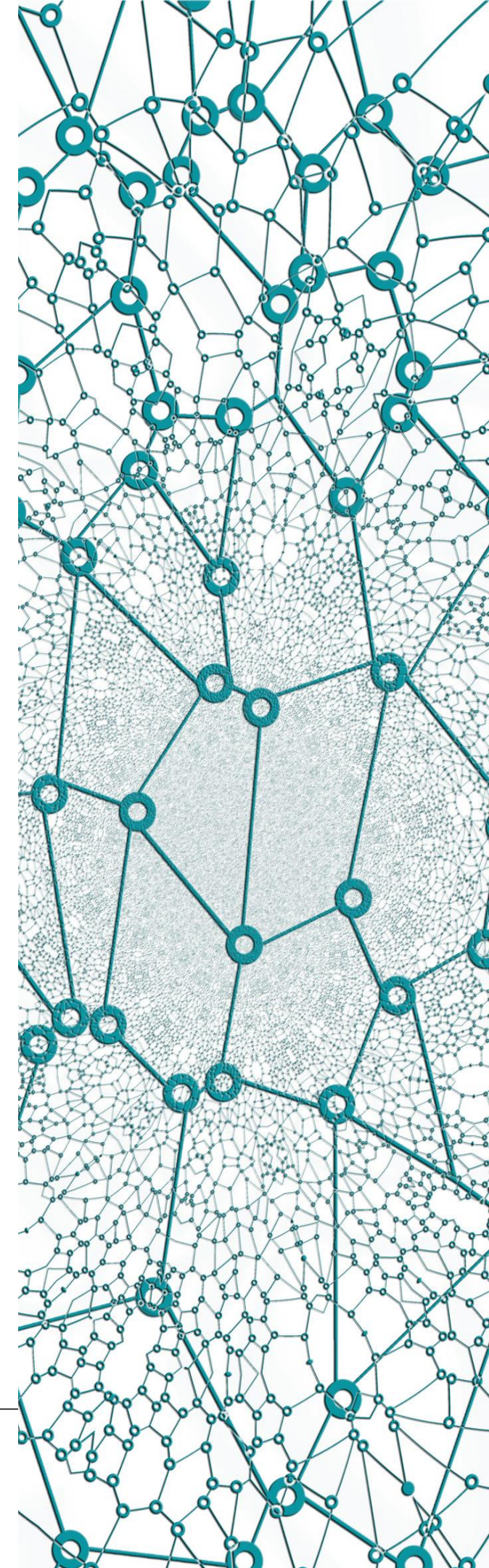


# Navigating the Regulatory Frameworks for DeFi Projects

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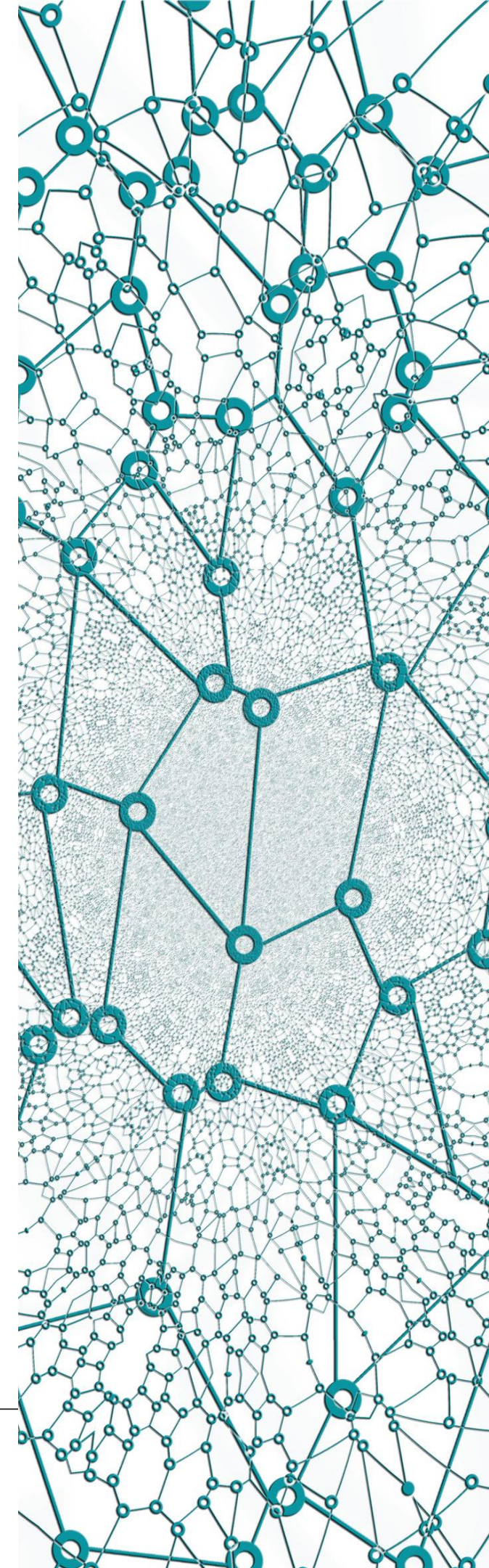
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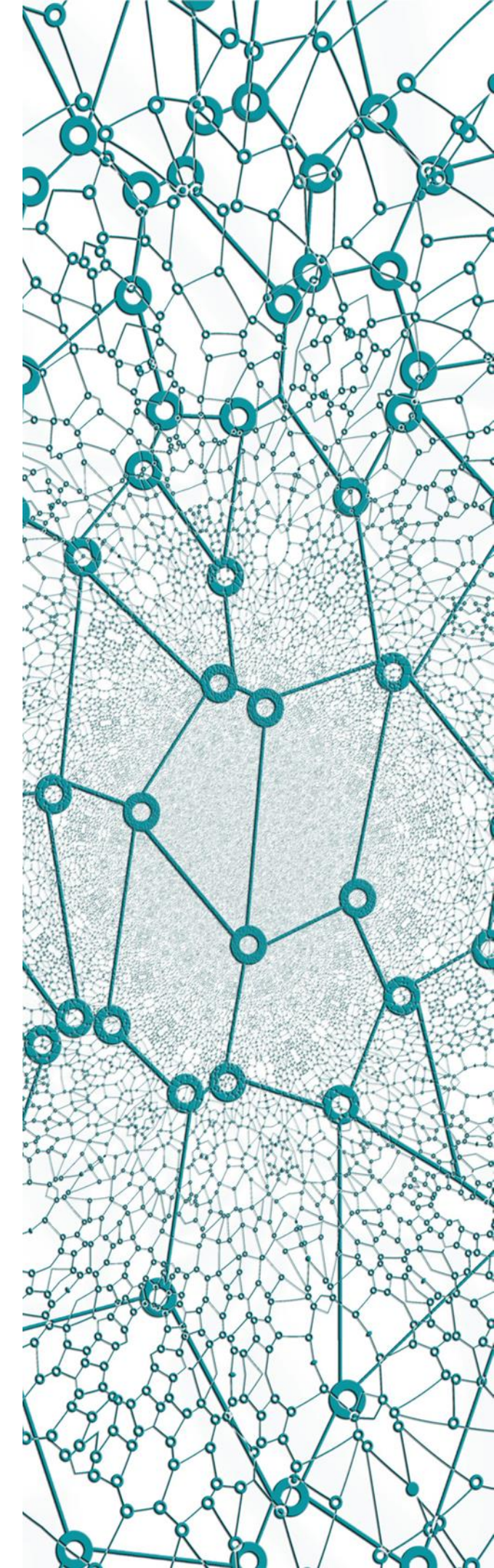
## I. What is the definition of DeFi today?



DeFi is a spectrum,  
not a monolith.

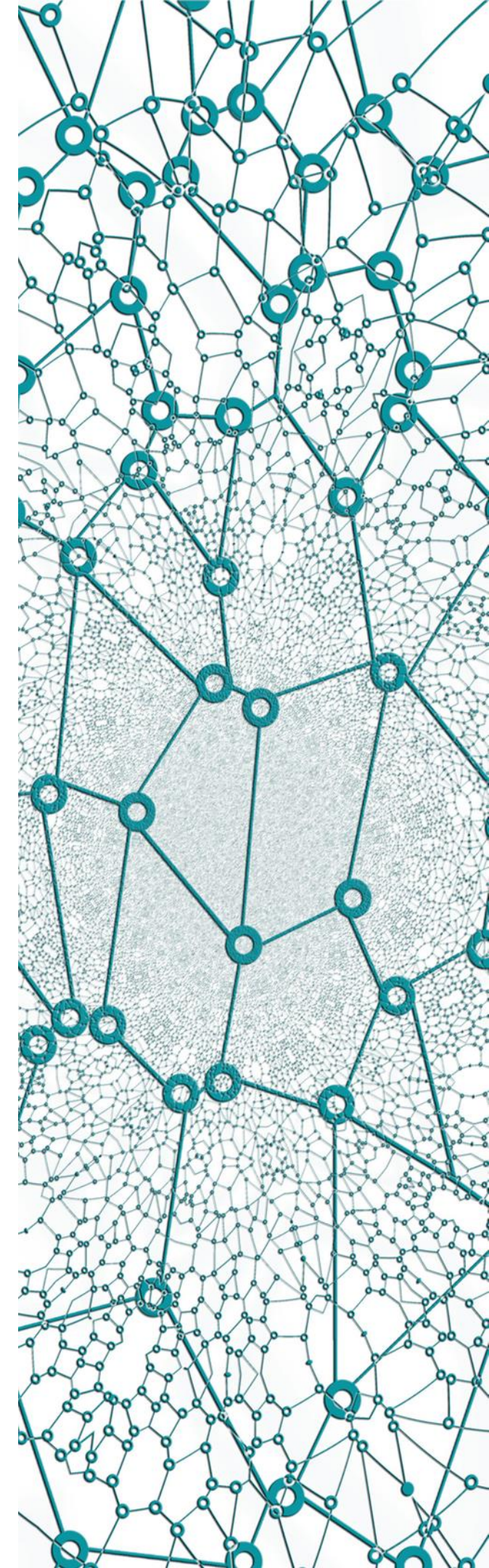
Service	Service Providers Examples	Description
Trading	DEXs	Facilitate the exchange of virtual assets through an order book exchange or liquidity pools; take deposits into liquidity pools and pay out accrued interest or other fees. <sup>39</sup>
Lending and Borrowing	Lending and Borrowing DeFi Services	Allow holders of virtual assets to earn a fixed or variable return on assets by depositing them in a pool that simultaneously allows other participants to borrow those assets for other financial activity. <sup>40</sup> Relatedly, some services provide “staking as a service” in which the service accepts and stakes virtual assets to participate in a proof-of-stake consensus mechanism. Some services provide “liquid staking,” in which the service accepts and stakes virtual assets for users and typically issues a “liquid staking derivative” virtual asset in exchange for the staked virtual asset. Users earn a portion of staking rewards or transaction fees.
Access Across Blockchains	Cross-Chain Bridges	Facilitate network interoperability by allowing users to exchange virtual assets or information from one blockchain to another.
Mixing	Decentralized Mixers	Functionally obfuscate the source, destination, or amount involved in a virtual asset transaction. These types of services may involve centralized or decentralized mechanisms and may be effectuated using several techniques. <sup>41</sup>
Aggregation	Aggregators	Query a range of DeFi services to collate the best terms for a trade or other activity for users, often viewable in a single user interface; some aggregators can route transactions to fulfill desired parameters. <sup>42</sup>
Provision of Off-Chain Information	Oracles	Connect a smart contract to “off-chain” data, such as stock prices or off-chain collateral value, that may be an input for that smart contract’s functionality. <sup>43</sup>
Purportedly Stable Virtual Assets	Algorithmic Stablecoin Protocols	Purport to maintain a stable value via protocols that provide for the increase or decrease of the supply of the stablecoin in response to changes in demand. <sup>44</sup>

Source: “ Illicit Finance Risk Assessment of Decentralized Finance” , US Department of Treasury, April 2023



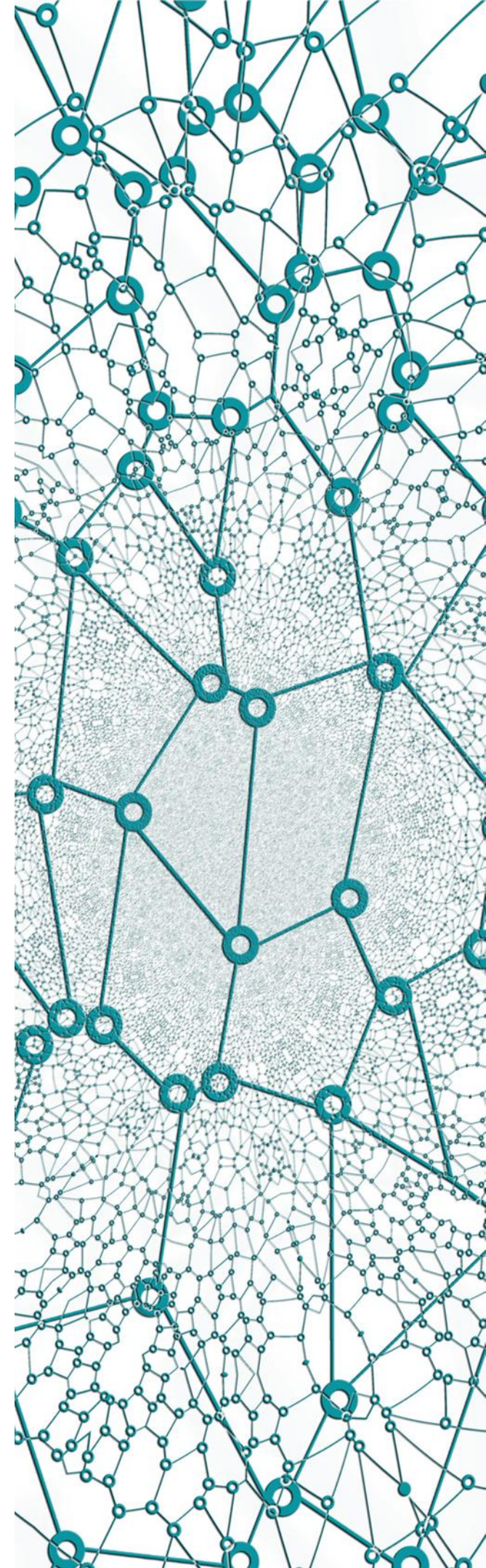
## DeFi vs. CeFi

- **No centralized intermediaries;**
- **Different potential regulatory access points/regulatory hooks** (software developers, users, significant token holders, exchange services, wallet providers, miners, stakers, nodes, ISPs, information intermediaries, blockchain-specific intermediaries, and mining hardware manufacturers).



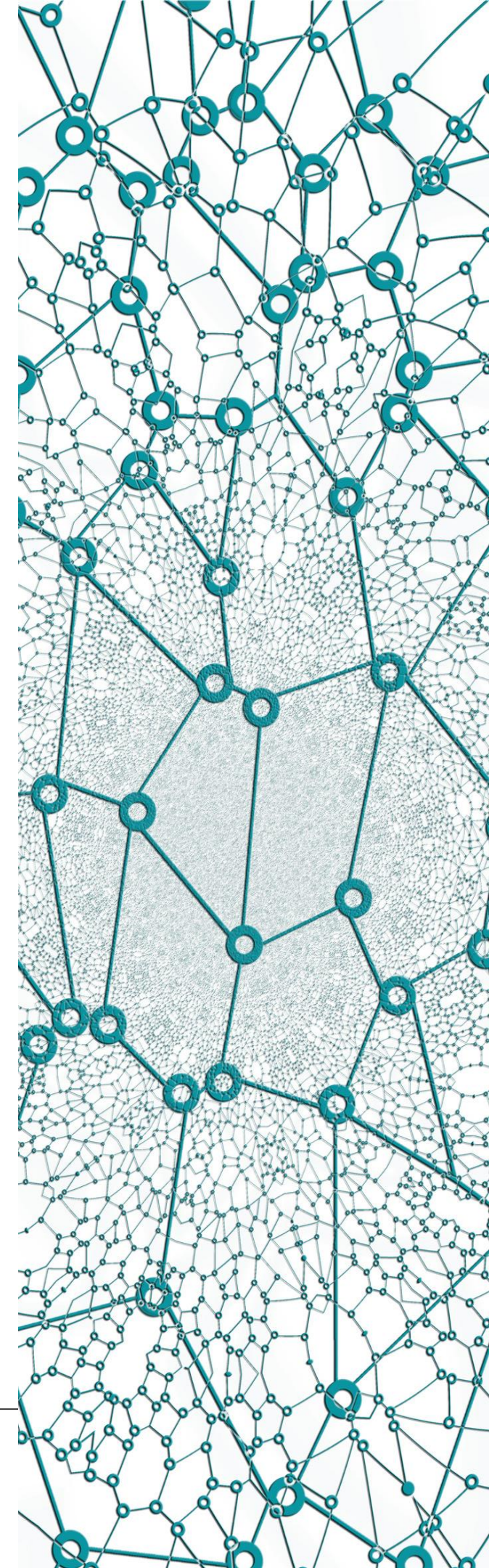
The foundational principles that guide the operational framework of the DeFi ecosystem

- **Self-reliance;**
- **Code is law.**



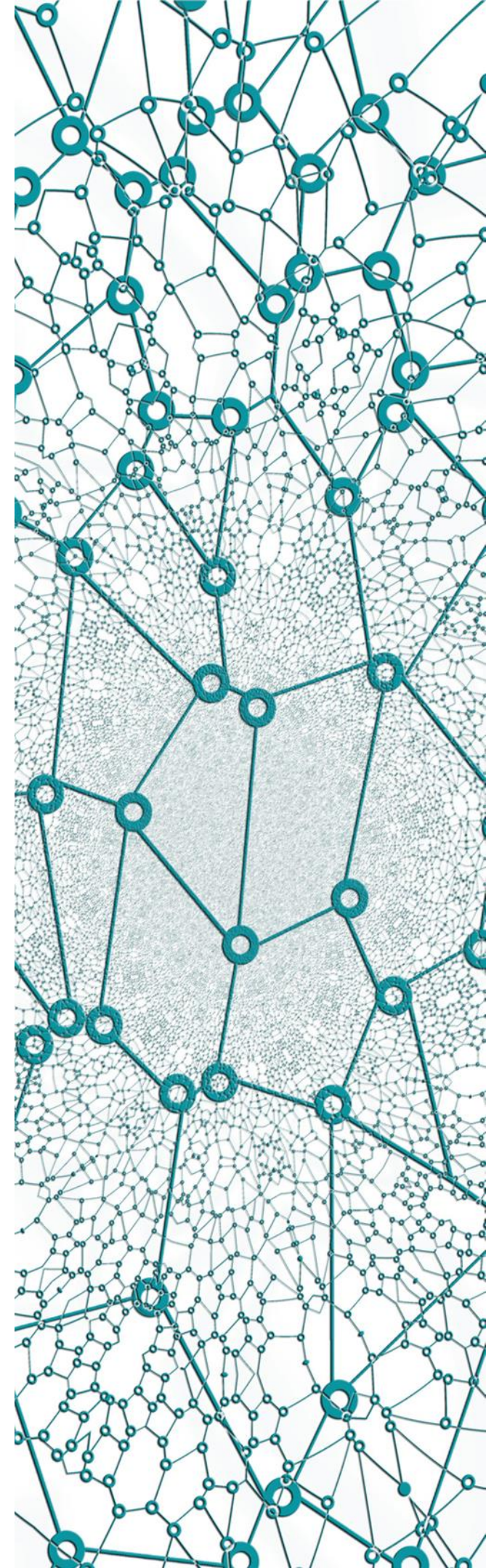


## II. Is code (still) the law?



The primary concerns associated with the concept of code as a self-executing mechanism of regulation

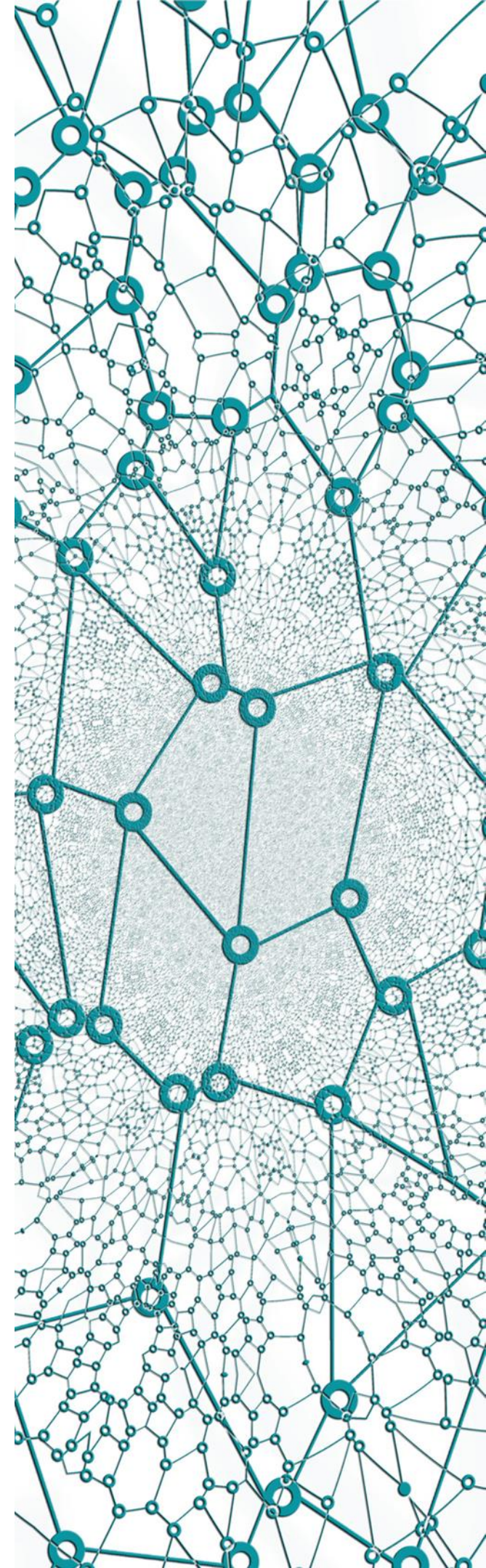
- Smart contracts are **prone to vulnerabilities** (Reentrancy Attacks, Integer Overflow/Underflow, Front-running, Denial-of-Service (DoS) Attacks, Unchecked External Calls, Governance Attacks, Misleading or Incomplete Code);
- Smart contracts are **inherently incapable of encompassing all market circumstances** through programming alone, rendering the 'code is law' paradigm inflexible and consequently susceptible to fragility;
- **The code has no legal secondary considerations.** The displacement of traditional law and regulation by code has certain limitations. Particularly, concepts present in legal contracts, such as 'good faith' **cannot be precisely translated into binary smart contract code.**





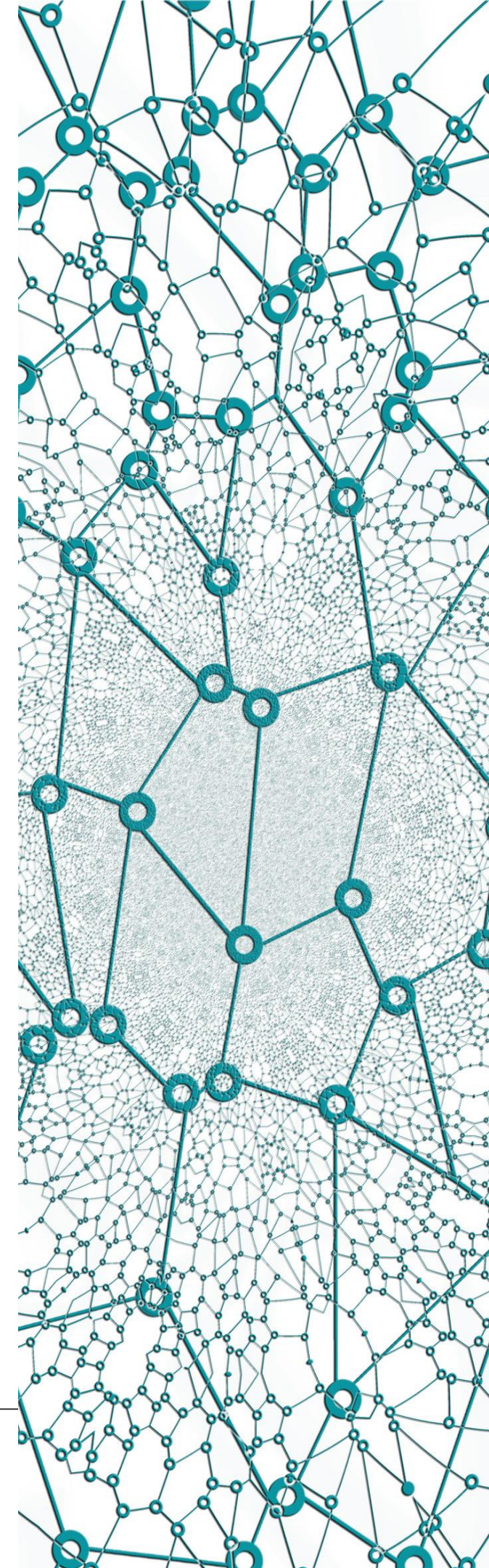
## Caveat emptor doctrine

- Resonates with many within the crypto community;
- Nonetheless, in every significant financial market across the globe, avenues for investor recourse and mechanisms for holding accountable those responsible for actions that compromise market integrity are provided.





**III. Is regulated DeFi an oxymoron?**



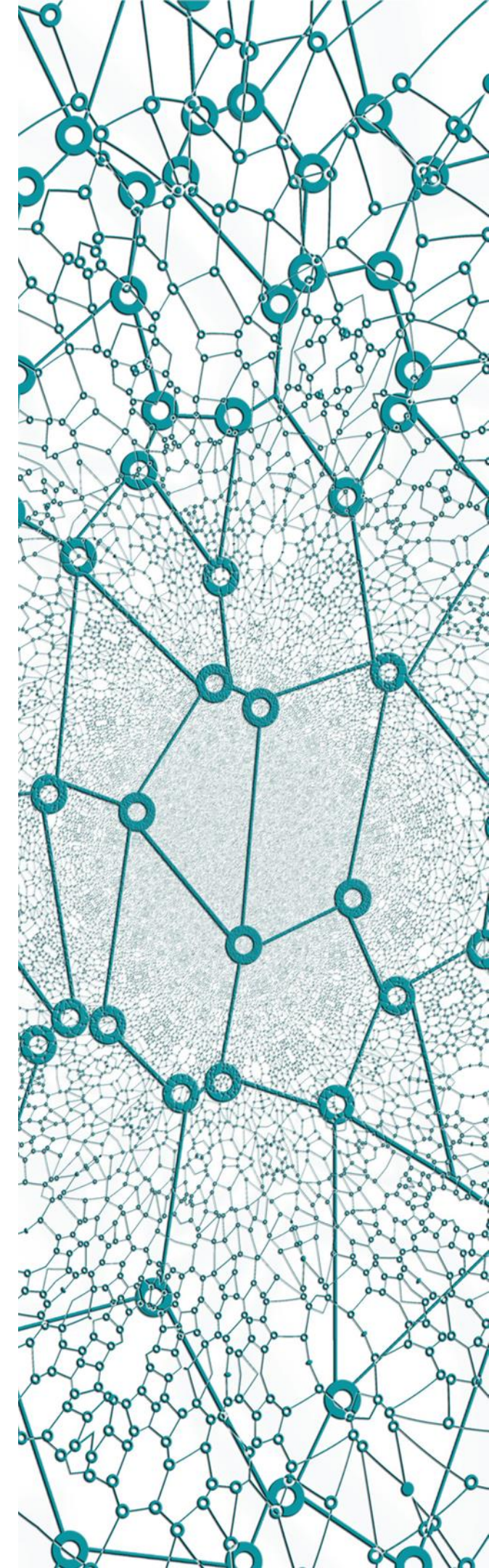
Regulatory national, regional and international bodies across the globe are looking into regulating DeFi .

Certain existing regulatory obligations may be applicable to DeFi activities where access points/regulatory hooks can be identified.

	Rulemaking	Public statement and speeches	Discussion papers and consultations	Reports and working papers	Other*
Canada				✓BoC	
European Union		✓EBA ✓ECB	✓EIOPA	✓EBA ✓ECB ✓ESMA ✓EC	✓ECB
France		✓AMF ✓BdF			
Germany		✓BBK		✓BBK	
Italy		✓BoI			
Japan				✓BoJ	
Netherlands				✓DNB	
Singapore		✓MAS			
United Arab Emirates	✓DFSRA		✓ADGM FSRA ✓DFSRA		
United Kingdom		✓BoE	✓UK Treasury	✓BoE	
United States		✓OCC ✓SEC ✓FED ✓US Treasury		✓GOV ✓FSCO ✓FED ✓PWGFM ✓US Treasury	✓CFTC ✓US Treasury

\* = enforcement measures, articles in annual reports, newsletters, bulletins and blogs.

Source: "Crypto, tokens and DeFi: navigating the regulatory landscape", FSI, May 2023



# Switzerland

FINMA encourages innovation and competitiveness in the Swiss financial marketplace.

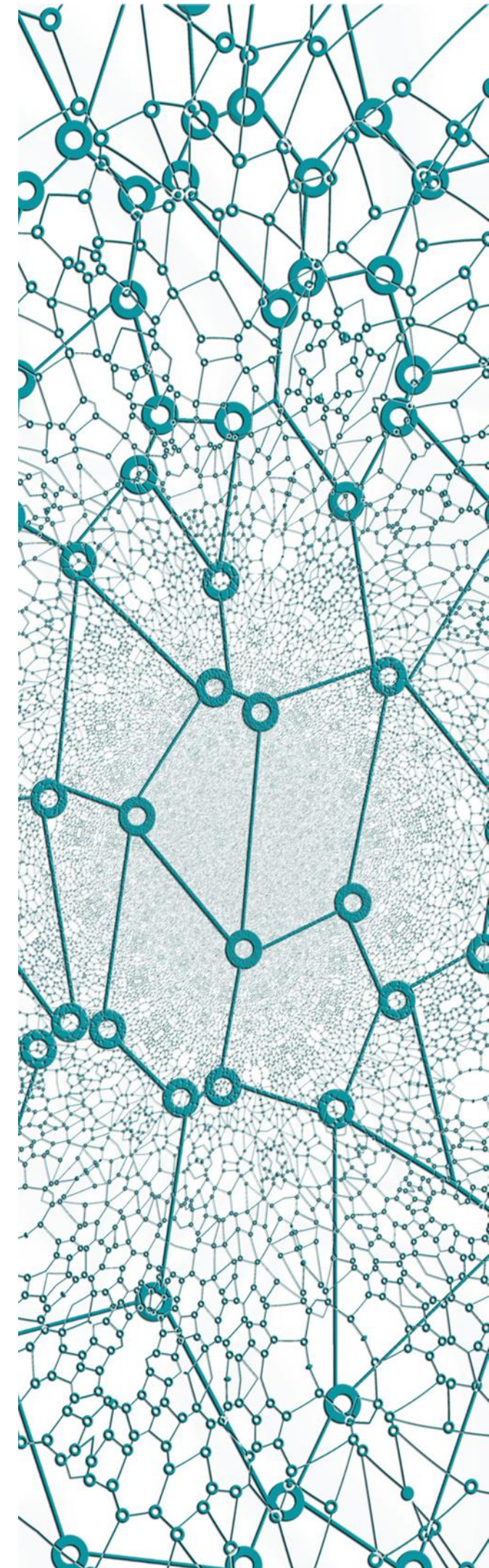
FINMA supervises the financial markets in accordance with the following acts (the financial market acts):

- a. Mortgage Bond Act of 25 June 1930;
- b. Federal Act on Contracts of Insurance of 2 April 1908;
- c. Collective Investment Schemes Act of 23 June 2006;
- d. Banking Act of 8 November 1934;
- e. Financial Institutions Act of 15 June 2018;
- f. Anti-Money Laundering Act of 10 October 1997;
- g. Insurance Supervision Act of 17 December 2004;
- h. Financial Market Infrastructure Act of 19 June 2015;
- i. Financial Services Act of 15 June 2018.

(Art. 1 FINMA Act)

In accordance with the financial market acts, financial market supervision has the objectives of protecting creditors, investors, and insured persons as well as ensuring the proper functioning of the financial market. It thus contributes to sustaining the reputation, competitiveness and sustainability of Switzerland's financial centre.

(Art. 4 FINMA Act)



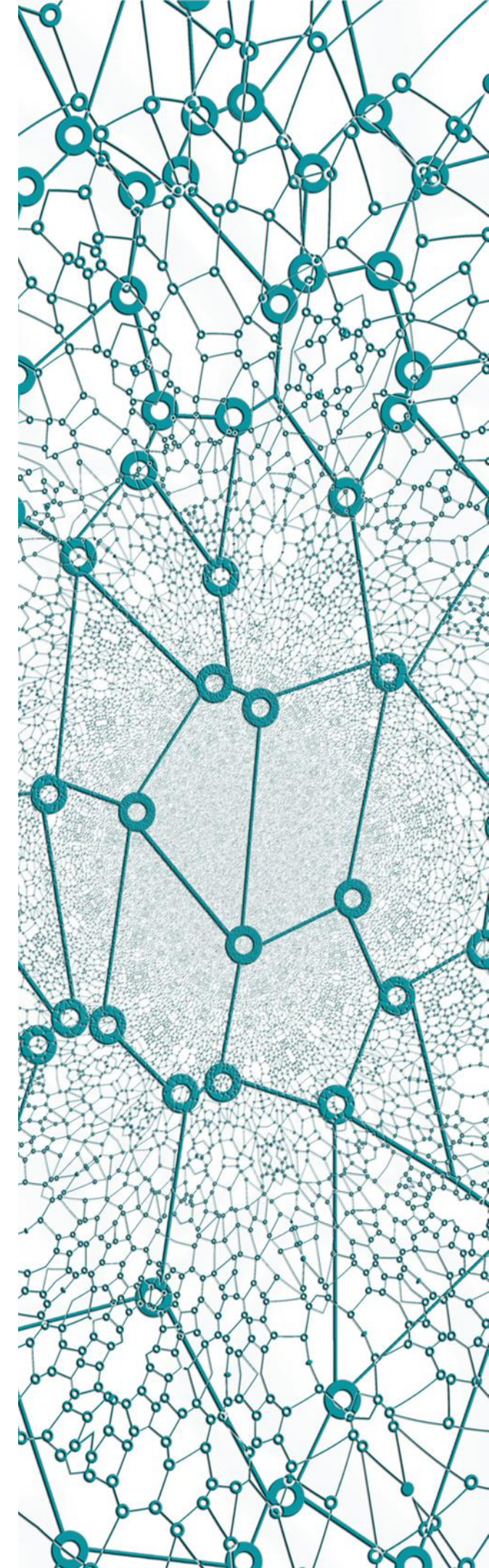
## Switzerland

When processing enquiries, it is important to distinguish projects without identifiable operators from those that describe themselves as DeFi but are actually organised and controlled centrally and therefore similar to traditional financial market intermediaries. Such projects fall within the scope of financial market law.

When responding to enquiries concerned trading platforms via which tokenised securities or cryptocurrencies can be traded, FINMA uses the following approaches:

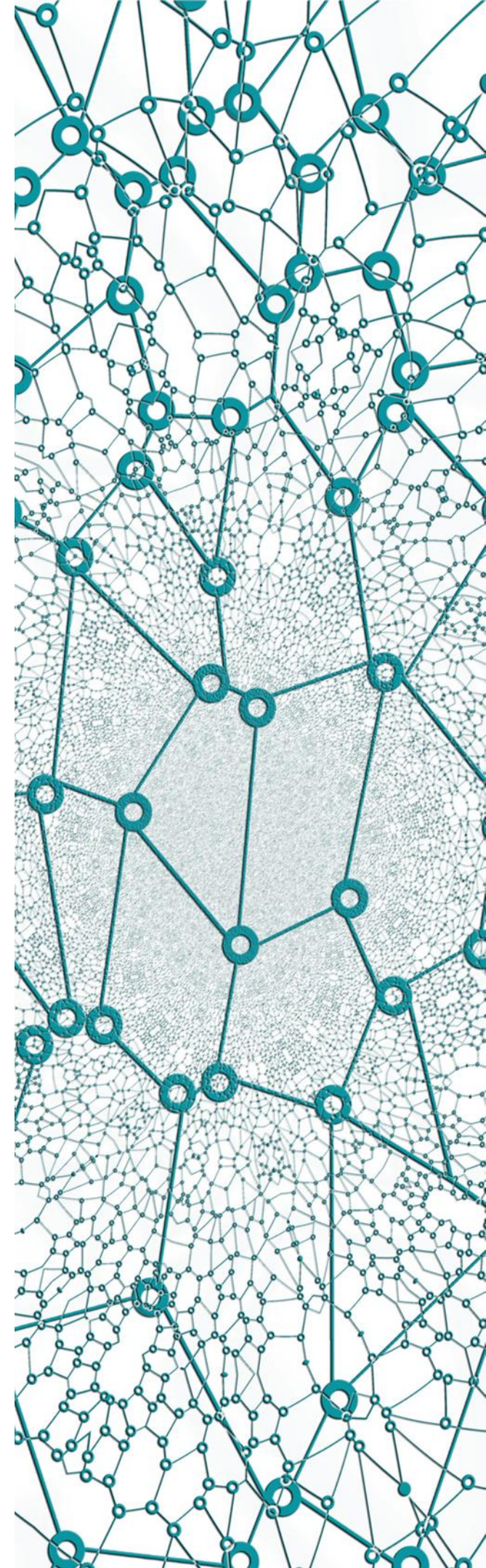
- **Principle of technology neutrality.** FINMA applies the existing rules to DeFi applications and in doing so abstracts from the use of specific technologies or procedures.
- **Same risks, same rules.** If a DeFi application offers the same service and poses the same risks as intermediaries in the traditional financial market, FINMA also applies the same rules (same risks, same rules).
- **Substance over form.** If, from an economic perspective, a DeFi application offers an activity under financial market law that would require licensing, FINMA also assumes a licensing requirement in the case of new types of technical or legal implementation.

Professional activity as a market maker in relation to financial instruments which qualify as transferable securities requires a license as an investment firm (Art. 41 FinIA) or a bank (see art. 6 para. 1 FinIA). No license is required for trading financial instruments that are not securities.



## European Union

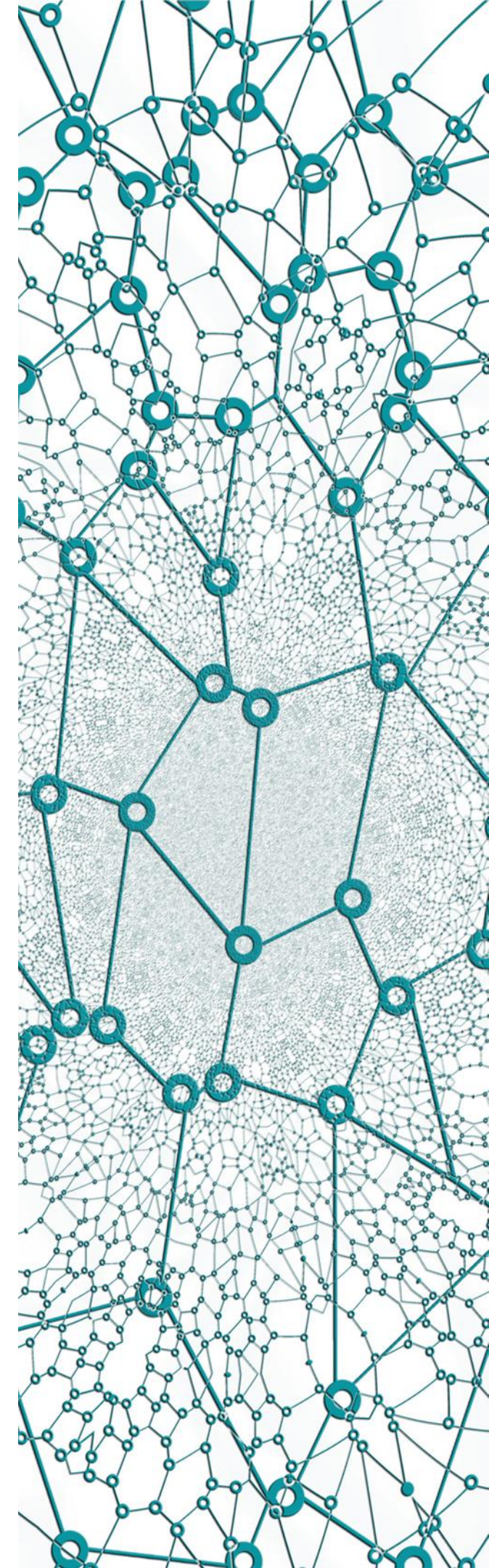
- The Regulation on Markets in Crypto-assets (MICA) does not cover EU financial instruments regulated elsewhere and the digital assets such as DeFi protocols, NFTs and CBDCs;
- National laws apply;
- Interesting approaches are developing on the European national level:
  - ✓ Germany - Germany regulator BaFin issues clear guidance on cryptoasset regulation in an amendment to the German Banking Act in 2020;
  - ✓ Malta - Malta has positioned itself as the "Blockchain Island" by providing a regulatory framework specifically tailored to cryptocurrencies and blockchain technology. The country has attracted a number of cryptocurrency exchanges and related businesses, including some DeFi projects.
  - ✓ Estonia has been proactive in embracing digital technologies and has introduced friendly regulations for cryptocurrency and blockchain companies. It has a digital residency program and a favorable business environment, which has attracted several blockchain and DeFi projects.



## United Kingdom

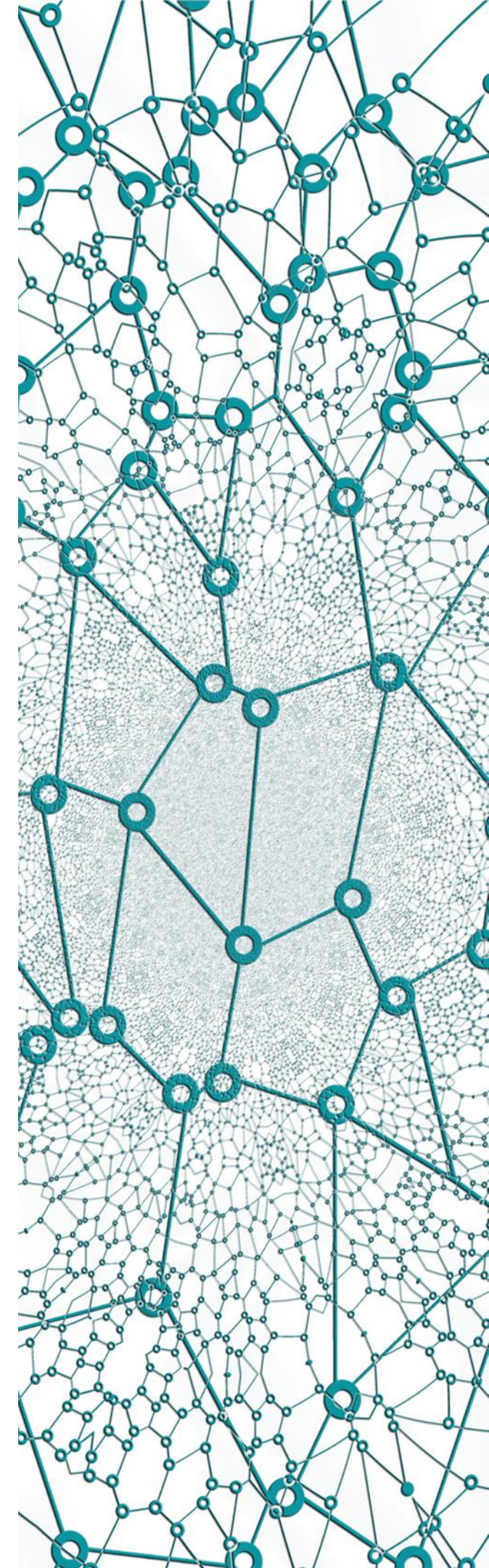
- Europe's biggest DeFi district in 2022\*.
- On 1 February 2023, HM Treasury unveiled its plans for the regulation of cryptoassets activities and confirmed its approach to cryptoasset financial promotions. In the HM Treasury Consultation Paper, the government is asking for industry views on how DeFi can be regulated (including determining where in a DeFi value chain "regulatory hooks" might be established).
- On May 2, 2023, the U.K. government's tax branch, His Majesty's Revenue and Customs (HMRC), announced it will be consulting crypto stakeholders for the next eight weeks on its plan. The government is seeking views on modifying the tax treatment of decentralized finance (DeFi) lending and staking. The intention of the consultation is to create a regime that better aligns the taxation of crypto assets used in DeFi lending and staking transactions (DeFi transactions) with the underlying economic substance, whilst reducing the administrative burden on users.

\*Source: Chainalysis Global DeFi Adoption Index



## United States

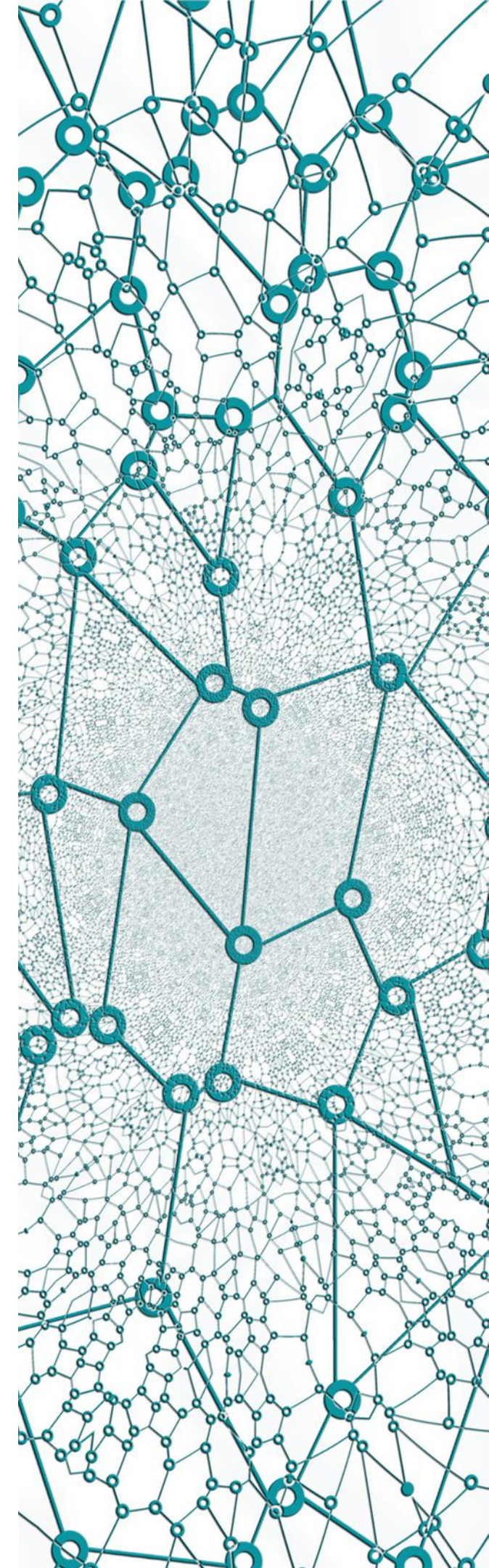
- Regulators are at early stages of assessing their approach to other areas of digital assets, including wider DeFi.
- Regulatory authorities have clarified that DeFi systems may fall within the remit of existing legislation, such as securities laws, banking laws and commodities laws.
- On April 6, 2023 the U.S. Department of the Treasury published the 2023 DeFi Illicit Finance Risk Assessment.





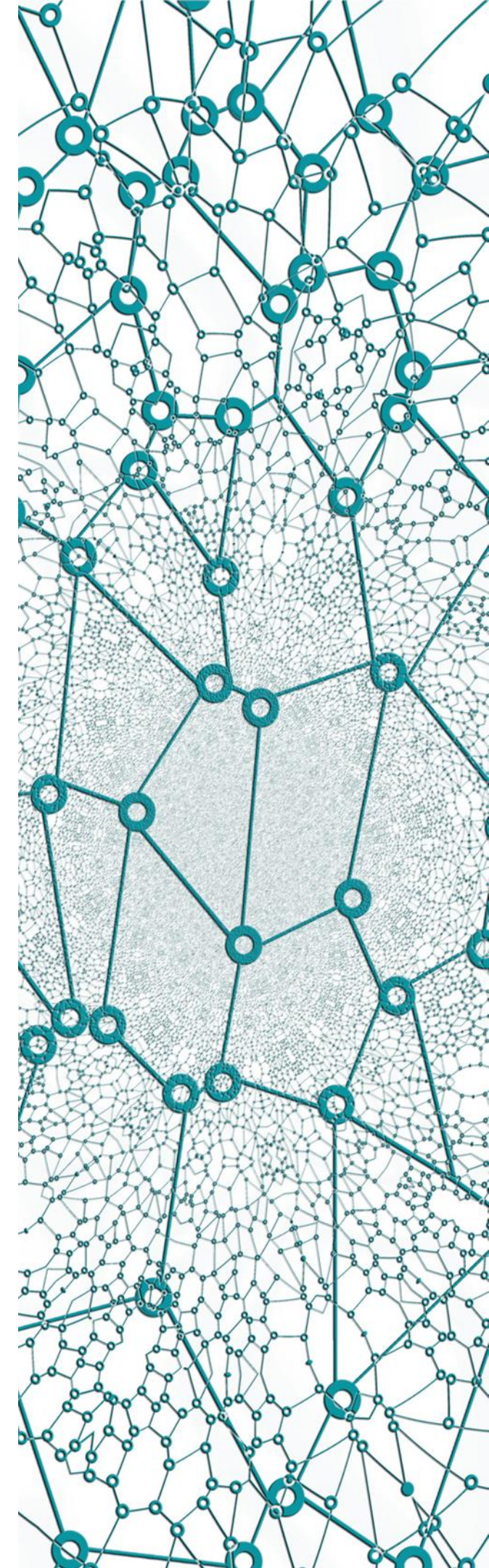
# Singapore

- Singapore has established itself as a fintech and blockchain hub in Asia. The country has a supportive regulatory framework, a strong financial sector, and government initiatives aimed at fostering blockchain innovation, making it an attractive location for DeFi projects
- Project Guardian – launched in 2022, goal: establishing policy guidelines and framework, defining acceptable governance model or accountability as well as technical standards for DeFi.
- Depending on the features DeFi digital assets may be regulated under the Payment Services Act (PSA) or Securities and Futures Act (SFA)
- Four months ago Singapore banks conducted their first DeFi real world application test using Aave to complete foreign exchange and government bond transactions.



## United Arab Emirates

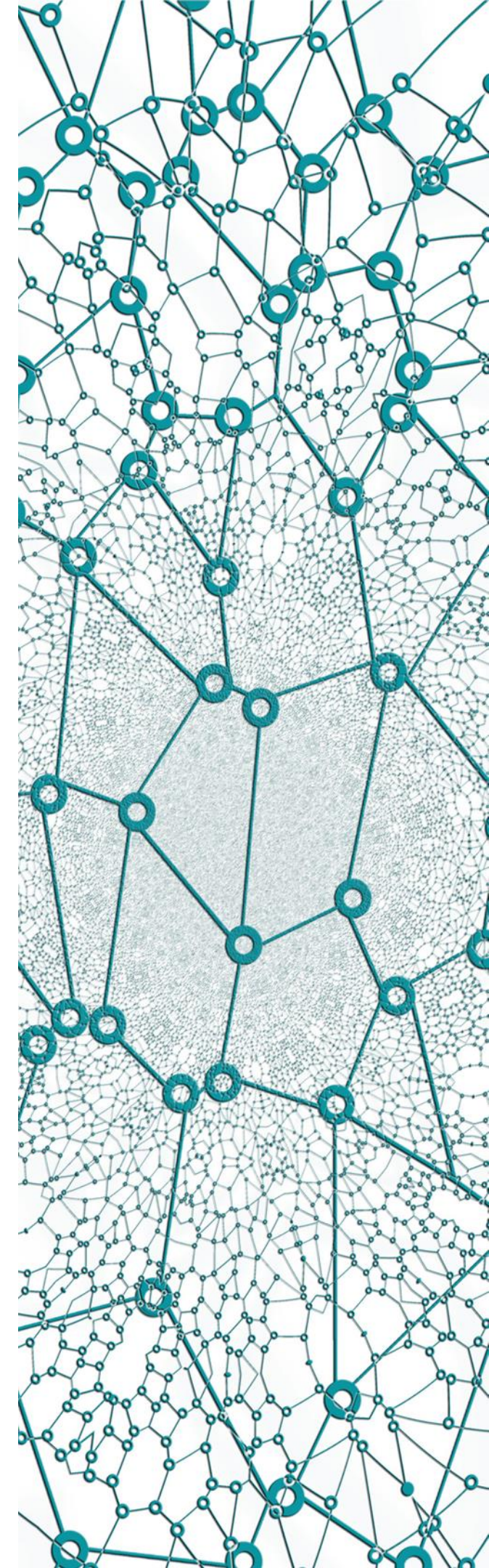
- Regulators are assessing their approach to DeFi;
- Major step has been taken by Dubai by establishing the Virtual Assets Regulatory Authority (VARA).



# India

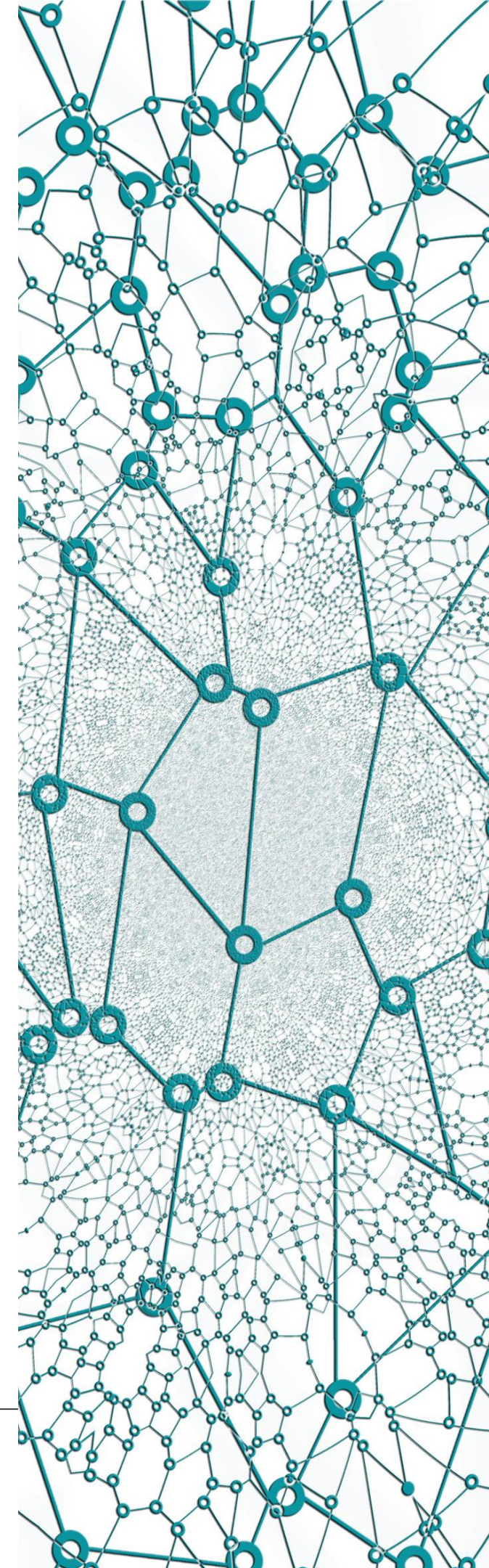
- In 2022 ranked no. 1 in DeFi value received\*;
- Regulatory landscape at the early stage;
- On 7 March 2023, the federal government issued a gazette notice on 7 March 2023, which requires intermediaries and crypto exchanges involved in virtual digital assets (VDA) to perform KYC verifications on their users and customers. Additionally, these intermediaries and exchanges must report any suspicious activity to the Financial Intelligence Unit India (FIU-IND).

\*Source: Chainalysis Global DeFi Adoption Index



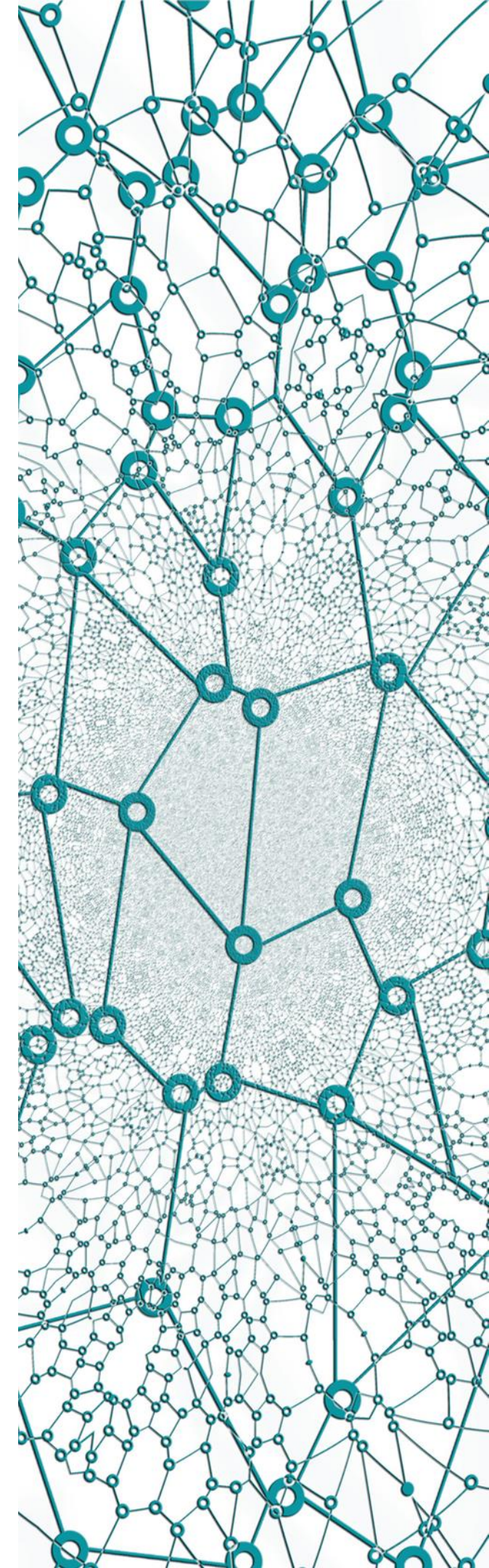


#### IV. How to achieve a mindset-oriented approach to regulation?



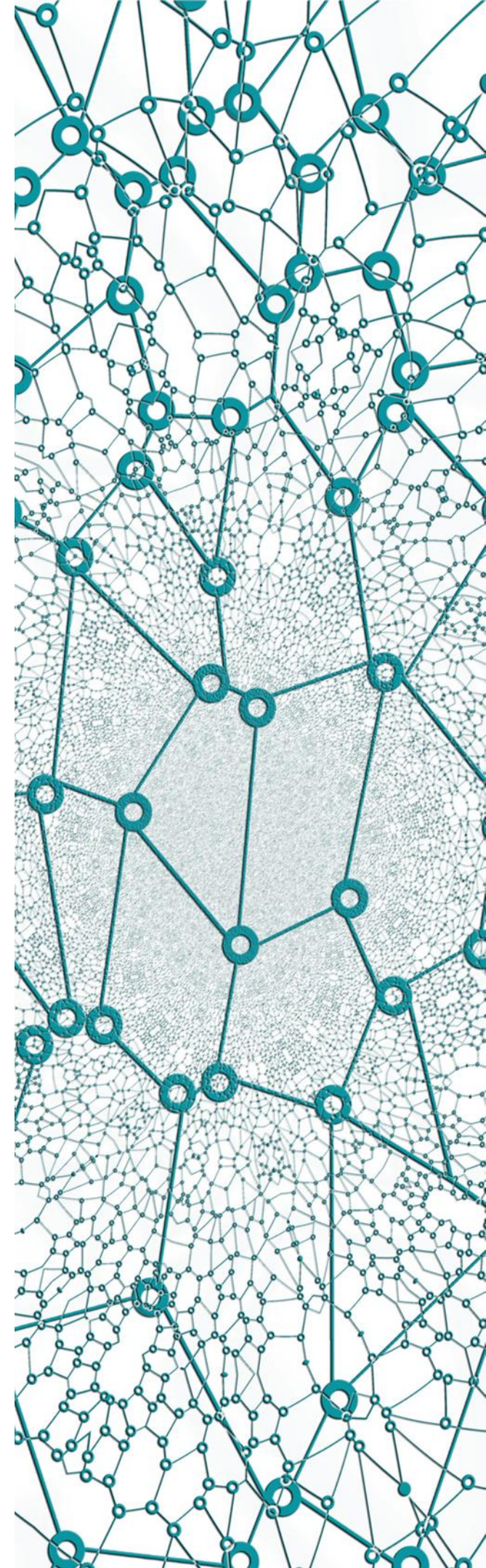
## Regulators and policymakers - principles

- Balanced Approach
- Risk-Based Approach
- Clarity and Legal Certainty
- Consumer Protection
- Innovation-Friendly Environment
- International Cooperation



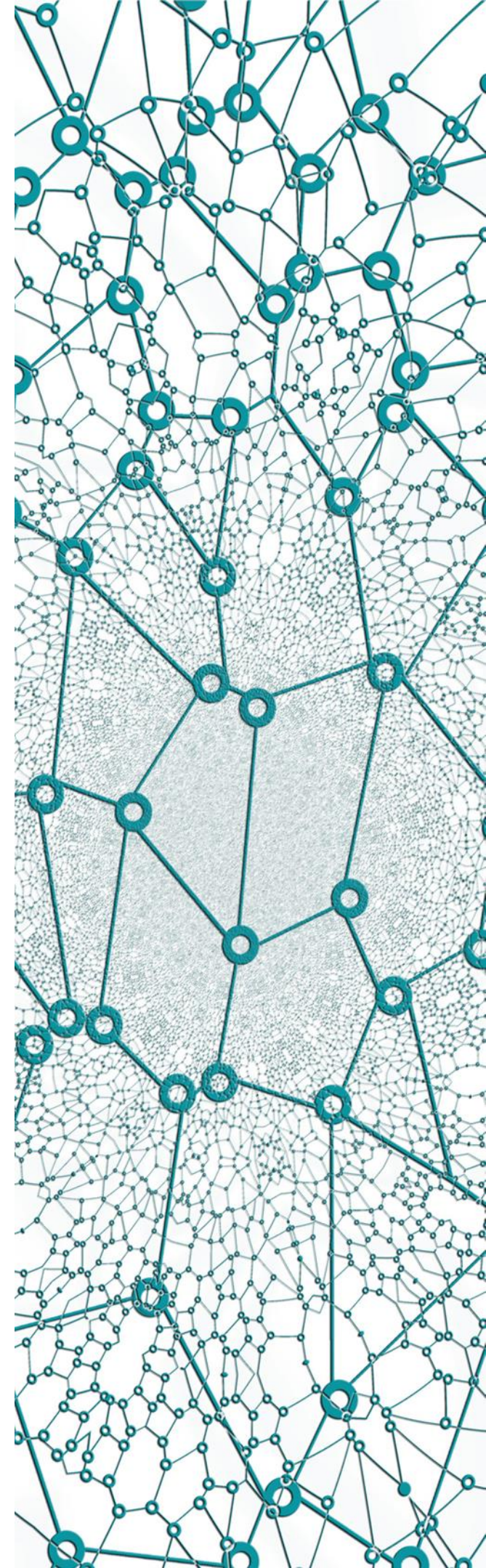
## Regulators and policymakers – possible approaches

- Developing a legal structure that acknowledges the various participants involved in managing or facilitating the functioning of DeFi protocols (introducing legal framework for DAOs);
- Oracles;
- Approaches focusing on the code used for building smart contracts and DeFi protocols;
- Whitelisted protocols (FSRA of the Abu Dhabi Global Market);
- Creation of an open policy framework for the benefits of DeFi services with a view to encouraging voluntary compliance.



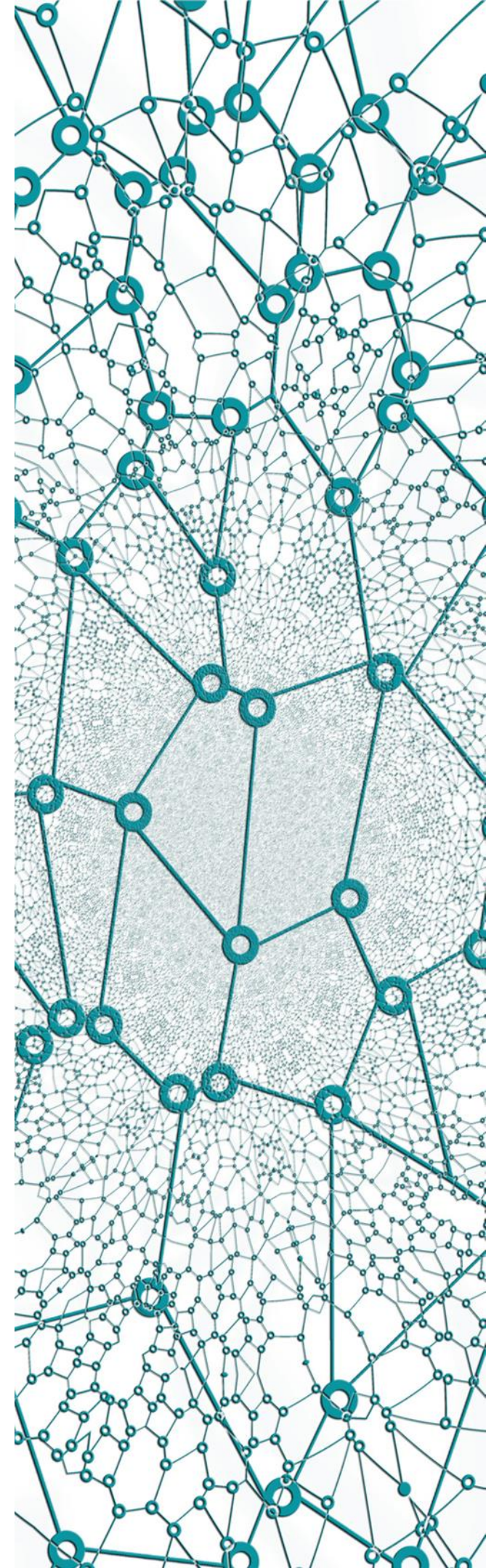
## DeFi Solutions Providers – Steps to be taken

- Define Your Project Idea;
- Develop a Solid Business Plan: Outline your project's goals, target audience, revenue model, and roadmap. Consider factors such as tokenomics, governance mechanisms, and user incentives;
- Assemble a Skilled Team;
- Choose the Right Blockchain Platform;
- Smart Contract Development;
- Token Design and Distribution;
- Build and Test Your Application;
- Community Engagement and Governance;
- **Compliance and Regulations**



## DeFi Solutions Providers – Compliance and Regulations

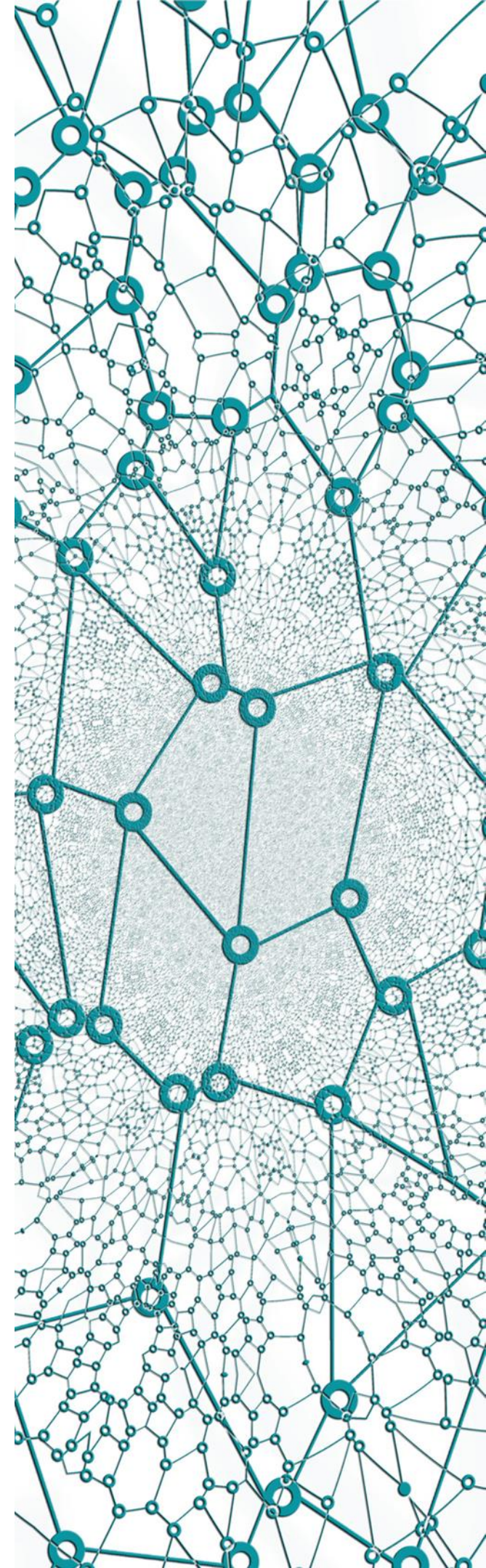
- Select the appropriate jurisdiction by considering not only the current but also the projected future legal framework.
- Comprehend and adhere to applicable legal and regulatory obligations.
- Adopt a proactive approach by seeking early validation of your approach.





# DeFi Solutions Providers – Compliance and Regulations

- Code technological features



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**Thank you for your attention !**

Let's shape

*Tomorrow*