

October 19, 2023



Secretariat
International Organization of Securities Commissions
Calle de Oquendo 12
28006 Madrid
Spain

Email: deficonsultation@iosco.org

Dear Sir or Madam,

Ripple Labs Inc. ("Ripple") welcomes the opportunity to comment on the consultation report on the Policy Recommendations for Decentralized Finance ("DeFi")¹ the ("DeFi Consultation Report") published by the International Organization of Securities Commissions ("IOSCO") on September 7, 2023.

Ripple would like to thank IOSCO for the in-depth and comprehensive analysis that has been undertaken in drafting the DeFi Consultation Report, as well as the opportunity to provide our comments. We respectfully request you take them into consideration as you consider the policy direction and scope of intended regulation for DeFi. We welcome the opportunity for further engagement with IOSCO on the DeFi Consultation Report, and any other related consultations as may be appropriate.

I. Introduction

Ripple's software products allow financial institutions to send money globally, on a real-time basis, at a fraction of the cost of traditional services available to market participants. Using blockchain technology and digital assets, Ripple allows financial institutions to process payments instantly, reliably, cost-effectively, and with end-to-end visibility anywhere in the world.

Ripple's aim is not to replace fiat currencies, but rather to enable a faster, less expensive, and more transparent method of making cross-border payments that is in the public's best interest.

¹ See <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD744.pdf>, Consultation Report on Policy Recommendations for Decentralized Finance (DeFi).

II. XRP and the XRP Ledger

The XRP Ledger is decentralized, open-source, and operates on what is known as a “consensus” protocol,² and the digital asset XRP is native to the XRP Ledger. While there are well over a hundred known use cases for XRP and the XRP Ledger, including in DeFi, Ripple leverages XRP for use in its product suite because of XRP’s suitability for cross-border payments. Key characteristics of XRP include speed, scalability, energy efficiency, and cost efficiency. Although Ripple utilizes XRP and the XRP Ledger in its product offerings, XRP is independent of Ripple.

III. General comments and policy considerations

We respectfully submit that any regulatory framework for DeFi should encourage responsible innovation by service providers and intermediaries while also ensuring appropriate risk management and consumer protection. We therefore believe it is imperative that IOSCO take into account the following guiding principles when supporting jurisdictions around the world as they develop regulatory frameworks for DeFi. Taken together, these principles will support an international regulatory framework that encourages the potential of DeFi, while also establishing important consumer and market protections that ensure global alignment, preserve financial stability, and reduce the risk of regulatory arbitrage.

Principle 1 - Adopt a globally consistent definition and taxonomy for DeFi

As the DeFi Consultation Report highlights,³ it is important to note that there is no single or generally recognised definition of DeFi at present. At the same time, it’s also important to note that as DeFi evolves, any definition or taxonomy would need to be updated over time to ensure it is appropriate. We would therefore urge IOSCO to formulate a global definition and taxonomy for DeFi and DeFi activities which is broad enough to encompass future innovation. Such a definition and taxonomy could be developed through the establishment of a joint task force between IOSCO, other standard setting bodies, national regulators, and industry. Ripple would also like to highlight that any definition and taxonomy for DeFi should consider the following characteristics as a way of building modularity and hence flexibility over time:

- The level of **decentralization** of the network or activity;
- Whether the network or activity is **open source**;
- Whether the network or activity is **autonomous**;
- The level of **standardization** for the network or activity; and
- Whether access and use of the network or activity is **non-discriminatory** in nature.

² See <https://xrpl.org/index.html>, XRP Ledger.

³ See DeFi Consultation Report, Footnote 3, Page 1.

Additionally, any definition or taxonomy should take into consideration the structure of DeFi which has several layers, namely:

- The **infrastructure layer**, which manages the ledgers by recording changes to the state of the blockchain, and sets incentives for validators and miners to maintain the chain. This layer is also responsible for the network's operations, including the consensus mechanism and dispute resolution.
- The **token layer**, which is where digital assets are created, using protocols built on top of the infrastructure layer. The token layer typically extends functionality for tokens, typically with regard to privacy and permissioning requirements.
- The **application layer**, which interacts with the underlying network to provide utility to end-users, including decentralized exchanges ("DEXs"), liquidity pools, and other applications. This layer is where most DeFi protocols are integrated, as they will rely on both infrastructure and token layers to execute their associated smart contracts.

Therefore, in practice, it's clear that a network or activity could have different levels of decentralization, ranging from completely decentralized to completely centralized, depending on which layer is being analysed.

Hence, Ripple firmly believes that a global definition and taxonomy for DeFi and DeFi activities needs to be formulated to understand the level of decentralization for a network or activity, and regulations should be calibrated accordingly.

Such a definition and taxonomy will help differentiate between those activities that are truly decentralized, and those that are 'decentralized in name only' ("DINO").⁴ This global definition and taxonomy should be comprehensive, but also have the ability to be reviewed to adapt with developments over time.

Principle 2 - Implement a risk-sensitive regulatory framework for DeFi

We are supportive of IOSCO's approach of applying principles-based and outcomes-focused standards which are aimed at DeFi products, services, arrangements, and activities.

We are also supportive of the intent to enhance cooperation among regulators to coordinate and respond to cross-border challenges in enforcement and supervision, and to address regulatory arbitrage concerns that arise from the cross-border nature of activities conducted by DeFi participants, in line with the principle of "same activity, same risk, same regulation".⁵

⁴ This refers to a project that is portrayed as decentralized, but in fact relies on a small group of individuals or entities to control its operations.

⁵ Referred to as "same activity, same risk and same regulatory outcome" in the DeFi Consultation Report. See DeFi Consultation Report, Page 2.

However, we recommend that any regulatory framework should also align with the following principles to be truly risk-sensitive:

- The regulatory framework should be **technology-agnostic**, and should not explicitly or otherwise endorse any particular technology. In practical terms, this means that services using DeFi as a solution should not be treated differently from services embedding legacy technology, and there should be parity in the treatment of all technology;
- We support IOSCO's intent to formulate a **principles-based and outcomes-focused** regulatory framework that is drafted in a way to steer market participants to specific regulatory and policy objectives while maximizing flexibility and breadth of application. Providing clear targets on desired outcomes will create a dynamic and proportionate regulatory environment that is most like to achieve public-sector objectives; and
- The regulatory framework should use a **risk-based** approach to identify DeFi services that pose sufficient risk to warrant regulation based on the level of decentralization.

The recommended regulatory framework, as proposed above, should be forward-looking and flexible while providing regulatory certainty and consumer safeguards, and at the same time meet the policy goals of encouraging innovation and growth of DeFi.

Principle 3 - Ensure global consistency and comparability for DeFi

Lastly, given the cross-border nature of DeFi products, services, arrangements, and activities, Ripple supports having minimum global standards, supported by cross-border cooperation and information sharing across jurisdictions, to help ensure an approach that is consistent and comparable. Ripple is supportive of IOSCO's approach of ensuring optimal consistency in the way DeFi markets are regulated within individual IOSCO jurisdictions, and ensuring the need for enhanced cooperation among regulators.⁶

We would also encourage convergence on definitions and approaches with other international bodies and regulators among different jurisdictions and sectors, for example with the Bank for International Settlements, Financial Action Task Force, Financial Stability Board, Office of Foreign Assets Control, and national central banks and other regulatory bodies. There is a growing risk that different regulatory sectors rely on divergent definitions of decentralisation, which could lead to fragmentation and regulatory arbitrage.

⁶ See DeFi Consultation Report, Page 37.

With this overview, Ripple respectfully submits the following feedback on the questions for consultation in the Appendix.

Ripple appreciates the opportunity to provide feedback on the DeFi Consultation Report as you study these important issues, and we would encourage and support further dialogue with all stakeholders. Should you wish to discuss any of the points raised in this letter, please do not hesitate to contact Rahul Advani (Policy Director, APAC) at radvani@ripple.com and Andrew Whitworth (Policy Director, EMEA) at awhitworth@ripple.com.

Sincerely,

Ripple Labs Inc.

APPENDIX

Ripple respectfully submits the following feedback to questions 1, and 6 set forth in Section IV in the DeFi Consultation Report.

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

While Ripple is supportive of IOSCO's approach of applying principles-based and outcomes-focused standards which are aimed at DeFi products, services, arrangements, and activities, we respectfully disagree with the Recommendations and guidance in the DeFi Consultation Report.

We firmly believe that the majority of the Recommendations, as currently drafted, do not take into account the unique structure of DeFi markets, and instead try to apply principles more relevant to centralized, traditional financial markets. While it's true that *some* DeFi arrangements and activities are in fact providing products and services that are equivalent to those provided by traditional market intermediaries, it doesn't mean that *all* DeFi arrangements and activities are equivalent.

Therefore, we believe it is essential that IOSCO adopt a globally consistent definition and taxonomy for DeFi, as highlighted in Principle 1 of Section III of this response (General comments and policy considerations). Any such definition and taxonomy should take into account the unique nature and structure of DeFi to determine the level of decentralization, and regulations should be calibrated accordingly.

It is also worth noting that the majority of the Recommendations in the DeFi Consultation Report are predicated on the identification of Responsible Persons.⁷ It is important to highlight here that identification of Responsible Persons will only be possible in DeFi arrangements and activities that have a degree of centralization. It may not be possible to identify Responsible Persons in other, more decentralized arrangements and activities, and this possibility is not considered in the DeFi Consultation Report. Additionally, it is unclear what "sufficient influence" such Responsible Persons hold, as this term is open to interpretation and not defined. We would argue that it is impractical, and would be bad practice, for a regulatory body to assert that some body or entity has responsibility over something that they do not, in fact, have the ability to influence materially.

Taking these points into consideration, there is a very real concern that regulators may focus more on identifying Responsible Persons, instead of focusing on implementing risk-sensitive, outcomes-based regulations. Having developers identified as Responsible Persons could lead to the unintended consequence of disincentivizing innovation, and/or incentivizing regulatory arbitrage by technology developers who could seek safe

⁷ See DeFi Consultation Report, Page 22.

haven from opaque or overly punitive laws which subject them to personal risk. Developers typically have very little control over how their blockchain network is used, and hence would not want to be liable or responsible for activities beyond their control. This also goes against the principle of technology-agnostic regulations, as outlined in Principle 2 of Section III of this response (General comments and policy considerations).

It's also worth noting that national regulators already have the supervisory powers to regulate centralized entities within existing mandates, and therefore it's unclear whether the Recommendations provide any additional benefit in practice.

Ripple believes that unless a definition and taxonomy for DeFi is formulated, the Recommendations and guidance in the DeFi Consultation Report are likely to be ineffective and create adverse incentives that counter the goals of the DeFi Consultation Report and Recommendations. Therefore, we urge IOSCO to form a joint task force with other standard setting bodies, national regulators, and industry to develop such a definition and taxonomy for DeFi.

Question 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?

Ripple believes that the IOSCO Standards should not be applied to all DeFi activities contained in the DeFi Consultation Report. As highlighted in our response to Question 1, we believe that the majority of the Recommendations, as currently drafted, do not take into account the unique structure of DeFi markets, and instead try to apply principles more relevant to centralized, traditional financial markets.

While the IOSCO Principles may apply to some DeFi arrangements and activities that are providing products and services that are equivalent to those provided by traditional market intermediaries, it doesn't mean that all DeFi arrangements and activities are equivalent.

Therefore, we believe it is essential that IOSCO formulate a globally consistent definition and taxonomy for DeFi, as highlighted in Principle 1 of Section III of this response (General comments and policy considerations). Any such definition and taxonomy should take into account the unique nature and structure of DeFi to determine the level of decentralization, and regulations should be calibrated accordingly.