Short Summary

As [GHO development](#) is in progress, B.Protocol would like to propose Aave DAO add a user-based backstop for GHO that will enable safer and more robust liquidation mechanics that can ensure peg stability also for less liquid collaterals as well as during radical market conditions.

As the value and stability of GHO are dependent on the collateral assets that are backing it, the accrual of GHO's bad debt is riskier than other, more "standard", bad debt as it can cause GHO to lose its value - hence the proposal to set up a backstop as another line of defense to protect its stability.

Users will be able to deposit their GHO into a backstop pool, where the liquidity will be used to facilitate liquidations with a fixed slippage.

Motivation

[B.Protocol](#) provides B.AMM (Backstop AMM) integrations for lending markets and over-collateralized stables. It's a novel DeFi primitive that uses provided liquidity to liquidate underwater positions without relying on flashloans, acting as a buffer that amplifies existing DEX liquidity. B.Protocol was launched in 2020 and had over $300m TVL at the bull market peak.

B.Protocol pools users' funds into segregated Backstop pools. This liquidity is used for liquidations as they happen on the integrated platform, e.g. Aave. Once a liquidation takes place, the Backstop AMM (B.AMM) smart contract pulls the needed funds from the backstop to facilitate the liquidation and automatically puts the seized collateral for sale according to a market price feed. Once sold, the return is deposited back to the backstop pool, and profits are accrued.

The backstop enables GHO holders and community members to help protect Aave as a platform from bad debt while strengthening GHO stability and gaining from liquidations. You can read more about the B.AMM on our [docs](#) or directly on the (more technical) [whitepaper](#).

Hi-level design of the Backstop -

A GHO backstop will ensure liquidations of even less liquid collateral assets on Aave can be made smoothly, or at least without exposing the Aave community to any bad debt from GHO liquidations, as the backstoppers who provide liquidity to the pool are willing to take the risk of potential losses, in return for the potential liquidation profits.

Currently, on Aave V2 there are a few assets with millions of USD value as collateral, but with very low DEX liquidity (see table below). Flashloan liquidation bots won't be able to liquidate even medium size positions in one transaction and will have to break it into a few "chunks", waiting for new liquidity to flow in by arbitragers. This process may take time and can expose the protocol to bad debt in case price keeps on dropping during this time period. Having a dedicated backstop offloads that risk from the protocol lenders and puts it on the backstop. You can read more about how a backstop improves illiquid assets' liquidation process in this

[blog post](#).

Defending Aave from bad debt which is created by GHO (users' borrowed GHO value is higher than the value of their deposited collateral in Aave) is more critical than other types of bad debt accrual in the Aave platform, as it can also affect the value of GHO as a stable. Assuming Aave wishes to maintain its competitive LTV values in the ecosystem, we believe a backstop for GHO will significantly improve the liquidation mechanics also during severe market conditions and will ensure GHO maintains its value while keeping the relatively high LTV values it offers to its users.

Asset

TVL ($)

LTV (%)

Liquidation Penalty (%)

Max liquidation size* ($)

BAT

4.85m

65

7.5

250k

ENJ

3.54m

60

6

150k

MANA

17.19m

61.5

7.5

450k

REN

4.38m

60

7.5

200k

xSUSHI

17.13m

50

8.5

100k

ZRX

14.03m

55

7.5

150k

Aave V2 Ethereum market assets with low DEX liquidity

*Max liquidation size possible with a price impact smaller than Liquidation Penalty (according to 1Inch, November 6th, 2022).

We believe that having a GHO backstop will not only enable the listing of less liquid collaterals but can also foster better trust in a new stable to hold during severe market conditions, as more robust liquidation mechanics will maintain a better GHO peg.

Integration Requirements

In order to kick-start the backstop pool, GHO holders will need to be incentivized to deposit their GHO in the backstop. We suggest 2 different options to incentivize the backstoppers:

1. Allocate $3m as an incentive to the backstop pool depositors, calculated as 5% APY for a $60m pool size.

2. Set the backstop as another eligible source for discounted interest rates for GHO. bGHO (GHO tokens in the B.AMM) holders can be set to be eligible for a discounted GHO interest rate similar to stkAAVE holders (with different parameters as the community will decide).

Next Steps

Upon a positive feedback signal from the community to support this proposal and the preferred method to incentivize GHO backstoppers (either one of the above-listed options or a third one preferred by the community), B.Protocol will make the development efforts for this integration, including any other requirements coming from the Aave community or the Aave Companies team who are leading the GHO development efforts.

The B.Protocol team is looking for any feedback on this proposal from the Aave community.