Frontier's Pridmore, who said "they met FTX in Australia" offers an illustrative experience.

"We have no exposure to FTX. We asked too many questions. We were too hard, and eventually, they went elsewhere," he said.

Gdanski emphasises the importance of issues that "have become pressing now with FTX" for crypto insurers. Among them: "segregating client assets, having trust arrangements to protect client funds, ensuring that you're doing the appropriate things from a fiduciary standpoint."

There is a real pressing need for insurance in general...way more acute now with FTX in the last couple of months to the last week and a half. And I think you're going to see a lot of activity within the industry to kind of promote insurance and some other forms of external validation.

Jared Gdanski, Evertas

Crypto insurance infrastructure will require significant investments, similar to those that were previously done for exchange, custodian, data services, and even banking, and promulgation of standards and practices help reduce risk, specialise the market and ensure better security.

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OneInfinity's Tam finds the root cause of high prices and a lack of supply in crypto insurance is the lack of innovation in the insurance industry.

"We would like to see more innovation in insurance, especially on tech and blockchain areas," she said.

While the market is going through a disruption, Costero's Gadbury sees a significant competitive advantage for those ultimately offering the broadest protection for their clients.

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