

Arcadia Finance [Draft]

November 2023

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ABSTRACT

(To Do) Arcadia Finance introduces a novel on-chain architecture for collateral management of margined positions.

The overarching vision of Arcadia Finance is to build standardized on-chain infrastructure for collateral management, unlocking the capital in diverse DeFi assets, and establishing a comprehensive platform for managing collateralized positions.

As we anticipate the continued growth of on-chain tokenized assets and financial primitives, the importance of standardized and efficient collateral management becomes increasingly paramount. Without it, the full potential of these assets and financial primitives remains unrealized, hindered by protocol inflexibility and fragmentation.

Arcadia strives to enable higher capital efficiency for users, transparent risk assessment, faster go-to-market time for new protocols without compromising on security, self-custody and decentralisation.

KEYWORDS

Collateral management, DeFi, EVM

1 INTRODUCTION (TO DO)

This paper will explain the rationale why we are building the Arcadia Finance Technology Stack, and go over its technical implementation.

The Arcadia Financial Technology Stack is a set of on-chain, inter-linked financial protocols, centered around collateral management. They facilitate non-trusting peers to close financial contracts without the need of intermediaries.

It consists out of three protocols, each with distinct responsibilities and permissions:

- The Arcadia Registry.
- The Arcadia Accounts.
- The Generalised Creditor.

2 TERMINOLOGY

DEBTORS AND CREDITORS: We will often use the terms Debtors and Creditors throughout this paper, our definition is broader than the commonly accepted context within traditional debt arrangements. We use the term Debtor for any holder of a financial instrument that results in liabilities on the balance sheet (borrowers, option writers, payers of cash-settled futures contract or swaps...). While the Creditor refers to the entity to whom the liability is owed.

OPEN POSITION: The size of the liability that a specific Debtor has with a specific Creditors.

COLLATERAL: The assets pledged by a Debtor to a Creditor to cover the credit risk in case the Debtor would default.

MARGIN: The value of collateral assets that a Debtor must hold in a Margin Account to cover the credit risk of its Creditor(s). The margin requirements, are set by the Creditor. It is the value of assets that is "locked" when a Debtor opens a position.

MARGIN ACCOUNT: Our definition of a Margin Account extends beyond the conventional usage within Brokerage Accounts. The holder of a Margin Account not only has the ability to utilize and transact with the assets within the account (as is the case with a cash account or your standard crypto wallet), but can also incur liabilities against those assets. The margin requirements (initial and maintenance margin) are set by the Creditor.

3 HISTORY OF COLLATERAL MANAGEMENT

Withing the financial system, Collateral serves a primary function in mitigating the counterparty risks borne by Creditors, in case Debtors would fail to fulfill their financial liabilities.

3.1 Origin

Evidence of collateralized loans, also known as secured loans, can be traced back to at least 400 BCE in Ancient Greece [7]. In these early transactions, borrowers provided tangible assets as collateral to secure loans, laying the foundation for the concept of collateralization.

3.2 Current State

Over the past decades we have witnessed significant advancements in collateral management practices.

With the rise of complex financial instruments and the globalization of markets, the role of collateral has expanded beyond traditional lending. Collateral is now used to secure a wide range of financial instruments, including derivatives trading, margin accounts, and other sophisticated financial contracts.

The digitalisation of the financial system greatly improved the efficiency of the exchange and settlement of collateral. Reporting, margining and reconciliation processes could be executed on a daily basis instead of on a weekly or even monthly basis [9].

The emergence of blockchain technology and decentralized finance (DeFi) led to a new wave of innovation for collateral management. Blockchain has some excellent properties with regards to collateral management:

- With its immutable and transparent ledger, collateral can be audited 24/7.

- Smart contracts enforce margin requirements real time on a 24/7 continuous basis.
- The atomic execution of transactions avoid expensive reconciliation processes and eliminates settlement risk.
- The atomic execution also enables optimistic execution of transactions (e.g. flash loans) which can greatly improve processes such as refinancing loans or even enable completely new financial use-cases.
- The permissionless nature of blockchain and Dapps (Decentralised Applications), combined with a shared state between all those applications, make different financial applications and assets composable and inter-operable by default.

It is no coincidence that some of the first blockchain applications with product market fit, were secured lending protocols. These early pioneers like Maker[10], Aave[11] or Compound[6] rely on collateralization as the only way to mitigate counter party risks and work with over-collateralized loans. As such they enable peer-to-peer or even peer-to-contract loans, without the need of any trusted intermediaries.

3.3 Collateral management in crisis

Collateralization, both in the traditional financial world and in DeFi, is not without its problems. Recent crises in both industries highlight the need for better collateral management infrastructure.

Bad collateral management, rehypothecation of collateral, opaque accounting practices of collateral, and outright fraud with collateralized assets, are all cited as root causes[4] behind the 2008 financial crisis. Following the crisis, a variety of major regulations were introduced (e.g. EMIR in the European Union, or Dodd-Frank in the USA). While these packages were successful in stabilizing the financial system, they have clear centralization tendencies[3]. The major beneficiaries of said regulations are the major established institutions, mandatory intermediaries for central clearing, central banks and the regulatory bodies themselves. This might paradoxically cement even greater systemic risks into the financial system.

In 2022 DeFi experienced its own financial crisis. In a few months time, many of the ecosystem's key (albeit mostly centralised) players collapsed, and removed all liquid with them. Again bad collateral management, rehypothecation of collateral, opaque protocol mechanisms, and outright fraud with collateralized assets were at the root of the problem.

A recurring trend with protocols that imploded in 2021 and 2022 is that the lack of collateralization was obfuscated behind complex protocol designs and narratives. Some of the notorious examples are:

- Synthetic stable-tokens such as Gaia-USDF, Iron-Titan and Luna-Terra.
- Olympus and its forks relying on the (3,3) model.
- Protocols where the only utility of a token is to receive more of the token itself (animal yield farms, reflective tokens...).
- Unsecured loans by market makers and CeFi players.

DeFi protocols should focus more on collateralization, and less on complex tokenomics that obfuscate who ends up paying when things go bad.

3.4 The Future?

The over-collateralized DeFi protocols however, operated remarkably well during the aforementioned crisis, even better than their traditional counterparts. This is well illustrated by some of the collapsed centralised entities, active in the space until 2022, that had both on- and off-chain liabilities. All on-chain Creditors were repaid in a timely and orderly fashion, as enforced by their smart contracts. While the lawsuits for the many off-chain Creditors are still ongoing (and probably will be for many years).

It is for these types of crises that liabilities are secured in the first place. These events further strengthened our vision that blockchain-based protocols have the potential to become the dominant infrastructure for collateral management. But before we get there, a number of Inefficiencies of current DeFi protocols must be overcome, as we will discuss in Section 4.2.

4 COLLATERAL MANAGEMENT IN DEFI

4.1 General Principles

4.2 Inefficiencies

In the next sections we will highlight a number of inefficiencies, which need to be overcome before DeFi can be broadly adopted as the go-to infrastructure for collateral management.

4.2.1 Hacks and exploits. The major problem in DeFi today is the number of hacks and exploits, the estimated amount of funds lost in 2023 ranges from \$400M to \$1B. There are many security related practices the sector as a whole should improve on, but we want to highlight one problem.

Almost all DeFi protocols use over-collateralization in some way of form to manage counterparty risks between different user-groups. Lending protocols, perpetual protocol, Prime brokerage protocols, option protocols etc. all require some or all users to deposit collateral. While the nature of the financial contracts may be very different for each of these protocols, they share a great amount of common logic:

- Pricing of collateralized assets.
- Management (depositing, withdrawing...) of collateralized assets.
- asset-liability specific risk parameters and calculations.
- Margin calls and liquidations of risky positions.
- Settling bad debt.

Pricing of assets, management of assets and liquidation logic is complex, error prone and most mistakes easily lead to severe user losses. Today all protocols implement these redundantly, even for new versions of the same protocol. Not only is this very costly in development time, the core logic is rewritten and re-deployed time and time again, and with each new deployment, new bugs can be introduced.

Being able to build on top of battle tested code would benefit smart contract developers, protocols, users and the overall ecosystem.

4.2.2 Fragmented and isolated collateral. The average DeFi-user has collateralized assets fragmented and isolated across a multitude of protocols (do we have any numbers on this?), and many quality assets are sitting idle. While isolated margin positions have there

benefits (they isolate risks), they are not capital efficient. Having the ability to use a portfolio of assets as collateral improves the capital efficiency for a number of reasons:

- The volatility of a portfolio of assets is always equal to, or lower than the weighted volatility of the individual assets. Or put different, assets losing in value can be compensated with assets increasing in value.
- Having less positions, with lower volatility, reduces the number of transactions.
- Depending on the correlation between collateralized assets, the Creditor might use less strict margin requirement.
- Debtors can use negatively correlated assets to hedge positions and limit liquidation risks.

Having a global shared state across applications and assets is often cited as one of the key advantages of blockchain over centralised financial infrastructures[8]. This should open up a whole new solution space for Debtors to manage collateralized positions, and might even enable a single Debtor to share its margin between non-trusting Creditors without intermediaries. Hence it is quite ironic that traditional brokers and clearing houses offer more advanced capabilities for cross- and portfolio-margined positions, compared to the state-of-the-art DeFi protocol.

Again there are again multiple underlying root causes why collateral in DeFi is still fragmented and under-utilized:

- As mentioned in Section 4.2.1, there is no shared collateral management layer, each protocol with collateral has their own non-standardized implementation.
- Protocols are build around specific assets types (eg. lending protocols for simple ERC20 or for AMM LPs, or for NFTs). Different asset types cannot be used within the same protocol to back a single position and emergence of new primitives/token standards requires migrations/new protocols.
- Blockchain is still a young technology, core non-financial infrastructure required for on-chain portfolio management (think Account Abstraction, intents or cross-chain messaging) is only recently developed.

Fragmentation of assets not only results in capital inefficiencies, it also contributes to a challenging user experience, more on that in the next Section (4.2.3).

4.2.3 End user complexity. End-user do not "want" to manage collateral, they want to optimize portfolio's to achieve a certain objective (e.g. increase yield, delta hedging, diversify exposure to different protocols...). Collateral management is a means to an end, it is not an activity most users enjoy doing.

End-user adoption will only increase outside of a niche bubble of tech enthusiasts if the technical complexities around collateral management are be abstracted away. Important note, abstracting away technical complexities should never come at a cost of hiding risks or relying on centralised and custodial solutions (as is to often the case).

As mentioned in the previous Section 4.2.2, the bad user experience is partly due to the fragmentation of assets and positions. Rebalancing portfolio's often require multiple transactions per asset and per position. Today the user has to execute multiple sequential transactions per asset, instead a single transaction that rebalances the complete portfolio. Let's take as example a user that wants to

earn yield from his collateralized assets and get exposure to Liquid Staking Tokens (LSTs). Since LST protocols introduce an additional layer of risk, he wants to diversify risks over 5 different LST service providers. Assuming our user has wrapped Ethereum, he would need to do 10 transactions via multiple platforms (5 approvals and 5 swaps or 5 approvals and 5 staking actions). Rebalancing said portfolio, or depositing it as collateral, would require another 5 to 10 transactions. Not only is this time consuming, it also introduces additional operational risks, to name a few:

- Herstatt risk (settlement risk) due to changing markets before each leg of the action is settled.
- Increased risk of manual mistakes (fat fingers, bad slippage settings).
- Increased risk of falling victim phishing attacks on one of the platforms..

A second abstraction is to let users define what they want, and provide them with the information (the calldata) how to do it. Since most collateral management actions require interactions with multiple assets/protocols, this abstraction can only be achieved after portfolio's as a whole can be managed with a single atomic transaction.

At the time of writing this paper, the required infrastructure to enable both abstractions, is heavily debated within the broader ecosystem and multiple proposals are launched to standardize the infrastructure. Most notable are the proposals for Account Abstraction (e.g. EIP-3074 and EIP-4337) and for Intent based architectures (e.g. EIP-7521)

Both abstractions are already successfully applied (albeit in a somewhat non-standardized form) within DeFi by Decentralised Exchanges, NFT-marketplaces and their aggregators.

Our philosophy is that users should express what they want to do, not how they do it.

4.3 New Architectures

During the last months many solutions were proposed by different protocols and stakeholders on how to build a more robust decentralised financial system. Notable recent papers are from Uniswap V4[1], Morpho[2] and Euler[5]. All mention similar concepts as the distinction between product and protocol, modularization of the protocol, oracle agnostic implementations and explicitly separating the logic of the protocol in different layers, where layers with different complexity evolve at different speeds.

Especially the last concept, to separate the logic in different layers, resonates with the long term vision of the Arcadia Finance team. Different Logic layers of the financial stack, with different complexities should have different life-cycles and innovation time-lines. With the lowest most core component the slowest moving, while the upper user facing layers must evolve and adapt quick in response ever changing markets.

A good practical example is uniswap V4, where Uniswap Labs implements the underlying core mathematical logic for CLAMMs (Concentrated Liquidity Automated Market Makers). Other teams can build in a permissionless manner on top of the Uniswap V4 protocol and develop feature rich and fast innovating new DEXs, without the need and risks of redundantly implementing the complex maths.

Also over-collateralized protocols would benefit from a similar architecture. A shared standardized and permissionless layer with battle tested logic for collateral management, on top of which Creditors build their application specific financial contracts.

Bringing back pristine focus to collateralization is exactly what we are doing with the Arcadia Financial Technology Stack. We believe that taking a collateral management first approach results in overall better DeFi protocols.

5 THE ARCADIA FINANCIAL TECHNOLOGY STACK

The Arcadia Financial Technology Stack is implemented for the Ethereum Virtual Machine (EVM) and consists out of three protocols:

- The Arcadia Registry.
- The Arcadia Accounts.
- The Generalised Creditor.

6 ARCADIA REGISTRY

The Arcadia Registry is non opinionated on-chain infrastructure with two main functionalities:

- (1) Standardize pricing logic to denominate a portfolio of on-chain assets in a given numeraire (unit of account).
- (2) Standardize logic to store, manage and process asset related risk parameters/variables.

6.1 Modular pricing logic

The Arcadia Registry is not a monolithic smart contract containing all logic. It consists of a main coordinating smart contract (also referred to as The Registry) and multiple Modules.

Each Module is a separate smart contract with the pricing logic for specific Oracle implementations or Asset types. The Registry keeps mappings per Creditor of which Module to use for a certain asset.

It is the Creditor itself that sets these mappings, the Creditor decides which Modules to use for each asset they allow their Debtors to use as collateral. Different Creditors can use different Modules to price the same asset, or a Creditor can choose to not allow certain assets at all.

Modules can only be appended to the Registry, not removed or overwritten. This ensures that Pricing logic is immutable, but it still gives flexibility to add new assets, or implement more efficient Pricing logic over time.

Working with this modular architecture has a number of advantages:

- Modules are re-usable by different Creditors, instead of redundant monolithic Pricing Contracts per Creditor, battle tested Pricing/Risk logic can be reused.
- Different Modules can call each other recursively, creating Pricing/Risk logic that is as composable as tokenized assets.
- Logic for new assets, or even asset types, can be added without the need of upgradable Proxy contracts and their inherent trust assumptions.

There are two main categories of modules: Oracle Modules and Asset Modules.

6.2 Oracle Modules

The Oracle Module implements the logic to convert oracle-rate of different oracle technologies into a standardized format. Each different oracle implementation (e.g. Chainlink oracles, Pyth oracles, Uniswap TWAPs...) has its own Oracle Module.

An oracle has a quote-asset and a base-asset, the oracle-rate R_{oracle} reflects how much tokens of the quote-asset are required to buy 1 token of the base-asset. The precision S_{oracle} of oracles is variable and can even be a binary fixed-point number. Since all pricing logic within the Arcadia Protocol uses fixed-point numbers with 18 decimals precision, a correction from the oracle precision to a precision of 18 decimals is required for the standardized oracle rate $R_{ba \rightarrow qa}$, returned by the Oracle Module.

$$R_{ba \rightarrow qa} = R_{oracle} \frac{10^{18}}{S_{oracle}} \quad (1)$$

6.3 Asset Modules

Just as Oracle Modules implement the logic to return oracle-rates in a standardized format, Asset Modules will return Asset values in a standardized format. And just as each oracle implementation has its own oracle Module, each asset type has its own Asset Module.

Next to pricing logic, Asset Modules also store and manage asset specific risk parameters, which we will discuss in more detail in Paragraph 6.5.

Asset Modules can be further divided into two distinct groups: Primary Asset Modules and Derived Asset Modules.

6.3.1 Primary Asset Modules. Primary assets are defined as assets that are not composed of other assets. Primary Assets must be priced using one or more on-chain oracles, for which the rates $R_{ba \rightarrow qa}$ are fetched from the Oracle Modules via the Registry.

Each asset of a Primary asset is priced in USD with 18 decimals precision. Since the asset amount, A_{asset} can have a variable precision (number of decimals), a correction S_{asset} is again applied to bring the usd-value of the asset V_{asset}^{usd} to 18 decimals precision.

Depending of the direction of the oracle, the value of the Primary Asset is calculated different. When the asset is the base-asset of the oracle:

$$V^{usd}(A_{asset}) = R_{asset \rightarrow usd} \frac{A_{asset}}{S_{asset}} \quad (2)$$

When the asset is the quote-asset of the oracle:

$$V^{usd}(A_{asset}) = \frac{1}{R_{usd \rightarrow asset}} \frac{A_{asset}}{S_{asset}} \quad (3)$$

For some assets, there might not be a direct oracle to USD. For these assets multiple oracles can be chained together:

$$V^{usd}(A_{asset}) = R_{asset \rightarrow x} R_{x \rightarrow usd} \frac{A_{asset}}{S_{asset}} \quad (4)$$

$$V^{usd}(A_{asset}) = \frac{R_{y \rightarrow usd}}{R_{y \rightarrow asset}} \frac{A_{asset}}{S_{asset}} \quad (5)$$

6.3.2 Derived Asset Modules. Derived assets are defined as assets that are composed of one or more underlying assets (which can be primary assets or other derived assets). Examples of derived assets are liquidity positions of AMMs, staked assets, yield bearing tokens.

The derived Asset Modules will calculate the usd-value in three steps. It will first calculate the amounts of the underlying assets A_u , given the amount of the asset to be priced A_{asset} .

$$A_u = f_u(A_{asset}) \quad (6)$$

Where $f_u(A)$ is a flashloan-resistant and protocol specific function. For example for a Uniswap V2 Liquidity Positions it can be derived from the reserves of the pool, or for ERC4626 tokens it can be calculated by calling `convertToAssets(shares)`.

In a second step the Derived Asset Module will recursively fetch for the usd-value of each of the underlying assets $V^{usd}(A_u)$ from the Registry, using the underlying asset amounts A_u from Equation 6.

$$V^{usd}(A_u) = V^{usd}(f_u(A_{asset})) \quad (7)$$

The underlying assets of a derived assets can be derived assets themselves (e.g. staked LP tokens, or liquidity positions of AMMs where one of the tokens is a yield bearing asset). In this case the underlying asset will in turn fetch the usd-values of their underlying asset(s). The stop conditions of the recursion are when the underlying asset is a Primary asset, or if a maximum recursion depth (set by the Creditor) is reached. By working with modular and recursive Asset Modules, the pricing logic of the Registry fully captures the benefits of composability withing DeFi.

Lastly, the total usd value of the asset, $V^{usd}(A_{asset})$, is calculated as the sum of the usd values of its underlying assets. Since all underlying assets are valued with 18 decimals precision, no additional precision correction is required.

$$V^{usd}(A_{asset}) = \sum_u V^{usd}(A_u) = \sum_u V^{usd}(f_u(A_{asset})) \quad (8)$$

6.4 Portfolio Pricing

Section 6.1 explains how the Registry can calculate the value of assets in usd. Building further on this logic, the Registry can price any combination of assets in any numeraire (the asset used as unit of account).

Given a portfolio P consisting of assets with amount A_i , the value of the portfolio denominated in a certain numeraire $V_{spot}^{num}(P)$ with precision S_{num} is given as:

$$V_{spot}^{num}(P) = \frac{\sum_i V^{usd}(A_i) S_{num}}{R_{num \rightarrow usd} 10^{18}} \quad (9)$$

The result of equation 9 is the spot or MtM (mark-to-market) value of the portfolio. Next to the MtM value of the portfolio, the Registry can also calculate risk adjusted portfolios value, where assets are discounted with a asset-numeraire specific risk factor RF_i^c , set by each Creditor. The risk adjusted portfolio value $V_{risk}^{num}(P)$ is then given as:

$$V_{risk}^{num}(P) = \frac{\sum_i RF_i^c \cdot V^{usd}(A_i) S_{num}}{R_{num \rightarrow usd} 10^{18}} \quad (10)$$

There are two important risk adjusted portfolios values: The Collateral Value V_{coll}^{num} of the Account and the Liquidation Value V_{liq}^{num} of the account. Both are used to check the Margin Requirements of the account. The Collateral Value can be calculated by plugging the asset-numeraire specific collateral factors CF_i^c of each

asset into equation 10. And the Liquid Value respectively by using the liquidation factors LF_i^c of each asset.

6.5 Creditor Specific Risk Parameters

Each Creditor can set a number of risk parameters in the Registry to protect themselves against different risks. These risk parameters are taking into account when depositing assets, or when risk-adjusted portfolio values are calculated.

The risk parameters can be asset specific, protocol specific or a single value per creditor.

6.5.1 Collateral, Liquidation and Risk Factors. As is described in detail in Paragraph 7.1, collateral factors and liquidation factors are used to discount asset values to account for market, liquidity and smart-contract risks.

Each asset i that can be priced by the Registry has a Creditor specific collateral factor CF_i^c and liquidation LF_i^c factor. For Primary Assets, the factors are set directly by Creditor.

For Derived Assets, the risk factors are a function of the risk factors of its underlying assets u , and optionally an additional protocol specific risk factor RF_p^c , to account for the additional complexity smart contract risk of derived assets:

$$CF_i^c = f(VCF_u^c, RF_p^c) \quad (11)$$

The relation between the risk factor and the risk factors of the underlying assets will depend on the specific nature of the derived asset. It can e.g. be the minimum of each risk factor of the underlying assets, a weighted average or something else.

For derived assets with a single underlying asset the risk factor becomes straightforward and is just the multiplication of the risk factor of the underlying asset and the protocol specific risk factor. As an example, take a protocol (p) with yield bearing assets, which has an ETH and a $USDC$ vault. The collateral factors of the corresponding $pETH$ and $pUSDC$ tokens are:

$$CF_{pETH}^c = RF_p^c \cdot CF_{ETH}^c \quad (12)$$

$$CF_{pUSDC}^c = RF_p^c \cdot CF_{USDC}^c \quad (13)$$

6.5.2 Maximum Exposure. The maximum exposures give Creditors a tool to set an upper boundary against the overall exposure they can have against certain primary assets or protocols. Creditors can even choose to not be exposed to certain primary assets or protocols (via derived assets) by setting the corresponding maximum exposure to 0.

There is again a difference how the maximum exposure is defined for primary assets and for derived assets.

For primary assets, the maximum exposure is defined per primary asset and per creditor. It limits the total amount (in the unit of the underlying asset) of exposure that a single Creditor can have against the primary asset. As such assets with low on-chain liquidity or small market caps can be used as collateral, while market manipulation risks, such as the Mango Market Exploit[12] can be mitigated.

The total exposure of a primary asset takes into account both direct deposits of the primary asset, as indirect exposures via derived assets. If a maximum exposure is reached, no additional amount of the primary asset can be deposited, nor can any derived asset be deposited that is composed of the primary asset.

For derived assets, there are two mechanisms that provide the Creditor to an upper bound for certain risks. As mentioned before, none of the primary assets of which the derived asset is composed can exceed their maximum exposure to mitigate risks of market manipulation and low liquidity. Secondly, each creditor can set an upper limit to the total USD exposure of all derived assets of a certain protocol (e.g. the sum of all liquidity position of Uniswap V2). As such the Creditor can limit potential losses due to exploits in the protocol.

6.5.3 Minimum Margin. Liquidating unhealthy positions has a considerable gas cost, which liquidators take into account when deciding to liquidate a position or not. This gas cost is independent of the size of the open position. Not taking into account the size independent gas cost could lead to very small positions that are never profitable to liquidate. Or even worse, liquidations that are successfully started, but never profitable to end.

To avoid both problems, accounts must have a Creditor specific minimum value of collateral, the minimum margin MM^c , before they can open a position. The minimum margin can not be used to back liabilities and can be seen as an amount of collateral that is locked to at least cover gas costs of Liquidators.

7 ARCADIA ACCOUNTS

Arcadia Accounts are the main moat of the protocol. Accounts serve as a user-controlled smart wallet from which the user can perform a multitude of actions.

Arcadia Accounts are owned by one specific user, the owner of the Account. Users can deploy one or more Accounts through the Arcadia Factory, ensuring the Account adheres to the code as developed by the Arcadia team. The owner of the Account holds many privileges, such as being able to deposit and withdraw assets, use the assets to interact with other DeFi protocols, change the creditor (see further) or transfer the Account to another owner.

7.1 Margin Accounts

Arcadia Accounts are an implementation of on-chain Margin Accounts. Margin Accounts enable non-trusting entities to manage counter party risks of financial contracts. An investor can use a margin Account for instance to increase their buying power, to short assets, or for financial contracts such as futures, swaps or options.

Each Margin Account is a separate user-owned smart contract that does the accounting of both the assets and liabilities of its owners. Margin Accounts can be seen as an extension to standard smart wallets. With the assets held by the Margin Account you can do similar actions as you can do with a standard wallet but additionally you can take liabilities against the Account.

The Margin Account will enforce its margin requirements continuously. This guarantees that the total value of all assets within the Account is always bigger as the liabilities against the Account (it is over-collateralized). If a certain transaction would bring the Account at risk of becoming under-collateralized, the transaction will revert.

In the next paragraphs we will express the Margin requirements mathematically, introduce some margin related concepts. Note that

we do not 100% follow the conventions and terminology of the traditional financial world.

7.1.1 Open position. The open position, op^c , equals the size of the liability that a specific Debtor has with a specific Creditor.

7.1.2 Minimum Margin. The minimum margin, M_{min}^c , is the minimum amount of collateral value that must be held in an Account to be able an open position with a Creditor. The main purpose of the minimum margin is to avoid having accounts with small liabilities, that are unprofitable to liquidate. The cost to liquidate assets in general consists of two parts, a cost that increases linearly with the size of the liabilities that has to be repaid (swap fees, slippage, liquidation penalties...) and a cost that is Independent from the size of the liabilities (mainly the gas costs executing the liquidation transactions on-chain). The minimum margin should be set by the Creditor such that it can cover in all costs these fixed costs related to the liquidation of assets.

7.1.3 Used Margin. The used margin, um , is the total amount of collateral value locked by the Account to ensure that the Account remains over-collateralized. Since collateral in the Account must be held to cover both the open position and the minimum margin, the used margin can be found as:

$$um = M_{min}^c + op^c \quad (14)$$

7.1.4 Available Margin. We define the available margin, am , as the total value that the Account can use to secure open positions. This total value equals the risk-adjusted portfolio value, expressed by Formula 10, where each asset is discounted with an asset-numeraire specific risk factor (the Collateral Factor). Hence the available margin equals the Collateral Value as defined in Paragraph 6.4 (we will the terms 'available margin' and 'Collateral Value' interchangeable).

$$am = V_{coll}^{num} = \frac{\sum_i CF_i^c \cdot V^{USD}(A_i) S_{num}}{R_{num \rightarrow USD}} \cdot \frac{1}{10^{18}} \quad (15)$$

7.1.5 Free Margin. The free margin, fm , is the remaining amount of collateral value that is left in the account. It is the amount of collateral value that can be withdrawn from the account, or it can be used to increase the open position.

The free margin can be found by subtracting the used margin from the available margin:

$$fm = am - um \quad (16)$$

7.1.6 Initial Margin. The initial margin of an asset, IM_i^c , is defined in the traditional financial world as the percentage of the value of an asset bought on margin (bought with debt), that must be covered by additional collateral held in the Account at the time of the sale. As an example, take an asset with an initial margin of 5%, if someone want to buy 10,000 worth of the asset on margin, they need to hold at least 500 worth of collateral in their margin account.

The astute reader will see the similarities with the available margin and Collateral Factors as defined in Paragraph 7.1.4. There is indeed a mathematical relationship between the two.

Take an asset i , for which an amount of x is bought on margin from Creditor C . If a value of x is borrowed, then at least a value of $IM_i^c \cdot x$ must be deposited as collateral into the Account. The

account now has an open position of x and holds in total $x + IM_i^c \cdot x$ of the asset i ($IM_i^c \cdot x$ deposited as collateral and x borrowed from Creditor C):

$$\begin{aligned} op^c &= x \\ V_i^{num} &= x + IM_i^c \cdot x \end{aligned} \quad (17)$$

When the minimal amount of collateral is deposited, the free margin will be zero, and after plugging Equation 15 into 16, the used margin equals the collateral value:

$$CF_i^c \cdot V_i^{num} = um \quad (18)$$

And if we ignore the minimum margin:

$$CF_i^c \cdot V_i^{num} = op^c \quad (19)$$

And finally after plugging in Equations 17 we find the relation between the initial margin and the Collateral Factor:

$$CF_i^c = \frac{1}{1 + IM_i^c} \quad (20)$$

7.1.7 Maintenance Margin. The maintenance margin of an asset, MM_i^c , is also a term often used in traditional finance and similar to the initial margin. It is the percentage of the value of an asset bought on margin, that must be covered by additional collateral held in the Account at all time after the transaction.

If the value of the additional collateral would ever fall below the maintenance margin, a margin call is triggered and a liquidation of the assets of the Account start.

A similar derivation as in Paragraph 7.1.6 can be made for the relation between the maintenance margin of an asset and its Liquidation Factor:

$$LF_i^c = \frac{1}{1 + MM_i^c} \quad (21)$$

7.1.8 Margin Account States. There are three different account states, depending on the value of the Used Margin of the Account and the total value of the assets of the account.

- (1) **HEALTHY STATE:** The Account is in a healthy state if the used margin is smaller than the Collateral Value:

$$um < V_{coll} \quad (22)$$

- (2) **UNHEALTHY STATE:** The Account is in an unhealthy state if the used margin is smaller than the Collateral Value but bigger than the Liquidation Value:

$$V_{coll} < um < V_{liq} \quad (23)$$

Accounts in the unhealthy state can only be de-risked by or reducing the open position, or adding more collateral. It is not possible to withdraw any assets or increase the open position.

- (3) **LIQUIDATABLE STATE:** The Account is in a liquidatable state if the used margin is smaller than the Liquidation Value:

$$V_{liq} < um \quad (24)$$

When an account is in the liquidatable state, anyone can trigger a margin call. The account is now frozen and a liquidation process of the assets within the account start. The liquidation ends when or the account is brought back in a healthy state, or all assets are liquidated.

7.2 Multi-collateral

By allowing multiple types of assets to be deposited within a single Account, users, institutions and protocols can build diversified portfolio's and complex strategies. The list of asset(type)s that can be deposited in Arcadia Accounts is continuously being expanded. Our goal is for users to unlock capital of any quality, price-able DeFi primitive.

Each Creditor can determine themselves which asset(type)s are to be allowed as collateral in Accounts of their Debtors.

7.3 Composable

Arcadia Accounts themselves are according to the ERC-721 standard and can thus be represented as a single asset. This means that Accounts are fully composable with existing infrastructure and are straightforward to integrate. Other benefits are that Accounts can be tracked and monitored through existing DeFi dashboards and it opens up use-cases where Accounts can be sold in their entirety (both assets and liabilities) on existing NFT marketplaces.

7.4 Token Standard Agnostic

7.5 Account Abstraction ready

7.6 Flash Actions

Flash Actions (or optimistic Actions or flash accounting) expands on the concept of flashloans, and are only possible thanks to a unique property of smart contracts: atomicity[13]. Just as with flashloans, each step of the Flash Action must be successful or the transaction as a whole fails. The final health check of the Account (assets can cover all liabilities) is done at the very end of the transaction. This allows the Account Owner to temporary bring the Account in an undercollateralized (or even non collateralized state) without the risk on bad debt for any Creditor. Since if the Account is not brought back into a healthy state during the transaction, the final health check fails and thanks to atomicity the whole transaction fails.

This gives Account Owners unprecedented flexibility to manage assets and liabilities. In a fully permissionless way they can chain the following together (= do a flash action):

- A margin Account can be opened for a new Creditor, if the new Creditor is approved by the Account Owner.
- The Creditor can execute arbitrary logic (e.g. give a flashloan).
- The Account owner can optimistically withdraw assets from the Account.
- The Account owner can transfer assets from his own wallet to the Account or external logic.
- The Account owner can execute external logic, where he uses the assets (loaned, withdrawn or transferred) to interact with multiple DeFi protocols to swap, stake, claim...
- The Account owner can deposit recipient tokens back into the Account.

The only requirement is that the Account is in a healthy state at the very end of the flash action.

Flash Actions are a very powerful tool that has no equal in traditional finance. We will list a few examples how flash actions from an Arcadia Account can be used out of the box (the list is far from exhaustive). And keep in mind that all of these actions can be done, even if the assets are used to secure liabilities.

- Rebalance whole portfolio's, swapping a portfolio of n different assets directly to a new portfolio of m different assets.
- Refinance liabilities (change to a different Creditors), without the need to sell any collateral.
- Stake or provide liquidity on approved DeFi protocols. External protocols used in this context will need to provide a receipt token which must be allowed as collateral as well within the Arcadia protocol. Examples can be providing liquidity on Aave (receiving approved aTokens), depositing assets on Yearn (receiving approved yTokens), ...
- Change ranges for Uniswap V3 LP. Contrary to Uni V2 and similar AMMs, Uni V3 positions are meant to be more actively managed in terms of liquidity ranges. Users that deposit Uni V3 positions in their Arcadia Accounts will have the ability to change those liquidity ranges without having to withdraw their tokens first.
- Claim airdrops that depend on address-owned tokens. Arcadia Accounts will feature "flash withdrawals". This feature can be used by the Account owner to claim airdrops using assets under collateral within their Arcadia Account, without having to close DeFi positions to withdraw their tokens first.
- ...

7.7 Intent ready

7.8 Automated Asset Management

7.9 Upgradeability

Each deployed Account is linked to a certain Account logic contract. Account logic will include the features Account owners can benefit from, for example, flash withdrawals, active collateral management, authorization delegation, ... The Account logic is upgradable, but the user has full control if and when they want to upgrade to new logic. Should a user wish to use features newly introduced in an upcoming Account version, it will be up to them to upgrade the linked Account logic. Users will not have to migrate assets or close DeFi positions when doing so.

Creditors can determine which Account logic versions are allowed to be used by their Debtors. As such, highly-customized Account logic can be implemented for protocol-specific versions should this be required. The Arcadia protocol can in no way change the version of a user-owned deployed Account, or change any functionality in existing Account logic.

8 ARCADIA CREDITOR

8.1 Generalised Creditor

8.2 Composable

8.3 Risk Management

8.4 Accounting Liabilities

8.5 Liquidations

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Figure 1: Example of an image.

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8.6 Arcadia Lending Pools

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9 SUMMARY

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DISCLAIMER

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