Posting on behalf of Lido DAO founders:

Background

"The Ethereum Beacon Chain was launched on 1 December 2020 and signalled a major milestone in the move from Proof of Work (PoW) to Proof of Stake (PoS). Lido was launched just a few weeks later, found market-fit rapidly and grew to become the leading liquid staking provider on Ethereum.

Lido works by connecting stakers (of any amount of ETH) with a network of independent professional Node Operators that run validators on their behalf. This design socializes both staking rewards from securing the Beacon Chain, as well as any slashing or inactivity penalties that may arise, across the entire pool of Lido stakers.

On Slashing

Slashing is a mechanism designed to detect activity that may be potentially harmful to the network and suppress any further activity from that validator. An example of a slashable offense includes validator keys being run on two machines concurrently. Slashing can also occur if a node operator proposes or attests to two conflicting blocks in the same slot.

The effect of slashing is significant and leads to the validator losing some portion of its staked ETH over a period of time and eventually being ejected from the Beacon Chain network. It is not possible to appeal against a slashing incident or avoid this outcome for the validator in question.

Insurance

Lido initially took out cover against slashing penalties via Unslashed Finance. The premium for this was modelled to account for ~25% of the DAO's annual revenue. A detailed study was conducted by the analytics team which modelled a number of scenarios, which you can read here:

Lido Finance – 21 Oct 21

Offline & Slashing Risks: Are Self-Cover Options Enough?

This post sets the stage in terms of outlining the landscape of cover options avilableand possible developments. We outline the typical risk scenario, the amounts of slashings and penalties, and evaluate impact to understand whether Lido can...

The Lido DAO decided (in a vote that concluded on 20 July 2021) to explore 'self-insurance' options, rather than spend such a large amount of income on this premium. Current protocol fees are 10% of staking rewards, with half of that (5%) going to Node Operators and the other half (5%) going to the Treasury (marked as usable for insurance purposes). At the time of writing the DAO holds 4,565 stETH in this fund. An equivalent of 920.08 wstETH will also be added to the insurance fund that was used to cover the latest RCC and operating expenses (OpEx)

Switching from Insurance to DAO Treasury

It is proposed that the DAO cap this slashing insurance fund and formally redirect revenues to the DAO treasury to build reserves and meet ongoing capital and operating expenses as it continues to build. A snapshot signalling vote to confirm this direction will begin later today, with an on-chain Aragon vote to formalise the change to protocol fee distribution pending that initial vote outcome.

If approved, the precise amount of stETH in the fund will be determined at the time of switching the fee flow. At current run rate, it can be estimated at >5500 stETH and an updated analysis of slashing incident costs and probabilities is being prepared. The insurance fund will change over time with daily rebasing of staking rewards and will be eventually moved to a separate address (fully controlled by the DAO) that is clearly labelled for ease of reference.

In the event of a widespread Slashing incident

This change means that if penalties from a widespread slashing incident (which remains possible, but remote given the quality of the Lido validator set and its proven track record) were to exceed the amount of the insurance fund, any excess loss would be socialized across Lido stakers (holders of stETH).

We welcome feedback on this proposal from the community below and encourage all stakeholders to vote accordingly.

You can find the relevant Snapshot vote here once live:Snapshot"