

Following

Arthur Hayes

Jun 30 · 24 min read · Listen

Save



Number Three

(Any views expressed in the below are the personal views of the author and should not form the basis for making investment decisions, nor be construed as a recommendation or advice to engage in investment transactions.)



This current crypto nuclear bear market marks my third brush with generalised market carnage. And while they can sometimes feel like reruns, every episode yields new lessons to be learned. Everyone is always going to have their own view of what those lessons are — but if it's the mainstream financial media you're listening to, I can tell you with confidence that you're being fed the wrong takeaways. They, in the service of the devil that is TradFi, will use any and every opportunity to poke fun at our economic / social experiment — gleefully proclaiming, “we warned you crypto was worthless!” In the holy name of our Lord Satoshi, I shall attempt to correct the invective that seeps forth from these malicious harpies.

In this piece, I'll be using the Three Arrows Capital (3AC) saga as a lens through which we can better understand the true insights that should be gleaned from the current bear market. Please note, while I personally know Su Zhu and Kyle Davies (the principals of 3AC), I have no knowledge of what transpired other than what has been reported

publicly. I intend to use my knowledge of crypto, financial services, and common sense to tease out the story of what I think led to its collapse, starting with the implosion of TerraUSD and Luna.

The collapse of 3AC in and of itself is unremarkable. A hedge fund that was previously successful executing boring but stable yielding arbitrage strategies decided to strap on leverage to accelerate returns, and paid the price. The use of borrowed funds to play the TerraUSD carry trade sealed their death sentence.

But what made the 3AC default so impactful is that it blew a whale shark-sized hole in many of the largest centralised crypto lending businesses. Due to losses on 3AC loans, many of these lending businesses have gated customer funds and become functionally insolvent. The withdrawal of credit from the crypto ecosystem has caused a generalised market crash of Bitcoin, Ether, and the whole pantheon of shitcoins. No coin has been spared.

But what's conveniently going unmentioned by much of the media is that both centralised and decentralised lending companies / platforms had exposure to 3AC — and only the players in one of these two markets went belly up. The centralised lenders failed en masse, while their decentralised counterparts liquidated collateral and operated with no hiccups. Using the story of 3AC as the canvas, let me paint you a picture that illustrates why Lord Satoshi and Archangel Vitalik's creations stood the test of time, and what this means for the future of crypto.

Hong Kong

Before we get too deep into it, though, let's first take a quick stroll down memory lane to better understand how 3AC's principals, Su Zhu and Kyle Davies, ascended to greatness.

Su and Kyle graduated university in 2008, the same year as myself, and at some subsequent point made their way to Asia Pacific as employees of TradFi banks / market makers.

The Hong Kong, Singapore, and Tokyo investment banking scene is very close-knit. While I didn't know either Su or Kyle directly until many years later (when we all entered crypto), we ran in adjacent circles of friends and were at most one degree separated at that time. The first time I met Kyle at a tempura restaurant in Singapore, I could have sworn I had seen him before at a party in Hong Kong.

I never did any business with Kyle, who worked for a time at Credit Suisse, but I did trade against Su while he was a market maker at FlowTraders. As the head market maker for the APAC Exchange Traded Fund (ETF) business at Deutsche Bank, I posted buy / sell quotes on the Hong Kong and Singapore stock exchanges for a large ETF product suite. I routinely made errors, and got served many ass whoopings at the hands of FlowTraders. No excuses — I just regularly lost money to them. Su was one of the FlowTraders professionals who kept me on my toes on a daily basis. Su followed up his time at FlowTraders with a stint at Deutsche Bank, and worked on an adjacent trading desk to Killah, who I talked about in a [previous essay](#).

The point of this story is that Su and Kyle are arbitrage guys. In their banking careers, they were trained to profit off of small discrepancies in price. Do it over and over again, and the money adds up. They brought this same approach and mentality to their founding of Three Arrows, which got its start by arbitrating the very inefficient over-the-counter Non-Deliverable Forward (NDF) market.

Now, moving on to my time at Citibank...

While I was the head ETF trader at Citibank, I also dabbled in equity index forward trading, including NDFs. Our desk traded equity index forwards on the major Hong Kong, Taiwanese, Indian, and Korean indices. I also ran the entire China A-Share ETF trading book and traded a large amount of equity-linked derivatives.

An NDF is a currency bet, but instead of exchanging home and foreign currency cash flows at the start and end of the swap, the difference between the entry and exit exchange rate is paid or received in USD.

Let's take the USDKRW (Korean Won) exchange rate. Korea does not allow Korean Won to be freely exchanged. Assume I would like to sell KRW vs. buy USD 30 days in the future and I want to lock in the rate today. I would trade on the Right-Hand Side (RHS) of a USDKRW NDF. If I enter the 30-day NDF at a rate of 1,000 Won and the spot rate settles at 1,200 Won, I make $[200 \text{ Won} * \text{the USD Notional} / \text{USDKRW Spot Exchange Rate}]$. If I traded a size of 1,000,000 USD that would equate to a profit of approximately 166,666 USD.

Understanding why NDFs are a necessary part of equity index forward trading isn't essential to this story, so I'll spare you the gory details.

The OTC NDF market is very large and all the major investment banks have trading desks specialising in these derivatives. Back in the 2010's, trading happened over Bloomberg chat. That meant that while traders had a general idea how a particular NDF should be priced, they couldn't see a consolidated market like they could for spot currency. As a result, it was very easy to arbitrage the different NDF trading desks.

Every day I would pick a currency and attempt to "arb" two trading desks. Let's say I wanted a 20,000,000 USD notional 30-day KRW NDF. Bank A would quote me 1,000 / 1,001; Bank B would quote me 1,002 / 1,003. Do you see the trade?

I buy at 1,001 vs. Bank A, and then I sell at 1,002 vs. Bank B. In 30 days I will net 1 won per dollar in profit. On 20 million USD notional, that's a total profit of 20,000 USD assuming the spot rate is 1,000 Won. That's not much for a bank trading desk, but if you do this enough times, it adds up to a few million dollars a year of risk-free PNL each year.

As bankers, Su and Kyle saw this inefficient market and used their own money to start a fund with a trading strategy centred around profiting on these mispricings. It's worth noting that unless you are a trader at a bank or extremely large hedge fund, it is almost impossible to trade in the NDF market. You must have an ISDA, and the senior management of the bank you are trading with must allow you to trade with them. But somehow, some way, 3AC managed to open accounts at a few investment banks and arbitrated them against each other in the Asian NDF market. When Su and Kyle told me how they got started, I was pretty impressed they had hustled their way into this lucrative market.

This is how 3AC made money for many years. Then, at some point, the firm discovered crypto, and plied their trade as cash-and-carry basis traders. This is the bread and butter of any crypto arb fund. The perpetual swap over its history has net paid shorts — which means if you sell USD, buy BTC, and then sell a BTC/USD perp, you will net earn funding over time.

These currency arbitrage and funding trades are very profitable, but they are also capital intensive. You must post margin to trade every NDF derivative, and you will not get credit for having the equal and opposite position at

another bank. For the crypto perp funding arb trade, you cannot use any leverage. This means that the growth of your hedge fund's AUM is slow and predictable; but you won't be starring in Big Pimpin' anytime soon.



The only way to juice the performance of your hedge fund is to become a directional trader, and/or use borrowed funds. 3AC did both.

From the horse's mouth:

"We have been long crypto for a while," Davies said. "We've not always been long Ethereum, in fact we've been short for periods of time, too. What's the best way to beat Bitcoin right now? Well it's just to own Ethereum. The ultimate goal of my book is to outperform Bitcoin."

Davies said that Ethereum is currently the firm's largest cryptocurrency holding. It has gained 245% this year compared with the U.S. dollar, while Bitcoin is up 29%.

Source: Bloomberg

TerraUSD / Luna

This cycle's carry trade of the century was sponsored by Do Kwon and TerraUSD.

TerraUSD (UST) was a DeFi algorithmic stablecoin. The goal of the code underpinning UST was to attempt to maintain a 1:1 peg with the USD. I discussed how this peg worked in ["Luna Brothers, Inc."](#)

The hard part for any currency that does not derive its value from the barrel of a government-owned gun is generating intrinsic demand. When [10,000 Bitcoin](#) were exchanged for a Papa John's Pizza in 2010, that marked the first known transaction of Bitcoin for a real world good. That was extremely important, because it meant that the hodler of a real pizza believed some Bitcoin was enough to compensate him in the transaction.

So how did TerraUSD go about convincing people to use UST? Easy ... another Terra ecosystem project called Anchor offered a fixed 20% yield on staked UST. If you pledged your UST to the Anchor protocol, you earned a

continuous rate of interest that annualised to 20%.

How did Anchor generate such a stupendous yield? My trusty research analyst sleuthed this out for you readers:

Borrowers paid ~10–12% APY depending on their protocol. Borrowers were incentivized with distributions of ANC as a reward for borrowing, usually around 7%.

Anchor would also stake its collateral funds to receive staking awards.

These were not enough to shake off the incredible imbalance in demand between borrowers and lenders.

Anchor also had a reserve, mostly financed by the Luna foundation, which would help cover the difference between ~10–12% and 20%.

The idea was that eventually the Terra ecosystem will grow enough that it can support the high APY. But the reality was that Terra continued to burn its reserves and (would have eventually) run out of money.

Terra was essentially paying for Anchor's growth and adoption. The hope was when the subsidies expire in 2024, there would be a vibrant ecosystem for savings and loans on the Anchor Protocol.

Source: Medium

A 10% yield deficit is a big hole to fill when billions of dollars are pouring in to receive the advertised 20% APY. Neither Anchor nor Terra survived long enough to ascertain whether the ecosystem could support a removal of the subsidy.

Very few money managers stopped to engage the critical thinking part of their brain and ponder how the fuggity fuck Anchor generated these yields. But it didn't matter, because up until the crash of UST and LUNA, it paid out 20%. This was the mother of all crypto carry trades.

I'm sorry, but I need to beat this particular draft horse to death. I did a bit of analysis on the roughly 3 million bonds that Bloomberg indexes. I specifically screened for bonds with a maturity of less than one year, and a yield to worst of at least 20%. Out of 3 million bonds, only 159 fit these criteria. For those of you who like maths, that's less than 0.01%. Included in this list of extremely high-yielding instruments are bonds from countries such as Sri Lanka, Ukraine, Argentina, and Turkey. To state the obvious, lending to these sovereign governments has been a road to ruin for investors for centuries. If these are the sorts of entities that pay 20% yields, what does that say about Anchor's ability to do the same and ensure the repayment of principal?

Any so-called institutional money manager who poured their own or their clients' funds into the TerraUSD carry trade and was surprised when they lost all their money should find a new line of employment.

Back to our boys at 3AC.

The reason why I rambled on about Hong Kong history earlier is because I want you to understand how these guys initially grew their fund. A carry trade like UST cannot be ignored — particularly for folks like Su and Kyle, who have been big proponents of DeFi and who made a lot of money directly betting correctly on the growth in price of a

number of other protocols. We know that 3AC held a large amount of LUNA — but what we don't know is how deep they were in the UST carry trade.

“Davies said 3AC invested over \$200 million in LUNA tokens as part of a \$1 billion raise by the Luna Foundation Guard in February, an amount that is now essentially worthless since the Terra ecosystem imploded in mid-May. “The Terra-Luna situation caught us very much off guard,” Davies told the WSJ.

Source: Wall Street Journal

The UST carry trade was very simple.

1. Borrow USD at less than 20%
2. Convert USD into UST
3. Deposit UST into Anchor and earn 20%
4. Annualised Unrealised Profit = 20% — Borrowing Costs

To realise a profit, they would do the reverse.

1. Withdraw UST + interest in UST from Anchor
2. Convert UST into USD
3. Payback your USD loan
4. The residual is your profit

Using your own capital as a hedge fund severely limits the profit potential. A real master of the universe, when presented with such a juicy carry trade, levers up by borrowing money.

Imagine you could borrow \$1 billion at 10% APY, collateralising it with a portfolio of shitcoins you already own (or even nothing at all). You then convert \$1 billion into UST 1 billion and earn 20%. Every year you will make \$100 million, and it requires zero effort to manage this position. Again, I have no idea how large of a UST position 3AC put on, but if we believe they had almost \$18 billion AUM at one point earlier this year, it is extremely plausible they borrowed billions to deploy to this carry trade.

Your ability to borrow money rests on your collateral and reputation. The goal is to borrow money with as little collateral as possible. The less collateral requested of you, the more the borrower trusts you.

3AC adeptly built an aura of invincibility. It was a combination of calling the market correctly in the past, and aggressively telling everyone how well they traded on social media. 3AC at its height was one of the largest pools of dedicated crypto capital globally. This reputation for trading excellence, combined with the sheer size of assets they controlled, allowed 3AC to borrow on very generous terms. For example, Voyager, a publicly traded company, lent 3AC hundreds of millions of dollars without *any* collateral. 15,250 BTC and 350 million USDC, to be exact—leaving them shirtless, pantsless, and utterly defenceless against the bullet that 3AC's default sent ripping through their dome.

Game Over

That brings us to my (purely speculative) thoughts on how 3AC began its slide towards insolvency.

As I suggested above, I suspect that 3AC not only used its own capital, but borrowed USD from individuals and funds in order to play the UST carry trade. For the loans that were collateralised, 3AC posted a combination of Bitcoin, Ether, and, most importantly, various other less liquid and more volatile shitcoins as collateral. On paper, 3AC's portfolio of crypto assets was extremely impressive. But when UST broke the peg and the entire \$40 billion Terra ecosystem collapsed in under a week, what was once a juicy carry trade quickly became a rotten nightmare — and 3AC's demise became a question of when, not if.

When the market falls, it falls in a correlated fashion. This simple fact spelled doom for 3AC, whose pumped-up valuation stemmed in large part from the market value of the many extremely illiquid shitcoins they held. When the market started to fall, liquidity in these shitcoins evaporated, and the orderbook went offered only. The prices reflexively fell lower and lower in a non-linear fashion as 3AC continued selling through rapidly drying demand — eventually making it impossible to recover enough USD to pay back the loan.

3AC suddenly owed a lot of USD that it didn't have and couldn't recoup, since the remaining assets that it could liquidate to pay back these loans had fallen 50% to 75%. If the broader crypto market had not fallen, 3AC might have been able to salvage the loss of capital tied up in UST and LUNA. Instead, the market sniffed out a wounded lion and proceeded to eviscerate it.

Then the questions started.

Who lent money to 3AC?

How much money was lent to 3AC vs. how much collateral?

What was that collateral?

Did 3AC pledge the same collateral multiple times?

Wah ... Soooo Danga!!!

And as the weeks drew on, various large centralised crypto lenders came under pressure. A number of the major companies declared insolvency and went cap in hand to the handful of crypto OGs with enough capital to restore their solvency.

“But, how could the default of one fund spiral into the near-annihilation of an entire industry?” you might be wondering. Great question — Let's take a closer look at how 3AC's whoopsie took down many of the largest and most high profile centralised crypto lending players.

Centralised Crypto Lenders

First let's familiarise ourselves with the major players in the centralised lending space. Some of the big names currently feeling the pressure from 3AC's demise include Voyager, Celsius, BlockFi, and Babel Finance.

Reminder: I have no non-public information about these companies. I only have the powers of deduction and public statements to go off of.

Lending businesses are very simple: lenders accept deposits and pay depositors interest in exchange for the ability to loan out their funds. The lender then loans out the funds at a higher rate than the interest it is paying to its depositors in order to turn a profit.

The simplicity of this model comes with some pitfalls — with one of them being that lending businesses inevitably come under stress during any sort of financial crisis. Unless you work at the company, there is no way for depositors to understand whether the company acts in a prudent fashion with their capital. Therefore, at any sign of stress, you rush for the exit, and if the lender is taking any duration risk, they will quickly become insolvent.

With that in mind, let me describe the safest way to run a lending business.

Assume you have 3 customers: Mark Karpeles aka MagicalTux, Do Kwon aka The King of Korea, and Su Zhu aka The Sultan of Singapore. They each have 1 ETH and would like to earn a return on their assets. Each person has a time preference.

Mark = 1 Month; Do = 3 Months; Su = 1 Year

Let's call the lender Long-Term Crypto Management (LTCM).

LTCM can be a safe lender or a risky one.

If LTCM is being conservative, it will lend at maturities matching the time preferences of each person. Therefore, LTCM lends 1 ETH for 1 month, 1 ETH for 3 months; 1 ETH for 1 year. There is no risk that when Mark, Do, or Su ask for their money back, it is being lent out, and cannot be returned to them.

If LTCM is being aggressive, it will lend out in longer maturities than the time preference of each person. To illustrate this at an absurd extreme, LTCM could lend out 3 ETH for 10 years. Obviously, if any of the depositors ask for their money back on their preferred timeline, it won't be there. That is how a lender becomes insolvent. But LTCM could wager that it will be able to convince each depositor to roll over their deposit multiple times so that LTCM never becomes insolvent.

This analysis only covers the duration of the LTCM loan book. The second aspect of a lending business is the quality of the borrower. A lender's value as a company stems largely from its ability to properly assess the credit risk of borrowers, and ask for appropriate guarantees or collateral based on those risk assessments before lending money.

In crypto, there are three sources of demand for credit:

1. Carry trades and cash-and-carry basis trades. The borrower would rather not post collateral, as it wants to have as much cash as possible to most effectively use these strategies. You can read one of my earlier articles, "[All Aboard!](#)", for a detailed explanation of the cash-and-carry trade.
2. Margin loans for speculation. These are for directional long and short traders. Usually, they will post some sort of collateral. But failure to appreciate the changes in volatility and liquidity of the underlying collateral can lead to losses for the lender.

3. Mining asset-backed loans. A miner either pledges hardware (like ASIC Bitcoin mining machines) or crypto and receives fiat currency and/or stablecoin. These borrowers carry the least risk, as they have a strong crypto cash flow backing their loan. However, if you repossess ASIC machines from a defaulting miner, you must have a facility in which to plug in the machines and start mining to make full use of them.

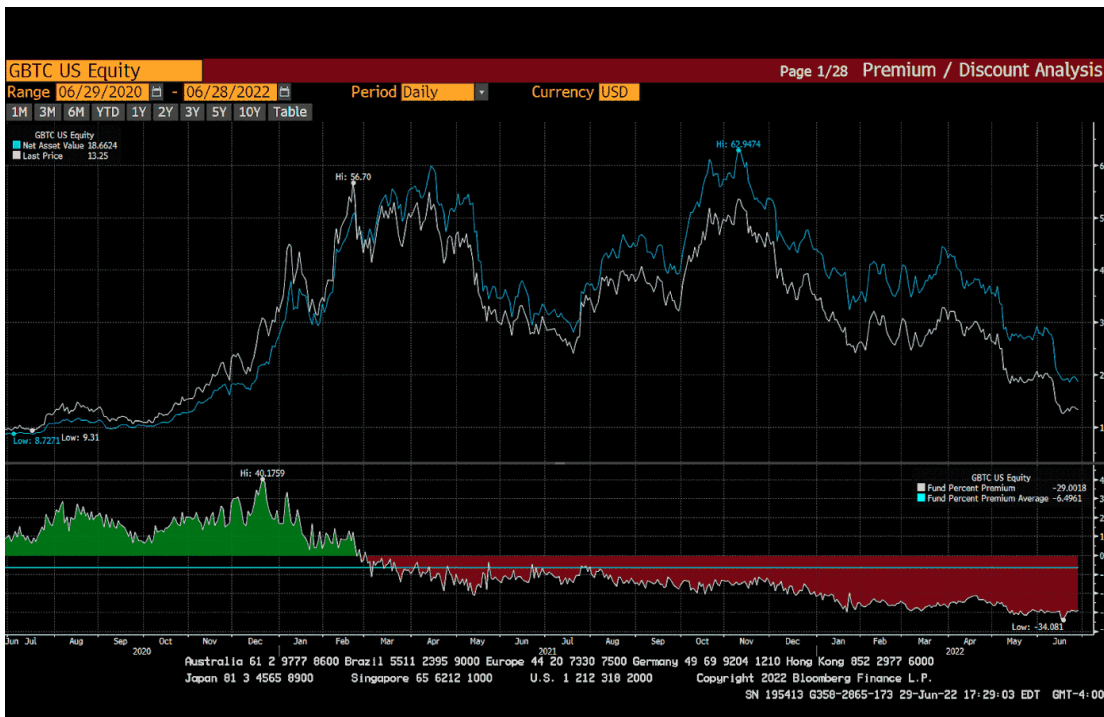
The major use case missing from crypto credit is business loans. This space is so new and risky that it makes no sense to lend to a crypto company. Crypto companies, similar to the underlying coins themselves, should be viewed as call options. In a default scenario, you will get wiped out regardless of where you sit in the capital structure. Assuming that, it's better to just own the equity — because at least you get to participate in the upside.

Because of the inherent volatility of crypto markets and the supposed profitability of various yield farming, carry, and basis trades, borrowers have been willing to pay extremely high rates of interest. This means that lenders can offer retail depositors extremely high rates of interest and still have a positive net interest margin (NIM).

I believe the major crypto lenders started out lending very sensibly, but then grew too quickly. The deposit rates were extremely attractive relative to what TradFi banks and sovereign governments offered on fiat currency deposits and bonds. This was the result of wanton central bank money printing and zero interest rate policies. Yield-starved retail investors could not get enough of these great yields on crypto and fiat stablecoins.

The billions of dollars that flooded into these few companies outstripped the supply of responsible borrowers. They had to deploy the funds because it cost them money to acquire them (remember, they are paying everyone interest). The pressure to lend out their capital forced firms to lower their borrowing standards, and also led them to engage in the very same carry trades as 3AC.

For example, BlockFi used to be one of the largest holders of US-listed Bitcoin tracker fund GBTC. BlockFi accepted BTC deposits, created GBTC shares, and then sold GBTC shares on the market to capture the premium. That was the plan, anyways — but it took six months to create GBTC shares. During that six-month period (between late 2021 and early 2022), the GBTC premium turned into a discount, and by the time they exited the arb, they had lost money. If you have Bloomberg, search GBTC US Equity HDS <GO>. Then, look up BlockFi, and you'll see they sold their 3.6 million shares of GBTC sometime in the first quarter of this year.



Above is a chart of the GBTC premium or discount to its net asset value (NAV). Given the six month lead time and humanity’s penchant for extrapolating short-term trends ad infinitum, **I bet many firms borrowed BTC to create GBTC hoping they could reap a 40% profit six months hence**. As you can see, that obviously didn’t happen, because GBTC has traded at a discount since the second quarter of 2021.

3AC was able to put on such large carry and directional trades in large part because it had a willing pool of capital that had to be invested. In my mind, there is no other explanation why a listed company such as Voyager lent them hundreds of millions of unsecured dollars and Bitcoin. 3AC said they would pay a high rate of interest, and Voyager took their word for it– because in the minds of Voyager’s principals, there was no other outfit with 3AC’s pedigree that could absorb the amount of capital that needed to be shipped out the door. As Chuck Prince so eloquently quipped in response to Citi’s participation in originating subprime mortgages, “When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing”.

Unfortunately, the lenders were all on the same side of the trade. They had the same borrowers. They held the same collateral. And the borrowers all lost money on the same carry trades. The only difference between 3AC and these lenders was their ability to market themselves. As we can see, none of them engaged in proper risk management to the degree required to weather this particular storm.

To make matters worse, these are private companies who do not have to routinely publish updates on the health of their loan books, nor do they have to set aside reserves in anticipation of bad loans like publicly-traded banks. We are left to speculate on the size of the potential losses these lenders face without any moorings. As a result, everyone attempts to pull their money at the first sign of stress — which, if the lender has duration mismatches, is the exact recipe for insolvency. And this is exactly what transpired, as the market wondered how large of a hole 3AC had punctured in these lenders.

It wasn’t just retail pulling out, either. These lenders also traded the same risks amongst themselves, meaning they also had exposure to one another — and they didn’t trust each other either. This complete loss of confidence in

centralised opaque lending outfits is why they almost all went extinct at the same time.

Half Time

To quickly recap: 3AC blew up because they took boring, stable, and predictable arbitrage strategies, strapped on an egregious amount of leverage, and succumbed to the market after the TerraUSD carry trade meltdown.

Due to their perceived investment acumen and large pool of assets, 3AC was allowed to borrow with little-to-no collateral by lending companies eager to redeploy retail deposits into high-yielding crypto credit instruments. These lenders, such as BlockFi, Babel Finance, Voyager, and Celsius eschewed prudent risk management policies in order to get as many loans out the door as quickly as possible. As a result, when 3AC failed to meet margin calls, these lenders were left holes the size of the Mariana Trench in their balance sheets. Unfortunately, these once-celebrated, billion-dollar-plus-valued “FinTech” startups are now headed towards insolvency first and the glue factory later.

There is nothing new or innovative about how these lenders became insolvent. For as long as there have been centralised lending businesses, there have been epic failures such as what this crop of crypto lenders experienced in this circumstance. The technology that underpins cryptocurrencies and DeFi has nothing to do with why 3AC and these lenders got into trouble.

Now that it's clear this was just a run-of-the-mill failure of a coterie of poorly risk-managed financial institutions, let us delve into how the actual crypto and DeFi applications handled these market stresses.

TerraUSD Worked

The Terra ecosystem was DeFi to its core. A group of engineers launched a codebase, visible to whoever would take the time to investigate, and these lines of code governed how the UST algorithmic stablecoin would behave. The UST code was executed 100% as designed. It worked; but investors did not care to understand *how* it worked. So, when the peg broke to the downside, the recursive logic governing how LUNA and UST were minted and destroyed to balance the ecosystem wiped out 100% of the ecosystem's value. This is purely maths and was more or less inevitable; the fact that many refused to read the whitepaper is not TerraUSD's fault.

DeFi Lending Protocols

The other group of entities that lent money to 3AC and various other addresses in the crypto ecosystem were DeFi lending protocols. The major ones that played a part in this melodrama were Compound (COMP), Aave (AAVE), and MakerDAO (MKR).

When you lend in a decentralised fashion, there are no arbitrary decisions made by individual humans. That means the protocol cannot factor any trust-related data points into its decision on whether to loan funds and how to secure them. The protocols, which are governed by the community, have sets of rules which clearly state the type of collateral required and its amount.

If I want to borrow USDC with Bitcoin collateral, the protocols will require the borrower to over-collateralise with Bitcoin. This is because Bitcoin is the more volatile asset vs. a fiat stablecoin, such as USDC. Usually the initial margin is 150% of the value of the USDC borrowed. If Bitcoin is \$100, and I want to borrow 100 USDC, then I must post 1.5 BTC as collateral against a loan of 100 USDC.

If the price of Bitcoin declines, usually to a set level of 120% of the value of the USDC loan, the protocol will immediately and programmatically liquidate the Bitcoin so that, in most cases, the 100 USDC is returned to the lender. These levels are established at the protocol level and can only be changed if enough of the governance token holders agree to loosen or tighten lending standards.

In fact, during this current crisis, some lending protocols have changed their policies. These changes had to go through a series of community-driven governance votes to be implemented. Wah, isn't it amazing when decision making can be done quickly, efficiently, digitally and in a programmatic fashion by self-interested parties? Just to give you an example, here is a recent [proposal](#) adjusting Compound.Finance's collateral factors, which was approved by the DAO governing the protocol.

The only information that these protocols have about a lender and borrower is their Ethereum wallet address. To them, 3AC is just an address with a balance. It is not a collection of humans with a certain pedigree that indicates they can and should be trusted to pay back what is owed even when no collateral is required up front. I will repeat: these lending protocols are designed with the explicit goal of removing the need for trust from the lending equation.

These protocols control loan books in the billions of dollars. Their lending standards, their borrowers / lenders' addresses, and their liquidation levels are completely transparent as it is all published publicly to the blockchain. We can evaluate the health of their loan books in real-time. Depositors in these protocols can process all the relevant information about the health of these protocols before they deposit their funds. Contrast that with the opaque nature of centralised lenders, where the depositors only have slick marketing campaigns to consider.

3AC and the cabal of centralised lending company bag holders all participated heavily on these DeFi lending protocols. We know this because using blockchain analytics tools, market participants were able to ascertain where certain companies would get liquidated on the large loans they had outstanding on these protocols. The market is cruel, and it systematically hunted for levels that would force the protocols to sell indiscriminately in order to make its lenders whole. And thankfully, due to the community stipulating conservative margin requirements, all of these major DeFi lending protocols survived.

The protocols did not have to halt any withdrawals.

The protocols continued to issue loans.

The protocols did not suffer any downtime.

Rekt'um Damn Near Killed 'Em

When you remove trust from the equation and rely purely on transparent lending standards executed by impartial computer code, you get a better outcome. This is the lesson to be learned. Don't let the media proclaim the failure of these centralised companies is evidence of the shortcomings of the good Lord Satoshi. For he saved those who deserved saving.

The problem now is that with hundreds of thousands or millions of humans rekt due to the contraction of centralised crypto credit, who is left to borrow funds? That is the issue these DeFi lending protocols will grapple with as this nuclear bear market marches on.

At some point, the price-to-book multiple for these DeFi lending protocols will become attractive again. Currently, they still trade too expensively given the near-term outlook for loan demand. With the speculators, large trading houses, and centralised lenders rekt, there is no pool of large organic demand for loans. Maybe I'm just being greedy, but I hope the market gives me an opportunity to own COMP, AAVE, and MKR at a much lower level before we exit this bear market.

Thirst Trap

Water, water, every where,

And all the boards did shrink;

Water, water, every where,

Nor any drop to drink.

-The Rime of The Ancient Mariner, Coleridge

Centralised crypto lenders be thirstaaaayyy! However, should the sweet succour of capital be provided to these parched zoombies?

For crypto hedge funds such as 3AC, their intrinsic value rests solely on the ability of their portfolio managers (PM) to take risk judiciously and make money consistently over time. If a group of PM's blew up because of an improper use of leverage, what value is there in the fund they control? I suspect that 3AC made frantic phone calls to Baron CZ and Baron SBF, but what would the nobles be buying exactly? A hot mess, that's for sure. And I suspect that 3AC and funds in a similar position will find no saviour.

When it comes to the crypto lending companies, their only value rests in their client list and a tiny fraction of good loans. If these clients can be retained and sold additional crypto financial products, then it might make sense to purchase the crippled centralised crypto lender for a song and assume their liabilities. Their radioactive loan books might contain a few properly underwritten loans, and these loans can be purchased at attractive prices. The problem is that the longer these lenders go without a lifeline, the less likely it becomes that they will ever reopen and allow their retail depositors to withdraw. The time pressure to conduct due diligence on these opaque entities makes it even harder to accurately assess whether the crypto barons will part with their capital and save these sinners.

Surely the Fed or another central bank could bail out these hedge funds and companies, but these entities dealt in crypto. These entities are not part of the club of TBTF financial institutions, and shall therefore die an ignoble death. But let us not shed too many tears, for we have learned through these trials and tribulations that the promise of a new decentralised financial system has weathered yet another test.