

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

December 8, 2022

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: December 13, 2022, Full Committee Hearing entitled, “Investigating the Collapse of FTX, Part I”

The full Committee will hold a hearing entitled, “Investigating the Collapse of FTX, Part I” on Tuesday, December 13 at 10 a.m. ET in room 2128 of the Rayburn House Office Building/ Cisco Webex. This hearing will have one panel with the following witness:

- **John J. Ray III**, Chief Executive Officer, FTX Group

Background

FTX, a global cryptocurrency trading platform (or crypto exchange), was co-founded by former Chief Executive Officer (CEO) Sam Bankman-Fried and former Chief Technology Officer (CTO) Gary Wang in 2019.¹ FTX allowed users to buy, sell, hold, and lend many cryptocurrencies, as well as trade on margin derivatives of these cryptocurrencies.² FTX, at its peak, was the third-largest crypto exchange in terms of daily trading volume (behind Binance and Coinbase).³ The main FTX exchange was valued at \$32 billion at its recent funding rounds in January and in the fall of 2022.⁴ FTX is headquartered in the Bahamas and was previously headquartered in Hong Kong.⁵ FTX engaged with U.S. customers via a separate entity, FTX.US, which was valued at \$8 billion,⁶ although it has been reported that U.S. customers may have also engaged with the non-US FTX exchange using virtual private networks.⁷ Mr. Bankman-Fried was also the owner and founder of Alameda Research (Alameda), an unregistered crypto-asset trading and venture capital firm, founded in 2017.⁸

Crypto exchanges often offer their own cryptocurrencies, known as exchange tokens,⁹ in order to distinguish themselves from other competitors. Exchange tokens can offer a range of benefits including trading fee discounts, rebates, and early access to token sales.¹⁰ Like other centralized cryptocurrency exchanges,¹¹ FTX created its own exchange token called FTT.¹² The FTT token debuted in 2019 and a

¹ [FTX Celebrates Two-Year Anniversary](#), FTX International (May 10, 2022); [Who Is Gary Wang, the Mysterious Co-Founder of FTX and Alameda?](#), CoinDesk (Nov. 22, 2022).

² [A Quick Guide to FTX Crypto Exchange and Its Top Features](#), Bein Crypto (Mar. 9, 2022).

³ Daily trading volume is measured for the previous 24 hours on any given date. For example, FTX had a trading volume of more than \$1.5 billion on August 22, 2022, measured for the previous 24 hours. See [Crypto Exchange FTX's Revenue Soared 1,000% in 2021: Report](#), Decrypt (Aug. 22, 2022).

⁴ [Cryptocurrency exchange FTX hits \\$32 billion valuation despite bear market fears](#), CNBC (Jan. 31, 2022).

⁵ [Bankman-Fried's Crypto Exchange FTX Leaves Hong Kong for Bahamas](#), Bloomberg (Sept. 24, 2021).

⁶ [Coinbase rival FTX U.S. valued at \\$8 billion as investors brace for 'crypto winter'](#), CNBC (Jan. 26, 2022).

⁷ See [U.S. Crypto Traders Evade Offshore Exchange Bans](#), Wall Street Journal (Jul. 30, 2022).

⁸ [A closer look at Sam Bankman-Fried's Alameda Research and twentysomething CEO Caroline Ellison](#), Fortune (Nov. 13, 2022).

⁹ [What Is an Exchange Token?](#), CoinDesk (Nov. 9, 2022).

¹⁰ *Id.*

¹¹ A centralized cryptocurrency exchange can be understood as “a company [in the digital assets ecosystem] with an executive team and structure similar to a traditional finance company, that maintains an order book of buyers and sellers.” See [What Is an Exchange Token?](#), CoinDesk (Nov. 9, 2022).

¹² FTT is not available to trade or invest in by those using the FTX.US platform. See FTX, [FTT Transparency Page](#) (accessed Dec. 5, 2022).

few years later was valued at approximately \$80.¹³ The discounted trading fees benefited traders using the FTX platform and FTX offered users holding over \$100 worth of FTT a 3% discount when trading on the exchange.¹⁴ On the FTX website, FTT was described as “the backbone of the FTX ecosystem,”¹⁵ yet customers were not aware that tens of millions of those tokens were not widely distributed, which would impair the market’s ability to price or value the token.¹⁶ Ultimately, a large, previously unknown, amount of FTT belonged to FTX, and appears to have been valued on the FTX balance sheet using the public FTT value, which was based on the smaller known number of tokens.¹⁷ Additionally, FTX’s balance sheet was also propped up by tokens FTX received as collateral from Alameda when Alameda borrowed billions from FTX. These tokens, Serum, Oxygen, Maps, and Bonfida, were issued by affiliates of Mr. Bankman-Fried¹⁸ and were controlled by him or Alameda Research. The four tokens were likely worth much less than the FTX balance sheet entry of \$6.4 billion.¹⁹

Neither the main FTX exchange nor FTX.US were registered and overseen by the SEC or CFTC. However, FTX.US was registered as a Money Services Business (MSB) with the Treasury Department’s Financial Crimes Enforcement Network (FinCEN), and FTX listed almost all states as “States of MSB Activities,” excluding New York.²⁰ FTX US Derivatives was registered with CFTC since 2017 as a designated contract market (DCM), swap execution facility (SEF), and derivatives clearing organization (DCO).²¹ This allowed FTX to operate a derivatives trading platform in the U.S. in addition to crypto-asset trading. FTX.US, through acquisitions, also owned FTX Capital Markets, LLC, which is an SEC-registered broker-dealer and Embed Clearing LLC, a securities clearing firm registered with the SEC.²² Another entity owned and controlled by FTX was LedgerPrime, which (until November 8, 2022) was registered with the SEC as an investment adviser.²³

Overview of Events

On November 2, the crypto media platform, CoinDesk, reported a leaked balance sheet from Alameda,²⁴ that showed that \$3.66 billion of its \$14 billion in assets were “unlocked FTT.”²⁵ \$2.16 billion were listed as “FTT collateral,” meaning that over \$5 billion of the company’s assets held in FTT.²⁶ On November 6, in response to reporting that suggested FTX’s potential insolvency, Alameda CEO Caroline Ellison tweeted that the “balance sheet info which has been circulating recently” showed only a subset of Alameda’s corporate entities.²⁷ Later that morning, Mr. Zhao, founder and CEO of Binance, tweeted that Binance would liquidate its holdings of FTT “due to recent revelations that have come to light.”²⁸ Then Ms. Ellison offered to buy all of Binance’s FTT holdings for \$22 per share.²⁹ OtherFTT holders started to sell, and FTX reportedly experienced \$5 billion in exchange withdrawals.³⁰

¹³ [FTX made a cryptocurrency that brought in millions. Then it brought down the company](#), NPR (Nov. 15, 2022).

¹⁴ [What Is an Exchange Token?](#), CoinDesk (Nov. 9, 2022).

¹⁵ [FTX made a cryptocurrency that brought in millions. Then it brought down the company](#), NPR (Nov. 15, 2022).

¹⁶ *Id.*

¹⁷ [FTX’s Balance Sheet Was Bad](#), Bloomberg (Nov. 14, 2022).

¹⁸ [FTX Effort to Save Itself Failed on Questionable Assets](#), The Wall Street Journal (Dec. 5, 2022).

¹⁹ *Id.*

²⁰ West Realm Shires Services Inc. is the name of the FTX business which operated FTX.US. See Financial Crimes Enforcement Network, [MSB Registrant Search](#) (MSB Registration Number: 31000227230547) (accessed Dec. 5, 2022).

²¹ [FTX US Finalizes Acquisition of LedgerX](#), FTX.US (Oct. 25, 2021).

²² [FTX US Launches FTX Stocks Offering Trading on US Listed Equities & EFTs](#), FTX.US (May 19, 2022).

²³ [Form ADV](#), LedgerPrime (Jul. 13, 2022).

²⁴ [Divisions in Sam Bankman-Fried’s Crypto Empire Blur on His Trading Titan Alameda’s Balance Sheet](#), CoinDesk (Nov. 2, 2022).

²⁵ *Id.*

²⁶ *Id.*

²⁷ Twitter, [Ms. Ellison’s Tweet re: Balance Sheet](#) (Nov. 6, 2022).

²⁸ Twitter, [Mr. Zhao’s Tweet re: FTT Liquidation](#) (Nov. 6, 2022).

²⁹ [Binance CEO Goes Full FUD in Attempt to Bury FTX](#), BlockWorks (Nov. 7, 2022).

³⁰ [FTX held less than \\$1bn in liquid assets against \\$9bn in liabilities](#), Financial Times (Nov. 6, 2022).

By the close of November 8, the price of FTT had dropped below \$5 per token³¹ and FTX reportedly sought more than \$1 billion, and possibly up to \$6 billion, from investors, before turning to Binance for possible acquisition.³² Mr. Zhao tweeted that there was “a significant liquidity crunch” at FTX and, in order to protect users, Binance had signed a nonbinding letter of intent to acquire FTX.com, which would not include FTX.US.³³ Detailed terms were not publicly disclosed. Mr. Bankman-Fried announced that withdrawals from the FTX platform were effectively paused.³⁴

On November 9, Binance announced that it was not going through with the purchase of FTX “as a result of corporate due diligence, as well as the latest news reports regarding mishandled customer funds and alleged U.S. agency investigations.”³⁵ On November 10, the Securities Commission of the Bahamas froze the assets of the FTX subsidiary in the Bahamas, FTX Digital Markets (FDM), including those of customers and trust.³⁶ Mr. Bankman-Fried also tweeted that “FTX US, the US based exchange that accepts Americans, was not financially impacted . . . Every user could fully withdraw.”³⁷

On November 11, FTX commenced voluntary proceedings under Chapter 11 of the United States Bankruptcy Code in Delaware.³⁸ Named in the proceedings were FTX.US, Alameda, and more than 130 affiliated companies.³⁹ FTX also announced that Mr. Bankman-Fried had resigned as CEO and John J. Ray III was the incoming CEO.⁴⁰ Mr. Ray had previously worked on many large corporate bankruptcies, including Enron’s liquidation.⁴¹

On November 12, reporting indicated that over \$663 million in funds were removed from FTX and FTX.US crypto wallets, and \$447 million was believed to have been removed by a hack.⁴² While it was later revealed that the Securities Commission of the Bahamas, where FTX is headquartered, claimed that it had instructed individuals to move funds from FDM to a Commission wallet for safekeeping,⁴³ the full scope of funds and whether there was an additional hack have not been verified.

On November 14, court filings from the bankruptcy proceedings indicate that FTX has over one million creditors, which include U.S.-based customers.⁴⁴ FTX has between \$10 billion and \$50 billion in liabilities.⁴⁵ On November 15, FDM filed for Chapter 15 bankruptcy protection in the Southern District of New York (SDNY)⁴⁶ and later filed an emergency motion to transfer the proceeding to Delaware.⁴⁷ Additional court filings from the bankruptcy proceedings on November 17 noted that Alameda’s assets

³¹ Coin Market Cap, [FTX Token FTT](#) (accessed Dec. 5, 2022).

³² [Sam Bankman-Fried Reportedly Waned \\$6 Billion From Wall Street & Silicon Valley Billionaires](#), Ethereum World News (Nov. 8, 2022).

³³ Twitter, [Mr. Zhao’s Tweet re: Non-Binding LOI](#) (Nov. 8, 2022).

³⁴ [FTX Exchange Halts All Crypto Withdrawals](#), CoinDesk (Nov. 9, 2022).

³⁵ Twitter, [Binance’s Tweet re: FTX Acquisition](#) (Nov. 9, 2022).

³⁶ Securities Commission of The Bahamas, [Securities Commission of The Bahamas Freezes Assets of FTX](#) (Nov. 10, 2022).

³⁷ Twitter, [Mr. Bankman-Fried’s Tweet re: FTX US](#) (Nov. 10, 2022).

³⁸ [Voluntary Petition for Non-Individuals Filing for Bankruptcy](#) (Nov. 11, 2022), Bankr. D. Del. (22-11066).

³⁹ *Id.*

⁴⁰ Twitter, [FTX Press Release re: Chapter 11 Bankruptcy Proceedings](#) (Nov. 11, 2022).

⁴¹ [From Enron to FTX](#), CoinDesk (Nov. 11, 2022).

⁴² [\\$477 Million in “Unauthorized Transfers” from FTX](#), Elliptic (Nov. 20, 2022).

⁴³ Securities Commission of The Bahamas, [Securities Commission of The Bahamas Assumes Control of Assets of FTX Digital Markets Ltd.](#) (Nov. 17, 2022).

⁴⁴ [Motion of Debtors for Entry of An Order \(I\) Modifying Certain Creditor List Requirements: \(II\) Authorizing the Debtors to Serve Certain Parties by E-Mail; and \(III\) Granting Related Relief](#) (Nov. 14, 2022), *In re: FTX Trading Ltd., et al.* Bankr. D. Del. (No. 22-11068).

⁴⁵ [Sam Bankman-Fried steps down as FTX CEO as his crypto exchange files for bankruptcy](#), CNBC (Nov. 11, 2022). [Sam Bankman-Fried steps down as FTX CEO as his crypto exchange files for bankruptcy](#), CNBC (Nov. 11, 2022).

⁴⁶ [FTX Bahamas Unit Files for Chapter 15 Bankruptcy in New York](#), Bloomberg (Nov. 16, 2022).

⁴⁷ [Emergency Motion Pursuant to Fed. R. Bankr. P. 1014\(B\) \(I\) To Transfer Chapter 15 Proceeding Relating To FTX Digital Markets Ltd. and \(II\) For a Stay](#) (Nov. 11, 2022), *In re: FTX Trading Ltd., et al.* Bankr. D. Del. (No. 22-11068).

involved loans to FTX executives, including \$1 billion to Mr. Bankman-Fried, \$543 million to Nishad Singh, and \$55 million to Ryan Salame.⁴⁸

As bankruptcy hearings and court filings continued, Mr. Bankman-Fried spoke with journalists and conducted interviews. In a 90-minute live interview at the November 30, New York Times' DealBook Summit, Mr. Bankman-Fried conceded to various FTX failures including management failures, oversight failures, and transparency failures.⁴⁹

Use of Customer Assets

FTX.com's terms of service with users said it would not trade customer funds.⁵⁰ Mr. Bankman-Fried also tweeted indicating this was true on November 7, stating that FTX did not "invest client assets (even in treasuries)."⁵¹ However, FTX lent out \$10 billion in customer assets for proprietary trading with Alameda, and reports indicate over \$1 billion is missing.⁵² An attorney for FTX said during the first bankruptcy hearing on November 22 that "[a] substantial amount of assets have either been stolen or [are] missing" and that "substantial funds appear to have been transferred from other silos to Alameda."⁵³

Risk Management Failures

Several commentators, in addition to Mr. Bankman-Fried, have suggested a complete absence of any risk management at FTX. In a December 1 interview with ABC News where Mr. Bankman-Fried admitted that if he had spent "an hour a day" thinking about risk management, he could have prevented FTX's collapse.⁵⁴ He claimed, "I wasn't even trying. I wasn't spending any time or effort trying to manage risk on FTX."⁵⁵ Further information, made public through the FTX bankruptcy filing, showed that neither FTX nor Alameda had an accounting department⁵⁶ and that FTX expenses, including large transactions between FTX-owned entities and high-value executive expense reports, were approved in chat messages with emojis, rather than formal processes.⁵⁷

Investigations and Lawsuits

Prior to filing for bankruptcy, on November 9, there were several reports that the Department of Justice (DOJ), Securities and Exchange Commission (SEC), Commodities and Futures Trading Commission (CFTC), and SDNY have ongoing investigations into FTX.⁵⁸ On November 21, the SDNY U.S. Attorney's Office announced that FTX was part of a broad investigation into crypto platforms that it had been conducting for "several months."⁵⁹ On November 16, a class action lawsuit in the U.S. District Court for the Southern District of Florida seeking \$11 billion in damages was filed against Mr. Bankman-Fried and various celebrities who endorsed FTX.⁶⁰ On November 29, the day after filing for bankruptcy,

⁴⁸ [Declaration of John J. Ray III in Support of Chapter 11 Petitions and First Day Pleadings](#) (Nov. 17, 2022), *In re: FTX Trading Ltd., et al.* Bankr. D. Del. (No. 22-11068).

⁴⁹ [Legal professionals astonished as SBF admits failures, apologizes 12 times in interview](#), CoinTelegraph (Dec. 1, 2022).

⁵⁰ [FTX's terms-of-service forbid trading with customer funds](#), AXIOS (Nov. 13, 2022).

⁵¹ [Inside SBF's Now-Deleted Tweets: Clients' Assets, Tom Brady and Binance's CZ](#), CryptoNews (Nov. 15, 2022).

⁵² [Wave of lawsuits over FTX expected, but investors will face legal hurdles](#), Reuters (Nov. 17, 2022).

⁵³ [FTX lawyer calls this case 'a different sort of animal' in first bankruptcy hearing](#), CNBC (Nov. 22, 2022).

⁵⁴ [Former FTX CEO says he 'wasn't even trying' to manage risk](#), GMA (Nov. 30, 2022).

⁵⁵ *Id.*

⁵⁶ [FTX and Alameda Research didn't have their own accounting department - and it's impossible to rely on any of their financials, bankruptcy filing says](#), Markets Insider (Nov. 17, 2022).

⁵⁷ [FTX employees were claiming expenses through online chat and random managers used emojis to approve them, new CEO says in bankruptcy filings](#), Business Insider (Nov. 18, 2022).

⁵⁸ [SEC, DOJ Investigating Crypto Platform FTX](#), The Wall Street Journal (Nov. 9, 2022); [Report: SEC and CFTC Investigating Crypto Exchanges FTX and FTX US](#), PYMNTS (Nov. 9, 2022).

⁵⁹ [US Prosecutors Opened Probe of FTX Months Before Its Collapse](#), Bloomberg (Nov. 21, 2022).

⁶⁰ [Tom Brady, Gisele Bündchen, Kevin O'Leary, and 9 Other Celebrities Named in FTX-Related Class-Action Lawsuit](#), Bitcoin.com (Nov. 16, 2022).

BlockFi sued Mr. Bankman-Fried over Robinhood shares that he allegedly pledged to them as collateral days before FTX failed.⁶¹

Impacts on the Crypto Industry and Beyond

Earlier this year, crypto firms were managing the downturn in the crypto market—for example, Bitcoin and Ethereum, two prominent cryptocurrencies, were down 70% and 77% respectively as of June 2022.⁶² Due in part to this exposure to FTX, on November 11, cryptocurrency platform BlockFi paused client withdrawals.⁶³ Less than three weeks later, on November 28, BlockFi filed for Chapter 11 protection in New Jersey bankruptcy court.⁶⁴ On November 16, Genesis, another crypto lender with exposure to FTX, temporarily suspended customer withdrawals and new loan origination.⁶⁵ Over November 12 and 13, Crypto.com, another firm with exposure to FTX, saw withdrawals increase and its native crypto token dropped 28% to a 22-month low.⁶⁶ Bank regulators have indicated that damage has been limited to the crypto industry and has not spread to the banking system, as regulated financial institutions have limited exposure to digital assets.⁶⁷

Regulatory Structure

SEC Chair Gary Gensler has maintained, through application of the U.S. Supreme Court’s *Howey* test, that most crypto tokens are securities, and “it follows that many crypto intermediaries are transacting in securities and have to register with the SEC in some capacity.”⁶⁸ Chair Gensler has also recently said that the crypto industry is “significantly non-compliant” with these regulations.⁶⁹ Similarly, former SEC Chair Jay Clayton, who said when speaking about initial coin offerings, “I believe every initial coin offering (ICO) I’ve seen is a security.”⁷⁰ The SEC has published a Framework for “Investment Contract” Analysis of Digital Assets that outlines how to analyze whether digital assets are securities, identifying the three prongs of the *Howey* test: 1) investment of money in a 2) common enterprise with a 3) reasonable expectation of profits to be derived from the efforts of others.⁷¹ On November 7, 2022, a federal judge agreed with this viewpoint in *SEC v. LBRY, Inc.*, finding that LBRY offered and sold the LBC crypto asset as a security and that in using the *Howey* test “the SEC had based its claim on a straightforward application of a venerable Supreme Court precedent that has been applied by hundreds of federal courts across the country over more than 70 years.”⁷²

State financial industry regulators have applied a patchwork of existing regulations to digital assets, including cryptocurrencies, and digital asset exchanges.⁷³ In addition, cryptocurrency exchanges like FTX, which allow for trading in digital assets and their derivative contracts, may hold licenses at the state level and have registered with FinCEN as money services businesses.⁷⁴

⁶¹ [Bankrupt Crypto Lender BlockFi Sues Bankman-Fried for Robinhood Shares](#), FT Reports, CoinDesk (Nov. 29, 2022).

⁶² [FTX boss Sam Bankman-Fried has bailed out struggling crypto lender BlockFi with a \\$250 million loan](#), Markets Insider (June 22, 2022).

⁶³ [Crypto Lender BlockFi Suspends Withdrawals in FTX Contagion](#), Bloomberg (Nov. 10, 2022).

⁶⁴ [Crypto firm BlockFi files for bankruptcy as FTX fallout spreads](#), CNBC (Nov. 28, 2022).

⁶⁵ [Genesis crypto lending arm suspends customer withdrawals after FTX meltdown](#), Fox Business (Nov. 6, 2022).

⁶⁶ [Crypto.com native token plummets as FTX collapse fuels contagion fears](#), Yahoo! (Nov. 13, 2022).

⁶⁷ See House Committee on Financial Services, [Testimony of Acting Comptroller of the Currency Michael J. Hsu, Oversight of Prudential Regulators](#), 117th Cong. (Nov. 16, 2022); [FTX contagion would be worse if banks were ‘dangerously intertwined’ with crypto](#), The Block (Nov. 30, 2022).

⁶⁸ [Gensler: It’s time for crypto businesses to register with SEC](#), Protocol (Sept. 8, 2022).

⁶⁹ [SEC Chair Gary Gensler Speaks with CNBC’s ‘Squawk Box’ Today](#), CNBC (Nov. 10, 2022).

⁷⁰ Senate Committee on Banking, Housing, and Urban Affairs, [Testimony of SEC Chairman Jay Clayton, Virtual Currencies](#), 115th Cong. (Feb. 6, 2018).

⁷¹ SEC, [Framework for ‘Investment Contract’ Analysis of Digital Assets](#) (accessed Dec. 5, 2022).

⁷² [Memorandum and Order](#) (Nov. 7, 2022), *SEC v. LBRY, Inc.*, D.N.H. (No. 1:21-cv-00260).

⁷³ See [Cryptocurrency Laws and Regulations by State](#), Bloomberg Law (May 26, 2022).

⁷⁴ West Realm Shires Services Inc. is the name of the FTX business which operated FTX.US. See Financial Crimes Enforcement Network, [MSB Registrant Search](#) (MSB Registration Number: 31000227230547) (accessed Dec. 5, 2022).