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IOSCO explains how Decentralised Finance is cloning Financial Markets

IOSCO has today published a detailed report setting out how decentralised finance (“DeFi”) is quickly evolving to mirror conventional financial markets.

Ashley Alder, IOSCO Chair and Chief Executive Officer of the Securities and Futures Commission (SFC) of Hong Kong, said: “DeFi is a novel and fast-growing area of financial services, and this report outlines key areas of concern for IOSCO.”

The IOSCO report offers a comprehensive review of the fast-evolving DeFi market, its new products, services and principal participants. It identifies some products and services which are novel to DeFi. But most of the new services which are emerging replicate more traditional financial services and activities, but with weaker regulation and increased risks for investors.

The report casts doubt on a key claim of DeFi innovators that it is a peer-to-peer marketplace with no centralised insiders in control. By looking in detail at how DeFi works, it identifies central actors who, it concludes, often retain control – for example, through the distribution of “governance tokens”. It also highlights the important role played by centralised trading platforms who often face substantial conflicts of interest.

In response to the report, IOSCO has also announced the establishment of a new task force. Tuang Lee Lim, Assistant Managing Director (Capital Markets) of the Monetary Authority of Singapore (MAS) and chair of this new task force said: “The report provides evidence of both the potential opportunities as well as significant risks that DeFi can bring to investors and markets. IOSCO’s decision to establish the task force signifies our members’ resolve to take timely and coordinated policy action to appropriately address the risks arising from this fast-growing area. I look forward to working closely with experts and colleagues on the task force in charting its work ahead.”
IOSCO has called for comment and input from the public, including crypto-asset market and DeFi participants and from any other interested party, on the issues raised in its DeFi report, as well as on any other crypto-asset or DeFi related matters. Comments may be submitted to DeFi@iosco.org.

Notes to the Editor:

1. IOSCO is the leading international policy forum for securities regulators and is recognized as the global standard setter for securities regulation. The organisation's membership regulates more than 95% of the world's securities markets in some 130 jurisdictions, and it continues to expand.

2. The IOSCO Board is the governing and standard-setting body of IOSCO and is made up of 34 securities regulators. Mr. Ashley Alder, the Chief Executive Officer of the Securities and Futures Commission of Hong Kong, is the Chair of the IOSCO Board. The members of the IOSCO Board are the securities regulatory authorities of Argentina, Australia, Bahamas, Belgium, Brazil, China, Egypt, France, Germany, Hong Kong, India, Ireland, Italy, Japan, Kenya, Korea, Malaysia, Mexico, Morocco, Nigeria, Ontario, Pakistan, Portugal, Quebec, Russia, Saudi Arabia, Singapore, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States of America (both the U.S. Commodity Futures Trading Commission and U.S. Securities and Exchange Commission). The Chair of the European Securities and Markets Authority and the Chair of IOSCO’s Affiliate Members Consultative Committee are also observers.

3. The Growth and Emerging Markets (GEM) Committee is the largest committee within IOSCO, representing more than 75% per cent of the IOSCO membership, including ten of the G20 members. Dr. Mohammed Omran, Executive Chairman of the Financial Regulatory Authority, Egypt is Chair of the GEM Committee. The committee brings members from growth and emerging markets together and communicates members’ views and facilitates their contribution across IOSCO and at other global regulatory discussions. The GEM Committee’s strategic priorities are focused, amongst others, on risks and vulnerabilities assessments, policy and development work affecting emerging markets, and regulatory capacity building.

4. IOSCO aims through its permanent structures:
   • to cooperate in developing, implementing and promoting internationally recognized and consistent standards of regulation, oversight and enforcement to protect investors, maintain fair, efficient and transparent markets, and seek to address systemic risks;
   • to enhance investor protection and promote investor confidence in the integrity of securities markets, through strengthened information exchange and cooperation in enforcement against misconduct and in supervision of markets and market intermediaries; and
   • to exchange information at both global and regional levels on their respective experiences to assist the development of markets, strengthen market infrastructure and implement appropriate regulation.
5. Currently, there is no generally accepted definition of “DeFi,” or what makes a product, service, arrangement or activity “decentralised”. DeFi as used in the IOSCO report refers to a marketplace estimated in size at about $200 billion and mostly built on the Ethereum block chain which has grown strongly over the last three years offering a range of financial services including derivatives and borrowing. It currently constitutes only a small portion of the overall crypto asset sector but is growing quickly, fueled by venture capital investments.

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