

## March 2023 Investor Update

### ProChain in the News

[Bitcoin Above \\$22K 'Remarkable' Sign of Resilience](#); *Coindesk*, Feb 14

[Banks or Ponzi schemes?](#); *The Modus Operandi, RT.com*

[Jamie Dimon, Banking Crisis Action Hero?](#); *Power Corridor*, Mar 29

For a 3<sup>rd</sup> consecutive month, and as we predicted, legal and regulatory was the most prevalent theme in crypto news and developments.

In line with *ProChain's* comments on February 14 to *Coindesk* ([above](#)), despite the attacks by US regulators and lawmakers (a lot more on that below), the resilience of the price of cryptocurrencies (currently, even higher) continues to exhibit the strength of the case for cryptocurrency as a safe haven in the face of (i) worldwide banking turmoil, (ii) uncertain effects of surging interest rates and (iii) doubts relating to safe but low-yielding fixed-income assets.

Although the last months have seen numerous human failures in crypto, the technology has never failed, and this period may be a most important proving period for the revolution in asset digitization.

Since our last investor update, we have witnessed two major disruptions:

1. Strains and failures in the banking system, including, the closures of Silvergate Bank, Silicon Valley Bank, and Signature Bank, and the forced sale of Credit Suisse.
2. Regulatory and legal attack of Coinbase, Binance and, partly, all cryptocurrencies other than Bitcoin; essentially, the final bastions of cryptocurrency that had not yet been explicitly attacked.

In short, there are no remaining un-attacked crypto enterprises or crypto assets. The asset-class has hit its nadir, in terms of the openness and the tactics its enemies and attackers ([Operation Chokepoint 2.0](#)).

Nevertheless, strength in crypto prices is being witnessed, which reinforces our overall confidence.

## 1. Adoption

### a. *Investment.*

- The **stablecoin** battle is currently a two-horse race, between **Tether (USDT)** and **Circle (USDC)**. And, it seems that since [Circle had \\$3.3B of reserves tied up in the collapse of Silicon Valley Bank](#), which it has since recovered, Tether has taken the lead in the race. Ironically, Tether has long been criticized for being less than fully transparent on the nature of its reserves (*e.g.* cash, money market securities, treasuries, corporate debt, etc.); in contrast, Circle has been more completely transparent with the public.

### b. *Currency and Use.*

- **Caitlin Long (Custodia Bank)** is one of the most thoughtful, hardworking, and patient members of the crypto banking movement. Custodia has been operating on a completely USD-backed basis for deposits, as a simple custodian for digital assets. Recently, [the Federal Reserve rejected Custodia's request to become a member of the Federal Reserve System](#), which would have allowed Custodia to directly clear payments for customers at the Federal Reserve, reducing the cost, delays, reconciliation headaches and counterparty risk involved with traditional intermediaries. Custodia has since filed an amended complaint against the Federal Reserve.

## 2. Regulation and Legal

- In the case of the seizure and closure **Signature Bank**, which was a well-known and high-profile bank to the crypto industry, according to some insiders (including, Rep Barney Frank, a Signature director), the move to close the bank [has not been justified with a finding or allegation of insolvency](#), and [was meant "to send a very strong anti-crypto message."](#)
  - Furthermore, the ensuing sale of Signature Bank's assets to **Flagstar Bank** specifically [excluded the bank's crypto deposits](#).
- US regulators have continued the cryptocurrency warpath, which has been titled by the industry as "[Operation Chokepoint 2.0](#)"; the concerted effort by the US Government to de-platform crypto from the banking system.
  - **Coinbase (COIN)** announced that [the SEC is investigating several of its product offerings](#), including, its exchange, its staking/yield-earning service (Coinbase Earn) and its crypto wallet.
    - Interestingly, each of these product offerings was described with detail in Coinbase's stock offering documentation and in quarterly earnings' reports since the company's IPO in April 2021.
    - Moreover, for the SEC to have standing to bring this action, Coinbase must be violating laws relating to "securities", as opposed to "commodities" (the CFTC's domain).
  - Industry players are increasingly concerned that the SEC [is not only precluding businesses from operating without registration, but also failing to provide any viable path to registration](#).
    - Case in point, last week, the SEC filed charges against a small exchange, **Beaxy**. In the wake of [the complaint](#), Beaxy shut down. The complaint highlights the following issues:
      - Because the exchange is unregistered (like all exchanges, other than Coinbase), all the deposits are the property of the exchange and could be used for non-depositor purposes.

- Because the exchange is unregistered, it could trade against its own customers.
  - Any tokens minted by and offered by the exchange are unregistered securities.
  - **However**, the SEC offers no advice on how to bring the exchange and its activities into compliance.
- The litigation process may finally bring some clarity to US crypto regulation, but it will take a while.
- In a speech in mid-March, SEC Chairman, **Gary Gensler**, made a clear argument that [proof-of-stake protocol tokens \(which include Ethereum and many other tokens, but not Bitcoin\) are “securities” pursuant to US law.](#)
  - The **Attorney General of New York** [agrees with Gary Gensler.](#)
  - In stark contrast, **CFTC Chairman, Rostin Behnam**, told the Senate Agriculture Committee that [Ethereum is a commodity.](#) Thankfully, there is consensus among all regulators that Bitcoin is a commodity, and not a security.
    - In a move to build bridges with the crypto community, [the CFTC constituted a Technology Advisory Committee](#), made up of technology leaders from government, policy, academia and industry.
    - Similarly, the [Office of Comptroller of the Currency established a “fintech” office](#) to enhance the regulator's expertise on matters including digital assets.
- The **CFTC’s** positive posture toward the crypto asset class didn’t stop it from bringing [legal action against Binance](#), the world’s largest crypto exchange (70% market-share of volume) and [one of the last major crypto players to face legal challenge from US regulators.](#)
  - The charges include operating a centralized digital asset trading platform through an intentionally opaque common enterprise, at the direction of **CZ**, the founder of Binance. The crux of the complaint is that Binance acted as (unregistered) futures commission merchant (“FCM”) and therefore was subject to, but intentionally flouted, U.S. anti-money laundering laws (“AML”). The action by the CFTC presumes that Binance violated laws relating to commodities and/or futures (in contrast with securities).
  - The complaint further alleges willful evasion of the requirements of the Commodity Exchange Act (“CEA”), [alleging Binance conducted certain activities outside the U.S. designed to avoid CFTC regulation](#), such as intentionally structuring entities and transactions to avoid registration requirements and instructing U.S. customers as well as other customers as to how to evade Binance’s compliance controls.
  - Some of the evidence in the complaint, which includes electronic messages among Binance personnel, is quite damning.
  - The CFTC’s case, on the one hand, [could lead to precedent that Bitcoin, Ether, and stablecoins are commodities](#) (countering the position of the SEC). On the other hand, it could substantially prevent US firms from engaging with a large swath of crypto.
- As if the regulators needed help in their crusade against cryptocurrency, [Sen. Elizabeth Warren is becoming a more explicit and active opponent of the asset class and the industry](#), and she’s working hard to recruit other senators from both parties.

- Despite believing that Bitcoin (and all other cryptocurrencies) are worthless, because they are not government-backed, [it's no surprise that Sen. Warren embraces the concept of a CBDC](#), which would give the US government outsized transparency and control over US-issued CBDC holders.

### 3. Public Companies

- Short seller Hindenburg Research published a research report on **Block (SQ)** claiming that Cash App, Block's digital wallet, has inflated user numbers and could lose significant revenue as regulators change measurement rules.
  - Exemplifying its questionable claims, Hindenburg cited a Pandemic Unemployment Assistance (PUA) fraud case and provided a cropped screenshot of an indictment, stating that "the only peer-to-peer electronic payment processor mentioned was Cash App." What Hindenburg failed to report was that the criminal rapper fraudulently accessed more than \$1,200,000 with electronic benefit transfer (EBT) debit cards issued by Bank of America and cashed them out largely in the traditional banking system—ATMs, bank branches, debit cards—not fintech apps. In fact, the rapper used money transfer/fund transfer services, including Cash App, to access only \$85,130 of the fraudulent funds, compared to \$375,177 from ATMs, \$39,180 from bank branches, and \$205,273 from debit cards issued by traditional banks like Bank of America.
  - Even if Hindenburg's claims prove unfounded, regulators have been focused on combating peer-to-peer payment fraud on Venmo, Zelle, PayPal, and Cash App and might intensify those efforts, perhaps forcing companies like PayPal and Block to report unique users instead of active accounts.
- In the wake of the recent actions in the US against unregistered (and registered, such as Coinbase,) firms, it is interesting that [three of the largest regulated exchanges in Canada are combining](#); **WonderFi Technologies (WNR)**, **CoinSquare** and **CoinSmart Financial (SMRT)**.
- **Hut 8 Mining (HUT)** [reported a challenged 4<sup>th</sup> quarter](#), resulting from low Bitcoin prices and electricity disputes. As previously publicized, Hut 8 is in the process of merging with US Bitcoin Corp., for one of the largest mergers in the sector to-date.



**David D. Tawil**

President

+1-646-479-9387

[david@prochaincap.com](mailto:david@prochaincap.com)

Linked  