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# Viewpoint

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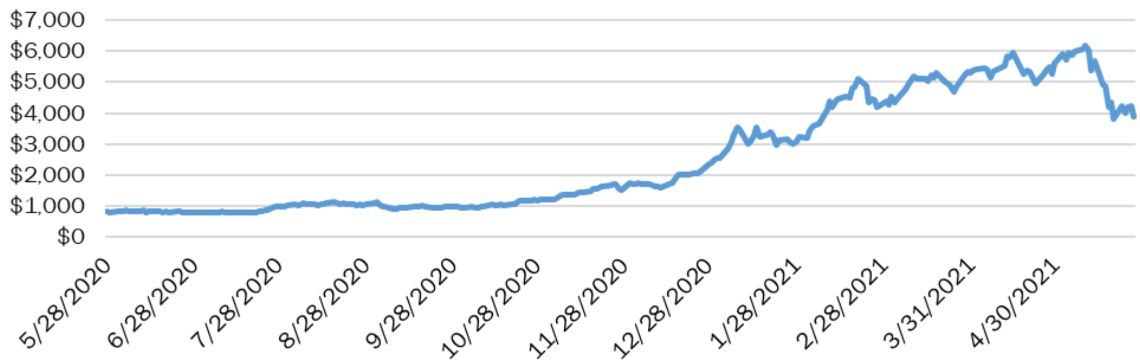
## Crypto Comes Into Focus

**By Scott Hawkins, Director, Insurance Research, and Alan Walters, Vice President. Insurance Research**

In the first half of 2021, leading cryptocurrencies Bitcoin and Ethereum appreciated over 100%,[1] while the growth of newer currencies such as DOGE has bewildered and shocked investors and observers alike.[2] In May 2021, cryptocurrency valuations had a sudden and significant drop,[3] continuing their history of extreme volatility (see Figure 1).

In mid-2021, some insurers have begun to wade into the cryptocurrency market[4] with some initial positions, and regulators have taken note.[5] What remains unknown is how cryptocurrencies will change insurance industry practices and investments. Are cryptocurrencies a temporary bubble or the early steps in a fundamental change in the way insurers operate?

**Figure 1** S&P Cryptocurrency MegaCap Index

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### The Cryptocurrency World

Cryptocurrencies are a type of digital currency. Digital currency is a form of currency that is available only in digital or electronic form, and not in physical form. Other names include digital money, electronic money, electronic currency, or cyber cash.[6]

Digital currencies are intangible and can only be owned and transacted in by using computers or electronic wallets connected to the Internet or a designated network. In contrast, physical currencies, like banknotes and minted coins, are tangible and transactions are possible only by the holders who have the physical currency in their possession.

Most of the traditional money supply is bank money held on computers and could be considered digital currency in some cases. It could be argued that in an increasingly cashless society all currencies are becoming digital currencies. Using a digital wallet to pay for a triple large latte is possible because of digital currencies.

Digital currencies can be divided into two categories based on who issued the currency. The most common has been those currencies issued by central banks, such as the Federal Reserve. As a result, these regulated digital currencies can be exchanged for the physical form.

The other is cryptocurrency, which is a digital currency that is not issued by a central bank. It is a virtual currency because it has no physical form. Cryptocurrencies get their name because they use cryptography to secure and verify transactions and to manage and control the creation of new currency units. The better-known cryptocurrencies include Bitcoin and Ethereum, although many more exist in the market.

Because cryptocurrencies are not issued by a central authority, they use distributed ledger technology, such as blockchain, that allows for a public database of transactions. Most well-known cryptocurrencies follow this decentralized formula. While they garner much attention, as of April 2021, the total market cap of cryptocurrencies was $2 trillion, up from $1 trillion at the start of the year.[7]

While cryptocurrencies have become volatile, making them difficult to use as day-to-day currency, stablecoins look to fill that gap.[8] Similar to crypto, stablecoins offer security for transactions. However, they are intended to retain the stability of traditional currencies as most are pegged at a 1:1 ratio with fiat currencies or precious metals.[8] In Conning's opinion, stablecoins may bring a more business-relevant use case for digital currency into existence.

## Insurers Buy In

With the growing media attention, it is not surprising that the insurance industry has taken notice and begun to identify opportunities to utilize cryptocurrencies. What is already noticeable is that there are clear differences in how life-annuity insurers see their opportunities compared to property & casualty insurers.

### P&C Operation and Product Opportunities

For property & casualty insurers, one potential use of cryptocurrency is to pay premiums and claims. For example, Metromile, a pay-as-you-drive personal auto insurer, announced in May 2021 that it now accepts premium and offers claim payouts in Bitcoin.[9]

Conning's analysis suggests that future use cases for potential cryptocurrency utilization in the property & casualty sector include the further development of claims settlement. As part of a broader insurance program including parametric insurance for certain events, blockchain technology could instantly settle claims, paying out in the insured's preferred currency. This could be used for paying property claims tied to events such as hurricanes and earthquakes, or for travel insurance plans.

Lastly, our analysis indicates that the growth in cryptocurrency investment, if not outright usage, could result in demand for traditional risk management approaches. Holders of digital currency use online wallets to stash their coins. While generally secure, some investors wish for additional protection. Cryptocurrency is similar to a bearer asset, and possessing a crypto coin effectively establishes ownership and entitles the possessor to the underlying value. Consequently, when crypto coins are stolen, it's difficult to establish rightful ownership without actual possession of that crypto coin.

Cryptocurrency theft is a real risk. Fraud was the leading crypto crime in 2020, followed by theft and ransomware.[10] Even with the potential loss due to crime, crypto owners face other risks ranging from human errors and mistakes to technical malfunctions.

*"There are clear differences in how life-annuity insurers see their opportunities compared to property & casualty insurers."*

These risks are creating an opportunity for P&C carriers to develop new insurance products. For example, in 2020, Lloyd's syndicate Atrium began to offer an insurance policy to protect against digital theft. The policy limit is tied to price changes of underlying currency held. Insurance partners of the syndicate include Markel and TMK.[11] Another recent entrant to the market, HCP National, offers four coverage types including D&O/E&O, crime insurance, custody insurance and decentralized finance insurance.[12] Such a comprehensive approach is intended to provide cover for crypto holding and for management's action in relation to those holdings.

## Life Annuity Insurers Investment and Product Opportunities

Until recently, there had not been any significant activity by life-annuity insurers regarding cryptocurrencies. That changed in 2020.

In December 2020, MassMutual added $100 million of Bitcoin to its general investment account.[8] By way of context, MassMutual's General Account portfolio held approximately $224 billion of assets at that time.[13] So, the $100 million investment represented a very minor stake in bitcoin. That said, the company's interest in cryptocurrency extends beyond this relatively small investment. For example, MassMutual is an investor in New York Digital Investment Group, or NYDIG.

NYDIG has attracted some attention because of fundraising activities as well as the involvement of several insurers in the company (Figure 2 lists key NYDIG events). NYDIG was formed in 2017 as a subsidiary of Stone Ridge Asset Management.[14] The firm provides Bitcoin funds as well as services to individuals and institutions.[15] In March 2021, New York Life Chairman and CEO Ted Mathas joined NYDIG's board of directors.[16] In April 2021 NYDIG, announced it had raised $100 million of additional growth capital from strategic partners including P&C insurers Starr Insurance and Liberty Mutual Insurance. Those firms joined NYDIG's existing life insurance and annuity strategic partners New York Life and MassMutual.[17]

NYDIG also announced in April 2021 that Mike Sapnar, former CEO of TransRe, was joining NYDIG as Global Head of Insurance Solutions to oversee NYDIG's insurance activities. In that role, he will focus on the global P&C industry. He joins Matthew Carey, NYDIG's U.S. Head of Insurance Solutions, who is focused on solutions for U.S.-based life insurance and annuity providers. Prior to joining NYDIG, Matt was co-founder and CEO of Blueprint Income, an online annuity marketplace that was acquired by MassMutual from Stone Ridge.[17] The April round of funding followed a $200 million capital raise in March 2021 which included New York Life and an additional investment from MassMutual. At that announcement, NYDIG stated that life, annuity, and property & casualty insurers now own, in aggregate, more than $1 billion of direct and indirect bitcoin exposure on NYDIG's institutional custody platform.[18]

In Conning's opinion, these investments by life-annuity insurers in NYDIG are further opportunities to develop an understanding of how cryptocurrency products could work.

**Figure 2** NYDIG (New York Digital Insurance Group) Key Events

| | |
|---|---|
| 2017 | • Formed as a Stone Ridge subsidiary<br>• Raises $50 million from Bessemer Venture |
| 2020 | • Raises $50 million from multiple investors<br>• MassMutual separately invests $5 million, purchases $100 million of bitcoin |
| 2021 | • March, raises $200 million in April, investors include MassMutual and New York Life<br>• March, New York Life Chair and CEO joins NYDIG board<br>• April, raises $100 million from Liberty Mutual, Starr and other P&C insurers<br>• April, former TransRe CEO Mike Sapnar joins NYDIG as head of global insurance solutions<br>• April, former CEO of the annuity platform Blueprint Income, Matthew Carey, joins NYDIG as head of U.S. insurance solutions<br>• April, NYDIG states that its platform holds ~$1 billion of bitcoin exposure for insurers |

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Beyond a learning opportunity, our analysis suggests that other product opportunities for life-annuity insurers could involve including cryptocurrency funds as variable annuity and variable life subaccounts. It could also involve adding cryptocurrencies to the bespoke investment accounts supporting private placement life insurance.

## Regulators Take a Stand

One hurdle to continued investment by insurers with cryptocurrency is the treatment of those investments under statutory accounting. In February 2021, the NAIC ruled that cryptocurrencies were non-admitted assets due to their failing to meet the definition of cash.[19] Cash is defined as being able to be deposited immediately at a bank or financial institution and cryptocurrencies do not meet that threshold today. In Conning's opinion, this could be a significant hurdle to overcome either through legislation, regulation or innovation.

That said, the NAIC continues to study and research current insurer holdings and future interest in holding these currencies and appears poised to stay up-to-date on the subject going forward. For example, the NAIC's Innovation and Technology (EX) Task Force was created in 2017 and charged with monitoring emerging technologies like blockchain and cryptocurrencies.[20]

Specific states have acted on crypto. Wyoming is recognized in the cryptocurrency community as being friendly to crypto and blockchain including passing a law which recognizes crypto as money.[21] In 2020, the state went further, signing into law the first provision in the nation allowing domestic insurance companies to invest in a virtual currency which is not recognized as legal tender by the United States government.[22]

## The Crypto Road Ahead

In May 2021, the cryptocurrency world experienced significant volatility. On May 19 Bitcoin lost 35% of its value in a single day of trading.[23] The decrease began the week of May 12, when Tesla Inc. billionaire Elon Musk criticized Bitcoin for wasting energy and backtracked on a decision to allow crypto transactions.[24] Losses accelerated after China warned that digital tokens cannot be used for payments.[25]

This brings us back to the question we initially raised: Are cryptocurrencies a temporary bubble or the early steps in a fundamental change in the way insurers operate?

Answering that question is crucial to understanding the role cryptocurrencies might play for the insurance industry. With respect to the insurance ecosystem, the benefits of cryptocurrency are still being defined. As an investment, there may be some merit to diversifying portfolio risk with a crypto strategy. Albeit capital charges would impact the desire for insurers to hold significant amounts of cryptocurrency. Cryptocurrency funds may provide another investment option for variable annuities and for private placement life insurance sold to ultra-high net worth individuals.

> ***"With the emergence of digital fiat currencies, consumers and institutions may have greater confidence in the value of their digital wallets, and investors may experience less volatility. "***

In terms of product opportunities, the potential development of cryptocurrency coverage will depend in part on the continued adoption and integration of cryptocurrency into the broader economy. If cryptocurrency becomes an accepted way to transact business, then in Conning's opinion the need for crypto coverage would likely increase. This leads us to the crux of the matter in answering our question: What advantages do cryptocurrencies provide over other digital currencies?

Relative to other digital currencies, cryptocurrency's first advantage may be its global footprint. This reduces the frictional costs of exchanging currencies in international transactions. Another advantage is the encryption used may offer a greater level of security in transferring any payment between parties.

These advantages may be limited, however, by the emergence of digital fiat currencies. The European Central Bank has been working to develop a digital euro.[26] In December 2020, the Swedish Riksbank announced the plan to beginning developing a digital krona,[27] with the goal of launching the currency by the end of 2022. Perhaps most noticeable was that The Peoples Bank of China issued a digital renminbi in April 2021[28] for use within domestic transactions.

With its own digital currency underway, perhaps it was not surprising that on May 19, 2021, Peoples Republic of China regulators banned domestic financial institutions and payment companies from providing services related to cryptocurrency transactions.[25] It further warned investors against speculative crypto trading. Under the ban, such institutions, including banks and online payments channels, must not offer clients any service involving cryptocurrency, such as registration, trading, clearing and settlement.

With the emergence of digital fiat currencies, consumers and institutions may have greater confidence in the value of their digital wallets, and investors may experience less volatility.

For insurers, in Conning's opinion, digital fiat currencies may be more beneficial than cryptocurrencies for two reasons. First, insurance regulators may view digital fiat currencies as another form of cash. That would reduce the capital charges for insurers holding digital fiat currencies. For property & casualty insurers, the potential development of digital currency coverage would increase if digital fiat currency was broadly adopted. Investors and users of cryptocurrency may see value in being able to buy insurance products to protect against technical glitches and server crashes, but time will tell if such products turn into another cyber product or just a passing fad.

Reviewing the digital currency and cryptocurrency landscape in late May 2021, in Conning's opinion, it is not difficult to see both an investment fad and the early days of a new approach to conducting business. As a result, Conning would expect the insurance industry to continue to remain cautious, but increasingly curious, about how to adapt their investments and operations to a changing digital currency landscape.

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## FOOTNOTES

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