Hybrid pools and the Transmuter,

Increasing capital efficiency.

Getting deeper liquidity, and better returns for liquidity providers

Increasing capital efficiency - that is the main aim of all these defi products – allow people to do more with their money. The aim of this is to talk through the concept of a hybrid pool, explain what it is, what it may be able to achieve, the potential drawbacks and risks. A hybrid pool is where some proportion of the funds are kept in another yield accrual protocol and then withdrawn and swapped out when trades are executed. This is then linked into the transmuter as an active balancing feature, to maximise yield for the debt that needs re-paying and the overall stability of the system.

Some terminology:

AL(ETH/USD/BTC/…) = ALC

coin = C

where “C” can be any coin that Alchemix decides to add later.

YC = yearn Coin

arb = arbitrage

LP = Liquidity Providers

Life as we know it:

The transmuter allows people to have their ALC converted to C this helps keep the peg between ALC and C. The Curve LP pool provides liquidity between the ALC and C pair, so people can swap out of the less useful coin into the more useful one. The site allows repayment in either ALC or C so there is no difference there and no reason to swap back into the ALC coin. What this means is that there is constant selling pressure on the ALC to C side, so it is constantly needing to be arbitraged.

Problems and inefficiencies with the current system:

You have constant selling pressure, meaning someone has to arb the other way. Then they can take their ALC stick it in the transmuter to convert it to C, so they and keep on arbing back. This is a wasteful process that siphons funds out of the Alchemix eco system, reducing the yield for users and thus the transmuter. It also means that for most blocks in eth the LPers capital is not doing anything, this is again a waste.

Good parts of the current system:

It is more distributed and thus safer. The transmuter is not in the same smart contract as the ALC/C pool if something goes wrong in the ALC/C pool or the transmuter these are isolated and thus more protected. If they where all combined then there would be a risk that all of it can break at once, be that in a hack or a bug. If the number of attack vectors are reduced, then an overall safer environment is achieved.

What is a hybrid pool:

The overarching aim of a hybrid pool is to increase the amount of time that the capital inside of the pool is being “put to work”. An easy and straightforward way of achieving that is by putting some of the assets inside of a Yearn vault and integrating the transmuter all into one thing. So if the pool has an 5:90:5 split (numbers can be changed) with the assets ALC:YC:C. The yield from all the liquidity inside of the pool acts like additional deposits inside of the Alchemix ecosystem, increasing the yield and providing additional funding for the transmuter to help it rebalance itself. The number of coins inside of the YC section is measured as the amount of C that it holds, not the raw amount of YC, this means that as yield is generated for the LPers the amount of liquidity inside of the system increases over time. To the user, they will just a see a 5:95 pool (ALC:C) and all of this will be abstracted away behind the scenes.

How do the different processes inside of the pool work:

The transmuter:

When the call goes to yearn to draw down all the coinage and it performs the rebalancing, it sells its C and YC into the pool in amounts that will aim rebalance the pool, imagine after a day of people selling ALC to C the pool might be out of balance. This massive cash injection into the pool can help get it back to stability.

Swaps:

If the swap amount is over some threshold as a proportion of coins in the pool, then the YC are swapped back into C on their way out. This means that because we have larger liquidity from all the funds in the Yearn pool the whales (the people affected most by low liquidity) will be grateful for the lower slippage and wont mind the extra gas cost of drawing coins down from yearn. The smaller fishes will not have to draw down from yearn and instead will be paid out from the smaller 5% C pool.

LPers:

The pool works normally with the transmuter/yearn draw down process acting as a stability mechanism on top.

Diagram

Description automatically generated

Summary:

There seems to be a lot of positive reasons to do this, but it is a big project and would of course be a large undertaking, with many risks stemming just from the complexity of the project alone. I think I am to biased to really look critically at this proposal, so I now hand it over to you, the reader to message me @biddls.eth and roast the hell out of my idea. And hopefully after a nice bit of barbequing we will get a juicy proposal.

What needs more development:

* The 5:90:5 ratio needs more discussion; it could start out closer to a 3rd for each and then rebalance over time.
* How the change over between C and YC goes within the pool and how it is structured.
* When Alchemix is deployed on a L2 the pool could just be a ALC:YC pool, due to the lower fees.