Bitcoin and Ethereum are cryptocurrencies built on blockchain technology, a decentralized digital ledger that reflects all transactions made on that blockchain. Blockchain technology allows users to — among other things — obtain, sell and invest in digital assets, like cryptocurrencies.

DeFi uses the blockchain to allow users to engage in financial activities to handle finances on a peer-to-peer level.

The DeFi blockchain technology is run using apps called dApps and "protocols", which are programs used to handle financial transactions using Bitcoin and Ethereum, and that allow users to access the applications from anywhere in the world.

Who sets the rules and governs how DeFi works?

A decentralized autonomous organization (DAO), sometimes called a decentralized autonomous corporation (DAC), is an organization represented by rules encoded as a computer program that is controlled by the organization's members.

A DAO's financial transaction record and program rules are maintained on a blockchain and it uses blockchain technology to provide a digital ledger. A blockchain digital ledger is a computer file where monetary and financial transactions are recorded.

Smart contracts, a self-executing contract with the terms of the agreement between buyer and seller directly written into lines of code, are used to handle DeFi transactions. The code and the agreements contained therein exist across a distributed, decentralized blockchain network. The code controls the execution, and transactions are trackable and irreversible.

Decentralized exchanges (DEXs), meanwhile, facilitate peer-to-peer transactions without the need for an intermediary that holds custody of the funds.

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.
- 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.
- 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 be located anywhere in the world.
- Is DeFi really accessible to everyone? The collateral required to use DeFi lending is typically equal to at least 100 percent of the value of the loan, greatly limiting who is eligible.
- Understand DeFi technology. DeFi requires you to have a private key to secure your wallet that houses your cryptocurrency assets. A private key is a long, unique code known only to the owner of the wallet. If you lose your private key, you lose access to your funds—there is no way to recover a lost private key.
- 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.
- 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 licensed. Use extreme caution before you put your money at risk in an unregulated marketplace that may be operating illegally.

Bottom Line

Always check with your state or provincial securities regulator before risking your money.