

Fund Tokenisation – A Blueprint from the Investment Association

In case anyone missed it, the Investment Association published a very interesting (and very well constructed) document in November 2023, specifically addressing the topic of Tokenisation of UK funds. This document not only spells out a vision for the future of funds and other assets being traded on a tokenised basis, but also talks extensively about what is happening right now to make that vision a reality. It is a very interesting to me, and for anyone involved at any stage with UK funds makes for necessary reading.

We suspect that if we were to ask people in the industry what is meant by “**tokenisation**”, that the spread of answers would be anything from “I’ve never heard of it”, or “I’ve heard of it but don’t know what it is” all the way up to “yes I know all about it and it will change the future of our industry”. So, given such a wide audience we thought that just pulling out the key points of interest from the IA’s paper would be a good way to draw attention to the issue for anyone who hasn’t seen or had time to read the full document.

Key takeaways for why UK Fund tokenisation should move forward at pace include:-

- For the UK funds industry specifically – ““there are no significant regulatory barriers to adoption in the context of industry’s blueprint model for tokenisation”. In other words, the existing regulatory framework does not need to be adapted or enhanced before fund tokenisation can occur, thereby avoiding a potentially long-lead-time and barrier to fund tokenisation initiatives taking place.
- “UK Finance recently estimated that digital assets could represent as much as 10% of the global market by 2030, equivalent to a value of between \$4-\$5 trillion”. As 2030 is now only 6 years away, if this prediction/opinion is true, asset managers need to look at tokenisation now.
- There are already tokenisation initiatives under way in foreign markets, and although they are dabbling rather than mainstream, countries like Germany, Luxembourg, France, Italy, Spain, the USA, and Singapore are moving forward. If the UK is to maintain its prominence in the world of Financial Services then it too needs to embrace tokenisation as a future way of working in the industry.
- Key benefits:-
 - Simplification of books and records, including reconciliations
 - Reduction in fund administration costs
 - Quicker settlement and reduced temporary liquidity funding
 - Potential for greater liquidity (or transparency thereof)
 - Automation driven by smart contracts
 - Enhanced data disclosure
 - Improved reporting capabilities including real time access for regulators or distributors
 - Access to a wider set of investment products by the injection of liquidity from secondary markets and reduced investment minimums
 - Potential for increased use as collateral
 - Improved processing of corporate actions through automation
 - Hyper-personalisation of portfolios to address specific investor needs
 - Improved transferability

So, we've outlined some of the key reasons quoted for considering a move to tokenisation of UK funds, but we haven't yet spelled out what tokenised funds actually are. For those wishing to be enlightened...

Tokenised Funds issue tokenised shares or units to represent the investor's interest in them and are generally traded and recorded on a distributed ledger rather than a traditional system of records. They simply seek to leverage the benefits of the underlying technology DLT (Distributed Ledger Technology) and Blockchain. This technology increases automation and efficiency.

The other thing which the paper discusses is the various phases of tokenisation that will occur. Stage one includes the introduction of the Digital Sandbox. Through the Sandbox, industry participants will be able to set up financial market infrastructures that utilise digital asset technology, which can perform a number of activities in relation to digital securities under a temporarily modified legislative and regulatory framework. Stage 1 is intended to stimulate the UK Tokenised Fund initiative. Further phases will be more complex and are being considered now.

Whilst it is still in its infancy, tokenisation is coming to the investment industry. The enabler is the underlying DLT and Blockchain technology that makes it possible. Ultimately it can be deployed right the way across the spectrum of instruments traded, even the illiquid ones or those that are physical real-world assets. As technology advances at an even greater pace than ever before, who knows how long it will be before tokenisation is the norm? For the asset management industry, it is not a question of if tokenisation will be the preferred method of ownership and trading, but when.

Contact us product@iscltd.com