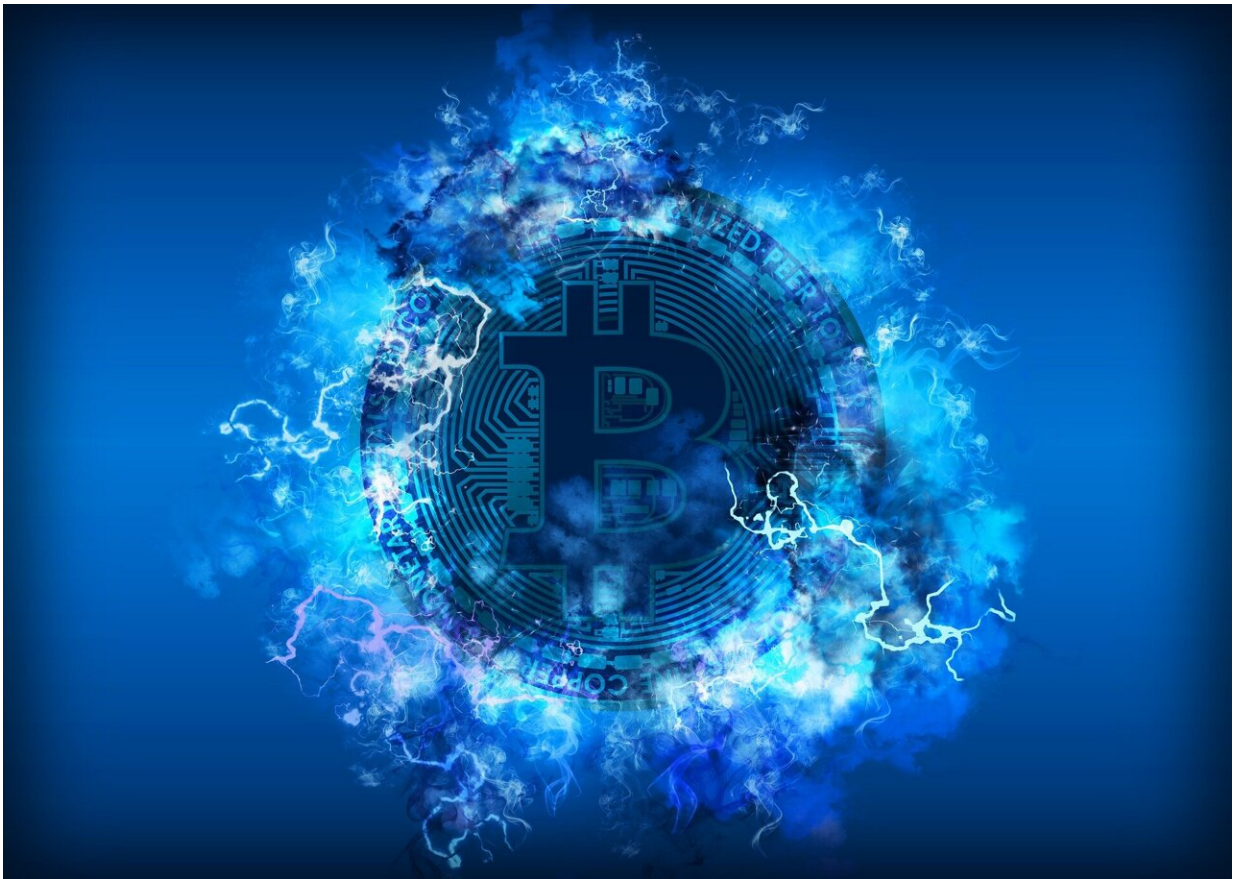


# What the FTX collapse means for the cryptocurrency market

December 2 2022, by Angie Basiouny

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Credit: Pixabay/CC0 Public Domain

When FTX founder Sam Bankman-Fried testified before a U.S. Senate committee in February—months before his cryptocurrency exchange

collapsed under the weight of his own financial misdeeds—Wharton legal studies and business ethics professor Kevin Werbach was also there.

Answering policymakers' questions about the risks faced by consumers in the cryptocurrency market, Werbach advocated for better regulatory frameworks and more funding for enforcement to fight crime in the digital space. Bankman-Fried also endorsed the idea of more oversight, although his comments to the committee now seem hypocritical. Once valued at \$32 billion, FTX has filed for bankruptcy after a run on deposits exposed a deep hole in the balance sheet, and Bankman-Fried has resigned amid accusations of fraud. A U.S. House committee hearing is scheduled for December.

"It's pretty shocking what has come out over the past several days with the collapse of FTX, and I'm sure there's a lot more yet to come," Werbach told Wharton Business Daily on SiriusXM. "In terms of business ethics, this is an easy one: Don't commit fraud, don't steal your customer's money, and don't use it for all sorts of personal ventures."

Werbach said the incident raises larger questions about what is happening on cryptocurrency exchanges and how they should be regulated to protect investors. Congress has been examining the issues for several years and some bills are pending, but the FTX case is likely to "light a fire" under policymakers to create a more formal and extensive regulatory structure, he said.

"I think seeing this catastrophe happening—when there's not a framework in the U.S. and when these exchanges set up and get very large overseas—is going to significantly ramp up the pressure to pass legislation here," Werbach said.

## **Who has jurisdiction over crypto?**

Digital assets are not entirely unregulated, but there is no formal structure at the federal level. The professor explained that the Securities and Exchange Commission regulates any investment that meets the definition of a security, and the agency has taken action against fraudulent offers of crypto and other [digital assets](#). Still, laws controlling securities aren't well-designed for digital assets.

"The SEC has been reluctant to be very explicit about what exactly makes a cryptocurrency token or digital asset a security," Werbach said. "They've been reluctant to say, "Here's a bright line," because I think they're worried that the moment they do that, everyone will try to get just slightly over that line."

Digital assets may be regulated by the independent Commodity Futures Trading Commission (CFTC), which has also taken action against some crypto exchanges in the U.S. and abroad. In 2021, a [federal court](#) ordered five companies operating the overseas-based BitMEX exchange to pay \$100 million after the CFTC filed charges of multiple violations.

During that same Senate committee hearing in February, CFTC Chairman Rostin Behnam asked Congress to grant his agency greater oversight, saying it was "well situated" to play a central role. But digital assets don't always fit neatly into the commodities bucket, Werbach said, which makes the question of who has authority even more unclear.

"The regime we have for commodities is designed for commodities trading, which are almost entirely institutional markets," Werbach said. "[There are] not a lot of individual retail investors who are active commodities traders. [There are] a lot of individual retail investors who are active traders of bitcoin and other digital assets. So, we need a clear legal regime that gives whoever the regulators are the ability and tools to have oversight. We need mechanisms to ensure that firms are transparent and provide disclosure."

He also said regulators will need to be aggressive because so much crypto activity involving American consumers is taking place overseas.

## **A problem across borders**

Werbach expects the future will bring greater global cooperation in regulating cryptocurrency. The European Union already has two frameworks in place, and the professor has run workshops at Wharton since 2017 with regulators from around the world to foster informal dialogue. "There also really needs to be coordination on enforcement to ensure that countries are not a safe haven and that there's that level of global cooperation," he said.

The rapid dissolution of FTX made headlines this month, but the company is not the only exchange to be accused of fleecing investors. Because there are so many opaque actors in the digital assets space, "we don't know the extent of the contagion. We don't really know who basically has a hole in their balance sheet that they've been covering because of FTX or because of the earlier blowups," Werbach said, noting the previous collapses of Celsius, Three Arrows Capital, and Terra Luna.

"I'm worried that there is a lot more yet to come," he said.

Provided by University of Pennsylvania

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