Insurance Fund Introduction

What is the Insurance Fund?

Drift's Insurance Fund is the first backstop to maintaining the solvency of the exchange in the event of any bankruptcies. Any user can stake into Drift's USDC Insurance Fund to accrue fees fromRevenue Pool at the risk of resolving user bankruptcies / AMM deficits.

There are separate Insurance Funds for each asset that can be deposited on the platform - USDC, BTC, ETH and SOL. Since the USDC pool collects exchange fees from trading activity on spot and perpetual trading, the USDC pool will support liquidations from perpetual trading, while the other pools will backstop the respective asset-denominated liquidations from borrow-lend.

Anyone can provide passive liquidity by staking the corresponding asset into the Insurance Fund to further collateralise it in return for a portion of the liquidation and trading fees generated by the exchange.

Why is the Insurance Fund necessary?

An Insurance Fund is necessary to protect against levered losses sustained by users of the protocol. When markets are particularly volatile, accounts with insufficient margin may not be liquidated in time or at their zero price.

In these instances, the balance of these accounts may fall below zero (i.e. they have more unrealised loss than available collateral margining the position) and the exchange is left to pay this 'bad debt '.

The insurance fund exists as a safety net to resolve these bankruptcies. It offers a solvency buffer for the protocol and assures users that up to a certain amount of levered losses occurring (per market), there are enough funds to pay out profitable positions.

When is the Insurance Fund used?

The Insurance Fund is used to pay off liabilities when an account is bankrupt.

By default the Insurance Fund will pay out any bankruptcy losses:

- in full for spot market balances; and
- up to the perp market's set max insurance limit.

Drift Protocol has multiple asset pools. As a result:

- USDC balances in the Insurance Fund will only cover USDC-denominated liabilities. USDC fees will cover all perpetual liquidations and are likely to be the biggest vault given that all exchange fees are collected within USDC and pooled within the same USDC balance.
- SOL balances in the Insurance Fund will only cover SOL-denominated liabilities, etc.

How is the Insurance Fund funded?

The Insurance Fund is funded by both stakers and protocol. Funds increase via premiums collected from liquidation, trading, and borrow fees. Since exchange fees are collected in USDC, they will be pooled in the USDC pool and in turn, the USDC pool will backstop the allotted portion of bankruptcies in each perpetual market.

All excess losses (beyond the allotted limits) will be covered by the socialised loss mechanism.

What is Socialised Loss?

Socialised loss occurs where losses sustained on the platform are socialised across the deposits and/or positions of all users.

This only occurs when the levered losses sustained within the particular market are greater than the token balance of that market in the Insurance Fund; i.e. where deleveraging was not sufficient to ease the bad debt.

In that situation, the losses incurred will be socialised among participants:

- Perpetual Traders: paid for pro-rata (by base amount) by all open positions
- Lenders: paid pro-rata (by token amount) by all lenders.

What is an Isolated Insurance Fund?

Isolated Insurance Funds are assigned to markets that are deemed highly volatile. A market with an Isolated Insurance Fund is isolated from the standard Insurance Fund and is funded exclusively via a portion of premiums collected for that specific market.

Users of a designated market will not have access to the standard Insurance Fund to reconcile any losses accrued by that market beyond the Limited Insurance Fund for that market.

The Isolated Insurance Fund for a particular market will be used to:

- protect against levered losses sustained by users of the protocol trading in that specific market
- pay off liabilities when an account is bankrupt.

All losses beyond the Isolated Insurance Fund for that market will be covered by a socialised loss mechanism.

Liquidity Provider FAQ Insurance Fund Staking