OpenGov Referendum #432 | Bifrost vDOT liquidity loan

Treasury Proposal for DOT Liquidity Loan for Bifrost DOT Liquid Staking Token (vDOT), Subsidising Interlay iBTC Vaults with DOT Staking Rewards.

By: @OnlyDeFiGuy

Proposal summary

- The Bifrost team is requesting a loan of 1,000,000 DOT (~$7,000,000) from Polkadot Treasury, they are offering to pay an interest rate of 5% on this loan and the loan duration is being set at 1 year.
- These funds will be split evenly between both the Bifrost and Interlay parachains.
- Bifrost intends to use their allocation to provide liquidity to their stableswap pool.
- The interlay allocation will be used for increased vault collateral to increase the total supply of iBTC available to be minted.

Background

Bifrost

- The Bifrost parachain is a liquid staking provider, their core product is centred around allowing users to deposit tokens and mint liquid v tokens as a representation of the users percentage ownership in the staking pool.
- At present, Bifrost have 141.9K DOT and 130.1K vDOT in their stablepool. This represents $1,950,000 USD in total tradeable liquidity in this pool.
- The Bifrost stablepool is a concentrated liquidity pool built specifically for assets trading at predictable prices. This increases the total liquidity provided per tick of price movement. This technology not only provides increased fees for liquidity providers but also tighter spreads for traders and market participants.

Interlay

- The Interlay parachain uses collateral assets stored in vaults to secure the native Bitcoin deposits they hold. When a user wants to mint iBTC, they specify the amount of BTC they would like to convert into iBTC. This request is then sent to the vault operator, who issues the user with a native BTC deposit address. Once the user deposits BTC into this address, then they are able to redeem iBTC on interlay which can be used in the polkadot ecosystem.
- Over-Collateralization: Vaults are over-collateralized to mitigate the risk of price fluctuations in the underlying collateral assets. This ensures that there's always sufficient collateral to cover the value of the BTC held by the Vaults.
- Liquidation Mechanisms: If the value of a Vault's collateral falls below a certain threshold relative to the BTC it holds, the collateral can be liquidated to ensure users can always redeem iBTC for BTC or collateral assets.
- *Core Interlay Issue:* As it stands the total iBTC that is available to be minted on interlay from the vaults in operation stands at 0.03764043 IBTC (~ 1,500 USD)

Ecosystem

- The lack of iBTC liquidity has meant that most parachains are forced into using Wormhole wrapped Bitcoin.
- This forces users into taking both Wormhole bridge risk and to transact on ethereum mainnet which entails costly gas fees.
- One must understand that Wormhole, while advertised as “interoperable” this is not the case. E.g. WBTC bridged through Moonbeam is not the same as WBTC bridged from Acala. This would not be the case with iBTC as a user could buy iBTC and it would be the same underlying asset across all the parachains.

Predicted effects of this proposal

Bifrost

- This would increase liquidity on the Bifrost stable pool by 25% which would have a non linear effect on liquidity due to the concentrated liquidity technology being used in their pools.
- The increased liquidity would improve trading conditions allowing for traders to execute transactions at more favourable prices. This in turn positively affects confidence in the current fair market value of vDOT at any point in time, as larger amounts of vDOT can be liquidated into DOT.
- Increased pool liquidity, generally results in increased trading volume.

Interlay

- The positive effects on the interlay protocol cannot be understated. This proposal would significantly increase the total available iBTC that is available to enter circulation by increasing the incentives to open vaults on their platform.
- Interlay’s 500,000 DOT staking reward, roughly 18% (depends on live staking APR) 90,000 DOT, will be sent to a specific pallet that will fully distribute the funds to all vaults on a per block basis during the intervals. This will increase the incentive to open more vaults on Interlay and therefore should increase the total amount of iBTC that can be issued.

Strategic Impact Assessment

Bifrost

- Increased liquidity and volume on the bifrost stable pool would be both beneficial to the protocol, vDOT holders, and vDOT vault operators.

Interlay

- As their core business model is the issuing of iBTC, the situation they are currently in is where a user is unable to mint iBTC is a dire situation for their protocol.

- If their team is unable to address this core issue, this will have major negative effects on polkadot's decentralised finance markets as it pushes teams towards wrapped bridged tokens which are objectively a less desirable product.
- The increase in vault liquidity would go a long way to resolve the issue Interlay is currently facing. It is my opinion that Interlay are obtaining significantly more benefits from this proposal than Bifrost this is due to the major vault liquidity crunch they are currently experiencing.

Economic Trade-offs and Risks

- As the nature of this request is a loan, it is intended to be paid back on the loan expiry date. This will mean that the proposal will be a net benefit to the treasuries balance sheet overall but there is still a risk that this loan may not be repaid in full.
- This solution for the interlay team, will get them out of their vault liquidity predicament, but it by no means will solve this issue forever or even provide enough vault liquidity to grow the protocol to an acceptable long term iBTC issuance rate.
- Interlay will need to work hard to use this liquidity to bootstrap the next phase of their vault growth, as it stands it is unclear if they will be able to do this.
- While a low probability event, there is a risk that due to an error in the Interlay protocol, that the loaned DOT would have to be given to iBTC holders in the event that vaults are unable to return native BTC to users.
- While a low probability event, if the Bifrost protocol was to encounter a technical error e.g. excessive minting of vDOT token, the DOT liquidity in their pool would quickly be drained and removed from their chain which would lead to a default on their treasury loan.
- We must also ask ourselves if these funds could be used in a more effective way?

Team Trustworthiness

** I will stress the importance of this section in each proposal I review. There are far too many untrustworthy, inexperienced or highly incompetent teams in the decentralised finance markets at this point in time. Funding teams that we all may like but do not have the technical abilities or trustworthiness should be avoided at all costs**

Bifrost

- I have personally met many of the Bifrost team both online and in person and at live events.
- Bifrost and their developers are highly active on their Discord, Twitter and I have been able to get into direct contact with their developer team on multiple occasions. They were able to answer any and all questions I submitted and I respect their technical abilities, audits and the competence of their management team.
- To my knowledge there are no outstanding accusations of mismanagement.

Score: 9/10

Interlay

- I have also personally interacted with Alexei Zamyatin, their CEO on many occasions. He is held in very high regard in the polkadot ecosystem and his reputation is spotless.
- The Interlay team are easy to contact, they are active on Twitter and discord on a regular basis.
- To my knowledge there are no outstanding accusations of mismanagement.

Score: 9.5/10

My recommendation regarding this proposal.

It is my opinion that this proposal will be a net benefit to the polkadot treasury and community, as Bifrost have successfully repaid previous loans. I have confidence we can trust them to also repay this loan. In particular Interlay is in desperate need of increased vault liquidity. It is also my opinion that filling this liquidity gap is of the utmost importance for the health of Bitcoin DeFi markets in the ecosystem.

- I believe the goals, of this proposal will be a net benefit to all in the polkadot community and my recommendation to all OpenGov participants is to **vote AYE on proposal #432**
- I will be voting AYE on this proposal.

Disclosures

- I actively trade on Bifrost in their stablepool. The increased liquidity would benefit me while doing these transactions.
- I have a significant holding in Polkadot tokens and Polkadot liquid staking tokens including but not limited to vDOT, stDOT, LDOT.
- I hold both iBTC and vDOT as inventory for the trading algorithms I manage.
- Aside from a small holding for gas tokens (less than 100 USD) I do not hold BNC or INTR tokens.
- I have met the management of these teams either online or in person, I believe Bifrost also gave me some merch at a live event.
- Any and all tokens I receive for the creation of this report will be used to do decentralised finance trades and transactions in the Polkadot ecosystem.