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Insurers shun FTX-linked crypto firms as contagion risk mounts

Posted On: Dec. 19, 2022 9:31 AM CST

(Reuters) — Insurers are denying or limiting coverage to clients with exposure to bankrupt crypto exchange FTX, leaving digital currency traders and exchanges uninsured for any losses from hacks, theft or lawsuits, several market participants said.

Insurers were already reluctant to underwrite asset and directors and officers protection policies for crypto companies because of scant market regulation and the volatile prices of Bitcoin and other cryptocurrencies.

Now, the collapse of FTX last month has amplified concerns.

Specialists in the Lloyd’s of London and Bermuda insurance markets are requiring more transparency from crypto companies about their exposure to FTX. The insurers are also proposing broad policy exclusions for any claims arising from the company’s collapse.

Kyle Nichols, president of broker Hugh Wood Canada Ltd., said insurers were requiring clients to fill out a questionnaire asking whether they invested in FTX, or had assets on the exchange.

Lloyd’s of London broker Superscript is giving clients that dealt with FTX a mandatory questionnaire to outline the percentage of their exposure, said Ben Davis, lead for digital assets at Superscript.

“Let's say the client has 40% of their total assets at FTX that they can’t access, that is either going to be a decline or we’re going to put on an exclusion that limits cover for any claims arising out of their funds held on FTX,” he said.

The exclusions denying payout for any claims arising out of the FTX bankruptcy are found in insurance policies that cover the protection of digital assets and for personal liabilities of directors and officers of companies that deal in crypto, five insurance sources told Reuters. A couple of insurers have been pushing for a broad exclusion to policies for anything related to FTX, a broker said.

Exclusions may act as a failsafe for insurers, and will make it even more difficult for companies that are seeking coverage, insurers and brokers said.

Bermuda-based crypto insurer Relm, which previously has provided coverage to entities linked to FTX, takes an even stricter approach.

“If we have to include a crypto exclusion or a regulatory exclusion, we're just not going to offer the coverage,” said Relm co-founder Joe Ziolkowski.

D&O question

Now, one of the most pressing questions is whether insurers will cover D&O policies at other companies that had dealings with FTX, given the problems facing exchange’s leadership, Mr. Ziolkowski said.

U.S. prosecutors say former FTX CEO Sam Bankman-Fried engaged in a scheme to defraud FTX's customers by misappropriating their deposits to pay for expenses and debts and to make investments on behalf of his crypto hedge fund, Alameda Research LLC.

A lawyer for Bankman-Fried said on Tuesday his client is considering all of his legal options.

D&O policies, which are used to pay legal costs, do not always pay out in cases of fraud.

Insurance sources would not name their clients or potential clients that could be affected by policy changes, citing confidentiality. Crypto firms with financial exposure to FTX include Binance, a crypto exchange, and Genesis, a crypto lender, neither of which responded to e-mails seeking comment.

While the least risky parts of the crypto market, such as companies that own cold wallets storing assets on platforms not connected to the internet, may get cover for up to $1 billion, a D&O insurance policyholder's cover may now be limited to tens of millions of dollars for the rest of the market, Mr. Ziolkowski said.

The FTX collapse will also likely lead to a rise in insurance rates, especially in the U.S. D&O market, insurers said. The rates are already high because of the perceived risks and lack of historical data on cryptocurrency insurance losses.

A typical crime bond — used to protect against losses resulting from a criminal act — would cost $30,000 to $40,000 per $1 million of coverage for a digital assets trader. That compares with a cost of about $5,000 per $1 million for a traditional securities trader, Hugh Wood Canada's Nichols said.