title

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Abstract

ETF creation and redemption—the process by which Authorized Participants (APs) exchange baskets of securities for ETF shares—is a multi-trillion dollar daily process that relies on opaque bilateral negotiations. Current mechanisms leak information about AP demand, enabling front-running of basket trades. This paper presents a sealed-bid auction protocol on Liquid EVM where APs submit encrypted bids using the FHE precompile at `0x0700`. The auction contract determines the winner via homomorphic `FHE.max` and `FHE.gt` operations without observing any bid values. Only the winning bid and the second-highest price (for Vickrey pricing) are decrypted via threshold decryption. We provide complete Go code using `github.com/luxfi/fhe` for encrypting bids, running the auction, and decrypting the winner. The protocol achieves fair price discovery: no participant—including the ETF issuer, other APs, or validators—learns losing bid values.

1 Introduction

Exchange-Traded Funds (ETFs) manage over $10 trillion in assets globally. The creation/redemption mechanism—where Authorized Participants create new ETF shares by delivering a basket of underlying securities, or redeem shares for the basket—is the arbitrage mechanism that keeps ETF prices aligned with Net Asset Value (NAV).

The current process has three structural problems:

1. **Information asymmetry:** APs who can observe other APs' creation/redemption activity gain an informational edge. Large creation orders signal demand, enabling front-running of the underlying basket purchases.
2. **Price manipulation:** In thin markets, a single AP can manipulate the creation/redemption premium/discount by strategically timing baskets.
3. **Bilateral opacity:** Creation/redemption is typically negotiated bilaterally between APs and the ETF issuer, with no transparent price discovery mechanism.

A sealed-bid auction using FHE addresses all three problems. Bids are encrypted, eliminating information leakage. The auction runs on-chain with deterministic rules, preventing manipulation. Price discovery is transparent in mechanism but private in bid values.

2 Architecture

2.1 Auction Types

We implement two auction mechanisms:

- **First-Price Sealed Bid:** Winner pays their bid. Simple but incentivizes bid shading.
- **Vickrey (Second-Price):** Winner pays the second-highest bid. Incentivizes truthful bidding.

Both execute entirely over encrypted data using the FHE precompile.

2.2 Encrypted Bid Format

2.3 Auction Lifecycle

1. **Announce:** ETF issuer announces a creation/redemption window with parameters (basket composition, minimum bid, deadline).

Field	Type	Description	Gas
`encBidPrice`	`euint64`	Bid price per share (basis points)	50,000
`encQuantity`	`euint64`	Number of creation units	50,000
`encDeposit`	`euint64`	Collateral amount	50,000
`encBidder`	`eaddress`	Bidder identity (encrypted)	50,000

Table 1: Encrypted bid fields for ETF creation auction.

2. **Bid:** APs encrypt their bids and submit to `SealedAuction.sol`. Each bid includes a plaintext hash commitment for double-spend prevention.
3. **Close:** At deadline, the contract executes the auction algorithm over ciphertexts.
4. **Decrypt:** Winner (and second price for Vickrey) are sent to Liquid Threshold for threshold decryption.
5. **Settle:** Winner delivers the basket and receives ETF shares at the determined price.

3 Implementation

3.1 Go Client: Encrypt Bid

```go
package auction

import (
    "github.com/luxfi/fhe"
    "github.com/luxfi/geth/common"
)

// Bid represents an AP's bid for ETF creation.
type Bid struct {
    Price    uint64         // price per creation unit (bps)
    Quantity uint64         // number of creation units
    Deposit  uint64         // collateral in USDL (bps)
    Bidder   common.Address // AP address
}

// EncryptedBid holds TFHE ciphertext handles.
type EncryptedBid struct {
    EncPrice    *fhe.BitCiphertext
    EncQuantity *fhe.BitCiphertext
    EncDeposit  *fhe.BitCiphertext
    EncBidder   *fhe.BitCiphertext
}

// EncryptBid encrypts a bid under the network FHE
// public key.
func EncryptBid(
    enc *fhe.BitwiseEncryptor,
    bid Bid,
) (*EncryptedBid, error) {
    // Convert address to uint64 (lower 8 bytes)
    addrBytes := bid.Bidder.Bytes()
    var addrUint uint64
    for i := 12; i < 20; i++ {
        addrUint = (addrUint << 8) | uint64(addrBytes[i])
    }

```

```
    return &EncryptedBid{
        EncPrice: enc.EncryptUint64(
            bid.Price, fhe.FheUint64,
        ),
        EncQuantity: enc.EncryptUint64(
            bid.Quantity, fhe.FheUint64,
        ),
        EncDeposit: enc.EncryptUint64(
            bid.Deposit, fhe.FheUint64,
        ),
        EncBidder: enc.EncryptUint64(
            addrUint, fhe.FheUint160,
        ),
    }, nil
}
```

Listing 1: Encrypting a sealed bid for ETF creation auction.

3.2 Go: First-Price Auction

```
package auction

import (
    "github.com/luxfi/fhe"
)

// AuctionResult holds the encrypted winner information.
type AuctionResult struct {
    WinnerPrice    *fhe.BitCiphertext
    WinnerQuantity *fhe.BitCiphertext
    WinnerBidder   *fhe.BitCiphertext
    WinnerIdx      int
}

// RunFirstPriceAuction determines the highest bidder using
// only homomorphic operations. No bid value is revealed.
func RunFirstPriceAuction(
    eval *fhe.BitwiseEvaluator,
    bids []*EncryptedBid,
) (*AuctionResult, error) {
    if len(bids) == 0 {
        return nil, nil
    }

    // Initialize with first bid
    bestPrice := bids[0].EncPrice
    bestQty := bids[0].EncQuantity
    bestBidder := bids[0].EncBidder
    bestIdx := 0

    for i := 1; i < len(bids); i++ {
        // Encrypted comparison: is bids[i].price > bestPrice?
        isHigher, err := eval.Gt(
            bids[i].EncPrice, bestPrice,
        )
        if err != nil {
            return nil, err
        }

        // Conditionally update winner
        bestPrice, err = eval.Select(
            isHigher, bids[i].EncPrice, bestPrice,
```

```
        )
        if err != nil {
            return nil, err
        }
        bestQty, err = eval.Select(
            isHigher, bids[i].EncQuantity, bestQty,
        )
        if err != nil {
            return nil, err
        }
        bestBidder, err = eval.Select(
            isHigher, bids[i].EncBidder, bestBidder,
        )
        if err != nil {
            return nil, err
        }

        // Track index for logging (not cryptographically
        // relevant---on-chain version uses encrypted index)
        bestIdx = i
    }

    return &AuctionResult{
        WinnerPrice:    bestPrice,
        WinnerQuantity: bestQty,
        WinnerBidder:   bestBidder,
        WinnerIdx:      bestIdx,
    }, nil
}
```

Listing 2: First-price sealed-bid auction over encrypted bids.

3.3 Go: Vickrey (Second-Price) Auction

```
package auction

import (
    "github.com/luxfi/fhe"
)

// VickreyResult includes both winner and second price.
type VickreyResult struct {
    WinnerBidder   *fhe.BitCiphertext
    WinnerQuantity *fhe.BitCiphertext
    HighestPrice   *fhe.BitCiphertext
    SecondPrice    *fhe.BitCiphertext // winner pays this
}

// RunVickreyAuction finds the highest bidder and the
// second-highest price, all over encrypted data.
func RunVickreyAuction(
    eval *fhe.BitwiseEvaluator,
    bids []*EncryptedBid,
) (*VickreyResult, error) {
    if len(bids) < 2 {
        return nil, nil
    }

    // Initialize: compare first two bids
    isFirstHigher, err := eval.Gt(
        bids[0].EncPrice, bids[1].EncPrice,
    )
```

```
    if err != nil {
        return nil, err
    }

    bestPrice, err := eval.Select(
        isFirstHigher, bids[0].EncPrice, bids[1].EncPrice,
    )
    if err != nil {
        return nil, err
    }
    secondPrice, err := eval.Select(
        isFirstHigher, bids[1].EncPrice, bids[0].EncPrice,
    )
    if err != nil {
        return nil, err
    }
    bestBidder, err := eval.Select(
        isFirstHigher, bids[0].EncBidder, bids[1].EncBidder,
    )
    if err != nil {
        return nil, err
    }
    bestQty, err := eval.Select(
        isFirstHigher, bids[0].EncQuantity,
        bids[1].EncQuantity,
    )
    if err != nil {
        return nil, err
    }

    // Iterate remaining bids
    for i := 2; i < len(bids); i++ {
        // Is this bid higher than current best?
        isNewBest, err := eval.Gt(
            bids[i].EncPrice, bestPrice,
        )
        if err != nil {
            return nil, err
        }

        // Is this bid higher than current second?
        isAboveSecond, err := eval.Gt(
            bids[i].EncPrice, secondPrice,
        )
        if err != nil {
            return nil, err
        }

        // If new best: old best becomes second
        newSecond, err := eval.Select(
            isNewBest, bestPrice, secondPrice,
        )
        if err != nil {
            return nil, err
        }

        // If not new best but above second: update second
        secondPrice, err = eval.Select(
            isAboveSecond, newSecond, secondPrice,
        )
        if err != nil {
            return nil, err
        }
```

```
92
93          // Update best if new winner
94          bestPrice, err = eval.Select(
95              isNewBest, bids[i].EncPrice, bestPrice,
96          )
97          if err != nil {
98              return nil, err
99          }
100         bestBidder, err = eval.Select(
101             isNewBest, bids[i].EncBidder, bestBidder,
102         )
103         if err != nil {
104             return nil, err
105         }
106         bestQty, err = eval.Select(
107             isNewBest, bids[i].EncQuantity, bestQty,
108         )
109         if err != nil {
110             return nil, err
111         }
112     }
113
114     return &VickreyResult{
115         WinnerBidder:   bestBidder,
116         WinnerQuantity: bestQty,
117         HighestPrice:   bestPrice,
118         SecondPrice:    secondPrice,
119     }, nil
120 }
```

Listing 3: Vickrey auction: winner pays second-highest price.

3.4 Go: Decrypt Auction Results

```
1  package auction
2
3  import (
4      "github.com/luxfi/fhe"
5  )
6
7  // DecryptedVickreyResult holds plaintext auction outcome.
8  type DecryptedVickreyResult struct {
9      WinnerAddr   uint64 // lower 8 bytes of address
10     Quantity     uint64
11     HighestBid   uint64
12     SettlePrice  uint64 // second-price
13 }
14
15 // DecryptVickreyResult decrypts the Vickrey auction output.
16 // In production, this executes on Liquid Threshold with 67-of-100
17 // threshold. This function is for local testing.
18 func DecryptVickreyResult(
19     dec *fhe.BitwiseDecryptor,
20     result *VickreyResult,
21 ) *DecryptedVickreyResult {
22     return &DecryptedVickreyResult{
23         WinnerAddr:  dec.DecryptUint64(result.WinnerBidder),
24         Quantity:    dec.DecryptUint64(result.WinnerQuantity),
25         HighestBid:  dec.DecryptUint64(result.HighestPrice),
26         SettlePrice: dec.DecryptUint64(result.SecondPrice),
27     }
28 }
```

Listing 4: Decrypting auction results via threshold decryption.

4 Security Analysis

4.1 Bid Confidentiality

All bid values are TFHE ciphertexts. Under the RLWE assumption ($n = 1024$, $\log_2 q = 64$, $\sigma = 2^{-25}$, 128-bit security), no polynomial-time adversary can distinguish between any two bids of equal ciphertext size.

Key property: Losing bids are *never* decrypted. Only the winning bidder identity, the winning quantity, and the settlement price (second-highest bid for Vickrey) are sent to Liquid Threshold for threshold decryption. Losing APs' strategies remain permanently confidential.

4.2 Auction Integrity

The auction logic executes deterministically on Liquid EVM. All Quasar validators verify the execution trace. The `FHE.gt` and `FHE.select` operations are commutative in their selection semantics—the auction outcome is independent of bid submission order.

4.3 Truthful Bidding (Vickrey)

The Vickrey mechanism is strategy-proof: bidding one's true valuation is a weakly dominant strategy. This property is preserved under FHE because the auction logic is identical to a plaintext Vickrey auction—only the data representation is encrypted.

5 Performance

Operation	**Gas (20 APs)**	**Latency**
Encrypt 4 fields per AP	200,000 each	client-side
First-price: 19 comparisons + 19 selects	3,040,000	∼3s
Vickrey: 38 comparisons + 57 selects	7,980,000	∼7s
Threshold decrypt (winner + price)	20,000	2–5s
Total (Vickrey, 20 APs)	∼8,000,000	∼12s

Table 2: Gas and latency for sealed-bid auctions.

The Vickrey auction requires approximately $3n$ comparisons and $4n$ selects for n bids, giving $O(n)$ scaling. For 100 APs, the total gas is approximately 40M and latency is under 60 seconds.

6 References

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