What Is Tokenized Private Credit?

Lending to real businesses through a blockchain — where the yield actually comes from, who absorbs the first loss, and what happened the last time this category was tested.

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Tokenized private credit is the second-largest category in the real-world asset market, and by some distance the least understood. The proposition is a high single-digit or low double-digit yield, paid from loans to real businesses — trade finance, receivables, consumer lending, emerging-market credit — accessed through a token rather than a fund. That yield is genuine and so are the loans. What most explanations skip is what you are actually doing when you buy in, which is not depositing money somewhere but *lending it, unsecured, to borrowers you cannot see*. This report is about that distinction and everything downstream of it. It assumes you know what real-world assets are.

AT A GLANCE

WHAT YOU BECOME **A lender, not a depositor**	THE YIELD IS **A credit spread, not a return**	STRUCTURE **Pools, often tranched**
FIRST LOSS **Sits with junior capital**	RECOVERY HAPPENS **Off-chain, slowly, in courts**	ALREADY TESTED **Defaults in 2022 and 2023**

01

You are the lender

Start with the role you are taking, because everything follows from it. When you put money into a tokenized credit pool you are not depositing it, not buying a share of a company, and not holding a claim on government paper. You are making a loan — usually to a business,

frequently in another country, often unsecured or secured only by receivables you will never inspect — through an intermediary that arranged it.

That is a legitimate and ancient activity, and it is also the highest-risk position in the real-world asset market by some margin. It differs from tokenized treasuries in kind, not degree: there the borrower is a government that has never failed to pay in the relevant currency, and the instrument is a wrapper around near-certainty. Here the borrower is a company that might not repay, and the wrapper is around genuine credit risk. Both are called real-world assets and both pay a yield, but they are not variations on one thing.

02

Where the yield comes from

The most common mistake is reading the headline rate as a return on capital. It is not. It is a *credit spread* — the extra compensation demanded for lending to a borrower who might default, above what a risk-free lender would accept. That spread exists precisely because losses are expected to occur.

The correct way to read a double-digit yield is therefore as a market estimate of how likely the borrower is to fail, plus the cost of illiquidity, plus the arranger's margin. A higher rate is not a better deal; it is the market saying the risk is greater. And your *realised* return is the headline rate minus actual credit losses minus fees — a figure known only after the fact. Any pool advertising a rate substantially above others in the same category is telling you something specific about its borrowers, and the sensible interpretation is the unflattering one.

03

Pools, tranches and first loss

Most of these arrangements pool many lenders' capital and lend it out through a structure, and the structure is where the risk is actually allocated. The common pattern splits the pool into *senior* and *junior* claims. Senior capital takes a lower yield and is paid first. Junior capital — often called first-loss — takes a higher yield and absorbs losses before the senior tranche is touched.

Understanding which position you hold is the single most important thing about any given pool. First-loss capital is frequently contributed by the borrower, the arranger, or a sponsor, and its existence is what makes the senior claim reasonably safe: a modest level of defaults is

absorbed entirely by the junior layer. But that protection is finite. Losses beyond the junior tranche flow straight to senior holders, and in a genuine credit event the buffer that looked comfortable in normal conditions can be exhausted quickly. Two questions follow, and they are the ones to ask first: *which tranche am I in*, and *how much first-loss capital sits beneath me, contributed by whom*. A pool where the sponsor has meaningful money at risk behind you is a materially different instrument from one where it does not.

> *A yield is not a reward for being clever. It is the price of a risk somebody has decided to take — and in credit, the person taking it is you, whether or not the interface makes that obvious.*

04

The information problem

Here is the structural weakness at the centre of the category, and it is the same one that broke tokenized property. The blockchain records the loan token, the pool balance, and every transfer, with complete accuracy. It records nothing whatever about whether the borrower's business is sound, whether the receivables pledged actually exist, whether the same collateral has been pledged elsewhere, or whether the reported financials are true.

All of that lives off-chain, and you are relying on the arranger's underwriting to have checked it. That is a real dependency and it is not a technological one: it is the same credit assessment that a bank's loan officer performs, done by a party whose incentive is to originate volume. Transparency about the *token* is not transparency about the *loan* — precisely the distinction that made the failures in real estate tokenization possible despite perfect on-chain records. When you assess one of these products you are assessing an underwriter, not a protocol, and the questions that matter are how they select borrowers, what they verify, and what happens to their own money when a loan goes bad.

05

The category has already been tested

Unusually for this market, tokenized private credit has been through a full credit cycle, and the results are instructive rather than catastrophic. During the market stress of 2022 and into 2023, several prominent pools suffered borrower defaults — a trading firm that failed when a major counterparty collapsed, and borrowers in emerging-market lending that could

not repay. Lenders in affected pools took losses, and the category's total lending contracted sharply from its peak.

Two things are worth taking from that episode. First, the defaults were *ordinary*. Businesses that had borrowed money failed to repay it, which is what happens in credit lending during a downturn and would have happened identically had the loans been arranged conventionally. The blockchain neither caused nor prevented it. Second, the response was constructive: surviving protocols tightened underwriting, changed their structures and rebuilt, and the category has since recovered past its earlier size. A market that has taken losses, learned and continued is in a better position than one never tested — which describes most of this sector. But nobody should buy in believing defaults are hypothetical. They have happened, they will happen again, and the yield exists because of that.

06

What happens when a loan goes bad

This is the part with no on-chain answer. If a borrower stops paying, recovery is a legal process in the borrower's jurisdiction, conducted by the arranger or a servicer on the pool's behalf, against a company that may have few realisable assets. It takes months or years, it costs money that comes out of the recovery, and the outcome depends on local insolvency law and the quality of the security — if any was taken at all.

Three practical consequences. Your token cannot be redeemed against a defaulted loan, so an impaired pool typically restricts withdrawals — meaning liquidity disappears at exactly the moment you want it, and any secondary market for the token trades at a steep discount if it trades at all, for the reasons set out in market liquidity. Recoveries are partial: creditors in these situations routinely receive a fraction of principal, and that fraction arrives late. And the reporting of a distressed loan is at the arranger's discretion, so the interval between a borrower's trouble beginning and lenders learning of it can be considerable. None of this is unique to tokenization; all of it is unfamiliar to people who arrived expecting a yield product.

07

Why the size figures disagree

Anyone reading about this category encounters wildly different numbers for how large it is, and the discrepancy is not an error — it is a definitional split worth understanding. The

narrower measure counts loans genuinely settled and held on public blockchains, and produces a figure in the low billions. The broader measure includes assets originated on permissioned, private infrastructure — notably large volumes of consumer and home-equity lending run by a single specialist — and produces a figure several times higher.

Both are defensible; they measure different things. Establish which basis a figure uses before repeating it, because the two describe quite different markets: one a genuinely on-chain, largely permissionless lending market of modest size, the other mostly conventional lending using distributed-ledger infrastructure as a back office. When someone calls private credit the second-largest tokenized asset class, the claim is usually true on the broader basis and the composition is not what a reader would assume. The wider market is mapped in our report on RWA tokenisation.

08

What to check

Eight questions, in order of how much they tell you. Who are the borrowers — sector, country, and whether they are named or merely described? Who underwrote the loans, and what is their record through a downturn rather than a bull market? Which tranche would you hold, and how much first-loss capital sits beneath you and who put it there? Is the lending secured, and if so against what, and could that security actually be enforced where the borrower operates?

Then: what are the historical default and recovery figures for this arranger's pools, disclosed rather than inferred? What are the withdrawal terms, including whether redemptions can be suspended and under what conditions? What fees does the arranger take, and are they charged on assets originated or on returns delivered — because the first rewards volume and the second rewards prudence? And what would you actually own if the arranger itself failed, the question our note on evaluating a cryptocurrency applies to any counterparty. Judged properly this is a credit investment with an unusual settlement layer, and it should be assessed with the tools of credit analysis rather than those of crypto. Sized accordingly — as a small allocation to a genuinely risky asset class, not as a savings alternative — it is a reasonable thing to hold. Sized as though the yield were safe, it is the most likely place in this market to lose money slowly and then all at once.

“The wicked borroweth, and payeth not again: but the righteous sheweth mercy, and giveth.”

Methodology & Sources

This report explains a category and how to assess it as at the date of publication; it names no protocol, arranger, borrower or platform, and deliberately contains no yields, default rates, recovery percentages, pool sizes, fee levels or market-size figures beyond directional characterisation — all of these vary by product and change continuously, and readers should consult current issuer disclosures. Structural descriptions reflect arrangements in general use: lenders' capital is pooled and lent to businesses through an arranger; pools are frequently divided into senior and junior claims, with junior or first-loss capital absorbing losses before senior holders are affected; first-loss capital may be contributed by borrowers, arrangers or sponsors, and the amount and source vary materially. The characterisation of headline yields as credit spreads compensating for expected default risk, rather than as returns on capital, is standard credit analysis. The account of defaults during 2022 and 2023 — including borrower failures connected to the collapse of a major trading counterparty and difficulties in emerging-market lending pools, followed by contraction, tightened underwriting and subsequent recovery of the category — reflects publicly reported events; no protocol, borrower or individual is named and no conclusion is drawn as to fault. The description of recovery as an off-chain legal process producing partial and delayed outcomes reflects ordinary insolvency practice and varies by jurisdiction. The divergence between narrower on-chain measures and broader measures including permissioned infrastructure is a definitional difference, not a contradiction. Nothing here is a recommendation regarding any protocol, pool, token or transaction, and nothing here is investment advice; lending of this kind carries risk of partial or total loss of principal.

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