Blockchain meets private debt: Is there a road ahead?

Guest comment by **Matthias Kirchgaessner**

The last year has seen blockchain become one of the most exciting areas in finance. But just how willing are private debt firms to get on board?

Research company Gartner cited that blockchain is forecast to create more than $176 billion-worth of the annual business value by 2025 and accelerate to over $3 trillion by 2030. A 2018 PwC survey also revealed that 84 percent of executives were "actively involved" in blockchain technologies somehow.

With the use cases increasing exponentially, blockchain technology has captured the attention of many companies across sectors. The financial sector got particularly awakened by seeing the rapidly developing decentralised finance (DeFi) segment as a potential threat.

Since 2020, we've witnessed a turning point of acceptance across the board; before, the momentum appeared somewhat comparable to the early 90s when people did not know what to do with the internet without any applications and use cases. Now, people are realising the ground-breaking potential of blockchain and adapting rapidly.

What is blockchain?

Blockchain is a type of distributed ledger technology (DLT) where transactions between mutually distrusting entities without the need for a trusted arbiter are recorded with an immutable cryptographic signature/timestamp, called a hash. Information that has been validated usually cannot be manipulated and thus builds the foundation of trust. A smart contract is built on top of the blockchain, which essentially is an application that computes and validates transactions that are stored on the ledger. DeFi is one of the use cases on the foundations of DLT and smart contracts that aims to reconstruct and reimagine services that usually belong to the financial industry. The DeFi ecosystem is in a rapid buildout phase and, based on total value locked (TVL), grew from $320 million at the beginning of 2020 to $13 billion by the year-end and then jumped to $85 billion in August 2021.

Blockchain enters private debt

DLT/blockchain offers lenders and asset managers the chance to rewrite how they operate and facilitates the restructuring of traditional value chains. It has the potential of greater data transparency and removes redundant and inefficient processes.

In the public markets, few examples of on-chain syndication of bonds have appeared over the past couple of years. The latest in Europe was the European Investment Bank's first €100 million digital bond on a public blockchain. Within the universe of private debt strategies, we already see an established use case with trade finance, projects in direct lending, and peer-to-peer lending. In strategies like distressed, litigation financing, asset transfers and specialty finance it appears rather complicated as acquired "off-chain" assets would need to be individually rewritten in a smart contract which can be cumbersome.

DLT/Blockchain is moving from experimentation to commercialisation across sectors, value chains and jurisdictions. Obstacles and risks are not neglectable at this stage, but it should be expected that those will diminish or be solved over time and tackling the emergence of the technology is outstripping the risks. As always at the beginning of a new technology life cycle, there are plenty of items that need to be ironed out, but for private debt, the train has left the station, and institutions need to familiarise themselves with the technology and consider the opportunities that arise with it. ■

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