FSB assesses financial stability risks of decentralised finance

The Financial Stability Board (FSB) today published a report on the financial stability risks of Decentralised Finance (DeFi). DeFi is commonly used to describe services in crypto-asset markets that aim to replicate some functions of the traditional financial system in a supposedly decentralised manner – though the actual level of decentralisation varies widely.

The report, which was delivered to the February G20 Finance Ministers and Central Bank Governors meeting, concludes that while the processes to provide services are in many cases novel, DeFi does not differ substantially from traditional finance in the functions it performs or the vulnerabilities to which it is exposed. DeFi’s specific features may result in some of these vulnerabilities – such as operational fragilities, liquidity and maturity mismatches, leverage and interconnectedness – playing out at times differently than in traditional finance. The fact that crypto-assets underpinning much of DeFi lack inherent value and are highly volatile magnifies the impact of these vulnerabilities when they materialise, as recent incidents demonstrate.

The extent to which these vulnerabilities can lead to financial stability concerns largely depends on the interlinkages and transmission channels between DeFi, traditional finance and the real economy. To date, these interlinkages are limited. However, if the DeFi ecosystem were to grow significantly, then the scope for spillovers would increase. The report identifies indicators that can be used to monitor DeFi vulnerabilities and transmission channels.

Based on these findings, the FSB will carry out additional work to:

- Analyse the growth and implications of the tokenisation of assets, i.e. the creation of a digital representation (token) of a financial instrument or real asset, as it could increase linkages between crypto-asset markets/DeFi, traditional finance and the real economy.

- Explore approaches to fill data gaps to measure and monitor interconnectedness of DeFi, in collaboration with standard-setting bodies (SSBs) and regulatory authorities.

- Examine the extent to which the FSB’s proposed policy recommendations for the international regulation of crypto-asset activities may need to be enhanced to acknowledge DeFi-specific risks and facilitate the application and enforcement of rules.

- Consider, in coordination with the SSBs, the regulatory perimeter across jurisdictions to determine which DeFi activities and entities fall or should fall within that perimeter. It also includes considering whether to subject such entities to additional prudential and investor protection requirements or to step up enforcement of existing requirements.
Notes to editors

In February 2022, the FSB published an *Assessment of Risks to Financial Stability from Crypto-assets*, which examined developments and associated vulnerabilities in crypto-asset markets, including stablecoins and DeFi. In October 2022, the FSB published *A proposed framework for the international regulation of crypto-asset activities*, which aims to ensure that crypto-asset activities are subject to comprehensive regulation and oversight commensurate to the risks they pose, while harnessing potential benefits of the technology behind them. The FSB expects to publish its final crypto-asset regulatory framework in July 2023.

The FSB coordinates at the international level the work of national financial authorities and international standard-setting bodies and develops and promotes the implementation of effective regulatory, supervisory, and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts. The FSB also conducts outreach with approximately 70 other jurisdictions through its six Regional Consultative Groups.

The FSB is chaired by Klaas Knot, President of De Nederlandsche Bank. The FSB Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements.

For further information on the FSB, visit the FSB website, [www.fsb.org](http://www.fsb.org).