

# UNDERWRITING CRYPTOCURRENCY: WHAT THE UNDERWRITER NEEDS TO KNOW



Edward Sheehan  
Underwriting Director  
SCOR  
Charlotte, NC  
esheehan@scor.com

## Introduction

The 2008 financial crisis awakened a great deal of interest in alternative currencies that are not tied to government control, intervention and possible manipulation. Alternative currencies are developed in response to financial crises or as solutions to local or social issues.<sup>1</sup> They aim to provide a complete substitute for traditional tender backed by the government.

In October 2008, an article posted on the web by an author under a pseudonym proposed a novel form of alternative currency based on computer programs and systems that create unique digital coins that can be traded for goods and services just like government-backed money. The author called it “cryptocurrency.”<sup>2</sup> Such cryptocurrency computer programs and systems provide a way to establish digital money that is secured with unbreakable codes that can only be opened and used by their owners in the process of buying and selling goods, services and the digital coins themselves.

At this time, cryptocurrency is considered a form of digital asset. There are currently over 10,000 cryptocurrencies in existence, but some like Bitcoin have far more interest and resources in them than others.<sup>3</sup> The systems and processes that support cryptocurrencies involve peer-to-peer networking and decentralization. Transactions are executed via secure blockchain technology.

Over the past decade, cryptocurrencies have gained increasing popularity with investors and have established a growing share of the financial market. An advantage of cryptocurrency is that it is not backed by a government and responds readily to the free market. A disadvantage of cryptocurrency is the opposite side of the coin - since it is not backed by a government, it is vulnerable to substantial volatility in the free

**Executive Summary** *Cryptocurrencies are an alternative form of currency that is a substitute for traditional tender backed by government. Since the 2008 financial crisis, cryptocurrencies like Bitcoin have become established nearly worldwide, and are popular among professional and novice investors. Underwriters will likely find more applicants relying on cryptocurrency holdings as part of their assets and net worth, as stated in their financial disclosures. Underwriters should understand what cryptocurrency is and how to assess the potential risks associated with it, as they evaluate the whole picture of an applicant’s finances and reasonable life insurance needs.*

market, as well as criminal activity at weak points in its otherwise secure system and processes.

As cryptocurrencies have now become more accepted and still gaining popularity, underwriters will inevitably find more applicants relying on cryptocurrency holdings as part of their assets and net worth, as stated in their financial disclosures. Therefore, underwriters should understand what cryptocurrency is and how to assess the potential risks associated with it, as they evaluate the whole picture of an applicant’s finances and reasonable life insurance needs.

## What Are “Cryptocurrency” and Other Related Terms?

When I began researching this topic, I decided to first look at the term “cryptocurrency.” I knew what currency meant - something used as a medium of financial exchange. Then I looked up the definition of “crypto”; it means “secret or hidden, not publicly admitted.” Put these two words together, and it sounds quite nefarious to me! It’s no wonder I’ve been suspicious of this whole thing.

All kidding aside, the simplest definition of cryptocurrency I found is “digital money that allows for secure peer-to-peer transactions on the internet.”<sup>4</sup> So how is that different than mobile payment systems like Venmo or PayPal? These rely on traditional financial systems for permission to transfer money on existing debit/credit accounts. In contrast, cryptocurrencies are decentralized and do not rely on traditional financial systems. This means that people anywhere in the world can send something like Bitcoin to each other without the involvement of a bank, government or other institution. It is simple, private and flexible.

Another related question frequently asked is “What is blockchain?” Each cryptocurrency transaction is executed using blockchain technology. Similar to a bank’s ledger or log of customers’ funds going in and coming out of a bank, blockchain is a “digital ledger” which holds a record of all cryptocurrency transactions. It is accessible to everyone at any time with sufficient public information in order to register and document a transaction.

This is where “mining” comes in. What is “mining”? For the blockchain to work, digital currency transactions have to be validated each step of the way. This is done by so called “miners” who modify their computer programs to authenticate each of the transactions by solving complicated mathematical problems to uniquely and securely identify each transaction. This programming task was once completed by individuals. Now the process is far too complex and time-consuming to sustain the necessary unique digital coin identifiers, and usually is performed by commercial enterprises specializing in it.

Cryptocurrency is an asset class that has become increasingly popular with investors, as it is highly volatile and has the ability to appreciate very quickly in reaction to the free market. The opposite is also true when free market forces cause the value of the cryptocurrency to decline or fall very quickly, such as when an overvalued economic bubble for that cryptocurrency bursts.<sup>5</sup>

### **Why Should Underwriters Be Concerned About Cryptocurrency?**

The growing popularity and secrecy (privacy) aspects of cryptocurrencies have started to attract considerable attention around the world from all sorts of people and groups. There is very little government regulation at this time, but whether cryptocurrency will be viewed as a material asset like an original painting by a famous artist or as a security is still to be determined.<sup>6</sup>

As of the date this article was written, various institutions within the US government have not reached a consensus regarding the regulatory framework for cryptocurrencies.<sup>7</sup> For the time being, they are being viewed as either a security, commodity or currency, depending on whom you ask. The Internal Revenue Service considers cryptocurrencies as property and accordingly subject to applicable federal income tax laws.<sup>8</sup> The Infrastructure Investment and Jobs Act that President Joe Biden signed on November 15, 2021, includes a future reporting requirement for cryptocurrency exchanges to issue a 1099-B.<sup>9</sup> This paper trail should assist underwriters with the verification of these types of assets down the road, but it may be a few years before it takes effect.

Many of us know the story of Bitcoin – it was created over a decade ago and initially worth a fraction of a US penny in 2010.<sup>10</sup> By 2016 a Bitcoin was worth about \$700, and a mere 4 years ago a Bitcoin was worth about \$7,000 because there is only a finite supply of Bitcoins that will ever be created. Seven thousand dollars sounds like a great deal by today’s standard, right? But this is also the type of volatility in value that has the potential to complicate an underwriter’s ability to financially underwrite insurance applicants.

Consider an applicant with \$5,000,000 worth of Bitcoin in September 2020. By April, 14, 2021, that amount would have reached a high of almost \$30,000,000. As of mid-July 2021, that Bitcoin holding would be worth about \$15,000,000. As of December 9, it would be valued around \$23,000,000.<sup>11</sup> It is safe to say that Bitcoin is a volatile investment, and determining an acceptable amount of insurance cover for an applicant with substantial cryptocurrency holding will not be simple. Over-insurance and persistency risks could be present, especially if Bitcoin turns out to be an economic bubble that bursts.

Cryptocurrency has also attracted the eye of criminals; there are many recent headlines involving criminals who were caught using cryptocurrency for illegal activities such as theft, extortion, money laundering and infrastructure vulnerabilities.<sup>12</sup> Although the actual creation of cryptocurrency itself is secure, criminals seek out weak points and vulnerabilities in the process and system to focus their time, energy and resources on gaining access to cryptocurrency assets through hacking and cryptowallet heists using corruption, deception and extortion. We, as underwriters, have to do our best to establish who our applicant is, know our applicant, and determine if any red flags exist.

As an example, Ramon Abbas (more popularly known as “Hushpuppi”) is a Nigerian national and influencer on Instagram with 2.5 million followers. He flaunted his extravagant lifestyle on social media: private jets, luxury cars, vacations, etc. He is now in the US facing charges of conspiring to launder hundreds of millions of dollars from a variety of cybercrime schemes and possibly involving North Korean hackers.<sup>13</sup> As an industry, we certainly do not want exposure to these types of situations.

### What Can Underwriters Do?

First, we need to be aware of the potential for problems, and this is why we are addressing the topic of cryptocurrency and raising awareness. Your company (including underwriting, legal, risk and anti-money laundering personnel) might consider establishing guardrails, and here is a partial list of considerations:

- If the amount being currently applied for and the total line can be financially justified for the stated purpose without including an applicant’s cryptocurrency holding, it is probably acceptable to proceed without additional concerns for all face amounts and total lines.
- If the financial justification of an applicant’s cryptocurrency value is needed to justify the amount and total line, consider obtaining proof of current ownership – account, address and/or cryptowallet. As mentioned earlier, this could become easier as government reporting requirements are implemented.
- Underwriters should make sure that financial reporting is required only from sources involving directly conducted transactions on exchanges where people buy, sell and trade cryptocurrency. These are the sources that make the most sense for understanding what cryptocurrency assets an applicant has. Requiring reporting from ancillary vendor groups like miners and digital wallet repositories is as meaningless as mandating that the electric company for Merrill Lynch provide information on stock trades.
- It makes sense for direct insurers to take a fresh look at the financial verification forms/interview questions when it comes to applicants providing detailed breakdowns of their net worth. Is their current wording going to properly capture whether or not an applicant has substantial cryptocurrency holdings?
- If an applicant’s cryptocurrency holdings must be included in order to financially justify the amount applied for and total line, consider looking at both the current value of those holdings and also a rolling average over a longer period of time. Can the total line be financially justified

using the lower of these two figures? If not, how close or far apart are you?

- If cryptocurrency is a considerable percentage of an applicant’s total net worth, proceed with caution. Consider completing a thorough web search of the applicant to investigate and establish any risk of fraudulent activity or other concerning background.
- If you work for a company with an anti-money-laundering department, consider discussing with them. When in doubt, consider also consulting with your legal and/or risk teams.
- With so many cryptocurrencies available, consider developing a limited list of cryptocurrencies that you feel are firmly established based on your corporate risk tolerance and stick with those only.
- Carefully vet any case involving a foreign national or politically exposed person with heavy cryptocurrency holdings. This can be done with Office of Foreign Assets Control (OFAC) searches.

### Conclusion

Cryptocurrencies are a novel form of asset that is growing and becoming popular, yet the dynamics of this class of asset are still changing, uncertain and vulnerable to crime. Underwriters need to determine if an applicant’s cryptocurrency holding is a significant factor in the financial profile and net worth as part of their typical financial underwriting workup. If the applicant has significant investment in cryptocurrencies, the underwriter should investigate this further as they evaluate the whole picture of an applicant’s finances and reasonable life insurance needs. Assistance and support from other internal insurance resources, including underwriting, legal, risk and anti-money-laundering personnel, are suggested.

### Notes

1. [www.ig.com/en/news-and-trade-ideas/other-news/top-10-alternative-currencies-190605](http://www.ig.com/en/news-and-trade-ideas/other-news/top-10-alternative-currencies-190605).
2. [en.wikipedia.org/wiki/Bitcoin](http://en.wikipedia.org/wiki/Bitcoin).
3. [www.investopedia.com/tech/most-important-cryptocurrencies-other-than-bitcoin/](http://www.investopedia.com/tech/most-important-cryptocurrencies-other-than-bitcoin/).
4. [www.coinbase.com/learn/crypto-basics/what-is-cryptocurrency](http://www.coinbase.com/learn/crypto-basics/what-is-cryptocurrency).
5. [www.cnn.com/2021/09/30/investing/foreseeable-future-cryptocurrency/index.html](http://www.cnn.com/2021/09/30/investing/foreseeable-future-cryptocurrency/index.html).
6. [www.jdsupra.com/legalnews/nfts-but-is-it-art-or-a-security-1053589/](http://www.jdsupra.com/legalnews/nfts-but-is-it-art-or-a-security-1053589/).
7. [www.skadden.com/insights/publications/2021/09/quarterly-insights/cryptocurrency-regulation-and-enforcement-at-the-us-federal-and-state-levels](http://www.skadden.com/insights/publications/2021/09/quarterly-insights/cryptocurrency-regulation-and-enforcement-at-the-us-federal-and-state-levels).
8. [www.investopedia.com/cryptocurrency-regulations-around-the-world-5202122](http://www.investopedia.com/cryptocurrency-regulations-around-the-world-5202122).
9. [time.com/nextadvisor/investing/cryptocurrency/infrastructure-bill-crypto-taxes/](http://time.com/nextadvisor/investing/cryptocurrency/infrastructure-bill-crypto-taxes/).
10. [en.wikipedia.org/wiki/History\\_of\\_bitcoin](http://en.wikipedia.org/wiki/History_of_bitcoin).
11. [www.statmuse.com/money/ask/bitcoin+price](http://www.statmuse.com/money/ask/bitcoin+price).
12. [swiftheadline.com/what-to-do-if-your-bitcoin-ether-or-other-cryptocurrency-gets-stolen/](http://swiftheadline.com/what-to-do-if-your-bitcoin-ether-or-other-cryptocurrency-gets-stolen/).
13. [www.forbes.com/sites/daviddawkins/2021/02/19/nigerian-influencer-ramon-hushpuppi-abbas-laundered-funds-for-north-korean-hackers-says-us-department-of-justice/?sh=46c961311dd5](http://www.forbes.com/sites/daviddawkins/2021/02/19/nigerian-influencer-ramon-hushpuppi-abbas-laundered-funds-for-north-korean-hackers-says-us-department-of-justice/?sh=46c961311dd5).

**About the Author**

**Edward Sheehan** has been leading SCOR's underwriting audit team since 2019, which handles both internal and external client reviews. He is also an integral member of a client solutions team that handles reinsurance pricing opportunities, and also aims to deepen client relationships and create added value for SCOR's clients. Prior to his current role, Ed was responsible for the direct supervision, management and motivation of SCOR's Large Case Underwriting Team from 2013-2019. Ed had served as Regional Underwriting Director at the company since 2005, where he worked closely with clients to deliver unique and creative solutions to meet their needs. He first joined the company in 1999 and has a combined 25 years of underwriting experience. Ed holds a Bachelor of Science degree in Marketing from Bryant University. He currently serves on the Program Committee of the Twin Cities Association of Home Office Underwriters. He previously served as President of the Southeastern Home Office Underwriters Association in 2012-13 and was on its executive committee in 2009-2014.