Sam Bankman-Fried was convicted of fraud. Here's what cryptocurrency investors need to know

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In the fast-paced world of cryptocurrency, vast sums of money can be made or lost in the blink of an eye. In early November 2022, the crypto exchange FTX was valued at over US$30 billion. By the middle of that month, FTX was in bankruptcy proceedings. And less than a year later, on Nov. 3, 2023, its founder, Sam Bankman-Fried, was found guilty of seven counts of money laundering and fraud, following a trial that featured less than a month of testimony and only about four hours of jury deliberation.

D. Brian Blank *and* Brandy Hadley *are professors who study finance,* executives, firm governance *and fintech. They explain how and why this incredible collapse happened, what effect it might have on the traditional financial sector, and whether you should care.*

1. What happened?

A million years ago, back in 2019, Sam Bankman-Fried founded FTX, a company that ran one of the largest cryptocurrency exchanges.

FTX was where many crypto investors traded and held cryptocurrency, similar to the New York Stock Exchange for stocks. Bankman-Fried also founded Alameda Research, a hedge fund that invested in cryptocurrencies and crypto companies.

In the traditional financial sector, these two companies would be entirely separate firms or at least have firewalls to avoid conflicts of interest. But in early November 2022, news outlets reported that a significant proportion of Alameda's assets was a type of cryptocurrency released by FTX itself.

A few days later, news broke that FTX had allegedly been loaning customer assets to Alameda for risky trades without customers' consent and also issuing its own FTX cryptocurrency for Alameda to use as collateral. As a result, criminal and regulatory investigators began scrutinizing FTX for potentially violating securities law.

These two pieces of news led to a bank run on FTX, and soon afterward, FTX, Alameda Research, and 130 other affiliated companies founded by Bankman-Fried filed for bankruptcy. This left huge numbers of investors who bought cryptocurrencies through the exchange with no good way to get their money back.

Within a month, Bankman-Fried was arrested and charged with wire fraud, wire fraud conspiracy, securities fraud, securities fraud conspiracy and money laundering by the Southern District of New York. In February 2023, additional criminal charges related to political donations were announced, followed by another indictment in March related to bribery.

Bankman-Fried's first trial began on Oct. 3, 2023, , and largely focused on the "essentially unlimited" access to capital Alameda had on the exchange through a secret line of credit. The trial ended on Nov. 3, with Bankman-Fried convicted of seven counts of fraud and money laundering. He is expected to appeal.

2. Did a lack of oversight play a role?

In traditional markets, corporations generally limit the risk they expose themselves to by maintaining liquidity and solvency. Liquidity is the ability of a firm to sell assets quickly without those assets losing much value. Solvency is the idea that a company's assets are worth more than what that company owes to debtors and customers.

But the crypto world has generally operated with much less caution than the traditional financial sector, and FTX is no exception. About two-thirds of the money that FTX owed to the people who held cryptocurrency on its exchange—roughly $11.3 billion of $16 billion owed—was backed by illiquid coins created by FTX. FTX was taking its customers' money, giving it to Alameda to make risky investments, and then creating its currency, known as FTT, as a replacement—a cryptocurrency that it could not sell at a high enough price when it needed to.

In addition, nearly 40% of Alameda's assets were in FTX's cryptocurrency—and remember, the same person founded both companies.

This all came to a head when investors decided to sell their coins on the exchange. FTX did not have enough liquid assets to meet those demands. This in turn drove the value of FTT from over $26 a coin at the beginning of November 2022 to under $2 by Nov. 13. By this point, FTX owed more money to its customers than it was worth.

In regulated exchanges, investing with customer funds is illegal. Additionally, auditors validate financial statements, and firms must publish the amount of money they hold in reserve that is available to fund customer withdrawals. And even if things go wrong, the Securities Investor Protection Corporation—or SIPC—protects depositors against the loss of investments from an exchange failure or financially troubled brokerage firm. The crypto world lacks such guardrails.

3. Why is this a big deal in crypto?

While the collapse of FTX and Alameda—valued at more than $30 billion and now essentially worth nothing—was dramatic, the bigger implication is simply the potential lost trust in crypto. Bank runs are rare in traditional financial institutions, but they are increasingly common in the crypto space. Since Bankman-Fried and FTX were seen as some of the biggest, most trusted figures in crypto, these events may lead more investors to think twice about putting money in crypto.

4. If I don't own crypto, should I care?

Though investment in cryptocurrencies has increased, the entire crypto market—valued at over $3 trillion at its peak—is much smaller than the $120 trillion traditional stock market.

While investors and regulators are still evaluating the consequences of this fall, the impact on any person who doesn't personally own crypto will be minuscule. It is true that many larger investment funds, like BlackRock and the Ontario Teachers Pension, held investments in FTX. Still, the estimated $95 million the Ontario Teachers Pension lost through the collapse of FTX is just 0.05% of the entire fund's investments.

The takeaway for most individuals is not to invest in unregulated markets without understanding the risks. In high-risk environments like crypto, it's possible to lose everything—a lesson investors in FTX learned the hard way.

5. What does the trial reveal about the regulatory environment for crypto?

The trial of Bankman-Fried has brought attention to the ever-evolving and complex nature of cryptocurrency regulation and oversight. After the case, Damian Williams, the federal prosecutor for the U.S. Justice Department, underlined the department's dedication to fighting fraud, even in the relatively new crypto space.

This case shows that the U.S. is willing to assert broad jurisdiction over financial crimes targeting its citizens, regardless of where the perpetrating company is based—which, in FTX's case, was the Bahamas. Notably, this trial did not fall directly under the supervision of the Securities and Exchange Commission or other regulatory bodies. However, pending civil cases from both the SEC and the Commodity Futures Trading Commission, along with ongoing class-action lawsuits, underscore the complexities in regulating the cryptocurrency sphere.

Despite a recent crypto crackdown by the SEC, the U.S. continues to lag behind other nations in establishing comprehensive crypto regulations. This is evident in the formal regulatory frameworks introduced by places such as the U.K. and the European Union. The International Monetary Fund's call for comprehensive regulations further underscores the necessity for more robust regulatory measures within the crypto industry, hinting at a widening gap between the U.S. and much of the rest of the world.

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