The Fall of FTX

FTX's sudden and catastrophic collapse sent shudders through the entire cryptocurrency industry.

What was, at one point, the third-largest cryptocurrency exchange is now in a death spiral of bankruptcy and legal reviews, that has billions of dollars left in limbo.

If you're wondering how FTX managed to arrive at this point, this is an overview of everything that went wrong.

What exactly is FTX?

FTX is a cryptocurrency exchange based in the Bahamas. It was founded by Sam Bankman-Fried in 2019 and let users buy, sell, hold, and trade cryptocurrency, although those functions are no longer available due to the firm's collapse (like anybody would want to use them)?

FTX's business model was simple- take a very small commission for trading assets, in this case cryptocurrencies.

Multiply this tiny commission by the millions of transactions done, and it becomes very profitable indeed. If the company then makes its own cryptocurrency FTT, and trades mainly that, the money can just roll in, with investors buying the FTT generated for free by the company, and selling for up to $80 each in September 2021.

At its peak, FTX spent vast sums of money on several sponsorship deals.

The NBA's Miami Heat arena became the FTX Arena, and the company also snagged a deal with Mercedes-Benz Formula One team and sponsored the professional esports organisation Team SoloMid (TSM), which was called TSM FTX for some time.

All these deals are off now, of course, with TSM dropping FTX from its logo on 16th November.

Celebrity endorsers for FTX included Tom Brady and his wife, Gisele Bündchen, who signed on as an environmental and social initiatives advisor, as well as other stars like four-time NBA Champion Stephen Curry, tennis star Naomi Osaka, and many others.

Bankman-Fried was CEO of the firm from its inception until FTX filed for bankruptcy. After Bankman-Fried resigned, John J. Ray III (who was Enron's bankruptcy administrator) took over to help lead the company through a massive restructuring process.

So, how did we get here?

It is fair to say that he cryptocurrency industry as a whole has faced a number of challenges this year.

An uncertain economy coupled with the collapse of the Terra protocol, which powered the TerraUSD stablecoin and its sister token Luna, set off a domino effect that caused several other firms to fail throughout 2022.

This culminated in numerous companies, including Three Arrows Capital, Celsius, and Voyager Digital, filing for bankruptcy over the summer. Things were still looking rosy for

FTX at this point. In fact, Bankman-Fried burnished his reputation by publicly attempting to bail out other struggling crypto firms. This ploy was, however, short-lived.

When did things start to look bad for FTX?

FTX started on its downwards slope when *CoinDesk* published a damning report about Alameda Research, the crypto trading firm also owned by Bankman-Fried.

According to *CoinDesk*, Alameda Research relied heavily on FTX's native FTT token which made up the majority of its assets on Alameda's balance sheet, and had been buying it profusely.

This raised concerns about the close relationship between the two businesses and their potential to manipulate, and so artificially inflate the value of FTT, creating even bigger problems for Bankman-Fried.

Once this had come to light, Changpeng "CZ" Zhao, the CEO of the crypto exchange Binance, announced his plans to sell Binance's FTT holdings, driving worried investors to withdraw their funds from FTX.

The result was a run on the bank that had FTX processing more withdrawals than it could actually afford. FTT has, from a peak of around $51 in March, dropped to around $1.28 at the time of writing.

Binance was supposed to buy FTX

On 8th November, ChangPeng (CZ) Zhao, CEO of Binance signed a letter of intent to buy FTX but included a clause noting the agreement was non-binding.

Just a day later, on 9th November, CZ backed out, stating FTX's issues were beyond its "control or ability to help."

Binance's announcement noted "news reports regarding mishandled customer funds and alleged US agency investigations." At around the same time, a report from *The Wall Street Journal* indicated that FTX used about $10 billion of customer assets to fund risky speculation at Alameda Research, and *Bloomberg* reported that US regulators are looking into whether FTX mishandled user funds.

When did FTX file for bankruptcy?

FTX and Alameda Research filed for Chapter 11 bankruptcy on 11th November, and Bankman-Fried stepped down as CEO.

The filing reveals a number of internal issues at FTX, including that the company has not even verified the number of users on its platform and that it doesn't possess an "accurate list of bank accounts and account signatories."

Former employees noted that the firm had bad record-keeping "that left its profits and losses unclear." Tara MacAulay, who helped Bankman-Fried start Alameda Research, said on Twitter that she and a group of others resigned "due to concerns over risk management and business ethics."

John J. Ray III, FTX's new CEO (the man who oversaw the administration of Enron) said in his filing that he's never "seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here."

Subsequent court filings, such as the one that details all the entities that FTX and Alameda Research owe money to, also reveal some questionable activity. The filing states that Alameda owes its top 50 creditors over $3 billion.

How did Bankman-Fried respond?

"A few weeks ago, FTX was handling ~$10b/day of volume and billions of transfers," Bankman-Fried wrote in one tweet. "But there was too much leverage, more than I realized. A run on the bank and market crash exhausted liquidity."

In a letter to staff, Bankman-Fried apologized to employees and explained that FTX's collateral (the assets a debtor will seize if the borrower can't pay back their loan) decreased from $60 billion to just $9 billion. While Bankman-Fried didn't break down which of FTX's assets make up that collateral, indications are that Alameda used $2.16 billion worth of FTX's FTT token as collateral when taking loans out.

What effect did FTX's fall have on the crypto market?

Crypto investors are worried. The collapse of an exchange as big as FTX means it can happen to other ones, too, like Crypto.com or Binance.

This led the lending arm of the major crypto brokerage Genesis to suspend loan redemptions and new originations, as it couldn't afford to process the abnormal number of withdrawals resulting from FTX's collapse, and their creditors are exploring their options to keep the company from filing for bankruptcy.

But Genesis isn't alone. BlockFi, a company that lets users buy, sell, and trade crypto, suspended withdrawals before filing for Chapter 11 bankruptcy on November 28th. It lists FTX as its second-largest creditor at $275 million.

To reassure investors, some exchanges have committed to publishing proof of reserves to show users that they aren't using their money to fund risky bets. However, this data doesn't really prove much, as it only reveals the amount of money these companies have in their reserves, not what is owed to other firms.

What's going to happen to Bankman-Fried now?

Bankman-Fried's net worth has plummeted from around $16 billion to $1 billion, and in an interview, he claimed to have only $100,000 left in his bank account. American and Bahamian authorities have been in talks about extraditing Bankman-Fried to the US for questioning, possibly to face criminal charges.

He has, however, been ordered to appear at a hearing on 2nd February 2023, as part of the Texas State Securities Board investigation into whether FTX broke Texas securities laws.

It remains to be seen what the overall impact on the crypto market will ultimately be.

It seems though, that the fall of FTX and its associate companies is already having a knock-on impact on the rest of this marketplace, with good, well-managed platforms and tokens dragged into the fray.

As many readers know, I am not enthused by crypto generally, but for so many people to lose so much money to so few, in whom they had almost unquestioning belief is nothing short of tragedy.