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NEWS RELEASE

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Financial Literacy Tip of the Week

DECENTRALIZED FINANCE AND ITS POTENTIAL IMPACTS FOR INVESTORS

Boise, Idaho... As we continue to spotlight Financial Literacy Month, the Idaho Department of Finance seeks to raise public awareness regarding the developing area of decentralized finance (DeFi) including what it is, how it might impact the financial services industry, and how investors can help protect themselves from potential scams. “With any new investment or innovation, understand the risks and never invest more than you can afford to lose”, said **Patricia Perkins**, Director of the Idaho Department of Finance.

What is DeFi?

First, it is important to understand our current, centralized financial infrastructure.

Financial services markets are traditionally overseen by different regulators. To gain access to money, one must work with financial intermediaries for auto loans, mortgages, brokerage accounts, investment accounts, stocks and bonds. Regulators set the guidelines and rules that consumers must meet to get a bank account, access loans and invest.

DeFi refers to financial services provided by an algorithm on a blockchain, without a financial services company. It is an alternative approach, based on the belief that the centralized approach is inefficient and that current banking systems are especially vulnerable to cyber-attack because of the centralized nature of the system and the use of outdated technology.

Unlike traditional banks and investment firms, DeFi financial services firms use digital assets, instead of fiat currency, to provide banking and financial services such as depository services, lending, investing and management services. Some of these services may be operated outside current regulatory frameworks.

How Might DeFi Impact the Financial Services Market?

The growing popularity of cryptocurrencies is one of the main drivers behind the development of alternative banking and business opportunities that may rely on DeFi models.

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Companies entering this space are now offering banking and investing services that rely on cryptocurrencies instead of conventional fiat currencies, such as the U.S. or Canadian dollar or Mexican peso.

These alternative financial services providers distinguish themselves from mainstream companies by offering lending, banking and investing options that are decentralized, or not dependent on traditional financial markets.

These alternatives tend to be unregulated or operate illegally in a regulated space. As a result, DeFi markets lack many of the protections offered by regulated service providers. Investors should use caution any time they consider investing in unregulated investment products on unregulated platforms.

How Can I Protect Myself from DeFi Scams?

DeFi is an emerging technology and as such, its risks differ from those in traditional markets:

1. Most jurisdictions do not regulate these types of depository accounts or products under banking laws because they are predicated on cryptocurrencies and not fiat currencies. Don't invest more than you can afford to lose.
2. There are no restrictions or guidelines on who can use DeFi, so anyone can have a crypto wallet or use a smart contract. Do your homework and understand the technology. Although it may be accessible to everyone, it may not be right for everyone. Be wary of representations of full transparency and security and understand what the actual risks are. While a blockchain may be nearly impossible to alter, most of DeFi's potential use cases rely on software systems that are vulnerable to hackers.
3. There are no DeFi consumer protections in place. Users may have little recourse should a transaction go wrong, and the parties involved in the transaction could literally be located anywhere in the world. Is it too good to be true? Given the complexity of the various lending and borrowing mechanisms at play with DeFi, an average investor may find it hard to distinguish between DeFi opportunities that have real value and those that are scams.
4. Should it be regulated? If it looks like an investment, lending, or banking opportunity, there is a good chance the service and the people selling it should be registered. Use caution before you put your money at risk in an unregulated marketplace that may be operating illegally.

Bottom Line

As with any new technology an investor can expect to see many opportunities for investment. Always check with your state or provincial securities regulator before risking your money.

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