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Curve Finance Offers Solution to Impermanent Loss

August 3, 2025
— Categories: Crypto

Curve Finance has introduced a new mechanism designed to solve one of decentralized finance's (DeFi) most persistent challenges: impermanent loss. The platform's latest protocol, called Yield Basis, aims to protect Bitcoin (BTC) and Ether (ETH) liquidity providers (LPs) from value erosion, while also introducing a flexible, market-driven approach to token inflation and yield distribution.

Impermanent loss happens when the value of tokens in a liquidity pool changes unfavorably compared to simply holding those assets. This issue has long deterred potential LPs from participating in decentralized exchanges, as price fluctuations often leave them with less than they started. According to Curve Finance founder Dr. Michael Egorov, the root of the problem lies in the price formula used in most DeFi pools, specifically, its dependence on the square root of an asset's price.

"Impermanent losses happen because of this square root dependency," Egorov explained in an interview with *Cointelegraph*. "So, we want to get rid of the square root. The best way mathematically to get rid of the square root is to square it."

Yield Basis addresses this through a structure based on compounding leverage, keeping positions overcollateralized by 200% at all times. This is achieved using crvUSD, Curve's decentralized stablecoin pegged to the U.S. dollar. By borrowing crvUSD and supplementing each position, the protocol ensures the total value of the position is always double the collateral. This squaring effect, Egorov argues, eliminates the mathematical condition that causes impermanent loss.

Beyond solving this technical problem, the protocol also introduces bifurcated yield options. Users can receive returns either in tokenized Bitcoin or in the platform's native Yield Basis (YB) token. This dual-yield system creates a built-in incentive structure: during bullish markets, users may prefer the YB token for its growth potential. In contrast, during market downturns, more conservative users can opt for Bitcoin, offering protection against inflation and volatility.

This flexible system, Egorov suggests, allows the protocol to self-regulate. As more users choose between Bitcoin and YB tokens depending on market conditions, the overall inflation rate and token emissions adjust naturally without centralized intervention.

"In different market conditions, you need to do different things," Egorov said, emphasizing the importance of adaptability in DeFi.