Twitter Thread by Private Chad

Private Chad
@Privatechad_

My Chads, institutions and retail are entering the DeFi space at unprecedented volume. One of the key primitives in DeFi will be the securitization and tranching of DeFi and is still massively undervalued. Enter https://t.co/Gx4H3hIzNg ($SFI).

Don't worry, let me ELI5.

1/ Alright so securitization and tranching, that's a mouthful. ■■

Let's take a step back. If you look at any financial activity within DeFi, whether it is yield farming, lending or liquidity providing, there are risks involved.

2/ As an honest farmer / liquidity provider, the rewards are yield, and the risk is losing your funds due to e.g. smart contract risk and (potentially) IL.

As an honest lender, the rewards are interest, and risk is default of the borrower.

3/ 99% of the current retail participants don't use portfolio risk management in their DeFi activities. We farm a bit, IL a bit, loan and borrow a bit and hope we make gains at the end of the day. For institutions, portfolio management is much different.

4/ The problem for institutions to enter such DeFi activities as yield farming, liquidity providing and lending/borrowing, is that it's inherently risky and not quantifiable with variable rewards. We early adopters don't mind this risk, but this prevents adoption by institutions.

5/ So what is securitization and tranching?

Securitization means taking several assets and pooling these together to create a new fancy asset.

Tranching means cutting a security into two or more several pieces, where each piece carries a different level of risk.

6/ Easy enough right? Let's do an example.

Imagine a risky activity such as being a LP to SUSHI/ETH on Sushiswap.

Uncertainty about rewards:
1. What's the price of SUSHI?
2. How much are the fees I receive?

Uncertainty about risk:
1. Loss of funds (e.g. SC risk)
2. IL

7/ The methods of securitization and tranching allows you to create new assets from an original asset (i.e. the SUSHI/ETH LP tokens is the asset in this case). For example, let's say we create one tranche for the retail apes that want risk, and one tranche for the institutions.

8/ SUSHI/ETH LP tokens split into (hypothetical):

SUSHI/ETH retail tranche:
- x5 multiplier rewards.
- IL
- If smart contract exploit, funds first go to INSTITUTIONS tranche.

SUSHI/ETH institution tranche:
- Low (potentially fixed) rewards
- Funds SAFU
- No (or reduced) IL

9/ Astute readers will realize that the SUSHI/ETH Institution LP tokens actually look more like a loan (low (fixed) rewards, and no/low smart contract risk). This is the power of securitization and tranching. It allows transformations of DeFi activities with set risk boundaries.

10/ The sky's the limit with securitization and tranching. Instead of splitting up one asset like SUSHI/ETH LP tokens, one could first pool certain assets together (securitization) and then divide those assets into distinct tranches (often called “junior” and “senior” tranches).

11/ But Chad, if securitization is so cool, is it used in the traditional Finance world? A picture says more than a thousand words. The derivatives market completely dwarfs the other global markets. Securitization (Credit Default Swaps anyone?) is HUGE. And for good reason.

12/ Now that we understand the power of securitization and tranching. Let's talk about one of the few projects in the crypto market that has a real shot of being the gateway for institutions to enter DeFi through securitization and tranching:

13/ Saffron Finance ($SFI) started in October 2020 with a fair launch. It launched through an epoch system, with rewards provided to farmers. Currently about 80% of the SFI is circulating, with hard cap of 100K SFI. The last epoch will finish 6 February 2021. TVL 50M USD.

14/ Besides the insane use-case, what intrigues me about $SFI are:
1. Its focus on the tech (no over-hype), which is needed for a complex product such as securitization and tranching. Also rumors about core dev being ex-CMC founder.
2. Strong community.

15/. 3. Though not the focus atm, interest from various projects and integrations are happening.
* Chainlink reached out (props to the amazing $LINK team).
* Talks with $ALPHA and rumored upon V2 releases there will be a collaboration.
*Cream integrations in v2
* $COMP tranches

16/ 4. Saffron Finance is going to be cross-chain compatibility initiative (e.g. Polkadot and Binance Smart Chain). Based on an AMA, more information will be released when development is in a further stage.

17/ The beauty about Saffron Finance is that it is not a competitor to existing DeFi projects, but empowers these projects. This allows for many interesting partnerships to happen, e.g. $YFI Yearn ecosystem farming tranches, $AAVE tranched loans, $SNX staking tranches.

18/ The above also embodies the power of decentralized finance. Securitization is typically done with loans in the traditional world. But the DeFi world has many yield bearing assets that are verifiable on-chain, and can be pooled together permissionless to create new assets.

19/ Currently Saffron Finance v1 platform has tranches for Compound / stablecoin farms divided into A, AA, and S tranches. A tranches bear the smart contract risk of the Compound platform and in exchange get a x10 yield, while the AA and S tranches do not incur such risk.

20/ The real innovation will happen in v2 of the Saffron platform. V2 will be in beta in the upcoming weeks, and will a.o. have:
- Lower gas costs
- Roll-over system (deposit once and forget, no more epoch system)
- Include more asset tranches
- Customizable risk params

21/ The end-goal of V2 is a complete customization, aggregation and/or splitting of risk factors of any DeFi activity. I expect major integrations to happen with various platforms in the upcoming weeks/months.

22/ As I said there are thousands of use-cases for Saffron, but some of the ones I am looking forward to:
A. Customizable risk yield farming / liquidity providing. Already partly in V1 of Saffron, but V2 will allow for much more customization in risk level.

23/
B. Fixed-interest delta-neutral yield farming / lp / loans.
Based on the risk customization, V2 will have fixed-interest/APY yield farming. The impact of this cannot be understated. Besides institutions, many crypto projects have huge unused treasuries (some 100M USD+).

24/ Why? Because projects do not want to deploy these funds when there's a risk of losing funds, or there is a variable APY. Variable APY's require management of funds, which crypto projects do not want to actively do. They want fixed rates for a long period of time.

25/ Any good (investable) project requires a clear use-case for its token. $SFI use-case will be:
1) Staking in the SFI staking pool to earn SFI.
2) Accrue fees regenerated from the protocol
3) Requirement for joining some tranches for enhanced yield
4) Governance

26/ I expect Saffron Finance to be a main pillar in the DeFi world in the upcoming months. It’s one of the sole projects in securitization. The integrations and coding will take some time, but that's the cost of being early in a project. You'll also reap the x100 gains though■.

27/ As you can tell, I'm incredibly bullish on SFI. It's the % in my portfolio. So that should tell you something. Besides it being an incredible project, it also has a clear catalyst of V2 in the upcoming weeks. And we all saw what $ALPHA did in their run leading to V2.

28/ Oh and one more thing. Saffron Finance had a fair launch and therefore didn’t receive any funding. Currently 25% of the SFI are rewarded to the dev team.

This SFI has been used to secure a funding round by leading VC’s. These VC’s will be locked up. More announced soon.

29/ For more information I refer to:

Great interview by Psykeeper for Delphi:
https://t.co/77ZH9le7Lb

AMA + how to join liquidity pool video:
https://t.co/aHqd84VLvi

Medium posts:
https://t.co/VEi6b8SuDc

Great article from Messari about the scope of fixed income protocols: https://t.co/jLc8gNBssg