

Markets in Focus

Q4 2023

DIGITAL RISK

Economic Overview &
Market Update



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Table of Contents

| | |
|---------------------------------|----|
| 2023 Year in Review | 3 |
| Impactful Industry Events | 4 |
| BTC Mining | 5 |
| Blockchain + Web3 | 7 |
| DeFi + CeFi | 8 |
| Metaverse + Gaming | 10 |
| Final Summary | 11 |

2023 YEAR IN REVIEW

The Digital Risk industry, which includes blockchain, web3, DeFi, and digital assets, experienced another volatile year in 2023. Notable players in the space, such as FTX and Silvergate Bank, suffered headline-grabbing collapses and brought the digital asset marketplace down with them. And, while these events caused turmoil in the crypto market cap and venture capital investment in the space, we end the year on the positive news of a much-anticipated Bitcoin ETF and possible regulatory clarity from the SEC in the coming year.

The insurance market continues to be challenging for digital risk companies to navigate. As the space matures and claims materialize, underwriters cautiously manage their capacity and exposure to contagion events. While there have been new

entrants to the marketplace, there have also been carriers that have closed capacity for digital asset and blockchain industry companies. The result is a continued need for more diversity in options, and pricing remains elevated compared to other industries.

As we look to 2024, digital risk companies should continue to take aggressive steps toward managing their on-chain risks and transferring their off-chain risks where possible. We expect the insurance market to continue to mature and offer additional capacity, as well as see new coverage options emerge from existing carriers and new entrants.

We end the year on the positive news of a **Bitcoin ETF and **regulatory clarity** in the coming year.**



2023 IMPACTFUL INDUSTRY EVENTS

There was no shortage of blockbuster headlines for the digital asset and blockchain in 2023, with few being positive. However, as the industry grows from its infancy, more and more consumers, investors, and institutions are recognizing the broader economic importance of digital assets.

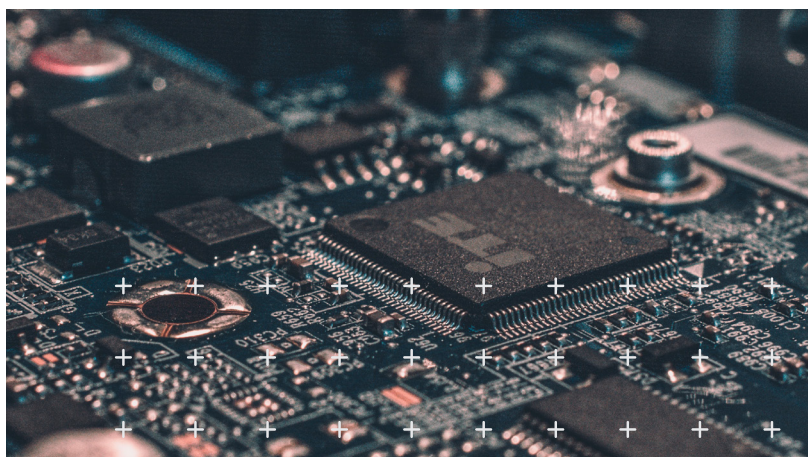
Insurance coverage and pricing are reflective of past events. Ultimately, insurance availability and affordability are determined by the state of recent events. This is true for all industries, but especially so for emerging technology industries where vast troves of actuarial data are scarce. In 2023, the following events had direct impacts, for good or bad, on the insurance marketplace for digital risk companies.

- + [The FTX collapse](#) and [ongoing trial of SBF](#)
- + [Terraform and Do Kwon's SEC fraud charges](#)
- + [SEC charges Coinbase](#)
- + [Ripple's "win" in SEC case](#)
- + [Impending bitcoin ETFs](#)
- + [Positive impacts of BTC mining](#)
- + [The White House's executive order on digital assets](#)
- + [The E.U.'s markets in crypto assets \(MiCA\) regulation](#)
- + [\\$1B in hacked crypto in 2023 improves over 2022](#)

These stories helped shape the narrative of the digital asset and blockchain industry in 2023. Underwriters' perception helps determine the scope of coverage and pricing available and causes them to evaluate their portfolio to determine any unforeseen risks.

As such, some changes should be expected during upcoming renewals or market submissions. These include:

- + Additional underwriting questions on all lines
- + Required FTX exposure questions; addition of FTX exclusions on policies
- + Increased premiums/deductibles
- + Other cyber due diligence, especially around bridge node exposure
- + Details needed on any rehypothecation, collateral re-use, of client assets
- + Balance sheet, cap table, and fundraising due diligence



BTC MINING

After hitting nearly \$70,000 in November of 2021, 2022 ushered in a crypto winter for Bitcoin and almost every other cryptocurrency, with BTC bottoming out in November 2022 at around \$15,000. In 2023, the market for Bitcoin was much improved. Still, off from all-time highs, BTC pricing has remained north of \$25,000 since mid-year, with several notable spikes related to the expected spot ETF approvals.

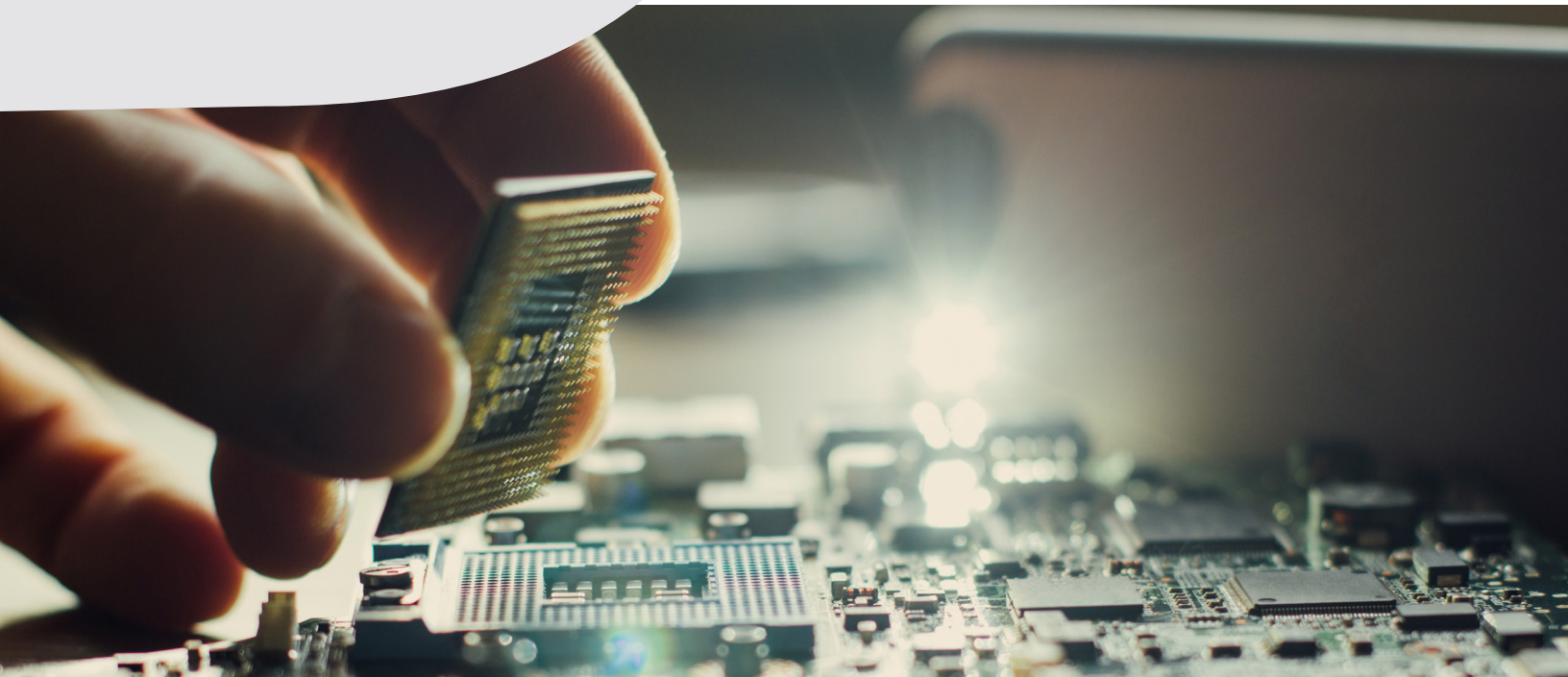
For BTC Mining operations, 2023 was a year of improving processes and managing cash flow ahead of the upcoming “halving” – the quadrennial event based on the source code of the Bitcoin blockchain that makes mining twice as tricky. It is also typically the start of the next bull market, with some experts anticipating a new all-time high of \$100,000 or more. It will, however, be a challenge for institutional miners to weather the storm and consider consolidation or entry into other data center business models, such as High-Performance Computing (HPC).

**2023 was a year of
improving processes and
managing cash flow.**



WHAT THIS MEANS FOR YOU

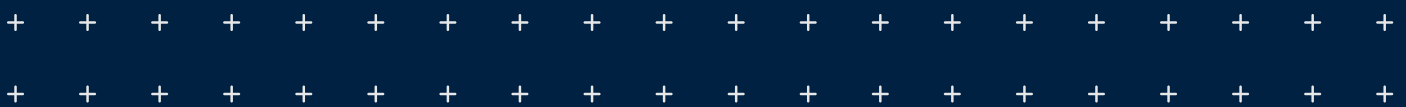
- + Diversification of assets across geography can improve risk profile.
 - Texas, which accounts for nearly 30% of the U.S. hash rate, is also one of the most unpredictable states for weather and grid stability.¹
 - + New Application-Specific Integrated Circuit (ASIC) miners and Graphics Processing Units (GPUs) will make mining and alternative cloud services (HPC, AI) more efficient and lower risk.
 - + Property insurance capacity is limited across a few markets, and rates remain elevated compared to other property placements.
 - U.S. property rates increased by approximately 50% in July 2023 due to natural disasters like wildfires and hurricanes.² Expect rates to increase again or remain mostly flat in 2024.
 - + New construction risks will remain more accessible to place than retrofit data centers. Some carriers prefer specific configurations like containerized operations or liquid immersion.
- + Key insurance considerations:
 - **Cyber** – As of September 2023, public U.S. companies are required by the SEC to disclose “significant cybersecurity incidents” within four days via an 8-K filing.³ As a critical aspect of cyber insurance, breach council becomes even more vital for companies to maintain for compliance purposes.
 - **Crime** – For BTC Mining clients that hold BTC on their balance sheets, discussing whether insuring the digital assets from theft is essential.
 - **Property** – Risk mitigation may improve insurance programs when added where possible and diversity operations across various geographies.
 - **Directors & Officers** – The D&O market continues to improve for BTC miners as more underwriters are comfortable with the business model and experienced teams join the industry.



BLOCKCHAIN + WEB3

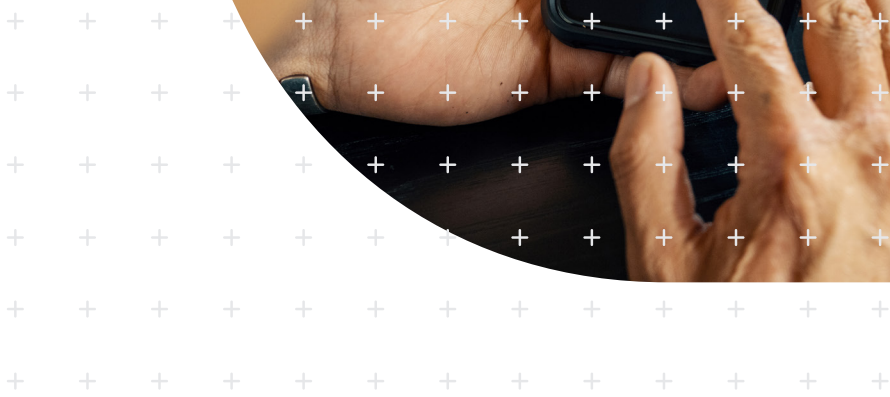
The broader blockchain industry continued to mature in 2023. While the cryptocurrency market continued to stagnate, blockchain infrastructure and tokenization of real-world assets (RWA) became more mainstream. Notable players in the finance world, including J.P. Morgan⁴ and Citi⁵, launched new blockchain initiatives to bring tokenization and smart contracts into their finance capabilities.

Non-Fungible Tokens, or NFTs, rose to prominence in 2022 only to become a battered market that has yet to recover in 2023. However, NFT technology continues to gain widespread adoption. As layer 1 blockchains, such as Ethereum, Avalanche, Solana, Polkadot, etc., mature, they are increasingly supported by layer 2 blockchains that increase speed, efficiency, and lower energy consumption.



WHAT THIS MEANS FOR YOU

- + Insurance options for blockchain companies are becoming more accessible and secure as a result of the maturation of the market.
- + Exposure to bridge nodes is a key risk factor, and notable cyber hacks in the space have primarily utilized bridges.
- + Multi-Sig frameworks and Zero-Knowledge Proof (ZKP) technology are useful risk management tools to consider.
- + Companies tokenizing RWAs should be prepared to have a thorough on-chain and off-chain risk management strategy.
- + 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

2022 saw one of the world's largest centralized exchanges (CEX) fall with FTX. The collateral damage, however, extended far into 2023 and remains an issue for anyone operating in the DeFi/CeFi industry. DeFi has seen a major influx of capital in the months following FTX's collapse, though the total market cap in the space remains suppressed below all-time high levels of 2022.

FTX was a watershed moment for CEX and ushered in a new wave of regulatory interest in the U.S. and E.U. Decentralized exchanges (DEX). Protocols are emerging as alternatives for users seeking more privacy, control, and security. DeFi protocols, such as options and derivatives trading platforms, spot exchanges, and lending platforms, continue to gain favor among investors and venture capitalists.

The fall of FTX ushered in a new wave of regulatory interest.

WHAT THIS MEANS FOR YOU

- + FTX had a singular, negative impact on the insurance market for DeFi and CeFi companies, with every insurer in the space now taking the opportunity to re-underwrite companies.
 - + Rehypothecation of funds, while common in TradFi, is becoming increasingly viewed as incompatible within DeFi and CeFi, as it runs counter to the very premise of cryptocurrency and has resulted in significant losses to the ecosystem.
 - + Regulatory scrutiny will continue, and DeFi/CeFi companies should remain agile in compliance with existing and future regulatory guidelines.
 - + Robust cybersecurity protocols are now considered mandatory.
- + Key insurance considerations:
 - **Cyber** – Cyber risk is the chief concern for users of exchanges and protocols. Cyber attacks and breaches, as well as 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, such as multisig frameworks, cold storage, and custodial diversification, should be implemented.
 - **Directors & Officers** – Heightened scrutiny on cap tables and executives should be expected. Specialty markets are still typically required, especially in large towers.



METaverse + GAMING

The Metaverse continues to grow in scale and scope and is no longer viewed as a video game technology, though young users are critical to the ecosystem. Governments worldwide have begun to adopt standards and frameworks for building metaverse economies. Tech giants in the U.S. continue to develop hardware and software to bring to life digital twin technology.

Gaming companies, especially user-generated content (UGC) gaming, were the first adopters of the Metaverse and virtual worlds and have the most robust business models to date for metaverse economies. In-game digital assets open new revenue possibilities and more engaging user experiences, such as social spaces and communities.

User-generated content gaming companies have **the most robust business models** for metaverse economies.

WHAT THIS MEANS FOR YOU

- + Metaverse and gaming risks remain difficult placements for many insurers.
 - + Concerns around privacy, harassment, mental health, and illicit activity should be well managed.
 - + Personally Identifiable Information (PII) should be protected while complying with AML/ KYC frameworks.
 - + Theft of digital assets and the social engineering of users are critical cyber risks.
 - + Media liability risks are substantial, as many third-party brands seek to interact with the Metaverse while wanting to protect their IP.
- + 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** – Cyberattacks, breaches, and social engineering are frequent in the Metaverse. Identity theft and invasion of privacy is a concern of users, which needs 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 companies continues to improve. As more data becomes available, underwriters will continue looking for opportunities in the space and will build more bespoke products that are fit for purpose for the sector. New insurance options are entering the market regularly, including on-chain options.

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. Provide full information, completed application, and any requested supporting data to expedite the process.



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 is fragile for Digital Risks. Understand your broker needs and how a broker can represent you based on their expertise in the space and market leverage. Poor coverage design is unlikely to perform correctly in the event of a claim.

As the digital asset and blockchain industries mature, the insurance market for them will also. Until then, it's essential to prepare for the complex process of obtaining the right insurance program.

Sources:

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- 5 Citigroup Inc. (2023, September 18). *Citi Develops New Digital Asset Capabilities for Institutional Clients*. Citigroup. <https://www.citigroup.com/global/news/press-release/2023/citi-develops-new-digital-asset-capabilities-for-institutional-clients>



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