This proposal was authored by me, governance lead at Citadel One; a dYdX Validator.

Background

Recently the dYdX chain has passed a governance proposal supporting the deployment of a portion of the Community Pool funds via liquid staking to increase its economic security and address the centralization of dYdX's validator set. The proposal has been successfully executed under the following conditions:

- LSD provider:

Stride

- Amount:

20,000,000 $DYDX

- Fees:
- 92.5% of rewards used to auto-compound DYDX into the treasury's staked position, growing it over time.
- 7.5% of the rewards flow to the Stride protocol
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- Term:

12 months

The proposal to community stake with Stride has undeniably brought much-needed improvements to the dYdX chain from an economic security & network decentralization perspective. However, it could be argued that this wasn't without trade-offs:

- The cost incurred by the community pool is relatively high: At a price of 1.95$/ DYDX, an APR of 18.58% and a 7.5% commission, the cost to the community pool stands at ≈543,000 $USDC per year.
- Yield dilution to $DYDX Stakers: The community pool staking 20 million $DYDX lowered the staking yield to native Stakers by approximately 14.60%: post-proposal, the voting power of the Community Pool represented roughly 14.6% of the total voting power.

Description

In this post, I'd like to propose two suggestions to the original proposal with the goal of addressing the trade-offs mentioned above:

- Revise the fees applied by Stride
- Redistribution of all earned $DYDX earned by the community pool back to native Stakers
- Revise fees applied by Stride

With the following assumptions: DYDX price: 1.95$, APR: 18.58% and Stride commission: 7.5%

The cost of liquid staking with Stride is ≈543,000 $USDC for a duration of 12 months. In exchange, Stride handles the following:

- Validator selection and active management of delegations
- Auto-compounding rewards

For the record: Stride has already lowered its commission by 2.5% from the standard 10% fee. However a fee of 7.5% still seems relatively high. This is because, dYdX isn't/ won't be making use of the features liquid staking unlocks (liquidity, DeFi use cases…).

Unlike the reasoning in the original proposal, I do not think that a trusted third party is required to handle a fair distribution of stake. Instead, it could be done via a delegation strategy that is actively rebalanced/ monitored by a dYdX sub-DAO based on predetermined criteria that are voted on by governance. There is a chance this approach will be explored in the future once the legal and technical structures are in place. But until that happens, LSD providers present the safest way to execute community pool staking.

My argument here is that the fees charged by Stride shouldn't be considerably higher than the cost of funding a sub-DAO to do the same work.

Therefore, I propose reducing Stride's fees from 7.5% to 5% (half of Stride's standard fee).

It's also worth noting that a reduction in fees applied by Stride could serve as a powerful gesture of goodwill, reinforcing Stride's commitment to the dYdX community's long-term interests.

1. Redistribute accrued rewards back to $DYDX stakers

One of the downsides of the community staking proposal is the yield dilution to $DYDX stakers by roughly 14.6%. This yield is instead used to buy-back and stake $DYDX on behalf of the community pool. This auto-compounding has the positive effect of continuously increasing the economic security of the dYdX chain as well as supporting the token price, but also the negative effect of increasingly diluting the yield of $DYDX native Stakers.

The rationale behind the loop of buy-back and stake of DYDX in the original proposal is to continuously keep increasing the economic security of the chain. There is an argument here that this could render staking less and less attractive for $DYDX holders as the yield continuously diminishes.

The community staking is a also first-time initiative for the dYdX chain and should therefore be conducted with as few trade-offs as possible.

For these reasons I'd like to put forward the idea of redistributing all fees back to $DYDX Stakers to completely offset the yield dilution.

There is more than one way to achieve this, all of which are technically challenging and would require additional development from Stride. Which is why I propose the following:

At the conclusion of the proposed term (12 months), the dYdX community passes a community spend proposal of $DYDX tokens equivalent to the surplus accumulated from staking, with the dYdX staking contract address as the recipient address.

For example: If the 20M staked $DYDX has accumulated 4M $DYDX from staking rewards, 4M $DYDX will be distributed back pro-rata to $DYDX stakers.

Note: In order to achiever this, the community isn't required to terminate staking with Stride. If community staking continues, idle $DYDX from the community pool equal to the amount required could be used to redistribute the yield. This way, the economic security of the protocol won't be affected.

Implementation

Below, are the details for how the proposed improvements could be implemented:

1. Revise Stride fees:

If approved by dYdX governance, this will require a follow-up proposal on Stride side and will only happen if the Stride community approves it as well.

1. Redistribution of earned $DYDX from community staking back to Stakers:

If approved by dYdX governance, this will require a follow-up community spend proposal on dYdX to execute the distribution, at the end of the term.

Next steps

At the moment, this is just a forum post to gather feedback from the community. If there is enough support, it will move to on-chain governance.

I believe that the two improvements proposed here are both beneficial to the dYdX chain but they are in no way linked. Which is why, if they make it to on-chain governance, they will each be voted on separately.

Conclusion

Ideally, the dYdX community shouldn't rely on LSD providers to address issues such as economic security and validator set decentralization. Instead, the community should opt for a delegation strategy that recalibrates regularly based on predetermined criteria that are approved by governance. This eliminates any additional costs and incentivizes validators' good behaviour continuously.

But until it is possible to implement such an approach, I think these suggested improvements could be beneficial for the current dYdX community staking proposal with Stride as it will:

- Reduce the community pool's cost.
- Strengthen the relationship between Stride and dYdX, and potentially paves the way for longer-term staking initiatives.
- Offsets the yield dilution incurred by native Stakers.