# CoinShares DeFi Spotlight Q2 2022

**11th July 2022**

DeFi protocols continued to work as intended despite falling prices, cascading liquidations and high volatility. However, DeFi tokens continue to show weaknesses on multiple fronts including poor tokenomics, weak security practices and questionable governance systems.

- Total Value Locked (TVL) decreased 70% to $70 billion, mostly due to a fall in token prices rather than withdrawals.
- Growth in Stablecoin supply and growth of DeFi TVL are highly correlated.
- Rehypothecation of assets for Q2 peaked at 27% but is now less than half of that.


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## Introduction

In this report we look at key trends and metrics within the DeFi ecosystem over the last quarter. The major sectors in DeFi continued to evolve, with Bridges becoming a major hub. Lido's staked ETH decoupled from the price of ETH causing confusion and a liquidity crunch. However, while many centralised entities struggled to cope with the fall in prices due to high leverage, DeFi protocols showed resilience through the adversity.

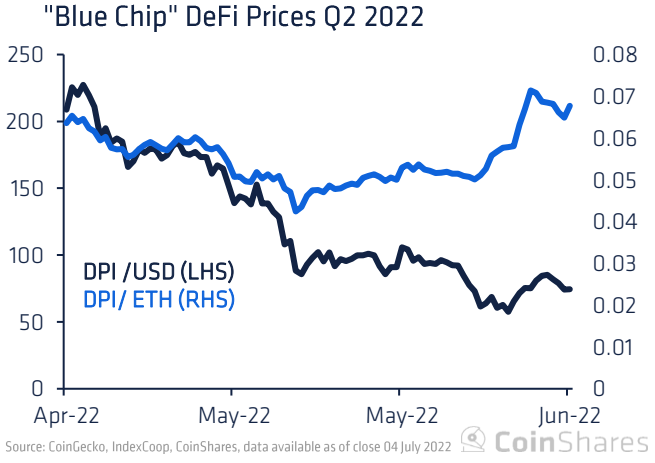
Decentralised Finance (DeFi) can be described as a suite of financial services (lending, borrowing, insurance, trading, derivatives etc.) that are open to anyone with an internet connection. Developers write smart contracts (code) which can perform pre-determined transactions when called upon and paid for. These services are available without the need for intermediaries like banks or other institutions and therefore have lower transaction times and lower take rates.

Furthermore, as these DeFi primitives are written in code, they can be built on top of or added to existing products. Some examples of novel DeFi applications (that don't exist in traditional finance) include self-repaying loans, non-collateralised loans paid back in the same transaction, and token swaps. DeFi aims to provide these services in a more transparent, trust-minimised, efficient, and inclusive manner.

## State of the market

### Price Action

Since the market crash in May 2021, DeFi token prices have continued their free-fall. The average "blue-chip" DeFi token is now 90% below its May peak with the majority of DeFi tokens experiencing even greater drawdowns[1]. The sharp contraction seen over the past year is likely somewhat due to the stellar price performance in 2020/21 causing profit-taking and the subsequent de-risking. Q2 2022 has proven to be one of the worst quarters for DeFi tokens as prices for "blue chip" tokens declined over 65% on average against USD but flat vs ETH. We show the price action for DeFi tokens using the DeFi Pulse Index (DPI) as a proxy for the "high-quality" market.



## Poor Tokenomics

A popular technique used by DeFi protocols is to reward users and contributors with its governance tokens. This practice has been successful in attracting users and bootstrapping the ecosystem, however the issuance of these tokens is inflationary and has caused downward pressure on token prices. As the inflationary rewards persist, token holders continue to lose value, which further incentivises them to sell. The rewards are then worth less and contributors leave in search of higher yield elsewhere. Overuse of these monetary incentives across the sector stimulated unsustainable growth during good times and compounded the decline in activity and pricing of DeFi during bad times. The decline in token prices reduces the value of protocols' treasuries which in turn requires greater selling to maintain a protocol's funding runway. A protocol's failure due to tokenomics isn't always a slow bleed, when reflexive incentives are strongly built in, this can result in implosion like that of the Terra blockchain. Projects will need to rethink their tokenomics if they are to not only survive but grow in a sustainable way.

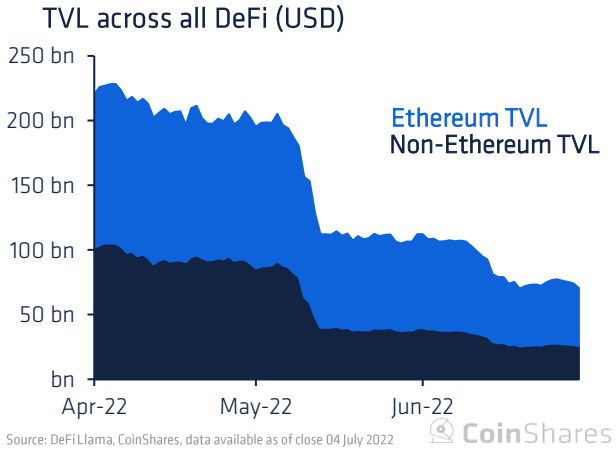
## Robust Mechanics

While the token prices have fared poorly, the protocols themselves have continued to execute their programs correctly. Unlike their centralised counterparts, no DeFi protocols paused withdrawals or filed for bankruptcy nor were there any contagion effect among these dApps. DeFi protocols continued to work as intended with orderly liquidations, 24/7 token swaps and no intermediaries. These functions were all performed on-chain in a transparent manner for any entity to audit. As discussed later, the amount of rehypothecated assets is comparatively measurable, allowing for enhanced risk management practices. This quarter has shown some of the key differences between DeFi and CeFi (Centralised Finance).

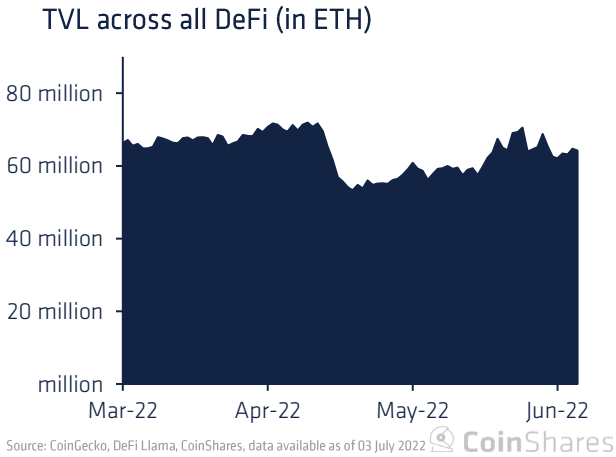
## Total Value Locked (TVL)

TVL is the sum total of assets deposited within a DeFi protocol. These assets are not necessarily owned by the protocol but are instead deposited by users of the dApps in search of a return on their capital. Protocols usually incentivise users to add to its TVL by issuing tokens as a reward. Protocols with a large TVL are seen as more trustworthy (although this is not necessarily true) hence a large TVL can attract more funds and potentially reduce the need for unsustainable incentives. A large TVL also helps with liquidity and expands the potential use cases.

As of Q2 2022, TVL has decreased 70% in the last quarter alone to $70 billion. Below we show the evolution of TVL for the last quarter.

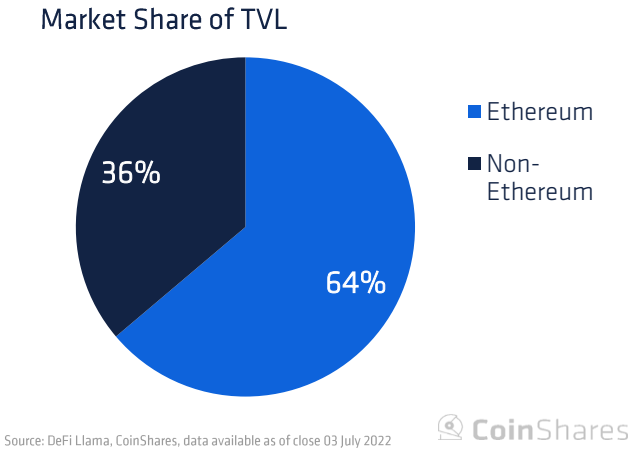



The decline in TVL closely matches the decline in crypto prices over the same period. When normalising the TVL by measuring the deposits in ETH as a proxy (instead of US dollars) we see that the reduction in TVL was mostly due to a fall in token prices rather than withdrawals. In fact, it appears that TVL deposits have been somewhat flat since the start of the quarter and remain close to all-time highs. We show below the evolution of TVL since March 31st, 2022.

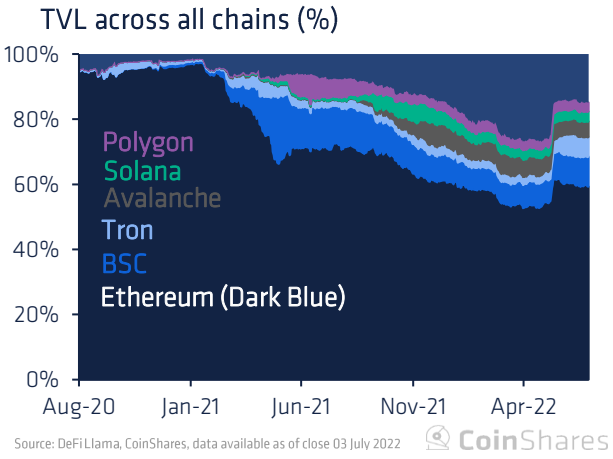


## TVL Market Share

While Ethereum may be the first mover and pioneer of DeFi, a plethora of financial activity has exploded across other blockchains as well. Alternative layer-1 chains and layer-2 chains have started to launch their mainnets along with sizable incentive programs to attract users and TVL. With just under $30 billion locked up in non-Ethereum chains, the market share of these chains stood at 36% or roughly one-third of all TVL.



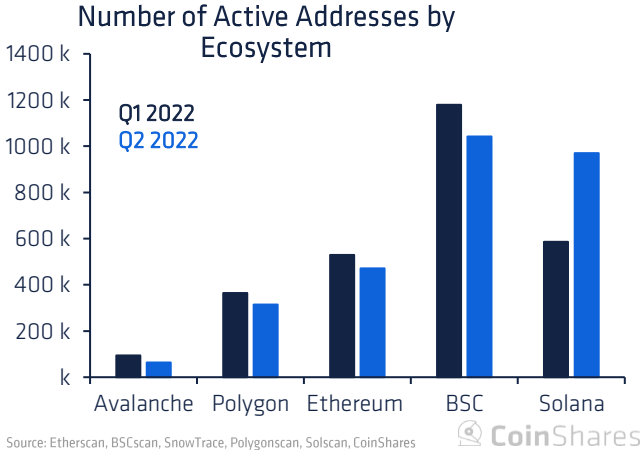

Due to the high gas fees on Ethereum, massive token incentive programs, and a flurry of DeFi dApps being built on other chains, Ethereum has been losing ground on its commanding TVL position. Below we show the progression of TVL market share across the DeFi ecosystem.



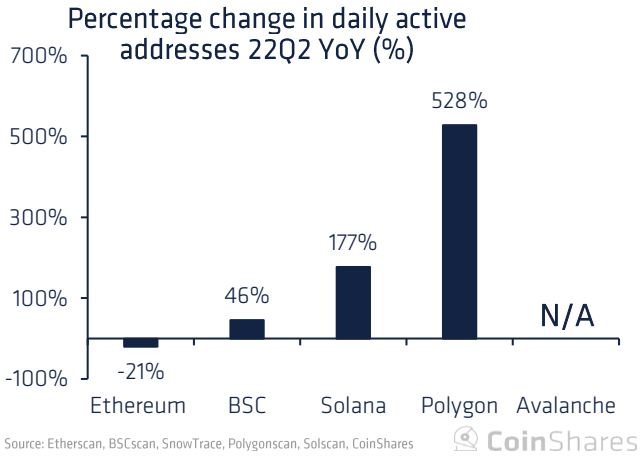

However, as prices have come down across the board, and the collapse of the Terra blockchain, the Ethereum ecosystem has remained relatively strong and even regained market share in the second quarter of 2022. During this last quarter, Ethereum's TVL market share increased by 7 percentage points to 60%. In fact, including the value locked up in layer 2s, we derive a 62% market share. Notably, Terra and Fantom have dropped out of the top 6 and been replaced by Tron (6.05%) and Polygon (2.75%). Within the top six blockchains, four of them are EVM-based (derived from the Ethereum Virtual Machine), meaning that the underlying code works just like that of Ethereum's. This makes it easier for developers to re-use code that was originally written for Ethereum and opens up the number of developers who already have the skillset and tools required to write smart contracts.

## Number of Users

Although one user can have multiple addresses, the number of unique addresses can still serve as a proxy for unique users. Below we show the average number of unique addresses declining in each of the major blockchains except Solana which saw users rise by an average of 84k during Q2 2022.




Despite the fall in users during the ninety-day period, daily active addresses are still materially up year over year. Below we show the yearly change in DAW (Daily Active Wallets) with Polygon showing the largest percentage uptake of over 500% (250k users onboarded). Ethereum's decline in user growth may be attributed to increased competition among the top smart contract platforms.

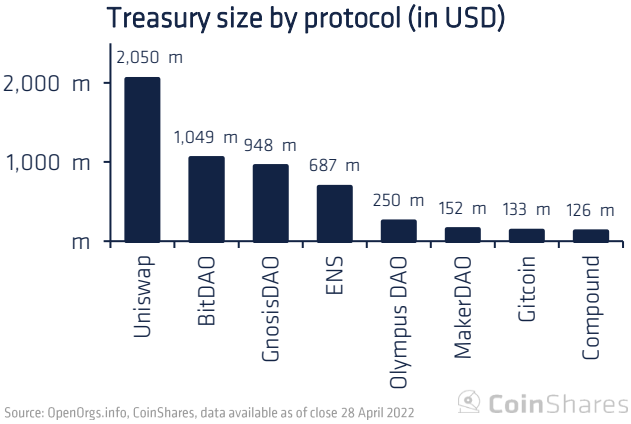



Source: Etherscan, BSCscan, SnowTrace, Polygonscan, Solscan, CoinShares

## Treasury

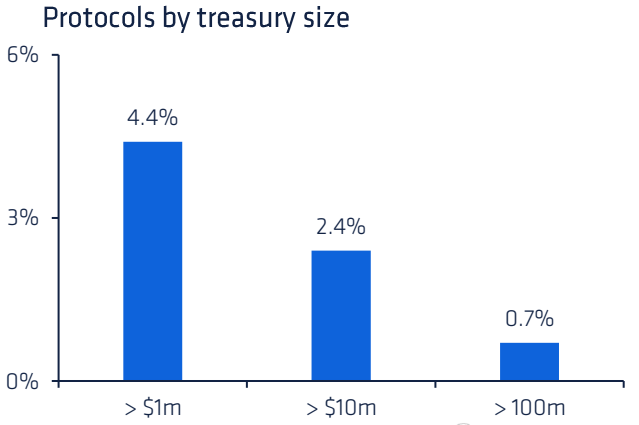
Unlike TVL, the treasury of a protocol does indeed reflect the assets under the purview of the token holders. These assets, otherwise referred to as "protocol-controlled value", represent the value that token holders can influence through the governance process. These assets can be obtained through a predetermined supply schedule or as profits from financial services.

At the end of Q2 2022, the largest treasury belonged to Uniswap which had $2.0 billion on its balance sheet of which $1.3 billion was accessible and the remaining $0.7 billion will gradually unlock (as coded in the supply schedule). On the other hand, Olympus DAO, which popularised the concept of "protocol owned liquidity", allows its token holders to have influence over its full treasury as per its governance policy. The importance of treasury management within the DeFi industry has only recently started to become more recognized. Below we show the protocols with the largest treasuries for Q2 2022.




Source: OpenOrgs.info, CoinShares, data available as of close 28 April 2022

The crypto treasury market is around $7.7 billion and the above 8 protocols constitute 70% of the market ($5.4 billion). The majority of protocol treasuries are relatively small as over 2,100 protocol treasuries hold under $1 million. Below we show the percentage of the largest protocols by treasury size.

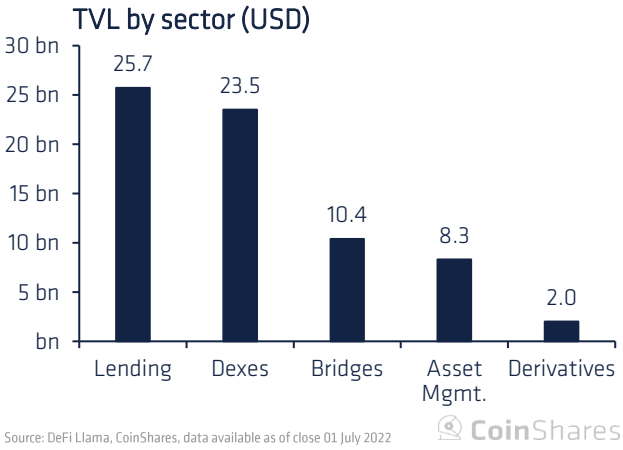



Source: DeepDAO, CoinShares, data available as of close 03 July 2022

## Sector Analysis

### Industry Classification

Similar to TradFi (Traditional Finance), within DeFi there exist different financial sectors and services. We examine some of the major sectors, namely, Decentralised Exchanges, Asset Management, Derivatives and Lending. We also highlight the Bridging sector which has seen a material increase in TVL and usage since Q1. Bridges are the infrastructure used to connect different blockchains with each other. As of Q2 2022, Bridges have replaced Insurance as a top-5 sector within DeFi and we highlighted its growing importance in our previous report. Despite these sizeable gains, we see that Decentralised Exchanges and Lending protocols continue to host the largest TVLs within crypto followed by Bridge protocols in a distant third. We highlight the largest sectors by TVL for Q2 2022 below.



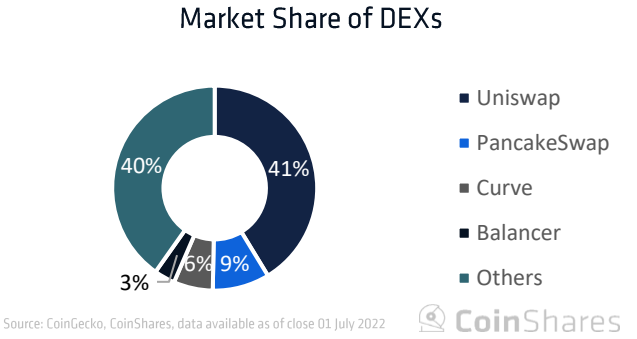

## DEXs

DEXs (Decentralised Exchanges) have been an important component of the DeFi ecosystem, allowing users to easily trade assets with each other in a permissionless fashion. Traditional order matching systems exchanges are relatively complex and have higher gas fees making them infeasible for blockchain usage in their current state. Enter AMMs (Automated Market Makers) - these are the prevalent form of DEXs in the crypto exchange landscape and rely on a mathematical formula *instead of intermediaries* to price assets. AMMs work by incentivising liquidity providers (LPs) to supply funds to liquidity pools (smart contracts) which buyers and sellers trade against. Liquidity providers are then rewarded with the trading fees collected from the pools. One can see that higher liquidity encourages more trading and results in more fees earned by LPs which attracts more liquidity and hence a flywheel effect. At the end of Q2 2022, TVL across DEXs stood at $24 billion. Below we highlight some of the trade-offs when using a DEX AMM.

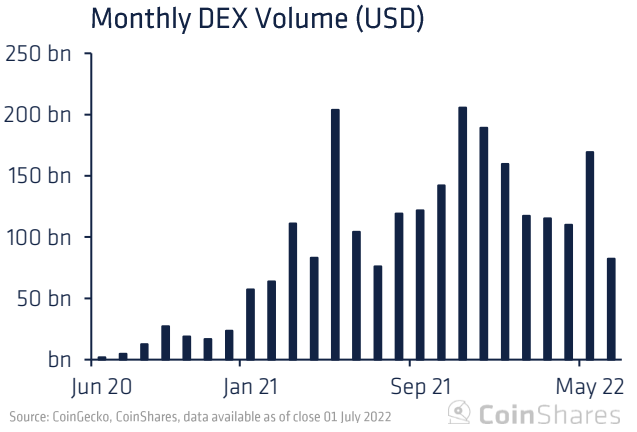
| Advantages | Disadvantages |
|---|---|
| Autonomous | Liquidity limitations |
| Non-custodial | Speed |
| Transparent | Slippage costs |
| Secure | Fees |
| Accessible | No advanced tooling |

*Source: CoinShares, data available as of 1st July 2022*

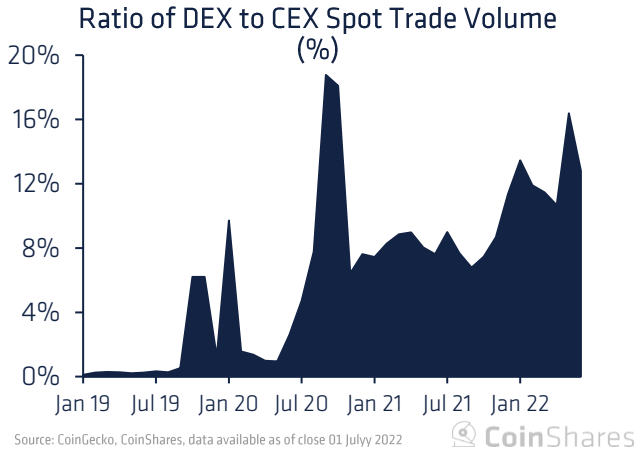
Of all the DEXs, the standout winner has been Uniswap with a respectable 41% of the market share. Indeed, even the 2nd largest DEX, PancakeSwap is a fork (copy) of the original Uniswap protocol (as well as countless others).




During the second quarter of 2022, despite the contraction in prices and relatively muted on-chain activity, trading volume across DEXs averaged over $95 billion per month with over 100 million monthly DEX visits.

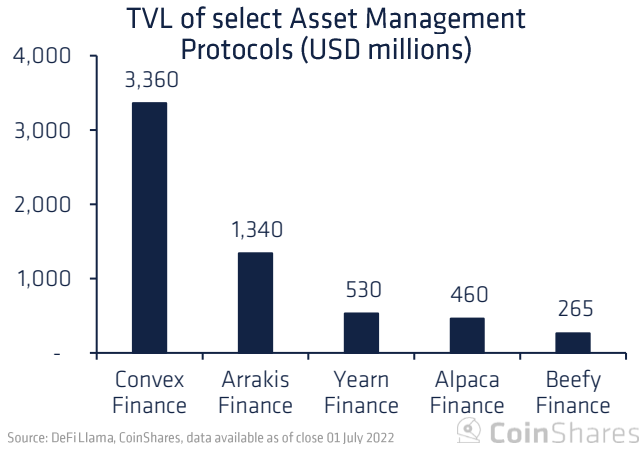



When looking at how well the crypto DEX market fares against the CEX (centralised exchange) market, we see that DEX spot volume still represents less than 1/6th (12.8%) of total spot volume. However, as blockchains become faster and cheaper this fraction is continues to grow. We expect DEXs to significantly increase their market share in the coming years.




## Asset Management / Yield Aggregators

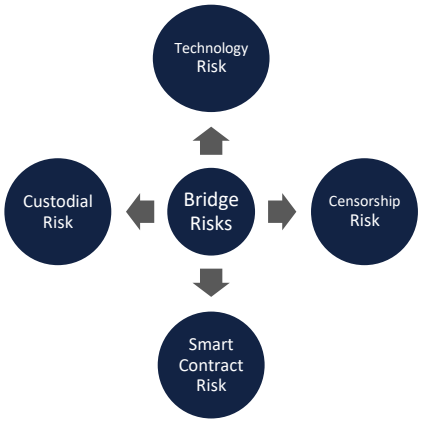
Without the requirement for human interaction, protocols execute autonomous and optimised investment strategies to boost the returns on users' deposited funds. While many applications charge less, some of these protocols, like hedge fuds, charge a 2 and 20 fee model. Also like hedge funds, not all asset management protocols generate alpha. However, there are no accredited investor requirements, no multi-year lock-up periods, and no minimum capital requirements. Most asset managers deploy users' funds into a variety of staking, farming, auto rebalancing, arbitrage trading or leveraged strategies. Other dApps offer risk tranches to its users who either want safer, less volatile returns (senior tranches) or are willing to take on more risk for greater reward (junior tranches). At the end of Q2 2022, TVL across asset management protocols stood at $8.3 billion.




## Bridge Protocols

Bridges is a term for the technology that connects different blockchains and has become more important given the growing evidence of a multichain world. Blockchains are inherently siloed networks that adhere to strict rules in an effort to maintain order and security, this makes it hard for them to natively communicate with each other. The current issues with many chains are i) dApps are only composable with other dApps on the same chain ii) Liquidity is fragmented across many different chains which is quite capital inefficient and 3) Unfriendly user experience with paying fees to move assets between chains. Bridges aim to solve these problems.

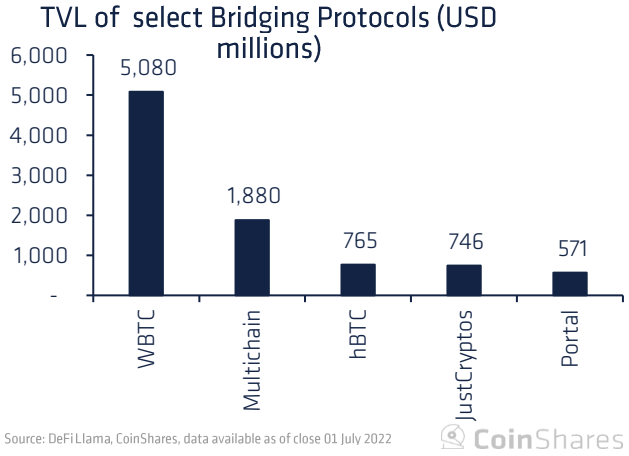
Broadly speaking, bridges can fall into 2 categories i) Liquidity bridges - used to transfer tokens between chains, and ii) Data bridges - used to transfer arbitrary messages between chains. Below we highlight the various risks factors associated with bridges.




*Source:CoinShares*

There are now dozens of implementations of bridges, each with its own speed, security, and trust trade-offs. It should be noted that the risks associated with these different implementations are not trivial. In fact, two of the three largest crypto hacks were from bridge protocols, highlighting the need for greater security and risk management. Technology and smart contract risks can arise from buggy code, human error, spam, or malicious attacks while custodial and censorship risks involve bridge operators

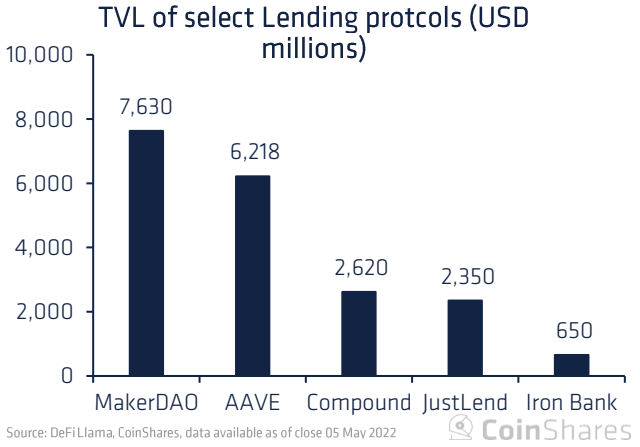
halting transactions or stealing users' funds outright. Below we show the top bridges by TVL.



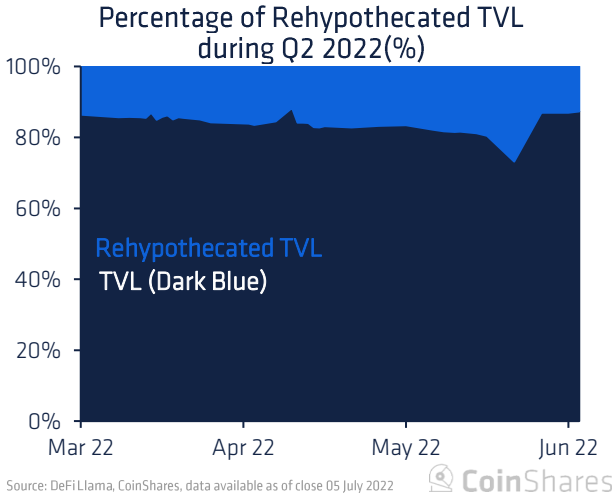

## Lending & Borrowing

Credit is the lifeblood of a thriving economic system and thus an important component of decentralised finance. Like traditional banks, DeFi lending platforms aim to offer loans using funds deposited on the platform by its users. The interest rates are algorithmically determined by the ratio that exists between the supplied and borrowed tokens in a particular market. This is all performed in a permissionless manner without any intermediaries or KYC and credit checks. While eliminating intermediaries leads to greater efficiencies, no KYC requirements increases AML risks. Furthermore, the lack of credit checks can't be overlooked, and this is why the vast majority of DeFi lending platforms require over-collateralised loans which severely limit the usefulness of these lending services. However, a concept known as "flash loans" allows borrowing with no collateral, provided that the borrowed funds are returned to the pool (in this case the lender) within the same transaction block, thereby guaranteeing the funds will be repaid.

It should be noted that lending within DeFi is not peer to peer but rather peer to pool to peer. This system spreads the risk while also allowing token holders to vote on which assets are acceptable as collateral, as well as the agreed upon collateralisation level required for each asset. Below we show the largest lending protocols by TVL.




Another advantage of DeFi lending vs TradFi lending is that the transparent nature of the blockchain allows for more accurate estimates of rehypothecation among projects. For the last quarter, rehypothecation peaked at 27% in mid-June but declined to approximately 13% by the end of the quarter.

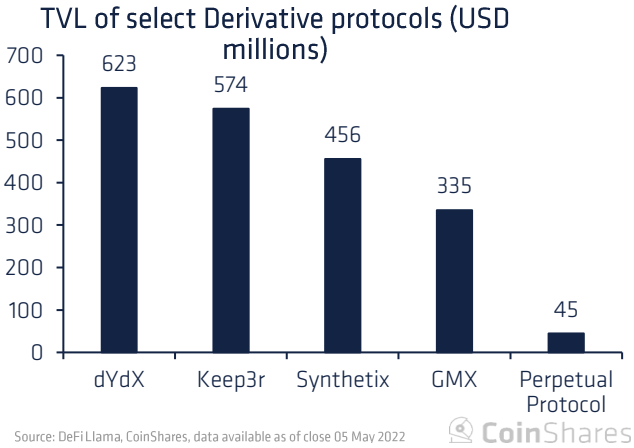



## Derivatives

Derivatives play a large role in traditional finance, with the size of the TradFi derivatives market estimated to be over $10 trillion annually. Within DeFi, the derivatives market is much smaller but given the size and its importance in mature financial markets, it's only a matter of time before crypto derivatives begin to play a larger role. However, there are some hurdles that need to be overcome to become a flourishing industry, namely;

i) Transaction delays - slow execution time can be detrimental to a derivatives trader trying to take advantage of volatility or mispricing.
ii) High gas fees - for derivatives protocols, data-intensive calculations are needed to help value the derivatives and the need for frequent oracle calls also increases gas costs.
iii) Capital inefficiencies - due to the volatility in DeFi there is a large reliance on over-collateralisation for many products, for instance Synthetix requires a collateralisation ratio of 400% which creates a high opportunity cost for one's capital.
4) Risks associated with creating, buying and selling these derivatives have been difficult to quantify.

A solution to 1 & 2 is to migrate the dApps to a layer 2 protocol (a faster, cheaper blockchain) and while the risks of crypto derivatives will eventually be thoroughly gauged, over-collateralisation remains an open problem in the industry. At the end of Q2 2022, TVL across derivative protocols stood at $2 billion as highlighted below.

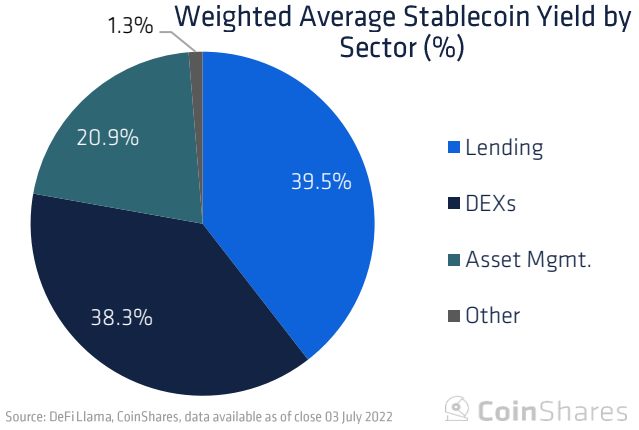



## Other Key Metrics

### DeFi Yields

Yield Farming is a term within DeFi used to describe the actions of earning a yield using DeFi tokens. When compared to traditional investing, yield farming can be compared to bond yields, dividend yields or savings accounts. However, the attractiveness of DeFi yields exist because token holders take on elevated levels of risk and the rates can be quite variable in nature.

DeFi yields are highly reflexive, this is due to the correlation between price action and on-chain activity. The source of these yields can vary by token, protocol and chain, each of which can further vary in yield and riskiness. Below we show the main sources of yields across all *legitimate* chains and protocols in DeFi weighted by TVL. We also removed low TVL protocols (<$1m) to further filter out projects that, for example, reward users with 4-digit APYs to stake their inflationary tokens (with little or no utility).

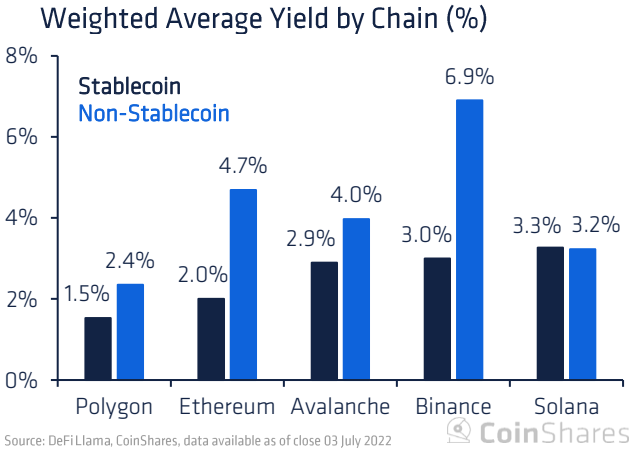



It's no surprise to see that the largest sectors by TVL are where most DeFi users source their yields from. Yields on Lending protocols are dependent on borrowing activity and opens lenders up to credit and default risks. Yields from DEXs are dependent on trading volume and expose liquidity providers to impermanent loss risk. Asset management protocol yields depend on the strategy employed while exposing users to risk of loss of capital.

Protocol usage, liquidity, and leverage all increase with crypto prices due to greater swap fees collected by liquidity providers, rising deposit rates on loan markets, and rising value of token-denominated incentives. This increased utilisation also results in higher yields. These mechanisms incentivise more money to enter DeFi because of the rising rates, but the opposite is also true when prices start to fall. Falling prices lead to falling on-

chain activity, decreased liquidity and hence yield compression.

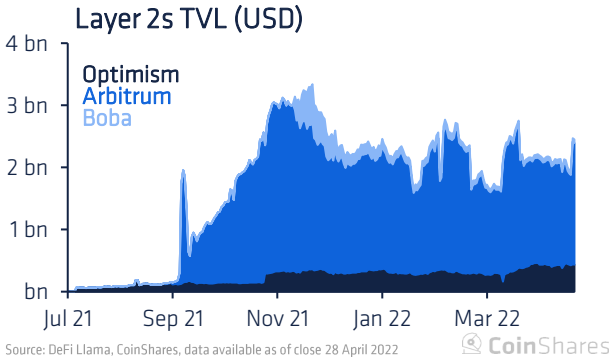
Zooming out below, we look at the stablecoin yields offered on select blockchains. Polygon offers one of the lowest yields while Solana (which has highly inflationary tokens) offers one of the highest stablecoin yields. In the long term, we expect that yields across the leading ecosystems to head towards parity with each other.




On average, the yield across all chains for all *legitimate* tokens was 4.96% for the end of Q2 2022. This is 1.5 percentage points lower than the 30 days prior.

## Layer 2s

Layer 2's are separate blockchains built on top of an existing Layer 1 blockchain that help to scale the main chain (in this case Ethereum) with faster throughput and lower fees all while preserving security. Below we highlight the three largest general-purpose layer 2s by TVL. Similar to the first-mover advantages exhibited by Ethereum, Arbitrum is reaping rewards for its early progress. Despite having no token incentives and an incomplete product, Arbitrum had over $2 billion in TVL by the end of Q2 2022 and an 72% market share among general-purpose layer 2s.




## Governance

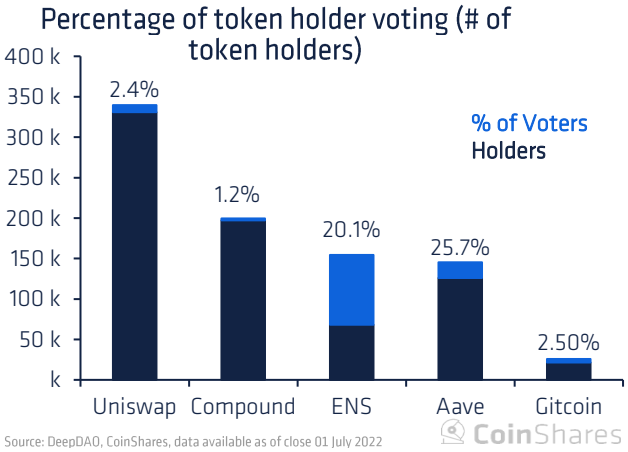
Governance is a key area of exploration for blockchains today with the two main approaches being off-chain governance and on-chain voting.

| On Chain Voting | Off Chain Voting |
|---|---|
| More transparent than off-chain voting. | No transaction fees required to vote. |
| No trusted third party required to count votes, which can be enacted automatically. | More participation, particularly from smaller holders and the wider community. |
| The system can be gamed or formed into a plutocracy. | External actors without a significant stake in the platform may exert too much influence. |
| Works well for approving protocol changes or other high-risk votes. | Works well for sentiment polls or other low-risk votes. |

*Source: CoinShares, data available as of 1st July 2022*

Within DeFi, most tokens provide token holders with voting rights similar to those of shareholders. The typical governance process starts with a stakeholder (DAO member, developer, investor) conducting research and developing a formal proposal. Proposal discussions then occur across social media, online forums, and offline. The community, including core team members, will review the

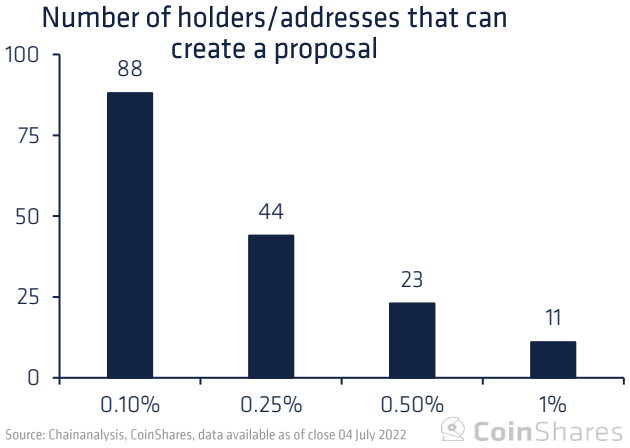
proposals and provide feedback. Depending on certain criteria, a proposal is put forward and voted upon - generally, a significant majority is required to adopt a proposal. While there are no legally binding contracts, the developers tend to abide by the outcome of the vote. However, voter apathy remains high in DeFi, likely due to high fees associated with voting as well as the potential complexity of the matters being voted on. Below we highlight a selection of popular DAOs, and the percentage of active tokens used to vote on their proposals.




## The Fallacy of DAOs

Decentralised Autonomous Organisations are the entities who are charged with the governing of crypto protocols. While this sounds revolutionary, at this stage, DAOs are mostly decentralised in name only and they are certainly not autonomous. In fact, it's hard to envision a future anytime soon where these protocols have "decentralised" governance and it's more daunting to see how that governance can be ever automated.

As highlighted before, voter activity is not high among crypto protocols, furthermore the majority of tokens that do vote are held by a few addresses. In fact, less than 1% of all token holders have 90% of the voting power[2]. These concentrations exist due to the supply distribution of the protocols (higher allocations towards team members) which are touted as being decentralisation friendly. Even the criterion for creating a proposal involves holding a minimum number of tokens which further exacerbates the issue. Below we show the share of holders that can create a proposal based on the token holding criteria. As shown below, only 88 addresses can create a proposal when the minimum token holding is 0.10% of the supply while only 11 addresses can create a proposal when the minimum token holding is 1% of the supply.




This system is admittedly closer to that of shareholder voting than a decentralised one. In fact, we have seen instances of large token holders making outsized votes to target individuals and eject them from the system. This power structure seems to go against, not only the decentralisation narrative but also the ethos of a censorship-resistant and open system.

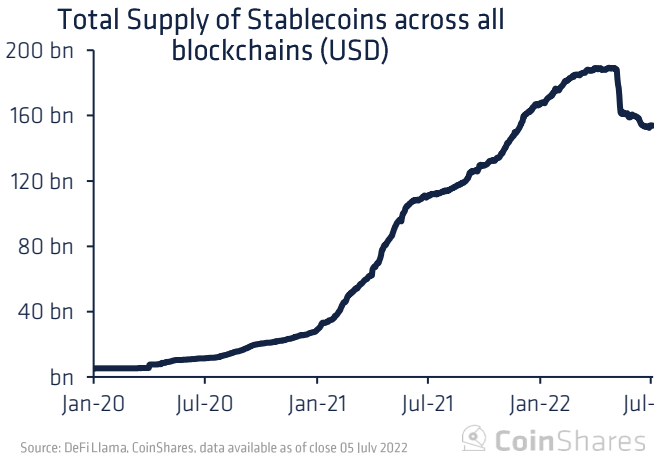
On the other end of the spectrum, protocols such as Sushiswap have failed to maintain its market share partly due to multiple crisis of leadership and no clear strategic direction. This is an instance where a greater concentration of power might have been beneficial to the protocol and its token holders. So, while a plutocracy is certainly not ideal, having some form of governance hierarchy is not necessarily a bad thing. It's arguable that some DAOs could benefit by shifting into structures more commonly seen in TradFi with various boards, departments and committees.

## Stablecoins Supply

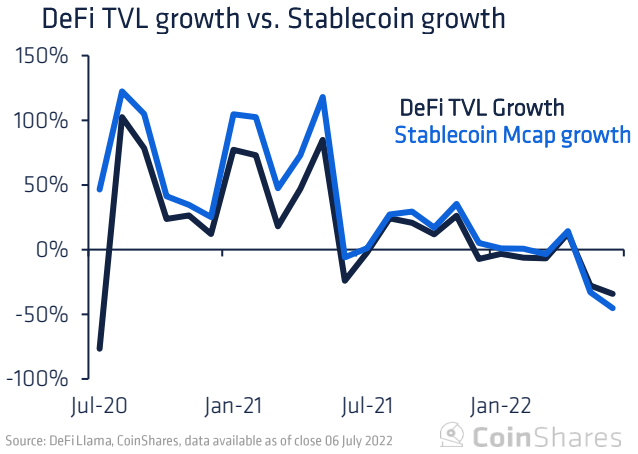
Collateralized Stablecoins are a type of cryptocurrency that's pegged to a non-volatile asset (such as the US dollar). These

stablecoins address the issues of inherent volatility risks within the crypto space and help to facilitate more predictable transactions. The vast majority of stablecoins (c.90%) are issued by Circle (USDC) and Tether (USDT). These coins are *mostly* backed by US cash & cash equivalents, other short-term deposits and commercial paper held in bank accounts to help maintain trust in the peg[3].

There also exists Algorithmic Stablecoins, which maintain their peg through algorithmic incentives and in some cases, partial reserves (like FRAX). However, with the current implementations of algorithmic stablecoins, reliance on a governance token to maintain the peg can be detrimental. This is because as the stablecoin loses its peg, the governance token also loses trust and value, so both coins rely on each other holding value otherwise both fall into a "death spiral" as has happened numerous times before. As shown below, the supply of stablecoins in DeFi has grown tremendously over the past couple of years. However, with the collapse of UST (evidenced by the sharp drop in May) and the billions in redemptions of USDT, the total supply of stablecoins has decreased by 20% for the quarter.




As further evidence to the importance of stablecoins within the DeFi ecosystem, we see below that the growth of stabelcoins and TVL are highly correlated with a correlation coefficient of 0.79.




## DeFi Risks

No financial sector is without risks and within DeFi there are many that one should be aware of:

i. Crypto is inherently volatile and this can affect the value of a dApp's treasury or even a user's collateral. This is why over-collateralisation is popular and also why Compound Treasury (the institutional fixed-yield product) had its treasury rated B- by S&P[4].

ii. More specific to DeFi, there are smart contract bugs. A smart contract ensures that the logic contained in it is carried out exactly as written but the correct execution of the smart contract code does not guarantee its safety. As the blockchain is immutable, errors in smart contracts cannot be easily rectified after they have been published to the blockchain. As long as humans remain imperfect, so will the code they write. These smart contract risks will likely persist for newer dApps and upgrades until they become battle-tested over time.

iii. As of Q2 2022, the vast majority of DeFi tokens offer no true value accrual mechanisms. Tokens grant non-legally binding voting power but not much else and it's sometimes unclear at times why a token is even needed for a protocol's operations. Instead, to make up for this lack of fundamental value, protocols could be tempted to opt for more ponzinomics to attract users and

increase (temporarily) the price of its tokens.

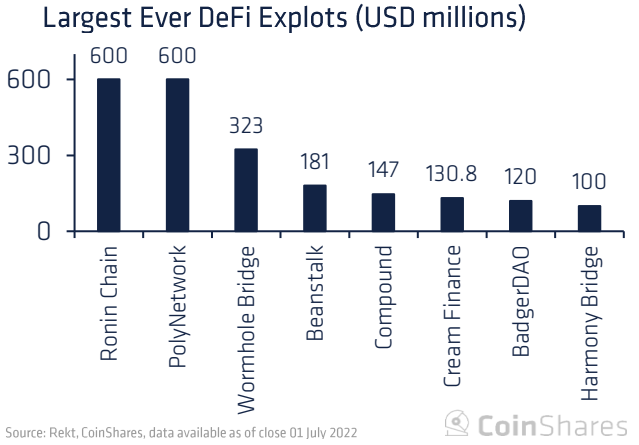
iv. The ability to attract and retain liquidity is a necessity and failure to do so can be detrimental to a project. Protocols attract liquidity in a variety of ways including incentive programs, marketing, prize giving, and grants. However, these practices aren't always sustainable and can lead to mercenaries (liquidity miners who come for the incentives and leave after) who only extract value. Certain tokenomics can help create access to more robust liquidity but more experimentation needs to be done.

v. As stablecoins continue their growth, any de-pegging from algorithmic failure or loss of belief in reserve assets may also prove to be a systemic risk. Indeed, algorithmic stablecoins have proven to be not so stable as evidenced by Iron Finance, Empty Set Dollar, Dynamic Set Dollar, Basis Cash, and of course, TerraUSD.

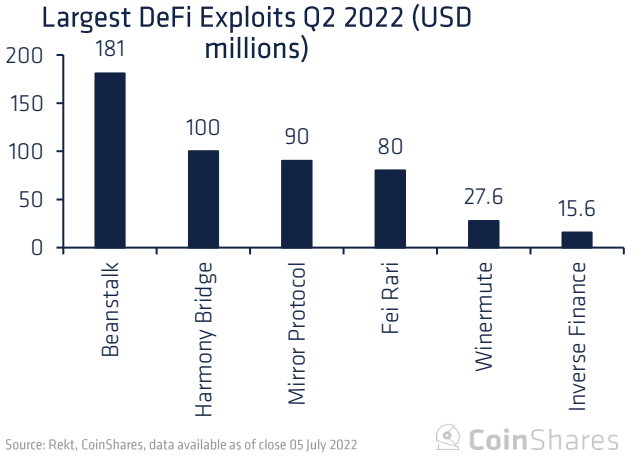
vi. Governance risks from poorly managed or structured DAO and poor tokenomics. Governance is not an easy endeavour, especially in a decentralised setting. The current "1 token 1 vote" system leads to voter apathy and higher chances of plutocracy. Short-sighted governance can also lead to tokenomics that distribute wealth to those in control in an unsustainable manner.

vii. Regulatory risks for DeFi are considerable as many jurisdictions across the world take dissimilar approaches to regulate the asset class. Countries like China and Egypt have outright banned crypto while countries like the USA permit usage but don't allow citizens to participate in types of fundraising or airdrops.

More than $1.5B of user funds have been lost across 10 exploits in 2022 alone, which already exceeds all of the value lost in 2021[5].
Below we show the largest DeFi exploits ever recorded. We see that the largest 8 exploits accounted for over $2.2 billion in value (although a portion of these funds have been returned by the hackers.



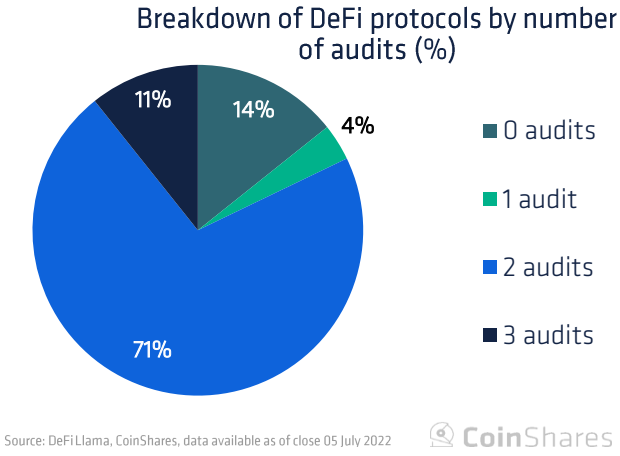

Once again, we show the largest DeFi exploits but only for the most recent quarter. We see that the largest 6 exploits accounted for just under $500 million in value (although a portion of these funds have also been returned by the hackers).




Given the severity and frequency of smart contract exploits, many projects opt into having their code audited by third parties in order to provide both the team and the users with a sense of security. However, these audits aren't infallible and depend heavily on the quality of the auditor and the complexity of the code.

In fact, having a stamp of approval by a questionable auditor on a complex protocol may actually do more harm than good. Below

we show a breakdown of the number of audits per *legitimate* project.




## Conclusion

All in all, Q2 2022 has been a negative period for price action but has highlighted the resiliency and predictability of the major DeFi protocols. Each sector continues to exhibit power-law distributions in terms of TVL and usage, highlighting the importance of network effects among the top protocols. However, while it is still early, DeFi has a series of obstacles ahead of it ranging from regulatory and educational issues to technological and economic challenges. The DeFi space continues to iterate and work towards a shared goal of a credible and sustainable financial system.

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(3) https://coinshares.com/research/is-tether-a-systemic-risk-to-the-crypto-market
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(5) https://rekt.news/leaderboard/

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