Lido has established itself as the leading solution for ETH staking, and is quickly expanding into other PoS chains (e.g.Terra and Solana) and leading dApps. As investors and believers in Lido, Delphi Labs is excited to propose a liquid staking solution for AAVE.

We want Lido to be the default choice for anyone considering staking to any of the main PoS chains and dApps. This can only be achieved through wide coverage and brand trust, earned through Lido integrations consistently providing significant advantages over direct staking. Aave is the biggest DeFi app by TVL with currently $21B locked, so to achieve this vision a Lido liquid staking integration for Aave is important.

This development proposal will be suggested to the Lido DAO. We will give a few days for feedback on this forum thread and then initiate the on-chain vote where LDO holders will be able to voice their support.

Drawbacks of current solutions on AAVE

There are currently two main ways for users to stake their AAVE tokens: 1) through the staking contract provided by Aave, and 2) through 3rd party staking services, such as xToken's xAAVE contracts.

When staking with AAVE's contract, users receive 1 stkAAVE token for every 1 AAVE token staked, with the staking rewards accounted for separately. Users who wish to compound their gains need to actively claim the rewards and restake which can incur very high gas costs.

When staking with xToken, users get back a certain amount of xAAVE tokens for every AAVE token deposited. As staking rewards are accumulated, the exchange rate between AAVE and xAAVE changes; specifically, each xAAVE becomes worth more AAVE. This design may be less intuitive for users new to DeFi.

Moreover, xToken's contract does not allow xAAVE holders to vote in Aave governance. Instead, the xToken team votes on behalf of users. For this purpose, two variants of xAAVE tokens are created: xAAVEa and xAAVEb, which votes on the basis of left- and right-wing political ideologies respectively. We consider this a less than ideal solution as not only are the users stripped of the opportunity to voice their own opinions, but also someone has to interpret what ideology any given vote corresponds to, with that governance power currently being concentrated into the hands of a few xToken team members. This is an especially serious drawback in a money market protocol, in which governance decisions determine the balance between capital efficiency and protocol solvency. Stakers underwrite protocol risk and are on the hook for up to 30% of their principal in the case of Shortfall Events, giving them skin in the game incentives to participate in governance.

Another adverse effect of splitting xAAVE into two variants is the fragmentation of liquidity. As there is a 10-day cooldown period for unstaking, xToken created 50%/25%/25% xAAVE/AAVE/WETH pools on Balancer, so that users can off-ramp using the exchange without waiting. However, since liquidity is split into two pools containing each of the two xAAVE variants, each pool is shallower and large trades may incur slippage.

Our solution

Upon examining the drawbacks mentioned above, we propose the development of a liquid staking solution for AAVE (stAAVE) with the following characteristics:

- The staking rewards are automatically compounded;

- The balance of stAAVE token in each user's wallet automatically updates every block, reflecting the staking rewards accrued (similar to stETH);

- Holders of stAAVE can vote in Aave governance, the same way as stkAAVE holders can;

- Low-slippage trading between AAVE and stAAVE utilizing a Curve pool.

Note: stAAVE will have to be approved by Aave governance as a voting token through a poll before holders will be able to vote directly. Before this is accomplished, the Lido DAO has the power to decide how to vote in each Aave governance poll. Lido DAO can relinquish this power at any time.

In addition, as the Aave Safety Module naturally evolves over time to become a sophisticated insurance product (as per our latest proposal), stakers will have additional options to underwrite specific markets and take on differing levels of risk. We envisage our stAave product streamlining this process for users.

Timeline and Future Work

- Completion of smart contract development [May 2021]

- Completion of two audits and further testing [June - July 2021]

- Mainnet release [July 2021]

- Lido governance proposal to incentivise liquidity for stAave pool [Q3 2021]

- Aave governance poll to approve stAAVE as a voting token [Q4 2021]

Suggested Fee and Incentive Structure

We split the fee and incentives into three parts to best align us with future success of Lido, the success of the stAave integration and help us with incurred costs.

- Lido Token Incentives: Using vested tokens distributed according to milestones reached.

- Revenue Share: An ongoing revenue share between Delphi Labs and the Lido DAO.

- Delivery fee: To help us cover costs incurred with development and bringing the integration to market.

Each of these are outlined below.

Lido Token Incentives

To align us long-term with the success of the Lido DAO we propose the following terms:

200,000 LDO tokens issued with a 1 year cliff and 1 year vesting when Lido for AAVE manages to capture 2.5% of the staked Aave supply.

Revenue Share

An ongoing revenue share aligns incentives between Delphi Labs and the Lido DAO whereby generated fees are split with 20% of fees generated paid to Delphi Labs and 80% to the Lido DAO treasury.

We believe that this simple structure is best suited to incentivize independent investment and expansion of integrations on our end by tying our revenues to those generated for the DAO at large.

Delivery Fee

While the above incentives align us with the success of Lido DAO and our Aave integration, an amount paid on launch of the implementation would be helpful to cover costs associated with development and bringing the integration to market.

For this we propose $60,000 to be paid in ETH from the DAO treasury once smart contracts are audited, deployed to mainnet and the staking widget is integrated into Lido's UI.

Model

To help understand the fees at certain percentages of stAave market share we have produced the following model.

At current prices, given a 1% performance fee and 20% market share for our stAave product, the model shows we will generate $122k for Lido per year, repaying Lido's investment in approximately 4 years. In a worst case scenario of 2.5% market share (the minimum threshold at which we receive our LDO tokens), Lido would make back its investment in ~15 years. We also believe the 1% performance fee can be increased over time as stAave becomes adopted.

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Screenshot 2021-06-01 at 20.34.27

3072×934 403 KB

](https://europe1.discourse-cdn.com/business20/uploads/lido/original/1X/45138a7e4f04bb0c2109955aab42e8fb714dbda1.png)

Next Steps

We have already been in contact with various stakeholders from the Lido and AAVE ecosystems and started the development of our proposed Lido liquid staking solution for AAVE.

Our next step is to gather more feedback from LDO holders and other ecosystem members on this proposal and the proposed spec, which we are encouraging with this forum post.

On June 7th, we will issue a Snapshot vote to determine whether the Lido DAO is in favor of supporting our proposal. If the proposal passes, we will speed up development of the Lido for AAVE program in accordance with the spec and iterate on the spec with the goal to release a useful version to integrate into AAVE.

Why Delphi Labs

Delphi Digital has built a strong reputation as the leading independent research boutique covering the digital asset market,

with our client base including some of the industry's most prominent funds, financial institutions and investors. Through our consulting services (now Delphi Labs), we've worked closely with top projects in the space such as Aave, Synthetix, Axie Infinity and others to model, optimize and redesign their economic models.

More specifically, our team deeply understands AAVE's safety module, having spent significant time vetting and contributing to AAVE's insurance model and token economics to refine the viability of the design (see our proposals [here](#) and [here](#)). Having an intimate understanding of how the AAVE network is designed and functions will aid us in our development of stAAVE.

Was are also investors in LIDO at Delphi Ventures, having contributed 303 ETH to the Lido DAO in the recent on-chain purchase alongside Paradigm, Coinbase Ventures, and others. We are big believers in both Lido DAO and its founders, who we consider some of the most impressive founders we've met in the space. We intend for stAave to be the first of many products we build for Lido in the coming years.