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Risk bytes

Newsletter
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Cosmos: Atom 2.0 to revise tokenomics and bring liquid staking

At the Cosmoverse conference held in Colombia last month, the Cosmos team presented their Atom 2.0 whitepaper. The paper sets out major changes for Cosmos and its wider ecosystem, such as revised tokenomics and a new liquid staking feature called delegation shares.

Dubbed "The Internet of Blockchains", Cosmos is a "Layer 0" interoperability platform that aims to provide a secure, decentralised gateway for Layer 1 blockchains to interact and exchange value. Safe and secure interoperable bridges are one of the key challenges DeFi still faces. Transacting across separate blockchains is difficult and requires complex bridging procedures that can be vulnerable to attacks. In February, over $320m was stolen in an exploit of the Solana-Ethereum 'Wormhole' bridge. So far in 2022, over $2 billion has been stolen in similar bridge exploits, highlighting the severe consequences for insecure bridges.

The Cosmos Hub, powered by its native coin ATOM, is the Layer 1 blockchain at the centre of the ecosystem and acts as a middleman to connect separate blockchains. ATOM works like other proof-of-stake assets; it is used to pay transaction fees and is paid as staking rewards to validators in return for confirming transactions.

The new whitepaper outlined key changes to the way new ATOM is issued. Currently, like most POS coins, there is no fixed supply of ATOM. As staking rewards are paid to validators, new coins are issued, creating an inflationary supply.

The new whitepaper aims to change this by gradually decreasing the issuance rate for new ATOM. Once the changes are implemented, 10m ATOM will be released in the first month. Every month thereafter this will decrease until the issuance settles at 300,000 ATOM per month. This reduction in ATOM's future issuance could have a positive effect on its stock-to-flow rate and subsequent value.

Typically, when assets are staked within a network, they are "locked" as collateral and cannot be used for other purposes. Liquid staking allows for liquidity to be preserved while staking through the issuance of a tradeable derivative. Although liquid staking does exist currently for ATOM through protocols such as Stride, Cosmos plans to develop this natively. In its current form, Cosmos's liquid staking requires providers to take custody of the underlying assets as collateral, which poses security and centralisation risks. "Delegation shares", as they are referred to in the new whitepaper, will be issued while the staked ATOM is delegated to validators.

The issuance of native delegation shares could help increase the amount of staked ATOM, resulting in a more secure network, as well as freeing up valuable liquidity for inter-chain bridge transactions. Circle, the issuer of USDC, have also announced they will allow USDC to be minted natively on a Cosmos-compatible blockchain. This, paired with the potential liquid staking improvements, is a great sign for the evolution of cross-chain lending and borrowing capabilities.

Sources:

Cosmos CNBC

Circle reveals plans to bridge native USDC across chains

USDC, the second largest stablecoin by market cap, has now processed a total of $6 trillion in on-chain transactions. This milestone was announced at Circle's Converge conference held in San Francisco at the end of September. They also revealed plans to make USDC available on five additional chains: Arbitrum, Cosmos, NEAR, Optimism and Polkadot —bringing the total to 14.

Support on Arbitrum, NEAR, Optimism, and Polkadot are expected to arrive by the end of the year, with Cosmos due to arrive in early 2023. Circle's VP of Product, Joao Reginatto, said in a statement: "Extending multi-chain support for USDC opens the door for institutions, exchanges, developers and more to innovate and have easier access to a trusted and stable digital dollar".

Fully asset-backed stablecoins like USDC and USDT have cemented themselves as a trusted store of value in digital assets after Terra's algorithmic stablecoin, UST, collapsed in May and wiped out around $40 billion in value. UST was not backed by any assets, and instead depended on an algorithmic relationship with LUNA (Terra's native token) to maintain its 1:1 US dollar peg.

Circle also announced the launch of a cross-chain transfer protocol that will assist developers in creating wallets and apps to bridge native USDC liquidity across chains. Most ecosystems, especially those that have a burgeoning DeFi market, require a stable store of value to operate optimally.

Fragmented liquidity, caused by dozens of competing bridges each creating wrapped assets, can result in little to no liquidity for handling large volumes of transactions. With this development from Circle, we could see an increase in institutional players moving assets across chains now that this vital stable store of value has proven itself.

Sources:

Circle

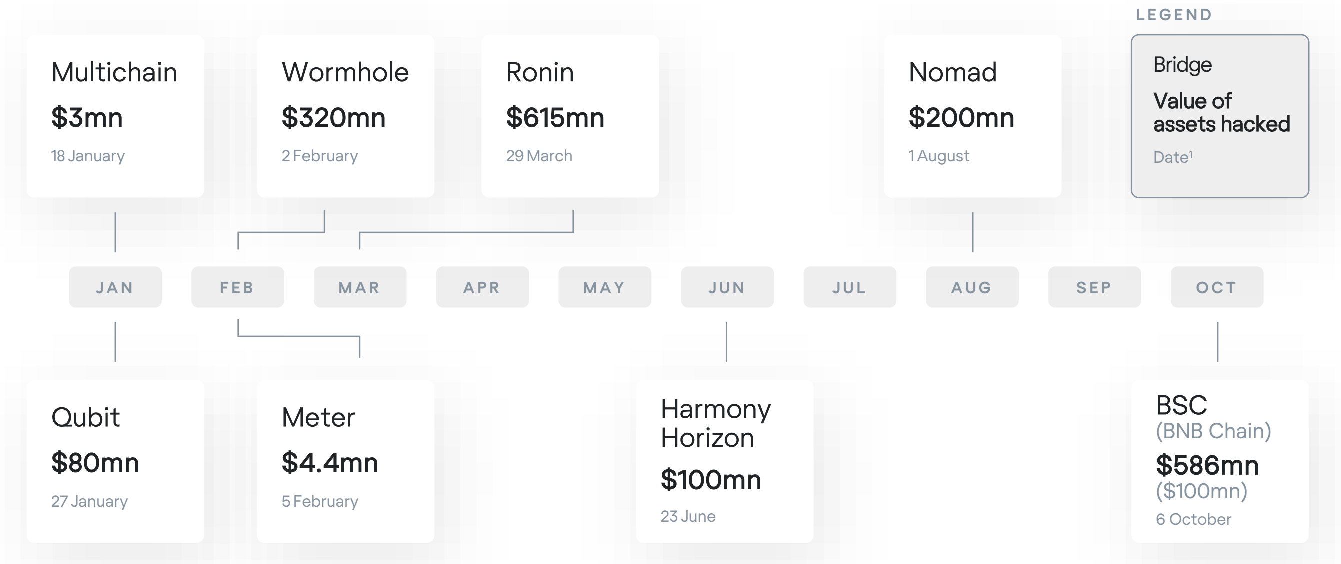
Bridges: Total Value Hacked

Last week, the Binance Beacon Chain and the BNB Chain suffered the latest of 2022's bridge hacks. The exploit allowed the hackers to mint BNB directly into their address. At the time, the price of BNB was hovering around $293 before suffering a 10% decline to $265.

The hackers minted 2m BNB tokens, resulting in a total value hacked (TVH) of an estimated $586m. It was set to be one of the biggest hacks in the digital asset space (rivalled only by Ronin) before Binance were able to put a stop to it.

Validators were able to do this by pausing BNB chain activity and freezing $429m out of the total amount the hackers were trying to drain. According to recent reports, prior to the freezing, hackers managed to migrate around $100M of funds to other chains.

This exploit is currently ranking as the 5th largest DeFi exploit in 2022 so far and is comparable in magnitude with Harmony Horizon's losses. The table below summarises all the bridge hacks so far in 2022, showcasing the estimated TVH to be close to $2 billion.



Bridge hacks have been occurring at an alarming rate, facilitated by weaknesses in system security. A key lesson learnt from previous bridge hacks is that the limited number of validators required to approve transactions can greatly compromise security. In Harmony Horizon's case, hackers compromised a small number of accounts to gain access to password credentials to withdraw assets.

Similarly in Ronin's case, hackers extracted private keys from five out of the nine validators to gain access to the crypto assets locked in the system. In Nomad's case, hackers identified a weakness that allowed the withdrawal of assets, even if there were not enough retained in the system. The hack was then magnified when more hackers spotted the weakness and joined in.

Nevertheless, bridges are an integral tool for interoperable decentralised finance applications. As the DeFi universe evolves, blockchain developers will need to devise more sophisticated solutions to safeguard assets and allow seamless transactions between networks. There are also question marks over blockchain bridges; if they are subject to regulations, what potential impact could this have on how they will operate?

Sources:

Reuters

CNBC

[1] Dates when hacks were publicly confirmed by exchanges.
Value of Assets Hacked is equivalent USD value.

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