DIGITAL ASSET RESEARCH

16 December 2022

Uniswap Fee Switch Proposal

SUMMARY

- Uniswap is the largest decentralized exchange (DEX) by trading volume. As of May 2022, Uniswap had a lifetime cumulative trading volume of over $1 trillion.
- In December 2022, a proposal to implement a fee switch pilot program was submitted on the Uniswap governance forum.
- Voting for the proposal that would implement the pilot program is expected to start before the end of 2022.

OVERVIEW

Uniswap is an automated market maker (AMM) protocol that allows users to swap ERC-20 tokens. It was initially introduced and deployed by Uniswap Labs to the Ethereum blockchain in late 2018. Amongst Decentralized Exchanges (DEXs), Uniswap has stood out because all trading fees are distributed to Liquidity Providers (LPs). Consequently, holders of the protocol's token, known as UNI, do not receive any direct benefits related to trading activity within the protocol. UNI simply acts as a governance token, allowing tokenholders to vote on proposals submitted to the Uniswap governance forum. However, UNI tokenholders have always considered the possibility of receiving a percentage of the Uniswap protocol's revenue, as other DEXs have adopted this mechanism.

After the launch of Uniswap V3 in May 2021, the community tried to implement a fee switch for the legacy V2, which passed an initial voting round known as the "Consensus Check". For the proposal to be put in place and become active, it would have to win a final vote as a governance proposal. This was the stage of the process where strict requirements needed to be met to propose a smart contract code amendment. This did not occur and the latest information is that a "Temperature Check" to allocate funding for fee switch research for both Uniswap V2 and V3 received a "no" vote from the community.

THE STATE OF THE CURRENT PROPOSAL

The potential fee switch program has massive impacts for UNI tokenholders and the Uniswap protocol itself. Currently, Uniswap charges a fee between 0.01%-1% per trade conducted on its platform. The entirety of that fee, which amounts to more than $2 billion across all trades since inception, is given to LPs. However, if this fee switch proposal is activated, a portion of that fee would be distributed to UNI tokenholders, reducing the net fee that LPs receive.

A proposal for a fee switch pilot program that impacts specific pools was filed on the Uniswap governance forum and successfully passed both the Temperature Check and the Consensus Check stages in July 2022. The vote was then put off to 1 December 2022 so that people would have more time to consider their options.

Details regarding the pilot program:

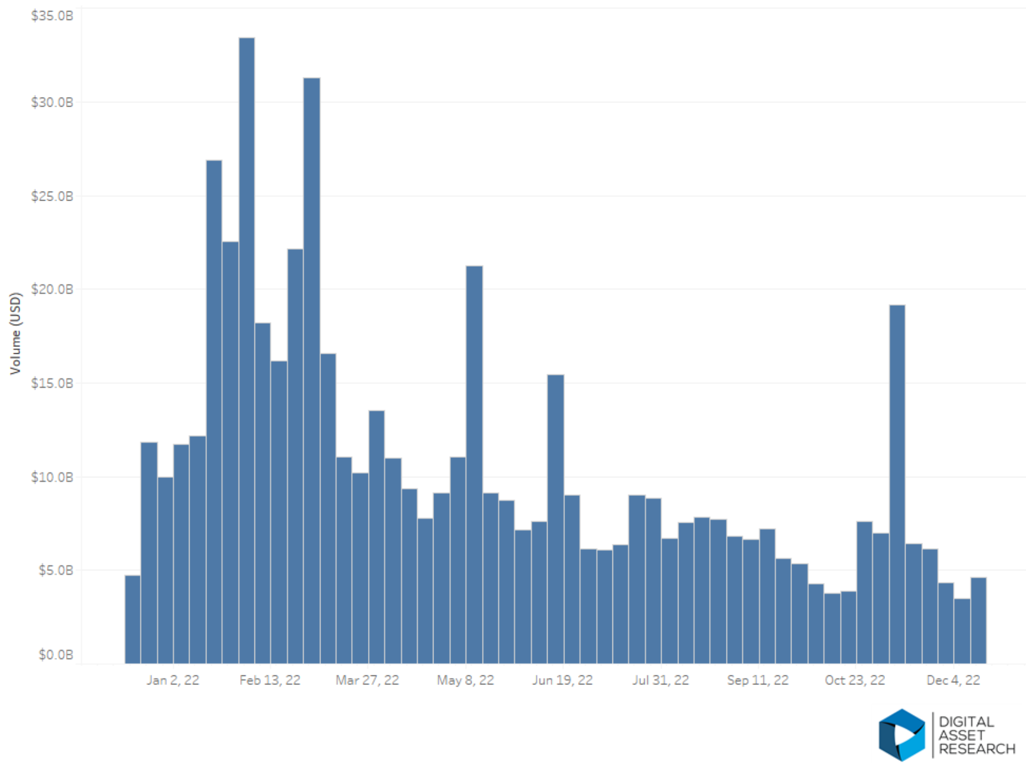
- The goal is to assess whether the fee switch will decrease trading frequency and volume on the select pools.

- It will impact these select pools for 120 days:
    - DAI-ETH (0.05% fee rate)
    - ETH-USDT (0.3% fee rate)
    - USDC-ETH (1% fee rate)

- It will not increase costs for end users of the Uniswap protocol.

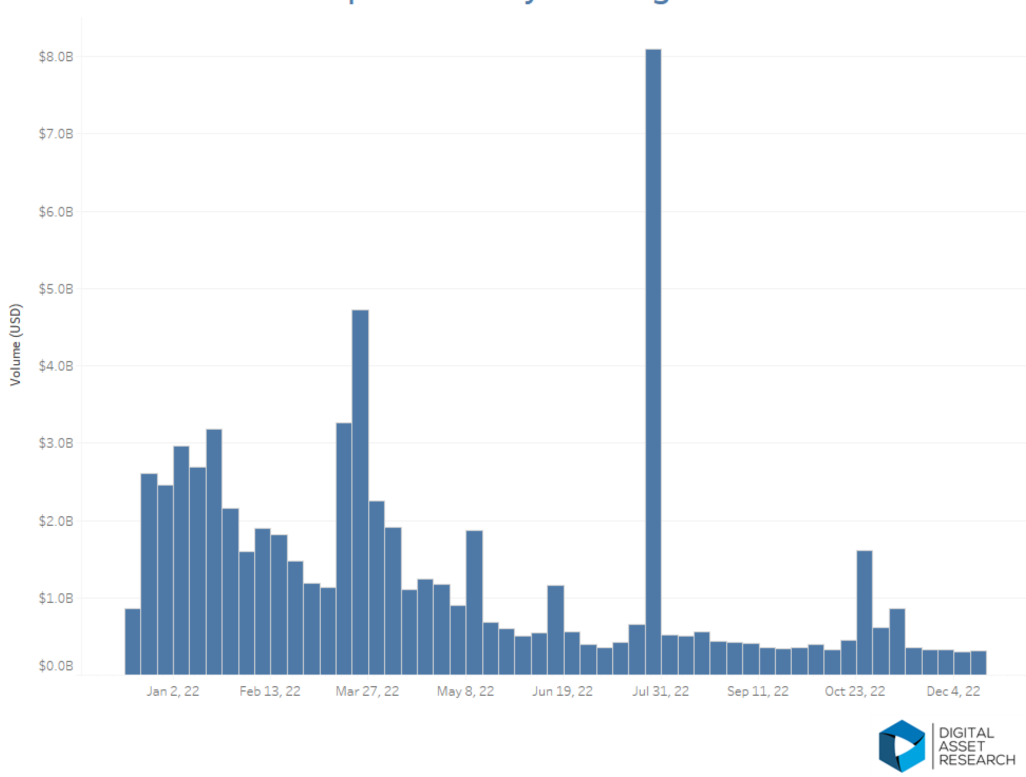
Sushiswap, one of Uniswap's primary competitors, directs a portion of its trading fees back to SUSHI tokenholders. If Uniswap had implemented a fee switch across all of its pools since the beginning of 2022 and maintained the same trading volume, it could have generated 9-figures in revenue for UNI tokenholders.

Uniswap V3 Weekly Trading Volume



Source: DAR Price

Uniswap V2 Weekly Trading Volume



Source: DAR Price

CONCLUSION

Uniswap's implementation of a fee switch that would redirect a portion of fees to UNI tokenholders would be a milestone for the DeFi ecosystem if passed. Although sharing revenue with tokenholders is not new, Uniswap would be the most dominant protocol, with more than $3 billion in TVL, to implement such a model. Uniswap also has a predominantly U.S.-based team and the implementation would show that U.S. tokenholders can receive cash flow, though this could increase regulatory risks for the UNI token.

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