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De-Coding Crypto



Enigma Weekly

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Our Market View

May you live in interesting times. An up and down week - ripped past \$50,000 middle of last week, hit highs of \$58,000 over the weekend, and came crashing back to earth with a -23% drawdown over the course of Monday and Tuesday. Not exactly unexpected in terms of either the highs or the lows; we would continue to urge some measure of caution prior to expiry (with \$56,000 serving as hard resistance should we find our way back there in such short order), and perhaps for the weekend afterwards too, with outlook generally picking up significantly from Monday onwards.

Alts fared much more poorly over the week, with some large-caps losing as much as 25% - as usual, corrections hitting alts harder, and those stagnant alts like LTC/BCH (who have outperformed in patches on the way up) particularly hard. Despite this, tend to think outlook is improving now on quality alts - most notably ETH (which thoroughly retested breakout points in both USD and BTC terms) - and that we see a disproportionate bounce near-term on them.

DeFi and interoperability continue to be the watchwords in general; BNB is up 64% on the week (taking it to the 3rd-highest market cap at the moment), and said rise has largely been predicated on the basis of an uptick in volumes on its Uniswap clone (Pancakeswap). SOL leads mid-caps at +105% due to developments on its DEX project Serum (the native token for which, SRM, is also +70%).

Please direct all enquiries about this week's research to jedwards@enigma-securities.io.

Major

Ticker	Price	7D	1M	6M	12M	Cap
BTC	49858	-3.5%	47.5%	330.7%	467.5%	929.2B
ETH	1661.91	-10.0%	17.9%	309.9%	619.0%	190.8B
LTC	183.06	-20.4%	28.6%	218.4%	202.5%	12.18B
BCH	533.42	-26.5%	17.9%	95.9%	66.2%	9.96B
EOS	3.934	-19.8%	44.1%	23.7%	10.1%	3.74B
Selected						
Ticker	Price	7D	1M	6M	12M	Cap
DOT	34.46	9.7%	91.5%	452.0%	1067.0%	31.45B
ADA	1.027	15.9%	185.9%	765.4%	1961.0%	32.38B
LINK	28.34	-13.4%	16.3%	68.4%	559.7%	11.58B

Tether latest: the NYAG case

Last week we wrote about Tether, about the discourse surrounding it, and why in our view we generally believed that concerns regarding operational risk etc. were, while not unfounded, overblown.

Regular readers will know that we rarely do direct follow-ons like this week-to-week, but for once, it does seem appropriate, even necessary, because the following frightening headline came up on terminals across the world yesterday:

***NY AG ENDS BITFINEX & TETHER VIRTUAL CURRENCY TRADING**

First things first: how did markets react?



The answer: extremely positively. +5% within minutes, and a peak of +8% within a hour. This seems counterintuitive: it's not. Let's explain.

The Tether court case

We did make some reference to the case in question last week:

The ownership structure of Tether Limited, and specifically its relationship with Bitfinex (the exchange that initially put it on the map) is murky at best; the two have shared ownership and are generally considered to be sister companies, and there have been concerns in the past about the exact nature of the relationship between the two (with particular note to a \$900m credit line from Tether supporting Bitfinex operationally during the 2018 bear market).

It of course now bears some further explanation. There has been an ongoing, public probe by the New York Attorney General's office for a couple of years now with regards to Tether Limited and Bitfinex, and specifically relating to a suit filed by said AG (Letitia James) in April 2019. To quote the NYAG press release at the time:

“Our investigation has determined that the operators of the ‘Bitfinex’ trading platform, who also control the ‘tether’ virtual currency, have engaged in a cover-up to hide the apparent loss of \$850 million dollars of co-mingled client and corporate funds,” said Attorney General James. “New York state has led the way in requiring virtual currency businesses to operate according to the law. And we will continue to stand-up for investors and seek justice on their behalf when misled or cheated by any of these companies.”

The charges laid against Bitfinex and Tether were essentially as follows:

- 1) In 2018, Bitfinex ran into trouble when Crypto Capital Corp (a Panama-based payment processor used by a number of major exchanges) froze roughly \$850m of customer and corporate funds. As of today, said funds have never been returned.
- 2) The loss of said funds was severe enough as to make Bitfinex essentially insolvent if not addressed.
- 3) To deal with this issue, Bitfinex opened a credit line with Tether Limited and borrowed an amount equivalent to the missing funds.
- 4) Assets for said credit line were taken from Tether reserves (\$2.7bn equivalent in Tether was in circulation as of October 2018).
- 5) Hence, while that credit line was in place, Tether was no longer 1:1 backed in terms of cash and equivalents.
- 6) It's unclear how long the credit line was open in full or part, though Bitfinex announced in January of this year that it had fully repaid the balance.

All of said points have been admitted, though we should note that said admissions have been in the public sphere ever since the probe began (and that Tuesday's announcement hence broke no new ground in that regard); to quote Tether general counsel Stuart Hoegner on April 30th, 2019:

As of the date I am signing this affidavit, Tether has cash and cash equivalents (short term securities) on hand totaling approximately \$2.1 billion, representing approximately 74 percent of the current outstanding tethers.

This represented the meat of the NYAG case. The potatoes, as it were, is with regards to whether Bitfinex and Tether had been involved in wrongdoing beyond that, principally with regards to the idea that unbacked Tethers were actively being printed at any point - while the essential 'unbacking' of already printed Tethers via exposure to a long-term credit line was and is still ultimately a problem, it has never been the primary contention of those who claim Tether to be a full-on fraud.

Judgement and settlement

As with the opening salvo, the NYAG press release announcing the conclusion of the probe was once again full of vim and vigor:

NEW YORK – New York Attorney General Letitia James today continued her efforts to protect investors from fraudulent and deceptive virtual or “crypto” currency trading platforms by requiring Bitfinex and Tether to end all trading activity with New Yorkers...In the case of Tether, the company represented that each of its stablecoins were backed one-to-one by U.S. dollars in reserve. However, an investigation by the Office of the Attorney General (OAG) found that iFinex — the operator of Bitfinex — and Tether made false statements about the backing of the “tether” stablecoin, and about the movement of hundreds of millions of dollars between the two companies to cover up the truth about massive losses by Bitfinex.

In the judgement itself:

Based on the foregoing facts, OAG finds that Bitfinex and Tether violated New York General Business Law § 352 et seq. and Executive Law § 62(12).

Both sections refer, in general terms, primarily (to quote 352) to "fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale". This was, ultimately, expected; the charges that had essentially been publically admitted to already with regards to the secret credit line and resultant effective unbacking of Tethers, combined with the evidence that representations had been made regarding said 1:1 backing, was enough to bring some form of penalty.

So: why was this news received positively? Firstly, back to that headline: "NY AG ENDS BITFINEX & TETHER VIRTUAL CURRENCY TRADING". Any initial panic was offset quickly by the realisation that said enforcement in practice only meant that Bitfinex/Tether Limited cannot trade in New York state - something that they had been unable to do for several years anyway (and something that is at most a minor concern for most companies in the crypto space, given the difficulty in obtaining the NY 'Bitlicense' and the relative paucity of crypto businesses in the state in general).

For the rest of the points of the settlement, an \$18.5m fine is no major penalty either for a firm on Bitfinex or Tether's current scale (remember that the market cap now just for Tether itself is over \$30bn), and the transparency requirements should ultimately serve to strengthen confidence in USDT and crypto markets, not weaken it.

Secondly: the case had been settled. While it was largely taken as a given at this point that this was a case that would end in a relatively soft settlement rather than anything more severe (judging on the timescale that it had proceeded on and the relatively staid tone emanating from both parties in the meanwhile), confirmation is of course welcome news.

Thirdly, and most importantly: despite two years, and countless manhours, the NYAG report has seemingly found nothing to back up any broader theses with regards to the mass printing of unbacked Tether. There is a section on Tether being unbacked in 2017 (points 14 to 27), but the following two points sum up the tenor of said section:

20. Because of Tether's inability to conduct significant banking activity during this time, it could not itself hold dollars sufficient to back the hundreds of millions of new tethers that had entered the market. Until September 15, 2017, the only U.S. dollars held by Tether ostensibly backing the approximately 442 million tethers in circulation was the approximately \$61 million on deposit at the Bank of Montreal.

21. Between June 1, 2017 and September 15, 2017, Bitfinex held approximately \$382 million of Tether's funds in a comingled account, which should have been held by Tether as "backing" for tethers then in circulation but was not. In certain documents Bitfinex and Tether produced to OAG during its investigation, Tether accounted for this amount as a "receivable" from Bitfinex. Between June 1, 2017 and September 15, 2017, the total number of tethers issued and circulating rose from approximately 108 million to 442 million.

The contention of the NYAG is not that Tether was simply being printed unbacked, but rather that (due to Tether's inability to find appropriate banking arrangements in the summer of 2017 after losing its Wells Fargo accounts) Tether funds were being held and comingled with Bitfinex funds (and that a particular 'transparency declaration' in September 2017 was misleading in that regard). Again: in the end, bad practice, and ultimately a material misrepresentation, but no grand conspiracy.

Going forward

We are absolutely sure that this will not put an end to concerns about Tether, and probably not to the campaigning against it; we have already seen new rounds of anonymous doomsaying with regards to a supposed database hack against current primary Tether banking partner Deltec (which seems likely to us to be a complete fabrication).

However: the NYAG settlement probably does represent something of a watershed moment in that regard. While absolutely a minoritarian view, there certainly was anticipation in certain quarters with regards to, if not a fuller indictment, at least the revelation of some greater evidence of wrongdoing on Tether/Bitfinex's part.

This has not remotely come to pass. Again: we reiterate that Tether is an imperfect asset, that it is likely a mistake to have infinite-range confidence in it, and that there are legitimate criticisms to be made in terms of its transparency and ownership. However, there is ultimately very little evidence for the idea that it is unbacked, and for any resultant implications with regards to the health and stability of crypto markets more broadly.

Until next week – thank you for reading.



ABOUT US

Enigma Securities is a leading, regulated liquidity provider, offering its clients bespoke liquidity solutions through the use of a proprietary electronic trading platform and API access.

The firm was founded in 2017 as a subsidiary of Makor Partners Limited (UK), amid growing institutional demand for digital asset trading. Looking to seize the new, exciting opportunities presented by cryptocurrencies and blockchain technology, Enigma became one of the first regulated brokerage firms to set up banking relationships and custody solutions to meet institutional standards.

Since its launch, the firm has expanded its capabilities to the broader Fintech arena, leading innovation while working to bridge the gap between the traditional financial services industry and cryptocurrency markets.

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