Simple Summary

Discuss which assets should be listed on Aave V3 Ethereum initially and the configuration of those assets.

Abstract

Following the community's decision to deploy a new Aave V3 Ethereum, it is now time for the community to make important choices around how to design V3 ETH's initial market structure.

This ARC kickstarts community discussion around the tactical implementation of a new Aave V3 deployment on Ethereum. Decisions regarding V3 ETH deployment have both strategic and risk implications. Gauntlet can provide analysis and context around market risk, and the community should also weigh the strategic considerations when evaluating different tradeoffs.

- As a first step, we provide the community with recommendations and options for which assets to list initially on Aave V3 ETH, specifically for the "standard" market.
- After the community decides which assets should be initially listed on the "standard" market, the next topic of discussion is the configuration of specific modes (e.g., e-mode categories and which assets should be included in those categories, isolation mode, and siloed borrowing).
- Following that, Gauntlet can provide parameter recommendations for these assets and modes. Although Gauntlet's risk simulation platform will drive parameter recommendations for V3 ETH following

the V3 ETH launch, the initial V3 ETH launch requires more community input because there are meaningful strategic implications (e.g., incentivizing users to migrate their V2 positions onto V3), making it important for the community to discuss the tradeoffs.

Motivation

BGD has proposed rolling out a fresh deployment of Aave V3 ETH, instead of upgrading existing V2 contracts. The community has approved this proposal.

Now, there are important choices presented to the community. Given the sheer complexity and scope of the decisions that the community is faced with, we break down the decisions into several questions to help organize community discussion to find consensus:

1. Which assets should be initially included in the standard V3 Ethereum market?
2. Which V3 modes should be "active," and how should those modes be structured (which categories/assets should they include)?
3. What should the parameters be for initial V3 ETH deployment? In particular, what should the parameters be for the standard market? And if the community decides to enable specific modes upon initial V3 launch, how should those modes be configured?

It is important for the community to first decide on Question #1

. After the community decides on Question #1

, we will provide more color and recommendations on Question #2

and Question #3

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At a high level, as Aave V3 ETH scales to billions of dollars of TVL, protecting user funds is of utmost importance. This importance is greater magnified by the potential facilitator role V3 will play for GHO.

Specification

Gauntlet developed a scoring methodology to recommend assets to include initially in Aave V3 Ethereum's standard market based on features related to market size, risk, and V2 usage, incorporating both Aave's protocol data and external market data. We recommend that the assets in Aave V3 ETH's standard market should primarily be a subset of the assets on Aave V2 ETH, as the community has already decided to include those assets in the ETH protocol. Thus, we apply this scoring methodology to the list of assets on Aave V2 ETH.

We purposely did not run simulations for this exercise because 1) while V3 has overlapping qualities with V2, initial usage on V3 could be markedly different, making simulations have outsized statistical variance, and 2) simulation on new markets

requires numerous assumptions, many of which are likely to be inaccurate.

The following table ranks the assets for initial inclusion in Aave V3 ETH's standard market based on our overall score; we separated "Non-Stable Coin" and "Stablecoin" assets in order to give the market a diverse set of assets at the onset.

Non-Stable Coins

Stablecoins

Gauntlet recommends two initial listing options, both of which combine non-stable and stable assets, for Aave's V3 ETH's launch. The community may have strategic considerations around how broad the initial V3 launch for the standard market should be, so we provide the below 2 options to kickstart community discussion. To be clear, these recommendations are only for the selection of assets. If an asset is disabled as a collateral asset or disabled as a borrowable asset on Aave V2, we recommend initially maintaining those deactivations on the V3 ETH standard market. We understand that Aave V3 has new features such as Efficiency mode, Isolation mode, and Siloed Borrowing. We will address the community about utilizing those features in future discussions when we provide a more granular analysis of each asset candidate. We recognize that there may be more complex questions, such as "although USDT is not enabled as collateral on V3 ETH's regular market, should we enable it as collateral in isolation mode?" These questions are important; however, to help organize community consensus, we focus on Question #1

in this forum post.

Option 1 - Limited Launch

This conservative option selects the top 25th percentile of assets scored between the Non-stable and Stable assets.

Non-Stable Assets:

WETH STETH WBTC MANA LINK AAVE*

Stable Assets:

USDC USDT DAI

*AAVE is not in the top 25th percentile, but we still recommend listing the asset on the V3 platform for strategic and protocol value purposes.

To clarify, upon the initial V3 ETH launch, STETH and AAVE borrowing would be disabled, and USDT would not be enabled as collateral (consistent with V2 deactivation settings).

Option 2 - Broader Launch

This less conservative option selects the top 50th percentile of assets scored between the Non-Stable and Stable assets.

Non-Stable Assets:

WETH STETH WBTC MANA LINK CRV AAVE UNI MKR SNX 1INCH

Stable Assets:

USDC USDT DAI TUSD BUSD SUSD

To clarify, upon the initial V3 ETH launch, STETH and AAVE borrowing would be disabled. USDT, BUSD, and SUSD would not be enabled as collateral (to be consistent with V2 deactivation settings).

The community may decide to include more assets upon the initial Aave V3 ETH launch due to those assets' importance to the Aave DAO's business plans and partnerships. Those assets' strategic/partnership importance is more difficult to quantify, which is why those assets may be excluded from Gauntlet's recommendation, which relies on quantitative factors. We would encourage the community to discuss if there are additional assets that should be included in the initial V3 ETH launch. Our methodology is meant to be a starting point to kickstart community discussion.

Methodology

Our methodology scores assets to be recommended to V3 ETH using 6 features for non-stable assets and 4 features for stable assets. The features capture an asset's market opportunity and general market risk to Aave. Below we define the features within our scoring methodology:

- Volatility: This 30-day price volatility measurement is a proxy for liquidation, slippage, and insolvency risk on the platform. Using the Garman Klass volatility estimator, which utilizes both daily High

and Low

prices as well as daily Open

and Close

prices, the annualized volatility for each asset can be calculated as follows:

- Supply Balance: This is the total asset supply in USD on Aave V2 ETH. A higher supply balance implies a greater potential market opportunity and usage for the platform.
- Utilization: Asset utilization captures asset usage and market opportunity, as defined below.
- Borrow Usage: This reflects how aggressively suppliers of collateral borrow against their supply. Higher borrow usage implies more capital efficiency for the platform.
- Daily Volume/Supply Balance Ratio: This is a proxy of an asset's liquidity risk in relation to the supply balance on Aave's platform. In a worst-case scenario where a large supply of an asset was liquidated and thus sold at a discount, downward pressure on the asset could cause cascading liquidations across platforms. A high daily volume relative to supply implies the market can absorb such an influx of the supplied tokens without causing significant slippage or systemic liquidity issues.
- Daily Volume/Borrow Balance Ratio: This is a proxy of an asset's liquidity risk in relation to the borrow balance on Aave's platform. Liquidators must transact in the borrowed asset, which could cause meaningful slippage in extreme liquidation events. A high daily volume relative to borrow implies there is less risk of slippage with respect to borrowed assets.
- Market Cap: This reflects external opportunity size, level of liquidity, and adoption risk for an asset. The market cap is a proxy for how large reserves can grow on Aave.

Next Steps

- As a first step, the community should decide which assets to include for Aave V3 ETH's standard market (Question #1

), per the above analysis.

- Following that, discuss options and tradeoffs for Question #2

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- Following that, discuss options and tradeoffs for Question #3

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- We will publish Snapshot votes as needed to help the community reach a consensus. We will keep in mind the tradeoffs between allowing time for community discussion versus the speed of V3 ETH deployment.

Quick Links

BGD Proposal for a fresh V3 Ethereum deployment