Intro

Yearn Finance's YFI token has had a rough year in terms of price; after starting the year at around $24,000 per token, YFI sat at $20,000 per token in early December. That may not seem *too* bad, but, when compared to other major DeFi projects, it majorly underperformed. However, Yearn contributors understand this, and they've put forth a proposal to kickstart demand for the YFI and drive more value to YFI holders.

What is Yearn?

Yearn Finance is a "DeFi 1.0" protocol, meaning it was one of the first major blue-chips to see high adoption and usage. Its token, YFI, was released in the summer of 2020, which was known as "DeFi summer" since many blue-chip DeFi protocols gained popularity and users extraordinarily fast. Yearn allows users to earn yield on a variety of assets, all done through smart contracts, and provides some other products related to insurance and trading. Yearn controls over $5 billion of deposits at the time of writing.[1]

Yearn's most popular product is their **Yearn Vaults**. Vaults allow users to earn yield on deposits, and this is done through complex strategies involving moving the vault's funds around various places in the DeFi ecosystem to take advantage of high-yield opportunities and market inefficiencies. These strategies are designed to optimize returns, and the process for creating/approving/implementing a process is very rigorous. The best thing about Yearn Vaults for users? Depositors don't need to pay fees to move their funds around or know how to implement complex strategies; the vault's smart contracts take care of all that for them.

Yearn is the brain-child of Andre Cronje, a major name in the DeFi space. and one of the **most decentralized** projects out there; the YFI token was distributed via a completely fair launch. The entire supply of tokens were all given to users who provided liquidity to the platform early on, and a quality team of contributors quickly joined in to help move the project forward.

Yearn has become a rock-solid building block for many other projects/DAOs who want to provide their treasury or users yield, and Yearn continues to see growth, albeit more slowly than in the past. Despite all of this, the YFI token trades at very low price/earnings and price/sales ratios compared to other major DeFi protocols, mainly because there is no real value accrual to YFI token holders. The YFI supply is capped at 36,666 (**no inflation**) tokens, so there is no way to reward users with additional YFI incentives. All earnings (Yearn takes a % of yield earned) go to the protocol, which has thus far been earning about $100 million/year.[2] YFI token holders have not directly seen any of that. However, all of this is about to change.

New Tokenomics & Why They Matter

Yearn Finance currently has a proposal up for vote to revamp their tokenomics in order to drive more value to token holders and more demand for the YFI token. Keep in mind this proposal has not yet passed, but it currently has over 99% of votes as “Yes” and it finishes on December 28th.

How is this proposal going to help the YFI token and Yearn Finance in general? Through **4 major steps** implemented one by one.

Step 1

Users will be allowed to stake YFI and receive a token called “xYFI” in exchange. xYFI will entitle users to (a) a share of protocol revenue, and (b) voting rights. The share of protocol revenue will be distributed as YFI, but no new YFI will be minted. Instead, to provide this yield to xYFI holders, YFI will be accumulated via buybacks; Yearn will spend most of its revenue, while still maintaining a healthy treasury balance, on buying YFI off the open market. They have already spent $7.5 million on buybacks, and they plan to spend at least $35-45 million per year on these in the future.

Since YFI has no inflation, Yearn’s buybacks directly impact the price of YFI and add a value accrual mechanism for YFI stakers (as mentioned before, the YFI bought during buybacks goes to xYFI stakers). For anyone familiar with Sushiswap’s SUSHI token, this mechanism closely resembles the xSUSHI token design. xYFI can be unstaked for YFI at any time.

Step 2

Rather than staking YFI to get xYFI in return, users will be allowed to stake YFI and get veYFI (vote-escrowed YFI) in return. To do this, users will need to agree to lock their YFI for a period of time ranging from 1 to 4 years. The longer you agree to lock your YFI for, the more voting power you get. Users can withdraw early to get their original YFI back, but this involves paying a fee that goes to all veYFI holders.

veYFI holders, since veYFI will replace xYFI, earn the YFI yield that comes from Yearn’s YFI buybacks. This locking of YFI also encourages longer-term view-alignment for holders. Further, only veYFI holders will be allowed to vote in governance. For those familiar with Curve’s CRV token, this is very similar to their veCRV mechanism.

However, you may be thinking, “why would anyone lock up their YFI for years just to get more voting power and some extra yield?” Good question - step 3 will describe the main incentive for doing this.

Step 3

Step 3 is perhaps the most important of all of these steps. Remember that Yearn’s main product is their Vaults, where depositors can deposit tokens and earn yield through strategies run under the hood. There are multiple vaults, and each takes a different token. For instance, you can deposit USDC into the USDC vault to earn, at the time of writing, about 5% APY. This is a small yield in the DeFi space, but Yearn is one of the *least-risky* places to earn yield in all of DeFi, and it can support a *lot* of size, evidenced by the $5 billion in deposits.

Step 3 will introduce “vault gauges” that allow holders of veYFI to boost the rewards for the vaults they deposit into, up to 2.5x the rewards. If holders of a **lot** of veYFI deposit into the USDC vault, more YFI rewards (earned from buybacks, as we discussed earlier) are directed towards that vault.

This provides another major incentive for holding veYFI. This could very well draw other DAOs/protocols to want to accumulate veYFI to boost rewards on their deposits, which they can pass on to their users. We’ve already seen this go down in the “Curve wars”, where there are many major protocols competing to accumulate as much CRV tokens as they can in order to get more veCRV, which they can use to boost their earned rewards from deposits into Curve.

Yearn could see something similar to the Curve wars. After step 3, there are incentives for protocols to compete to accumulate YFI so that they can lock it, turning it into veYFI, and boost the rewards on their deposits. This adds demand pressure for the YFI token and removes it from the market, as YFI must be locked to get veYFI that can be used to boost rewards via the vault gauge system.

Further, we have also seen something similar to this play out with Tokemak. Tokemak allows TOKE token holders to vote on where to direct liquidity, which has caused protocols to actually start bribing TOKE holders (with tokens, so a financial reward) to vote for their interests. For Yearn, since veYFI holders will be able to provide votes to boost rewards for certain Yearn Vaults, it is very possible that protocols may bribe veYFI holders to vote for them! This would be yet another way that this tokenomics revamp would drive more value to YFI holders.

Voting power that can directly result in increased yield or other financial incentives has become a huge deal in DeFi lately. The Curve wars and bribes for TOKE holders are just two examples of this. Yearn is just one of many protocols that looks to be entering this sphere where governance voting power is highly sought after and can have direct financial impacts. It’s a very interesting concept to see unfold.

Step 4

This is a smaller step that just allows veYFI holders to earn additional rewards by doing useful work for Yearn Finance, including help to set fee parameters, providing insurance, and other things like these.

Future

If this proposal passes - and it looks like it will - Yearn contributors will begin implementing these changes step by step. Yearn is also beginning to expand to other blockchains like Fantom, with more likely on the way. These new tokenomics could have a direct impact on the future price of YFI, but, even if not, understanding these mechanisms will be very useful as other protocols follow suit and the utility of governance power, in many cases, continues to grow.

Citations

[1] https://defillama.com/protocol/yearn-finance

[2] https://blockworks.co/yearn-finance-launches-yfi-buyback-program-markets-wrap/

[3] https://snapshot.org/#/ybaby.eth/proposal/0x8f7417fa5565d9f46e16618503e8808c36d51b2a9e8217a68c632d7c090d69d9

Links

Website: yearn.finance
CoinGecko Listing: coingecko.com/en/coins/yearn-finance

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