title: V2 → V3 Migration & V2 Deprecation Plan

status: Call for Discussion

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Simple Summary

This ARC presents the community with the opportunity to accelerate the migration of capital from several of the legacy V2 markets to the newer, more secure V3 markets. As well as providing formal milestones and an initial plan towards deprecation of the V2 markets.

The proposal seeks to do this by adjusting the Reserve Factor of the various aTokens that are supported on Aave V3. Adjusting the reserve factor will decrease the yield earned by depositors, encouraging them to migrate collateral, which will increase the borrow rate, encouraging borrows to migrate. A side effect of this strategy is that the DAO will earn more revenue as its take-rate from the generated interest of the market is increased.

Motivation

Aave V3, the latest version of the Aave Protocol, has been live for over 200 days, during some of the most turbulent market conditions, and has performed as designed without incident. While V3 brings increased capital efficiency for users, most importantly it brings a whole host of new risk management tools that will allow the DAO to continue securely operating the largest multichain DeFi contract system. The authors believe that the DAO should focus its efforts towards the future, by pausing the addition of assets to the V2 markets, begin using its various contract levers to encourage users to migrate, and begin the process of deprecating the older V2 deployments.

While the DAO has several different tools at its disposal to encourage users to migrate, the authors believe that two in particular are best suited for this task, Reserve Factor adjustment, and Safety Module coverage.

As a refresher, the Reserve Factor (RF) is the percentage of interest paid by borrowers that goes to the DAO's reserves. It controls the difference between the Supply APR and Borrow APR via the following formula:

Supply APR = Borrow APR * (1 - Reserve Factor)

When the RF increases, the amount of interest borrowers pay remains constant, while suppliers earn less, given no changes in Utilization Ratio.

It is expected that an increase in reserve factor will cause suppliers to exit the market, causing borrowers to have less liquidity and higher rates, causing them to exit the market.

The authors have selected RF over other mechanisms such as LTV or Liquidation Threshold adjustments, as RF changes do not risk the immediate liquidation of user positions solely due to the parameter change.

The second tool the authors recommend using is Safety Module (SM) coverage. The safety module is Aave DAO's secondary backstop (after treasury funds) to provide additional backing should there be a shortfall in a given market. Presently the Ethereum, Polygon & Avax V2 markets + Aave ARC Market are covered by the Safety Module. By removing safety module coverage, the DAO can directly signal to market participants that they need to migrate to the more secure V3 release, if they wish to continue receiving SM protection. Similar to Reserve Factor, a Safety Module policy change does not cause immediate liquidation of user positions, instead it is a signal to users, especially DeFi integrators who balance deposits across various contract systems, that the V2 markets are being deprecated and V3 should be their new target.

The authors propose the following process to kick off the migration and deprecation process. First, a snapshot vote to informally set a DAO policy to halt the listing of new assets on the Polygon, Avax, Ethereum and Ethereum AMM V2 markets, and formally classifying them as "legacy". Second, a series of on-chain AIPs every few weeks to gradually increase the Reserve Factor 60% above existing levels on all Polygon & Avax V2 assets. Third, the commitment to vote on Safety Module status, and full deprecation (frozen reserves) once certain TVL thresholds are hit.

Timeline

- Initial Snapshot Vote: Aave DAO informally agrees to not list any new assets on the Polygon, Avax & Ethereum AMM, classifying them as "legacy" markets.
- Initial On Chain Vote - AIP 1: Increase all Reserve Factors on Polygon & Avax V2 Markets by 5% (i.e. 10% → 15%)
- T+ 2 Weeks - AIP 2: Increase all Reserve Factors on Polygon & Avax V2 markets by additional 5% (15% → 20%)
- T+ 4 Weeks - AIP 3: Increase all Reserve Factors on Polygon & Avax V2 markets by additional 10% (20% → 30%)

- T+ 6 Weeks - AIP 4: Increase all Reserve Factors on Polygon & Avax V2 markets by additional 10% (30% → 40%)
- T+ 8 Weeks - AIP 5: Increase all Reserve Factors on Polygon & Avax V2 markets by additional 15% (40% → 55%)
- T+ 10 Weeks - AIP 6: Increase all Reserve Factors on Polygon & Avax V2 markets by additional 15% (55% → 70%)
- March 11th, 2023 - AIP to extend Safety Module Coverage to Polygon V3, Avax V3 & Ethereum V3 Markets
- This date marks exactly 1 year after Mainnet V3 deployment, providing ample time to battle-test the contracts, and for the DAO to make a determination on if they are secure for it to extend Safety Module Coverage
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Deprecation Milestones:

- If TVL of Avax V2 or Polygon V2 Market goes below $25MM USD for 1 continuous week (as measured by DeFiLlama.com) an AIP to remove Safety Module Coverage for that market will be put forward.
- If TVL of Avax V2 or Polygon V2 Market goes below $7.5MM USD for 1 continuous week (as measured by DeFiLlama.com) an AIP to fully deprecate the market (Freeze all reserves) will be put forward.

Specification & Voting - N/A

- This proposal currently is a call for discussion. The migration and deprecation of the V2 markets is a big and complex decision and all stakeholders are encouraged to voice their thoughts!
- Upon further community dialogue a formal specification and vote section will be drawn up, and proceeded to a snapshot vote.
- The authors would encourage the community to in parallel discuss various means of incentivizing users transitioning from V2 → V3. Additionally we encouraging the community to build / fund tools to assist with migration (ideally via Grants DAO).

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