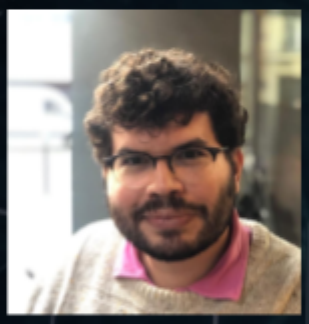
diffuse*tap*
Virtual Event Series

# Insuring Crypto Exposure

*Guest Speakers:*

Josh Faier
Head of Finance
Figment



Marouane Hajji
CEO
Unslashed Finance

*Hosts:*

Kenny Estes
CEO & Founder
Diffuse

Ayla Kremb
COO & Co-Founder
Diffuse

# DiffuseTap: Insuring Crypto Exposure

Last time on DiffuseTap, **Josh Faier, Head of Finance and Staking Operations at Figment, and Marouane Hajji, CEO of Unslashed Finance**, talked to us about DeFi and crypto insurance, what the regulation looks like in this space, and underwriting risks in a new and constantly evolving industry.

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## DiffuseTap

This networking session is part of our weekly virtual events series. Networking (you'll bump into at least a dozen high caliber fund managers) meets purposeful (you'll tap into brand-new sources of ideas)... straight from your armchair like a boss.

## Meet the Speakers

Josh Faier is the Head of Finance and Staking Operations at Figment, a decentralized blockchain infrastructure provider for token holders and developers investing in and building on Web 3.0 technology. Prior to Figment, Josh worked as Manager of Financial Planning and Analysis at Bitfarms, one of North America's largest cryptocurrency mining companies. Linkedin: @joshuafaier

Marouane Hajji is an expert in traditional financial markets and investment banking. Also a serial entrepreneur with a passion for blockchain and fintech, Marouane is the CEO of Unslashed, an insurance provider for decentralized finance companies that also develops software to secure against risks for protocols, DAOs, and institutions.
Linkedin: @marouane

## About Diffuse

We are an alternative fund platform offering differentiated investment products. From digital assets, to VC funds, and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information visit www.diffusefunds.com.

KENNY ESTES: Our speakers today are Josh and Marouane. Josh, do you want to give a little bit of your background to start us off?

JOSH FAIER: Sure, thanks. I'll try to keep it as brief as I can. First and foremost, pleasure to be here. Thank you Diffuse for organizing these types of events and bringing some very interesting topics to light. It's my first time hearing about DiffuseTap, so I will most certainly be a regular after this. My name is Josh. I joined Figment about a year ago, and like many startups, I've worn many hats.

When I started, I was head of finance and staking operations. Now, I've shifted to product management and product strategy. The lens by which I am viewing insurance is more so as a consumer for our staking service offering. For context, this is not liquidity pool staking. This is more proof of stake staking.

To give just a little background, Figment, among other exciting things, provides proof of steak Infrastructure as a Service. Why? Because running and maintaining a validator is complex. Token holders can delegate the power, if you will, of their tokens to Figment. Figment will use the power of these tokens as a key ingredient for the validation services provided to the network, and earn rewards for this service. The majority of the rewards will go to the actual delegators, and Figment will take a share of that. That's how the business works. Delegators who delegate their proof of stake tokens can expect to earn anywhere between 5 and 20% generally, but as high as 400% in some of the earlier stage networks.

However, staking does come with risk, like any other DeFi yield-bearing alternative. So, one of the methods Figment is approaching risk mitigation is through coverage and insurance, which can help limit the downside for our delegators, and either mitigate it or entirely eliminate it.

That's why we started working with Unslashed. In general, by reducing your risk, more high net worth individuals are likely to get into the space and will be more willing to stake and try to earn yield, and to deploy their tokens that they own. There has been a significant change in perception of late. Insurance has been viewed as kind of boring, but Web3 is much more sexy. I'm definitely excited to jump in and start talking about insurance with you all.

KENNY: Awesome. That's a great segue as well. Marouane, do you want to give a little introduction to yourself and Unslashed?

MAROUANE HAJJI: Sure. Thank you for having me here, it's great to be with everyone here. My name is Marouane. I started working on Unslashed back in 2019. The way we were viewing blockchain was that it was going to revolutionize the financial sector. That was my main thesis back in 2017 and in 2016, when I discovered Ethereum. What was happening back then, was that there were little bits of lending protocols. We were looking at the insurance layer, and we realized that there wasn't much. We thought that it was something that was going to be important.

So, we started by focusing our attention on the slashing risk with the hypothesis that staking and proof of stake networks were going to attract a lot of institutional investors that were going to use services like

Figment, who are professionally managing the staking infrastructure. From the start, we were oriented more towards the institutional customers.

What is interesting about Unslashed is that it's a DAO to begin with, and it's also a protocol that allows anyone to create ILSs, which are vehicles that receive capital, and that underwrite different types of risks. We have one vehicle that is created that is on-chain, and it is managed by the DAO. This vehicle allows to underwrite slashing risk, for example, with Figment. It allows us to underwrite Tether's depeg risk, for example, or smart contract risks for various protocols. And we have some other products in the pipe that we're going to launch.

The idea for us as a DAO and as a protocol is basically to be able to launch as many vehicles like this as possible. Some are going to be really specialized in a certain number of risks. Others are going to be more generalist while being crypto focused. The long term vision is to allow institutions to join the crypto world while having some of their risks mitigated. And at the same time, we want to start addressing some niches in terms of insurance needs in some parts of the world that don't have access to insurance.

AYLA KREMB: Love the thorough introduction there. As we can tell, the insurance universe sounds complicated. So maybe we'll kick off with a little bit of definitions. Josh, if you don't mind sharing, what is crypto insurance really like? What does it cover? What are the buckets that we should keep in mind when we think about this topic?

JOSH: Yeah. Like I mentioned, my lens is more so from the staking perspective. When it comes to a more broad definition of what insurance can possibly cover, I would definitely pass that question to Marouane. But from our perspective, it's more about the slashing, downtime penalties, and missed rewards. It's more about the actual loss that can happen while you stake.

Generally, it happens if you have extensive downtime, where the validators are offline and are not active, and you receive a penalty. Slashing generally happens with something called double signing, which is when two instances of the validators sign the same blocks, creating a mini fork in the network. That is the more severe type of slashing. This type of insurance that we're looking to get helps cover that potential risk of loss.

Aside from risk of loss, we also generally cover "missed rewards", which basically means in the rare case when our validators are offline, we will cover the amount that the client would have received had we been online.

Marouane and Unslashed are focused on on-chain insurance. At Figment, we believe strongly in having multiple layers of protection. Along with on-chain insurance, we also have traditional off-chain insurance with a more traditional insurance provider. We rely on our balance sheet as well. The definition of insurance can mean multiple things. But for us at Figment, we're focused on risk mitigation as a whole. And insurance for staking is just one way of doing that.

MAROUANE: Yeah, I completely agree with everything that Josh just said. I would add that our focus is on the tail risk. We're not going to be covering the price movements for a crypto asset. We're not going to be covering frequent events. We are just looking at fat tail risks, and trying to provide products that mitigate or hedge those types of risks. The risks that Josh mentioned are technical risks related to the operations of Figment. But there are other types of technical risks.

For example, the smart contract risks, or the custody risks for exchanges and custodians. There are other types of risks that are not technical, but that are more related to the system design, or how a system works. This could be, for example, the depeg risk for a certain number of algo stablecoins.

There are also risks that are related to regulation. When I'm talking about Tether, the way we approach it is by looking at the price movements and modeling it. But at the same time, we stretch the price movements in our models in order to take into account a certain number of possibilities, such as having a bank run on Tether and regulators stopping their activities, etc.

There are lots of different risks. The technical ones are the main risks so far, to be honest. And we are adding new layers. That could be for example, the credit risk, in case there are uncollateralized lending activities on-chain or off-chain. We try to check whether the conditions of the claim are met. It's pretty similar to traditional insurance in terms of definition. We use some of the traditional tools for modeling. They're just applied to the crypto world.

We also use some of the new tools for modeling as well that traditional insurance providers might not be in a position to use, like AI or ML. Traditional insurance companies are not going to use that because they have a certain number of rules or models that they need to follow. That's how I would frame it.

KENNY: That makes a lot of sense. It seems that you have a lot more flexibility, with your focus on the technical elements. Let's expand on that and compare it with traditional insurance, which is one of the most regulated spaces. Daniel had a question about that specifically. You mentioned ILSs. ILSs, cat bonds, and things of that nature are very regulated. Are your products regulated? Or are you taking the position that they shouldn't be? Where's your head around that?

MAROUANE: Basically we're functioning as a DAO in the same way Compound or Aave are functioning. Right now, we consider that the way things work is fine until there is more clarity with regards to regulation. Once there is more clarity regarding the regulation, we'll be able to be categorized into this thing, or that thing, in the same way Compound or Aave or Maker will be fitting into a certain number of categories. I think we are still early from this point of view.

We are also working with a partner who is going to allow us to streamline the process of creation of ILSs from a more legal and regulated point of view. That's also something that we have been keeping an eye on. In order to figure out how things would work, we need a framework that gives us some kind of direction.

 

KENNY: You're taking the position that until there's that clarity, it's hard for you to be in compliance with that. Josh, do you have anything you want to add on that subject as it pertains to regulation in insurance and crypto in general, and how you guys are positioning yourselves?

JOSH: We try to work with brokers in a traditional sense to see who we can work with that is off-chain. That way, they're regulatory compliant. That was step one. And then, we started seeing that the appetite for these types of providers is extremely low. That's starting to change from six months ago, when we started asking. Since then, it seems like traditional insurance providers are warming up to this industry.

I think we're going to opt for the route of umbrella coverage with a traditional insurance provider, if that's an option. But everything we do or try to do is to focus on building and developing web3. So, working with a company like Unslashed, regulatory compliance or not, is still appealing. Because at the end of the day, it's supporting web3. The people are the ones who are funding these policies. And ultimately, so long as it's coded in the smart contract properly, we will automatically receive our payments once we make a claim, so long as someone doesn't try to challenge that claim.

We can talk about that whole challenging mechanism as well. But ultimately, we don't see much of an issue around working with a company like Unslashed, despite still uncertain regulatory issues when it comes to fitting into the traditional square peg.

AYLA: One of the questions that then comes naturally is, how do you price and underwrite the risk that you guys are taking? How do you think about it? There are a lot of risks that are ever evolving, and there are new ones coming on board all the time. How do you make sure you're always underwriting the latest risks that are out there, and how do you actually price it?

MAROUANE: Honestly, I don't think we are in a position where we can underwrite the latest risks. I don't think it's possible. That's because you have some products that are basically moving all the time, and it's really hard to model them. It's really hard to put a price on them. And sometimes, it's not even worth it to focus on them.

We have certain areas of focus that are more stable, and that allow us to develop models, work on them, and try to improve them. We make sure that what we have makes sense and is balanced and diversified, in terms of insurance capacity and risk that we underwrite.

In terms of pricing and risk assessment methodology, it really depends on the risk. For some risks, we're going to have a pure rating approach, combined with a little bit of data that is available. If we think of smart contract risks, the data that is available does not allow us to build traditional models. So, we're going to try to use partly a quantitative approach and partly a pure rating approach, where we're going to look at the smart contracts, see the complexity of the smart contract, look at the different attack vectors,

the audits that they had, etc., and combine these pieces of data with what is happening in the market and come up with a pricing that makes sense.

For other risks, we can have more pure quantitative approaches, or systemic approaches. When we are thinking about stablecoins, the way we approach them is, we factor in those conditions that would cause those events that we're covering to happen. Then, we're going to model the whole system. I'm talking about algorithmic stablecoins. We're going to try to model the whole system and see how it works, including when it could break. We're going to try to stress-test it and put it in a position where it breaks, and this will give us a probability of the system breaking and under which conditions it would.

So It really depends on the risk itself. When things are moving too much, we cannot position ourselves immediately. We need time to work on things and make sure that we have something robust, use it for a certain period of time, and adapt it when needed. But we cannot change things all the time.

JOSH: What's been interesting is that working with Unslashed has been great because they have very flexible policies, and they will come up with what works best for both parties. I find that with my experience with Unslashed, versus some other providers that I've been speaking with, is that Unslashed does not opt-out of providing very "tail risk" risks for the very “tail risk” risks.

There are a ton of exceptions that you tend to see in more traditional insurance, where there's always the need to read the fine print. That's how insurance companies wiggle out of actually making payments. That doesn't, at least from what I can tell, exist with Unslashed. The policies are very clear and are all available on-chain. From our perspective, it's been the most robust type of coverage that we can receive, that really covers even the most extreme cases of risk.

MAROUANE: We collaborate on the policies. We work on them together. We try to understand the needs of the customer, and figure out how to structure the policy in a way that makes sense for the consumer. And that makes sense for us as well in the sense that we have something that we can actually underwrite. That's the way we work. We know that we are not at a stage where we can standardize everything. Not yet. So, we tend to go for a collaborative approach when creating these policies, and we make sure that we have everything covered within the policy documents.

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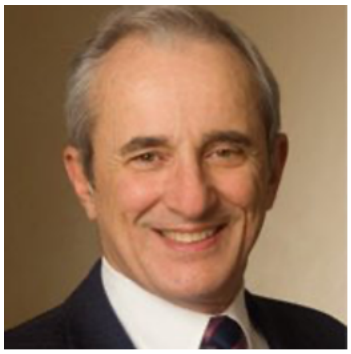
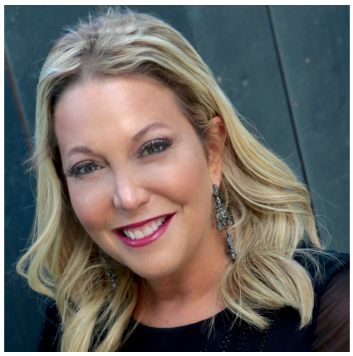


## Dennis Chookaszian

Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

Sharing his decades-long expertise on corporate governance, Dennis talked about how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on



## Susan Brazer

CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan described the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on

## Raj Mukherjee J.D.

VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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