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*Journalist:* Ladies and gentlemen, thank you for joining us today to discuss the factors that led to the downfall of one of the most promising crypto exchanges - FTX. Please allow me to introduce our esteemed panelists – Tech and Non-Tech. First and foremost a question to both of you - how did it happen that investors were putting money into FTX without noticing the issues the exchange had?

*Non-Tech:* Few could have even imagined that charismatic person like Sam Bankman-Fried (SBF) would be involved in unethical activities, especially when he was placed among the pioneers in the crypto world. Not to mention that no one even doubted the noble cause promoted by SBF just like in the famous Charitable Corporation Scandal from 18<sup>th</sup> century.

*Tech:* Indeed. Yet, apart from SBF there were other significant catalysts. On corporate level – lack of sufficient oversight, and on industry level – confusion about which authority - SEC, CFTC, IRS, or the Federal Reserve should be supervising FTX. As a result, FTX successfully concealed transactions with its affiliated entity, Alameda.

*Journalist:* Tech, can you elaborate on specific regulations that should have been involved?

*Tech:* Sure. The main business of FTX is equivalent to securities broker-dealer which are heavily regulated in the US under the Securities Act of 1934, Rule 15c3-1, known as the "net capital rule." According to this rule, broker dealers are required to have certain amount of net capital based on the asset and volumes traded. For instance, for commodities, CFTC require registration as a “futures commissions merchant” (FCM). According to CFTC 1.17(a)1(i), FCMs are required to have minimum \$1 million net capital. Given the extreme volatility of crypto currencies and the volumes treated by FTX, the minimum requirement should have been substantial. Furthermore, If FTX has been regulated as broker dealer then customer funds should have been kept segregated from funds available to the firm.

*Journalist:* What do you suggest in this case and what would be the effect resp.?

*Tech:* Concise guidelines on net capital rules for crypto exchanges and regular audits to verify compliance with relevant rules and adherence to financial reporting standards.

*Journalist:* Non-Tech, do you see how this would have prevented the FTX scandal?

*Non-Tech:* Certainly, if FTX was required to have sufficient resources to cover potential liabilities it wouldn't have been able to remove customer funds. In worst case only Alameda would have gone busted.

*Journalist:* Should such capital rules be accepted only for US markets or around the world?

*Tech:* The existing regulation mentioned operates on a multinational scale, addressing entities globally and various industries. It aims to tackle challenges in interwoven financial systems that transcend sectors. It's a global regulation applicable to entities in diverse sectors. It aims to manage risks across borders and industries. Likewise, I suggest rules affecting not only local crypto-exchanges but worldwide.

*Journalist:* Non-Tech, how will such changes in tightening cryptocurrency regulation affect the market?

*Non-Tech:* The value of cryptocurrency could decrease due to added layer of costs to adhere to regulation. It could also stifle innovation as some users would consider it of limited accessibility. On the flip side, new players who previously preferred only traditional financial instruments might enter this market. With stricter regulation and audit requirements, confidence in an investment like cryptocurrency could increase for this group of investors.

*Journalist:* As we mentioned existing regulation on financial markets and prospective rule for crypto exchanges - will regulation bring crypto assets closer to traditional financial assets?

*Non-Tech:* Regulation would certainly centralize the crypto world which is a definite no-go for crypto believers. However, regulation addressing safety without impeding freedom can only be beneficial to investors and customers. Alternatively, there could be both worlds. Regulated crypto activities can be allowed in countries with established sensible guidelines on investments. Unregulated crypto activities would then be confined to other countries that offer economic incentives for liberal engagement with cryptocurrencies (e.g., El Salvador)

*Journalist:* Drawing a comparison, how does the intended effect of this regulation relate to its alignment with the broader goals of financial regulation?

*Tech:* Compared to traditional regulations, this one delves into technical aspects often overlooked. It aims to address vulnerabilities arising from intricate financial interdependencies. Unlike conventional regulations, this regulation targets intricate technical aspects often missed, aiming to prevent crises from complex interdependencies.

*Journalist:* How do behaviors such as greed, fraud, corruption, and attempts to hide losses play a role in financial scandals, such as the FTX one? Ultimately, they erode trust and contribute to the need for stronger regulatory measures?

*Tech:* Misbehaviors in cryptocurrency involve exploiting information asymmetry, manipulating prices through trading strategies, and distorting market perceptions.

*Journalist:* Non-tech, what other measures should be taken apart from capital requirements to avoid similar situations?

*Non-Tech:* To address unethical behavior, standardized codes of ethics should be implemented for both employees and management. Good practice would be to firms to have a dedicated compliance officer, that would oversee the implementation of these measures. This body would also be able to address instances of fraud and unethical behavior, in addition to lack of internal controls. Compulsory ethics trainings can certainly contribute in this line of thoughts.

*Journalist:* Tech, to what extent did incompetence play a role in the FTX crisis, resp. how could it be deterred in the future?

*Tech:* Incompetence can result from inadequate risk assessment methodologies, improper hedging strategies, and ignorance of market dynamics. Regulatory measures focusing on financial disclosure deter misbehaviors by exposing hidden risks, promoting responsible market conduct. Comprehensive disclosures deter misbehaviors by revealing hidden risks, encouraging ethical behavior within financial markets.

*Journalist:* Non-Tech, in conclusion - is this the end of “the wild west of crpyto”?

*Non-Tech:* Finding the right balance between freedom and regulation is essential. The key is to find sensible regulation that leave room for innovation. The market integrity requires stable environment where safety is prioritized. Yet, there will be certainly some areas in the world left where cowboys can thrive. Inevitably, outlaws as well.

Sources:

1. The FTX Implosion, by Dan DiBartolomeo
2. A Peak Inside Forest Road's Digital Assets Chartbook, Chris Solarz, CIO, Digital Assets
3. FTX’s collapse mirrors an infamous 18th century British financial scandal, Amy Froide