

## Web 3.0 and DeFi

January 2023

*Web 3.0 envisions a future integration of ordinary activities into online life with a greater degree of individual control over data and transactions intermediated by fewer and fewer actors. This disintermediation would drive companies to find new ways to engage customers, but those customers may spend more time online, creating more data, and raising demand for internet-linked services (such as cloud and digital wallets). The January edition of DataTalk explored Web 3.0 and related elements of decentralized finance (DeFi) in the provision of financial services, particularly as market participants consider the infrastructure required to offer their services in the coming years.*

### **Agreeing on conceptual definitions of DeFi and Web 3.0 is key to realizing their promises.**

Going forward, it will be important to be clear about the particular activity, or set of activities, occurring when referencing “DeFi”. Decentralized finance may simply refer to activities being executed in a less centralized manner relative to previous operations, which is different from the idea of activities executed via entirely decentralized operations. Similar considerations apply to Web 3.0, where the term is frequently used in reference to a wide range of – at times, disparate – activities or concepts, reflecting the early stage of exploration and practitioners’ evolving understanding.

**Regulatory knowledge of new technology and trends is important for adoption.** As new technologies come under the scrutiny of regulators and supervisors, more collaborative exercises with the private sector and academia will help cement common knowledge that enables further development of products and services that benefit consumers. Clarity on governance, operational, and legal fronts would allow institutions to more effectively explore DeFi and Web 3.0 use cases. This is particularly relevant in the context of tremendous change in the last few months – where regulators are becoming agents of change by taking a more active role in understanding these new technologies, and market participants are going one step further into looking at possible business cases that can be deployed. Europe and Asia are set to become pioneers in DeFi regulation, though development may slow due to recent regulatory skepticism.

### **Connecting DeFi systems and institutions has the potential to deliver long-term value.**

Pseudonymous finance presents challenges from a number of points, including governance, legal, compliance, regulation, supervision, and data privacy considerations. On the other hand, institutions using well-crafted DeFi processes (via permissioned blockchains, or possibly zero-knowledge proofs) may raise fewer concerns with regulatory authorities, making them accretive projects over time. To this end, some institutions are advancing notable DeFi research and related pilots with the potential to deliver long-term value.

**The path forward: infrastructure overhaul or use cases?** Some market participants believe that as long as cybersecurity, privacy, and operational risks are managed, Web 3.0 and DeFi could revolutionize infrastructure and the financial system as a whole. Others are inclined towards a more practical approach, developing concrete use cases that make existing products more efficient, secure, or resilient. Applications such as digital identification and validation will play a key role in building trust for further developments in these spaces. Clear liability expectations must be agreed upon to deliver further advances. One thing appears clear: whether profound changes or case-by-case advances, cloud services seem best positioned to act as the base infrastructure for further steps in this area.

*We look forward to continuing the DataTalk series on February 22 at 9:00 AM Washington DC / 2:00 PM London, where we will focus on digital wallets and digital identity in the context of increasing competition for direct contact with customers.*