

Client Alert: Digital Assets and Blockchain Market Advancements

Adverse headlines in the digital asset and blockchain sector are commonplace. Amidst this “noise”, it can be difficult to discover that positive progress is being made with regulations, infrastructure and general acceptance of the technology. As this sector continues to develop, Aon’s Digital Asset and Blockchain team is continuing to further educate the insurance marketplace on comprehensive risk transfer solutions and consultative services.

Digital assets and blockchain acceptance

Digital assets and blockchain have been gaining more acceptance across industries as evidenced by established companies in technology, social media and banking verticals announcing ambitious plans to enter the cryptocurrency and blockchain space. For example, companies recognize the potential of cryptocurrencies for transferring value and of blockchain for streamlining transactions and reducing costs. In contrast to Bitcoin (“BTC”), which is based on a “permissionless” blockchain technology and allows anyone to participate in the network, these new plans focus on a “permissioned” blockchain, which requires a company or association to approve any participants. Those companies with a large customer base will have a meaningful advantage as they launch their networks.

Regulatory progress

2017 witnessed a cryptocurrency boom with the price of Bitcoin surging to \$20,000 and companies raising billions of dollars through initial coin offerings (“ICOs”). In 2018 the price of BTC and other cryptocurrencies crashed and regulators, notably the Securities Exchange Commission (“SEC”), severely cracked down on ICOs as we entered the “crypto winter”. Unsurprisingly, the insurance marketplace generally avoided providing coverage for ICOs, with insureds seeking Directors & Officers (“D&O”) insurance primarily due to regulatory concerns. It has taken over a year for the thaw to arrive and, along with the steady rise of cryptocurrency prices in 2019, there have been several other notable positive developments.

In July 2019, the SEC for the first time cleared (or “qualified”) two regulated token offerings. Blockstack has been approved to raise funds via a Regulation A+ framework which allows the sale of tokens to retail investors as well as to accredited investors and institutions. Shortly thereafter the SEC approved YouNow for conducting a Reg A+ offering in which it will distribute an Ethereum-based blockchain token by way of an “airdrop” – distributing tokens to users and creators. These qualified offerings are significant in that they illustrate how companies can raise funds through token offerings in compliance with regulations after many companies failed to do so during the ICO wave of 2017. While companies conducting “compliant” token offerings may still find it challenging to obtain broad D&O insurance due to the start-up nature of their business, it should give comfort to insurers that regulators have begun to provide their approval on certain offerings.

Other recent regulatory developments:

- U.K.’s Financial Conduct Authority (“FCA”) released guidance on “cryptoassets” to provide clarity on how they view and will regulate exchange tokens, utility tokens and security tokens.
- The New York Department of Financial Services, in an effort to maintain its position as a financial innovation hub, announced the establishment of a new Research and Innovation Division with responsibilities that include licensing and supervising virtual currencies.

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Infrastructure development

As regulations involving digital assets continue to develop, so too does the infrastructure supporting the storage and exchange of these assets. As an example, the Commodities and Futures Trading Commission has granted ErisX a license for the trading of digital asset futures contracts.

"ErisX is unique in that for our digital asset market, we have divided the trading and settlement functions using traditional DCM (exchange) and DCO (clearing) models," said Thomas Chippas, Chief Executive Officer of ErisX. "This reflects the structure that institutional investors expect from other asset classes and will help drive these markets toward greater relevance and accessibility."

Insurance Marketplace

Insurance underwriters focusing on digital assets and blockchain experienced a deluge of submissions largely starting in 2017 to coincide with the surging price of Bitcoin and the ICO wave. While overwhelming at times, it also provided insurers with a valuable education as they compared the risks of these companies. Fast forward to 2019 and astute insurers now ask in depth questions and request detailed information to underwrite these risks. Key high-level areas of focus for underwriters include:

- Management team experience
- AML/KYC compliance
- Security protocols
- Adherence to regulations
- Third party advisors

It is critical for clients to be thoroughly prepared for meetings with underwriters, particularly as the overall insurance marketplace is firming and rates are increasing for all sectors. Aon has successfully secured comprehensive risk transfer programs for our clients utilizing traditional commercial insurers and captive insurance placements.

Critical coverages for this sector include:

- **Crime:** entities storing digital assets in hot, warm or cold storage have exposures to the theft of assets and internal/external fraud
- **D&O:** claims brought by shareholders and regulators
- **Cyber and Technology E&O:** network disruption, security breaches and liability associated with technology products & services
- **Financial Services E&O:** for broker dealers, exchanges and investment advisors

The insurance marketplace for Crime, D&O, Cyber and E&O remains extremely challenging at-large, but we are hopeful that the positive progress occurring in the industry will lead to a more competitive marketplace, with meaningful options available to companies in this space. In an effort to drive this more competitive marketplace and expand insurance capacity for our clients, Aon's Digital Asset and Blockchain Team has hosted underwriter workshops and webinars to educate insurance underwriters about emerging digital asset and blockchain risks and these efforts are ongoing.

About Aon's Financial Services Group

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