Delphi Digital

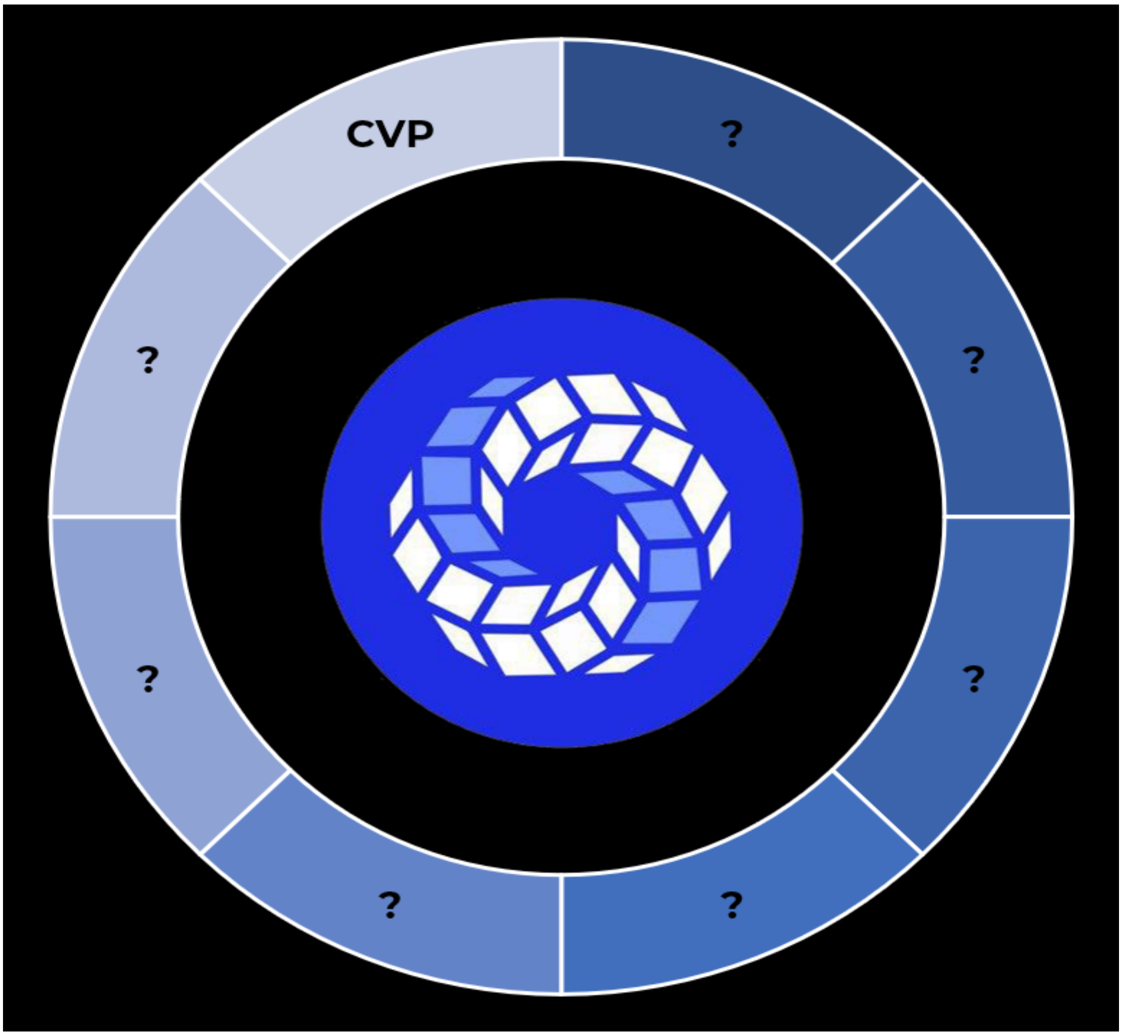
What if we redesigned PowerPool as a liquidity pool rather than a lending protocol? LP shares effectively become an ETF token for the DeFi sector, with PowerPool acting as the governance layer built on top.

Reimagining The PowerPool

Medio Demarco · Saturday, September 12th, 2020

Disclosures: Delphi has taken a position in CVP. This is intended to disclose the potential conflict of interest and should not be misconstrued as a recommendation to purchase CVP. Delphi Digital did not take part in the Alpha or Beta rounds but has been admitted into the Gamma round. Participating in future liquidity mining programs comes with risk, which people should evaluate based on their own risk tolerance.

One of my favorite parts about this space is how anyone can join a community, contribute their time / ideas and help build the future. In a recent post, I proposed an idea for how to improve the stickiness of PowerPool's liquidity, and thus their governance power. While I was recently farming Cream, however, I wondered how PowerPool could differentiate itself from the other projects already out there and further increase its staying power. My partner Anil and I brainstormed about this for a while, coming up with strategies that either weren't good enough or were a little too crazy to propose. Then, after much back and forth, an idea came to us. Rather than PowerPool being built on a lending protocol, why not do it on a liquidity pool instead? This wouldn't just be any liquidity pool, this would be the "PowerPool".



Before we dive into the details of this strategy, let's start by highlighting one clear strength of the redesign. Under the lending model, PowerPool's voting influence was limited to the tokens that were supplied but not lent out. Building it on a liquidity pool instead allows all of the assets deposited to be used for voting, maximizing governance power. Now a Uniswap style pool wouldn't be ideal for this because they can only contain 2 tokens. Thinking back to a liquidity pool thematic we published in October 2019, I recalled that Balancer pools can support up to 8 tokens each. By forking Balancer, we can create a pool comprised of the top 7 DeFi governance tokens, with CVP as the 8th member. This would allow the following strategy to work:

Phase 1 (Pre-Liquidity Mining):

- CVP holders will be given a choice to lock their tokens for a multi-month period for governance.

- The first major vote will be on which DeFi governance tokens to include in the "PowerPool". This will drive engagement in governance right away and generate interest in various communities as each will want their token included.

- The incentive to participate in this can be increased voting power, a reward in CVP and the opportunity to make a token you hold farmable. Since the CVP used to vote will be locked, however, participants won't be able to use those tokens in Phase 2. This is where some game theory comes into play, where each CVP holder will need to assess the trade-offs on which round they want to focus their efforts on.

Phase 2 (Liquidity Mining & Beyond):

- Now that the 7 DeFi governance tokens have been selected, the PowerPool can launch.

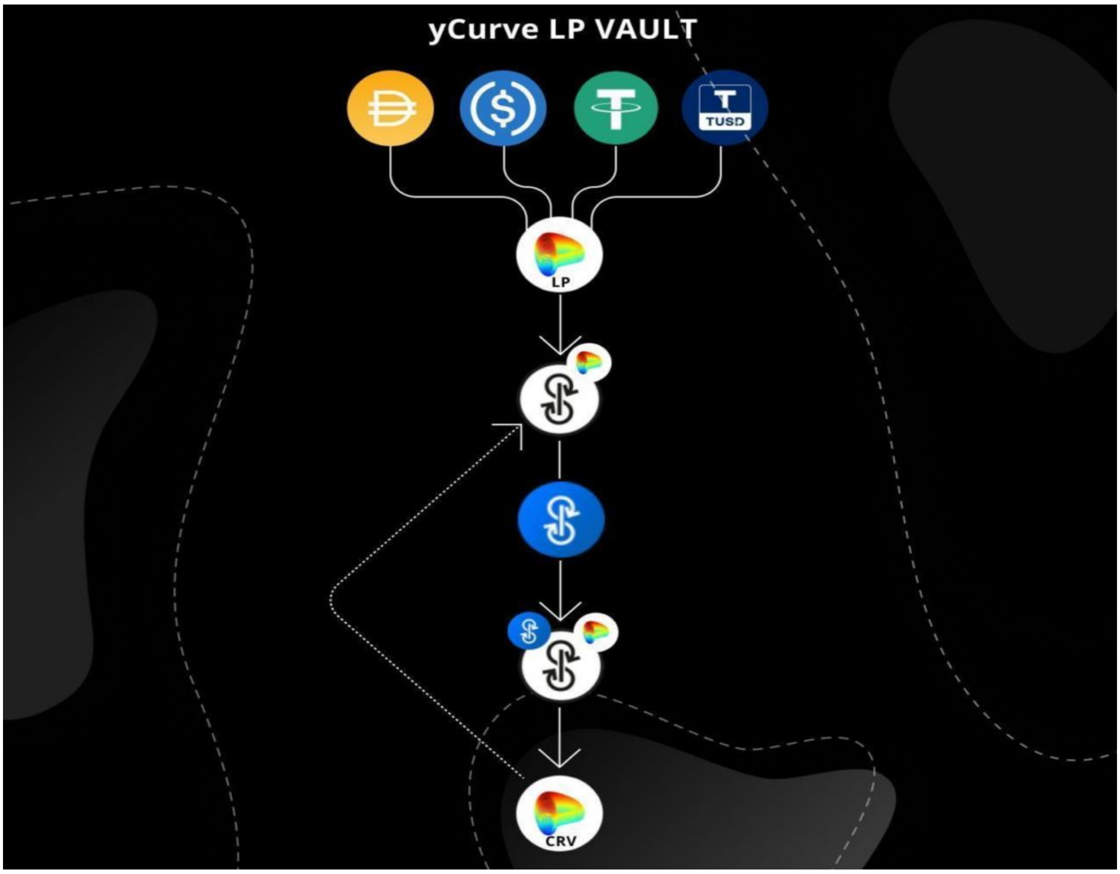
- While the weights of each token in the pool can and will vary, the target weight for each will be 1/8th of the pool. Liquidity mining rewards will be sized based on deviations from the 1/8th target weights. For example, adding liquidity for a token that makes up 30% of the pool will yield less CVP. In contrast, adding liquidity for a token that only makes up 2% of the pool will yield more CVP.

- **LP shares of the PowerPool effectively become an ETF token for the DeFi sector, with PowerPool acting as a governance layer built on top of it.** While Balancer is often thought of primarily as a liquidity pool, this framing is actually more in line with how Balancer was originally envisioned, with each pool being viewed as a portfolio of assets. The liquidity provided could be much stickier because holding a share of this pool is equivalent to owning a basket of the top DeFi tokens. As the value of the DeFi sector rises, from fundamental growth or future yield farms driving demand for those assets, your LP share will also rise in value, potentially making it a good diversified hold.

- This will drive demand for CVP, since it will be needed to farm 1/8th of the PowerPool. At this stage, the CVP supply could become very scarce due to the Beta and Gamma 3 month vesting periods and tokens locked up in governance from Phase 1. As liquidity pours into the other slices of the pool, demand for CVP could soar as the yield spikes from CVP being underweight in the pool (i.e. < 1/8th).

- A Yearn vault strategy could be implemented for the PowerPool, diverting large flows of liquidity into it. This would only happen though, if the vault strategy could sell CVP to generate yield, thus invalidating the use of a vesting period for rewards. For PowerPool to make the most of the CVP distribution used for liquidity mining, it will need to actually accumulate enough liquidity to make it worth it. Yes, there can be selling pressure from the CVP distributed, but making a vault strategy possible can drive so much liquidity near-term, that it makes it more likely for PowerPool to succeed over the long-term. It's essentially the necessary cost of having Yearn supercharge your bootstrapping phase. What if, instead of forcing those CVP rewards to be locked though, you just incentivized the vault strategy with a higher yield for holding it? As we mentioned in the point above, if CVP is underweight in the pool due to the scarcity of its supply, then providing liquidity for it will generate the highest yields. As a result, we incentivize the vault strategy not to sell its CVP right away because it's more useful to keep using them.

- A vault strategy for this would also make it instantly possible to farm the 7 DeFi governance tokens voted in, and CVP, through Yearn, boosting demand for each. This could operate very similarly to the yCurve vault but with DeFi governance tokens instead of stablecoins.



- By being a Balancer fork, LP trading fees can be customized and even an exit fee for withdrawing liquidity could be added. In the spirit of our past proposal, the value generated from these trading fees could be left in the PowerPool permanently. Overtime, this would generate perpetual liquidity and governance power for PowerPool. During the liquidity mining period, the yield from CVP rewards should be sufficient to attract liquidity. After the liquidity mining period, CVP holders could vote on what portion of trading fees to leave in the pool and what amount to distribute. Let's face it, nobody farms for the interest or trading fees, they do it for the token rewards. Let’s use that to our advantage to give PowerPool greater staying power.

- As with any liquidity pool, impermanent loss is something that needs to be considered. However, since the top DeFi tokens are generally correlated with one another, impermanent loss may be small. As long as the price of the DeFi tokens move proportionally with one another, impermanent loss shouldn’t be much of a concern. There are other aspects to ponder over as well. Even with deep liquidity, a trader might still get better execution elsewhere. This is fine. PowerPool doesn’t need to be the primary trading venue for these tokens. Recall that the Balancer-based pool will act more like a portfolio than your standard liquidity pool. People won’t just be adding liquidity to it, they would be receiving a DeFi ETF via their LP share. In addition, a Balancer pool would be less risky than the lending model, since leverage isn’t involved, and technically easier to execute.

- In the future, you could spin up multiple “PowerPools” for different sectors.

- The meme becomes a simple pie chart, showing the PowerPool’s weights and the depth of its liquidity. If successfully launched, this would be the first of its kind.

We’ve run this proposal by the development team and they are excited about the proposal. We’ll be posting this publicly on their governance forum soon to get buy in from the community but we wanted to share our thoughts with our members first.