Twitter Thread by Messari

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Over $600M has been locked up for staking in eth2. Problem is, it will potentially be immobile until 2022

Derivative ETH (DETH) to the rescue ■

The first step to becoming an ETH 2.0 validator requires sending at least 32 ETH to a deposit contract on Ethereum's PoW chain. The deposit contract is a one-way street and any ETH staked for ETH 2.0 will be locked until ETH's PoW chain is merged with ETH 2 (likely 2022)

While this indefinite lockup was a security conscious decision made by developers, it imposes a high opportunity cost on stakers.

Validators can earn anywhere from 4-23% yield on their staked ETH, but it's difficult to say whether or not that capital could be put to more productive use elsewhere; particularly if the current market momentum continues.

Recognizing the illiquidity and opportunity costs stakers face, multiple solutions have emerged that will allow stakers to gain liquidity on their staked ETH.

For example, @liquidstake will allow stakers to borrow USDC against ETH staked through their platform.

More broadly, a variety of firms and protocols are beginning to rollout offerings that allow users to securitize their staked ETH for liquidity, giving birth to an entirely new category of derivative ETH, or "DETH."

Before we break down DETH, you can get all of this and more in our full Ethereum 2.0 report.

Look for helpful commentary from eth2 infrastructure provider @BisonTrails

Read: https://t.co/rBuJzT6Gw3

We're likely to see multiple flavors of DETH issued by exchanges and staking pools that will allow stakers to rehypothecate their staked ETH for use across DeFi.

In addition to managing validator software, these services will accept ETH staking deposits and mint a corresponding amount of DETH for the depositor. DETH will represent a claim on the underlying stake that the depositor can put to work across various DeFi protocols.

While this will allow stakers to have their cake and eat it too by earning validator rewards while still maintaining liquidity on their ETH, there are considerations to be made.

Stakers will have to trust that whichever service they stake to is adequately maintaining their validator. Failure to do so will lead to reduced rewards and slashing penalties. Custodial risks will need to be considered as well.

Lastly, secondary market liquidity for different flavors of DETH will come into play. Just as the market has settled on a small handful of fiat-backed stablecoins, it will likely settle on a handful of DETH solutions.

Certain ETH derivative tokens may find themselves as illiquid as the underlying ETH locked in the deposit contract so stakers must choose wisely.

Exchanges are particularly well positioned to be major DETH issuers, as they're among the largest holders of ETH and issuers of other wrapped assets (mainly stablecoins).

Since exchanges are already in the game of capital aggregation and in the past have raced to offer ancillary services outside of trading, there's little doubt they will jump at this opportunity.

However, staking concentration among centralized providers could threaten Ethereum's PoS security. Thankfully, decentralized solutions like @Rocket_Pool and @StaFi_Protocol will create two sided marketplaces for staking that will match stakers with validators.

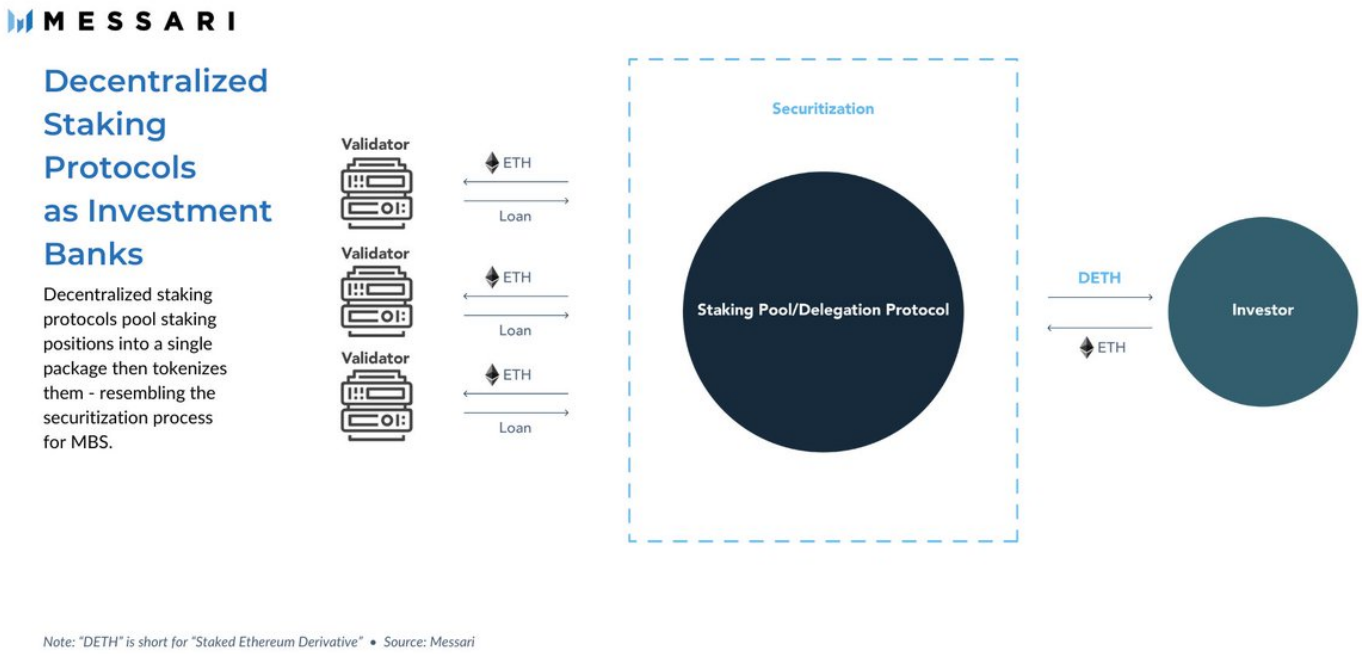
These protocols will first allow users to pool their ETH together, then allocate that pooled ETH to a network of validators for staking.

Decentralized solutions will reduce the 32 ETH barrier to entry for stakers while allowing them to outsource the infrastructure requirements, giving them liquidity on their stake, all while supporting the decentralization of Ethereum.

Meanwhile validators will gain the ability to scale their operations without needing to purchase 32 ETH for each validator they run.

Decentralized staking solutions will also create a flavor of DETH that will depend not on the competency of a single provider, but on the competency of a pool of providers, diversifying the overall slashing risk.

This flavor of DETH will resemble securitized products like mortgage-backed securities. Where mortgage-backed securities represent the value of an aggregation of many loans, staking derivatives will pool staking positions into a single package and then tokenize them.



Note: "DETH" is short for "Staked Ethereum Derivative" • Source: Messari

With a large addressable market and multiple flavors of DETH, there will be many additional financial services built on top of ETH staking derivatives.

In addition to being available for use across DeFi protocols, DETH could be packaged into a host of other products:

+ ETF-like index products
+ Swap products that allow stakers to fix their yield and traders to speculate on yield

+ Structured products like fixed income

The ETH derivatives space as a whole is understandably still very early, but should play a much larger role in the wake of the the Beacon Chain and proof of stake on Ethereum 2.0.

For more, check out our full report

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