Case 8: FTX

Module 8: What Comes Next?

Background

FTX was a cryptocurrency exchange founded in May 2019 by Sam Bankman-Fried (commonly known as SBF) and Gary Wang. A cryptocurrency exchange is a platform where users can buy, sell, and trade digital assets such as Bitcoin and Ethereum. FTX distinguished itself by offering sophisticated trading products – including derivatives, leveraged tokens, and prediction markets – that appealed to professional and institutional traders.

FTX grew with extraordinary speed. By January 2022, the exchange had raised approximately USD 2 billion in venture capital from investors including Sequoia Capital, SoftBank, and the Ontario Teachers' Pension Plan, reaching a valuation of USD 32 billion. SBF became the public face of the cryptocurrency industry, testifying before the US Congress on regulatory matters, sponsoring a Major League Baseball stadium (renamed FTX Arena, in Miami), and running a Super Bowl advertisement. His stated philosophy of "effective altruism" – earning as much as possible in order to donate it – earned him favourable media coverage and political access.

Alongside FTX, SBF controlled Alameda Research, a quantitative trading firm he had co-founded in 2017. Alameda was supposed to be a separate entity that traded on FTX's platform alongside other customers. The relationship between the two firms would prove to be the centre of the fraud.

What Happened

On November 2, 2022, CoinDesk, a cryptocurrency news outlet, published an article based on a leaked balance sheet from Alameda Research. The balance sheet revealed that a large portion of Alameda's assets – approximately USD 5.8 billion of USD 14.6 billion in total – consisted of FTT, a token created by FTX itself. FTT's value depended entirely on FTX's continued success. Alameda's balance sheet was, in effect, circular: its largest asset was a token whose value was backed by nothing other than confidence in the company that created it.

On November 6, Changpeng Zhao (CZ), the CEO of Binance (the world's largest cryptocurrency exchange and an early investor in FTX), announced on Twitter that Binance would sell its entire FTT holdings – approximately USD 580 million worth. The announcement triggered a classic bank run. Over the next 72 hours, FTX customers withdrew approximately USD 6 billion from the exchange.

FTX could not honour the withdrawals. On November 8, SBF announced that Binance had agreed to acquire FTX, but Binance withdrew from the deal within 24 hours after reviewing FTX's finances. On November 11, FTX filed for Chapter 11 bankruptcy. John J. Ray III, a restructuring specialist who had previously overseen the Enron bankruptcy, was appointed CEO. His initial filing stated: "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."

The bankruptcy proceedings revealed that approximately USD 8 billion in customer funds were missing. The funds had been transferred from FTX to Alameda Research through a backdoor in FTX's accounting software. Alameda used the money to cover its own trading losses, make venture capital investments, purchase real estate, and fund political donations. FTX had no board of directors, no independent audit committee, and no chief financial officer. Corporate expenses were approved via emoji reactions in an online chat application. Accounting was done on QuickBooks, a software package designed for small businesses.

In November 2023, SBF was convicted on seven criminal counts including wire fraud, securities fraud, and money laundering. He was sentenced to 25 years in federal prison in March 2024. Several other FTX and Alameda executives, including Gary Wang and Caroline Ellison (Alameda's CEO), pleaded guilty and cooperated with prosecutors.

The Analysis

FTX was not a failure of technology. The exchange's trading engine worked. The matching algorithm worked. The mobile app worked. What failed was governance – the structures, controls, and accountability

mechanisms that are supposed to prevent the people running a financial institution from stealing customer money. This is the oldest problem in finance, and it is the reason the regulatory frameworks covered in M7 exist.

The case connects to M8's forward-looking question ("What comes next?") because FTX represented the most prominent argument that the future of finance would be built on crypto exchanges and decentralised technology. SBF explicitly positioned FTX as a responsible, regulated-friendly alternative to the "Wild West" reputation of earlier cryptocurrency platforms. The collapse demonstrated that without basic corporate governance – independent directors, segregated customer accounts, external audits, regulatory oversight – the label of innovation provides no protection.

Several features of the crypto industry's structure at the time enabled the fraud:

No segregation of customer funds. In traditional securities markets, customer assets are held separately from the broker's own assets, and this segregation is verified by regulators. FTX commingled customer deposits with its own trading operations through Alameda.

Regulatory arbitrage. FTX was incorporated in the Bahamas, beyond the reach of US securities regulators for most of its operations. The Bahamian Securities Commission had limited capacity to oversee an exchange of FTX's scale and complexity.

Vertically integrated structure. FTX was simultaneously the exchange, the market maker (Alameda), the token issuer (FTT), and the custodian of customer funds. In traditional finance, these functions are deliberately separated to prevent conflicts of interest.

Hype-driven due diligence. Venture capital firms invested USD 2 billion in FTX without identifying the absence of basic financial controls. Sequoia Capital's profile of SBF, published in late 2022, described him playing video games during a fundraising pitch and framed it as evidence of brilliance. The profile was later deleted.

The FTX collapse accelerated regulatory action worldwide. The EU's Markets in Crypto-Assets Regulation (MiCA), adopted in 2023, established licensing requirements for crypto exchanges operating in Europe. The US SEC increased enforcement actions against crypto platforms, and several countries banned or restricted offshore exchanges from serving their residents.

Discussion Questions

1. Using M8L4 (Future Synthesis), analyse how FTX's collapse affected public and regulatory attitudes toward cryptocurrency as a component of the future financial system.
2. FTX served as exchange, market maker, token issuer, and custodian simultaneously. Using the infrastructure separation concepts from M6L2 (Core Banking), explain why traditional finance separates these functions and what happens when they are combined.
3. Venture capital firms invested USD 2 billion without identifying the absence of a CFO, a board of directors, or audited financial statements. Connect this to the due diligence failures discussed in the Wirecard case (Case 1) and the risk measurement gaps in M4L3 (Institutional Risk).
4. If you were a regulator tasked with designing a licensing framework for cryptocurrency exchanges in 2021 (before FTX collapsed), what minimum requirements would you have imposed regarding customer fund segregation, governance, and auditing?
5. Could a platform with FTX's level of control over customer assets emerge again in a different sector of digital finance (e.g., tokenised securities, stablecoin issuers, DeFi front-ends), or have post-FTX regulations closed this gap?

Further Reading

- Ray, J. J. III (2022). *Declaration of John J. Ray III in Support of Chapter 11 Petitions.* US Bankruptcy Court, District of Delaware, Case No. 22-11068.
- US Department of Justice (2023). *United States of America v. Samuel Bankman-Fried.* Superseding Indictment, S6 22 Cr. 673 (LAK).
- Alloway, T. and Wile, R. (2023). "How FTX's Sam Bankman-Fried Stole Billions." *Bloomberg Businessweek*, October 2023.