How Did SBF's Alameda Research Fail So Badly? : Everything You Need to Know

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Despite it being a week since Sam Bankman-crypto Fried's empire imploded dramatically, many questions linger. One of the most pressing is how exactly did his trading company, Alameda Research, lose billions of dollars. The abrupt bankruptcy appears to have been caused by a withdrawal run on the trading platform FTX after someone in Bankman-operation Fried's fraudulently transferred customer funds from FTX to Alameda in response to the losses.

There is still a lot we don't know about what led to Alameda's massive decline in population, but we're starting to get a sense of what might have happened. To get a feel for the most prevalent beliefs, we discussed Alameda with a half-dozen crypto traders and investors. Forbes reached out to a representative for Sam Bankman-Fried and previous co-CEOs of Alameda, Caroline Ellison and Sam Trabucco, but did not receive a response. We asked Bankman-Fried some questions through the Signal messaging program, but he hasn't responded to us yet.

Arbitrage to High-Risk Bets Transition

A popular hypothesis holds that the youthful traders at Alameda, formerly one of the world's major crypto trading firms, weren't as experienced as their reputation had them believe they were. When he launched Alameda in 2018, Bankman-Fried was already well regarded as an exceptional trader, and his business model hinged on exploiting the wide price disparities between marketplaces for cryptocurrencies through the practice of arbitrage. The next year, however, he moved his attention to the introduction of his trading platform, FTX. High frequency stock trader-turned-crypto trader Doug Colkitt claims that Gary Wang and Nishad Singh, two of the most skilled employees at Alameda, were among many who followed them to FTX.

Alameda shifted its focus from generating fast, market-neutral bets that didn't depend on anticipating the rise or fall of cryptocurrencies after bitcoin's strong spike in the fall of 2020. The rise of more seasoned firms like Jump has caused some investors to speculate that Alameda was forced to alter its approach to trading cryptocurrency.

One of Alameda's co-CEOs at the time, 26-year-old Caroline Ellison, seemed to acknowledge this turn in March 2021 when she tweeted, "Also relatable is the point where he realizes he's been wasting time trying to trade back and forth for a few points of edge and the way to really make money is figure out when the market is going up and get balls long before that." To gamble on a price increase, or "go long," is to anticipate that the price will continue to grow.

One month later, in the winter of 2020, Alameda's other co-CEO, Sam Trabucco, tweeted, "we got… uh, pretty long." He elaborated, saying, "because that's where all the cash is." Before joining Bankman-Fried to trade cryptocurrencies, Ellison and Trabucco both only had a couple of years of experience trading on traditional markets. That's a small pond from which to draw wisdom and understanding.

Traders speculate that Alameda lost a lot of money on its long bets after May 2022, when the severe downturn in the cryptocurrency market was exacerbated by the collapse of the stable coin terraUSD and its sister cryptocurrency luna. Marina Gurevich, COO of one of the most active crypto trading firms in the world, Wintermute, based in London, says, "What makes you a hero in bull markets destroys you in bear markets." In fact, Bankman-Fried admitted to a Vox reporter through Twitter that his company had amassed a lot of hazardous leverage around the time of luna's crash.

Utilizing Leverage on top of Big Bets

It’s likely that Alameda was using excessive leverage, or debt that may magnify both gains and losses. Company leaders purportedly did this in part by securing loans with FTX tokens (FTT) and a related token (serum), both of which are relatively hard to sell.

For instance, Bankman-Fried played a role in th

e development of a serum that will be made available to the public in the year 2020. The amount of readily tradable Serum coins is rather little because initially 90% of them were kept away for several years. However, he might theoretically extend and conclude that all the coins in circulation were worth $10 billion if the circulating amount of serum was worth $1 billion. A greater estimate would allow him to qualify for larger loans. Crypto investor Jason Choi has claimed that Bankman-Fried used the same approach with additional digital assets, which became known as “Sam coins” among industry insiders.

Last week, Choi tweeted, “This is likely how Alameda/FTX incurred the multi-billion-dollar hole: Alameda pledging illiquid collateral to borrow money to cover wagers, which got margin called as markets went down this year.”

Borrowing Money to Invest in Other Crypto Players

Venture capital investments were an additional source of capital drain. PitchBook reports that Alameda has made over 150 investments in the cryptocurrency industry, including stakes in both the bitcoin mining firm Genesis Digital Mining and the defunct cryptocurrency brokerage Voyager Digital. It appears that Alameda used loans to finance these wagers. Lenders reportedly attempted to recall assets that were locked up in illiquid investments like cryptocurrencies as the market plummeted. Wall Street Journal reports that FTX and Alameda executives took the dubious action of trying to repay some of the Alameda debts with FTX client monies.

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Borrowing for Other Major Spending

In spite of the best efforts of the lawyers, financial detectives, and bankruptcy veterans who have been tasked with unraveling Bankman-web Fried's of interconnected companies' finances, large swaths of information remain hidden from view. However, documents filed in bankruptcy court reveal that FTX executives borrowed billions of dollars from Alameda to finance activities ranging from political donations to Bankman-purchase Fried's of a 7.6 percent share in Robinhood for $650 million. It's not obvious how, on top of everything else, these loans might have contributed to Alameda's losses. A petition made on Thursday in the Chapter 11 bankruptcy proceedings in Delaware shows that Alameda itself has $5.1 billion in outstanding liabilities.

Poor Accounting and Record-Keeping Procedures

Finally, Bankman-enterprises Fried's had inadequate record-keeping and accounting processes, which likely contributed significantly to Alameda's losses. A bankruptcy complaint claims that FTX does not keep account of consumer deposits, therefore it is unknown what is owed to customers at this time. An illustration of this uncertainty is the disparity between the leaked FTX balance sheet, which lists $8.8 billion in liabilities, and Thursday's filing in the Delaware bankruptcy case, which lists only $6.4 billion in liabilities. It's not obvious what accounts for the discrepancy, but nonetheless, the figures are still in motion. "This balance sheet was generated while the Debtors were managed by Mr. Bankman-Fried, I do not have faith in it," workout veteran John J. Ray III, the new CEO of FTX supervising the bankruptcy noted in the complaint. Bankman-Fried has tried to attribute virtually all of the trouble to "messy accounting + margin."

Poor bookkeeping practices on the part of Bankman-Fried appear to have begun in the first days of

Alameda. Alex Pack, a crypto venture capitalist, was conducting due diligence on Alameda in early 2019 and learned the company had lost $10 million in a single month, a significant amount for a company of its size. In response to Pack's inquiry, Bankman-Fried cited "trading errors," as Pack recalls.

Pack claims he tried to find out what happened, but no matter how hard he looked, he couldn't. "At one point, they just remarked, 'Sorry, we didn't have fantastic record keeping back then. We can't address all these questions.'" Not interested in the deal, Pack said no. The "severe carelessness around risk taking and incredibly bad infrastructure and accounting" turned him off from what else seemed like savvy traders.

In today's market, Pack warns that keeping tabs on your crypto holdings might be especially challenging due to the need to develop your own trading techniques, a chore that becomes "exponentially more difficult" as your book of business expands. And Pack believes it's "not unthinkable" that Alameda may have ended up with considerably more debt than they knew, as Bankman-Fried has asserted, provided they started with faulty accounting processes.