This post is in response to the rapid success of the EDSR that we have observed since its activation approximately 48 hours ago. Overall I think we can consider the experiment a success, but I want to propose some changes aimed to ensure that the EDSR benefits regular Dai holders rather than disproportionately benefit ETH whales.

In that 48 hour timeframe since EDSR launch Dai supply has increased by almost 0.5 billion, and DSR utilization has already almost hit the 20% threshold which will make the EDSR automatically decrease to around 5.8%. This significant market reaction within such a short timeframe has already given us a couple of important data points:

1. Offering high yields on a well-established stablecoin will result in rapid, large scale capital inflows that will quickly consume the excess yield and equilibrate it with the market. This is quite obvious and shouldn't be a surprise, but it is still good to confirm this as it is a key assumption of how SubDAO yield farming will lead to growth in Endgame, and makes it more likely we will not need to consider yield-cap mechanisms on SubDAO farming yield.

2. Giving higher yields on holding Dai than the cost for collateralized borrowing results in even more massive large scale capital inflows and borrowing activity to perform the so-called "borrow arbitrage" where you currently borrow Dai at 3.19% and then deploy it for 8% yields in the EDSR. In hindsight not exactly a surprise this would happen at massive scale. This observation is an even more significant argument for not needing yield caps on SubDAO farming yield, but it also means that we have to focus on borrow rates being high enough to avoid capital leakage.

Overall, while in hindsight it is now obvious to me, I think the massive scale of ETH and Staked ETH whales harvesting yield from the EDSR through borrow arbing is unintended because it crowds out regular Dai users that the EDSR was supposed to primarily benefit, and I think we should act immediately to optimize the EDSR with this context in mind, to make sure it primarily benefits regular Dai holders.

These are changes I have included in the new update to the Stability Scope, that I believe warrant a GOV12.1.2 edit as it deals with the unintended consequence of the EDSR disproportionately being used by large-scale whales: # MIP102c2-SPXX: MIP Amendment Subproposal - #2 by rune

A summary of the changes are as follows:

- EDSR would be changed to a maximum value of 5%, rather than 8%. In addition, Tier 1 EDSR would now cover the entire range of utilization from 0-35%, so the maximum value EDSR would last significantly longer than before and be more sustainable.

- Tier 2 EDSR (with a DSR multiplier of 1.3x) would last from a utilization of 35-50%.

- Crypto borrow rates would also increase to be equivalent to the EDSR, so initially they would go to minimum 5%, and this would make it impossible to profit from performing the borrow arbitrage that is currently happening at very large scale. ETH-A, ETH-B and ETH-C would be exceptions to this, and would continue to have lower rates, and enable the borrow arbitrage (but with very low capital efficiency).

Overall I think these are reasonable changes, although the one downside is that it results in higher borrow rates for regular, organic vault users. I don't think this is a big problem for users of the established native vault engine, as it has significant lindy effect and in the current super high rates environment 5% is still a good borrow rate.

However, I do think it presents a problem for Spark Protocol, as it is still a new and relatively unproven borrowing platform, and as a result it should have preferential terms - unfortunately we cannot give it lower borrow rates as it would then open up for the borrow arbitrage again and interfere with the EDSR.

Instead, I think a more interesting solution that would give early users of Spark Protocol a fair reward for their early participation in Spark Protocol and their support in bootstrapping the Spark DAO community, is to establish a retroactive subdao token farming airdrop

for Spark Protocol users, so that all users that are actively borrowing from Spark Protocol starting from the moment the EDSR increases the borrow rate on Spark Protocol, will be rewarded for their early participation and contribution to building up the Lindy effect of Spark Protocol.

I will make a future proposal to provide more details for how this Retroactive Farming Airdrop should be calculated and distributed, but the key detail is that users should start retroactively earning it from the moment the EDSR causes an increase to the Spark Protocol borrow rate, so that we create an incentive for users to stick with Spark Protocol.

This proposal is still a work in progress and I may update it further as more data and input comes in, so please leave your feedback in the thread.