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Lawmakers grapple with sheer size of FTX's missing billions

Sen. Sherrod Brown (D-Ohio) accuses the industry of being 'easy, too easy' for corruption

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Lawmakers on Wednesday attempted to grapple with the stunning collapse of cryptocurrency exchange FTX a day after federal prosecutors laid out a case of brazen financial crimes allegedly perpetrated by its former CEO, Sam Bankman-Fried, who is being held by authorities in the Bahamas.

Bankman-Fried, known frequently as "SBF," was arrested Monday at his luxury compound in Nassau at the request of the U.S. government, and he was charged with multiple crimes including conspiracy, fraud, money laundering and campaign finance violations.

The Justice Department, Securities and Exchange Commission, and Commodity Futures Trading Commission said Bankman-Fried, 30, used consumer deposits on his FTX platform to fund risky bets through his Alameda Research hedge fund.

Members of the Senate Banking Committee in a hearing Wednesday considered proposals to regulate crypto markets, including applying strict conditions like those over gambling, classifying crypto assets as securities, and pushing federal agencies to extend existing regulations for banks and brokerage houses into crypto markets.

Senate Banking Committee Chairman Sherrod Brown (D-Ohio) accused crypto of being "easy, too easy" for corruption and assailed celebrity endorsers, saying they duped investors in glitzy Super Bowl commercials and online ads.

Sen. Patrick J. Toomey (Pa.), the top Republican on the Senate Banking Committee and a leading crypto booster in Congress, called for a more lenient response to the FTX crisis and cautioned against punishing the crypto industry for problems at one exchange.

He compared FTX's meltdown to the 2008 subprime mortgage crisis. "Did we decide to ban mortgages?" asked Toomey, who will leave the Senate in two weeks after not seeking reelection. "Of course not."

He suggested that cryptocurrencies could protect against inflation and allow for private financial transactions.

“Let’s remember to distinguish between human failure and the instrument with which the failure occurred,” Toomey said. “In this case, the instrument is software, and a code committed no crime.”

Before its collapse, FTX had been the third-largest crypto exchange by volume in the world. The firm’s tailspin began this past month, when Changpeng Zhao, chief executive of rival crypto exchange Binance, announced he would sell off $530 million worth of an FTX-issued crypto token. Bankman-Fried was leaning on the native token to secure his firms’ sizable debts.

The move sparked a panic, with FTX customers racing to pull $5 billion worth of deposits off the platform. In a last-minute bid to meet the demands, Bankman-Fried turned to Zhao for help, and the Binance chief executive agreed to buy FTX. But Zhao reneged the next day, saying that a review of FTX’s books revealed “mishandled customer funds.” Two days later, Bankman-Fried stepped down, and the company said it was filing for bankruptcy.

“One put the other out of business intentionally,” Kevin O’Leary — an entrepreneur and “Shark Tank” television personality who was paid $15 million to promote FTX — told the Senate panel.

FTX customers are pursuing a class-action lawsuit against O’Leary and 10 other FTX celebrity endorsers — including Tom Brady, Gisele Bündchen, Larry David and Naomi Osaka — arguing that such personalities should bear responsibility for luring consumers into a bad deal.

A spokesperson for O’Leary didn’t respond to a request for comment about the lawsuit. Representatives for the other 10 defendants either didn’t respond to requests for comment or declined to comment.

Other witnesses included Hillary Allen, an American University law professor of banking and securities regulation; Jennifer Schulp, who studies financial markets at the conservative Cato Institute; and Ben McKenzie Schenkkan, an actor and star of TV hits “The O.C.” and “Gotham.” McKenzie Schenkkan has become one of the crypto industry’s unlikely but most prominent critics, arguing that it is a bubble filled with malefactors. He is co-writing a book on the industry set to publish this summer.

When Brown asked the witnesses whether FTX-like “carelessness, misconduct or worse” was present at other crypto firms, McKenzie Schenkkan responded that it was “endemic.”

Brown said, “FTX and Alameda Research took advantage of the crypto industry’s appetite for speculation.”

The hearing came as Brown signaled a desire to work with top financial regulators to forge a federal rule book for the crypto industry. Other members of the panel have their own proposals, and Sen. Elizabeth Warren (D-Mass.) is adding to them with a bill — co-sponsored by Sen. Roger Marshall (R-Kan.) — aimed at cracking down on national security risks posed by cryptocurrency. The measure seeks to more strictly apply anti-money-laundering standards already imposed on traditional financial institutions to crypto businesses.

“Crypto doesn’t get a pass to help the world’s worst criminals, no matter how many television ads they run or how many political contributions they make,” Warren said in the hearing.

If convicted, Bankman-Fried faces up to 115 years in prison related to the charges brought by regulators and prosecutors. He appeared to fight the United States' extradition request during an appearance in a Bahamian court Tuesday. A judge ordered him held without bail after local prosecutors argued that he was a flight risk and could have money stashed in other countries.

Bankman-Fried's lawyers countered that their client suffered from depression and had dietary restrictions that could not be met in prison. They also pledged that Bankman-Fried would appear at future proceedings.

Wednesday's Senate proceedings came a day after the House Financial Services Committee held a hearing that included John J. Ray III, FTX's new CEO, who was brought in to clean up the company's finances. Ray called Bankman-Fried's actions "plain old embezzlement." Ray said it would take "months, not weeks" to claw back lost consumer deposits, noting that "we're not going to be able to recover all the losses here."

U.S. officials called Bankman-Fried's actions "one of the biggest financial frauds in American history," during a news conference Tuesday, and they hinted that more charges could be forthcoming against other FTX officials and Bankman-Fried's associates.

The Justice Department indictment, filed in the Southern District of New York, implicates co-conspirators "known and unknown." The SEC complaint includes details of real estate purchases and loans for Bankman-Fried, his parents and FTX executives worth at least $2 billion allegedly derived from ill-gotten gains.

"Neither the fact of the loans and purchases, nor the poor documentation of significant company liabilities and expenditures, was disclosed to investors," the complaint states.

Before FTX's collapse, Bankman-Fried pursued political and pop culture influence. He was the second-biggest Democratic donor in the 2022 midterm elections, fashioning himself as the crypto industry's top surrogate in Washington. His mop of hair and pledges to philanthropy — an approach known as effective altruism — endeared him to legions of online followers.

But FTX also pursued major marketing ploys to boost consumers' faith in the industry. It purchased advertising space on the uniforms of Major League Baseball umpires. The National Basketball Association's Miami Heat said it would terminate its $135 million arena naming-rights deal with FTX in the wake of the company's collapse. The agreement, signed in 2021, was intended to last 19 years.

Since FTX's collapse, politicians have grappled with how to distance themselves from Bankman-Fried. In the two years leading up to November's midterm elections, the crypto executive donated $40 million to federal candidates and campaign groups, according to federal records. Most of his money went to Democrats, though Bankman-Fried has alluded to additional, undisclosed contributions to Republicans.

Two of Bankman-Fried's biggest beneficiaries in 2022 were the House Majority PAC and the Senate Majority PAC, which help elect Democrats to their respective chambers. Those organizations alone received about $7 million from him over the past two years, federal data shows.

Damian Williams, the U.S. attorney for the Southern District of New York, called Bankman-Fried's donations "dirty money" used to attempt to influence policy decisions.

Two key lawmakers, Sens. Debbie Stabenow (D-Mich.) and John Boozman (R-Ark.), on Tuesday confirmed that their offices had donated or would donate the money they had received from Bankman-Fried to charity. The two had worked hand-in-hand with the now-disgraced crypto mogul on legislation seen as friendly to the industry.

Even before his arrest, though, some lawmakers had started trying to separate themselves from a man who once had been in their better graces.

Rep. Hakeem Jeffries (D-N.Y.), who is set to become House minority leader in the next Congress, donated his contributions to the American Diabetes Association several weeks ago, according to an aide. Sen. Joe Manchin III (D-W.Va.) contributed his sums to a local food bank before Thanksgiving, the office said. And Sen. Kirsten Gillibrand (D-N.Y.), a longtime crypto advocate, gave her donation this past month to a nonprofit fighting poverty, according to a spokesman.