



The Next Frontier: Frameworks for DeFi Governance and Regulation

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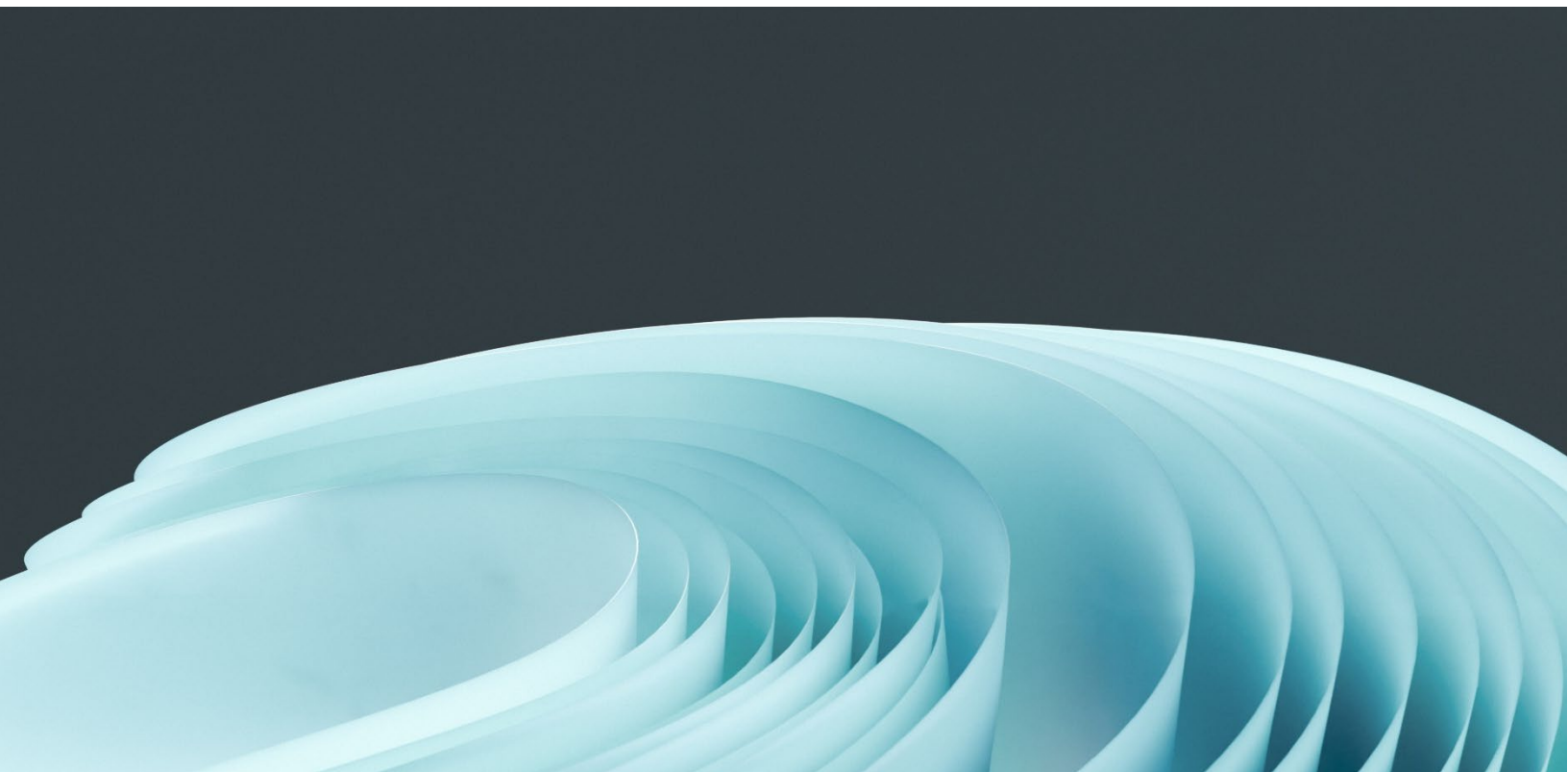
Executive Summary

Discussions on the regulation of decentralised finance (DeFi) have gained momentum over the past few years. The International Organization of Securities Commissions (IOSCO) has finalised its recommendations on how supervisory oversight could be applied in its [Final Report with Policy Recommendations for Decentralized Finance \(DeFi\)](#), which are predicated on the concept of ‘Responsible Persons’. Similarly, as a part of [Project Guardian](#), the Monetary Authority of Singapore (MAS) is exploring the concept of ‘Trust Anchors’, which are regulated financial institutions that screen, verify and issue verifiable credentials to entities that wish to participate in DeFi protocols.

However, the question still remains: What are the challenges and opportunities when it comes to DeFi regulation? Why has it been so difficult to achieve this? Is there a need for more private-public partnerships and awareness programs? And finally, how are DeFi players integrating compliance into their very infrastructure?

These were some of the themes that emerged at the closed-door, invitation-only Elevandi Insights roundtable at the Point Zero Forum 2024 hosted by Ripple and TRM Labs. A select group of global regulators, investors, technology providers, and senior leaders from financial institutions joined the session to share their insights on the evolving landscape of DeFi regulation, the challenges in implementation, and innovative approaches to compliance in decentralised systems.

Here are the key takeaways from the discussion.





#1 Developing a Global Framework for DeFi Taxonomy

Creating a single global definition or taxonomy for DeFi has proven to be an elusive goal. The complexity is the result of its borderless nature, disparate regulatory frameworks, and, until now, the global regulatory focus on the more centralised cryptocurrency ecosystem.

"The lack of a single, universally recognised definition for DeFi is leading to confusion and misalignment in regulatory approaches."

ROUNDTABLE PARTICIPANT

Despite the lack of consensus on a clear definition, there has been progress in developing frameworks to analyse DeFi. National regulators are experimenting to better understand DeFi mechanisms and their impact on traditional finance, while international bodies are proposing multi-layered approaches to evaluate DeFi projects considering corporate structure, functionality, and technical details. These efforts highlight the need for a nuanced, flexible approach rather than a single, rigid taxonomy.

As discussions continue, the focus is shifting to practical regulatory challenges. Policymakers are looking to collaborate with DeFi developers to address technological and regulatory issues. There is also growing interest in using blockchain's transparency for better oversight. While a global DeFi taxonomy remains a work in progress, these ongoing dialogues between the public and private sectors are laying important groundwork for developing governance frameworks that can adapt to this changing landscape.

#2 Addressing Regulatory Challenges in the DeFi Landscape

The global financial landscape is evolving with the emergence of DeFi. However, a key challenge to regulating this new financial ecosystem lies in the varying levels of understanding and regulatory capacity among different countries. This disparity can create openings for regulatory arbitrage, where institutions could take advantage of inconsistencies in regulations across jurisdictions. This can potentially undermine the effectiveness of regulations and introduce risks to global financial stability.

Another challenge is the nature of DeFi transactions, which often use smart contracts. In traditional finance, intermediaries like brokers, dealers, and banks play specific roles and hold clear accountability. However, smart contracts in DeFi eliminate these intermediaries, making it difficult to assign responsibility in case of malfunctions or disputes. This raises concerns about enforceability and accountability within a decentralised environment. The decentralised nature of smart contracts themselves can further complicate regulatory efforts.

Finally, the national reach of regulations is challenged by the global reach of the DeFi ecosystem. In the absence of global alignment, this also creates potential for regulatory arbitrage. Enhanced international



cooperation among regulators is crucial to effectively address the global nature of DeFi. This could involve establishing frameworks for information sharing, collaborative investigations, and coordinated enforcement actions to create a more cohesive regulatory environment.

#3 The Need for Public-Private Partnership

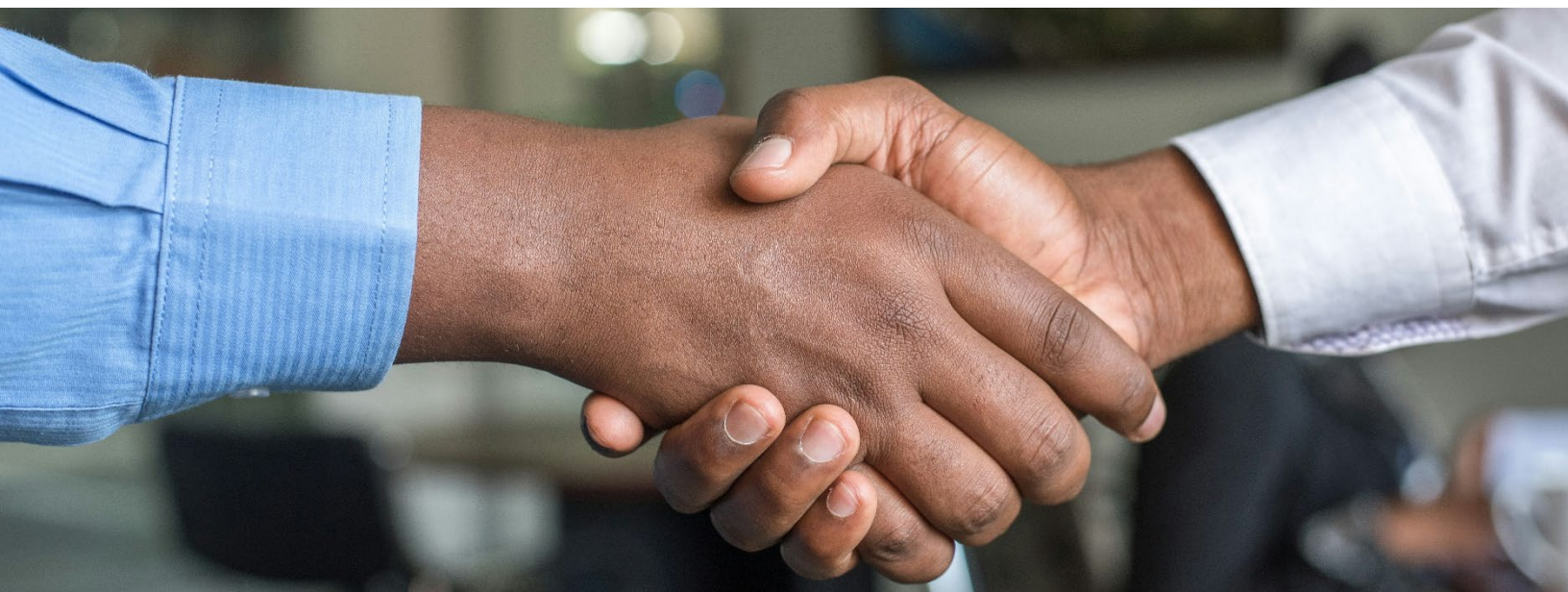
Effective DeFi regulation requires cooperation between regulators and industry participants. This is particularly important due to the borderless nature of DeFi, which makes unilateral regulation by any single jurisdiction challenging. Through collaboration, both sectors can develop more comprehensive and practical oversight frameworks.

One key aspect of this collaboration is capacity building for regulators, particularly regarding emerging technologies like DeFi and digital assets. Initiatives such as the [University of Cambridge's digital asset courses](#) can play a crucial role in this process. Additionally, the development of digital tools like dashboards for stablecoin tracking can equip regulators with the necessary insights to effectively monitor the evolving digital finance landscape. One such example is [Project Pyxtrial](#), which explores using technology solutions to monitor asset-backed stablecoins' balance sheets in near real-time.

"An open dialogue between public and private sectors is important for collaboration in DeFi. This includes integrating compliance smoothly for sustainable growth and regulatory harmony."

ROUNDTABLE PARTICIPANT

Striking a balance between fostering innovation and ensuring financial stability is crucial. Public-private partnerships can leverage technologies like blockchain for beneficial uses while ensuring compliance with existing regulations. Examples include collaborations between regulators and private companies to facilitate the secure transfer of funds for humanitarian aid using blockchain. This cooperation can promote technological advancements that enhance efficiency and productivity within financial markets, ultimately benefiting the global economy.





#4 Balancing Innovation and Regulation: The Path Forward for DeFi Compliance

DeFi players are already implementing different forms of compliance by design, even in the absence of specific regulations. Key approaches include using blockchain analytics tools to screen wallet addresses for illegal activity, implementing token screening systems to flag potential scams or fraudulent tokens, and maintaining high-security standards to prevent hacks and exploits. For user-facing interfaces, DeFi protocols include compliance checks and risk management practices, such as blocking flagged addresses from connecting. However, implementing compliance at the core protocol level is still a challenge due to the immutable nature of smart contracts.

"Today we are siloed. However, by giving stakeholders a common language on digital payments, we empower all - from policymakers to entrepreneurs - to navigate and innovate effectively."

ROUNDTABLE PARTICIPANT

Looking ahead, there are opportunities to improve compliance in DeFi through technological innovation. Ideas being explored include developing more sophisticated on-chain identity and whitelisting systems that could work at the protocol level, creating configurable liquidity pools that allow for controlled trading environments, and improving real-time transaction monitoring capabilities across centralised and decentralised systems. The goal is to achieve regulatory objectives around risk management and consumer protection while preserving the open, accessible nature of DeFi.

#5 Navigating the Governance Shift: From Centralised to Decentralised Finance

Traditional financial systems, that depend on centralised control and hierarchical decision-making, are being transformed by decentralised networks and blockchain. Projects like [mBridge](#), which involves multiple central banks, are leading this shift. mBridge works as a decentralised network with each bank managing its own node. However, its governance still relies on traditional committees. While decentralised governance promises more transparency and inclusivity, the transition is not straightforward. Projects like [Agora](#) and [Mandala](#) are exploring how compliance can be managed in a decentralised system, learning from existing DeFi practices. Greater public-private cooperation can lead to more effective and innovative governance models that can be applied across both decentralised and traditional financial systems.

Conclusion

While a specific definition or taxonomy regarding DeFi may be difficult if not unachievable at this point, the ecosystem can still work towards greater alignment from a regulatory perspective.

To that end, it is important to enhance the understanding and level of knowledge among policymakers and regulators globally about the nature and potential impact of DeFi. Most regulators are very open to the input and insight shared by the DeFi industry and the whole ecosystem could profit from more public-private partnerships and collaboration going forward.





About Ecosystem

Ecosystem is a Digital Research and Advisory Company with its global headquarters in Singapore. We bring together tech buyers, tech vendors and analysts onto one integrated platform to enable the best decisionmaking in the evolving digital economy. Ecosystem has moved away from the highly inefficient business models of traditional research firms and instead focuses on research democratisation, with an emphasis on accessibility, transparency, and autonomy. Ecosystem's broad portfolio of advisory services is provided by a team of Analysts from a variety of backgrounds that include career analysts, CIOs and business leaders, and domain experts with decades of experience in their field. Visit ecosystem.io

About Ripple

Ripple is the leader in enterprise blockchain and crypto solutions, transforming how the world moves, manages, tokenizes and stores value. Ripple's business solutions are faster, more transparent, and more cost effective - solving inefficiencies that have long defined the status quo. And together with partners and the larger developer community, we identify use cases where crypto technology will inspire new business models and create opportunity for more people. With every solution, we're realizing a more sustainable global economy and planet - increasing access to inclusive and scalable financial systems while leveraging carbon neutral blockchain technology and a green digital asset, XRP. This is how we deliver on our mission to build crypto solutions for a world without economic borders. Learn more at <https://ripple.com>

About TRM Labs

TRM provides blockchain intelligence to help government agencies investigate and build cases for digital asset fraud and financial crime. TRM's Blockchain Intelligence platform includes solutions to follow the money, identify illicit actors, build cases, and construct an operating picture of threats. TRM is trusted by a growing number of leading agencies worldwide who rely on TRM for their blockchain intelligence needs. TRM is based in San Francisco, CA, and is hiring across engineering, product, sales, and data science. To learn more, visit <http://www.trmlabs.com/>.

About Point Zero Forum

[The Point Zero Forum](#) is a not-for-profit initiative of [Elevandi](#) and the [Swiss State Secretariat for International Finance](#) to promote a policy and technology dialogue in Financial Services.

Every year, over 1,000 central bankers, regulators and industry leaders convene around a series of leadership dialogues, public-private roundtables, deep dive workshops and networking opportunities to drive confidence, adoption and growth of transformative technology, and assess and promote the appropriate governance and risk frameworks.

This report is based on the conversations during a roundtable at the Point Zero Forum 2024 hosted by Ripple and TRM Labs and moderated by Ecosystem. It is also based on the analyst's subject matter expertise in the area of coverage in addition to specific research based on interactions with technology buyers and technology vendors, industry events, and secondary research.



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