The collapse of FTX

The idea of “cryptocurrency” already makes some investors’ heart rates rise. Once a shiny and mysterious glimpse into the future of money, cryptocurrency is now commonly associated with concerns over regulatory issues, cybersecurity, and fraud. One name in particular keeps making headlines: Sam Bankman Fried (known as SBF) and his now infamous cryptocurrency exchange, FTX.

Regardless of your opinion on crypto, it’s likely you’ve heard about the sudden and astonishing collapse of FTX. But does one exchange’s downfall impact the entire crypto industry… and what about the industry outside of crypto? Should you care about FTX? Below is some food for thought.

Is Cryptocurrency Bad?

With all the negative press it’s been getting, this is a fair question to ask. While we won’t give you a “yes” or “no” answer, we do recommend approaching it similarly to other types of investments. For example, just because large online retailers, like Pets.com, collapsed during the Dot Com bubble burst in 2001, that doesn’t mean the internet went away forever.

If you are interested in pursuing cryptocurrency, approach it using the same core tenants you would when selecting other opportunities: do your research, avoid getting too overconcentrated in it, and keep a long-term outlook on your investments.

There are some additional considerations to make, some of which became even more apparent as the FTX scandal unfolded in recent months. Primarily, a lack of oversight and regulations can leave investors more vulnerable to large-scale scams and fraud.

What Is FTX?

FTX was one of the largest crypto exchanges where investors could trade digital currencies (cryptocurrency) for either other digital currencies or for actual money. It was based in the Bahamas and followed some trading practices that would be considered risky in the United States — and not necessarily legal. The exchange had its own native cryptocurrency, which was called FTT. This is important to know, as FTT sits at the center of the FTX scandal.

FTX: A Timeline of Events

Since this case has been developing for several months, let's look month-by-month at the details that have emerged regarding FTX and SBF.

November 2022

Over a 10-day period in early November, FTX collapsed swiftly and declared bankruptcy. But why?

On November 2, the news outlet Coindesk released a breaking news story that claimed SBF's other investment company, Alameda Research, was being propped up by FTT (FTX's native cryptocurrency).[1] Alameda held around $5 billion worth of FTT, which made FTT's value rise while deceitfully inflating Alameda's worth.[2]

Large holders of FTT, including the chief executive of Binance, sold off FTT tokens, which spooked investors, and thus created a tidal wave of panic.

Investors went en masse to withdraw their money from FTX, which created a shortfall of $6 billion for the company.[3] On November 11, they filed for bankruptcy.

On November 16, former celebrity endorsers including Kevin O'Leary, Larry David, Steph Curry, Naomi Osaka, Shohei Ohtani, and Shaquille O'Neal filed a class-action lawsuit against SBF for the alleged fraudulent scheme.[2]

December 2022

The Department of Justice and Securities and Exchange Commission (SEC) began an immediate investigation into FTX over allegations that the two companies (FTX and Alameda) were propping each other up and creating inflated valuations — instead of remaining completely separate from one another, as SBF claimed they were.

SBF was arrested in the Bahamas on December 12, and he was released on December 22 on a $250 million bond, the largest in history.[4]

January 2023

On January 3, SBF plead “not guilty” to all eight criminal charges against him in federal court, and he is set to go to trial in October 2023. For now, SBF is confined to living in his parents’ house in Palo Alto and cannot leave the northern California area.[2]

Several departments and committees have created task forces to further investigate the full wrongdoings of FTX, as well as recover the remaining money missing from traders’ accounts.

What Does This Mean for Investors Like You?

At it’s core, the issue was that the value of FTX assets in real life didn’t necessarily line up with the value of FTX assets on paper. It funded its own growth using questionable (and highly unethical) means.

On top of that, the company may have used customer money to fund its own trading activity. Traditional banks and financial firms are not allowed to do this; they must keep any in-house trading—known as proprietary trading—separate from client money. However, as a cryptocurrency exchange, FTX and other similar companies aren’t regulated the same way banks are.

As the story continues to develop, it’s clear that there’s been a domino effect hitting the crypto space. Many firms either had FTX accounts or built products using FTX technology, meaning others have experienced their own turmoil as a result of these events. This, understandably, has certainly dimmed investor sentiment, with more choosing to sell off Bitcoin, Ethereum, and other crypto assets — which in turn causes prices to collapse.

Given that one in five Americans has invested in crypto at one point or another, large shifts like this are certainly significant.[5] As of now, no one really knows what, exactly will happen next.

From what they’ll call the FTX arena to how Congress or regulators will respond, we’re likely to see some big changes to the crypto space in the future. If anything, this event has hopefully served as a warning to other crypto exchanges and traders alike that fraud and deceitful practices can come back to bite you in a big, big way.

Sources:

1 Divisions in Sam Bankman-Fried’s Crypto Empire Blur on His Trading Titan Alameda’s Balance Sheet

2 What Went Wrong with FTX?

3 Crypto exchange FTX saw $6 bln in withdrawals in 72 hours

4 Explainer: How did Bankman-Fried secure $250 mln bail?

5 One in 5 adults has invested in, traded or used cryptocurrency, NBC News poll shows