Summary

Chaos Labs' Launch Incentives Program Proposal for V4

Chaos Labs proposes a 6-month Launch Incentives Program to be deployed on V4. This program is designed to motivate the seamless migration of volume and users to V4.

Our proposal is structured in distinct phases:

1. Preliminary Research:

An in-depth exploration to tailor the incentives for optimal user engagement.

1. V4 Analytics and Risk Portal Creation:

This portal will offer real-time insights, enhancing user understanding and trust in incentive distributions.

1. V4 Rewards Leader Dashboard:

The portal will serve as a leaderboard where users can view accounts accruing the highest rewards.

1. Rewards Distribution Oversight:

Ensuring a transparent and efficient allocation of rewards post-launch.

Description

As dYdX approaches the launch of dYdX V4, a significant challenge awaits: effectively transitioning and expanding the existing V3 user base. Ensuring liquidity and facilitating migration is critical to the success of V4. Historically, Liquidity Mining or token reward programs have consistently demonstrated their efficacy in spurring protocol growth and bootstrapping trading volume. Consequently, a strategic Launch Incentives program will be crucial in effectively incentivizing a transition to V4. It is important to note that the proposed Incentives program is in addition to the native V4 Rewards program. With a focus on robust reward distribution, the Trading Rewards program is designed to catalyze migration, amplify adoption and volume, and reward early users.

The Goal: V4 Adoption Through Launch Incentives

Our aim with the proposed Launch Incentives Program is to amplify the incentives, motivating traders to migrate to V4.

We suggest an allocation of $20M USD worth of $DYDX Tokens to be distributed among V4's early adopters over ~6 months. Predicting V4 adoption with precision is challenging; hence, our role includes regularly evaluating the program's success and its rate of adoption. We will compare these findings against our preliminary expectations and spending, making appropriate modifications to the distribution quantum and the program's duration as necessary. The metrics and criteria for gauging the program's success are detailed in the subsequent sections.

Motivation

Why Do We Users Need Incentives?

Recognizing Early Adopters

Early and aggressive adoption is critical. The main goal of the native V4 Rewards Program is to automatically send rewards, capping at 100% of a fill's net trading fee. This is a powerful mechanism for reducing trading friction costs. However, V4 is a large migration for the dYdX community, as described below. Users taking risks and investing time and resources to become the earliest adopters deserve rewards for their contributions to the dYdX community.

Early Aggressive Growth is Needed

Empirically, the early months after a new protocol launch are critical. Momentum, early adoption, and initial trading volume are telltale indicators of a protocol's prospective success. Simply put, we haven't observed many protocols that see little to no adoption over the first year and suddenly skyrocket in usage later. We can utilize a portion of the community treasury to bootstrap explosive growth and ease the migration to a protocol.

What Will the Community Get From This Program?

If successful, the program will drive significant early adoption and help solidify dYdX's current and future market share as an

industry leader. Furthermore, this program serves as a lever to reward dYdX contributors who will play a pivotal role in enabling the successful launch of V4.

Migration Challenges

Chaos Labs understands the intricacies of shifting liquidity and the nuances of migrating users, as this has been a core focus with numerous protocols for which Chaos manages Risk and Economic security. Drawing parallels, Chaos Labs' oversight of the Aave V2 to Aave V3 migration over the recent year provides insight. Even with Aave V3's enhanced risk management and capital efficiency, the adoption trajectory has been gradual, and we expect a similar path for dYdX. V4 is a new financial product with a few critical changes, including the following:

- A new protocol with a new mechanism design as we consider the introduction of validators, on-chain matching, and more.

- Migrating from Ethereum to Cosmos.

- Introduction of [On-Chain MEV](#)

- New infrastructure (e.g., Bridging, CCTP bridge)

- Decentralization risks - Additional governance-driven changes are expected as the protocol moves towards decentralization.

Chaos Labs' dYdX Contributions

Chaos Labs has had the privilege of contributing to dYdX extensively over the past 2 years. Our collaboration has spanned diverse domains, including parameter optimization, mechanism design research, analytics, asset listing, developer tooling, and fine-tuning trading rewards for V3. A more comprehensive list can be found below.

Furthermore, Chaos Labs is an industry leader in Risk, Economic Security, and Optimization and has worked closely on Incentive Optimization with protocols such as Aave, Venus, Osmosis, Benqi, and more.

Our multi-disciplinary team is unique in its track record and ability to execute across the research, engineering, and product requirements of leading a successful Trading Rewards program.

Specification / Implementation

Chaos Labs proposes a 6-month program, iterative in nature. This proposal can be delineated into pre-launch and post-launch phases, as detailed below:

Prelaunch Research and Platform Prerequisites

A program of this magnitude requires research and engineering resources. Here, we detail two core work streams: V4 Launch Incentives Genesis Research and V4 Analytics and Risk Portal.

V4 Trading Reward Genesis Research

Establishing and Defining Good Behavior

Research is critical for determining the methodologies and framework to govern the reward distribution. Rewards are a powerful lever for incentivizing desired behavior, and the goal of this phase is to align the desired behaviors and punishable behaviors as seen fit by the DAO.

Incentivizing Desired Behavior

The rewards program will focus on incentivizing organic, positive usage of V4. We can define four activities that should qualify users to receive rewards.

1) Deposits

- Users depositing funds on the platform are a prerequisite for any trading activity. We'd like to see funds migrating to V4 in the early days of the launch and believe that deposits should be awarded accordingly.

2) Trading

- Trading is at the core of dYdX. Rewards should be a function of volume driven and fees paid throughout this time period.

3) Staking

- Staking is integral for the security of V4 and should be rewarded.

4) Governance

- Participation in governance increases the decentralization and distribution of the dYdX community and is imperative for ensuring a vibrant community of contributors and users. The early days of V4 will see important governance initiatives, and the community will benefit from hearing the voices of our users.

Launch Incentives Distribution Formula

Deposits and Trading are foundational to our reward distribution, whereas Staking and Governance, though valuable, have a lesser impact on our migration goals, primarily focused on platform volume and TVL. We won't disclose the complete rewards formula to prevent potential manipulation, such as the wash trading issues dYdX previously faced. Instead, we'll emphasize the behaviors we wish to incentivize and maintain transparency in distribution insights and trading analysis. Recognizing the challenges of discerning genuine activities in a blockchain context with pseudo-anonymous wallets, we prioritize transparency but are cautious of adverse actors manipulating the trading rewards program and benefiting disproportionately. Hence, we'll communicate the core principles and expected outcomes of specific actions, like trading and deposits, without detailing the exact distribution mechanics.

Assuring the dYdX community controls the distribution and oversees Chaos Labs' recommendations

We propose and elaborate below on the reward distribution's total flow, including making incentive distribution recommendations

. These recommendations will be posted publicly, along with a verifiable trading report and supporting data for community members to observe. While the precise formula driving our recommendations won't be made public, anyone should be able to easily confirm that accounts receiving significant rewards drive significant volume and accrue real fees on the platform. The community will be able to verify this via trading season reports, which Chaos will publicize with every recommendation and with the dYdX Chaos Labs Risk Portal. Of course, for any community member preferring to verify the data independently, everything can be confirmed on-chain.

Wash Trading Detection

Wash Trading refers to buying and selling the same asset without any net change in ownership, often to create a misleading impression of trading volume or market activity. This practice can give the illusion of high demand or satisfy exchange requirements for activity, or in this case, be used to 'game the system' to maximize reward accrual.

Chaos Labs will customize our market integrity and wash trading modules to detect wash trading on V4. Chaos Labs' internal platform is used across DeFi protocols to detect fraudulent activity and market manipulation. Chaos will extend this tooling to cover V4 to ensure that trading rewards are distributed to users who drive healthy, non-toxic flow. Historically, wash trading has been a challenge for the community, with Epoch 0 rewards being canceled and various iterations and improvements made to reduce the distribution of rewards to accounts exhibiting toxic flow.

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A rewards program of this magnitude is bound to attract adversarial actors, aiming to maximize rewards. The goal of developing this module is to deter actors from driving toxic flow to make sure liquidity incentives are well spent and incentivize organic trading behavior.

V4 Analytics and Risk Portal

We can only optimize what we can measure. Furthermore, since the exact distribution methodology will not be public, tooling enabling verification of wallets receiving rewards is critical. The portal's goal is to represent a publicly available source of truth, allowing us to measure the efficacy of reward distributions while enabling community members to verify the activity of accounts receiving rewards.

Analytics and Risk Portal

Chaos Labs will build a public-facing portal to be utilized by the community. The portal will be an all-encompassing data hub for all things V4, allowing for complete transparency across all markets and aggregating top-level data.

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This will be an asset for the community, allowing us to explore all markets to better understand user activity and market interest.

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However, the function this will serve in the context of the Rewards Program is critical. The portal will serve as a platform enabling the monitoring of accounts receiving rewards and will allow us to measure the effectiveness of the distribution methodology. The portal will feature the ability to dive deep into all accounts and review open and historical positions.

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The portal will also allow a deep dive into specific accounts and subaccounts.

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The portal will also allow a deep dive into specific accounts and subaccounts.

The portal is a large-scope initiative that warrants a post to collect feedback, which we will post shortly with greater detail.

V4 Reward Leaderboard Portal Overview

The dYdX Rewards Leaderboard Portal is envisioned as a platform dedicated to transparent representation of user engagements and the rewards they've accumulated.

Key Features of the Leaderboard Portal:

1. Wallet Ranking:

The leaderboard will ensure that users can see the results of their trading actions and the associated rewards.

1. Historical Data:

Users will have access to historical performance, allowing them to track their progress over time and understand trends and behavior.

1. Filter and Search:

The leaderboard can be filtered based on different criteria – daily, weekly, monthly performances, or specific activities. A search function will also enable users to locate their position or view the standings of others quickly.

1. Educative Content:

To assist new users or those looking to improve their position, the portal could also feature tips, tricks, and best practices to maximize rewards.

By serving as a transparent and interactive hub for the dYdX community, the Rewards Leaderboard Portal will not just be a tool of recognition but will play a pivotal role in incentivizing and educating users, fostering a spirit of healthy competition, and enhancing community engagement.

Post-Launch Incentive Iterations

The Trading Rewards program will comprise several discreet trading seasons, similar to epochs. At the end of each season, rewards will be distributed.

Trading Season Analysis Reports: Insights and Analysis

Chaos Labs will deliver reports after each trading season (epoch). We intend to enhance transparency, fostering a richer comprehension of market dynamics, user behavior patterns, and overarching protocol efficacy. These reports will spotlight prominent traders and the primary contributors to the dYdX protocol's fee generation. Such insights will be instrumental in shaping reward allocation decisions.

Season Incentive Distribution Recommendations

Chaos Labs will make reward distribution recommendation proposals after analyzing epoch trading data per the framework established in the research phase. Every proposal will include exhaustive data, ensuring clarity on which accounts will receive rewards, complemented by a detailed account of their trading behavior. This facilitates an open platform for the community to weigh the distribution dynamics.

Incentive Distribution Governance Proposals**

Consequent to each Chaos Epoch Report and recommendations, there will be a governance proposal. A passing proposal will result in reward distribution per the Chaos recommendations.

Incentices Distribution Refinements and Evolution

Reward Distribution isn't a static mechanism but requires oversight based on real-time adoption metrics. To this end, Chaos Labs will invest substantial effort between seasons, finetuning the reward strategy and enhancing our capabilities to detect wash trading anomalies. As our models collect more data and calibrate, we expect them to improve precision. Our goal is a progressively refined reward distribution mechanism as we journey forward.

Measuring Success

The rewards program aims to facilitate the transition of trading activities from V3 while propelling us beyond V3's current trading volume. This transition mirrors what we have observed in various protocols, where adopting new versions is ongoing. While rewards can support the migration of a new version, it's crucial to acknowledge that there are additional variables beyond the direct purview of the rewards program, including:

- Ecosystem Dependencies:

Notably, actors active on Ethereum mainnet might not experience a seamless transition to the Cosmos ecosystem.

- Battle Testing:

User confidence is bolstered over time as they witness the system being utilized extensively and with significant trading volumes.

- Overall Market Sentiment:

Historical data indicates that overall market sentiment and liquidity significantly influence the adoption of new protocols and are likely to impact V4.

- V3 Deprecation:

Since the current user base of V3 is, in large part, the target audience for V4, the steps taken to wind down V3 are expected to have an impact on the success of the migration and will impact the extent of the reward distribution plan.

While these exogenous growth factors are not integral to the reward program, assessing its success is paramount. These factors cannot directly translate into precise growth projections, but they can offer valuable insights. During the research phase, we will emphasize analyzing previous protocol version migrations and the expansion of trading venues. This analysis will enable us to establish growth benchmarks guiding KPIs for the incentive program.

1. Criteria for Evaluating Success:

It's crucial to set a clear metric for success post-launch. For instance, if we witness a $50M volume within weeks post-launch, should that be considered a positive outcome? Our evaluation criteria should be multifaceted:

- Asset Diversity

: Depending on the variety of traded assets.

- Market-wide Fluctuations

: Consider the overall changes in perpetual contract volumes across the market.

- Volume Sources Analysis

: Determine the significant contributors to this volume. This would involve observing volume dynamics in both the CeFi and

DeFi sectors. Platforms like dYdX V3 and GMX will be mainly under our radar.

1. Establishing Benchmarks for Niche Assets:

While the current model acknowledges that "Trading Rewards don't effectively boost volume in these markets," we believe there's room for improvement. The proposal is to:

- Analyze Niche Markets

: Understand the dynamics and requirements of niche asset markets.

- Strategize Incentives

: Design and implement actionable strategies that target and bolster volumes in these areas.

1. Strategic Transition from V3 to V4:

We recognize that V3 and V4 are tailored to cater to similar user demographics. With V3 accounting for half of the on-chain perpetual contract volume, it provides insights into potential V4 adoption rates. Our proposal:

- Phased Deprecation of V3

: Strategically phase out V3, ensuring no abrupt disruption for our users.

- Monitor V4 Growth

: Track the growth of V4, particularly emphasizing those assets that consistently augment volume.

- Feedback Loop

: Maintain a continuous feedback mechanism to refine and adjust our strategies based on real-time user responses and market dynamics.

Milestones and Timelines

Pre-Launch Phase: Wash Trading Model Development

Customizing the Chaos Labs Asset Protection and Market Manipulation Tool to monitor trading activity on dYdX V4 and ensure honest actors earn rewards as intended on the platform.

Development Time: 5 weeks

Pre-Launch Phase: V4 Trading Reward Genesis Research

Conducting research, culminating in a Trading Rewards Distribution Framework.

Development Time: 5 weeks

Pre-Launch Phase: V4 Analytics and Risk Portal

Deploying and publically launching the dYdX V4 Analytics and Risk Portal. The portal will be general purpose in nature but allow community members to independently analyze the accounts receiving rewards, increasing transparency and distribution accountability.

Development Time: 8 weeks

Post-Launch Phase: Retroactive V4 Launch Incentive Distribution Report & Proposals

The end of the trading season will result in a Chaos Labs Recommendation set, specifying reward distribution per account. These recommendations will culminate as a governance proposal shared with a Season Trading Analysis report for the community's review.

Post-Launch Phase: Incentive Distribution Ratification

Should the community choose to accept the recommendations, Trading Rewards will be distributed accordingly.

Ask

With this proposal, we request the community's approval to allocate a $20M notional value of $DYDX tokens to the V4

Reward Program.

If community governance approves this program, Chaos Labs will request funding from the DGP to lead the Trading Rewards program. This includes all pillars mentioned above, specifically, research, engineering, and deployment of the dYdX Analytics and Risk Hub, administering trading seasons (epochs), trading analysis reports, reward distribution recommendations per season, government proposals, and ultimately a report to measure the efficacy of the program once it is complete.

1. Research & Engineering:

Comprehensive research, including creating and deploying the dYdX Analytics and Risk Hub.

1. Trading Seasons Administration:

This involves overseeing the trading epochs, ensuring smooth transitions and adherence to proposed strategies.

1. Trading Analysis Reports:

Regular insights and analytics related to trading behaviors, patterns, and potential areas of enhancement.

1. Distribution Recommendations:

Periodic suggestions on reward distribution for each trading season aligned with the broader objectives of the V4 migration.

1. Government Proposals:

Drafting, presenting, and refining proposals that ensure the program's alignment with the community's vision and aspirations.

1. Efficacy Report:

At the conclusion of the program, we commit to delivering a comprehensive report gauging the effectiveness of the Trading Rewards program, highlighting achievements, challenges, and insights for future endeavors.

Next Steps

If this receives support, we will move forward to a signaling snapshot proposal.

Note: The post title has been edited to V4 Launch Incentives Proposal to minimize any confusion with the native on-chain rewards, meant to cover a proportion of user trading fees.

Appendix

Previous dYdX Contributions by Chaos Labs

- [dYdX V3 Parameter Recommendations Portal](#)

- [Permissionless Markets Research](#)

- [dYdX Trader Rewards Calculators](#)

- [dYdX V3 Asset Listing Portal](#)

- [dYdX Tooling Grant](#)

- [dYdX Trading CLI](#)

- [dYdX Perpetual Funding Rate Application](#)