# Public Comment on IOSCO’s Consultation Report on Policy Recommendations for Decentralized Finance (DeFi)

*Consultation Public Comment by the Digital Currencies Governance Group*

## About DCGG

*Digital Currencies Governance Group (DCGG) is a trade association that represents digital assets issuers and service providers in the European Union and the United Kingdom. Our mission is to facilitate an open dialogue and encourage communication between policymakers and digital asset experts to support the design of a sound and proportionate regulatory framework that ensures safety for all market participants. Our Members include Tether - currently the largest stablecoin issuer worldwide, Ledger - a leading technology service provider for self-custody, Bitfinex - a major centralised crypto-assets exchange, ZKValidator (ZKV) - a leading proof-of-stake validator, and Iden3 - a solutions provider for self-sovereign identity management. Our team of former government officials, lawyers, and cryptoasset experts regularly engage with policy-makers and regulators both at the national and international level. For any general enquiries or to request further information, please do reach out to [info@dcgg.eu](mailto:info@dcgg.eu).*

## Consultation questions

### 1. Do you agree with the Recommendations and guidance in this Report? Are there others that should be included?

The Digital Currencies Governance Group (DCGG) applauds the effort made by IOSCO to seek public input on DeFi regulation, and we are pleased to contribute our members' perspectives to this vital discussion. We support the Recommendations and guidance offered in the report but urge caution in developing a detailed taxonomy ahead of placing potentially over-burdensome regulations.

The regulation of DeFi is complex due to the various actors involved and different levels of governance and transparency. Protecting consumers is crucial, and a technology-neutral approach should be taken, but DeFi presents unique regulatory challenges. We propose that IOSCO promotes a coordinated approach to define DeFi-specific activities, such as creating or operating a protocol, which would enable tailored regulations for these activities. This would help determine where regulation applies among various degrees of decentralisation. Therefore, it is essential to define ‘centralisation’ and the manner in which it should be measured and assessed within a protocol in order to develop applicable guidelines.

From both a regulatory and industry standpoint, we agree with Recommendation 1, which emphasises the importance of understanding DeFi products and activities within a jurisdiction. As highlighted, we believe IOSCO could take a lead role in creating standardised definitions for DeFi activities.

While we agree with Recommendation 2 that seeks to place liability through the identification of responsible persons and entities exercising significant influence, the lack of a clear definition of 'decentralisation' makes this objective challenging for regulators and industry players. We disagree with classifying developers as equally liable as those holding financial or legal controls. Developers' roles are limited to the product's creation, testing, and launch, which differs from other examples in the report. However, we do support obligations for proper product testing to ensure consumer safety, the obligation to be transparent about the nature of the organisation as a decentralised entity, the standards and protocols followed, and some indications of the risks associated with the products or services.

An ill-defined taxonomy could lead to regulatory fragmentation and reduced legal clarity for the industry (especially considering different DeFi arrangements and the cross-border character of the sector), as well as significant difficulties for regulators to effectively oversee and supervise such arrangements, especially when a 'responsible person' cannot be identified. Clear definitions can help regulators distinguish between centralised providers posing as decentralised ones and true decentralised setups, allowing appropriate rule enforcement.

The definition and measurement of decentralisation should be considered in the context of IOSCO's full list of Recommendations and guidance. Moreover, we see it as necessary for more clarity to be provided on conflict of interest identification and liability for responsible persons in decentralised ecosystems. A detailed classification can aid market development, disclosure preparation, and legal protection clarification for DeFi arrangements.

Regarding this last point, we believe it is important to take a more balanced approach that recognises the liability of a DAO itself while providing individual members with limited liability. This stands in opposition to a recent court case in the US that ruled that any individual American who, at any point, owns or owned tokens in a DAO could be liable for violations the DAO commits.

Given the global and complex nature of this sector, we support increased cooperation between regulators, experts, researchers, academics, and trade bodies to comprehensively address emerging risks without hindering industry growth. To bolster regulatory insight and innovation, we suggest expanding the guidance to recommend the establishment of regulatory sandbox initiatives. These controlled environments allow companies to test their products and business models without full regulatory requirements, fostering innovation. Such sandboxes can be domestic or cross-border, aligning with Recommendation 8 to promote cross-border cooperation and information sharing, similar to the success of the Global Financial Innovation Network (GFIN).

**2. Do you agree with the description of DeFi products, services, arrangements, and activities described in this Report? If not, please provide details. Are there others that have not been described? If so, please provide details.**

From DCGG's perspective, the description of DeFi products, services, arrangements and activities put forward in this Report summarises the current ecosystem adequately and sufficiently. We do not have further comments to add at this stage.

**3. Do you agree with the Report's assessment of governance mechanisms and how they operate in DeFi? If not, please provide details**

DCGG agrees that certain DeFi arrangements could exhibit a higher level of centralised governance at the initial stage (e.g., infrastructure building, development, and subsequent testing and launch) and that governance mechanisms are not self-implementing. However, as an alternative viewpoint, as long as abuse is not carried out post-launch, we believe a more centralised structure prior to the launch of a DeFi protocol (such as the processes mentioned above) is helpful for mitigating potential risks and ensuring smooth operation of the arrangement, for example through the testing and security auditing of the smart contract to avoid the exploitation of vulnerabilities.

As long as no majority power is held by one individual, entity or group of individuals post-launch and during operations, users are able to properly harness the benefits of a decentralised service. We believe the different governance mechanisms outlined in this Report contribute to meeting various consumer demands, and in order to avoid risks for DeFi users and promote informed investor decisions, we support transparent disclosures regarding governance structures, as well as increased cooperation between industry experts and regulators, to achieve this objective.

The Report's assessment of DeFi governance mechanisms correctly pinpoints the risk of concentrated governance (i.e., one or several entities exercising significant and disproportionate control over a DeFi arrangement). More in-depth understanding of these structures should be developed through engagement with industry participants to understand how a balance can be struck between ownership of governance tokens and, importantly, customer protection. Joint efforts should focus on developing thresholds in order to estimate how concentration could, for example, impact the execution of a DeFi protocol, taking into account the size, customer base, functionalities and use-case.

**4. Do you agree with the risks and issues around DeFi protocols identified in this Report? If not, please provide details. Are there others that have not been described? If so, please provide details. How can market participants help address these risks and/or issues, including through the use of technology? How would you suggest IOSCO members address these risks and/or issues?**

DCGG notes that, while we agree that the risks identified in this Report can occur, it is important for regulators to be able to establish a methodology to assess whether certain risks are isolated and can be attributed to the nascent character of the DeFi industry, or whether they have the potential of becoming systemic, and therefore more likely to affect market stability or spill over into traditional markets. Such a methodology should be subject to joint efforts by industry experts and regulators alike in order to strike the appropriate balance between safeguarding consumers and market integrity, and allowing the necessary flexibility for the sector to grow. Furthermore, it is important that the regulator takes into account the extent to which some of these risks are controllable by developers of DeFi protocols, and liability should be proportionate.

**5. Do you agree with the description of data gaps and challenges in the Report? If not, please provide details. Are there others that have not been described? If so, please provide details. How can market participants address these data gaps and challenges, including through the use of technology? How would you suggest IOSCO members address data gaps and challenges?**

DCGG observes that the data gaps and challenges identified in the Report can indeed occur and are in line with the reality of an early development stage of a sector such as DeFi. Based on this, our view is that addressing these challenges should happen collaboratively and simultaneously by market participants and regulators alike.

For instance, the Report notes the difficulty in analysing and interpreting data stemming from Blockchain activity in the DeFi context. To ensure these insights are taken into consideration as efficiently as possible, we believe Regulators should be open to receiving comprehensive training to be able to handle and make observations and conclusions based on such data, or alternatively allow the industry a sufficient period of time to develop common standards for DeFi activity data analysis before any strict regulatory obligations are enforced. In general, our view is that standardisation regarding any of the data challenges outlined in this Report can be achieved, as long as an adequate amount of time is given to industry participants to coordinate. Importantly, this would also contribute to a better and more holistic understanding of the sector by regulators.

Furthermore, we see the suggested metrics for analysis of DeFi protocols, blockchains and the market more broadly in Annex C as sensible, but we would like to highlight that not all of these are fully applicable due to the diverse and constantly innovating nature of DeFi products and services. We would therefore welcome more clarity as to the scale of importance for each set of metrics, as well as the methodologies through which these would be assessed, such as the proposed 'metrics for stablecoins'.

Considering the nascent nature of the DeFi space, DCGG views the data gaps described in this Report as to be overall in line with the early stage of development and adoption that the sector is in. Moreover, two of the specific gaps defined in the Report, i.e., lack of financial reporting and failure to register/license are in our view not relevant at this stage, given no holistic, bespoke regulation of DeFi exists among IOSCO members, nor a clear definition/taxonomy. Yet, we do support the suggestion of the DeFi sector to establish a self-regulatory organisation (SRO) to establish a set of practices and standards for facilitating data collection and distribution. We see this to be beneficial not only for forging cooperation between regulators and industry, but also for the broader industry as a whole to adopt crucial standards for the collection, interaction and distribution of data where relevant.

**6. Do you agree with the application of IOSCO Standards to DeFi activities contained in this Report? Are there other examples of how IOSCO Standards can apply?**

We support global standard setting as a positive step toward understanding DeFi, facilitating safe adoption and promoting consumer protection, while simultaneously fostering growth and innovation in the sector. IOSCO's Standards, in tandem with recommendations and non-legally binding principles put forward by other international bodies such as the Financial Action Task Force (FATF) and the Financial Stability Board (FSB), are crucial for understanding the sector and mitigating potential risks. Nevertheless, as outlined earlier in our response, applying these standards should not be a one-size-fits-all approach, and there should be careful consideration as to the level of decentralisation (e.g., fully decentralised, partially centralised, or fully centralised) of a DeFi arrangement and to what extent these standards can apply as they are, or if they would have to be modified to adequately address the specificities of the  respective product or service.

**7. Is there any additional guidance that you would find relevant to help IOSCO members comply with these Recommendations? If so, please provide details.**

As outlined in our response to Question 1, DCGG and its members strongly recommend that IOSCO members look into enforcing and complying the proposed Recommendation only after a proper definition of decentralisation and DeFi (arrangements, products and services) is developed to facilitate the oversight and supervision process, as well as promote legal clarity for industry participants.

**9. Are there particular methods or mechanisms that regulators can use in evaluating DeFi products, services, arrangements, and activities, and other persons and entities involved with DeFi? If yes, please explain.**

From DCGG's perspective, as already pointed out throughout our response to this consultation report, taking into account the current lack of clear definitions, the conceptual and operational complexities of DeFi arrangements and the nascent character of the industry, the most effective approach at this stage would be close cooperation with regulators internationally, as well as industry experts, researchers, academics and developers. This would aid in establishing sound taxonomy that would later significantly facilitate the process of evaluating different DeFi arrangements and the specific level and weight of involvement of persons part of a specific ecosystem where a higher level of centralisation can be observed.

**10. Do you find the interoperability between this report and the IOSCO CDA Report to be an effective overall framework? If not, please explain.**

With IOSCO being an international standard-setting body, we see the benefit of interoperability of this Report and the CDA Report to achieve a more holistic and comprehensive framework in the pursuit of the 'same activity, same risk, same regulatory outcome' principle. Yet, as highlighted earlier in our response, the lack of clear definition of decentralisation could make this objective more difficult to achieve and cause unnecessary friction in application of regulatory measures for the DeFi sector in particular.

This can be observed in the flowchart outlined in this Report, whereby the condition of arrangement self-identifying or being identified by a regulator as decentralised or DeFi, which is central in the differentiation from the CDA report, appears quite vague and generalised as it currently stands. We urge for more granularity in this regard, preferably through sound definitions and methodologies for estimating what is considered decentralised and its level of decentralisation, before there further interlinkages with the CDA report are prompted.