

MIP119: Onboard DAI Funds to the Flux Finance DAI Lending Pool

Preamble

MIP#: 119 Title: Onboard DAI Funds to the Flux Finance DAI Lending Pool Author(s): Flux Finance Contributors: Tags: D3M Type: General Status: Obsolete Date Proposed: 2023-02-21 Date Ratified: N/A Dependencies: Replaces: N/A Forum URL: <https://forum.makerdao.com/t/mip119-onboard-dai-funds-to-the-flux-finance-dai-lending-pool/19885> Ratification Poll URL: Extra: This MIP has been made obsolete by the passage of MIP102c2-SP1.

Sentence Summary

Flux Finance proposes a D3M of 500MM into the Flux Finance DAI Lending Pool in order for MakerDAO ("Maker") to earn yield over-collateralized by tokenized US Treasuries.

Paragraph Summary

MIP119 is a proposal to onboard and activate a DAI 500MM vault that lends DAI to the Flux Finance DAI Lending Pool. Flux Finance is a decentralized lending protocol developed by Ondo Finance that enables over-collateralized lending and borrowing in a peer-to-pool model. The protocol is a fork of [Compound V2](#) with minor modifications related to permissioning that have been audited through code4rena. Loans on Flux are overcollateralized by the [Ondo Short-Term US Government Bond Fund \(OUSG\)](#), a class of limited partnership interests in Ondo I LP, a Delaware limited partnership. OUSG is backed by investments in the [Blackrock iShares Short Treasury Bond ETF \(SHV\)](#) and uses third-party regulated service providers for custody, fund administration, and auditing. This proposal begins by providing an overview of Ondo entities and the structure of OUSG before turning to Flux and its DAI Lending Pool.

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Component Summary

MIP119c1: Ondo Finance and Ondo I LP

MIP119c2: Flux Finance and Ondo DAO

MIP119c3: Flux Market Parameters

MIP119c4: Vault Deployment, Integrations and Migrations

MIP119c5: Fees

Motivation

MIP119 achieves the following goals for Maker:

- Generates significant on-chain yield for Maker

in a lending pool, targeting a yield paid on borrowed DAI of OBFR (currently >4.5%) - 50 bps, thereby supporting the Endgame Plan

- Protects the collateralization of DAI
- Flux is over-collateralized with very low risk collateral, a tokenized limited partnership interest backed by the Blackrock iShares Short Treasury Bond ETF, a short-term US Treasuries exchange traded fund
- Flux is a fork of Compound v2, a battle tested protocol, with minimal changes related to permissioning that have been reviewed by code4rena
- Flux is over-collateralized with very low risk collateral, a tokenized limited partnership interest backed by the Blackrock iShares Short Treasury Bond ETF, a short-term US Treasuries exchange traded fund

- Flux is a fork of Compound v2, a battle tested protocol, with minimal changes related to permissioning that have been reviewed by code4rena
- Promotes the utility of DAI

, establishing it as the most liquid asset lent into what is effectively an on-chain Treasuries repo market, giving tokenized Treasuries holders the ability to quickly access and repay loans for working capital * fDAI, a receipt of DAI lent on Flux and backed by tokenized Treasuries, can be transferred permissionlessly and used as collateral throughout DeFi, benefiting Maker as new fDAI investors drive demand to DAI, some of which is held on Flux unutilized

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Specification / Proposal Details

MIP119c1: Ondo Finance and Ondo I LP

[Ondo Finance](#) is a blockchain services company with a technology arm that develops decentralized finance technology and an asset management arm that creates and manages tokenized funds. Ondo Finance was founded in 2021 by Nathan Allman and raised \$24 million to date. Its investors include Pantera Capital, Founders Fund, Coinbase Ventures, and Tiger Global. The Ondo Finance executive team has diverse experience across leading institutions like Goldman Sachs, Fortress, Bridgewater, and MakerDAO.

Ondo Finance fully owns Ondo I GP (the general partner of Ondo I LP) and Ondo Capital Management LLC (the investment manager) (as applicable, “Ondo”), which manage or provide certain other services to Ondo I LP (the “Fund”), the issuer of OUSG. The Fund is a Delaware limited partnership that holds its assets at Clear Street, a prime broker and qualified custodian, and Coinbase Prime. Ondo I LP also receives third-party fund administration from NAV Consulting and will receive an annual audit.

Ondo Leadership Team

Nathan Allman ([Nathan Allman](#)):

Nathan is the Founder and Chief Executive Officer at Ondo Finance. He previously worked at Goldman Sachs, a multinational investment bank and financial services company, on the Digital Assets team. He also has a background in private credit investing at Prospect Capital Management. Nathan has an A.B. from Brown University.

Eric Rapp ([Eumenes](#)):

Eric is the Director of Structuring at Ondo Finance. Prior to joining Ondo in 2021, he has contributed at MakerDAO, a decentralized global reserve stable coin protocol that resides on the Ethereum blockchain; Fortress Investment Group, LLC, an investment management firm based in New York City; DBRS Morningstar, a global credit rating agency; and the KCK Group LLC, an investment management firm based in New York. He has a M.B.A. from the University of Chicago, a B.A. from Columbia College and attended the PhD Economics Program at Northwestern University.

Brendan Florez ([Brendan Florez](#)):

Brendan is the Director of Operations at Ondo Finance. Prior to joining Ondo, he held prior roles as Managing Director and Head of Portfolio Operations for a Missouri-based family office, Senior Relationship Manager at Bridgewater Associates, Founder and CEO of Base Capital (a fintech focused on student finance before being acquired by Stride Funding), and President & COO of Polyera (a semiconductor startup before being acquired by a subsidiary of SAES Getters.) He is an active angel investor and a Venture Partner at Purpose Built Studios (a venture studio) and has a degree in Electrical Engineering from Princeton University.

Fund Service Providers

The Fund engages regulated third-party service providers in accordance with best practices for fund management. Clear Street is the qualified custodian and broker for the Fund’s ETFs, NAV Consulting performs third-party administration services including a daily calculation of the Fund’s net asset value, and Coinbase helps to process stablecoin subscriptions and redemptions by custodialing small stablecoin balances and converting stablecoins to USD and back.

[Clear Street](#) is building modern infrastructure for capital markets. Founded in 2018 by industry veterans, Clear Street is an independent, non-bank prime broker working to solve the industry’s most neglected problem: legacy technology. The firm has built a proprietary, cloud-native, clearing and custody system to replace the legacy infrastructure used across capital markets – improving speed, access, and service for its clients. Clear Street’s first product is its equity finance platform, which processes more than \$10 billion in trades every day. The firm’s goal is to create a single-source platform to serve all investor types, across all asset classes, globally.

[NAV Consulting, Inc](#) is a fund administrator owned by the NAV Fund Administration Group. NAV Fund Administration Group is an international, privately owned fund administrator with a strong reputation for cost-effective and reliable fund administration solutions. NAV has achieved more than 30 years of year-over-year growth primarily via client referrals and maintains a remarkable 99% client retention rate. They are among the top global hedge fund administrators by number of funds, servicing more than \$180 billion assets under administration.

[Coinbase Prime](#) is an integrated solution that provides secure custody, an advanced trading platform, and prime services so you can manage your crypto assets in one place. Coinbase Prime is offered by Coinbase, which was founded in 2012. Coinbase has approximately 108 million verified users and 245,000 ecosystem partners in over 100 countries who trust Coinbase to easily and securely invest, spend, save, earn, and use crypto.

OUSG Transaction Diagram

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1. Ondo Finance wholly owns the Investment Manager and GP
2. The Investment Manager is responsible for the purchase and sale of ETFs
3. The GP acts as the General Partner of the Fund
4. OUSG Investors send stablecoins to the Fund's Coinbase account, purchasing OUSG tokens, which the Fund sends to the OUSG Investors
5. The Fund has engaged Coinbase to hold stablecoins, convert stablecoins to USD, and wire funds to Clear Street, as directed by the Investment Manager
6. The Fund has engaged Clear Street for prime brokerage services and utilizes Clear Street to hold and trade assets
7. The Investment Manager instructs Clear Street (CS), which executes trades, clears, and custodies the Fund's assets in the Fund's CS Account

Ondo I LP

On Feb 2, 2023, Ondo launched Ondo I LP (the "Fund") and its Ondo Short-Term US Government Bond Fund limited partnership class (OUSG). The Fund enables stablecoin holders to gain exposure to the Blackrock iShares Short Treasury Bond ETF (SHV) by investing in a tokenized bond fund that provides daily liquidity. OUSG is a total return fund that automatically reinvests dividends paid out by SHV.

The Fund currently accepts USDC and DAI but could accept other stablecoins at the GP's discretion. The OUSG limited partnership class holds one primary asset, [Blackrock/iShares Short Treasury Bond ETF \(SHV\)](#), plus a small quantity of stablecoins and cash for processing during subscriptions and redemptions. SHV is a liquid, exchange traded (NASDAQ) ETF with approximately \$19 billion in assets and averages almost \$300 million in daily trading volume.

OUSG is currently the only share class in the Fund, but others are anticipated, specifically OSTB and OHYG, which will each invest in a single Blackrock or PIMCO ETF. The market risks of the holdings in each share class do not impact the other share classes as the fund is not using leverage. If the investments of OSTB and OHYG both go to zero, investors in OUSG are unaffected.

OUSG limited partnership interests are issued as tokens ("Tokens") on the Ethereum blockchain. OUSG can be minted (i.e. subscribed to) and redeemed on any US business day (excluding federal holidays). Subscriptions and redemptions are processed based on the next daily NAV as calculated by the fund administrator, NAV Consulting, Inc. Ondo anticipates redemptions to take up to 2-3 business days to settle (for an investor to receive their stablecoins/USD) if the fund does not have sufficient stablecoins or USD on hand to service the redemption immediately, as it takes two business days to access dollars and then stablecoins from the sale of the ETFs.

NAV Consulting has read-only API access to the Fund's accounts, which are at Coinbase and Clear Street. On a daily basis, NAV Consulting calculates the NAV per Token as follows:

1. sum the current value of all the fund assets (SHV shares, cash, and stablecoins)
2. subtract accrued fund expenses and management fees, and
3. divide by the number of Tokens outstanding

Ondo updates the contract price for OUSG daily using the calculation provided by NAV Consulting. You can read more

about this process in the “Flow of Funds and Operational Controls” section below. NAV Consulting also reports the NAV on a monthly basis directly to all OUSG investors. Expenses and management fees are capped at a combined 30 bps, as we explain below in “MIP119c5: Fees”.

OUSG is available to both US and non-US investors. Potential investors are required to pass KYC/AML/CFT screening and be both “accredited investors” and “qualified purchasers” under Rule 501(a) promulgated under the Securities Act of 1933, as amended, and under Section 2(a)(51) of the Investment Company Act of 1940, as amended, respectively. Permitted Token holders may redeem their Tokens daily and also may transfer their Tokens on-chain to other permitted investors. Ondo uses smart contracts to enforce these transfer restrictions.

Though withholding tax applies to certain types of income for non-US investors (not US investors), Ondo has agreed to pay all investor withholding taxes on behalf of the Fund. Moreover, the vast majority of income generated by OUSG (~97% for the trailing twelve months) is exempt from withholding taxes, as it is [Qualified Interest Income \(QII\)](#), resulting in a very low withholding tax burden.

Flow of Funds and Operational Controls

Ondo manages the flow of funds between the blockchain, the Fund’s accounts at Coinbase Prime, and the Fund’s brokerage account at Clear Street. Coinbase Prime acts as an intermediary that converts investor funds between stablecoins and US dollars, while the Clear Street accounts are where the SHV ETFs are purchased, sold, and custodied. The brokerage accounts (at both Coinbase Prime and Clear Street) are opened in the name of the Fund. Ondo implements strict operational controls with industry-leading security mechanisms for smart contract and fund management.

On the blockchain, Ondo uses Gnosis Safe multisig contracts configured to require three signers for the execution of smart contract management or token transfer actions. Each participant in the multisig is an employee of Ondo and is required to utilize a hardware wallet.

Ondo uses the following permitted multisig contracts for their respective listed capabilities:

[Ondo Cash Management Multisig:](#)

- Configure minimum redemption and subscription amounts on the CashManager contract.
- Configure rate limiter parameters on the CashManager contract. (i.e. what quantity of subscriptions and redemptions can be serviced in a single day)
- Configure fee recipients on the CashManager contract (fees are currently turned off).
- Set exchange rates for the minting of OUSG.
- Mint OUSG to service subscriptions.
- Pause functionality on the CashManager contract in the event of an emergency
- Burn OUSG in the event of an emergency.
- Upgrade the OUSG implementation contract in the event of an emergency.
- Execute a multicall function in the CashManager contract for the scenario in which a user accidentally transfers tokens to the CashManager contract.

[Ondo Redemption Multisig:](#)

- Can send stablecoins it has possession of through the CashManager contract to service redemptions.

Please note that Ondo uses role-based access control (RBAC) in its smart contracts and reserves the right to deploy additional multisigs to utilize a more secure and granular RBAC scheme.

Ondo has worked with Coinbase to establish security policies that minimize employee access to the Fund operations and accounts. In order to perform critical actions on the account, a consensus of three employees must be reached and validated by each employee’s respective Yubikey hardware authentication device. These critical actions include adding trusted withdrawal blockchain addresses, transferring funds on the blockchain or between Fund accounts, and changing user access levels. For withdrawals of a notional value larger than \$500,000 the consensus requirement increases to four employees. All consensus configuration changes require a consensus of three employees and a video call with a Coinbase representative.

The Fund accounts at Coinbase are only permitted to send US dollar wire transfers to the Fund’s accounts at Clear Street. The Clear Street account wires are sent and received through its bank, BMO Harris, while Coinbase wires are sent and received through its bank, Silvergate Bank. It is not possible for the Fund to “fat finger” a wire to another account. In order to get another account approved to receive a wire transfer, the Fund would have to first receive a wire transfer from that bank account to the Fund’s Coinbase account, and then work with a Coinbase representative to configure the bank as a trusted

withdrawal destination.

With respect to the Fund's brokerage account at Clear Street, Ondo employees only have read-only permissions to the Clear Street portal. All money transfers and trades are instructed over electronic communication channels and are strictly confined to sending (or receiving) money via wire to (from) the Fund's Coinbase Prime account or purchasing and selling the SHV ETF. In order for a new bank account to be approved as a new destination for outgoing wire transfers, the following criteria must be met:

1. One of the Fund's authorized personnel has to ask for the new account to be added over email.
2. The new bank account must be under the "Ondo I LP" name.
3. The authorized person must give verbal confirmation on a phone call with a representative from Clear Street.

Legal Documents

The OUSG subscription docs, limited partnership agreement (LPA), and private placement memorandum (PPM) are available [here](#). You can find detailed risk factors on the offering in the PPM.

MIP119c2: Flux Finance Overview and Ondo DAO

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Flux Finance: Permissionless Lending Meets Permissioned Collateral

[Flux Finance](#) (Flux) is a special purpose lending protocol facilitating stablecoin loans against tokenized US Treasuries collateral. Flux is similar to Treasury repo markets, where large institutions effectively lend and borrow over-collateralized against Treasuries. Flux is designed to deliver Treasuries-backed yield in a highly liquid form on-chain. Flux was developed by Ondo and is now owned by Flux Finance, a British Virgin Islands business company and wholly owned subsidiary of Neptune Development Foundation, a Cayman Islands foundation company. Flux is an autonomous protocol on the Ethereum blockchain with certain upgrades governed by the [Ondo DAO](#).

Flux is a fork of Compound V2, with minimal modifications to enable support for assets that have transfer restrictions, such as OUSG. Just like Compound, Flux follows a peer-to-pool model and is designed to always quote a lend and borrow rate based on supply and demand.

Lenders can supply stablecoins (currently DAI and USDC) to earn yield, while borrowers can pledge tokenized Treasuries as collateral. The tokenized Treasuries supported are in the form of OUSG (discussed above).

Flux Governance

As part of the Ondo DAO, ONDO token holders have the ability to modify certain economic parameters of Flux through on-chain governance proposals. The Ondo DAO is a fork of Compound's Governor Bravo. There is a three day voting period and a one day timelock. Voting power is based on ONDO token ownership, and token holders can delegate their voting power to other wallets.

You can read more about the Ondo DAO and its parameters at the following link:[The Ondo DAO | Flux Finance Docs](#)

Tally maintains a front-end where ONDO token holders can participate in DAO votes at the following link:[Tally | Ondo DAO](#)

Flux Diagram, including OUSG origination at Ondo and borrowing DAI via Flux

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How Flux Works

You can access documentation on Flux at the following link:<https://docs.fluxfinance.com/>

You can also read the most relevant details below.

fTokens

Users supply assets into Flux to mint fTokens, ERC-20 tokens representing balances on the protocol. For example, a user can supply DAI into Flux to mint fDAI. Some supplied assets are lendable by the protocol and earn the user interest in return. In the case of DAI, the user would earn Flux's DAI supply rate.

fTokens are a fork of [Compound V2's cTokens](#), enhanced with additional functionality to support permissioned assets and their transfer restrictions. For example, fOUSG can only be transferred to addresses that are permitted to hold OUSG. Note that fDAI can be transferred permissionlessly, just like DAI.

Lending

Users can become lenders by supplying assets to mint fTokens. The interest earned by the protocol isn't distributed; instead, the exchange rate for fTokens increases, and users will be able to redeem more assets over time as interest is earned. The interest rate earned by lenders (supply rate) fluctuates and depends on the market's utilization (i.e. the percentage of supplied assets that has been borrowed).

Borrowing

Flux is an over-collateralized lending protocol. Borrowers must provide collateral worth more than the debt to guarantee an incentive to repay it. Each asset has an associated collateral ratio, i.e. the share of its value that can be borrowed. Assets with zero collateral ratio can't be used as collateral. Borrowers can use fTokens as collateral to borrow other assets.

The borrow rate for an asset fluctuates based on its utilization (i.e. the percentage of the asset's pool that has been borrowed). The borrow rate increases as utilization increases, balancing supply and demand for a given asset. The borrow rate increases sharply once utilization surpasses a threshold ('kink'), incentivizing borrowers to repay some of the debt to maintain enough liquidity for lenders. If an account's liquidity (i.e. the aggregate collateral factor of its assets) becomes negative, this account becomes liquidatable and might incur a small liquidation fee.

Liquidation

A borrower's collateral should always be worth more than the borrowed balance to ensure the protocol and its lenders suffer no losses. Liquidations should be rare on Flux, particularly for high quality Treasury-backed collateral such as OUSG. However, in certain extreme scenarios, a borrower's equity can become too low and the account might need to be liquidated: some of its collateral is sold off to pay back the debt. Third-party liquidators are incentivized to take on this role by being able to buy the collateral at a small discount compared to the oracle price.

Liquidations on Flux are very similar to [liquidations on Compound V2](#).

An account becomes subject to liquidation when its liquidity (i.e. the aggregate collateral factor of its assets) becomes negative. At that point, a third-party liquidator will be able to pay off some of the borrower's debt and seize the corresponding collateral at a small discount. The protocol will also collect a small piece of the collateral and add it to its reserves.

However, unlike on Compound, liquidations on Flux respect the underlying asset's permissions (e.g. KYC). For example, to liquidate an account using OUSG as collateral, the liquidator must be KYC'd and whitelisted to hold that token.

Additionally, as a safety mechanism, Flux's oracles never price stablecoins at more than 1 USD, reducing the risk of external oracle manipulation (e.g. to prevent a borrower from being liquidated due to a manipulation upwards in the price of a stablecoin).

Bad Debt Accrual

Bad debt accrual should be extremely unlikely on Flux since its assets, tokenized Treasuries, are generally very stable. The greatest weekly move ever in SHV, the short-term Treasuries ETF that OUSG invests into, is less than 0.5% since its inception in 2007. Considering that liquidations of loans against OUSG begin at 92% LTV, this provides a tremendous margin of safety to lenders on Flux.

MIP119c3: Flux Market Parameters

Lending Asset Parameters: DAI and USDC

- Interest rate curve:
- 0% utilization → 0% APY
- 90% utilization (kink) → Overnight Bank Funding Rate (OBFR) - 50 bps*
- 100% utilization → OBFR + 300bps

- 0% utilization → 0% APY
- 90% utilization (kink) → Overnight Bank Funding Rate (OBFR) - 50 bps*
- 100% utilization → OBFR + 300bps
- Collateral Factor (LTV): 0**
- Borrow Cap: No cap
- ProtocolSeizeShare: 1.75% (Compound V2 uses 2.8%)
- This is how much of seized collateral during a liquidation is added to reserves.
- This is how much of seized collateral during a liquidation is added to reserves.

*A multisig controlled by Flux Finance (the BVI company) will, for the time being, update the nominal “borrow rate at kink” if and when OBFR moves by more than 5 bps, until a third-party oracle for OBFR can be obtained (e.g. from Chainlink). See “Flux Finance Multisig Operations”

below for an overview of Flux multisig controls and operational safeguards.

**There is a pending proposal to set the collateral factor for all assets other than OUSG to 0, accessible here [\[FIP-01\] Adding USDT Support: Setting Stablecoin Collateral Factor to 0% - Governance Proposals - Flux Finance Governance Forum](#)

You can visualize the fDAI curve at current market rates below (accessible at [Flux Finance](#)):

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Borrowing Asset Parameters: OUSG

- Interest Rate Curve: Not a borrowable asset, so N/A
- Collateral Factor (LTV): 92%
- Borrow Cap: Not a borrowable asset, so not applicable
- ProtocolSeizeShare: Not a borrowable asset, so N/A (0%)

Miscellaneous Parameters

- Reserve Factor: 0%
- Liquidation Incentive: 5%

Flux Finance Multisig Operations

Flux utilizes a Gnosis Safe multisig contract that is configured to require three signers for the execution of smart contract management functions. Each participant in the following multisig is an employee of Flux Finance (a BVI company) and is required to utilize a hardware wallet. The multisig can be found at this [address](#).

The “Flux Governance” multisig has the permissioned owner role of the oracle contract used by the Flux lending market, the interest rate model contract, and OracleSafetyWrapper. It has the capability to perform the following functions for the respective Contracts:

[InterestRateModel \(a.k.a JumpRateModel\) Contract:](#)

- Change the owner of this contract
- Change the interest rate model (see above section titled “OBFR” for more)

[OndoPriceOracleV2:](#)

- Configure new “fan out” oracle associations. For example, having the oracle use Compound’s price oracle for pricing USDC, or a Chainlink oracle for a different stablecoin

- Configure a price cap in which the oracle will not return a price higher than for a specific fToken's underlying asset
- Set the price of an fToken's underlying asset directly

To prevent operational mistakes, the OndoPriceOracleV2 contract's price setting functionality is wrapped with some basic checks to limit the amount that the price can change in-between price setting transactions. The Flux Finance multisig can set a change tolerance constraint in basis points. The initial tolerance constraint set is 200 basis points, or 2%. The OracleSafetyWrapper contract can be found [here](#).

MIP119c4: Vault Deployment, Integrations and Migrations

Flux Finance will collaborate with Protocol Engineering Core Unit or functionally equivalent Core Units on the best technical implementation. Implementation will only occur once a technical assessment has been presented by the relevant Core Units.

We would kindly ask the Risk and Strategic Finance Core Units to make a recommendation on [Debt Ceiling Instant Access Module \(DC-IAM\)](#) parameters for this deployment.

MIP119c5: Fees

Flux does not charge any fees or spread at the DAI lending pool.

Ondo charges a 0.15% annual management fee for OUSG plus fund expenses, which are capped at 0.15% per annum, which are paid directly by OUSG investors (i.e. Maker would not pay these fees itself).