A Closer Look at How Three Arrows Capital Failed and Brought Down Numerous Investors

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Abstract:

- When 3AC filed for bankruptcy, it began a downward spiral that caught many crypto investors by surprise and sent them reeling.
- The hedge fund was unable to meet its lenders' margin demands.
- According to Nik Bhatia, a professor of finance and business economics at the University of Southern California, "3AC was intended to be the adult in the room."

In March, Three Arrows Capital was managing $10 billion in assets, making it one of the world's most notable crypto hedge funds.

Since its assets were wiped out by the decline in cryptocurrency values and a particularly dangerous trading technique, the company, which is also known as 3AC, is now headed to bankruptcy court.

It's possible that the worst is yet to come. Companies that invested in 3AC's capacity to at least stay afloat were a large portion of the company's backers. Investors who placed large wagers on companies like 3AC have seen their investments plummet by more than $1 trillion since April, largely due to the decline in bitcoin and ethereum.

Loans to 3AC have apparently caused Blockchain.com a $270 million loss. After 3AC couldn't pay back the roughly $670 million it borrowed from Voyager Digital, the digital asset brokerage filed for Chapter 11 bankruptcy protection. Losses have been incurred by U.S.-based crypto lenders Genesis and BlockFi, as well as the crypto derivatives platform BitMEX and the crypto exchange FTX.

According to Castle Island Ventures partner Nic Carter: "Credit has been destroyed and removed; underwriting requirements have been tightened; solvency has been tested, so everyone is pulling money from crypto lenders."

According to their business plan, Three Arrows borrowed money from throughout the sector and then used that money to fund new crypto initiatives. Since the company had been around for a decade, Zhu Su and Kyle Davies were able to establish some credibility in a field full of newcomers. Zhu was also a co-host of a prominent podcast on cryptocurrency.

According to Nik Bhatia, a professor of finance and business economics at the University of Southern California, “3AC was intended to be the adult in the room.”

3AC’s creditors are claiming that Zhu and Davies have yet to begin cooperating “in any meaningful sense” in court documents seen by CNBC. There’s no money to repay lenders, according to the statement, because the liquidation hasn’t begun, according to the filing.

Both Zhu and Davies were unavailable for comment at the time of this writing.

Observing the Dominoes as They Fall

When terraUSD (UST), one of the most well-known dollar-pegged stablecoin initiatives, went bankrupt in May, Three Arrows Capital went bankrupt as well.

Though UST promised that its value would not be affected by the volatility of the broader crypto market, the stability of UST relied on a sophisticated set of code with very little tangible currency to back up the arrangement. An annual dividend of 20 percent was offered as an incentive to investors on Anchor, the lending platform that was used in conjunction with it.

According to Bank of America’s global crypto and digital asset strategist Alkesh Shah, “the risk asset correction paired with less liquidity have exposed projects that promised high unsustainable APRs, resulting in their collapse, such as UST.

Investors lost $60 billion as a result of panic selling following the demise of UST and its sibling token luna.

Digital currency expert Bhatia, who wrote the book “Layered Money” last year, said that the collapse of terraUSD and luna is the “ground zero.” First, he referred to the catastrophe as the beginning of a “long, nightmare chain of leverage and deceit.”

As reported by 3AC, it has invested $200 million in luna. – The fund’s exposure was estimated to be $560 million by other industry sources. It didn’t matter how much money was lost, that investment was effectively useless when stablecoins failed.

Cryptocurrencies Fell Even Faster

As a result of the implosion of UST, cryptocurrencies fell even faster as part of a larger market recoil from risk.

In a flurry of margin calls, 3AC's lenders requested their money back, but it wasn't there. Retail investors who had been promised annual returns of 20% by several of the firm's counterparties were likewise unable to satisfy their own expectations.

There were no hedging transactions and "billions of dollars in creditors' funds fled," claimed Bhatia.

"Our consumers will not be impacted," Peter Smith, CEO of Blockchain.com, wrote in a letter to shareholders last week, according to CoinDesk. As Voyager's bankruptcy loomed, investors heard similar sentiments from the company's management.

He warned that every market participant with significant exposure to an asset that is failing or in crisis will be harmed by the cascade. Retail investors have no idea what, if anything, they'll wind up holding when they invest in crypto.

Emails sent to Voyager Digital customers recently stated that it will be some time before they could access their cryptocurrency. Stephen Ehrlich, the business's CEO, claimed on Twitter that clients who have cryptocurrency in their accounts could receive a "grab bag" once the company goes through bankruptcy proceedings.

A combination of their cryptocurrency holdings, common Voyager shares, Voyager tokens, and whatever proceeds they receive from 3AC might be included in this. According to CNBC, Voyager's investors don't have much faith in the company.