Title: [ARC] Repay excess debt in CRV market for Aave V2 ETH

Status: Proposed

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Simple Summary

Decide on a path forward to repay the excess debt in the CRV market (currently ~$1.6M USD, dependent on CRV's token price).

Llama and Gauntlet propose using Gauntlet's insolvency refund and Aave's Treasury to cover the excess debt.

Abstract

Over this past week, the user 0x57e04786e231af3343562c062e0d058f25dace9e

opened a short position on CRV using USDC as collateral. At its peak, the user was shorting ~92M units of CRV (roughly $60M USD at today's prices). The attempt to short CRV on Aave has been unsuccessful, and the user lost ~$10M USD from the liquidations. The user has been fully liquidated, but despite this, Aave has accrued a much smaller (~$1.6M USD) bad debt position as of today's CRV price.

This excess debt is isolated only to the CRV market. While this is a small amount relative to the total debt of Aave, and well within the limits of Aave's Safety Module, it is best practice to recapitalize the system to make whole the CRV market.

Motivation

As mentioned in Gauntlet's forum posts, there is VaR (Value at Risk) from market stress events and the CRV asset broadly posed a potential risk. While this realized insolvency event was well within the bounds of projected VaR, it is best practice to recapitalize the protocol. In a later post, Gauntlet will follow up with more market risk analysis on the events that occurred to provide the community with more context that can translate into improved community practices.

Regardless, Gauntlet's insolvency refund will be honored and triggered. The fund holds ~$280,000 worth of stkAAVE. Gauntlet will follow up with the next steps in the forum regarding logistics but wanted to first signify this commitment.

For the rest of the excess CRV debt to be covered, Llama proposes using the Aave Treasury (reserves). There are two clear options for covering the remaining excess debt. Using either the Safety Module, or the Aave Treasury (v2 Collector Contract). Given the relatively minimal amount of excess debt, we do not believe it would be efficient to use the safety module. Instead, using the Aave Treasury provides a diversity of assets to cover the shortfall, shows the DAOs alignment with users of the Protocol and provides a far lower technical barrier and a quicker solution. This could also be used as an opportunity to clear up the DAOs treasury, which contains a large number of low value long tail assets. The Safety Module should be saved for larger events.We will follow up in the forums with more details regarding logistics (the assets which will be used, etc.), but we wanted first to suggest using the funds in the Collector Contract and not the Safety Module.

Specification

- Use Gauntlet's insolvency refund and the Aave Collector Contract to cover the excess debt in CRV market.

Next Steps

- Welcome community feedback on the proposed specification above.

- If the community signals support, Gauntlet and Llama will follow up with implementation details.

At a later point, the community may want to revisit the risk/reward tradeoffs of allowing users to short certain assets. Because LTVs/LTs are delineated only by collateral asset rather than on the asset being borrowed, meaningful tradeoffs must be made here (if protocol mechanism design changes are not made). For example, reducing the likelihood of insolvency from users shorting assets would mean significantly reducing capital efficiency on blue chip collateral assets like USDC in a way that may make the protocol for use. Functionality that exists on V3 but not on V2 (such as borrow caps) mitigates these risks.

In addition, the community may like to revisit the prioritization towards migrating from V2 to V3.