Securities Regulation Daily Wrap Up, BLOCKCHAIN—CFTC fines operators of 3 DeFi protocols for illegal derivatives trading, (Sep 8, 2023)

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ZeroEx, Opyn, and Deridex all were charged with offering leveraged and margined retail commodity transactions in digital assets without registering with the CFTC; Commissioner Mersinger dissents.

The CFTC has simultaneously filed and settled charges against three decentralized finance, or DeFi, platform operators: Opyn, Inc., a Delaware-registered company based in California; ZeroEx, Inc., a Delaware company also based in California; and Deridex, Inc., a Delaware company based in North Carolina.

Deridex and Opyn are charged with failing to register as a swap execution facility or designated contract market, failing to register as a futures commission merchant, and failing to adopt a customer identification program as part of a Bank Secrecy Act compliance program required of FCMs.

ZeroEx, Opyn, and Deridex also are charged with illegally offering leveraged and margined retail commodity trades in digital assets.

Each of the firms offered transactions in connection with blockchain-based software protocols and smart contracts, or DeFi, which function similarly to trading platforms and claim to offer users the ability to engage in transactions in a decentralized environment.

The CFTC ordered Opyn, ZeroEx, and Deridex to pay civil monetary penalties of $250,000, $200,000, and $100,000, respectively, and to cease and desist from violating the CEA and CFTC regulations, as charged. The companies agreed to settle the charges.

Unlawful actions are not "smart." "Somewhere along the way, DeFi operators got the idea that unlawful transactions become lawful when facilitated by smart contracts," said Ian McGinley, the CFTC's director of enforcement, in a statement. "They do not. The DeFi space may be novel, complex, and evolving, but the Division of Enforcement will continue to evolve with it and aggressively pursue those who operate unregistered platforms that allow U.S. persons to trade digital asset derivatives."

- In the case of Opyn, Inc., the CFTC order stated the firm developed and deployed a blockchain-based digital asset trading platform (the "Opyn Protocol") that offered trading of digital asset derivatives based in part on the price of ether to traders in the U.S. and abroad. By accessing the Opyn Protocol, users could enter into long and short derivative positions in "power perpetuals," derivative products based on an index created by Opyn that tracked the price of ether, a commodity in interstate commerce, squared (i.e., to the power of two), relative to the stablecoin USDC. Opyn never registered with the Commission.

- ZeroEX, or "0x," developed a blockchain-based digital asset protocol that offered retail and global institutional users the ability to trade digital assets through various blockchains. 0x users trade on a peer-to-peer basis, meaning, according to 0x, that users "trade directly from [their] Ethereum wallet and retain complete custody of [their] tokens throughout the entire process." In addition, 0x created and operated a front-end user interface called "Matcha," which utilized the 0x Protocol to enable users to exchange digital assets. Matcha was marketed as a decentralized exchange (DEX), as well as a DEX aggregator that compiled price data from multiple other DEXs and market makers.

- Deridex developed and maintained a blockchain-based digital asset trading platform (called the “Deridex Protocol”) marketed as a “decentralized on-chain derivatives platform.” It also offered leveraged trading of digital asset derivatives to retail and institutional users in the U.S. and abroad, without registering with the CFTC. Through the Deridex Protocol, users could contribute margin and establish and liquidate positions in “perpetual contracts,” a leveraged derivative product whose value was based on the relative price difference between two digital assets.

Mersinger sees shift in CFTC’s position. In a strongly worded dissent against the enforcement actions, CFTC Commissioner Summer Mersinger emphasized that “’Enforcement First” has not always been the CFTC’s default position,” adding that she views the cases as concerning “in that they represent a significant shift in position on the merits of engagement with DeFi market participants.”

In these cases, “we are asked to find liability and impose sanctions based on a novel technology that was decentralized in conception and operation—an area that has not previously been the subject of a CFTC enforcement action,” Mersinger said.

In addition, the Commission’s orders “give no indication that customer funds have been misappropriated or that any market participants have been victimized by the DeFi protocols on which the Commission has unleashed its enforcement powers,” she said.

Blockratize set precedent. Although Mersinger saw the enforcement actions as moving the CFTC in a new direction, the cases were not without precedent.

As reported in *Securities Regulation Daily* in January of last year, the CFTC required Blockratize, Inc., doing business as Polymarket, to pay a $1.4 million civil penalty and take remedial actions for illegally offering off-exchange event-based binary options contracts and failing to register as a designated contract market or swap execution facility.

The platform offered contracts that traded on the outcome of current events in addition to contracts based on cryptocurrencies, or digital assets. The CFTC found that Polymarket’s event market contracts constituted swaps under the CFTC’s jurisdiction and could only be offered on a registered exchange in accordance with the CEA and CFTC regulations. Neither Blockratize nor Polymarket were registered with the CFTC.

“All derivatives markets must operate within the bounds of the law regardless of the technology used, and particularly including those in the so-called decentralized finance or ‘DeFi’ space,” said Vincent McGonagle, then the CFTC’s acting director of enforcement.

This is CFTC release No. 8774-23.

Companies: Opyn, Inc., ZeroEx, Inc. and Deridex, Inc.

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