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CATEGORY / SUBCATEGORY: Conflict of Interest



# Case study

## From Crypto Hero to Fraud

### Who is SBF?

Sam Bankman-Fried (SBF) is a young entrepreneur and founder of the companies Alameda Research and FBX, whose success made him renowned in the financial investment industry, especially those related to cryptocurrencies, becoming one of the youngest millionaires in the world. He was recognized as a genius by those around him for his vision of wanting to evolve the way payments are made around the world. He was also admired for including an altruistic approach as part of his speech, which generated confidence in him as a "Good Billionaire", as he claimed to seek to generate a social impact with those in need.

### SBF Companies

Alameda Research is a cryptocurrency investment fund company co-founded in 2017 with Tara Hedley, in which cryptocurrencies were bought and sold to investors at a different price. The company was soon successful; however, it did not gain great renown in its early days. By 2019, Caroline Ellison, then SBF's girlfriend, became CEO of the company.

However, it was in 2019, with the launch of FTX, that SBF became known in the world of cryptocurrencies hand in hand with his partner Gary Wang, by launching a platform for exchanging cryptocurrencies and storing funds, which generated exponential profits for investors, facilitating trades worth between \$10 billion and \$15 billion a day.

### Credibility and Trust

SBF gained credibility as, unlike other investment platforms since the mind behind the platform was known, becoming a benchmark of success in the financial environment. In addition, he enamored investors with his revolutionary vision of changing the way payments and transactions are made; many called him "the Mark Zuckerberg of crypto". Knowing his personal and academic background was key, as he was an MIT graduate and the son of Stanford ethics professors.

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He managed to position the company in the market with large Silicon Valley and Wall Street clients who trusted his vision, among them Sequoia Capital, Coinance and Binance, creating even more credibility for new investors. He surrounded himself with celebrities like Tom Brady (athlete), Kate Hundson (actress), Mr. Wonderful (entrepreneur and Shark Tank judge) who were not only clients but became faces of the brand. The Miami Heat team's arena was even named FTX Arena. Their customers, advertisement and market presence added to this image of change and credibility in his name as well as his companies'.

The platform operated through FTT Tokens (currency that reduced the exchange rate). In 2019, a token cost around 2 dollars; by 2021, its cost was almost 80, and by November 2022, around 22 dollars, regulated according to an equal distribution in the market, giving the idea that everyone outside the USA had an "equity live stake" which gives investors a percentage of control over the company. He even showed himself buying FTT tokens and investing just like everyone else, which gave investors' more confidence.

The company started in Hong Kong and was moved to the Bahamas in 2021 due to cryptocurrency regulatory issues, during this time the executives -like SBF himself-, contrary to what he preached, lived in a huge pent-house and invested in properties, living a life of luxury and ostentation.

### Behind the Scenes

In November of the same year, the true face of Crypto Genius SBF began to show. Ian Allison, a reporter for the cryptocurrency website CoinDesk, notified that there was a misappropriation of funds from FTX to Alameda, leaking a balance sheet of the company. This news goes live on November 4, 2022, in which it was reported that around 7 billion of the company's FTT was listed as FTT Tokens, meaning not only that Alameda was acquiring FTX funds, but that since a significant percentage of FTT was on the balance sheet, the price of the currency was being manipulated. The company stayed afloat by using FTX investor funds and paying off its external debt.

The CEO of Binance, one of the main investors in FTX, upon seeing the report, posted a tweet saying he would withdraw all his FTT funds, which caused many other investors to panic and decide to withdraw their money. Within minutes, millions of dollars held on the platform began to drop, losing around 4 million dollars a day. SBF immediately sought outside financing.

In addition, SBF gave different information from different sources. First, he stated that this was defamation; then he admitted that it was a mistake and offered apologies. Many believed his apology and promises, so they continued to trust the system and the genius of cryptocurrencies.

After the huge losses, the value of the currency dropped by 75%, leading to the beginning of the company's collapse. It even, as a desperate measure, sought to sell FTX to Binance. During the due diligence process to make the transaction, the severity in the companies' financial balance sheet came to the spotlight.

Faced with these news, many investors withdrew the total amount of money they had stored, leaving both companies, which subsisted on this credit, to go bankrupt. However, for many it was too late, since the companies had used all the money invested and had been left with nothing. This is how the embezzlement of funds between FTX and Alameda came to light, as the clients' money had disappeared.

## The Trial

On November 9, 2022, Caroline Ellison (CEO of Alameda and girlfriend of SBF) admitted that, because of the company's accounting situation, funds from FTX clients were used, admitting to fraud. Despite being involved in the execution, her statements made her the main witness in this case.

On November 11 of this year, FTX and Alameda filed for bankruptcy. There was an \$8.9 billion loss of customer funds.

At first, it denied the situation, but once the evidence came to light, SBF admitted that there were many mistakes and stated that it had never wanted to commit fraud. His image and confidence crumbled in a matter of days. He was then convicted of classic fraud, being sentenced to 165 years in prison.

Gary Wang (co-founder of FTX) pleaded guilty, admitting to making changes to the platform so that Alameda would have privileges and to knowing these actions were illegal. Caroline Ellison also admitted to having knowledge that customer funds would be used for loans to Alameda and to doing so in ignorance of the customers. Similarly, other executives from both companies admitted to making illegal transactions, adding to the fraud.

Lawyers worked to find the funds and somehow return money to the clients, however, to date, this process has not been fully completed.

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## The Opportunity

Conflicts of interest can arise from shared ownership, personal, shared, intertwined business relationships or emotional ties between people in decision-making positions.

In the case of Sam Bankman-Fried, he owned both companies in the cryptocurrency space, representing a potential conflict of interest since their inception. The founder claimed not to be part of Alameda Research, as he was not part of the decision-making roles and positioned FTX as independent, so in theory there was no conflict of interest. However, opportunities were identified for both companies to benefit from being in the same market.

These implemented controls were clearly ineffective, starting with the fact that the CEO of Alameda Research was his romantic partner, which represents a potential bias to objective decision making.

A conflict of interest clearly exercised with the intertwined business relationships, as with these links he manipulated the currency price, misrepresented funds, and gave monetary benefits to Alameda from his operation; all of these representing illicit activities that kept both companies afloat, generating billions of dollars in profits.

With this despite; their statements, these companies were not independent, since they were linked from the very construction of the business.

SBF, as owner of both companies, had knowledge of their processes and decision-making power, whether stipulated or not. He had access to the financial and operational controls of both, generating opportunities for personal gain at the price of his companies, trust, legitimacy and even his freedom.

**What elements of conflict of interest do you find in this case?**

**In what areas do you identify that a conflict of interest exists?**

**To what extent do you consider that the personal relationship between Caroline and SBF played a factor in the fraud?**

**SBF mentions that conflict of interest measures were implemented, what measures do you consider can be taken within such a scenario?**

**What are the main factors that led to FTX going bankrupt?**

**How could you have managed owning two crypto companies, without exercising conflict of interest?**

**To what extent did timing play a role in this fraud?**

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