@eek637 from the UF asked me to start a discussion on protocol fees and V4 afterthis post. The conversation the last few years has revolved on 1) whether the DAO should activate the fee switch, 2) which pools should charge fees, and 3) what share of LP fees the protocol should take.

With the V4 code now public, I think this conversation is no longer relevant. The fee switch token model could always be described as rent-seeking – if activated, token holders would add no incremental value to the protocol but would now be extracting value from other participants. In V4, the token model is also unenforceable, making the whole discussion moot.

I wrote more about this here (tweets 38-48):https://twitter.com/mjayceee/status/1673394949188976642?s=20

The protocol has gotten better and better, while the token has gotten worse and worse. This is before even considering that the lawyers at Uniswap and its investors are very unlikely to allow the fee switch to be activated, at least until there is more regulatory clarity. We could easily be on Uniswap V7 at that point.

I'm proposing a completely new UNI token model below. It requires no changes to the core protocol. It also may be more defensible from a regulatory perspective. I think it makes a lot of sense, but it also may not work. Still, I think it's worth a shot while the token is still worth something.

Where can $UNI add value?

While Uniswap currently dominates on blue chip pairs, the true magic of the XYK model is the ease with which it creates markets for long-tail assets. The expressivity of V4 is a great step towards defending Uniswap's blue chip dominance onchain, but it's an open question whether algorithmic models like XYK can beat out conventional order books over the long term for markets with deep liquidity.

Without neglecting the blue chips, a new UNI token model should lean into Uniswap's importance to the long tail of liquidity pools. Right now, most long-tail assets pair with ETH. This has been the logical standard for a long time, for a variety of reasons.

The problem with this is that ETH has an increasingly high opportunity cost. With staking, it's about 4%. With re-staking on the horizon, it may go higher. ETH is too precious at this point to be the go-to asset pair for shitcoins.

There is an opening here for UNI – a token with essentially zero opportunity cost – to supplant ETH as the asset pair of choice. UNI can serve as the liquidity connector and hub, linking an extensive portfolio of long-tail assets.

If this sounds like the Bancor V1 token model, that's because it basically is. But UNI has advantages that BNT never did. First, Uniswap is the preeminent DEX in a far more mature ecosystem, doing billions in volume. Second, UNI has a scale and market cap that BNT never had. Third, projects would be using UNI as a pair asset because it benefits them, not because it's imposed by the protocol.

UNI also brings the advantage of being more correlated to long tail assets than ETH is, meaning UNI pairs are less susceptible to impermanent loss.

Bringing this section together, UNI is preferable to ETH in terms of both opportunity cost (staking yield) and capital risk (impermanent loss exposure).

How would this work?

The transition from V2/3 to V4 may take a long time, but the clean slate of V4 is the perfect opportunity to enact an initiative like this. I'm proposing a two part plan to transform UNI from a mostly useless governance token into a focal part of the protocol it represents. The two parts

complement each other, with the goal of bootstrapping a new sustainable token model where UNI is the primary asset pair on Uniswap.

Part 1: The Uniswap Credit Facility

Before UNI can supplant ETH, it has to be much more accessible to liquidity providers. UNI currently has a limited presence on lending platforms. There isn't much demand to borrow UNI right now, so it's not a big deal. But for UNI to make a play as the base pair, it needs to be extremely cheap to borrow at scale.

Increasing UNI available on an external lending platform like Aave would be a step in the right direction. However, V4 hooks provide the foundation to build a much cleaner and more efficient solution.

The UNI Credit Facility (UCF) is a hook that allows LPs to borrow UNI for liquidity positions. It's more capital efficient than Aave in all cases, ranging from 1x to infinitely more. It requires no capital up-front, as borrowers only need to collateralize the deficit in their position if the pair token loses value against UNI.

Basic points:

- Hook provides UNI required for a liquidity position as needed
- UCF only requires LP to collateralize the deficit relative to the initial borrow, though in practice there will need to be a small up-front min collateral deposit
- Full initial UNI borrow is restored to UCF when liquidity position is closed

There's a scenario analysis with all the math at the bottom of this post. XYK math is tricky and some of these outputs won't seem intuitive on reading them. There's also a chance I got it wrong, but the larger points hold.

Basic example:

- Potential LP has $100 of SCOIN and needs $100 of UNI
- Via credit facility, LP borrows $100 of UNI to be immediately deposited with the SCOIN
- LP provides $20 in collateral as a buffer, as deficit needs to be backed by 120% LTV, even though there is no deficit at deposit time (XYK dictates that a token deficit only occurs if pair token loses value against UNI)
- SCOIN price drops by 25% relative to UNI (while UNI remains stable in $ terms), decreasing value of UNI side of position from $100 to $87
- LP now owes a debt of $13 but is still safe from liquidation with $20 of collateral (154% collat. ratio)
- LP pays down $13 of debt to close liquidity position and retrieve collateral

Uniswap Governance should seed the UCF with 100 million UNI and set the borrow rate for UNI to 0% for the foreseeable future.

Even at 0%, there are two ways that value accrues to token holders in this design. First, easy credit promotes UNI's role in liquidity markets, increasing demand for the token. Second, the UCF should be able to take a configurable share of the UNI side of swap fees generated by the hook's positions, thereby removing tokens from circulation over time.

In terms of dependencies, all that is required is a UNI oracle and an oracle for any collaterals. These can be configured safely within the Uniswap ecosystem. For the sake of simplicity, it might make sense to start with only ETH as collateral, even if it forgoes some of the reclaimed opportunity cost (staking yield).

The UCF might end up more like a B2B tool, rather than a retail lending platform. I won't get too deep into the technicals, but it may be difficult to ensure the solvency of many positions in one hook, meaning it'll probably need to be one position per hook/pool. That's fine - the UCF as a capital efficient, non-dilutive alternative to liquidity mining could be a boon to the protocol and token.

Part 2: A lot of incentives

This part is more straightforward. Armed with this new credit infrastructure, Uniswap should run small incentives/co-incentives programs with hundreds and hundreds of projects. Finding and allocating to this many worthy and unworthy projects is hard and it might not be perfectly fair, but an ambitious bootstrap period would go a long way towards getting this new model off the ground.

As with all token incentives, there will definitely be some dumping. But the treasury is worth $2b and there are currently no reasonable ways to use nearly that much money. If this works – and UNI effectively becomes an index for the long tail of tokens – the treasury could one day be worth much much more. It's a risky move for a conservative community, but there is a clear, attainable goal.

Presumably V4 (and the UCF) will be deployed on multiple chains, so these incentives would have a wide canvas to make an impact. Whoever ends up allocating these incentives - whether a DAO committee, the Foundation or the core team – would need to be accountable to the community while maintaining some latitude to do a difficult job.

It's not going to be easy, but Uniswap may be the only project in the space with the gravity to dislodge ETH as the base pair.

Closing Thoughts

This is just the first version of this proposal. There are probably holes in the design I haven't considered and potential additions that could improve the model. I have a bunch of other thoughts on the financial implications and derivatives of this model, but I think it's better to open it up to community feedback for now.

One final point: implementing this token model would require a high level of support and coordination from/between many stakeholders. While the UCF would need to be approved by governance, UNI would still have no privileged role within the Uniswap protocol. This might be the first attempt at a "social" token model, meaning the token derives value from coordination, not protocol-enforced tokenomics. While UNI makes sense thematically as the new base asset for Uniswap

LPs, PEPE would work almost as well.

Looking forward to hearing questions or feedback from the community. If there is enough interest and engagement, I'll prepare a more formal proposal in the coming weeks.

Math

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