

Crypto Bust—A Look Back at the Collapse of FTX

Cryptocurrency is a type of digital currency secured by cryptography which makes it impossible to forge or spend a second time. Cryptocurrencies are decentralized in nature and are based on blockchain technology—an online ledger which contains a list of transactions. It is almost impossible to forge transaction histories since the transactions have to be independently verified by each member of the network. Cryptocurrencies eliminate the need for an intermediary, such as a bank between two or more parties. Due to the presence of an online ledger, they leave a trail that law enforcement authorities can decode.

FTX (Futures Exchange) was a Bahamas-based cryptocurrency exchange started by Sam Bankman-Fried in 2019 which enabled customers to trade digital currencies for other digital currencies or traditional money, and vice versa. It mostly supported commonly traded cryptocurrencies such as Bitcoin, Tether, Ethereum, etc. Users would deposit fiat money (any government-issued currency) into their FTX account and then use the money to buy and sell cryptocurrency.

When rumours spread about FTX's financial condition and Alameda Research, its sister company, users frantically withdrew their money. FTX, being an exchange that connected two or more parties, was incompetent to handle mass withdrawals, since such institutions have mechanisms in place to recover the money and FTX was unable to do so.

A notable early investor was Binance founder and CEO Changpeng Zhao. By 2021, FTX was worth \$30 billion, second only to Binance. Changpeng Zhao's relationship with FTX soon turned sour and he sold his stake back in 2021. His familiarity with the inner workings of FTX played a crucial role in FTX's

debacle.

FTT is a token used by FTX. Like many cryptocurrencies such as Bitcoin, Ethereum, etc. FTT has value, can be used while trading and is used during transactions. For a while, FTT was a massive source of wealth for FTX. Investors were won over by the idea of FTX offering rewards in exchange for ownership of the token, which included trading discounts and VIP status on the site. To support the value of FTT, FTX regularly repurchases and burns its tokens. It does so by purchasing FTX tokens with 33 percent fees generated on the platform.

As of September 2021, FTT hit an all-time high of \$85 in exchange and as of 22 Dec. 2022, 1 FTT is worth \$0.84. This is one of the greatest ever destructions of wealth. The sudden crash was caused due to FTX's insolvency and its inability to return users' funds.

Binance is the world's largest cryptocurrency exchange registered in the Cayman Islands. It offers crypto-to-crypto trading in more than 600 cryptocurrencies and virtual tokens such as Bitcoin, Dogecoin, Ether, Litecoin, and Binance's very own Binance Coin (BNB). Binance was started by Changpeng Zhao 2017, a developer who previously created high-frequency trading software. He wanted to create a platform that was independent of fiat currencies. Binance emerged during the crypto boom of 2017 and soared in popularity by offering a plethora of facilities, such as digital assets and innovation, including its blockchain. By 2018, the number of users increased from 2 million to 10 million.

People Involved in the FTX Collapse

Sam Bankman-Fried



Sam Bankman-Fried (Source: Reuters)

Son of two Stanford Law School professors, an alumnus of Massachusetts Institute of Technology with a bachelor's degree in Physics, Bankman-Fried founded FTX's sister firm, Alameda Research in 2017. He founded FTX in 2019 and was its CEO until he resigned in November 2022. FTX rode a bull for crypto with a \$32 billion valuation before its collapse. He was the man behind FTX securing investments from firms like Sequoia Capital and SoftBank.

He has also had a prominent presence on Capitol Hill as the second largest donor to the US Democratic Party politicians in recent years, has testified before US Congress about crypto, and also put forth his suggested draft of a potential framework calling for the regulation of the crypto industry.

Sam Bankman-Fried was arrested by Bahamian authorities who charged him with eight criminal offenses, including conspiracy and wire fraud against investors, and has been extradited to the United States. He concealed from investors the diversion of FTX customer funds to his crypto trading firm Alameda Research. When word spread that Alameda's balance sheet was made of FTT's, it sent the market into upheaval, and investors and users began withdrawing their money. Even after pausing withdrawals, they were unable to get Binance CEO Changpeng Zhao to throw them a lifeline. He later said that they had mishandled customer funds.

John Ray III, the current CEO of FTX, called it, “really old-fashioned embezzlement” while testifying in front of the House financial services committee. He told lawmakers that there is an excess of \$7 billion in lost FTX funds from 7.6 million accounts, out of which 2.7 million were based in the US, while providing information on the company’s internal investigation. There was no corporate oversight. The owners, businesses, and senior management had virtual control of all accounts and could move money or assets if they desired, undetected by customers.

Caroline Ellison



Caroline Ellison. (Source: Twitter)

She was the CEO of Alameda Research as of its collapse. She joined Alameda in 2018, was a co-CEO with Sam Trambucco in October 2021, and became its sole CEO in August 2022. She is the daughter of two academics at the Massachusetts Institute of Technology.

She is a maths whiz who loves Harry Potter and fringe political philosophy. She was a maths major at Stanford. After graduating, she became a trader at Jane Street, where she met Bankman-Fried. He convinced her to join Alameda Research and

by the end of 2018, he moved Alameda's headquarters from Berkeley to Hong Kong.

She, along with FTX co-founder Gary Wang was charged with a multiyear scheme to defraud investors in FTX. According to the Securities and Exchange Commission, she was directed by Sam Bankman Fried to manipulate the financials of the crypto-trading firm.

Timeline

FTX decided to help BlockFi from going bankrupt in May of 2022. When a series of crypto collapses took place, it triggered a wave of bankruptcy among Celsius, BlockFi, and Voyager. FTX helping BlockFi cemented FTX as one of the strongest players in the crypto world.

November 2, 2022

The leaked balance sheet by CoinDesk from Alameda Research displayed a suspicious relationship between the trading firm and FTX. A large amount of the trading firm's assets was held in FTX native token FTT. At the time FTT token was worth \$25.50.

This triggered the beginning of the end for FTX.



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As part of Binance's exit from FTX equity last year, Binance received roughly \$2.1 billion USD equivalent in cash (BUSD and FTT). Due to recent revelations that have come to light, we have decided to liquidate any remaining FTT on our books. 1/4

9:17 PM · Nov 6, 2022



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Tweet from Binance announcing liquidation of FTT. (Source: Twitter)

November 6, 2022

Changpeng Zhao announced the following:

Due to this, the token's price began to fluctuate instantaneously, dropping to 10% and dipping below \$22.

Securities Commission of The Bahamas

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FOR IMMEDIATE RELEASE

Securities Commission of The Bahamas Freezes Assets of FTX

Nassau, The Bahamas, Thursday 10 November 2022 – Today, the Securities Commission of The Bahamas (the Commission) took action to freeze assets of FTX Digital Markets and related parties. The Commission also suspended the registration and applied to the Supreme Court of The Bahamas for the appointment of a provisional liquidator of FTX Digital Markets Ltd. (FDM).

Mr. Brian Simms, K.C. (Lennox Paton Counsel and Attorney-at Law) was appointed as provisional liquidator. Additionally, the powers of the directors of FDM have been suspended and no assets of FDM, client assets or trust assets held by FDM, can be transferred, assigned or otherwise dealt with, without the written approval of the provisional liquidator.

The Commission is aware of public statements suggesting that clients' assets were mishandled, mismanaged and/or transferred to Alameda Research. Based on the Commission's information, any such actions would have been contrary to normal governance, without client consent and potentially unlawful.

Since the unfolding of events involving FDM, the Commission has proactively dealt with the situation and continues to do so. The Commission determined that the prudent course of action was to put FDM into provisional liquidation to preserve assets and stabilize the company.

The Commission is committed to working with the provisional liquidator to endeavour to obtain the best possible outcome for the customers and other stakeholders of FTX.

Statement from the Securities Commission of The Bahamas announcing freezing of FTX's assets. (Source: Twitter)

November 11, 2022

FTX, FTX.us, Alameda, and other subsidiaries filed for bankruptcy in the USA. Sam Bankman-Fried resigned as CEO, opening space for John J. Ray III, a lawyer who helped run disgraced energy company Enron post-bankruptcy.

November 12, 2022

It was reported that around \$1 billion in FTX customer funds were unaccounted for. After Sam Bankman-Fried had moved \$10 billion from FTX to Alameda Research, a large chunk of that

sum (\$1 to 2 billion) had vanished.

November 15, 2022

A class action lawsuit was filed against FTX in Florida.

November 16, 2022

It was announced that the hearings will take place in December.

On the very next day, the new CEO of FTX said, "Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here. From compromised systems integrity and faulty regulatory oversight abroad to the concentration of control in the hands of a very small group of inexperienced, unsophisticated, and potentially compromised individuals, this situation is unprecedented."

November 22, 2022

Specifics of the finances behind Sam Bankman-Fried's empire begin to emerge as bankruptcy proceedings moved forward.

December 12, 2022

Sam Bankman-Fried was arrested in the Bahamas. The arrest followed receipt of formal notification from the United States that it has filed charges against Sam Bankman-Fried and was likely to request his extradition.

December 13, 2022

The Securities and Exchange Commission charged Sam Bankman-Fried with eight criminal charges, which includes defrauding investors, money laundering, and conspiracy.



Sam Bankman-Fried is arrested in The Bahamas (*Source: Business Insider*)

December 21, 2022

Sam Bankman-Fried was extradited to the United States.

December 23, 2022

Sam Bankman-Fried released on \$250 million bail as he awaits trial.

Fluctuations in Cryptocurrency and FTX Impact

For a while, cryptocurrency has been struggling to convince investors, regulators, and customers of its trustworthiness. The fall of FTX has helped accelerate the two-faced persona of cryptocurrency.

When the cryptocurrency market suffered losses worth \$2 trillion in 2022, FTX came with monetary lifeboats to help

several collapsing firms. A ripple effect of this loss: lenders such as Genesis and BlockFi have announced pauses in operations. The rapid fall of FTX made it clear that regulation is needed to protect investors and reduce crimes in the cryptocurrency market if any.

FTX's collapse came in the wake of months of losses in the cryptocurrency market which was set off by a catastrophic crash that triggered a massive pullback from crypto assets. This crash pushed many cryptocurrency exchanges into bankruptcy. Bitcoin has been trading for less than \$17,000, down from \$75,000 a year ago.

Charley Cooper, managing director of blockchain company R3 and a crypto visionary said "The original idea behind cryptocurrency was to rewrite the rules of finance on a global basis but we are now in a more centralized industry than banking."

Investors of FTX

At the time of the collapse, FTX had total funding of \$1.8 billion, 6 acquisitions, 21 investments, and 3 diversity investments. In the year 2019, the total money raised was \$8 million having the lead investor as Race Capital. In 2021, they raised a huge amount in two separate increments. The first one was \$1 billion with Sequoia Capital. The second was \$420.7 million with Ontario Teachers' Pension Plan and Sequoia Capital. In the year 2022, SoftBank Vision Fund and Temasek Holdings raised \$400 million.

Law Enforcement Intervention

The US Justice Department and Securities and Exchange Commission (SEC) had already been investigating the cryptocurrency exchange before its collapse, according to the Wall Street Journal. The investigation was focused on the exchange's US branch.

Hacking of FTX

A few days after FTX declared bankruptcy, a hacker stole almost \$400M worth of crypto from FTX. Sam Bankman-Fried is estimated to have lost more than \$15 billion in less than a week. It is said that the authorities know the identity of this hacker, but are keeping it under wraps.

Future of FTX

The downfall of FTX has raised questions on whether cryptocurrencies and cryptocurrency exchanges should be regulated to protect investors and users. FTX's downfall could lead to a domino effect, where its borrowers could go down, taking the investors down as well. Companies and organizations liquidating their assets or declaring bankruptcy is also a possibility.

This situation could be an opportunity in disguise for Binance, the leading cryptocurrency exchange. However, users might be wary of switching between cryptocurrency exchanges due to the current situation. They might keep their existing crypto tokens in a cold wallet till the market stabilizes.

Talking about the future of FTX, Prashant Kumar, CEO of weTrade, said, "The fallout between Binance and FTX has larger ramifications for the entire crypto market. As we have been seeing, cryptocurrencies across the globe have seen losses. However, the incident has brought up the need for regulations in the sector. The step taken by Binance to launch an industry recovery fund to help projects during a liquidity crunch is a positive step in that direction."

The collapse of a single cryptocurrency exchange has thrown the emerging industry into a crisis that will set it years back. This was once a medium where two parties could safely trade digital currencies and FTX's fall from power and grace has left investors, executives, enthusiasts, and users

questioning the future of the industry.

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