

Assessing NFT Insurance Coverage Options And Gaps

By **Brian Scarbrough and Edward Crouse** (April 29, 2022, 3:27 PM EDT)

Non-fungible tokens are digital tokens using blockchain technology, for which each token or series of tokens can incorporate unique characteristics. Whereas certain cryptocurrencies are fungible and each token in that cryptocurrency is interchangeable — like conventional currencies — NFTs are not.

NFTs function through smart contracts, which are blockchain applications typically deployed on one of several public blockchains to handle the control and transferability elements of the tokens. Anyone can view those public blockchain records — essentially a public database — to verify the control of each NFT and, frequently, to see where to locate items or the digital file associated with that NFT.

The file associated with the NFT could be virtually anything including an image file, like a digital piece of art, a contract, or a reference to an asset in the real world, among other things.

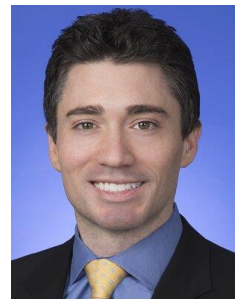
The combination undergirding NFTs — the potential for scarcity by incorporating a reference to something unique like a work of art in the digital or physical world, coupled with blockchain technology that enables efficient and frequently irreversible transfer of control — along with the relative novelty of the medium itself, has presented challenges for addressing risks associated with owning, selling and creating NFTs.

Some risks are common to crypto technology and digital content, including lost private keys, corrupted files, broken links, digital thefts, computer hacks and technological obsolescence. Other risks mirror those involved with purchasing other unique items: improper rights or licensing for intellectual property, transactional misrepresentations and broader financial stability of transactional entities.[1]

For example, the creator of an NFT may not own the rights to the image with which the NFT is associated, or may claim to make only one NFT but in fact mint many NFTs referencing the same image. Or the creator may make an NFT that purports to be part of a well-known limited series but only resembles that series without being part of it. This year, there's been a particular surge in counterfeit or fake NFTs.[2]

Current Insurance Frameworks

Because currently insurance policies do not necessarily come bundled with NFTs themselves, it then



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becomes incumbent upon an NFT owner to proactively acquire coverage.

Until NFT-specific insurance policies become more common — including becoming more linked with NFT transactions themselves — those looking to protect against risk can draw upon existing frameworks, although with potential coverage gaps.

For instance, many of the areas of risk protected by commercial property policies, which may include some level of protection for electronic data depending on the policy language, focus on physical loss or damage that may be less relevant for NFTs. That is, many of the risks to NFTs may not implicate what is traditionally thought of as physical loss or damage.

There are cyber and digital insurance policies that can potentially address many of the technology-based risks posed for NFTs.

For instance, companies and businesses that deal prominently with NFTs, such as digital marketplaces, can acquire forms of cyber liability insurance to cover risks of data breaches and cyberattacks on their businesses. And cyberinsurance policies can protect against so-called cryptojacking, a variant of ransomware that targets cryptocurrencies.

Additionally, there are digital asset coverage policies — often packaged together with stand-alone cyber policies or other types of policies — that can address NFT risk. For instance, some insurance policies may include within the definition of a covered "security failure" any unauthorized reprogramming of software, while others might include in a definition of "loss" the recollection of electronic data.

Commercial crime insurance policies might also be relevant if digital wallets or cryptocurrencies are involved in a theft or ransomware situation. However, detailed attention should be paid to the specific insurance policy wording; some insurance policies might explicitly exclude cryptocurrencies or digital tokens — and by extension, NFTs — or be silent on the issue of how coverage applies to cryptocurrencies, digital tokens and NFTs.

Therefore, it is important to closely examine the terms and conditions within a given insurance policy to see if it addresses NFTs either explicitly or implicitly. This analysis might also depend to some degree on the specific NFTs at issue and the risks to which they might be subject.

Sufficient understanding of the technology is necessary to understand how the policy language might map onto what is actually occurring at a technical level in most NFT loss scenarios.

New Horizons for Insuring NFTs

Given the current landscape of existing insurance coverage for NFTs, new industry actors have risen to provide risk mitigation alternatives.

Interestingly, one company, Arbol Inc., has not only begun using smart contracts as part of event-driven insurance policies, but even designed and stored those policies as NFTs themselves.[3] Another, Coincover, rolled out insurance-backed consumer and corporate protections for NFTs this year.[4] These plans run up to \$100,000 in coverage for individuals with custom policies for both company and individual policyholders.

Similarly, this month, Shield Coin announced that having a minimum of \$250 of its Shield Coin tokens in

a digital wallet will provide up to \$1,000 of blanket insurance on assets in that digital wallet against three types of scams. They include so-called rug pulls, which involve opportunistic draining of a project contract's liquidity, and imposter websites and fake mobile apps, which prey upon and steal from an owner's digital wallet.[5]

Ideally, tailored NFT-centric insurance policies will develop to address the constellation of risks posed to a particular type of policyholder.

In a Fool.com article, "Should You Get NFT Insurance?" Coincover Vice President Sharon Henley describes coverage as follows:

What are you buying protection for? Just the token? For the validity of the metadata? For the authentication of the JPEG? Having protection of a token when the metadata has been compromised — it's important to understand what protection you are buying.[6]

It is clear from both the existing insurance options and the developing NFT-specific policies that policyholders will want to combine insurance coverage with proactive and retroactive digital security measures.

As the insurance industry begins to more explicitly craft specific insurance policies for NFTs, prospective policyholders will need to consider which coverage will make the most sense based on their relationship with NFTs.

For instance, the types of coverage an NFT creator or owner might prefer will likely differ from the type of coverage sought by the online markets selling them, a third-party custodian of private keys, or a provider of digital servers storing files associated with NFTs, which generally process high volumes of data and transactions not necessarily limited to NFTs.

Even among NFT owners, needs will differ between (1) those who are more technologically sophisticated and self-custodying assets versus those using a third party to do so, or (2) those who purchase NFTs in a more speculative or financial manner for short-term holding, potentially as part of a broader crypto-asset strategy, as compared to those who acquire NFTs as they might a physical collectible for whom long-term data integrity might be of more importance.

Accordingly, policyholders might prefer some policies emphasizing financial risk coverage compared to the cybersecurity protection, or policies that protect a wider breadth of a holder's blockchain digital wallet versus a policy designed to protect a particular NFT asset.

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[1] For a prior Law360 overview of insurance and NFTs, see <https://www.law360.com/articles/1401544/the-need-for-insurance-options-to-protect-nfts>.

[2] <https://www.forbes.com/sites/lcarrel/2022/01/28/as-nft-scams-grow-in-number-nft-insurance-hits-the-market/?sh=175213c87bcb>.

[3] <https://www.spglobal.com/marketintelligence/en/news-insights/blog/mizuho-securities-is-now-available-in-sp-globals-aftermarket-research>.

[4] <https://www.coincover.com/>.

[5] <https://theshieldcoin.com/>.

[6] <https://www.fool.com/the-ascent/cryptocurrency/articles/should-you-get-nft-insurance/>.