[ARC] Ethereum v2 Reserve Factor - aFEI Holding Update

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Simple Summary

In response to Tribe DAO's proposal to enter a terminal state, this ARC proposes redeeming all aFEI for FEI and exchanging it for DAI.

Abstract

The Aave DAO currently holds around 619,185.82 units of aFEI in the Ethereum Reserve Factor. Due to the uncertainty around the future of Tribe DAO and FEI, this proposal presents the community the opportunity to reduce exposure to the FEI stablecoin.

If other lenders move to redeem aFEI for FEI before Aave DAO acts, then there is a risk that Aave DAO becomes trapped as a lender of last resort. Due to this risk, this proposal strongly encourages the DAO to redeem aFEI for FEI as an immediate priority.

After redeeming the aFEI for FEI, risk can be further reduced by redeeming or swapping the FEI holding for a stablecoin with a more certain future. In this proposal, we suggest redeeming the FEI for DAI via the Tribe DAO Peg Stability Module which will incur a 0.03% fee.

Motivation

The FEI lending market is a concentrated market with three main providers of liquidity. Tribe DAO, Aave DAO and Badger DAO make up the top three liquidity providers by providing 88.76%, 5.47% and 2.72% respectively. Fei Labs has proposed redeeming all aFEI for FEI which will remove 10,067,143.35 units of FEI from the lending market. However, there are only 9,033,330.80 units of FEI held within the lending market.

Fei Labs is unable to withdraw all of its FEI as there is insufficient liquidity, redeem amount 10,067,143.35 > available liquidity 9,033,330.80. This is a problem for Fei Labs and also other lenders.

The market currently supports 11,308,536.17 units of aFEI, with 2,275,205.37 units of debt and 9,033,330.80 units available for lenders to redeem their collateral from or for Users to borrow. Any User seeking to claim 9,033,330.80 or less is able to do so now, but this may change very quickly when Fei Labs or others starts redeeming aFEI causing liquidity to diminish.

Aave DAO has 619,185.82 units of aFEI at risk of being caught in an illiquid position. If the FEI held within the lending market falls below 619,185.82 units before Aave DAO redeems its position, it will become a trapped lender until such time as borrowers repay their loans. It is likely that as this market is unwound by large liquidity providers redeem aFEI, that the utilisation and interest rate will increase, which hopefully triggering borrowers to repay loans.

This proposal has been put in motion to try to prevent Aave DAO becoming a trapped lender in the FEI market by redeeming its aFEI before liquidity dries up. We encourage all Users of the market to take responsible action in light of recent events.

Once the aFEI has been redeemed for FEI, it is to be redeemed for DAI. Tribe DAO offers a DAI PSM with a 0.03% fee that facilitates redeeming FEI for DAI. This is a simple solution and one supported by the Tribe DAO community as part of the transition to a terminal state. The DAI PSM module has around $14.5M of liquidity at the time of writing and can be tracked here. In the event that redeeming FEI for DAI runs into any issues, FEI will be sold on market to DAI via a bonding curve. There is a bonding curve at peer review stage for swapping USDC for BAL which can be amended to facilitate offloading FEI into the spot market. We will provide updates in the comments as the situation unfolds.

Specification

The below provides a broad, high level summary of how the aFEI position held within the Reserve Factor will be managed.

- All of the aFEI held with the Ethereum Economic Reserve is to be redeemed for FEI.

- All FEI will be redeemed for DAI via the Tribe DAO DAI PSM

- If any issue arises, FEI will be sold on market to DAI via a bonding curve

- If any issue arises, FEI will be sold on market to DAI via a bonding curve

- DAI will be held in the Ethereum Reserve Factor

Next Steps

The next step for this ARC is after a period of discussion of at least 5 days to publish a governance snapshot vote at the earliest 25th August 2022

, with YAE / NAY / ABSTAIN options and in the case of YAE majority publish an AIP to proceed as outlined above at the earliest possible date 29th August 2022

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If we can move quicker than the proposed dates above, please do let reach out.

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