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FTX collapse likely to spook investors for now, could eventually spur consolidation, experts say

Analysis

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Responding to the collapse and subsequent Chapter 11 filing of the FTX cryptocurrency exchange this week, several experts told this news service that institutional investors will likely stay away from the space and that M&A activity will pause.

The tumultuous event could, however, lead to eventual consolidation in the sector, some of the experts agreed.

FTX's swift downfall began on 8 November, after heavy speculation about its financial health triggered USD 6bn of withdrawals in just 72 hours, which the exchange was unable to handle. Later this week, news outlets reported that the exchange propped up its sister company Alameda Research with up to USD 10bn of user funds, which spread further alarm throughout the industry. As a result, on Wednesday, rival Binance backed out of a potential deal to buy FTX.

Based in Nassau, The Bahamas, the company, along with roughly 140 associated businesses, filed for Chapter 11 earlier today and its CEO Sam Bankman-Fried resigned. FTX has between USD 10bn and USD 50bn in liabilities and upwards of 100,000 creditors, according to news reports. It was valued at USD 32bn as of January but saw its FTT token value plummet last week.

On Thursday morning, SEC Chairman Gary Gensler, appearing on CNBC's "Squawk Box" program, warned commercial investors to stay away from crypto. He noted that US crypto exchanges are not regulated unlike institutions like FDIC-insured banks, and consumers are not assured of their holdings.

Whether institutional investors follow the same advice is yet to be seen, but several experts that spoke to *Mergermarket* agreed that the FTX collapse will likely spook investors and slow M&A activity in the space.

"It will chill institutional investment, especially among VCs," said Josh Peck, founder of TrueCode Capital, a Denver-based hedge fund that invests in crypto currencies.

Emma Rose Bienvenu, chief of staff and chief investment officer at San Francisco-based Pantera Capital, concurred that it will likely slow institutional investment and M&A in crypto, but said in the long run the failure of FTX may be positive for the larger crypto space.

“I think it’s certainly going to improve due diligence. People will take a much closer look at balance sheets and general business practices before making acquisitions,” Bienvenu said.

Her view was shared by David Sacco, a practitioner in residence of finance from the Pompea College of Business at the University of New Haven.

While M&A will stagger, more “thoughtful” acquisitions could happen eventually, Sacco said. “I don’t think this will be the last time a firm involved in the crypto ecostructure blows up, but I think every time it happens, what is left is stronger.”

In a June piece by this news service, several experts stated that the impact of US regulation on crypto could be positive, “provided the regulations do not suffocate innovation.”

Sacco, however, said that regulation “can create a false sense of security for investors who don’t understand the risk and may lead to them not doing the due diligence required. My view on regulators is that they’re always very good at putting [rules] in that would have stopped the last problem, but the market usually [takes care of] that itself.”

Peck said that investors such as VCs will likely demand more regulation in America. He added, however, that US regulation probably can’t fix these issues "as much as consumer education can.”

New York-based attorney Roger Barton suggested that it may be too early to determine whether US regulation could have been applied to aspects of the FTX collapse.

“Who knows, maybe months from now they’ll figure out what happened,” he said. “A question that arises is, ‘What does the balance sheet look like here in the US, what does it look like offshore?’”

Barton also felt, unlike the other experts, that M&A could occur in the shorter term, as “there’s some weak players out there.”

Bienvenu stressed that she does not consider the FTX collapse to be caused by any failure in the crypto sector.

“This was a failure of centralized finance. FTX was a centralized institution that lacked a proper regulatory framework and played fast and loose with user funds," she added. "If you had traditional finance exchanges acting with no regulatory oversight, you’d see the same thing.”

Peck concurred, projecting that "asset prices will be really rocky for a while and then people will move on just as they do in conventional markets when a business fails.”

Sacco pointed out that by end of day Thursday, crypto prices were up from the day before, although this was likely due to recent reports saying inflation was nearly ending.

“As soon as [crypto] behaved like a normal market again, it comforted me, because it showed that there’s more depth to the crypto market than what some think.”

by Bob Chiarito in Chicago

OTHERS

[Company record pending]

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