

title: [TEMP CHECK] Safety Module Upgrade Part II - Asset Diversity, SM Categories & Slashing Updates

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Summary

This publication presents the community the opportunity to discuss Safety Module (SM) upgrades that enhance asset diversification, introduces risk tranching and potential growth synergies.

Abstract

This publication presents the community with the opportunity to expand the assets accepted within the SM. Currently, the SM is overly concentrated in AAVE via direct AAVE staking and ABPT staking which is a Balancer v1 80/20 AAVE/wETH liquidity token.

This publication seeks to explore the community's appetite to diversify the SM asset base and vary the portion of users' funds which can be auctioned in the event of a shortfall. Currently, 30% of user deposits are at risk when depositing into the SM.

Motivation

[@bgdlabs](#) is currently proposing to upgrade the [SM architecture](#) to support the launch of GHO, by enabling stkAAVE holders to access cheaper GHO borrowing rates. Further to this, Llama has kick started the conversation around migrating AAVE liquidity from Balancer v1 to v2 in this [forum post](#).

Several comments relating to the AAVE concentration and auction mechanism have been made on the forum which can be found [here](#), [here](#) and [here](#).

This publication presents three distinct categories for inclusion in the SM.

- Single Asset
- Volatile Asset Liquidity Positions
- Stable Asset Liquidity Positions

The net change to the existing implementation is the introduction of a third category, Stable Asset Liquidity Positions. The existing AAVE and ABPT represent Single Asset and Volatile Asset Liquidity Positions.

Although any Liquidity Provider (LP) position can be included, G-Uni, crvLP, BPT etc... This publication will initially focus on the overarching concept and how BPTs could be integrated.

BPTs were selected due to Aave's relationship with Balancer DAO and the veBAL holding which the community may elect to utilize here. It should be stressed, Aave DAO will elect which assets are to be included and the varying levels of slashing for each category.

Assets considered for inclusion should have minimal counterparty risk and display great on-chain liquidity amongst other considerations such as price correlation with Aave Protocol's TVL during varying market conditions.

Llama proposes three initial asset categories to be created within the SM.

The slashing parameters update aims to reduce the price impact on the AAVE token in the case of a shortfall event. We propose adding different levels of slashing to each category, as follows:

Single Assets

The current single asset, with 30% slashing, is AAVE. This proposal introduces other assets to this category with the goal of reducing the concentration of AAVE inside the insurance fund.

Possible assets for consideration inside the SM Single Asset Category include, not limited to:

- AAVE
- ETH and/or wstETH

If the community elects with the introduction of additional assets other than AAVE, then each asset could be considered individually. This publication retains the 30% slashing feature for Single Asset.

The inclusion of wstETH may attract additional incentives from Lido DAO, therefore Llama prefers having the ability to distribute multiple rewards types with external teams able to distribute their own token. Something similar to the Emission Admin role on Aave v3 will suffice.

Llama preference is for wstETH over wETH due to improved capital efficiency by enabling users to earn an overall higher APY from being a SM depositor. wstETH has become a major trading pairing token on Balancer and it has ample liquidity across various pools to route swaps through. Additionally, the stETH-ETH discount has reduced significantly (0.9938:1 for 100K ETH sold, which also demonstrates [very deep liquidity](#).

Llama would also encourage Lido DAO to indicate any potential support for this type of integration between the two protocols as inclusion in the SM would act to help retain or grow wstETH adoption via the creation of a unique use case for wstETH relative to other LSTs.

Max slashing proposed: 30% retained for single assets.

Initial assets proposed: AAVE / ETH and/or stETH

Risks Considerations

If LSTs (such as wstETH) are included in the SM, it creates a price divergence risk which, if sustained, can reduce the cover in the SM and create an unfair distribution of the rewards between ETH & wstETH. Post redemption the main risk consideration for LSTs becomes counterparty risk which if it materialized would lead to a significant discount to the LST price in ETH terms.

- To limit the de-peg risk, the SM could stop incentivizing below a defined ratio, so the total value would then be deduced from the total cover value. This acts to mitigate counterparty risk without requiring governance intervention.

Based upon technical feedback relating to the ease of implementation, Llama may revise this section of the publication.

Volatile Liquidity Provider Tokens

In addition to the replacement pool for the 80/20 AAVE/wETH pool on Balancer v1, to be determined by an earlier publication. This publication presents two other pools of strategic importance to Aave DAO for inclusion in the SM.

This publication presents the prospect of creating an 80/20 GHO/wETH (or wstETH) which offers less impermanent loss than a 50/50 pool whilst also providing very deep liquidity for risk off events which see spikes in stable coin swap volumes which can often lead to stable coins trading above \$1.

For the following categories, up to 75% of the current budget could be allocated.

Max slashing proposed 45% for volatile BPTs

Initial volatile BPTs proposed: B-80AAVE-20wstETH (or Part I proposal results) & B-80GHO-20WETH

Even if not yet created, this is probably the most interesting addition to this category as the trading volume of this pool will generate an important yield for LPs. The second pool could also be converted into a [Balancer Core Pool](#) by replacing ETH by IBTs as described in Part I.

Stable Liquidity Provider Tokens

In this third category, this publication presents an initial pool consisting of the [Balancer3pool](#) and GHO. Like other categories, in the future, additional assets can be added. If the community elects to launch BB-A-USD/GHO on Balancer or a stable coin pool on Curve, then this section can pivot to include the Curve pool.

Max slashing proposed: 60% for stable

Initial Stable BPT proposed: B-3Pool/GHO

This pool introduces a stable asset to the SM design and generates a significant amount of the coverage as 60% of the TVL can be slashed with very low price impact across the broader ecosystem. This is especially the case if something like Cowswap's auction mechanism was to feature in the new SM auction mechanism.

By integrating a GHO pair to the SM, Aave is essentially helping bootstrapping GHO adoptions through incentivised liquidity. Aave will also earn revenue from the GHO borrowing rate.

If the community elects to proceed with 3CRV/GHO, then this would increase the SM smart contract surface area through diversifying exposure concentration away from Balancer to include Cuve Finance and potentially Convex Finance risk as

well.

There is also the option of adding additional pools which could include GHO, MAI, LUSD, FRAX and others once live like crvUSD etc...

This proposal can be implemented independently from the following parts. In this case, "classic" gauges would be advised. Otherwise, the strategy & smBPT gauges discussions will be outlined & discussed in Part III.

Technical Specifications:

- Remove the BPT 80/20 from the current main module (30% slashing)
- Deploy two other modules on the SM for the new categories (45% & 60% slashing)
- Implement the new assets voted on Part II for the new categories
- Create the new pools depending on vote results

Voting Options

YAE - Implement Changes

NAE- Rework Proposal

ABSTAIN

Disclaimer

The Llama is not compensated by any of the mentioned communities outside of Aave.

Llama is an unpaid delegate within the Balancer ecosystem.

Members who contributed to this proposal are not angel investors or advisors to any of the mentioned communities but some do hold small holdings in those communities tokens.

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References

1. [\[TEMP CHECK\] Safety Module Update Part I - Migrate AAVE/wETH Balancer v1 Pool to Balancer v2](#)
2. [\[TEMP CHECK\] Safety Module Upgrade Part II - Asset Diversity, SM Categories & Slashing Updates](#)
3. [\[TEMP CHECK\] Safety Module Upgrade Part III - Enable gauges on BPT in Safety Module \(smBPT\)](#)
4. [\[TEMP CHECK\] Safety Module Upgrade Part IV - Incentives Management Upgrade](#)
5. [\[TEMP CHECK\] Safety Module Upgrade Part V - veToken Holding Management Framework](#)
6. [\[TEMP CHECK\] Safety Module Upgrade Part VI - Future considerations](#)