THE MONEY GAME AUG. 15, 2022

Everyone trusted the two guys at Three Arrows Capital. They knew what they were doing — right?

By Jen Wieczner

Illustration: Natalia Agatte

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The boat was a beauty of a thing: some 500 tons across 171 feet of glass and steel as white as Santorini. All rounded edges, the five decks — one with a glass-bottom pool — were made for July on the Mediterranean, sunset dinners among the islands near Sicily, cocktails in the turquoise shallows off the coast of Ibiza. Her would-be captains showed off pictures of the $50 million vessel at parties, bragging that it would be "bigger than all of the richest billionaires' yachts in Singapore" and describing plans to adorn the staterooms with projector screens, creating a waterborne gallery for their growing collection of digital art in the form of NFTs.

No matter that they had originally told friends they were shopping for a $150 million vessel; the superyacht was still the largest by well-established boat builder Sanlorenzo ever to be sold in Asia, a triumph of crypto's nouveau riche. "It represents the beginning of a fascinating journey," the yacht broker said in an announcement of the sale last year, saying it looked "forward to witnessing many happy moments aboard." The name the buyers had in mind was cleverly chosen — an inside joke nodding to the cryptocurrency dogecoin that would both thrill their social-media acolytes and be intelligible to all the pathetic, poor "no coiners" out there: *Much Wow*.

Her buyers, Su Zhu and Kyle Davies, two Andover graduates who ran a Singapore-based crypto hedge fund called Three Arrows Capital, never got the chance to spray Champagne across *Much Wow*'s bow. Instead, in July, the same month the boat was set to launch, the duo filed for bankruptcy and disappeared before making their final payment, marooning the unclaimed trophy in her berth in La Spezia on the Italian coast. While she has not been officially listed for resale, the intimate world of international super-yacht dealers has quietly been put on notice that a certain Sanlorenzo 52Steel, the coveted Cayman Islands flag billowing above her empty balconies, is back on the market.

The yacht has since become the subject of endless memes and jokes on Twitter, the functional center of the crypto universe. Pretty much everyone in that world, from the millions of small-scale crypto holders to industry employees and investors, has watched in shock and dismay as Three Arrows Capital, once perhaps the most highly regarded investment fund in a burgeoning global financial sector, collapsed in excruciating and embarrassing fashion. The firm's implosion, a result of both recklessness and likely criminal misconduct, set off a contagion that not only forced a historic sell-off in bitcoin and its ilk but also wiped out a wide swath of the cryptocurrency industry.

ON THE COVER

Illustration: Shira Inbar

Crypto companies from New York to Singapore were the direct victims of Three Arrows. Voyager Digital, a publicly traded crypto exchange based in

New York that once had a multibillion-dollar valuation, filed for Chapter 11 in July, reporting that Three Arrows owed it more than $650 million. Genesis Global Trading, headquartered on Park Avenue, had lent Three Arrows $2.3 billion. Blockchain.com, an early crypto company that provided digital wallets and evolved into a major exchange, faces $270 million in unpaid loans from 3AC and has laid off a quarter of its staff.

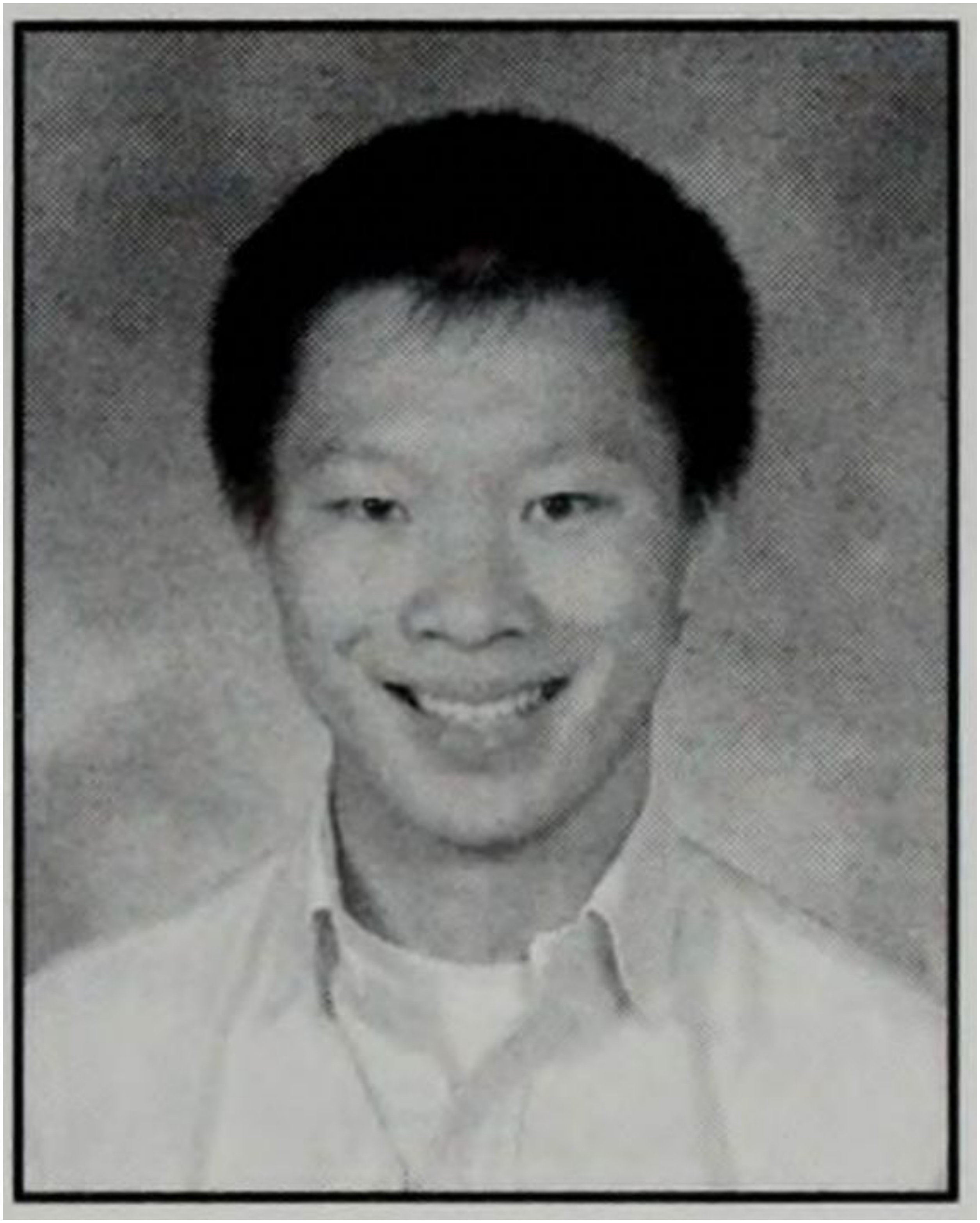
Among crypto's smartest observers, there is a widely held view that Three Arrows is meaningfully responsible for the larger crypto crash of 2022, as market chaos and forced selling sent bitcoin and other digital assets plunging 70 percent or more, erasing more than a trillion dollars in value. "I suspect they might be 80 percent of the total original contagion," says Sam Bankman-Fried, who as CEO of FTX, a major crypto exchange that has bailed out some of the bankrupt lenders, has perhaps more visibility on the problems than anyone. "They weren't the only people who blew out, but they did it way bigger than anyone else did. And they had way more trust from the ecosystem prior to that."

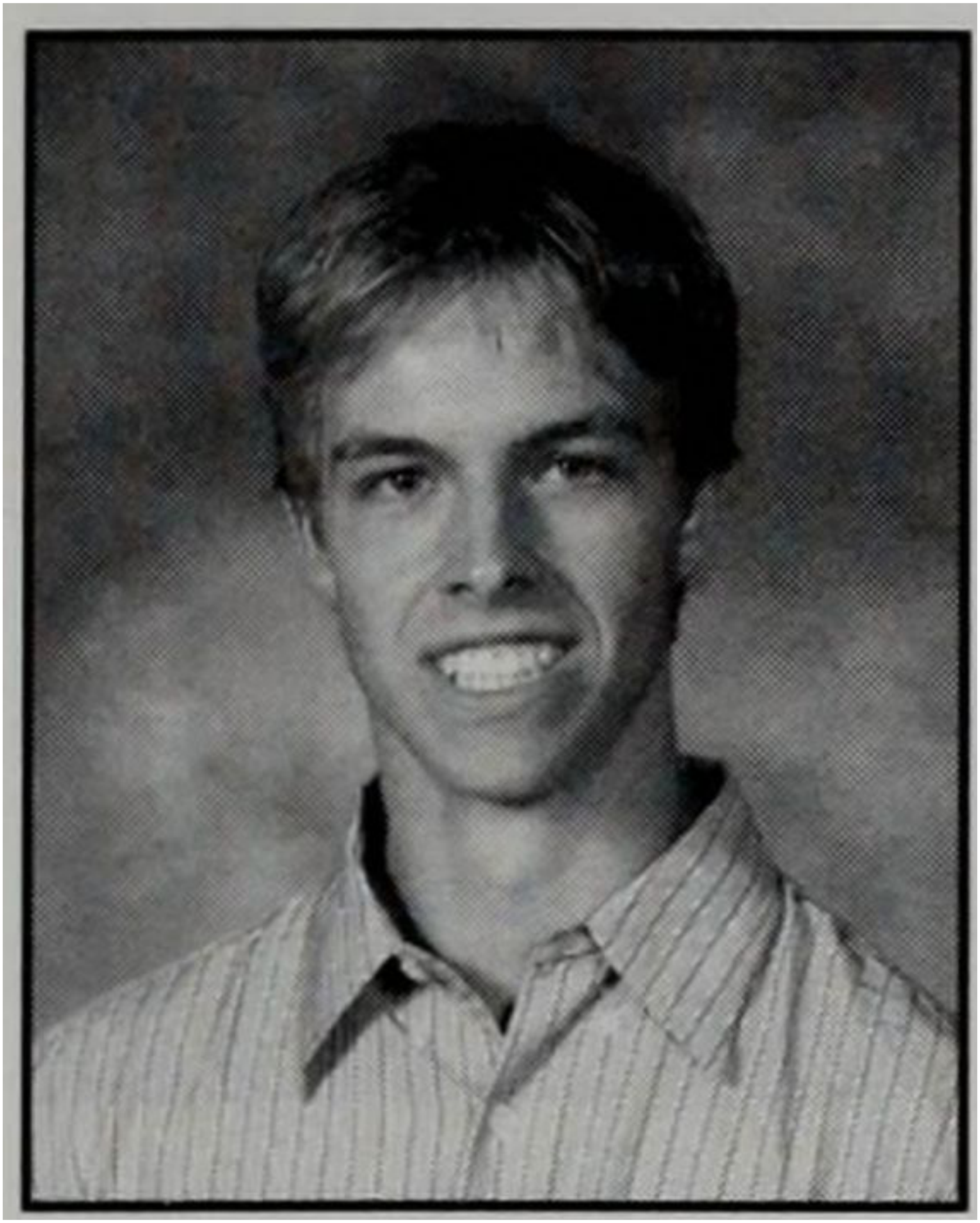
For a firm that had always portrayed itself as playing just with its own money — "We don't have any external investors," Zhu, 3AC's CEO, had told Bloomberg as recently as February — the damage Three Arrows caused was astonishing. By mid-July, creditors had come forward with more than $2.8 billion in claims; the figure is expected to balloon from there. Everyone in crypto, from the largest lenders to wealthy investors, seemed to have lent 3AC their digital coins, even 3AC's own employees, who deposited their salaries with its "borrowing desk" in exchange for interest. "So many people feel disappointed and some of them embarrassed," says Alex Svanevik, the CEO of Nansen, a Singapore-based blockchain-analytics company. "And they shouldn't because a lot of people fell for this, and a lot of people gave them money."

That money appears to be gone now, along with the assets of several affiliated funds and portions of the treasuries of various crypto projects 3AC had managed. The true scale of the losses may never be known; for many of the crypto start-ups that parked their money with the firm, disclosing that relationship publicly is to risk increased scrutiny from both their investors and government regulators. (For this reason, along with the legal complexities of being a creditor, many people who spoke about their experiences with 3AC have asked to remain anonymous.)

Meanwhile, the unclaimed yacht looms as a slightly ridiculous avatar of the hubris, greed, and recklessness of the firm's 35-year-old co-founders. With their hedge fund in the midst of chaotic liquidation proceedings, Zhu and Davies are currently believed to be in hiding. (Multiple emails to them and their lawyers requesting comment went unreturned, except for an automatic reply from Davies that reads, “Please note I am out of office at this time.”) For an industry constantly defending itself against accusations that cryptocurrency is, at its heart, a scam, Three Arrows seemed to prove the antagonists’ point.

Zhu and Davies are two ambitious young men, by all descriptions exceedingly smart, who appeared to understand the structural opportunity of digital currency rather well: that crypto is a game of creating virtual fortunes out of thin air and convincing other humans with traditional forms of money that those virtual fortunes deserve to be real-world ones. They built social-media cred by playing the part of billionaire financial geniuses, translated that to actual financial credit, then put billions of dollars in borrowed money to work in speculative investments they could cheerlead to success with their large, influential platforms. Before you know it, the pretend billionaire is a real billionaire shopping for super-yachts. They grokked the game, and the plan worked perfectly — until it didn’t.




Zhu and Davies in their senior year at Andover in 2005. Photo: Phillips Academy.

Su Zhu and Kyle Davies met at Phillips Academy in Andover, Massachusetts, part of the class that started high school the same week as 9/11. While lots of kids at Andover, as the top-ranked boarding school is commonly known, come from great wealth or prominent families, Zhu and Davies grew up in relatively modest circumstances in the Boston suburbs. “Both of our parents are not, like, rich,” Davies said in an interview last year. “We’re very much middle-class guys.” Neither were they especially popular. “They were both known as kind of weird, but Su especially,” says a classmate. “In reality, they weren’t weird at all — just shy.”

Zhu, a Chinese immigrant who had come to the U.S. with his family when he was 6, was known for his perfect GPA and for taking a heroic load of AP classes; he received the “most studious” superlative in his senior yearbook. He earned a special citation for his work in math, but he was far from just a numbers guy — he was also awarded Andover’s top prize for fiction upon graduation. “Su was the smartest person in our class,” remembers a fellow student.

Davies was a star on the crew team, but classmates otherwise remember him as an outsider — if they remember him at all. A budding Japanophile, Davies received top honors at graduation in Japanese. According to Davies, he and Zhu weren’t particularly close back then. “We went to high school together, we went to college together, and we got our first job together. We weren’t the best of friends all the way through, he said on a crypto podcast in 2021. “I didn’t know him that well in high school. I knew he was a smart guy — he was like valedictorian of our class — but by college we started to hang out a lot more.”

“College together” was at Columbia, where they both took a math-heavy courseload and joined the squash team. Zhu graduated a year early, summa cum laude, and moved to Tokyo to trade derivatives at Credit Suisse, where Davies followed him as an intern. They had desks next to each other until Zhu was laid off in the financial crisis, landing at a high-frequency trading shop in Singapore called Flow Traders.

It was there that Zhu learned the art of arbitrage — attempting to capture small variations in relative value between two linked assets, typically selling the one that’s overpriced and buying the one that’s underpriced. He focused on exchange-traded funds (basically mutual funds that are listed like stocks), trading in and out of related ones to collect small profits. He excelled at it, rising to the top percentile of moneymakers at Flow. The success gave him a new confidence. He was known to bluntly criticize colleagues’ performance and even call out his bosses. Zhu stood out in another way: The Flow offices, full of servers, ran hot, and he would come to work in short-shorts and a T-shirt, then remove the shirt, leaving it off even when he went through the building’s lobby. “Su would be walking around topless in his mini-shorts,” a former colleague recalls. “He was the only one who’d take off his shirt and trade.”

After Flow, Zhu did a stint at Deutsche Bank, following in the footsteps of Arthur Hayes, the crypto legend and billionaire co-founder of the BitMEX exchange. Davies had stayed on at Credit Suisse, but by then both were tiring of the big-bank life. Zhu complained to acquaintances about the low caliber of his banking colleagues and a bloated culture that allowed people to lose the firm’s money on a trade with little consequence; in his view, the best talent had already decamped for hedge funds or struck out on their own. He and Davies, now 24 years old, decided to start their own shop. “There was very little downside to leaving,” Davies explained in the interview last year. “Like, if we ever left and really messed it up hard, we would definitely get another job.”

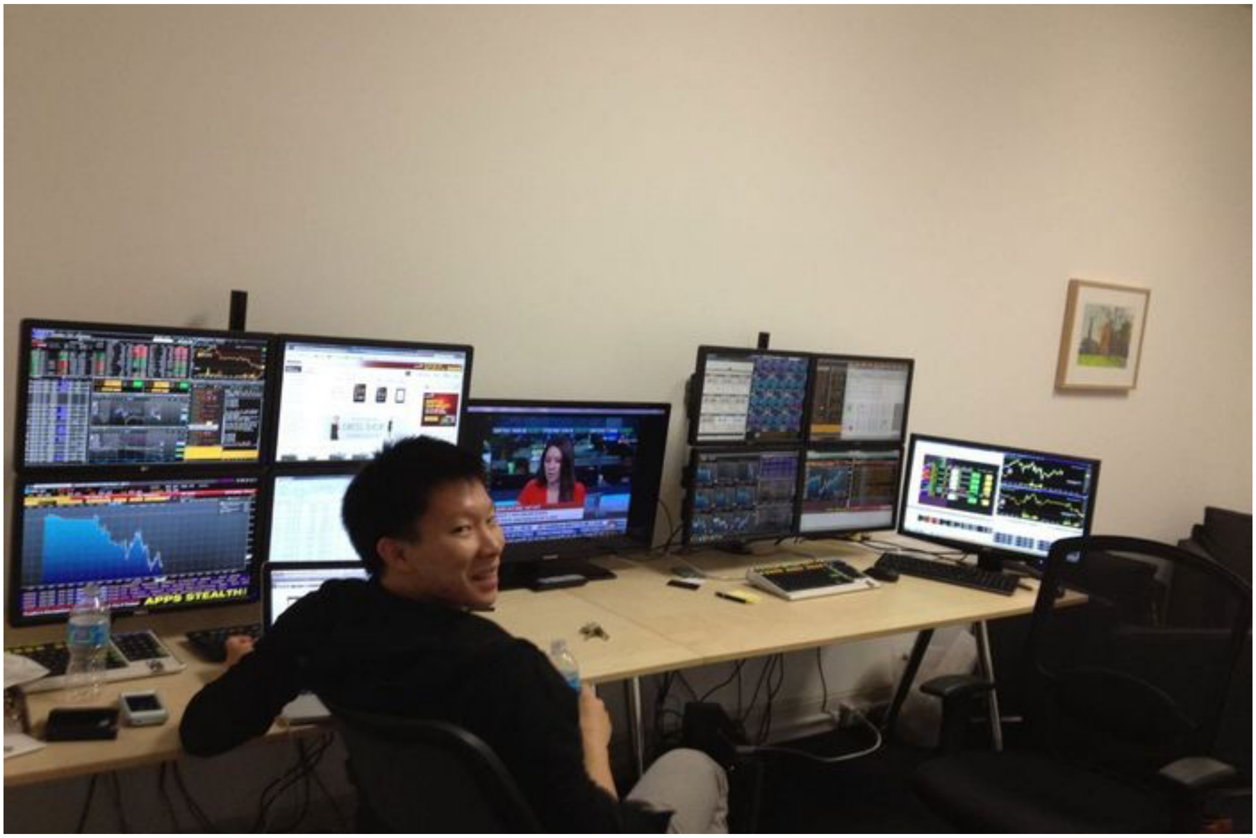
In 2012, while both were temporarily living in San Francisco, Zhu and Davies pooled their savings and borrowed money from their parents to scrape together about $1 million in seed funds for Three Arrows Capital. The name came from a Japanese legend in which a distinguished daimyo, or warlord, teaches his sons the difference between trying to snap a single arrow — effortless — and trying to break three arrows together — impossible.

In less than two months, they had doubled their money, Davies said on the podcast *UpOnly*. The pair soon headed for Singapore, which has no capital-gains tax, and by 2013, they’d registered the fund there with plans to relinquish their U.S. passports and become citizens. Zhu, fluent in Chinese and English, moved fluidly in the Singapore social scene, occasionally hosting poker games with Davies and friendly exhibition chess matches. They seemed frustrated by their inability to get Three Arrows to the next level, though. At a dinner around 2015, Davies lamented to another trader about how hard it was to raise money from investors. The trader wasn’t surprised — after all, Zhu and Davies had neither much of a pedigree nor a track record.

During this early phase, Three Arrows Capital focused on a niche market: arbitraging emerging-market foreign-exchange (or “FX”) derivatives — financial products tied to the future price of smaller currencies (the Thai baht or the Indonesian rupiah, for instance). Access to those markets depends on having strong trading relationships with big banks, and getting in the door was “almost impossible,” BitMEX’s Hayes wrote recently in a Medium post. “When Su and Kyle told me how they got started, I was pretty impressed they had hustled their way into this lucrative market.”

At the time, FX trading was moving to electronic platforms, and it was easy to find differences, or spreads, between the prices quoted at different banks. Three Arrows found its sweet spot trolling the listings for mispricings and "picking them off," as Wall Street calls it, often pocketing just fractions of a cent on each dollar traded. It was a strategy the banks detested — Zhu and Davies were essentially scooping up money these institutions would otherwise keep. Sometimes, when banks realized they'd quoted Three Arrows the wrong price, they would ask to amend or cancel the trade, but Zhu and Davies wouldn't budge. Last year, Zhu tweeted out a 2012 photo of himself smiling while sitting in front of 11 screens. Seemingly making a reference to their FX-trading strategy of picking off banks' bids, he wrote, "You haven't lived until you've hit five dealers on the same quote at 230am."

By 2017, the banks began cutting them off. "Whenever Three Arrows requested a price, all the bank FX traders were like, 'Fuck these guys, I'm not going to price them,' " says a former trader who was a counterparty to 3AC. Lately, a joke has been going around among FX traders who knew Three Arrows in its early days and watched it collapse with a bit of Schadenfreude. "We FX traders are partly to blame for this because we knew for a fact that these guys were not able to make money in FX," says the former trader. "But then when they came to crypto, everyone thought they were geniuses."



On May 5, 2021, with Three Arrows at the height of its fortunes, Zhu tweeted a 2012 photo of the firm in its earliest days, when he and Davies traded foreign currencies out of a two-bedroom apartment. Implicit in the tweet was a message: Think how good we must be to have built a multibillion-dollar firm from such humble beginnings. Photo: Su Zhu/Twitter

Abasic thing to know about crypto is that, so far anyway, it has been subject to a progression of extreme but roughly regular boom-and-bust cycles. In the 13-year history of bitcoin, the 2018 bear market was a particularly painful one. After reaching a record high of $20,000 in late 2017, the cryptocurrency crashed to $3,000, dragging with it thousands of smaller coins in the market. It was against this backdrop that Three Arrows switched its focus to crypto, starting to invest at such an opportune time that Zhu was often credited (which is to say, he took credit) for calling the bottom of the cycle. In later years, it looked like brilliance to many impressionable crypto noobs — and even industry insiders — who followed Zhu and Davies on Twitter. But the timing might have just been luck; after all, Three Arrows was looking for a new racket.

With cryptocurrencies trading on exchanges around the world, the firm's experience with arbitrage came in handy right away. One famous trading strategy was known as the "kimchee premium" — it involved buying bitcoin in, say, the U.S. or China and selling it at a higher price in South Korea, where the exchanges were more tightly regulated, resulting in higher prices. At that time, winning trade setups like this were plentiful and profitable. They were the bread and butter of Three Arrows Capital, which told investors it practiced low-risk strategies designed to make money in both bullish and bearish times.

Another crypto arbitrage might involve buying bitcoin at its current (or “spot”) price while selling bitcoin futures, or vice versa, in order to harvest a price premium. “The Fund’s investment objective is to achieve consistent market neutral returns while preserving capital,” 3AC’s official documents read. Investing in a way that involves a limited downside no matter what the broader market is doing is, of course, known as “hedging” (where hedge funds get their name). But hedged strategies tend to spin off the most money when executed at scale, so Three Arrows began borrowing money and putting it to work. If all went well, it could generate profits that more than covered the interest it owed on the loan. Then it would do it all over again, continuing to grow its pool of investments, which would allow it to borrow even larger sums.

Beyond heavy borrowing, the firm’s growth strategy depended on another scheme: building lots of social-media clout for the two founders. In crypto, the only social-media platform that counts is Twitter. Many key figures in what has become a global industry are anonymous or pseudo-anonymous Twitter accounts with goofy cartoon profile images. In an unregulated space without legacy institutions and with global markets trading 24/7, Crypto Twitter is the center of the arena, the clearinghouse for the news and views that move markets.

Zhu — and to a lesser extent Davies — earned his way into the elite upper tier of Crypto Twitter. According to friends, Zhu had a conscious plan to become a “Twitter celebrity”: It entailed tweeting a lot, pandering to the crypto masses with outrageously bullish prognostications, racking up a huge number of followers, and, in turn, becoming an apex predator on Crypto Twitter, profiting at the expense of everyone else.

Zhu gained his 570,000-strong following in part by promoting his theory of a cryptocurrency “supercycle” — the idea of a yearslong bull market for bitcoin with prices rising well into the millions of dollars per coin. “As crypto supercycle continues, there will be more and more people trying to larp how early they were,” Zhu tweeted last year. “Only thing that matters is how many coins you have now. Either you own the % of the key networks you should or you don’t. Being early and low conviction is gross tbh.” And: “As the supercycle continues, buttsore mainstream media will try to talk about how the early whales own everything. The richest ppl in crypto now had near-zero net worth in 2019. I know ppl who unironically say if someone had lent them

$50k more back then theyd have $500m more now.” Zhu hammered the point constantly on the platform and in his appearances on crypto podcasts and video shows: Buy, buy, buy now, and the supercycle will make you insanely rich someday.

“They used to boast that they can borrow as much money as they want,” says the former trader who knew them in Singapore. “This was all planned, man, from the way they established credibility to the way the fund was structured.”

These guys were not able to make money in FX. But then when they came to crypto, everyone thought they were geniuses.

As it grew, Three Arrows branched out beyond bitcoin into a slew of start-up crypto projects and more obscure cryptocurrencies (sometimes called “shitcoins”). The firm seemed rather indiscriminate about these bets, almost as if it viewed them as a charity. Earlier this year, Davies tweeted that “it doesn’t matter specifically what a VC invests in, more fiat in the system is good for the industry.” Says Chris Burniske, a founding partner of VC firm Placeholder, “They were clearly spray and pray.”

A number of investors remember having their first sense that something might be off with Three Arrows in 2019. That year, the fund began reaching out to industry peers with what it described as a rare opportunity. 3AC had invested in a crypto options exchange called Deribit, and it was selling off a stake; the term sheet set the value of Deribit at $700 million. But some investors noticed the valuation seemed off — and discovered its actual valuation was just $280 million. Three Arrows, it turned out, was attempting to flip a portion of its investment at a steep markup, essentially netting the fund an enormous kickback. It was a sketchy thing to do in venture capital, and it blindsided the outside investors, along with Deribit itself. Says David Fauchier, a portfolio manager at Nickel Digital Asset Management who received the pitch, “Since then, I’ve basically stayed away from them, held them in very low regard, and never wanted to do business with them.”

But the firm was thriving. During the pandemic, as the Federal Reserve pumped money into the economy and the U.S. government sent out stimulus checks, cryptocurrency markets rose for months on end. By late 2020, bitcoin was up fivefold from its March lows. To many, it looked like a supercycle. Three Arrows' main fund posted a return of more than 5,900 percent, according to its annual report. By the end of that year, it was overseeing more than $2.6 billion in assets and $1.9 billion in liabilities.

One of 3AC's largest positions — and one that loomed large in its fate — was a kind of stock-exchange-traded form of bitcoin called GBTC (shorthand for Grayscale Bitcoin Trust). Dusting off its old playbook of capturing profits through arbitrage, the firm accumulated as much as $2 billion in GBTC. At the time, it was trading at a premium to regular bitcoin, and 3AC was happy to pocket the difference. On Twitter, Zhu regularly blasted out bullish appraisals of GBTC, at various points observing it was "savvy" or "smart" to be buying it.

Zhu's and Davies's public personae became even more extreme; their tweets were increasingly pompous, and social acquaintances say they didn't bother to hide their condescension toward friends from the past and less wealthy contemporaries. "They have very little empathy toward most people, especially normal commoners," says a onetime friend.

Three Arrows was known for high staff turnover, most notably among the traders, who groused that they never received recognition for winning trades but were insulted as stupid when they screwed up — even their wages were garnished and their bonuses reduced. (Still, 3AC traders were highly sought after in the industry; before the fund's collapse, Steve Cohen's hedge fund, Point72, was interviewing a team of 3AC traders to potentially poach for its systematic trading unit.)

Zhu and Davies kept the inner workings of the firm cloaked in secrecy. Only the two of them could move money between certain crypto wallets, and most Three Arrows employees had no idea how much money the company was managing. Although the staff complained of long hours, Zhu was reluctant to hire new people, worried that they would "leak trade secrets," says the friend. In Zhu's view, Three Arrows was doing anyone who worked for it a favor. "Su said they should be paid instead for offering valuable learning opportunities to employees," the friend adds. Some business acquaintances in Singapore described the 3AC founders as playacting characters from a 1980s *Wolf of Wall Street* trading floor.

Both were now married fathers with young children, and they had become exercise fanatics, working out as much as six times a week and going on calorie-restricted diets. Zhu chiseled himself down to about 11 percent body fat and posted his shirtless "updates" on Twitter. On at least one occasion, a friend recalls, he called his personal trainer "fat." Asked about his drive to become "massive," Zhu told an interviewer, "I was super-weak for most of my life. After COVID, I got a personal trainer. I got two kids, so it's just like wake up, play with your kids, go to work, go to the gym, come back, put them to sleep. Shitpost in between."

Although not quite billionaires yet, Zhu and Davies began treating themselves to some of the luxuries of the superrich. In September 2020, Zhu purchased a $20 million mansion, known in Singapore as a "good-class bungalow," under his wife's name. The following year, he bought another one in his daughter's name for $35 million. (Friends say that Davies eventually upgraded to a GCB too, after becoming a citizen of Singapore, but that the house was still under renovation and he hadn't yet moved in.)

In person, though, Zhu was still an introvert who wasn't big on small talk. Davies was the outspoken one in the firm's business dealings as well as socially. Some acquaintances who had first encountered the pair on Twitter found them surprisingly understated in person. Davies had a hipster vibe. "He has heavy disdain for a lot of mainstream, popular stuff," says a onetime friend. When he became wealthy, Davies went to some trouble to purchase and customize a Toyota Century, the exclusive model of limo drivers in Japan. It's a simple-looking car but costs about as much as a Lamborghini. "He was very proud it was the only Japanese taxi in Singapore," says another friend.

While Zhu and Davies grew accustomed to their new wealth, Three Arrows continued to be a giant funnel for borrowed capital. A lending boom had taken hold of the crypto industry, as DeFi (short for "decentralized finance") projects offered depositors much higher interest rates than they could get at traditional banks. Three Arrows would, through its "borrowing desk," take custody of cryptocurrency that belonged to employees, friends, and other rich individuals. When lenders asked Three Arrows to put up collateral, it often pushed back. Instead, it offered to pay an interest rate of 10 percent or more, higher than any competitor was delivering. Because of its "gold standard" reputation, as one trader put it, some lenders didn't ask for audited financial statements or any documents at all. Even large, well-capitalized, professionally run crypto companies were lending large sums of money uncollateralized to 3AC, among them Voyager, which was ultimately pushed into bankruptcy.

For other investors, Three Arrows' appetite for cash was another warning sign. In early 2021, a fund called Warbler Capital, managed by a 29-year-old Chicago native, was trying to raise $20 million for a strategy that largely involved outsourcing its capital to 3AC. Matt Walsh, a co-founder of crypto-focused Castle Island Ventures, couldn't understand why a multibillion-dollar fund like Three Arrows would bother with onboarding such a relatively tiny increment of money; it seemed desperate. "I was sitting there scratching my head," Walsh recalls. "It started to put up some alarm bells. Maybe these guys were insolvent."

The trouble seems to have started in earnest last year, and Three Arrows' huge bet on GBTC was the nub of it. Just as the firm reaped the rewards when there was a premium, it felt the pain when GBTC began trading at a discount to bitcoin. GBTC's premium had been a result of the initial uniqueness of the product — it was a way to own bitcoin in your eTrade account without having to deal with crypto exchanges and esoteric wallets. As more people piled into the trade and new alternatives emerged, that premium disappeared — then went negative. But plenty of smart market participants had seen that coming. "All arbitrages die after a point," says a trader and former colleague of Zhu's.

Davies was aware of the risk this posed to Three Arrows, and on a September 2020 episode of a podcast produced by Castle Island, he admitted he expected the trade would fade. But before the show aired, Davies requested that the segment be edited out; the firm obliged. Unwinding the position was somewhat tricky — Three Arrows' GBTC shares were locked up for six months at a time — but Zhu and Davies had a window to get out sometime that fall. And yet they didn't.

"They had ample opportunity to get out with a graze but not blow themselves up," says Fauchier. "I didn't think they could be stupid enough to be doing this with their own money. I don't know what possessed them. This was obviously one of those trades you want to be the first one in, and you desperately don't want to be the last one out." Colleagues now say Three Arrows hung in its GBTC position because it was betting the SEC would approve GBTC's long-anticipated conversion to an exchange-traded fund, making it much more liquid and tradable and likely erasing the bitcoin price mismatch. (In June, the SEC rejected GBTC's application.)

By the spring of 2021, GBTC had fallen below the value of its bitcoins, and Three Arrows was now losing on what was likely its biggest trade. Still, crypto enjoyed a bull run that lasted into April, with bitcoin hitting a record above $60,000 and dogecoin, a cryptocurrency started as a joke, rocketing off on an irrational Elon Musk–boosted rally. Zhu was bullish on dogecoin too. Reports put 3AC's assets at some $10 billion at the time, citing Nansen (though Nansen's CEO now clarifies that much of the sum was likely borrowed).

In retrospect, Three Arrows seems to have suffered a fateful loss later that summer — if of the human variety, rather than the financial one. In August, two of the fund's minority partners, who were based in Hong Kong and routinely worked between 80 and 100 hours a week managing much of 3AC's operations, simultaneously retired. That left the bulk of their work to Davies, Three Arrows' chief risk officer, who seemed to take a more laid-back approach to looking out for the firm's downside. "I think their risk management was a lot better before," says the former friend.

Around that time, there were signs that Three Arrows was hitting a cash crunch. When lenders asked for collateral for the fund's margin trades, it often came back pledging its equity in Deribit — a private company — instead of an easily salable asset like bitcoin. Such illiquid assets aren't ideal collateral. But there was another snag: Three Arrows owned the Deribit stake with other investors, who refused to sign off on using their shares as collateral. 3AC, apparently, was attempting to pledge assets it didn't have the rights to — and was trying to do so repeatedly, offering the same shares to various institutions, particularly after bitcoin started falling in late 2021. The firm seems to have promised the same chunk of locked-up GBTC to several lenders as well. "We suspect that Three Arrows attempted to pledge some pieces of collateral to many people at once," says Bankman-Fried, the CEO of FTX. "I would be pretty surprised if that was the entire extent of misrepresentations here; that would be a pretty weird coincidence. I strongly suspect that they made more."

Bear markets in crypto tend to make any stock-market action look like child's play. The crashes are so severe that insiders call it "crypto winter," and the season can last years. That's where Three Arrows Capital found itself by the middle of January 2022, and it was poorly equipped to weather it. The GBTC position ate an ever-larger hole in 3AC's balance sheet, and much of its capital was tied up in restricted shares in smaller crypto projects. Other arbitrage opportunities had dried up. In response, Three Arrows seems to have decided to ramp up the riskiness of its investments in hopes of scoring big and getting the firm back on a solid footing. "What made them change was just overreaching for returns," says a major lending executive. "They were probably like, 'What if we just go long?' "

In February, Three Arrows took one of its biggest swings yet: It put $200 million into a buzzy token called luna, which was founded by a brash, alluring South Korean developer and Stanford dropout named Do Kwon, with whom Davies and Zhu had been hanging out in Singapore.

Around the same time, Zhu and Davies were making plans to abandon Singapore. They'd already moved some of the fund's legal infrastructure to the British Virgin Islands, and in April, Three Arrows announced it would move its headquarters to Dubai. That same month, friends say, Zhu and Davies purchased two villas for roughly $30 million combined, one next to the other on Dubai's Crystal Lagoon in District One, a manmade aquamarine oasis larger than any other in the world. Showing photos of the side-by-side mansions, Zhu told friends he had purchased his new seven-bedroom property — a 17,000-square-foot compound that looks like a fortress with hedge-lined fences and imposing Roman columns — from the consul of Azerbaijan.

Then in early May, luna suddenly collapsed to near zero, wiping out more than $40 billion in market cap in a matter of days. Its value was tied to an associated stablecoin called terraUSD. When terraUSD failed to maintain its dollar peg, both currencies collapsed. Three Arrows' holdings in luna, once roughly half a billion dollars, were suddenly worth only $604, according to a Singapore-based investor named Herbert Sim who was tracking 3AC's wallets. As the death spiral unfolded, Scott Odell, a lending executive at Blockchain.com, reached out to the firm to check in about the size of its luna hit; after all, the loan agreement stipulated that Three Arrows notify the company if it experienced an overall drawdown of at least 4 percent. "Was not that big as part of portfolio holdings anyway," 3AC's top trader, Edward Zhao, wrote back, according to messages made public by Blockchain.com. A few hours later, Odell informed Zhao that it would need to call back a significant portion of its $270 million loan and would take payment in dollars or stablecoins. Zhao appeared caught off guard. "Yo … uhh … hmm," he replied in their private chat.

The next day, Odell reached out to Davies directly, who tersely reassured him that everything was fine. He sent Blockchain.com a simple, one-sentence letter with no watermark, asserting that the firm had $2.387 billion under management. Meanwhile, Three Arrows was making similar representations to at least half a dozen lenders. Blockchain.com is "now doubtful that this net asset value statement was accurate," according to its affidavit, which was included in a 1,157-page document released by 3AC's liquidators.

Rather than back down, a few days later Davies threatened to "boycott" Blockchain.com if it called back 3AC's loans. "Once that happened, we knew something was wrong," says Lane Kasselman, chief business officer of Blockchain.com. Inside the Three Arrows office, the mood had changed. Zhu and Davies used to hold regular pitch meetings on Zoom, but that month, they stopped showing up, then managers stopped scheduling them altogether, according to a former employee.

In late May, Zhu sent out a tweet that may as well be his epitaph: "Supercycle price thesis was regrettably wrong." Still, he and Davies played it cool as they called up seemingly every wealthy crypto investor they knew, asking to borrow large quantities of bitcoin and offering the same hefty interest rates the firm always had. "They were clearly pumping their prowess as a crypto hedge fund after they already knew they were in trouble," says someone close to one of the biggest lenders. In reality, Three Arrows was scrounging for funds just to pay its other lenders back. "It was robbing Peter to pay Paul," says Castle Island's Walsh. In the middle of June, a month after luna's collapse, Davies told Charles McGarraugh, chief strategy officer at Blockchain.com, that he was trying to get a 5,000 bitcoin loan — then worth about $125 million — from Genesis to give to yet *another* lender to avoid liquidating its positions.

In practice, though, this kind of financial mess tends to create a whole lot of selling by everyone involved to raise cash in an effort to stay solvent. Three Arrows' position was so large that it effectively began to tank the broader crypto markets: All the scrambling to sell and meet margin calls, by 3AC itself and other panicky investors, in turn pushed prices down lower, creating a vicious cycle. The declines set off further declines as lenders demanded even more collateral and sold positions when 3AC and others couldn't post it, sending bitcoin and its peers toward multi-year lows. The crash generated headlines around the world as the overall value of the crypto markets made its way below $1 trillion from a peak of $3 trillion in late 2021. McGarraugh says Davies told him that "if the crypto market continued to decline, 3AC would not be okay." That was the last time anyone at Blockchain.com spoke to Davies. After that, he and Zhu stopped answering their lenders, partners, and friends.

Rumors that the firm was collapsing seized Twitter, further fueling the larger crypto sell-off. On June 14, Zhu finally acknowledged the trouble: "We are in the process of communicating with relevant parties and fully committed to working this out," he tweeted. A few days later, Davies gave an interview to *The Wall Street Journal* in which he noted he and Zhu were still "believers in crypto" but admitted, "The terra-luna situation caught us very much off guard."

Zhu started trying to get rid of at least one of his good-class bungalows; at the same time, the firm started moving its money around. On June 14, the same day Zhu posted his tweet, 3AC sent nearly $32 million in stablecoins to a crypto wallet belonging to an affiliated shell company in the Cayman Islands.

“It was unclear where those funds subsequently went,” the liquidators wrote in their affidavit. But there is a working theory. In Three Arrows’ final days, the partners reached out to every wealthy crypto whale they knew to borrow more bitcoin, and top crypto executives and investors — from the U.S. to the Caribbean to Europe to Singapore — believe 3AC found willing lenders of last resort among organized-crime figures. Owing such characters large sums of money could explain why Zhu and Davies have gone into hiding. These are also the kinds of lenders you want to make whole before anyone else, but you may have to route the money through the Caymans. Says the former trader and 3AC business partner, “They paid the Mafia back,” adding, “If you start borrowing from these guys, you must be really desperate.”

After the collapse, executives at crypto exchanges began comparing notes. They were surprised to learn that Three Arrows had no short positions, which is to say it had stopped hedging — the very thing it had maintained was the cornerstone of its strategy. “It’s very easy to do that,” says the major lending executive, “without any of the trading desks knowing you’re doing that.” Investors and exchange executives now estimate that, by the end, 3AC was leveraged around three times its assets, but some suspect it could be magnitudes more.

Three Arrows seems to have kept all the money in commingled accounts — unbeknownst to the owners of those funds — taking from every pot to pay back lenders. “They were probably managing this whole thing on an Excel sheet,” says Walsh. That meant that when 3AC ignored margin calls and ghosted lenders in mid-June, those lenders, including FTX and Genesis, liquidated their accounts, not realizing they were also selling assets that belonged to 3AC’s partners and clients. (This seems to be what happened with 8 Blocks Capital, which complained on Twitter in June that $1 million from its trading account with 3AC had suddenly disappeared.)

After the firm’s traders stopped responding to messages, lenders tried calling, emailing, and messaging them on every platform, even pinging their friends and stopping by their homes before liquidating their collateral. Some peered through the door of 3AC’s Singapore office, where weeks of mail was piled up on the floor. People who had thought of Zhu and Davies as close friends, and had lent them money — even $200,000 or more — just weeks earlier without hearing any mention of distress at the fund, felt outraged and betrayed. “They are certainly sociopaths,” says one former friend. “The numbers they were reporting in May were very, very wrong,” says Kasselman. “We firmly believe they committed fraud. There’s no other way to state it — that’s fraud, they lied.” Genesis Global Trading had lent Three Arrows the most of any lender and has filed a $1.2 billion claim. Others had lent them billions more, much of it in bitcoin and ethereum. So far, liquidators have recovered only $40 million in assets. “It became clear that they were insolvent but were continuing to borrow, which really just looks like a classic Ponzi scheme,” says Kasselman. “Comparisons between them and Bernie Madoff are not far off.”

When Three Arrows Capital filed for Chapter 15 bankruptcy, the process for foreign companies, on July 1 in the Southern District of New York, it was more or less a formality. But the filing itself did contain some surprises. Even as creditors rushed to file their claims, 3AC’s founders had already beaten them to it: The first person in line was Zhu himself, who on June 26 filed a claim for $5 million, along with Davies’s wife, Kelly Kaili Chen, who claimed she had lent the fund close to $66 million. The only documentation they had to back up their claims were simple, self-attested statements that did not specify when the loans had been made or the purpose of the funds. “That’s a total Mickey Mouse type of operation,” says Walsh. While insiders were unaware of Chen’s involvement in the firm, they believe she must have been acting on Davies’s behalf; her name appears on various firm entities, likely for tax reasons. Both Zhu’s and Davies’s mothers have also filed claims, according to people familiar with the situation. (Zhu later told Bloomberg News, “They’re gonna, you know, say that I absconded funds during the last period, where I actually put more of my personal money back in.”)

Since the firm filed for bankruptcy, the liquidators hadn’t been able to get in touch with Zhu and Davies until just before press time and still don’t know where they are, according to people familiar with the situation. Their lawyers said the co-founders have received death threats. On an awkward July 8 Zoom call, participants with Zhu’s and Davies’s usernames logged on with their cameras off, refusing to unmute themselves even as the pair of British Virgin Islands liquidators fired dozens of questions at their avatars.

The authorities are also taking a closer look at Three Arrows. The Monetary Authority of Singapore — the country’s equivalent of the SEC — is investigating whether 3AC, which it already reprimanded for providing “false or misleading” information, committed “further breaches” of its regulations. In the U.S., SEC enforcement attorneys are now being copied on all Three Arrows court filings.

On July 21, Zhu and Davies gave an interview with Bloomberg “from an undisclosed location.” The interview is extraordinary for several reasons — Zhu protests the headlines about his free-spending lifestyle by noting that he bikes to work, doesn’t go clubbing, and “only has two homes in Singapore” —

but also because the partners blame 3AC’s implosion on their failure to foresee that the crypto market could go down. Neither says the word *supercycle,* but the reference is clear enough. “We positioned ourselves for a kind of market that didn’t end up happening,” Zhu says, while Davies adds, “In the good times we did the best. And then in the bad times we lost the most.”

The pair also told Bloomberg they were planning to go to Dubai “soon.” Their friends say they’re already there. The oasis offers a particular advantage, say lawyers: The country has no extradition treaty with Singapore or the U.S.