Gauntlet would like to alert the Aave community of a potential source of risk that has emerged following the passage of AIP-192.

AIP-192 raised the supply cap of cbETH from 30k to 60k. Shortly after its implementation, a single large account, 0xccfa0, used nearly all of the new supply capacity, borrowing 20,824.73 ETH against 24,169.87 cbETH of collateral. See the following graph for the change in cbETH suppliers over time:

The account in question is in e-mode, meaning its liquidation threshold is 93%. Currently, it is borrowing $38M of ETH against $45M of cbETH, resulting in a collateral ratio of 85%. This poses a significant risk to the protocol due to the low on-chain liquidity of cbETH relative to the size of this account. Presently, the 25% depth of cbETH liquidity stands at only 17,300 tokens.

To illustrate the potential risk posed by 0xccfa0's position, consider the following scenario:

Should the value of cbETH temporarily fall in price against ETH by 9%, 0xccfa0 would become liquidatable. A liquidator would then have the opportunity to repay half of 0xccfa0's debt (10.4k ETH) in exchange for just under half of its collateral (11.4k cbETH). Currently, a sale of 11.5k cbETH would have a price impact of over 7% (likely higher in a depeg scenario due to concentrated liquidity near the current price ratio). Importantly, an additional 7% price drop could trigger a cascade effect, not only making 0xccfa0 insolvent but also putting many non-e-mode users at risk of liquidation or even insolvency.

Gauntlet's analysis shows that it would have been prudent to make the supply cap increase after the upcoming Shanghai upgrade, which is expected to improve liquidity for liquid staking derivatives like cbETH. To err on the side of caution, we would not recommend further supply cap raises until after the upgrade occurs. Moreover, it is important to note that the cbETH redemption mechanism is different from stETH, lacking a native buffering system for quicker withdrawals (see Gauntlet's previous analysis of stETH withdrawals). Based on Coinbase documentation, cbETH withdrawals may take weeks to months, which could lead to differences in liquidity immediately following the upgrade.

Next Steps

With the supply cap currently at 100% usage, Gauntlet strongly recommends against any further cap increases. We will continue to monitor the position and asset, providing updates and recommendations as necessary. In light of the stETH depeg in June 2022, when the price of stETH fell by 7% against ETH before recovering, it is crucial to acknowledge that a 9% cbETH depeg, even if temporary, could trigger cascading liquidations with potentially severe consequences.