



16 October 2023

DeFi Working Group
of the Board of the International Organization of Securities Commissions

Submitted via email: deficonsultation@iosco.org

Dear DeFi Working Group,

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

- [1] Thank you for the opportunity to provide comments on the Consultation Report published in September 2023 titled 'Policy Recommendations for Decentralized Finance (DeFi)', available here: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD744.pdf> (**Report**). This submission seeks to respond to several questions posed by IOSCO in order of the Recommendations rather than the Questions.
- [2] We invite the Board to refer to related and previous policy submissions made by BADAS*L at www.badasl.com/policy.
- [3] The efforts of the IOSCO DeFi Working Group are to be applauded. Much helpful guidance can be absorbed by the global web3 sector from the Report, particularly around market integrity, investor protections, and the emphasis that regulators are responsible for understanding the facts and circumstances of a DeFi arrangement which may require engaging professional support to understand the technology. The 'lifecycle' approach is sensible, as is the goal to have recommendations that are principles-based and outcomes-focussed.
- [4] However, there are both gaps and areas beyond the scope of IOSCO's global standards for securities markets regulation in the context of DeFi. Notwithstanding that IOSCO's global standards are widely accepted in traditional financial markets, the gaps and beyond-scope areas arise due to the features, differences, and idiosyncrasies of DeFi arrangements, the financialisation (through tokenisation) of non-financial things, models of decentralised governance and the decentralised global nature of the underlying network infrastructure.
- [5] Furthermore, use of the phrase 'same activity, same risk, same regulation / regulatory outcome' (**same, same, same**) as a guiding principle in and of itself is insufficient. The Report's language is that regulators can apply the same regulation **or** aim to achieve the same regulatory outcome. Precision of language (and the actual principle) is extremely important for promoting certainty of the principles and enforcement of rules for both regulators and entrepreneurs taking on risk to bring more choice, innovation and secure and affordable products to consumers and investors. Precision of language is especially important if a regulator does not have sufficient mandate or flexible enough powers to aim to achieve the same regulatory outcome and must instead bluntly use the 'same regulation' to enforce applicable laws (Recommendation 7) which may chill or kill innovation rather than produce the desired regulatory outcome. The Australian Treasury has today released a consultation paper endorsing the 'similar activity, similar risk, same regulatory outcome' approach,ⁱ which BADAS*L has long advocated for and encourages IOSCO to consider adoption of this more appropriate approach.
- [6] With the above said, we make the following comments:

With respect to Recommendations 1, 6 and 9

- (a) We agree that a regulator should aim to achieve a holistic and comprehensive understanding of DeFi products, services, arrangements, and activities, and that the regulator should assess what technological knowledge, data and tools are needed to understand and analyse DeFi products, services, arrangements, and activities.
- (b) We agree that the regulator should seek to understand the activities being conducted by or through the DeFi arrangement and what products and/or services are being provided. However, the mapping in the guidance under Recommendation 3 is simplified to such an extent that it is confusing and apt to lead readers and regulators relying on this Report for guidance into error.

Illustrative Example 1 below demonstrates the importance of precision of identifying the regulated person or persons and the regulatory obligations that are appropriate to apply to that person (if any), including obligations of clear, accurate and comprehensive disclosures. If anything, this assists to understand and assess the interconnections between and reliance upon DeFi actors and traditional financial markets.

Illustrative Example 1: Importance of precision of identifying the regulated person/s and obligations particular to that person

In the mapping at Recommendation 3 a liquidity provider (**LP**) token is provided as an example of a crypto-token offered or sold by an “aggregator or DEX” in the context of the Report suggesting that the “aggregator or DEX” would be the issuer of a potential financial instrument (including securities). However, language of an “aggregator or DEX” is not appropriate to describe the issuer because it describes the function of the DeFi protocol and because the protocol itself does not have legal personality. If governance of the protocol has been minimised, then there are likely no natural or legal persons involved in the protocol’s functioning that could intervene other than to ‘fork’ the code and upgrade it.

If the Report is attempting to suggest the DAO governing the DeFi protocol (or a Labs or Service or Foundation entity involved as the legal representative for the DAO) is intended to be caught as an issuer (or other regulated person) then the more appropriate language about the potential regulated person (rather than “aggregator or DEX”) would be, for example, ‘the composition of persons that are considered part of an unincorporated association of persons that comprise the DAO, or a legally recognised DAO, that governs the DeFi protocol’. We make comments below about a potential approach for understanding and regulating the Responsible Roles in a DAO, which is a necessary paradigm shift from the notion of a Responsible Person in traditional finance.

More precise and appropriate language is provided below as an illustrative (but incomplete) example of the persons upon which regulatory obligations could be appropriate to apply, presented in (rough) chronological order of what is referred hereafter as a DeFi ‘stack’:

Development stage – application level – DeFi protocol design

- (i) a person that designs, develops, and publishes under an open-source licence the source code for a protocol that can operate as an aggregator or DEX;

Development stage – application level – DeFi protocol governance design

- (ii) a person that designs, develops, and publishes the model of governance for an open-source licensed aggregator or DEX;

Public access stage - application level – deployer or contributor

- (iii) a person that chooses to deploy a liquidity pool (factory) protocol and that receives an LP token is the issuer of that LP token to themselves – that is, it is a self-dealing;
- (iv) a person that has issued an LP token to themselves and deals with it in other ways (in other DeFi protocols or off-chain dealings) such that it limits their ability (or responsibility) to monitor the performance of the pool and act accordingly;
- (v) a person that chooses to deploy (or contribute to) a liquidity pool (factory) protocol and that receives an LP token – such a person should not be an operator of the pool (the automations of the protocol take on that function and prevent the LP token holder from doing much other than withdrawing all or part of their liquidity and earned trading fees), nor is the developer of the protocol, nor is the person that hosts an interface. It is unclear whether the protocol design and financial incentives to monitor the pool's performance are sufficient to protect third party users of the pool or if bespoke regulatory obligations must be introduced that impact either or both of protocol design and disclosure and monitoring requirements;

Public access stage – application level - third party user access

- (vi) a person that hosts an interface that enables a third party to connect their own digital wallet and send instructions to the blockchain or smart contract to deploy, contribute or interact with a liquidity pool – such a person should not be an issuer of LP tokens nor an issuer or operator of a regulated activity (i.e. a financial market). The mere hosting of a display layer that facilitates a third party's ease of self-dealing or identification and use of a liquidity pool to trade should not amount to issuing, operating, arranging, dealing in, brokering of, or giving advice about regulated financial products when the third party remains solely in control of initiating and sending instructions to the blockchain or smart contract from their digital wallet;
- (vii) a person that provides digital wallet software to communicate with applications and distributed ledgers;
- (viii) persons involved in other forms of participation necessary for the DeFi arrangement to function (e.g. oracle providers, etc but not multi signature signers on a DAO treasury wallet);

Public access stage – application level – governance

- (ix) persons involved in the governance of an application deployed on a (claimed or actual) permissionless distributed ledger;

Public access stage - distributed ledger technology level (governance and operations)

- (x) a person that is responsible for producing blocks (layer 1) or sequencing transactions and blocks for settlement (layer 2s);
- (xi) a person that opportunistically intervenes in the process of producing blocks or sequencing transactions and blocks, which adversely affects the experience or outcomes of third party users of a blockchain-based application or blockchain;
- (xii) persons involved in the governance of an (claimed or actual) permissionless distributed ledger.

Instead of imposing regulatory obligations in a duplicative form upon each participant in the 'stack', or describing regulatory obligations so broadly that they could apply to multiple participants in a duplicative fashion, a semi-optional 'leapfrog' approach as proposed below could be efficient and effective.

Proposal 1: The semi-optional 'leapfrog' approach

The semi-optional 'leapfrog' approach involves the following elements:

- Impose a regulatory obligation upon each person involved in the DeFi 'stack' (except third party retail users that do not have conflicts of interest and are not seeking to manipulate the market) to disclose the extent to which they have considered and introduced measures to protect investors and market integrity.
- Impose a regulatory obligation upon each participant in a DeFi 'stack' to understand the extent to which regulatory protections have been provided by earlier stages and other levels in the stack to identify what is appropriate for each participant to contribute in the way of investor protections and market integrity.
- To support the elements above, establish a central source of truth that discloses (without revealing identity) what has been undertaken in the way of protections and measures at each stage and level. This could be undertaken by industry and / or regulators.
- If ultimately it is inappropriate or unworkable for persons involved in a stage or level to meet and disclose the protections implemented and measures taken, then persons later in the sequence can A) easily identify this and B) understand the risks of their self-dealing or be subject to 'catch-up' regulatory requirements (e.g. as a deployer of a DEX protocol). In this way, a third party user could easily ascertain whether they are dealing with an "aggregator or DEX" that has not made any regulatory measures and disclosures and thus assess whether they are prepared to take the financial risk (and potential privacy and data security risks) of engaging with the protocol or not.
- For market integrity purposes, a prohibition or requirement to "transition into regulatory boundaries" could be imposed on use or continued use of DeFi protocols where metrics exceed certain thresholds such as for total value locked, average daily value exchanged, value of governance tokens involved. If these metrics are specified in machine readable format, then a DeFi protocol could ping the relevant source and

as a matter of real-time compliance prohibit an on-chain transaction if thresholds are exceeded.

- (c) Clarification is required about IOSCO’s (welcome) recommendation for regulators to seek methods to obtain verifiable data and information about DeFi products, services, arrangements, and activities. There is a need to proscribe data standards to ensure relevant data is published on-chain, or to embed a legal obligation like the requirement that the general tax consequences of a scheme be disclosed in a prospectus or public disclosure statement. Crypto-specific licensing regimes such as the Rulebooks released in Dubai in February 2023 and the European Union Markets in Crypto-Assets Regulation do impose record-keeping obligations alongside IT system resiliency and continuity plans but there is no pro forma or standard form of regulatory data inputs specified. For tax purposes, the OECD’s Crypto-Asset Reporting Framework is very specific with the data inputs that must be collected, as is the FATF Travel Rule, so development of a data framework for regulatory data should be a common sense effort.

Industry Efforts Underway: Registry, regulatory and tax data standards (relevant to Q8)

BADAS*L is leading the Regulatory Interoperability working group of DAOstar – the not-for-profit standards body for DAOs – which is focussed on registry, regulatory and tax data standards. We would be pleased to continue our initial discussion held earlier this year with representatives of the DeFi Working Group to obtain feedback as the standards evolve and are adopted.

- (d) Clarification is required to understand when DeFi products, services, arrangements, and activities would be “occurring or located within” a jurisdiction.

Illustrative Example 2: Importance of clarity of “occurring or located within” a jurisdiction

Would (or should) a regulator apply its Existing Framework or New Framework upon an individual core DAO contributor that resides in the jurisdiction who is merely responsible for moderating community discussion but has nothing to do with development, use or security of the DeFi protocol?

Absent distinct legal personality for a DAO, nexus to one or many jurisdictions can be broadly drawn which chills and kills innovation and the attraction of high quality talent to contribute to governance or operations of a DAO-governed DeFi protocol, or other public goods-like ecosystem level participants that are involved in supporting other DAOs.

Proposal 2: Recommend that regulators publish clear guidance about what constitutes “occurring or located within” a jurisdiction

Regulators should be strongly encouraged through an IOSCO recommendation, to publish a position (and/or support legislative change) clarifying the following elements:

- Responsible Roles of a DAO-governed DeFi protocol or Responsible Person requirements (see our comments on Recommendation 2 below).

- That non-Responsible Roles or non-Responsible Persons engaged by or contributing to the DAO-governed protocol do not constitute “occurring or located within” a jurisdiction.
- That the access to and use of a DeFi protocol by a person by their exclusive initiation does not constitute “occurring or located within” a jurisdiction (borrowed from the MiCA Regulation).

With respect to Recommendations 2, 3, 5, 6 and 9

- (e) We agree in principle that there should be one or more people responsible for certain aspects of a (claimed or actual) DeFi arrangement that is (claimed or actually) DAO-governed, including to identify and address material operational and technology risks, and risks of interconnectedness between DeFi actors and traditional finance markets. Some aspects (but not all) of the well-understood concept of Responsible Persons in traditional finance could apply to achieve the same regulatory outcomes in DeFi.

BADAS*L advocates for Responsible Roles that persons are elected or engaged to fulfil – and not necessarily directly by the DAO – which reflect the different responsibilities at each stage of the lifecycle of a DAO-governed DeFi protocol. A person that could qualify as a Responsible Person in the development stage may not be an appropriately qualified and experienced Responsible Person in the public access stage or in times of DAO-specific distress.

- (f) We do not agree that Responsible Person(s) should “include those that maintain control or sufficient influence over a particular DeFi arrangement or activity.”

There are multiple stages and levels of enquiry relevant to a facts and circumstances analysis of a DeFi application deployed on a permissionless distributed ledger. This multi-stage and multi-level enquiry demonstrate that the concepts of ‘control’ and ‘sufficient influence’ are different to those of traditional corporations that have established legal forms and director and officer duties. Furthermore, the stages and levels of enquiry for a DeFi application are likely different for (claimed or actual) permissionless distributed ledgers that offer settlement finality only and for application-specific blockchains that combine the DeFi function (i.e., automated financial products) with the crypto-token transaction settlement function (i.e. blockchain settlement finality).

The varied and different forms of participation in DAO governance, operations and/or the DeFi protocol are often not the same as established roles and duties of directors and employees working within a corporate form with limited liability, or of rights and obligations of an investor, borrower, or consumer. Existing concepts of ‘control’ and ‘sufficient influence’ become murky in the context of DAO-governed DeFi arrangements that exist in the context of a composable and interconnected DeFi ecosystem that operates on decentralised network digital infrastructure.

Across the stages and levels of enquiry, there are no existing priority rules to determine who would have a higher/more heavily weighted or equal or ongoing level of ‘control’ or ‘sufficient influence’ and thus responsibility (or ongoing responsibility) as a Responsible Person. For example, Vitalik Buterin, as one of the founders of the Ethereum blockchain, continues to have influence about the current and future use and capability of the

Ethereum blockchain but arguably not 'control' or 'sufficient influence' to be legally responsible for investor protection compliance and disclosure (under Existing Laws or New Laws) for purchase of ether (**ETH**) or ETH staking, or use of ETH for an application to function.

There are questions at each stage and level of enquiry as to whom the Responsible Persons, or rather the Responsible Roles, should be. For illustrative purposes, below we have proposed some stages and levels for a common (but not universal) 'lifecycle' of a DAO-governed DeFi protocol deployed on a permissionless distributed ledger, presented in sequence of the lifecycle. The categories of person listed are applicable regardless of whether a limited liability entity houses the activities since a limited liability entity can be a mere friction point to establishing personal liability where a person is grossly negligent or acts fraudulently or criminally.

In contrast to the existing notion in traditional finance of a Responsible Person being the same person, over the lifecycle of a DAO-governed DeFi arrangement the personnel involved is subject to change and regularly. Thus, the proposal for Responsible Roles.

Persons may be elected for limited 'epochs' (time periods of 3, 6 or 12 months) or to deliver a particular milestone. As such, the start and stop of responsibility (and liability) of a Responsible Person, or Responsible Role, must be flexible enough and certain enough that it can apply and adapt for each stage of the lifecycle.

The Responsible Roles for persons in the first two stages proposed in Illustrative Example 3 below are reflected in a table at Schedule 1. Each are for illustrative purposes only and are incomplete, to demonstrate the obligations that might apply to persons performing a Responsible Role at each stage of the lifecycle.

Illustrative Example 3: Recognition of Responsible Roles for each stage in the lifecycle of a DAO-governed DeFi protocol

- (i) **(Formation stage)** At this stage in the lifecycle, the DeFi concept is created by one or more persons, the founding team is formed and capitalised privately, and there may be consideration of the best legal structure to use that is flexible enough to transition to a decentralised model of governance. Unlike in the 2017/18 'initial coin offering' days, a team is now (extremely) unlikely to raise capital by the issue of crypto-tokens to the global public at the concept stage. As such, potential persons performing a Responsible Role at this formation stage could comprise:
- a. persons that create the DeFi concept; and/or
 - b. persons in founding team; and/or
 - c. persons in founding team that are directors or officers; and/or
 - d. persons in founding team that prepare capital raise materials (pitch deck, lite paper, preliminary tokenomics and financial forecasts), participate in capital raise activities, and accept capital (whether as ordinary equity, ordinary equity with a token warrant, or a simple agreement for future tokens); and/or

- e. founders that contribute their own capital (time and resources) in consideration for current or future equity and/or token allocation; and/or
 - f. third party investors that provide capital (and usually ongoing informal advisory both positive and constructive as they monitor the performance of their investment).
- (ii) **(Development stage – open source DeFi protocol)** This stage concerns the development of a DeFi protocol to be published under an open-source license such as factory contract that can be self-deployed (e.g., create and seed a two-token liquidity pool for the purpose of third parties' exchange of one token for another, and the liquidity provider receiving crypto-tokens as trading fees). This stage assumes that any initial or subsequent versions of the code that may be published using software such as GitHub are not available to the public and persons with access are obliged to keep the code confidential. Potential persons performing a Responsible Role at this stage could comprise:
- a. persons in earlier or other stages; and/or
 - b. persons that design the specification (in plain language) for the DeFi concept; and/or
 - c. persons that develop (in code) the DeFi protocol; and/or
 - d. persons that determine whether code will be available under open-source licence terms or alternative terms or the licensing roadmap; and/or
 - e. persons that author or contribute to or review documentation to be published, such as:
 - i. a white paper (plain language description of DeFi protocol, tokenomics if a native token is involved in the protocol and/or its governance, team),
 - ii. a yellow paper (mathematical specification of protocol),
 - iii. other documentation; and/or
 - f. third party security auditor/s that audit/s the protocol for security vulnerabilities as well as whether the protocol functions match those described in the white paper or other documentation; and/or
 - g. third party legal review that audits the protocol, per function and having regard to the sequence and entirety of functions, to determine whether there are sufficient measures embedded in the code to achieve regulatory outcomes – under Existing Laws of the jurisdiction/s from which the team (as an unincorporated association or incorporated form) will publish the code – of:
 - i. protecting investors;
 - ii. the integrity of markets;
 - iii. other applicable laws such as AML/CTF, consumer protection, and data privacy laws,
- unless processes are put in place in the proposed model of decentralised governance to empower intervention by natural persons (or the legal entities

that are engaged by) to achieve such regulatory outcomes; and/or

- h. third party tax review that audits, per function and having regard to the sequence and entirety of functions, the protocol's inputs that can be queried or displayed on a block explorer to determine whether sufficient information is collected (from the perspective of a centralised security/financial product issuer or market operator) and recorded to the ledger for it to perform equivalently to tax law information collection, reporting and record-keeping requirements traditionally imposed on centralised entities that maintain proprietary databases of information.

- (iii) **(Development stage – decentralised model of governance and open-source DAO-governance protocol)** This stage concerns the development of the initial model of decentralised governance and open-source DAO-governance protocol. Unfortunately, factors related to the DAO-governance protocol are often mistakenly conflated with the DeFi protocol. Analysis of the facts and circumstances of a DAO-governed DeFi arrangement should always commence with analysis of the facts and circumstances of the DeFi protocol separately from the facts and circumstances of the DAO-governance protocol (and model of decentralised governance within which the DAO-governance protocol fits perhaps alongside manual functions). In the least, the separate analysis assists to establish the extent to which 'control' or 'sufficient influence' over the DeFi protocol can be attributed to persons involved in the model of decentralised governance (including the DAO-governance protocol).

Furthermore, it is worth emphasising the traditional separation between governance as an oversight function typically carried out by non-executive directors and a professional culture of good governance which is instilled in the everyday operations of an organisation. A deterministic open source DeFi protocol should be subject to governance as an oversight function which may necessitate a narrow scope of operational activities and human resources that must be directly engaged by a DAO. These activities could include moderating the DAO community's online venues, convening governance activities and events, and information disclosure. However, activities such as identification of the need for code maintenance, code upgrades, receiving a fee from DeFi protocol functions being used, deciding on the spending of fees from DeFi protocol functions used, and the regulatory and tax implications of those activities, are functions that should not 'live and breathe' within the DAO but should be carried out by separate legal persons.

If a DAO should have its own standalone legal personality and limited liability status, the functions of the DAO should be limited to coordinating the organ of governance only and limiting liability where governance activities are undertaken with the standard of care, skill and diligence that develop for the levels of governance seen in DAOs (e.g., discord sentiment, temp checks, off-chain votes, on-chain finality votes, etc).

A separate note but related to the sustainability to perpetually comply with regulatory obligations through Responsible Persons or Responsible Roles, relates to taxation. Where a DeFi protocol has a parameter that allows for the earning of fees, and it is switched on, the DAO should not be subject to tax on

that income if it used for the purposes of:

- coordinating the organ of governance over open source and public good DeFi infrastructure; and
- engaging third party suppliers to undertake operational activities deemed necessary by DAO governance,

which ensures the ongoing sustainability of the public good and overall equivalence that Responsible Roles can continue to be performed even if those roles and persons change more regularly than in traditional finance. If taxation status is not clear to participants, especially retail participants, investor harm can flow from tax penalties from non-compliance.

As such, possible persons performing Responsible Roles at this stage could be:

- a. persons in earlier or other stages; and/or
- b. persons that design the specification (in plain language) for the model of decentralised governance including the features/functions of one or more crypto-tokens carrying governance rights and the mechanisms to participate in governance (e.g. join discord server and post comments, join discord server and participate in off-chain temp checks, one crypto-token equals one-vote, or quadratic voting, or voting weight based on other mechanisms); and/or
- c. persons that develop (in code) the contract/s with parameters that control functional matters of the crypto-token/s carrying governance rights (such as total or elastic supply, approvals before a crypto-token transaction can be successful) and contract/s that allow the exercise of governance rights (such as a staking/lock up contract with or without voting weight consequences, e.g. veCRV); and/or
- d. persons that author or contribute to or review documentation to be published, such as:
 - i. a white paper (plain language description of DeFi protocol, tokenomics if a native token is involved in the protocol and/or its governance, team),
 - ii. a yellow paper (mathematical specification of protocol),
 - iii. other DAO documentation (describing model of governance, and may have terms of participation agreement); and/or
- e. third party security auditor/s that audit/s the DAO governance protocol (including the contracts that relate to crypto-tokens carrying governance rights) for security vulnerabilities as well as whether the protocol functions match those described in the white paper or other documentation.
- f. third party legal review that audits both:
 - i. the proposed decentralised model of governance (in plain language); and

- ii. any DAO governance protocol (including the contracts that related to crypto-tokens carrying governance rights), per function and having regard to the sequence and entirety of functions, to determine whether there are sufficient measures and processes in plain language (to be performed by an operational team) and/or embedded in the code to achieve regulatory outcomes – under Existing Laws of the jurisdiction/s from which the team (as an unincorporated association or incorporated form) will publish the code – of:
 - iii. protecting investors;
 - iv. the integrity of markets;
 - v. other applicable laws such as AML/CTF, consumer protection, and data privacy laws; and/or
 - g. third party tax review that audits both:
 - i. the proposed decentralised model of governance (in plain language); and
 - ii. any DAO governance protocol (including the contracts that related to crypto-tokens carrying governance rights), per function and having regard to the sequence and entirety of functions, to determine whether sufficient information is collected (from the perspective of a centralised security/financial product issuer or market operator) and recorded to the ledger for it to perform equivalently to tax law information collection, reporting and record-keeping requirements traditionally imposed on centralised entities that maintain proprietary databases of information.
- (iv) **(Development stage – decentralised model of operations)** Development of processes for natural persons and other legal persons to provide contributions or services required to maintain or upgrade the DeFi protocol or decentralised model of governance (including the DAO-governance protocol), and obtain legal and tax advice about the maintenance or upgrades. As such, potential persons that could be performing Responsible Roles at this stage are:
 - a. persons in earlier or other stages;
 - b. persons that design, author or contribute to or review documentation to be published that describes the operational processes, such as may be included in:
 - i. a white paper (plain language description of DeFi protocol, tokenomics if a native token is involved in the protocol and/or its governance, team),
 - ii. other DAO documentation (describing model of governance, and may have master terms of service and service line agreements or like for contributions); and/or
 - c. persons that identify, recruit, and supervise contributions; and/or
 - d. persons that provide contributions.
- (v) **(DAO community formation stage - online community venues)** This stage involves the formation of online community venues and usually the publication of documentation on a website. Participants do not have any crypto-tokens or

governance rights or access to use the DeFi protocol but mere ability to express sentiment and see demo videos. Persons that could be performing Responsible Roles are:

- a. persons in earlier or other stages; and/or
- b. persons that create and maintain or receive login and password details for online community venues (e.g. discord, twitter, telegram, GitHub repository); and/or
- c. persons that create official content for disclosure on online community venues including a white paper or other DAO documentation; and/or
- d. persons that moderate online community venues; and/or
- e. persons that post in discussions in online community venues; and/or
- f. persons that dominate or strongly influence discussions (or the outcome of discussions) in online community venues.

(vi) **(Testing stage - offering of testnet/beta access to DeFi protocol)** Persons that could be performing Responsible Roles at this stage are:

- a. persons in earlier or other stages; and/or
- b. persons that participate in testing and provide feedback.

(vii) **(DAO-governance formation stage - public representation and/or offering of governance rights and ability to exercise governance rights)** This stage involves the launch of initial model of decentralised governance (and representation of governance rights) for approval or ratification, as well as the ability to exercise governance rights. A person can connect their digital wallet to a venue such as Snapshot and participate in governance without a token. However, at this stage most teams would distribute tokens via airdrop based on publicly available data or pre-existing arrangements (such as those that provided capital for equity and a token warrant). Often, unrelated third parties may seed a liquidity pool (that may be visible on a user interface such as Uniswap or SushiSwap) that facilitates the acquisition by third parties of the DAO's token carrying governance rights but neither the DAO receives trading fees or royalties/commissions from the liquidity provider or third parties interacting with the pool nor is a third party purchaser prompted to read and agree to any terms of governance participation in the DAO or as a member of an unincorporated association of persons. Persons that could be performing Responsible Roles at this stage are:

- a. persons in earlier or other stages; and/or
- b. persons involved in token issuance or airdrop allocation decision and activities; and/or

- c. persons that hold crypto-tokens carrying rights to participate in governance but whom do not participate in governance activities; and/or
- d. persons that seed a liquidity pool involving a crypto-token carrying governance rights in a DAO;

(viii) **(Deployment stage – deploy DeFi protocol on mainnet and later stages)**

Persons that could be performing Responsible Roles at this stage are:

- a. persons that hold crypto-tokens carrying rights to participate in governance but whom do not participate in governance activities;
- b. persons that have exclusive access to sign/authorise a crypto-token spending activity from the DAO's treasury wallet;
- c. persons that have limited access to sign/authorise a crypto-token spending activity as an m of n participant in a multi signature arrangement;
- d. persons that have the ability to set or change parameters at their own discretion;
- e. persons that have the ability to set or change parameters in accordance with an approved DAO governance proposal (approved mandate to deploy code to be built);
- f. persons that have limited ability to set or change parameters only in accordance with an approved DAO governance proposal (approved code);
- g. persons that have authorisation from the DAO to issue or distribute for free crypto-tokens carrying rights to participate in governance or other rights to participate in the DAO;
- h. persons that may profit substantially once tokens vest and can be sold for fiat currency or other tokens (as opposed to the FATF guidance at footnote 44 that poses a relevant factor as 'whether any party profits from the service'.

Having regard to each of the potential Responsible Roles or Responsible Persons over the lifecycle as set out above, it becomes poignant to reflect on the regulatory outcomes sought to be achieved by the IOSCO standards for securities markets. As such, the table at Schedule 1 documents the investor protection and market integrity regulatory outcomes, and proposes a pragmatic approach to applying discrete and time bound responsibilities to persons performing a Responsible Role at each stage. This pragmatic approach moves away from the traditional notion of a Responsible Person.

Proposal 3: Consider limited liability (or like) protections for a Responsible Role

IOSCO should consider whether, if a person performs the Responsible Role to the standard of a reasonable person expected in that role, they should receive the benefit of limited liability (or like) protections. This is particularly necessary if the DAO itself does

not have separate and distinct legal personality but higher responsibilities and standards are expected of a person performing a Responsible Role.


With respect to Recommendation 4

- (g) Building on the comments above as to identification of the appropriate participant and person performing a Responsible Role, we agree that conflicts of interest should be identified and addressed.

With respect to Recommendation 7

- (h) We fully support the need for cross-border cooperation and information sharing.
- [7] In closing, we reiterate that the tokenisation paradigm extends to non-financial things and increasingly permissionless distributed ledger technology and networks will be used for trusted non-financial online transactions (such as digital identity and reputation credentials, social media posts, online advertisements, emails, messaging). Where these non-financial things are represented as transferable crypto-tokens, an inevitable financial and speculative element creeps in. As stated at the outset, there are gaps and beyond-scope areas of the IOSCO Principles which should be addressed (e.g. network participant obligations under a 'leapfrog' approach) or acknowledged (e.g. consumer protections for crypto-tokens primarily created for non-financial purposes but subsequently used for financial purposes by retail or non-retail actors).
- [8] The content in this submission and Schedule 1 do not constitute legal advice and should not be relied upon. Each person reading this submission is responsible for seeking their own independent and professional advice based on their circumstances.
- [9] We welcome the opportunity to discuss this submission and assist the DeFi Working Group and Board with the consultation.

Yours sincerely,

Signed by:

C3ED2589C326DBBA

Joni Pirovich
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A web3 focussed firm providing legal, strategic and policy services.



Schedule 1: Illustrative Example of persons performing Responsible Role/s

Responsible Role/s	Responsibilities of persons in Responsible Role/s		
	Investor protection	Market integrity	Basic corporate governance
Formation			
Persons in founding team that are directors or officers			Understand the obligations upon a director or officer
	<p>With respect to the proposed DeFi protocol functions and any proposed features of governance token/s involved in the proposed model of decentralised governance, the founding team members as persons in a Responsible Role are responsible for:</p> <ul style="list-style-type: none"> having regard to investor protection recommendations contained in IOSCO principles, IOSCO DeFi Working Group materials (including this Report), and applicable securities and financial services laws of jurisdiction/s that they reside; documenting how the investor protection recommendations have been considered to identify initial and at scale risks and how to address them. 		<ul style="list-style-type: none"> having regard to market integrity risks and recommendations contained in IOSCO principles, IOSCO DeFi Working Group materials (including this Report), and applicable securities, markets and financial services laws of jurisdiction/s that they reside; and documenting how the market integrity laws, risks and recommendations have been considered to identify initial and at scale market integrity risks and how to address them.
Persons in founding team that prepare capital raise materials, participate in capital raise	In the course of the capital raise activities, the founding team members participating in those activities are persons in a Responsible Role responsible for understanding and compliance with laws applicable to raising capital.		Duty to act for a proper purpose, loyalty, avoid conflicts of interest, etc

activities, and accept capital			
Third party investors that provide capital (and usually ongoing informal advisory both positive and constructive as they monitor the performance of their investment).	<p>With respect to the proposed DeFi protocol functions <u>and</u> any proposed features of governance token/s involved in the proposed model of decentralised governance, the third party investors are persons in a Responsible Role responsible for:</p> <ul style="list-style-type: none"> • asking whether investor protections have been considered and that are proposed to be incorporated in the Development and subsequent stages, subject to legal advice; and • receiving an appropriate response from the founding team. 	<ul style="list-style-type: none"> • asking whether market integrity measures have been considered and that are proposed to be incorporated in the Development and subsequent stages, subject to legal advice; and • receiving an appropriate response from the founding team. 	
<p>The status of being a person in a Responsible Role in the Formation stage should cease just before the Development stage commences where either or both of:</p> <ul style="list-style-type: none"> • the persons in the Responsible Roles having met the obligations expected of them at the Formation stage, as determined by the Development stage team; or • disclosure being made to an industry body, standards body or regulator in accordance with the standards prescribed by that body. 			
<p>Development – open source DeFi protocol</p>			
Persons that determine whether code will be available under open-source licence terms or alternative terms or the licensing roadmap;		<p>With respect to the proposed DeFi protocol functions <u>and</u> to the extent that any governance token/s are involved in the use of the DeFi protocol, the persons involved in determining the licensing terms as persons in a Responsible Role are responsible for:</p> <ul style="list-style-type: none"> • reading and understanding the materials prepared about market integrity laws, risks and recommendations by the persons in the Responsible Roles in the Formation stage; • reconsidering the materials and the laws, risks and recommendations in the light of the DeFi protocol code being available under open-source licence terms; and 	

		<ul style="list-style-type: none">documenting the measures considered appropriate to manage risks from code being 'forked' (i.e. copied and used) by other unrelated teams.	
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¹ See, Australian Government The Treasury, 'Regulating digital asset platforms' (16 October 2023), available at: <https://treasury.gov.au/consultation/c2023-427004>.