CONTENTCRUNCH

Founder Aave Labs: This Is Why DeFi Failed Until Now! - Stani Kulechov

Introduction to Stani Kulichov

- Stani Kulichov is the co-founder of a leading decentralized finance (DeFi) protocol with billions in locked value.
- He has been at the forefront of DeFi innovation since its early days.
- Stani is driving the expansion of an open, permissionless financial system.
- "If you want DeFi to scale, it needs to be very easy to use and accessible."

Vision and Development of Aave

- Stani read the original Eatland white paper (Eatland was before Aave) and found that many of the original ideas still make sense.
- The original vision included on-chain finance and tokenization.
- Stani believes it's important to follow the original vision, especially if it makes sense.
- Aave has grown to become a leader in DeFi, and there is still a lot of growth space.

Responsibility and Resiliency

- In the beginning, there was a lot of responsibility to the staff, users, community, and himself.
- The idea of a protocol is to remove the sense of responsibility and introduce resiliency.
- Aave aims to create a fault-proof financial infrastructure with less central points of failure than traditional finance.

Proudest Moment

- Launching the first version of the Aave protocol in January 2020 was a significant moment.
- During the COVID-19 pandemic, with central banks dropping interest rates, DeFi became an opportunity.

- Seeing early adopters use the product, provide feedback, and request features was the best feeling.

Lessons from DeFi 1.0

- The biggest learning from DeFi 1.0 is that early users are very forgiving.
- They are willing to take steps and figure out bottlenecks to access DeFi products.
- Aave needs to attract new audiences, including institutions and consumers.
- DeFi needs to be easy to use and accessible without compromising self-custody, governance, or transparency.
- Mainstream users will drop out if there are too many challenges in the experience.

DeFi Importance

- The failure of centralized lenders like FDX has reinforced the importance of decentralized finance.
- DeFi allows interaction with liquidity and peers without a middleman or central point of failure.

Early Challenges and Current Trends

- Early on, raising funds for DeFi projects like A and Eland was difficult due to the popularity of centralized lenders like BlockFi, Celsius, and Genesis lending.
- Despite the initial challenges, the behavior of borrowing against crypto holdings has moved on-chain, offering a more secure way without middlemen.

Institutional Interest and Regulation

- Institutions are showing increased interest in DeFi, and regulatory tailwinds are helping.
- A and Eland is considering how to apply its technology to traditional assets coming on-chain, as the technology is asset and use-case agnostic.

Stablecoin Landscape

- There's been a rise in the number of stablecoins, including algorithmic ones with similar insecurities to past failures.
- The speaker believes decentralized stablecoins are the right way to create resiliency.

A and Eland's Approach to Stablecoins

- A and Eland has a native stablecoin called go, created in response to user demand for more predictable borrowing costs on the A protocol.
- Go is over-collateralized with liquidation mechanisms to stabilize the peg, similar to other DeFi stablecoins.

Scaling Stablecoins and the Role of RWAs

- To scale stablecoins to billions of people, real-world assets (RWAs) will be needed as collateral.
- The approach involves using smart contracts to create a resilient system with diversification of collateral assets.

Innovation and Regulation in Stablecoins

- The speaker supports a low threshold for innovation and market participants to build businesses around stablecoin technology.
- Regulation should allow space for innovation while ensuring a level playing field.

Regulatory Frameworks in Europe and the US

- The speaker has a background in both technology and law, with a focus on ensuring rules allow innovation while protecting users.
- The speaker believes that MiCA (Markets in Crypto-Assets regulation) may not be the best application of regulation for the technology and services built around it.

Concerns About MiCA

- MiCA was initially built around the Libra stablecoin model, which is unlikely to see mass adoption.
- The speaker notes that there is already EMI (Electronic Money Institutions) regulation in Europe that regulates money held digitally.

Regulation and its Impact

- Regulation aims to reduce uncertainty and create a level playing field for institutions to engage with technology.
- However, inappropriate regulation can negatively impact small businesses.
- Regulations and the launch of ETFs are injecting liquidity into the Web3 ecosystem, but adoption lags due to misunderstandings.

DeFi Misconceptions and Functionality

- A common misunderstanding is the true nature of DeFi, which is an environment for financial algorithms driven by protocols governed by DAOs.
- Stable coins are essential for accessing decentralized finance and consuming liquidity.
- RWAs are crucial for scaling DeFi by bringing off-chain value on-chain, enhancing the ecosystem's size and potential.

On-Chain Value and Opportunities

- On-chain value enables borrowing, swapping, and other economic activities.
- Tokenization of assets can democratize investment opportunities, allowing broader access to companies like SpaceX or Stripe.
- There's a knowledge gap, as retail investors often find investments in private companies too complex.

Onboarding the Next Billion Users

- DeFi protocols will likely integrate more into centralized finance, with exchanges and FinTech companies using DeFi as a backbone.
- As central banks lower interest rates, DeFi opportunities become more attractive.
- High-interest rates on mortgages, car loans, and credit cards can slow down the economy, potentially leading to stagflation.

DeFi and Asset Managers

- DEI will attract more liquidity and consumption.
- Asset managers are key because they can package DeFi opportunities for their audience, facilitating traditional capital flow.

Inflation

- Inflation moves value from a large group of people to the stock exchange or government.
- Preserving capital is important to avoid value wipeout by governments through inflation.
- Inflation pushes people to take more risk.
- If people could save with the assurance of stable purchasing power, societies might be more relaxed.

Aave V4

- V4 has a new architecture that improves capital efficiency.
- V4 introduces liquidity hubs and spokes to solve the chicken and egg problem of new markets.
    - Liquidity hub: Where liquidity is stored.
    - Liquidity spoke: Configuration of what can be borrowed and which assets are listed.
- Liquidity hub can provide a credit line to each spoke, removing liquidity bootstrapping issues and segregating risk.
- Capital efficiency is increased, which can help grow liquidity and make it more successful.

Risk Premium

- V4 introduces a risk premium, where borrowers with riskier collateral compositions pay more.
- Borrowers with the least risky collateral pay the base rate.
- This eliminates free riding and prices liquidity more efficiently.
- Risk premium is calculated based on the risk configuration of each asset and the composition of collaterals.

Aave Ecosystem

- There are roughly 200,000 token holders.

- Aave uses liquid democracy where token holders can delegate voting power to active delegates.
- Service providers contribute to the Aave DAO and manage the protocol's risk.

Aave V4 and Layer 2s

- Aave V4 has an own layer 2 built on top of Ethereum, as per the original 2030 proposal.
- Plans include shipping Aave V4, expanding GHO (Aave's stablecoin) to new networks like Avalanche, building on its presence on L2s like Base and Arbitrum.
- A network is being planned as a continuation of how to store liquidity efficiently across different networks, but it's still in the proof of concept stage.

EVM vs. Non-EVM Chains

- EVM's power lies in network effects, security from Ethereum, and the ability to deploy code on every EVM with minimal changes.
- Non-EVMs require code to be written from scratch, which is difficult, especially for secure smart contract protocols with collateralization.
- Aave is building a Move implementation of Aave Protocol V3 on the Aptos blockchain, with development and security audits completed, and a security contest underway before launch.
- It's hard to build very secure DeFi on non-EVMs. Aave's brand is built on safety, security, and scalability.

Ethereum's Progress and Recognition

- Ethereum is the most secure and compliant chain but doesn't always get the recognition it deserves.
- People want to see action, entertainment, and progress.
- Ethereum scales with L2 scaling strategy, offering lower fees and more block space.
- Ethereum has progressed with the merge and other updates, making it a progressing ecosystem, especially considering the value at stake and institutional involvement.

Institutional Adoption and Stablecoins

- Stripe is using stablecoins within its platform, utilizing the Ethereum blockchain.
- This is a huge statement, showing recognition of the technology's trustworthiness, functionality, and uptime.
- More institutions like BlackRock are tokenizing funds and bringing them on-chain, providing social proof for DeFi and the on-chain space.
- Aave's next step is using Aave as collateral.

GHO Stablecoin and Real World Assets

- GHO is an overcollateralized stablecoin fully backed by on-chain assets like Ethereum, staked ETH, and wrapped Bitcoin.
- It's a resilient stablecoin with proven liquidation and peg control mechanisms.
- 100 million worth of GHO issued yields the same revenue to Aave as 1 billion USDC because GHO doesn't have LPs when minted directly to pools.
- Aave is launching Horizon, an RWA market where permissioned assets like BlackRock's BUIDL fund can be used as collateral to borrow stablecoins.
- Horizon will expand beyond crypto-native assets to include tokenized credit funds, ETFs, and equities.

Tokenized Assets

- Stocks and commodities will likely be tokenized and put on-chain for trading.
- Real estate tokenization is challenging; many projects are trying, but it's not working out.
  - The best way to tokenize real estate is to go where the liquidity is, like REIT markets.
  - Tokenizing REITs and bringing them on-chain adds value, like borrowing against them on weekends.
  - Scale is needed to create liquidity; concentration is important.
- Tokenizing single properties and fragmenting them causes problems because many factors impacting the property aren't included in the DAO.

Yields and Interest Rates

- Rates going down will positively impact DeFi.
- The Fed can only postpone action, but eventually, the economy will slow down, requiring them to act fast.
- Europe and the UK are lowering rates; the speaker is convinced Europe will lower rates tomorrow.
- Japan is raising interest rates because their economy isn't moving, and the yen has been used for carry trades.

Market Liquidation and Resilience

- During the market downturn, Aave liquidated $200 million worth of collateral across multiple networks without issues.
- This demonstrates the resilience of a decentralized financial system compared to centralized systems with closed doors and no transparency.

Rebuilding Aave/Ethlend

- If the speaker could go back to 2016 with current knowledge, they might focus more on the UX problem.
  - It needs to be easier to manage keys and connectivity.
- The goal is for people to use blockchain without realizing they're using it.
- Aave wants to be the HTTPS of DeFi, where people can use it without understanding the underlying technology.

Future of Web3

- The speaker is most excited about new audiences (consumers and institutions) and credit systems built on top of Aave and other collateralized loans.
- Current credit rating systems are horrible, and a blockchain-based system leveraging DeFi could create a better outcome.

Joining the Aave Ecosystem

- To join the Aave ecosystem, go to aave.com or governance.com, or join the Discord.