Lending protocols

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Aave and Compound, the leading lending protocols, hold pools of tokens deposited by lenders and allow borrowers to draw against collateral they deposit. Interest rates are set algorithmically by utilisation. If a borrower's collateral falls below a threshold, anyone may liquidate the position by repaying part of the debt and taking collateral at a discount. Lenders receive a receipt token (aUSDC, cUSDC) that accrues interest and can be redeemed for the underlying plus interest at any time, subject to the pool having sufficient liquidity.

The lender's legal position is the critical one. She has deposited tokens into a contract from which borrowers draw. In economic terms she has made an interest-bearing loan to a pool. In legal terms the question is whether anyone has accepted a deposit. The Federal Council's 2022 DeFi report concluded that a lending protocol with no operator accepts no deposit under the Banking Act, because no person has undertaken to repay.[1] The report was equally clear that a protocol whose governance token holders or developers can change the code, pause withdrawals or seize funds has an operator in substance, whose position must be analysed under the ordinary rules.

The borrower's position is simpler. She has pledged collateral and drawn a loan under terms set by code. If she is liquidated, she loses collateral according to the rules she accepted by using the protocol. Her complaint, if any, lies in the oracle (Chapter I) or in a code defect. The receipt token she holds is a claim against the pool and, as Chapter III explained, its classification depends on whether the pool has a manager.

Example

A Zug GmbH deposits USD 2 million of its treasury in USDC into Aave to earn yield. The GmbH holds aUSDC. In its accounts under the Code of Obligations the GmbH must decide whether it holds a receivable, a financial asset at fair value or something else, and must disclose the counterparty risk. The author's advice is to treat the position as a receivable against an unidentified group of borrowers, secured by pooled collateral and subject to smart-contract and oracle risk, and to describe it in the notes accordingly. For Swiss profit tax the interest accrual is income as it accrues. For wealth-tax purposes at shareholder level the aUSDC is valued at its redemption value. If the pool is exploited and the aUSDC becomes unredeemable, the GmbH has suffered a loss against no identifiable debtor and has no one to sue except, possibly, the holders of the protocol's governance token, a point Chapter VII takes up.

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Notes

1. Federal Council, Report on decentralised finance (DeFi), 16 December 2022, section 4.2 (banking law: no deposit without an obligor). Part E, Chapter IX.

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