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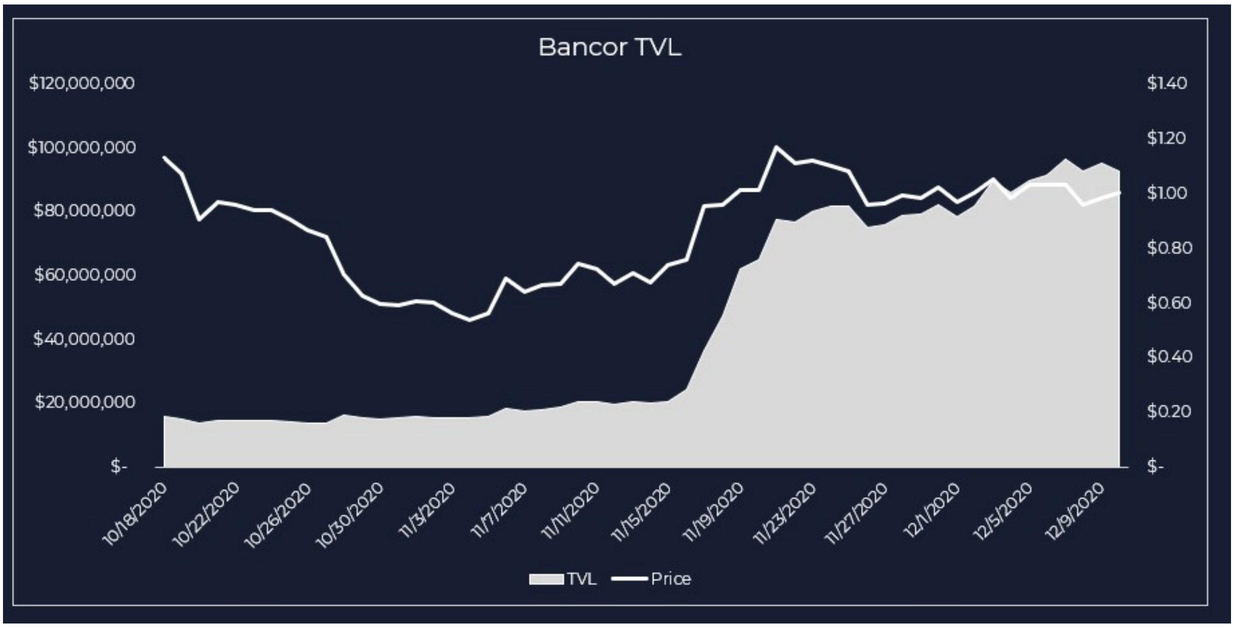
Bancor v2.1: IL Insurance Check-In

Paul Burlage · Friday, December 11th, 2020

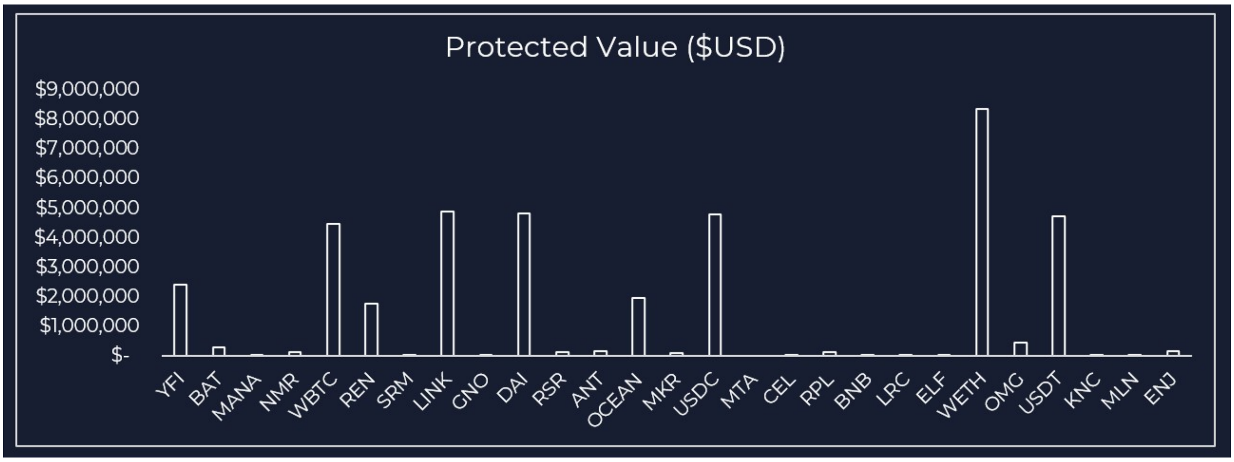
Bancor recently upgraded to Bancor v2.1 – which uniquely featured Impermanent Loss insurance facilitated by elastic BNT supply. For a good recap, please refer to this Delphi Daily. While conceptually similar as they are both dilutive, this method is distinctly different than the more popular liquidity mining rewards as a method to off-set LP risk (Yes, liquidity rewards are not primarily used to off-set IL). Bancor's IL insurance is retroactive and tied to measurable economic loss by LPs. On the other hand, Liquidity mining rewards have the capacity to over and undershoot LP IL exposure. When accessing the fair value of both IL insurance and mining rewards, both fall short if the associated liquidity does not bring equal value (trading volume, fees, etc.).

If I were an LP, which would I prefer (assuming even future fee returns)? It boils down to an LP's motivation. If my goal is purely as a mercenary farmer, the instant liquidity and forecastable nature make liquidity mining more favorable. If I'm an LP that's bullish on the farming token, liquidity mining also seems favorable as the range of your token rewards is more predictable. You do not protect liquidity to possibly earn BNT. How much is Bancor losing out in liquidity here? Probably a lot. IL insurance, however, distinctly favors more passive LPs who are long-term bullish on their supplied assets. This is a large market. Bancor's single-sided liquidity pool had this intention in mind. Let's take a look at how Bancor's v2.1 has gone so far with this all said.



As of writing, Bancor has managed to pull in around $92.6 million total value locked. This is a substantial increase from ~$18M of TVL in mid-October. With that said, Uniswap and Sushiswap continue to dominate the spot AMM market with $1.56B and $980M TVL. $21.8M of Bancor's non-BNT liquidity ($46.3m) is currently protected under Bancor's impermanent loss insurance. This indicates that IL insurance was an apparent pull factor in providing on Bancor for these respective LP's.

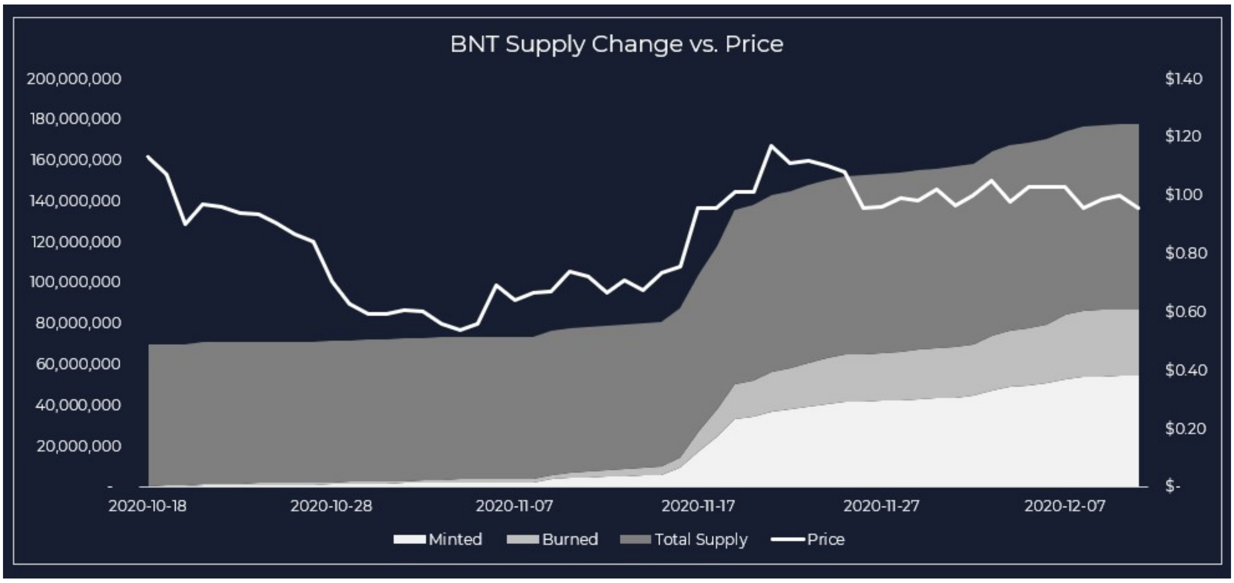
Protected Value Without BNT	$	21,827,169
Protected BNT Value	$	39,689,754
Protected Value	$	61,524,648
Unique Protected Positions		3,728
Unique Protected Wallets		1,334

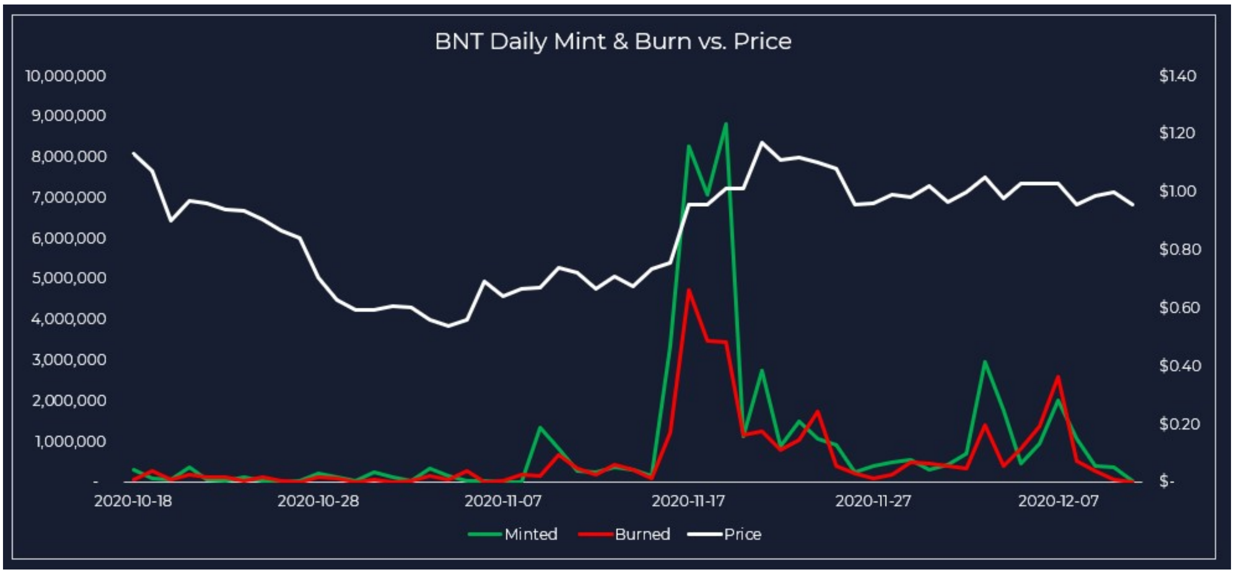


As mentioned in the previous Daily:

As pools are matched against BNT, the option value can increase when either BNT value decreases or token value increases. A large BNT price decrease is a systemic issue as this affects the IL across all protected pools – this could lead to a downward spiral as LPs pull liquidity all at once and dump BNT, further suppressing its price. If fees can outweigh the IL protection, then this system may be quite effective. However, this is entirely conditional on pulling enough volume onto bancor…. which is nothing but a given. It is hard to imagine idle holders not taking advantage of this perpetual option.

Monitoring the effect of BNT supply expansion (and possible contraction) could be significant, as this is potentially a tradeable event (untested). As LP's exercise one's IL insurance, the minted BNT is locked for 24-hours. This opens an opportunity to front-run said BNT movement.





Charting Price against mint/burn since October, we do not see a material edge here in the short-term. This may be just a function of the small mint/burn size in Bancor v2.1's nascency. As mint/burn sizes potentially increase alongside IL insurance payouts, a signal could emerge. In the long-run, Bancor is dependent on fees to off-set IL insurance. Therefore, a token holders’ worst-case scenario is a large amount of early protected liquidity that accrues large IL insurance but attracts little volume. Tracking the relationship between these two variables seems like a decent indicator for trading BNT over the long-run.

Source:

https://duneanalytics.com/ashachaf/bancor-protected-v2-1-data