Markets in Focus

Q4 2024

DIGITAL RISK

Economic Overview & Market Update

YEAR IN REVIEW

The digital assets, blockchain, web3, DeFi, and metaverse sectors experienced significant developments in 2024 that have reshaped the risk landscape and highlighted the urgent need for tailored insurance solutions. As these industries continue to mature, their rapid growth has also exposed new vulnerabilities, bringing attention to the critical role that insurance must play in mitigating risks. This year has seen major regulatory shifts, technological advancements, and high-profile incidents, directly impacting how insurance is structured and priced for companies operating in this space.

Key Industry Events Impacting the Insurance Market

+ **Rising Regulatory Scrutiny:** Governments worldwide have increased their scrutiny of the digital assets industry, particularly in the United States, the European Union, and Asia. The enforcement of new regulations focused on anti-money laundering (AML) and know-your-customer (KYC) compliance has created additional legal and operational risks for companies in this sector. The introduction of the Markets in Crypto-Assets (MiCA) regulation in the EU and further regulatory clarity in the U.S. following SEC litigation will drive demand for compliance-related insurance products, such as directors & officers (D&O) and professional liability coverage.

+ **Major Cybersecurity Breaches:** The sector has continued to surge in sophisticated cyberattacks. One of the most notable incidents this year was the hack of a leading decentralized finance (DeFi) platform, where a vulnerability in transaction verification layers was exploited. These events underscore the necessity for robust cyber insurance and crime insurance policies tailored to address the unique risks of digital asset companies, particularly those managing large pools of customer funds.

+ **DeFi and Smart Contract Vulnerabilities:** DeFi platforms, which operate without intermediaries, have faced growing scrutiny as smart contract vulnerabilities have led to substantial financial losses. In one of the most severe instances this year, a series of flash loan attacks on various protocols resulted in a loss of over **$200 million** across multiple platforms. As these vulnerabilities become more apparent, the market for smart contract audit insurance and parametric insurance products tied to DeFi protocols has seen increasing interest.

+ **NFT Market Volatility and Legal Risks:** The non-fungible token (NFT) market has experienced incredible highs and sharp declines in asset value throughout the year. With some NFT marketplaces suffering from intellectual property disputes and phishing attacks, the volatility in this sector presents new challenges for underwriters. The legal ambiguities surrounding the ownership rights of digital assets like NFTs also highlight the growing need for intellectual property insurance and other niche coverages.

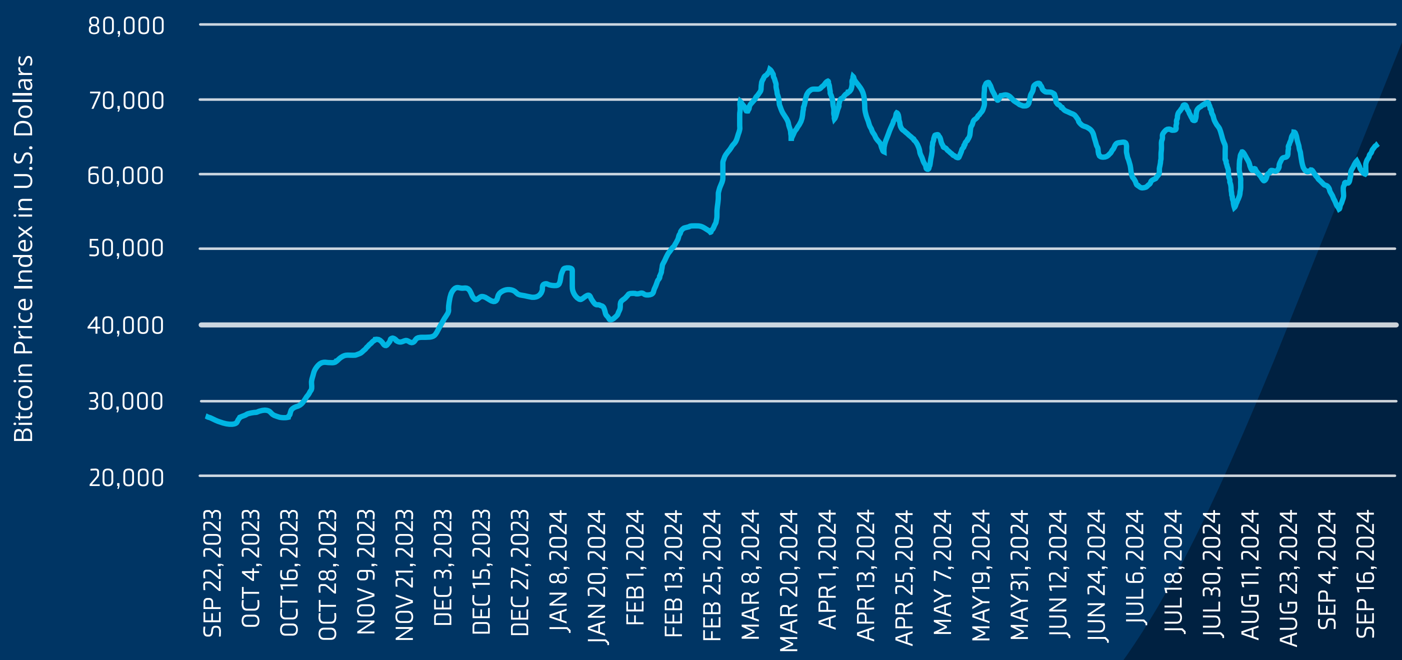
+ **The Metaverse and Virtual Real Estate:** The burgeoning metaverse economy, with its virtual real estate and digital commerce, has added new layers of complexity to the insurance market. As businesses increasingly invest in virtual storefronts and experiences, insuring digital assets within these environments has become a focus.

BTC MINING

Following a few turbulent years, two long-awaited events helped spark a Bitcoin rebound. In January, U.S. regulators approved 11 Spot Bitcoin ETFs, and on April 19, Bitcoin halved to 3.125BTC. The day after it halved, Bitcoin's value reached $73,844, nearing its all-time high of $75,830 set on March 14, 2024.

Unfortunately, Bitcoin's early-year momentum did not carry through into the year's second half. While Bitcoin stabilized in 2024, it did not sustain its first-half momentum. Bitcoin's value has hovered between $55,000 and $65,000 since April, and the Spot ETFs have underperformed. However, cryptocurrencies may realize improved growth in 2025 now that the Fed has begun lowering interest rates. The past 10-year history of crypto and interest rates shows a correlation between the two.[1] Still, market growth may be what defines crypto in 2024.

BITCOIN (BTC) PRICE PER DAY FROM SEPTEMBER 22,2023 TO SEPTEMBER 16, 2024



Source: Statista.com. accessed September 23, 2024.[2]

WHAT THIS MEANS FOR YOU

Stability in the price of Bitcoin offers insurers increased confidence in the industry at large, particularly for BTC mining companies. While property insurance rates remain higher than average for this industry, they continue to decrease compared to past years. This line of insurance tends to be the most expensive overall, so a reduction in rates is a positive development.

Additionally, the D&O insurance market has continued to stabilize and maintain favorability for buyers. For larger publicly traded BTC miners, the wave of class actions and new regulations could impact this line of coverage in terms of pricing and coverage capacity.

Key insurance considerations:

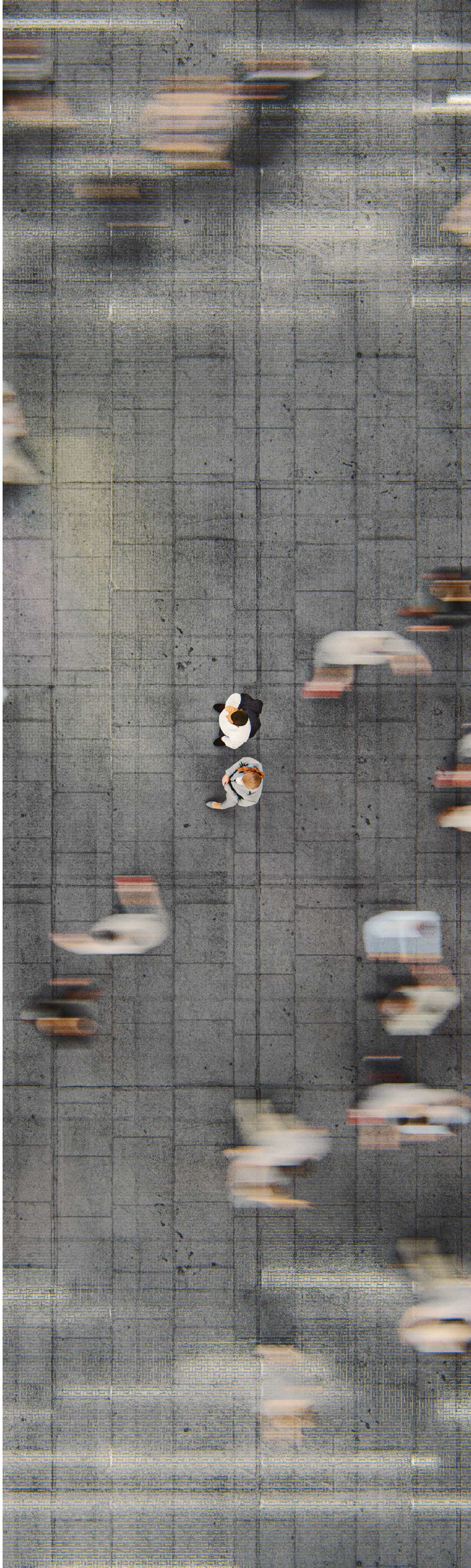
+ **Property** – As next-generation data centers, property values tend to be high for BTC miners. Many miners are also exploring HPC and cloud infrastructure using GPUs with a high cost per unit. Consider the concentration of values and what mitigation to aggregation loss can be achieved. This will greatly impact the overall cost and loss limit availability.

+ **Management Liability/D&O** – Pay attention to emerging regulations from the SEC, which are likely to impact management liability insurance. Additionally, focus on cybersecurity, a key risk area the board needs to understand to adequately protect the company.

+ **Cyber** – Cyber risks remain elevated for BTC miners, as the value of digital assets these companies develop is an attractive target for cybercriminals. Additionally, there are malware variants that specifically target ASICs.

+ **Crime** – Crime coverage should be explored for companies that maintain BTC on their balance sheets. Coverage should also be broadened to include digital assets as "currency/money" and the theft of digital assets by employees and unauthorized third parties.

+ **Errors & Omissions (E&O)** – E&O is often not purchased by BTC miners, though it should be considered for any company that performs mining services for others in any capacity. E&O is designed to cover final loss to third parties due to your product or services.



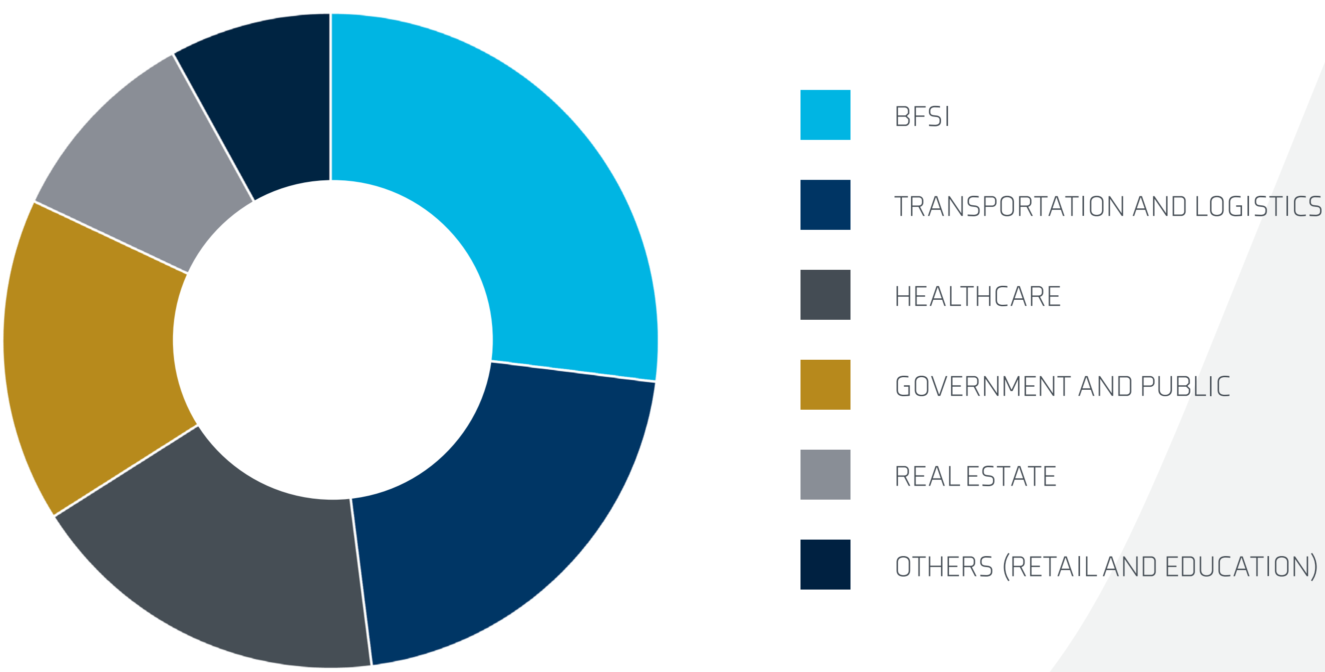
BLOCKCHAIN + WEB3

The blockchain industry continues toward wider market adaptation, and advancements in interoperability continue to be vital in realizing the broader use of this technology. As solutions mature to allow data transmission throughout blockchain decentralized ecosystems that are secure, scalable, fast, and collaborative, more and more developers are creating apps for use in everything from finance to Internet of Things.[3] Blockchain as a service is an evolving opportunity for companies who want to utilize this technology without managing the service in house.

Smart contracts technology realized significant growth in 2024 and is expected to continue over the next several years. Its market is projected to be $2.14B in 2024 and reach $12.55B in 2032. Improving interoperability is driving the current growth, and several industries, including finance, healthcare, and logistics, are already adopting smart contracts. Prospects for its applications are expected to improve for most private industries and government agencies.

While the market for non-fungible tokens, or NFTs, continues to drop in the near term, there is hope that this technology will rebound and become an integral part of web3.[4]

GLOBAL SMART CONTRACTS MARKET SHARE, BY END-USERS, 2023



Source: Medium. May 20, 2024[5]

WHAT THIS MEANS FOR YOU

As web3 and blockchain become more mainstream, finding insurance for companies in this sector has become easier than in previous years. Costs are still elevated for many of the critical lines of insurance, but new markets are interested in providing options for this industry – which will help drive the cost down over time.

Smart contract failure is a unique aspect of this space and not all carriers offer affirmative coverage for this exposure. Having a detailed audit of all smart contracts a company utilizes helps insurers underwrite the exposure and will aid in the balance of premiums and pricing.

Key insurance considerations:

- **Cyber** – Cyber risks remain one of the top exposures for blockchain companies. Social engineering, ransomware, and reputational harm risks can all be transferred to a cyber insurance policy.
- **Crime** – The theft of digital assets/tokens remains a concern for individuals and institutions. A broad crime policy that addresses digital assets should be explored.
- **Slashing** – Investors see slashing as a significant concern when engaging with blockchain validators. While the likelihood of a significant slashing event is rare, procuring slashing insurance may help convert clients and ease shareholder concern.
- **Errors & Omissions** – E&O for blockchain-based companies is a critical line of insurance. Often required via contract with clients, it is recommended as blockchain remains an emerging technology with a limited history in the legal system.

DEFI + CEFI

The DeFi ecosystem continues to mature, presenting new opportunities for innovation as the use of technology fits into the broader financial ecosystem. Traditional financial institutions are recognizing the potential of DeFi and integrating it into their operations.[6] While DeFi was originally a way to allow peer-to-peer digital financial transactions safely, it is now capable of offering everything from basic savings accounts to providing access to a broader range of traditional investment opportunities.[7] One reason for this adoption is the improving technology around crypto bridges, helping blockchains interact with each other and improving interoperability that allows users to transition assets to level 2 networks.

There is an increased focus on security measures and regulatory compliance around DeFi, emphasizing the importance of safeguarding DeFi ecosystems. Enhanced security protocols, audits, and adherence to evolving regulatory frameworks are critical factors for sustaining the growth and adoption of DeFi.[8]

WHAT THIS MEANS FOR YOU

This remains a difficult sector for insurance. Only some insurance companies are willing to take on this risk, especially for larger players in this segment. Often, finding the capacity for the total amount of risk to transfer is a challenge. Many of the larger companies in DeFi and CeFi have developed captive insurance options, as traditional risk transfer is limited.

Key insurance considerations:

- **Cyber** – Cyber risk is the chief concern for users of exchanges and protocols. Cyber-attacks, breaches, and social engineering of users and employees are well documented in the space. Proper controls are required for risk transfer options.
- **Crime** – Theft of digital assets is of equal concern for users, especially in light of FTX. Strong internal controls and policies should be implemented, such as multi-signature frameworks, cold storage, and custodial diversification.
- **Directors & Officers** – Heightened scrutiny on cap tables and executives should be expected. Specialty markets are still typically required, especially in large towers.

METAVERSE + GAMING

While expectations for the growth of the Metaverse have diminished over the past couple of years, it still projects to be a substantial market – around $1.6T by 2030. Investments into AI technologies might have taken dollars and focus away from the Metaverse in 2023. Still, AI technologies from content creation to customer experience are expected to eventually propel a large part in the virtual world's real-world growth.[9] Yet, with AI playing an important role in building out the Metaverse, it also brings all of AI's problems, such as security and user biases.

There is growing agreement that there should only be a singular Metaverse, one space with a set of standards to ensure interoperability. Nearly three dozen companies, consortia, and developer organizations launched the Metaverse Standards Forum to 'foster the development of open standards for the metaverse'.[10]

WHAT THIS MEANS FOR YOU

Metaverse and gaming companies should expect a challenging underwriting process, though options are available. User data protection and safety are paramount, so companies should highlight their efforts there. IP and copyright protection is also of significant importance. As this industry creates standardizations, it will become easier to evaluate – as the current decentralized nature combined with hundreds of different protocols makes it difficult for insurers to underwrite adequately.

Key insurance considerations:

+ **Media** – How metaverse and gaming companies manage media liability risks is important to secure coverage. Well-documented Digital Millennium Copyright Act (DMCA) policies and procedures are required.

+ **Cyber** – Cyber-attacks, breaches, and social engineering are frequent in the Metaverse. Identity theft and invasion of privacy are concerns of users, which need proper risk mitigation to avoid large-scale events that could impact the platform's reputation.

+ **Errors & Omissions** – Technology E&O is a critical coverage for metaverse and gaming companies, as platform failure has the impact to harm its users – especially institutional users and clients financially.

IN SUMMARY

The insurance landscape for digital risk continues to mature. Even as technologies evolve, data that helps underwriters create customized products to fit each sector and an organization's needs is becoming available. While new insurance options continue to open, underwriters are looking for control thresholds to be met.

It remains critical to be as transparent as possible with your broker and the insurance marketplace to unlock the best combination of coverage and cost. Brokers specializing in this space understand how to translate complex technology into simple terms that the market can understand.

Keys to success with upcoming insurance renewals/placements include:

START EARLY

Insurance placements in this space can take longer than other industries, often substantially so. To expedite the process, provide full information, completed application, and any requested supporting data.

HIGHLIGHT CONTROLS AND EXECUTIVE EXPERIENCE

Insurers' chief concerns for digital risks include cyber and board oversight. Having a solid cybersecurity program will impact coverage availability and affordability.

WORK WITH EXPERTS

The marketplace for digital risk remains fragile. To navigate it effectively, it's crucial to understand how your insurance broker can leverage their market and industry expertise to represent your needs. Poor coverage design is unlikely to perform correctly in the event of a claim.

As the digital asset and blockchain industries continue to mature, so too will their insurance options. Until then, preparing for the complex process of obtaining the right insurance program is essential for long-term protection.

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