October 2022 Investor Update

ProChain in the News

Markets will see a 'reckoning' of credit card debt; ***Mornings with Maria, Fox Business News***, Nov 22

FTX books a 'complete failure', investors did 'little homework' with billions owed; ***Just Business***, Nov 22

CoinMarketCap and CoinGecko Ranked FTX Highly. Why?; ***Blockworks***, Nov 17

FTX and **Sam Bankman-Fried** (**SBF**) have been all the rage since early November.

I will forego recounting each revelation in the SBF, FTX and Alameda saga. And, surely, there is more to come.

Moreover, I will forego speculation on the strategy and psychology of SBF and his accomplices. No doubt, those matters will be the subject of books and film to come.

We'll find out more at next week's hearing (*Tuesday at 10am EST*) before the **House Committee on Financial Services**. SBF has agreed to testify. You can watch the hearing here.

This is the first of numerous expected Congressional hearings on the FTX calamity. Although it hasn't been confirmed, we expect that SBF will testify at the **Senate Banking Committee** hearing on the following day, *Wednesday (Dec 14) at 10am EST*. That hearing can be watched here.

Thankfully, ProChain has emerged largely unscathed thus far.

"Largely," because ProChain did experience considerable loss in November. And we still don't know the full extent of the damage to the crypto world.

As a result, we the duty and ability to (i) analyze the lessons learned, (ii) dwell on the road ahead, and (iii) seek new opportunities.

FTX is what happens when decentralization and transparency are corrupted by greedy humans- centralization, opaqueness, and fraud ensue.

As a result of the run on liquidity, any illiquid or leveraged asset is at risk. The risk grows exponentially if both elements (illiquidity and leverage) are present.

The crypto ecosystem, despite the portrayal in media, is still relatively small and interconnected, so it is likely that when one big one falls, we all fall.

Despite the destruction, most critically, no blockchain was broken, hacked, or failed.

The survivors and new pioneers will regroup around what remains and begin to rebuild and move forward.

Investors, depositors, lenders, enablers will be more cautious, and the policing authorities (governments, legislatures, regulators) will be stricter.

Of course, that too will eventually wane. But, not before changing habits for the better.

One of the lessons that we've taken away from the last number of months is that decentralization is the way to go, and it's high time for the hardware to catch up to the software.

Since the business of hardware requires more up-front cost and its physical form challenges viral rollout, this will take some time. But we think that there is a lot of value there, which will allow for the next leg of adoption, and will reduce the need for and power of middlemen.

1. <u>Adoption</u>

a. Investment.

- The middlemen that are currently on the chopping block are **BlockFi** and **Genesis**.
    - **BlockFi**, a heavily promoted US-based crypto lender, filed for bankruptcy in the District of New Jersey. BlockFi has halted withdrawals and stated they had more than 100,000 creditors (in the context of bankruptcies overall, the creditor count in crypto bankruptcies is very high).
        - BlockFi previously raised $1B in venture funding from large funds like Tiger Global and Bain Capital. In July, following the LUNA and 3AC fallout, BlockFi agreed to a $400mm credit facility with **FTX**. With FTX in bankruptcy, this credit facility was dry. Moreover, $355 million of BlockFi's assets are frozen on the FTX platform. Despite holding $257mm of unrestricted cash, the limited liquidity likely prompted BlockFi's bankruptcy filing.
        - An interesting twist is that BlockFi was pledged **RobinHood** (**HOOD**) shares for forbearance on a $680mm debt owed by **Alameda** (the failed FTX-related hedge fund) to BlockFi. BlockFi has sued to foreclose on the HOOD shares.

        - To be frank, depositors/customers/creditors to BlockFi handed over their money or crypto to BlockFi with the unreasonable expectation that they would receive relatively high fixed returns without commensurate risk. In reality, BlockFi made high-risk loans and investments to achieve the expected returns, and those have failed. It's NOT a mind-blowing story, but there should be rules or disclosure that reduce the likelihood of these types of situations.
    - **Genesis** is a more interesting story because the roles that FTX, Alameda, and Robinhood play in the BlockFi story, are played by Genesis-affiliates (DCG, Grayscale, GBTC), in the case of the Genesis story.
        - Genesis is another crypto lender that dealt with FTX; it is not currently in bankruptcy. It has $175mm that are frozen on FTX. Genesis had a $2.3B loan to 3AC that is also uncollectable (47% of Genesis' loan book). DCG took the 3AC loan from Genesis and has also borrowed $1B+ from Genesis (payable in 10 years). In turn, Genesis has $1.8B borrowed from customers.
        - Genesis has halted withdrawals. If Genesis goes bankrupt, creditors will seek to foreclose on DCG. DCG's crown-jewel is Grayscale and GBTC (the publicly traded Grayscale Bitcoin Trust).
        - If possible, it's a more tangled web (read: more conflicts of interest) than BlockFi.
        - In another wrinkle, **Fir Tree**, a hedge fund, has sued Grayscale for mismanagement and conflicts of interest.
- **Tether** (**UST**), the stablecoin, is now caught up in the over-levered, illiquid loan conversation.
- In the wake of the FTX collapse, a few notable traditional finance (TradFi) entities and persons have come out in continued support of crypto
    - **Goldman Sachs** is looking for opportunities in the rubble.
    - **BlackRock** CEO, **Larry Fink**, is still in crypto for the technology, despite losing $24mm that was directly invested in FTX. Moreover, Fink proclaimed that "the next the next generation for markets, the next generation for securities, will be tokenization of securities."
    - Similarly, **Carlyle** co-founder, **David Rubenstein**, still sees capital flowing to blockchain endeavors.
- Democracy in DAOs is alive and well. Despite the previous approval of investing $1.5B of treasury cash with **Coinbase** Prime, the **MakerDAO** community has rejected a follow-up proposal to invest $500mm with **CoinShares** in bonds. This is a great development.
- In a disappointing use-case development, **IBM** and **Maersk** have abandoned their venture, **TradeLens**, that sought to organize worldwide shipping data on a single, private blockchain. Unfortunately, the endeavor didn't garner the necessary critical mass of industry participants. In ProChain's opinion, this business model will be revitalized at some point, and will eventually succeed.

b. *Currency and Use.*

- Similar to a move by **KKR** earlier this year, **Apollo** is going to offer a new fund on a public blockchain.
    - Blockchain technology is helping the funds reduce costs tied to record-keeping of fund investors, while providing easier ways to issue capital calls and give money back to backers. He also said it enables the use of stablecoins to facilitate fund subscriptions and distributions.

- **Brazil**'s congress has passed a bill that paves the way for banks to begin offering payment services around **Bitcoin** and other crypto assets.

2. **Regulation and Legal**

- The first Congressional hearing in the wake of the FTX collapse was held on December 1.
    - At the hearing of the **Senate Agriculture Committee** CFTC Chairman **Rostin Behnam** was the sole witness.
        - Behnam expressed support for Agriculture Committee Chairwoman Stabenow's Digital Commodities Consumer Protection Act (DCCPA) — which he says would have "prohibited" some of the actions at FTX from taking place. The most recent version of the proposed measure would place many cryptocurrencies under the purview of the CFTC. Stabenow during the hearing said that the legislation would still allow the Securities and Exchange Commission to have oversight over crypto that it deems securities.
- It seems that stablecoin regulation is coming soon; best guess is by September. Regulators are agreed on 95% of the terminology for the bill. The key will be fully audited disclosure of fiat/liquid asset backing.
- To be expected, other Congressional Committees and Regulators are getting in on the crypto-crackdown party.
    - Sen. **Ron Wyden** (D-Ore.), the leader of the tax-focused **Senate Finance Committee**, under the guise of protecting customers' deposits and assets, has asked the largest crypto exchanges (Binance, Coinbase, Kraken, Gemini, etc.), to explain how they would protect their customers in the event of a financial calamity.
    - The 'Bitcoin Senator', **Cynthia Lummis** (R-WY), and the co-author of the most well-known crypto legislation, the Responsible Financial Innovation Act, is using the failure of FTX to push passage of her draft legislation.

3. **Public Companies**

- Unsurprisingly, stablecoin issuer (**USDC**), **Circle**, has dropped its plans to go public via a SPAC acquisition.

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