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Weekly Crypto Wrap

Friday, November 11, 2022

*Welcome to MRP's Weekly Crypto Wrap, a look back at news reports, on-chain metrics, and other data that moved digital asset markets over the past week. These reports will be delivered every Friday morning, provided **free of charge** by MRP, and packed with useful information for those just beginning their research into Bitcoin and other cryptocurrencies, as well as investors with more experience in digital asset markets.*

Click here to see everything we covered in the last iteration of the newsletter.

THEMATIC SIGNALS

Aggregation of key events and breaking stories monitored by MRP

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ON-CHAIN ANALYTICS

Breaking down the most critical trends and transaction patterns on the blockchain

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After a spate of uncharacteristically low relative volatility in the price of Bitcoin (BTC), which sent a wave of calm over the broader cryptocurrency market, that balance was derailed this week by the sudden insolvency of FTX – the fifth largest crypto exchange by volume. The magnitude of this corporate crisis is illustrated by the fact that, on some exchanges like Coinbase, BTC trading volume spiked to its highest level since the COVID crash in March 2020. That sent the price of 1 BTC in US dollar terms down from a weekly high near $21,500 to a new two-year low below $16,000 – a decline of more than 25%.

With the eyes of the financial world fixed on FTX, we will use today's On-Chain Analysis section for a long-form analysis on what led to the fall of FTX and how it will ripple through the broader digital asset ecosystem.

To begin, it's not yet completely clear exactly what happened at FTX, but the sequence of events that led to the suspension of withdrawals began with a larger exchange, Binance, announcing it would liquidate all of its holdings of FTX Token (FTT), FTX's native cryptocurrency that had a market cap of almost $3.5 billion prior to its ongoing meltdown. Binance CEO Changpeng Zhao (colloquially known as CZ) ambiguously cited "recent revelations" for the company's sudden decision to sell off its entire position in FTX. Binance had acquired $2.1 billion in FTT and stablecoins by selling off an equity stake in FTX in July 2021.

Decrypt reports that Binance was in possession of at least 22,999,999 FTT (equivalent to $580 million at the time) worth of FTT, or 17% of the circulating supply, when CZ announced the company would liquidate this position. Naturally, this set off a broader wave of selling in FTT markets and open interest in FTT futures spiked. CoinDesk notes that the funding rate on these positions dropped sharply to an annualized -36%, per data provided by Matrixport Technologies, suggesting shorts had taken the upper hand and were willing to pay funding to longs to keep their positions open. Within a 24-hour period on November 7-8, the price of FTT had plunged as much as 86%.

FTX Token is one of the many existing "utility tokens" issued by exchanges – typically serving no functional purpose beyond aiding in speculation. Most exchanges offering utility tokens, including FTX, also function like trading platforms and FTT provides users with the ability to utilize this single token as a universal pairing with any other cryptocurrency on the platform. Using and holding FTT also helps users minimize fees incurred during trading. Most importantly, FTT allowed users to trade with up to 3x leverage, which was especially beneficial to speculators who could avoid trading on margin and having to paying interest on their positions.

However, the most obvious risk with FTT is that its value is intrinsically tied to the financial health and public perception of its issuer, FTX. If FTX's financial position is perceived to be deteriorating, the value of FTT will almost certainly reflect this downturn in public sentiment and, in turn, if the price of FTT is crashing, users of the FTX platform will assume the firm is at risk of insolvency. The combination of these factors have created a sort of "bank run" on FTX's reserves as users scrambled to secure whatever funds they could get out of the exchange, submitting requests for withdrawals worth $6 billion in just 72 hours. That quickly dried up liquidity at FTX, which struggled to find short-notice buyers for some of their illiquid assets. Hence, withdrawals were halted and insolvency was seen as unavoidable.

FTX's CEO, Sam Bankman-Fried (SBF), insisted in a recent Twitter thread that "FTX US USERS ARE FINE... FTX International currently has a total market value of assets/collateral higher than client deposits", and the lack of liquidity was simply due to miscalculation of leverage and how high daily withdrawals could actually go. According to SBF, the platform's leverage was actually 1.7x versus "0x" as he believed, and while liquidity was 24x average daily withdrawals, it was only sufficient to service 0.8x (80%) of Sunday's massive orders.

Though those numbers could be accurate, this explanation is a grossly understated characterization of the situation that is playing out. At first, Binance claimed they'd be willing to step in and conditionally acquire FTX, but that arrangement held together for just one day before Binance declared that "as a result of corporate due diligence, as well as the latest news reports regarding mishandled customer funds and alleged US agency investigations", it would not be able to move forward with talks to purchase FTX. Reuters reported yesterday that FTX was scrambling to pull together about $9.4 billion from investors and rivals to cover their needs, not an impossible sum for a firm that just raised $1 billion of VC cash at a $32 billion valuation in September, yet illustrative of a much greater crisis than the FTX executive's public statements suggest. As of Friday morning, CNBC reports that FTX has filed for Chapter 11 bankruptcy and SBF has resigned as CEO.

While the collapse of FTX, which follows the similar high-profile bankruptcies of Celsius and Voyager (which itself was just acquired by FTX in September), will undoubtedly dent public perception of cryptocurrencies, it was likely an inevitable catastrophe – and one that can make the digital asset ecosystem stronger in the long-term. For example, this could be the moment where "proof-of-reserves" accounting become an industry standard in crypto. Because of the public nature of blockchains and the data contained within them, exchange reserves of virtually any cryptocurrency can be proven and reasonably verified instantly with a simple wallet address. Major exchanges like Kraken and Binance already disclose these details to the public, but many other exchanges are still highly secretive about their financial positions.

Though crypto skeptics have seized this moment to declare FTX's irresponsible leadership a failure of Bitcoin, in what is likely to be its 465th supposed "death", it actually makes the case for Bitcoin quite clearly.

MRP has written extensively about the adoption of self-custody solutions – technologies that allow cryptocurrency owners to hold their own private keys and, therefore, secure their digital assets – and the inherent risks of users leaving large amounts of crypto on exchanges or with custodial "lending platforms". This is one of the many instructive moments where understanding the underlying philosophy, purpose, and structure of Bitcoin and other cryptocurrencies is critical and harkens back to perhaps the prominent adage in crypto: "Not your keys, not your coins."

Most of the largest centralized exchanges (essentially any company who requires one to transfer crypto to an address custodied by the firm to utilize their services) take control of private keys and allocate users a balance of assets equivalent to what they've deposited, but the user no longer controls the keys to the assets they have transferred. Cryptocurrencies like Bitcoin never actually "leave" the blockchain to enter a wallet, despite the common vernacular use of that term. The owner of a certain amount of BTC simply receives "keys" to access specific portions of BTC that are unspent.

If that centralized entity becomes insolvent or defunct, users risk losing access to their claim on the cryptocurrencies they deposited. As unsecured creditors, users' claim on the assets they've deposited in the platform are subordinated in priority and, in the event of bankruptcy, are unlikely to be paid back in full or in a timely manner. This risk is inherent to most depository institutions, and it is something that Bitcoin has sought to eliminate by empowering any person to custody their own assets and also transfer (or spend) them anywhere in the world through a decentralized network. It is no coincidence that Bitcoin was ultimately created and deployed in the wake of the 2008 financial crisis.

In the wake of the FTX meltdown, which will likely leave thousands of users locked out of their deposits, outflows of crypto assets from exchanges are surging with users finally realizing the risk they're taking by not controlling their own assets. Per Glassnode data, BTC exchange outflow volume has just reached a 4-month high. When cryptocurrency is sent off exchange, it typically enters a user's self-custodied wallet or other form of "cold storage". A continued wave of outflows from exchanges and into cold storage solutions could indicate that sales of hardware wallets are likely to boom. Hardware wallets are small, portable devices that securely store private keys to one's crypto assets so that nobody can transact those assets without the presence of the device. Those keys are guarded by a randomly-generated seed phrase that can act as a recovery method if the physical device were to be damaged or lost.

The two leading hardware wallet manufacturers, Ledger and Trezor, have roughly 5 million users today. In our August 5 *Crypto Wrap*, we highlighted Bloomberg reporting on Ledger's plan to raise another $100 million, following its most recent raise of $380 million in June 2021 at a valuation of more than $1.5 billion. The upcoming round should raise Ledger's valuation even further.

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October 18, 2022: Fallout From Ethereum "Merge" Bolsters Bitcoin's Hash Rate as Some Criticisms Still Linger →

October 7, 2022: Ethereum's Post-Merge Era Conquers Key Goals, Yet Centralization and Regulation Concerns Linger →

August 8, 2022: BTC Rebound Set to Revitalize Crypto Miners Bent by Bear Market Pressure →

June 22, 2022: SEC Decision on Key Bitcoin ETF Application Looms as Grayscale Preps Lawsuit, Dissent Rises From Within →

June 2, 2022: Sweeping Ethereum "Merge" Set For Launch as Soon as August, Solidifying New Proof-of-Stake Consensus →

THEMATIC SIGNALS: SUMMARIES

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Miners

Oil and Gas Giant Shell Signs Two-Year Sponsorship with Bitcoin Magazine

Shell, one of the world's largest oil and gas companies, has signed a two-year partnership with Bitcoin Magazine to sponsor the 2023 and 2024 Bitcoin Conferences. Representatives from Shell will speak on the mining stage about improving the energy costs of bitcoin mining using the company's own lubricant and cooling solutions.

Read the full article from Bitcoin Magazine +

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Stablecoins

82% of Tether reserves held in 'extremely liquid' assets, according to attestation

Eighty-two percent of Tether's reserves were held in cash, cash equivalents and other short-term deposits as of Sept. 30, 2022, the company disclosed.

Tether's exposure to commercial paper — a form of short-term corporate debt with a higher risk profile — has fallen to just 0.07% of its holdings. The company claims to have incurred no losses from winding down its commercial paper holdings by more than $24 billion.

Read the full article from CoinTelegraph +

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Exchanges

FTX to file for U.S. bankruptcy protection, CEO Bankman-Fried resigns

FTX will initiate bankruptcy proceedings in the United States while its Chief Executive Sam Bankman-Fried resigned. Bankman-Fried's trading firm Alameda Research is also part of the bankruptcy protection, the company said. Sources have said that it was partly behind FTX's problems and reportedly owes FTX roughly $10 billion.

Read the full article from Reuters +

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Ethereum

Why Ethereum Is More Decentralized After the Merge

Only hours after Ethereum's successful Merge to proof-of-stake (POS), various critics propagated a rumor that just three entities now have the power to halt the chain. Lido represents the largest entity on Ethereum by stake. At the time of publication, more than $5 billion worth of ETH is staked on Lido. Although that seems like a lot of Ethereum in one place, Lido is composed of about 30 independent operators.

To attempt a 51% attack, you'd need collusion from all 29 Lido operators and two other major validators.

Read the full article from Blockworks +

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Regulation

LBRY Sold Tokens as Securities, Federal Judge Rules

The LBRY protocol is a blockchain-based file-sharing network. The SEC sued LBRY in March 2021, alleging that its native LBC tokens were securities and that the startup had violated securities laws by selling them without registering with the agency.

One significant case the LBRY ruling could impact is the SEC's suit against Ripple Labs and two of its executives, who have been charged with selling $1.3 billion in unregistered securities.

Read the full article from CoinDesk +

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