

# Personal Lines Emerging Risk: Crypto Assets



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Developed: January 2023

## CISR Other Personal Lines Solutions



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## Introduction

Crypto assets are digital assets that can take the form of cryptocurrency or digital art or tokens that represent ownership or rights to certain products, transactions, or services.

Cryptocurrency is a peer-to-peer digital and virtual currency protected by several cyber security techniques and is created through:

- mining (solving complex mathematical authentication problems),
- collectible yet unspendable transactional rewards, or
- deviations in blockchain protocol.



## Cryptocurrency

Cryptocurrency transactions are supported by public, decentralized (no one single entity is in charge), blockchain databases that are secure and immutable (or unchangeable). Bitcoin (BIT) was the first cryptocurrency and remained the only one until 2011. Today, many sources estimate that there are tens of thousands of cryptocurrencies with Bitcoin (BIT), Dogecoin (DOGE), and Ethereum (ETH) being among the most recognizable, yet Bitcoin remains the “gold standard,” and is often demanded as ransom payments by cyber criminals.

Cryptocurrency has become such an important focus because the development and adoption of cryptocurrency is a promising solution for the flaws of traditional currency. Mainstream use of cryptocurrency could solve problems such as:

### 1. Fraud and theft vulnerabilities of electronic payment, credit cards, and wire transfers

Since cryptocurrency transactions are continuously validated by many computers on a decentralized network, the need for a single trusted intermediary, or authority, is eliminated. This nearly eliminates hacking vulnerabilities, currency duplication, and double-spending.

### 2. Transaction fees charged by banks and middlemen

While they may still be charged, transaction fees and percentages are not necessary on blockchains. In the absence of intermediaries, profit-generating transactions and account fees are minimized, if not completely avoided, using subsidies or coin developer cost absorption.

### 3. A lack of financial services around the world

Where financial and/or banking services are inaccessible, peer-to-peer systems enable the transfer of currency to happen within and across borders. This is known as “banking the unbanked.”



Cryptocurrencies may one day resolve the issue of unequal distribution of wealth and financial control on a global scale by distributing control among many people—a peer-to-peer network without borders. They could also eliminate extreme money printing by the government, which can devalue traditional “paper” currency and cause inflation.

## Crypto Tokens

Purchased with cryptocurrency, tokens may provide ownership or rights to access certain products, transactions, investments, services, or collectibles. Tokens are often referred to as NFTs or non-fungible tokens. Non-fungible means that the asset is unchangeable and retains a one-of-a-kind unique value, meaning they cannot equal a 1:1 value. Anything can be an NFT—a tweet from the social media Twitter platform, digital art, a picture, a contract, or a certificate of insurance.

Much like cryptocurrency, the purchase and collection of these items are recorded and verified on blockchain databases. The value of NFTs or crypto assets can range from free to millions (one-day, maybe billions) of dollars.

## Consider the Risk(s):

### Rapid Growth

Since the 2020 global pandemic, global adoption of cryptocurrency (and assets) exceeded 880% according to the 2021 Chainalysis Global Crypto Adoption Index. This same report found that adoption rates are not just increasing in financially secure countries but more so within countries that have weak financial infrastructures. This high global adoption rate indicates that crypto assets are no passing fad and that there is more to be learned about the risks and rewards of a global currency.

### Volatility



Blockchain and cryptocurrencies are in their infancy and are extremely unpredictable. Volatility got especially out of hand in 2017, when the price of Bitcoin jumped 1000%, but then came crashing down (along with most of the major currencies). A lack of financial and legislative regulation along with a global movement towards regulation is speculated as the cause of this crypto bubble and subsequent burst. **As volatility brings a call for regulation, could this devalue cryptocurrency even further, as avoiding regulation was part of its appeal?**



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## Purchasing, Exchanging, Selling, and Storing Crypto

Crypto exchanges such as Coinbase, Gemini, and Kraken are sites to purchase, exchange, or store your currencies. Storing on an exchange is high risk as they have been subject to hacking attacks in the past. After a purchase is made, the digital asset(s) may be moved to a personal, secure wallet. Some clients may buy and hold assets for potential future growth, though, some clients may become “traders” who actively buy and sell on a regular basis to maximize profit (similar to daily stock traders). Holding cryptocurrency can be done on the exchange where you purchased your currency or in a currency wallet (similar to a digital payment service like PayPal). **How protected and secure are these exchanges against hacking, theft, or fraud?**



## Insuring Crypto Assets

The Federal Deposit Insurance Corporation (FDIC) provides insurance of up to \$250,000 (per person, per bank), backed by the US federal government, to US citizens for money deposited in checking, savings, and money market accounts. This insurance does not apply to crypto deposits or investments. The Securities Investor Protection Corporation (SIPC) provides similar protection of up to \$500,000 for deposits to brokerage accounts (cash limit of \$250,000) and securities (such as stocks and bonds). But again, this coverage is not applicable to crypto assets.

## The ISO Homeowners 3 – Special Form Effective March 2022

The Insurance Services Office (ISO) updated the Homeowners Program, effective March 2022, and it now includes language for excluding virtual currency. Review the example excerpt below from the **ISO Homeowners 3 – Special Form HO 00 03 03 22**:

### SECTION I – PROPERTY COVERAGES

#### C. Coverage C – Personal Property

##### 4. Property Not Covered

We do not cover:

- m. Virtual currency of any kind, by whatever name known, whether actual or fictitious including, but not limited to, digital currency, crypto currency or any other type of electronic currency;

The Homeowners Program did not attempt to define virtual currency. **Consider this policy language and then ask yourself why the policy would not define virtual or cryptocurrencies or assets?**



Many personal lines insurance companies provide variations of identity fraud “coverage” but this does not translate into cyber coverage. And, never before has the personal lines insurance market insured loss of traditional currency or securities in large sums. Generally, coverage is limited within Homeowners Policies to a few hundred dollars for money and only a couple thousand for securities (like bonds or financial notes). **So why would a Homeowners Policy insure cryptocurrency, securities, or assets any differently?**

### ISO Homeowners 3 – Special Form HO 00 03 03 22:

#### SECTION I – PROPERTY COVERAGES

##### C. Coverage C – Personal Property

##### 3. Special Limits Of Liability

The special limit for each category shown below is the total limit for each loss for all property in that category. These special limits do not increase the Coverage C limit of liability.

- a. \$300 on money, bank notes, bullion, gold other than goldware, silver other than silverware, platinum other than platinumware, coins, medals, scrip, stored value cards and smart cards.
- b. \$2,000 on securities, accounts, deeds, evidences of debt, letters of credit, notes other than bank notes, manuscripts, personal records, passports, tickets and stamps. This dollar limit applies to these categories regardless of the medium (such as paper or computer software) on which the material exists.

This limit includes the cost to research, replace or restore the information from the lost or damaged material.

### Personal Lines Cyber Coverage

Insuring cryptocurrency and assets may be a little easier for commercial businesses than it is for personal lines consumers, though the market is beginning to pay attention and create solutions. Cyber policies would be the most likely contenders for coverage. “Theft” coverage provided by these policies may insure against the loss of money or other assets, potentially including cryptocurrencies. While cyber coverage has long been only applicable to commercial risk, it is a newer market for personal risk, and crypto assets are evolving so rapidly that cyber coverage has not yet adequately addressed the risks.



## Resources

Below are resources you may examine to further explore this topic. *For this activity, focus on the summaries of each resource as you may not have enough time during class to thoroughly review each resource.* Consider continuing your research after class.

### **A brief history of Bitcoin crashes and bear markets: 2009–2022, by Helen Partz**

<https://cointelegraph.com/news/a-brief-history-of-bitcoin-crashes-and-bear-markets-2009-2022>

Much like stocks and other financial investments, the state of the US and global economies, political environments, and other market conditions create highs and lows (sometimes wildly) in crypto assets. Between 2009 and 2022, cryptocurrencies (like Bitcoin) have risen in value and drastically crashed almost overnight.

- 2011: Bitcoin crash from \$32 to \$0.01
- 2015: Bitcoin crash from \$1,000 to \$200
- 2017: Bitcoin crash from \$20,000 to \$3,200
- 2021: Bitcoin crash from \$63,000 to \$29,000
- 2022: Bitcoin crash from \$68,000 to less than \$20,000

Review the resource to understand the author's analysis of what contributed to each crash.

### **Yuga Labs lawsuit won a key victory in a case against Ryder Ripps, by Jerry Christopher**

<https://www.todaynftnews.com/yuga-labs-lawsuit-won-a-key-victory-in-a-case-against-ryder-ripps/>

Consider the crypto asset, NFT. Personal lines clients are out there spending their cryptocurrency to collect or invest in digital art. One such popular digital art is the Bored Ape Yacht Club (BAYC) NFT collection created by Yuga Labs. When something is successful or popular, fakes begin to enter the market. Consider knock-off designer purses, shoes, or watches.

In a filed lawsuit *Yuga Labs, Inc. v. Ripps, et al.*, Yuga Labs won a landmark case against knockoff company Ryder Ripps for infringement of intellectual property. Ryder Ripps minted approximately 550 knockoff Bored Ape NFTs for .01 Ethereum (a cryptocurrency) valued at around \$200 US. Yuga Labs said that the knockoffs were diminishing the brand and creating confusion. Imagine the implications of personal investments in a highly valued digital brand when it could potentially be devalued by knockoffs.



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## Crypto Exchange FTX Trading Ltd., Bankruptcy

<https://www.sec.gov/news/press-release/2022-219>

- <https://www.cnbc.com/2022/11/11/sam-bankman-frieds-cryptocurrency-exchange-ftx-files-for-bankruptcy.html>

FTX Trading Ltd. was founded in May 2019 and was considered the third-largest cryptocurrency exchange by 2021. Just three short years after it began, the company filed for bankruptcy. As the liquidity of the company began to dry up, customers began to initiate withdrawals.

- <https://www.cnbc.com/2022/11/21/ftx-theft-hackers-start-to-launders-477-million-of-stolen-crypto.html>

Shortly after FTX filed for bankruptcy, hackers stole approximately 446 million worth of cryptocurrency. A series of transactions were discovered as a common tactic of laundering stolen cryptocurrency. Since cryptocurrency transactions are highly traceable, hackers will use a series of services or software (mixers) to cover the blockchain trail.

- <https://www.cnbc.com/2022/11/28/blockfi-files-for-bankruptcy-as-ftx-fallout-spreads.html>

The fallout surrounding the FTX bankruptcy began as cryptocurrency exchange BlockFi also filed for bankruptcy, listing a \$275 million loan to FTX US and its largest client having a balance of \$28 million invested in the company.

- <https://www.forbes.com/advisor/investing/cryptocurrency/what-happened-to-ftx/>

CEO/Founder of FTX Trading Ltd. was arrested on charges of wire fraud, securities fraud, securities fraud conspiracy, and money laundering. The SEC (Securities Exchange Commission) alleged that Mr. Bankman-Fried defrauded investors and platform consumers.

## Understanding the Opportunities for Personal Lines Cyber Insurance

<https://www.verisk.com/siteassets/media/downloads/underwriting/personal-property/understanding-the-opportunities-for-personal-lines-cyber-insurance.pdf>

When thinking about the initial risk of crypto assets, first think about the adoption of personal lines clients to even consider their cyber risk and how to protect themselves. Verisk conducted a study of US consumers which revealed that “just 20 percent of consumers own cyber insurance” even though “64 percent admitted to being concerned about cyber threats.” In the 21st century, consumers transact so much of their personal business online and are oftentimes unknowingly exposing sensitive information. Considering that cybersecurity has been a known risk since the 1980s, why has cyber insurance been so slow to develop, and the adoption rate has been even slower? If we then apply these considerations to cryptocurrencies and assets, the risk of loss becomes even greater, and yet, the market is still not evolving quickly enough.



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## Holding Cryptocurrency—Is Your Wallet Hot? Consider Whether Your Assets Are Insured Under A Homeowner’s Or Commercial Policy.

<https://www.natlawreview.com/article/holding-cryptocurrency-your-wallet-hot-consider-whether-your-assets-are-insured>

*Kimmelman v. Wayne Insurance Group, No. 18-CV-104 (Ohio)* was a first-of-its-kind lawsuit in which an insured (Mr. Kimmelman) claimed \$16,000 in stolen Bitcoin to his Homeowners Policy. The policy had a sublimit of \$200 for monetary losses and paid the claim as such. Mr. Kimmelman filed a lawsuit against the insurance company for breach of contract and bad faith. The court referenced an IRS ruling (2014-21) identifying cryptocurrency as property, not money, and thus the loss was not subject to the \$200 Special Limit.

### Conclusion

Now that you have completed your review of this resource, begin applying the risk management process you’ve learned about to this risk by answering the activity questions in your Learning Guide.

If you were unable to conduct a full review of the material during the time allotted, do not worry. More time will be spent on this subject during an open discussion of the topic.

The purpose of this activity is to practice applying the basics of risk management to any risk unknown to you. You are not expected to be an expert on this topic.



## Additional Resources/References

<https://bitcoin.org/>

<https://crsreports.congress.gov/product/pdf/R/R45427>

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- ii. Mark Leon Goldberg, "Cryptocurrency Isn't All Bad," Foreign Policy, June 22, 2021, <https://foreignpolicy.com/2021/06/22/blockchain-bitcoin-energy-decentralized-finance-development-poverty/>
- iii. Taylor Locke, "Jack Dorsey sells his first tweet ever as an NFT for over \$2.9 million," CNBC, <https://www.cnbc.com/2021/03/22/jack-dorsey-sells-his-first-tweet-ever-as-an-nft-for-over-2point9-million.html>
- iv. <https://www.cnn.com/style/article/beeple-first-nft-artwork-at-auction-sale-result/index.html>
- v. <https://newsdirect.com/news/ima-financial-group-issues-first-insurance-certificate-on-the-blockchain-685737986>
- vi. <https://blog.chainalysis.com/reports/2021-global-crypto-adoption-index/>
- vii. <https://www.rmmagazine.com/articles/article/2022/06/01/finding-coverage-for-cryptocurrency-losses>
- viii. <https://www.yahoo.com/entertainment/ryder-ripps-bored-apes-owning-180803409.html>



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# Resource Remediation Quiz

## 1. Risk Identification

What questions could you ask clients to help determine whether they have an exposure to this risk?

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## 2. Risk Analysis

What are some potential property and/or liability exposures that may occur with this risk?

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**3. Risk Control**

How might a client avoid, prevent, or reduce the property and/or liability exposures outlined above?

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**4. Risk Financing**

What risk financing solutions, including policies or policy endorsements, might you recommend to clients?

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**5. Risk Administration**

Once you and your client have implemented a coverage plan, what steps might you take to monitor the risk?

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# Resource Remediation Answers

## 1. Risk Identification

What questions could you ask clients to help determine whether they have an exposure to this risk?

### Sample Answers:

Do you have an interest in digital art or crypto assets?

Do have an interest in or own cryptocurrency?

Do you have a crypto wallet?

Do you interact or make purchases in a metaverse space?

Do you mine cryptocurrency?

Do you create and/or sell NFTs?

Have you received any digital/smart contracts, certificates, or other promissory notes?

## 2. Risk Analysis

What are some potential property and/or liability exposures that may occur with this risk?

### Sample Answers:

Theft of cryptocurrency

A child with access to a parent's crypto wallet spending the asset

Significant deflation of cryptocurrency

Loss of digital key or password to access crypto wallet

Cyber threat or extortion in exchange for cryptocurrency

Is the way you display or use crypto or digital assets secure?

Risk of damage to or loss of digital contracts

Is there a personal "business" exposure? Consider a monetary gain from creating and selling NFTs or other crypto collectibles.



### 3. Risk Control

How might a client avoid, prevent, or reduce the property and/or liability exposures outlined above?

#### Sample Answers:

Where are you storing or keeping passwords or digital keys?

How often do you monitor your cryptocurrency accounts?

If trading cryptocurrency, do you have an organized approach to trading to minimize risk?

Only invest the amount of capital you can afford to lose.

Verify sources of crypto assets and digital artwork before purchasing.

Do you have cybersecurity measures and monitoring in place?

### 4. Risk Financing

What risk financing solutions, including policies or policy endorsements, might you recommend to clients?

#### Sample Answers:

Does the crypto exchange offer any assurances or insurance?

Standalone Personal Lines Cyber Insurance.

Only invest the amount of capital you can afford to lose.

### 5. Risk Administration

Once you and your client have implemented a coverage plan, what steps might you take to monitor the risk?

#### Sample Answers:

Conduct an annual review to determine if the crypto asset exposure has changed.

Monitor developments in the insurance market for crypto asset coverage.

Monitor regulatory change involving cryptocurrency, crypto investments, and digital assets or collections.

Secure updates to the questions in #1, #2 and #3 above.

