

Update on the FTX Crypto Empire

Published December 16, 2022

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The [collapse of FTX/Alameda Research](#) put the digital assets industry in a state of shock, and reverberations are still being felt. Although the failure of a centralized counterparty behaving badly and operating in a lightly regulated offshore environment had nothing to do with digital assets, blockchain or cryptocurrencies failing, the interdependence among crypto companies remains strong, and contagion fears still abound.

Two weeks ago, Sam Bankman-Fried (SBF), the ex-CEO of FTX, gave a number of interviews stating that he did not intend to commit fraud and denied improper use of customer funds. The fact remains, however, that an estimated \$8 billion of customer funds went missing at FTX.

On the 12th of December, at the request of the US government, SBF was arrested by the Bahamian authorities and US prosecutors filed eight-count indictment against him. These charges include wire fraud, wire fraud conspiracy, securities fraud, securities fraud conspiracy and money laundering.

Centralized Exchanges That Show Proof of Reserves and Liabilities Will Benefit

There is now increased scrutiny being placed on centralized exchanges, particularly those operating offshore, but others as well. Demands are rising that centralized exchanges should provide proof of reserves and liabilities. The assets side would indicate which coins and tokens are held by the exchange, while the liabilities side would show the investor deposits. Both sides are important. Regular full independent audits, potentially conducted unexpectedly, would assuage fears that transfers of assets could take place to cover finance gaps and improve confidence among investors. What might still be left unaccounted for are off-balance sheet liabilities, which would continue to be difficult to track. It is possible that proof of reserves and liabilities will become the norm in the industry, benefiting those companies willing to be transparent about their assets and liabilities.

Many believe decentralized finance (DeFi) is the solution, but we believe the centralized exchanges will continue to play a significant role in the near future, as they have convenient on/off-ramps for digital assets and have established KYC1 and AML2 procedures in place.

The Role of Insiders in Token Issuance and Trading Needs to Be Scrutinized More Fully

The close connection between Solana and FTX and the rise and fall of the Solana token have led to increased scrutiny on layer 1 solutions, and questions are being asked about the viability of some of them. A particularly important area to investigate is the role of insiders in token issuance, the amount of issuance in public hands and the amount of true trading that stems from genuine usage of tokens and not from insider trading.

SBF was a big proponent of the Solana network and its native token, SOL, which has dropped -95%³ since November 2021. While part of this price turbulence is most likely related to FTX, we still see an active ecosystem around Solana.

For the moment, the Ethereum blockchain continues to have the widest developer community supporting the network and a vibrant ecosystem supporting both DeFi and non-fungible tokens (NFTs), although volumes have been dismal lately.

Bitcoin Miners under Pressure

Another group of companies we are actively monitoring is the bitcoin miners. Some of them have been operating at a loss for a few months now, and if the bitcoin price were to drop further, many of them would be in great distress. Some bitcoin miners have high debt levels, and rising interest rates and energy costs are putting pressure on margins. Bitcoin miners using renewable energy sources might be in a better position than others to deal with high energy costs.

Will Genesis Fail Too, and Will More Bitcoin Come to the Market, Depressing Prices?

We are also closely following the developments at Genesis, a major crypto prime broker and trading and lending firm and a wholly owned subsidiary of Digital Currency Group (DCG), one of the most powerful conglomerates in the crypto industry. In November, the lending arm of Genesis suspended redemptions and new loan originations, and several of Genesis Global Trading's creditors have hired restructuring lawyers to help prevent the bankruptcy. We have learned that Genesis owes funds to several parties, one of them being Gemini, which seeks to recover \$900 million from Genesis and DCG, and another unidentified party that is also owed \$900 million.⁴ The finance hole, therefore, seems to amount to at least \$1.8 billion.

DCG has also disclosed a \$2 billion intercompany debt between it and its subsidiary Genesis Global Capital. It seems that DCG currently owes \$575 million to Genesis, with payment due in May 2023. We believe this loan was possibly made to fund investment opportunities and repurchase stock from shareholders at Greyscale, another DCG company. There is a potential maturity mismatch here as this loan seems to be a short-term loan; however, private investments typically take years to come to fruition. In addition, DCG has a \$1.1 billion promissory note to Genesis (due in 2032) as a result of assuming Genesis's liabilities following the Three Arrows Capital collapse earlier in 2022 and a \$350 million credit facility from a group of lenders led by Eldridge.⁵

Perhaps more importantly, Greyscale's Bitcoin Trust currently has more than \$10 billion in assets under management, and this amounts to at least 600,000 bitcoins.⁶ The Greyscale Bitcoin Trust currently trades at a more than 40% discount to its net asset value. If DCG had to liquidate part of the Trust's bitcoin, it would have a significant impact on the bitcoin price and the crypto market in general. It is estimated that DCG and its affiliates currently own approximately 10% of the Greyscale Bitcoin Trust.⁷

Our Near-Term Outlook for the Crypto Industry

2022 has seen a significant decline in prices for digital assets. We believe that, in the short term, uncertainty is likely to continue as the industry tries to figure out which companies might still be impacted by the FTX/Alameda collapse.

The greatest casualty of the recent blow-up is perhaps investor confidence, which now must be rebuilt by cleaning up opaque business practices and increasing transparency into the assets and liabilities of the crypto companies.

Mirva Anttila is an employee of WisdomTree UK Limited, a European subsidiary of WisdomTree Asset Management Inc.'s parent company, WisdomTree Investments, Inc.

1 KYC refers to know your customer.

2 AML refers to anti-money laundering.

3 Bloomberg, 12/4/22.

4 Financial Times, 12/3/22.

5 Wall Street Journal, 11/22/22.

6 Digital Currency Group, Bloomberg

7 Coindesk

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