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The crypto exchange graveyard and why regulation is essential

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An unprecedented amount of cryptocurrency exchanges have collapsed to form an 'exchange graveyard'. One of the world's three cryptocurrency regulatory officers unpacks this phenomenon.



Joey Garcia, chief legal and regulatory officer at Xapo Private Bank

Recent high-profile crypto exchange failures such as FTX are well known, however few people are aware of the rate at which exchange collapses happen on a global scale. Since the FTX collapse, around 54 crypto exchanges have failed for a variety of reasons. These exchanges, referred to as the 'exchange graveyard,' have left a trail of destruction behind them. This begs the question: In an environment where users want to gain access to a virtual asset and a technology that they trust, how secure is the ecosystem and how secure are the exchanges providing access to that technology and asset class?

Joey Garcia, chief legal and regulatory officer at <u>Xapo Private Bank</u>, is one of the most respected global legal thought leaders on crypto regulations. He is a specialist consultant to the United Nations and various governments and entities on the evolution of crypto regulation, and a member of the prestigious global Wharton Reg@Tech think tank.

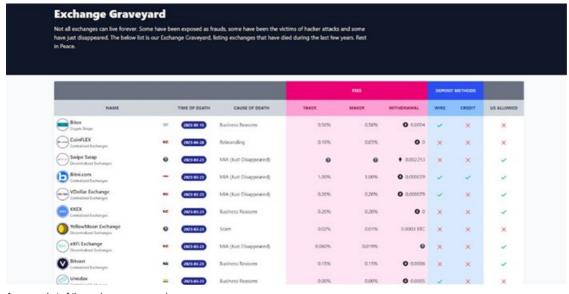
"Exchanges, large and small, act as the biggest 'intermediaries' in the world for users to gain access to virtual assets, but many of them work to very un-secure and unregulated standards that people are simply unaware of. Exchanges do not typically deal with the segregation of customer assets from the exchange assets properly in order to keep those assets safe, they are not capitalised appropriately to deal with business risk, and do not have even the basic governance structures in place that you would expect for any regulated business.

> *As more and more people enter the crypto market, it is crucial that they understand the importance of regulations...* **J**

"Users obviously don't tend to do due diligence on exchanges, and generally follow trends, but that creates its own issues. Looking at things like the proof of reserves of an exchange is not enough if you can't see the liabilities of the exchange recorded against those assets. Understanding that there are basically no principles or law in most of the world that relate to the integrity of the markets created by a crypto exchange is something that people need to understand. They should be aware that there are safer alternatives available," says Garcia.

Gibraltar-based Xapo Private Bank is the first fully regulated crypto-hybrid international bank offering crypto-friendly dollar accounts to protect one's wealth offshore. A pioneer in the international industry, it is the first bank in the world to support USDC deposits and withdrawals from a US Dollar bank account, enabling members to send USDC to beneficiaries anywhere in the world without any fees.

"We are the bridge between the regulated world of an interest bearing USD bank account, and the crypto/defi/web3 ecosystem by allowing our members to interact with that space on a crypto native blockchain payment rail basis. Any person can choose to send USDC out onto whatever platform they choose to take their own risk, but we are also the secure pillar and bridge to exit that space and hold the assets back on a deposit guarantee scheme insured USD bank account. It really is unique in the world."



A screenshot of the exchange graveyard

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What makes exchanges fail?

Just how did so many exchanges collapse? There have been several reasons:

- Lack of regulation: The lack of regulatory oversight in the crypto industry has also contributed to the collapse of some exchanges. Without proper regulations, exchanges are often left to their own devices, which can result in poor business practices, insufficient security measures, and lack of transparency. Sometimes not only the lack of regulation but the actual lack of the monitoring of those authorities can also lead to multiple issues.
- 2. Liquidity problems: Another challenge that crypto exchanges face is liquidity. Without enough buyers and sellers in the market, an exchange may struggle to match orders and provide sufficient liquidity for its users. This can lead to price slippage, making it harder for traders to execute their trades at the desired price.
- 3. Security breaches: One of the biggest challenges that crypto exchanges face is the security of their users' funds. If a hacker gains access to the exchange's servers they can have the ability to drain funds stored in those wallets. Many exchanges have suffered from such breaches, and users' accounts may not be insured or secured in any way.
- 4. **Business model issues:** Some exchanges have also faced issues with their business models, including unsustainable fee structures or a lack of revenue streams. In some cases, exchanges have struggled to attract enough users to sustain their operations, leading to financial difficulties and eventual collapse.
- 5. **Fraud:** Finally, there have been cases where exchanges have been outright fraudulent, with the operators stealing user funds or engaging in other illegal activities. These cases have usually resulted in the exchange being shut down and the operators facing legal action.

Garcia has been working tirelessly to train authorities around the world in regulation as crypto assets become the norm. As the crypto industry continues to grow, so does the need for regulations that can ensure the security and stability of the ecosystem in a way that can protect consumers.

"Without proper regulations, investors and traders are left vulnerable to the risks of fraud, theft and market manipulation. The lack of regulatory oversight can hinder the mainstream adoption of cryptocurrencies. The move to decentralised networks is not necessarily a solution but simply a shift in the risk of the middleman, to a risk of the middleware and this isn't something that is understood by many," says Garcia.

Prior to joining Xapo Private Bank in Gibraltar, Garcia's expertise and advocacy for increased crypto regulations made him a global authority and resource for authorities, companies and individuals on evolving crypto regulations. Currently, Garcia is working closely with the progressive <u>Gibraltar Financial Services Commission</u> to define modern regulatory frameworks and policy that bring a greater level of oversight to crypto-friendly banking and virtual asset custodianship by regulated entities like banks and Virtual Asset Service Providers (VASPs).

As more and more people enter the crypto market, it is crucial that they understand the importance of regulations and the risks that are associated not only with unregulated exchanges, but with exchanges which are 'regulated' only for compliance and money laundering purposes. Not for their core activity and business.

In conclusion, the crypto exchange graveyard is a stark reminder of the need for increased regulation across the industry. Joey's efforts to train authorities around the world in regulation and advocacy for increased oversight are critical to the long-term success of the crypto ecosystem.

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