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Binance Pulls Out of Deal to Acquire Rival Crypto Exchange FTX

The rapid collapse of FTX, built by the billionaire Sam Bankman-Fried, suggests that no company in the freewheeling, loosely regulated crypto industry is safe.

By David Yaffe-Bellany

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It was a stunning fall for a celebrated executive who was leading the crypto industry's charge into the mainstream of finance.

Over the last two years, Sam Bankman-Fried, a 30-year-old entrepreneur, built a crypto exchange called FTX into a $32 billion company. He spent hundreds of millions of dollars to prop up struggling crypto firms. And he became a major political donor to Joseph R. Biden Jr.'s presidential campaign as well as a frequent, welcome presence in the halls of Congress.

Then, in a matter of days, it was suddenly Mr. Bankman-Fried who needed a bailout, thanks in large part to Twitter posts from a rival that questioned the stability of FTX's business. The tweets sparked what was essentially a three-day bank run of an estimated $6 billion that sent FTX into crisis.

The rival, Changpeng Zhao, the chief executive of a bigger crypto exchange called Binance, agreed to bail out FTX. But FTX's future grew murkier on Wednesday when Binance abruptly said the deal was off. Without much explanation, the company said in a statement that its executives changed their minds because of regulatory concerns and issues with "corporate due diligence."

The deal's collapse has sent shudders through the entire crypto industry. The uncertainty around the future of FTX has become an existential threat to young crypto businesses as they struggle to convince Wall Street, regulators and mainstream consumers that they are trustworthy. As news spread of FTX's collapse, crypto markets took a battering, with Bitcoin and Ether both dropping more than 20 percent in value since Tuesday.

While the size of the hole in FTX's balance sheet will ultimately depend on the amount that customers were able to withdraw, it could be as much as $8 billion, according to a person familiar with the figures, who was not authorized to discuss them.

On Wednesday evening, Sequoia Capital, one of FTX's largest backers, said it now considered its $213 million investment worthless in a letter to its own investors. The firm said FTX was at risk of bankruptcy, though it didn't know "the full nature and extent" of the risk.

"This episode highlights the vulnerability of the entire crypto edifice," said Eswar Prasad, a Cornell University economics professor. "Even large and apparently financially solid institutions turn out to have fragile and shaky foundations that crumble at the least hint of trouble."

Many of crypto's foundational myths have already been punctured this year, and FTX's rapid fall suggests that no company in this freewheeling, loosely regulated industry is safe from extreme volatility.

FTX's business was built on a type of risky trade — in which investors borrow money to make big bets on the future value of cryptocurrencies — that remains illegal in the United States. But Mr. Bankman-Fried started a smaller U.S. affiliate that offered more conservative trading options, while lobbying American regulators to approve the riskier model. As the company grew, he became a prolific political donor, contributing more than $5 million to Mr. Biden's 2020 election effort.

Late Wednesday, Binance issued an unusually harsh statement explaining why it backed out of the deal, citing "mishandled customer funds" and investigations by regulators. The investigations could not be confirmed, and Binance did not offer details.

"Every time a major player in an industry fails, retail consumers will suffer," Binance said in its statement. "We have seen over the last several years that the crypto ecosystem is becoming more resilient, and we believe in time that outliers that misuse user funds will be weeded out by the free market."

FTX declined to comment on Binance's pullout from the deal. In an internal message to employees viewed by The New York Times, Mr. Bankman-Fried said: "I'm working, as quickly as I can, on next steps here. I wish I could give you all more clarity than I can. I completely understand if you want to step away, and don't blame you at all for it."

He added that Binance "had not previously informed us or expressed those reservations."

Unlike some other crypto companies that have imploded this year, FTX was almost a mainstream brand. Mr. Bankman-Fried ran a commercial during the Super Bowl and bought the naming rights to the Miami Heat's basketball arena. He was profiled in virtually every major news outlet, including The Times, and has nearly a million followers on Twitter.

"It's like if the person you thought was Hermione actually turned out to be Voldemort," the crypto journalist Laura Shin tweeted on Wednesday.

The crisis started after reports circulated over the weekend that one of Mr. Bankman-

Fried's businesses was on shaky financial footing. Mr. Zhao, who is known online as CZ, amplified the reports on Twitter, sparking a bank run that crippled FTX.

"CZ executed a pincer movement," said Lee Reiners, a crypto expert who teaches at Duke University Law School. "He surprised all of us."

As the company collapsed, FTX's venture investors were in the dark about Mr. Bankman-Fried's plans, and employees had little guidance. Other companies distanced themselves. "There can't be a 'run on the bank' at Coinbase," Alesia Haas, that U.S. crypto exchange's chief financial officer, wrote in a blog post. "We hold customer assets 1:1."

The announcement that Binance would take over FTX was initially greeted with cautious optimism in some quarters of the crypto community. But complications emerged quickly, according to a person familiar with the matter: FTX employees were departing, the person said, and Binance had trouble determining the exact size of the hole in the company's books.

Mr. Bankman-Fried's rise began in 2017 when he founded Alameda Research, a crypto trading firm that made a fortune exploiting arbitrage opportunities in the Bitcoin market. He parlayed that success into the creation of FTX, which was based in Hong Kong before relocating to the Bahamas last year.

Mr. Bankman-Fried was lobbying Washington on behalf of the crypto industry. Erika P. Rodriguez for The New York Times

He also embarked on a marketing blitz. In April, Mr. Bankman-Fried hosted a glamorous conference in the Bahamas, where he appeared onstage with former President Bill Clinton and former Prime Minister Tony Blair of Britain. At one point, he was worth an estimated $24 billion, according to Forbes, making him the second-richest crypto businessman, behind Mr. Zhao. Mr. Bankman-Fried vowed to one day give his entire fortune away.

When the crypto market crashed in May, Mr. Bankman-Fried was hailed as a savior. He lent $485 million to the troubled crypto company Voyager Digital and bailed out BlockFi, a crypto lending firm, with a $400 million credit line. FTX also established a presence in Washington and held talks with the Securities and Exchange Commission about registering as an exchange under the agency's jurisdiction, according to a person familiar with the matter. (Spokesmen for FTX and the S.E.C. declined to comment on the talks.)

But this fall, Mr. Bankman-Fried started to face blowback in the industry. Crypto enthusiasts criticized him for supporting regulatory proposals that they viewed as an affront to the philosophical principles of the technology.

Then last week, the crypto publication CoinDesk reported on a leaked balance sheet showing that a large portion of Alameda's assets consisted of FTT, a token that FTX had invented to ease trading on its platform. The news stoked fears that a plunge in FTT's value could cripple both FTX and Alameda, which are closely entangled.

A former FTX investor, Mr. Zhao still held a large quantity of FTT, which Mr. Bankman-Fried had given to him to buy back equity in FTX. Mr. Zhao also seemed to be growing disgruntled with Mr. Bankman-Fried. In October, Mr. Bankman-Fried had made a joke on Twitter suggesting that Mr. Zhao was not allowed to enter Washington, an apparent reference to the scrutiny that Binance has reportedly faced from the S.E.C. No action has been taken.

Over the weekend, Mr. Zhao announced on Twitter that Binance would sell its holdings of FTT. He insisted that he was not engaging in a "move against a competitor." But he later compared the FTT token to Luna, a cryptocurrency that crashed in May, setting off a broader crisis.

"We won't support people who lobby against other industry players behind their backs," he added on Twitter.

The impact was immediate. As customers rushed to withdraw funds, Mr. Bankman-Fried said on Twitter that "a competitor is going after us with false rumors."

Around the same time, Mr. Bankman-Fried was calling possible investors as he tried to raise money, two people familiar with the conversations said. But it was not clear how much he would need, one person said. The stakes were clearly high, though: Mr. Bankman-Fried explained that FTX was in an emergency situation, according to the other person.

On Tuesday, Mr. Bankman-Fried struck the agreement with Mr. Zhao. "Binance has shown time and again that they are committed to a more decentralized global economy," he wrote. "We are in the best of hands."

When the deal collapsed, he apologized to staff in the internal message. "I'm deeply sorry that we got into this place, and for my role in it," he said. "That's on me, and me alone."

The meltdown has attracted attention in Washington. Gary Gensler, the chair of the S.E.C., alluded to it in public remarks on Wednesday. And the Commodity Futures Trading Commission is looking into the collapse of FTX, a person familiar with the matter said. A spokesman said the agency was "closely monitoring" the situation.

Mr. Bankman-Fried had been scheduled to give a talk to Goldman Sachs employees on Thursday, according to a Goldman employee familiar with the plans, but it wasn't clear whether the event would go ahead. (A Goldman spokeswoman did not respond to a request for comment.) On Wednesday evening, a notice on FTX's website said the company was not processing withdrawals. Alameda's website was set to private and no longer viewable.

Mr. Bankman-Fried's fall from grace was also reflected in the size of his fortune. According to a Bloomberg wealth index, the executive, now worth $991.5 million, is no longer a billionaire.

Lauren Hirsch, Mike Isaac and Erin Griffith contributed reporting.