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Sam Bankman-Fried reveals how DeFi works like Ponzi scheme

As the Commodity Futures Trading Commission (CFTC) deliberates whether or not to allow FTX to [algorithmically settle margin trades](#), its founder and CEO, Sam Bankman-Fried (SBF), recently revealed how DeFi works similar to a Ponzi scheme.

In an eye-opening episode of the *Odd Lots* podcast, Bankman-Fried explained how yield farming works. The hosts weren't the only ones left stunned by the digital currency billionaire's explanation of how this shell game operates under the hood.

SBF explains yield farming with a box analogy

In an attempt to explain how yield farming works, Bankman-Fried asks viewers to imagine a box. He says, "You start with a company that builds a box," and that the marketers of this box will attempt to sell it as some sort of world-changing protocol. He explains how you can put digital currencies like [Ethereum](#) into the box and get an IOU.

The next step is for the developers to issue a token. Holders of said token will often have governance rights over what happens inside the box. For example, they might get to say what happens to the newly minted tokens that derive from the box. This [token](#) is then given away or purchased, giving it a larger market cap, causing other market participants to notice it and view it as valuable.

"I acknowledge that it's not totally clear that this thing should have a market cap, but empirically I claim it would have a market cap," Bankman-Fried pointed out.

The [FTX](#) boss then describes how the high returns derived from these boxes entice new speculators to put more money in. The fact that there's now a large amount of money in the box causes others to think it must be legitimate and to put more in. This can cause the token price to rise rapidly, and the whole process is amplified if the total number of tokens available is small.

Matt Levine intervenes at this point of the conversation, describing this as "cynical" and likening it to an outright [Ponzi scheme](#). Bankman-Fried says that these boxes mostly value market participants' perception.

Bankman-Fried and FTX sell these boxes

Despite acknowledging that it's unclear whether these tokens should have any market cap, [Bankman-Fried](#) is happy to sell them on his FTX exchange. Many of them are available to trade on leverage. To name but a few, FTX lists LUNA, CURVE, and YFI, all of which have undergone dramatic price rises at various points of the recent bull market. Many of these have also

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So, if Bankman-Fried is not sure these tokens should even have a market cap, why is he willing to sell them? And if he agrees that the whole process could be viewed as cynical, why does he participate in any of it, to begin with? Perhaps the next podcast host will ask him.

Should FTX be allowed to algorithmically clear leveraged trades?

The first paragraph of this article links to a story describing [how the CFTC is currently deciding](#) whether to allow FTX to algorithmically clear margin trades on its platform. Bankman-Fried touts this as financial innovation, but it really is the last check and balance on the activities of his firm.

If the CFTC allows this, all of the third parties involved in the trading process today, including brokers, would be cut out and would have no way to call foul on what's going on inside FTX. It would also give FTX algorithms the power to auto-liquidate traders, which should be viewed with alarm given that it [stands accused of counter-trading](#) its customers.

By Bankman-Fried's own description of how Defi works, it's one of the largest Ponzi schemes in history. Perhaps the CFTC should proceed with caution before giving one of its poster children unchecked power.

Follow [CoinGeek's Crypto Crime Cartel](#) series, which delves into the stream of groups—a from [BitMEX](#) to [Binance](#), [Bitcoin.com](#), [Blockstream](#), [ShapeShift](#), [Coinbase](#), [Ripple](#), [Ethereum](#), [FTX](#) and [Tether](#)—who have co-opted the digital asset revolution and turned the industry into a minefield for naïve (and even experienced) players in the market.

New to Bitcoin? Check out CoinGeek's [Bitcoin for Beginners](#) section, the ultimate resource guide to learn more about Bitcoin—as originally envisioned by Satoshi Nakamoto—and blockchain.

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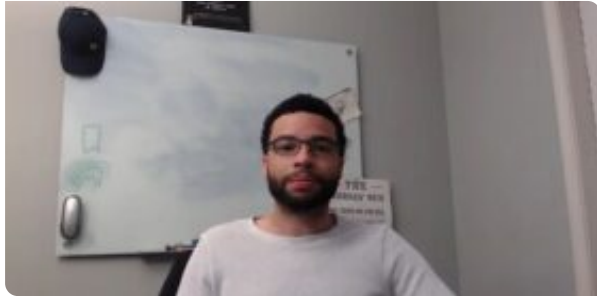
A New York federal court has ordered the co-founders of BitMEX exchange to pay \$30 million in civil monetary penalty in connection with charges of violating the U.S. Bank Secrecy Act.



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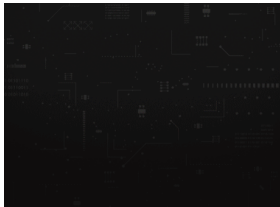
BSV developer and thought leader Joshua Henslee recently shared his thoughts on why the Bitcoin protocol and its being set in stone matters.



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