

How FTX forced
the crypto industry
to grow up



Introduction

FTX marked the end of the beginning. In the wake of its dramatic collapse, the cryptocurrency industry awoke to harsh realities. The fevered speculation of skyrocketing NFT prices has been replaced by sober debate around regulation, scrutiny over use cases, value, and environmental impact.

While some purists may still harbour hopes that crypto will return to its fully decentralised roots, the truth is that the FTX saga was a seismic moment for digital assets. It has compelled the crypto world to mature and incorporate elements of the traditional financial sector to protect investors.

By **Richard Byworth** *Managing Partner, Syz Capital*

So what has changed?

FTX exposed a complete failure of corporate controls and a disturbing void of credible financial reporting. However, we believe the removal of criminal and fraudulent operations will allow the industry to rebuild and emerge more constructively.

Post-FTX, it is no longer sufficient to merely claim that you're segregating client assets from exchange funds or that your books are subject to regular independent audits. Now, you must be able to provide the necessary documentation to prove it.

These rules have been imported from the traditional financial world, signifying that the crypto space is undergoing a maturation process – and a purging of its more 'Wild West' elements. Additionally, regulations are expected to be adopted from the conventional economic system, further bridging the crypto ecosystem with reliable accounting practices.

New initiatives will emerge, focusing on transparency and mandating regular reporting and auditing of reserves, assets, and liabilities across major crypto entities, including exchanges, brokers, lenders, custodians, and stable coin issuers. We see a clear parallel with the dot.com boom, where the tech industry emerged stronger and more stable.

The door opens for banks

FTX's dramatic collapse has also opened the door for traditional banks. Ironically, banks, which were initially expected to be side-lined from the future of crypto, are now creating safer access pathways into the crypto world.

Respected institutions are increasingly entering the space with custody and trading for individuals and institutions, where they can leverage their long history of trusted custodial services.

These services are designed to offer a level of safety and convenience to investors who want to gain exposure to cryptocurrencies and benefit from diversification, and potential returns, without the complexities of self-custody.

Harnessing extreme alpha

In the aftermath of FTX, the crypto landscape remains fragmented and volatile. Arbitrage strategies offer profitable risk-adjusted returns reminiscent of the early days of traditional hedge funds. However, the emergence of crypto as a distinct asset class has brought a new set of challenges. These include issues related to wallet management, smart contract risks, limited hedging tools, and the presence of younger managers with little experience in conventional finance.

This immaturity and the introduction of novel risks emphasise the pressing need for experienced oversight once more. Funds of hedge funds, equipped with traditional operational due diligence capabilities, can play a vital role in this evolving industry. They not only detect warning signs but also adapt their diligence assessments to address the unique risks in the crypto space, ultimately providing invaluable protection to investors seeking to harness the considerable potential of crypto's extreme alpha.

Bitcoin emerges as an anti-fragile asset class

It is inaccurate to claim that 99% of cryptocurrencies have no value; a fairer estimate is around 99.9%. However, even within that minuscule fraction, there is tremendous potential for economic and social utility, as well as potential investor value.

Bitcoin, in particular, stands out among thousands of coins. It possesses unique characteristics that make it crucially important to the entire crypto ecosystem and accounts for over half of crypto's \$1.13 trillion value. We see it as anti-fragile because it demonstrates resilience and strength in the face of adversity. Its decentralised nature, with no single authority or government control, makes it resistant to censorship and government interference.

And confronted with attempts to regulate or suppress it, Bitcoin tends to garner even more support and adoption, showcasing its resilient characteristics. Additionally, Bitcoin's limited supply of 21 million coins creates scarcity, driving demand, especially during economic uncertainty or inflation. Its role as a store of value, similar to gold, further strengthens its anti-fragile qualities, as it is not subject to the same vulnerabilities as traditional fiat currencies.

Meanwhile, Bitcoin's network security, maintained through a proof-of-work consensus and increased mining activity in response to threats, adds to its anti-fragility. With a global user base and a borderless design, Bitcoin also remains less susceptible to localised economic or political events – and has emerged stronger in the face of negative crypto headlines, such as the FTX debacle.

Societal value continues to grow

One of the most significant societal values that cryptocurrencies (mainly Bitcoin, and Tether, a USD stablecoin) offer, often overlooked since the headline collapse of FTX and other exchanges, is the potential for financial inclusion. In many developing countries, a significant portion of the population lacks access to traditional banking services.

Cryptocurrencies, accessible through smartphones and the internet, can provide previously unbanked or underbanked individuals with access to financial services, enabling them to save, invest, and transact securely.

For example, people in rural areas without access to brick-and-mortar banks can use cryptocurrencies to store value, send remittances, and engage in e-commerce. This new-found financial access can empower individuals and communities, reducing poverty and fostering economic stability.

Africa stands out as an enthusiastic adopter. According to Chainalysis, Nigeria ranks as the world's second-largest market for digital assets in terms of grassroots adoption, with other African countries, including Kenya, Ghana, and South Africa, also displaying high levels of uptake.

For these nations, cryptocurrencies serve as a solution to many financial challenges in the region - including high transaction fees for cross-border payments, limited access to traditional banking, and the ability to preserve wealth amidst fluctuating national currencies.

Economics re-imagined

21 million bitcoin is all the bitcoin there will ever be... this finite money against a backdrop of irresponsible money printing has also prompted a new generation to re-imagine economics. Traditional financial systems are centralised, with governments and central banks exerting control over the issuance and management of money.

On the other hand, Bitcoin operates on a decentralised network of computers, eliminating the need for a central authority. This challenges the conventional view that centralisation is necessary for monetary stability.

While some economists view it as a ground-breaking innovation, others remain sceptical about its long-term impact and stability. Nonetheless, Bitcoin's existence and growing influence have undeniably introduced new dimensions to economics and finance.

We believe it is a mistake to write off digital assets. This evolving asset class will eventually benefit from global adoption and institutional guardrails. We believe the painful FTX collapse may, in hindsight, be viewed as a necessary evil.

For further information

Syz Capital AG
Zentrum Staldenbach 5
CH - 8808 Pfäffikon
T. +41 58 800 98 00
syzcapital.com

Richard Byworth, Managing Partner, Syz Capital
rbyworth@syzcapital.com

This marketing document has been issued by Bank Syz Ltd. It is not intended for distribution to, publication, provision or use by individuals or legal entities that are citizens of or reside in a state, country or jurisdiction in which applicable laws and regulations prohibit its distribution, publication, provision or use. It is not directed to any person or entity to whom it would be illegal to send such marketing material.

This document is intended for informational purposes only and should not be construed as an offer, solicitation or recommendation for the subscription, purchase, sale or safekeeping of any security or financial instrument or for the engagement in any other transaction, as the provision of any investment advice or service, or as a contractual document. Nothing in this document constitutes an investment, legal, tax or accounting advice or a representation that any investment or strategy is suitable or appropriate for an investor's particular and individual circumstances, nor does it constitute a personalized investment advice for any investor.

This document reflects the information, opinions and comments of Bank Syz Ltd. as of the date of its publication, which are subject to change without notice. The opinions and comments of the authors in this document reflect their current views and may not coincide with those of other Syz Group entities or third parties, which may have reached different conclusions. The market valuations, terms and calculations contained herein are estimates only. The information provided comes from sources deemed reliable, but Bank Syz Ltd. does not guarantee its completeness, accuracy, reliability and actuality. Past performance gives no indication of nor guarantees current or future results. Bank Syz Ltd. accepts no liability for any loss arising from the use of this document.