

Josef Bergt

Decentralized Finance Unmasked

Behavioral Finance and Public Policy Insights
on Financial Market Regulation



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The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data are available on the Internet at <http://dnb.d-nb.de>

ISBN 978-3-7560-0715-8 (Print)
978-3-7489-4301-3 (ePDF)

British Library Cataloguing-in-Publication Data

A catalogue record for this book is available from the British Library.

ISBN 978-3-7560-0715-8 (Print)
978-3-7489-4301-3 (ePDF)

Library of Congress Cataloging-in-Publication Data

Bergt, Josef
Decentralized Finance Unmasked
Behavioral Finance and Public Policy Insights on Financial Market Regulation
Josef Bergt
227 pp.
Includes bibliographic references.

ISBN 978-3-7560-0715-8 (Print)
978-3-7489-4301-3 (ePDF)

1st Edition 2023

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Published by

Nomos Verlagsgesellschaft mbH & Co. KG
Waldseestraße 3–5 | 76530 Baden-Baden
www.nomos.de

Production of the printed version:

Nomos Verlagsgesellschaft mbH & Co. KG
Waldseestraße 3–5 | 76530 Baden-Baden

ISBN 978-3-7560-0715-8 (Print)
ISBN 978-3-7489-4301-3 (ePDF)
DOI <https://doi.org/10.5771/9783748943013>



Online Version
Nomos eLibrary



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Dedication

*To Tabea, whose spirit inspired every line.
And to the one who is yet to be, who will bring the story to life,
May you discover the power of dreams and the magic of your own
journey.*

*To those who dare to dream beyond the confines of reality,
Who find solace in the whispers of imagination,
In your hands, we entrust the magic of worlds yet unseen,
For without you, these pages would wander through eternity,
Bound to the echoes of what could have been.
Imagination, our most faithful companion and guide,
Will often carry us to realms of wonder and delight,
Weaving tapestries of stories that never were,
Yet without its embrace, our souls would remain anchored,
In the harbor of the mundane, never to embark on the infinite
seas.*

*So, to the dreamers, the visionaries, the weavers of tales,
Let your hearts soar and your spirits take flight,
For you are the architects of the worlds that never were,
And it is your imagination that propels us to the stars,
Boundless, free, and forever untamed.*

Acknowledgements

I would like to begin by expressing my profound gratitude to my colleagues and fellow researchers in the field. Without their collective wisdom, insights, and dedication to advancing our understanding, this book would not have been possible. The collaborative spirit that defines our academic community has been instrumental in shaping the ideas presented within these pages.

My heartfelt appreciation goes to my mentors and advisors, whose guidance and encouragement have been invaluable throughout my academic and professional journey. Their wisdom, expertise, and unwavering support have not only inspired my work but also nurtured my growth as a scholar and thinker.

To my peers who have generously contributed their time and expertise by reviewing and providing feedback, I extend my deepest gratitude. Your constructive criticism and suggestions have been vital in refining the arguments and ideas presented in this work.

Lastly, I wish to express my eternal gratitude to my family and friends for their unwavering love, patience, and support throughout this journey. Their belief in me and my work has been a constant source of strength and inspiration.

To all who have played a part, both large and small, in the creation of this book, I offer my sincerest appreciation. It is my hope that this work contributes to the ongoing dialogue and furthers our collective understanding of the subject at hand.

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Editorial Notes

For better readability, the use of gender-specific forms of speech is dispensed with in work. All gender identities are expressly included.

Furthermore, it should be noted that the abbreviation and citation rules of the American Psychological Association (2020), Publication manual of the American Psychological Association (APA), 7. ed. Washington: APA, are predominantly followed with regard to citation in this work. Parts of the work have been used at the Seeburg Castle University, Seekirchen am Wallersee, Austria.

Lastly, where implementation has already taken place in the respective jurisdictions, the European Case Law Identifier (ECLI) is used to cite court decisions. Similarly, secondary European law is cited using the European Legislation Identifier (ELI).

1 Abstract

English

The advent of decentralized finance (DeFi) has engendered a myriad of novel challenges and prospects for investors, intermediaries, and regulatory bodies alike. To navigate this complex landscape, it is imperative to understand the intricate interplay between behavioral finance and public policy, enabling the development of efficacious regulatory strategies that tackle these challenges while harnessing and capitalizing on the advantages and benefits offered by DeFi. This conceptual literature review investigates DeFi's transformative potential within financial systems and the associated risks, encompassing smart contract vulnerabilities, dependencies on other protocols, decentralization shams and trust mechanisms. By dissecting the complexities at the intersection of behavioral finance and public policy, this study delves into the decision-making processes in financial markets and regulatory public policymaking, particularly within the context of DeFi. Subsequently, recommendations for refining regulatory frameworks and practices to facilitate a more robust and adaptive financial ecosystem are proposed, taking findings from behavioral finance into account. In short, the answer to regulating DeFi, may be found in regulating peers based on their offered services (if any), making them responsible for compliance with financial market regulation, trade law, tax law, and other provisions as applicable.

German

Das Aufkommen von *decentralized Finance* (DeFi) hat eine Vielzahl neuer Herausforderungen und Chancen für Anleger, Intermediäre und Regulierungsbehörden gleichermaßen geschaffen. Um in dieser komplexen Landschaft navigieren zu können, ist es unerlässlich, das komplexe Zusammenspiel zwischen *behavioural finance* und *public policy* zu verstehen, um wirksame Regulierungsstrategien zu entwickeln, um diese Herausforderungen zu bewältigen und gleichzeitig die Vorteile und Chancen, die DeFi bietet, nutzen und ausschöpfen zu können. Diese konzeptionelle Literaturarbeit untersucht das transformative Potenzial von DeFi innerhalb der Finanzsysteme und die damit verbundenen Risiken, einschließlich der Schwachstellen von Smart Contracts, Abhängigkeiten von

anderen Protokollen, Dezentralisierungsschwindel und Vertrauensmechanismen. Durch die Aufgliederung der Komplexität an der Schnittstelle von *behavioral finance* und *public policy* analysiert diese Arbeit die Entscheidungsprozesse in Finanzmärkten und regulatorischen *public policy* Entscheidungen, insbesondere im Kontext von DeFi. Anschließend werden Empfehlungen zur Verfeinerung der regulatorischen Rahmenbedingungen und Praktiken vorgeschlagen, um ein robusteres und anpassungsfähigeres Finanzökosystem zu ermöglichen, unter Berücksichtigung von Erkenntnissen aus dem *behavioral finance* Bereich. Kurzum, die Antwort betreffend die Art der Regulierung von DeFi könnte darin bestehen, Peers auf der Grundlage der von ihnen angebotenen Dienstleistungen zu regulieren und sie für die Einhaltung der Finanzmarktregulierung, des Handelsrechts, des Steuerrechts und anderer Vorschriften, soweit anwendbar, verantwortlich zu machen.

Keywords: Financial literacy, behavioral economics, imperfect information, heuristics, trust, nudging, decision-making environment, ecological rationality, behavioral finance, behavioral biases, investment decision making, information asymmetry, public policy, sociology of law, DeFi, decentralized finance, market efficiency, prospect theory, investor psychology, investor behavior, social sciences, legal studies, investment decisions, cryptocurrencies, decentralization, herding, bitcoin, risk, perceived risk, behavioral economics, regulation, public policy, finance, financial market, financial institution, financial regulation, government policy, corporate governance, financial crisis, regulation of financial institutions.



Bergt, J. (2023). Sociology of law as a candle in the dark & decentralization theater