Five Key Predictions for Digital Assets in 2022

February 2022

Digital assets are being rapidly adopted as investors and businesses alike continue to recognize their appeal. Although digital assets are still considered a highly speculative asset class, their mainstreaming in 2022 — characterized by greater regulatory clarity, digital asset industry consolidation and new customer horizons — presents opportunities and risks to be carefully managed.

As the adoption of digital assets grows and evolves, here are 5 key trends we should watch for in 2022:

LOCKTON®

1

Increased Regulatory Focus

Will more certainty in 2022 pave the way for growth?

With the recent meteoric rise in popularity of digital assets, there has been a marked increase in regulatory activity. We expect this continued and heightened regulatory focus on the digital asset space to continue through 2022. How this regulation takes shape remains to be seen.

Of the many unknowns, how the Securities and Exchange Commission (SEC) will respond is top of mind. With Gary Gensler now at the helm of the SEC, while initial expectations suggested his policies would be more crypto-friendly, his actions have proven otherwise.

Adding to this uncertain regulatory landscape, penalties assessed against digital asset-related firms for violations are becoming steeper and more prevalent and related regulations are becoming more cumbersome.

Last summer, the Financial Crimes Enforcement Network (FinCEN) weighed a penalty of $100 million against a crypto derivatives exchange for violating the Bank Secrecy Act (BSA).

And in November, the Office of the Comptroller of the Currency (OCC) clarified its previous guidance and provided details around the requirement to have appropriate risk management measures in place before banks can engage in cryptocurrency activities. This might slow the pace of crypto's entry into the US banking system and could initially favor the largest banks with the most secure funding.

ETF APPROVAL

Last year, the SEC approved a bitcoin futures exchange traded fund (ETF), which would incorporate digital assets into the more traditional financial sector. However, crypto is still waiting for a spot ETF approval and industry experts speculate a launch will likely not even happen this year.

While certain regulatory decisions might slow growth in the digital asset space at the outset, enhanced security and consistent rule-making should increase the appeal to insurers offering coverage. The long-term health and sustainability of the digital asset ecosystem will rely on a healthy balancing act of these two forces.

2

Corporate Transaction Activity

Continued growth will encourage more involvement from traditional financial services firms

Although 2021 already proved to be a monumental year for corporate transactions involving digital asset companies, it is projected that 2022 will be even busier.

Merger and acquisition activity in the digital asset industry swelled 131% in 2021 to the tune of $6.1 billion. Many of these companies that went public last year did so via a traditional IPO or a deSPAC.

Not to be outdone, venture capital deals also broke records by investing $30 billion in the digital asset space in 2021 — quadruple the previous record and a 719% increase in funding year-over-year. This funding consists of a total of 1,700 VC deals, which represents a 126% increase year-over-year compared to 2020. Given these numbers, along with the desire of traditional financial services firms to meet growing client demands and set themselves apart from their peers, we expect to see even more traditional financial services firms involved in digital asset company deals in 2022.

3

Expanding Digital Asset Adoption

Rapid change, new audiences and shifting sands create opportunity and competition

The adoption of digital assets, both by individuals and corporations, will likely continue at its rapid pace of growth.

Traditional companies will continue to integrate digital assets into their business in one form or another. Digital assets have already been adopted by FinTech companies like PayPal and Square, certain banks, and card networks like Visa and MasterCard.

There could be more governmental buy-in on the horizon. More governments, and possibly a central bank, could follow countries like El Salvador's lead and buy into digital assets to stay competitive. Some feel that those countries that adopt sooner than their peers will have an advantage over others.

4

Innovation Continues at a Fast Clip

NFTs, DeFi, GameFi and Metaverse have our attention

Non-fungible tokens—or NFTs—are a digital representation of a wide range of items, including art, virtual real estate in the Metaverse, memes, sneakers and clothing, to name a few. After a breakout year in 2021, when global sales passed $4 billion, NFTs are projected to continue to grow in 2022. Crypto markets tend to follow Bitcoin, which has faced a recent drop following the Fed hinting at raising interest rates. However, NFTs have bucked this trend and prices have remained strong, suggesting NFTs may be more stable than some other forms of digital assets.

While 2021 was the year of the NFT, it was not the only innovation — **decentralized finance** (DeFi) continued to expand and will continue to do so. **GameFi** — essentially a combination of gaming, DeFi, and NFTs — emerged on the market last year and grew rapidly as well.

With GameFi and Metaverse projects new to the scene, there will inevitably come additional risks that need to be considered. This is yet another development driving companies toward the purchase of insurance, which ultimately will add to the digital asset ecosystem's sustainability.

5

Emphasis on Insurance

Look to newer insurers, creative solutions and increased competition from the traditional markets

The increase in digital asset adoption has led to a heightened focus on the need for insurance.

Crypto-native companies and even more traditional companies that have incorporated digital assets into their business must understand the importance of insurance and the benefits associated with protecting company balance sheets, the personal assets of the individual company leaders and, of course, client assets.

Over the last decade, the motivation for buying insurance has shifted from what was initially looked at from more of a marketing perspective to something whose value is truly appreciated. The focus on crime coverage (insuring the loss of assets due to an external hack among other things), “cold storage” specie coverage (insuring the loss of assets due to a physical loss), and directors and officers (D&O) liability coverage (insuring the company’s balance sheet and the directors and officers running the company) is likely to continue through 2022.

However, as we started to see in 2021, we expect 2022 to be a year of insurance innovation with the continued launch of new digital asset-focused insurance products entering the space via non-traditional insurers. More “creative” solutions could take the form of smart contract insurance or other more tailored coverages. In 2022, we expect to see even more non-traditional insurance entrants and solutions than seen in the past.

Whether through new, more forward-thinking insurer entrants or from more traditional commercial insurance markets, greater supply of insurance is much needed. As competition in the insurance space continues to heat up, don’t be surprised if we see the shift we’ve been waiting for as the traditional insurance markets become more open to offering insurance coverage to companies in the digital asset space.

Understanding the digital asset ecosystem and having trusted advisors by your side can help you navigate these unchartered territories.

For more information about Lockton’s executive risk products and services, and Lockton’s Emerging Asset Protection (LEAP) team’s capabilities, please contact your Lockton representative or email us at LEAP@lockton.com.

UNCOMMONLY INDEPENDENT