GETTING TO GRIPS WITH TOKENISATION

CALASTONE

Getting to grips with tokenisation

As the OECD defined it in a 2020 paper, the tokenisation of assets involves the creation of digital tokens representing real assets issued on the blockchain. Since then, some have drawn a distinction between the tokenisation of "real world assets" and digitally native issuances – a more recent development, particularly in the area of fixed income.

A new survey of both asset managers and their service providers confirms a slowly emerging consensus on the mainstreaming of tokenised funds within the next three to five years.

A survey conducted in Q3 2023 by Global Custodian in partnership with Calastone set out to determine the commitment of funds industry participants to incorporating tokenisation into their customer offerings. The bulk of responses came from asset managers (around 80%) with fund administrators, custodians and Mancos making up the rest, allowing for a tentative assessment of whether expectations of future developments are aligned along the value chain.

Some 150 institutional respondents took part in the survey from across the globe in all asset bands (See Figs 1 and 2) with representation from the full range of investable asset classes, including equities, fixed income, alternatives and private assets.

Results were relatively consistent across the response pool. As might be expected, there are some variations by geography, asset size and job function. Although they do not radically alter the overall picture, the most significant of these are identified in the following pages.

Attitudes to tokenisation

Respondents were asked about their current attitudes to tokenisation and its likely impact on their own day-to-day

Fig 1: Response pool: origins

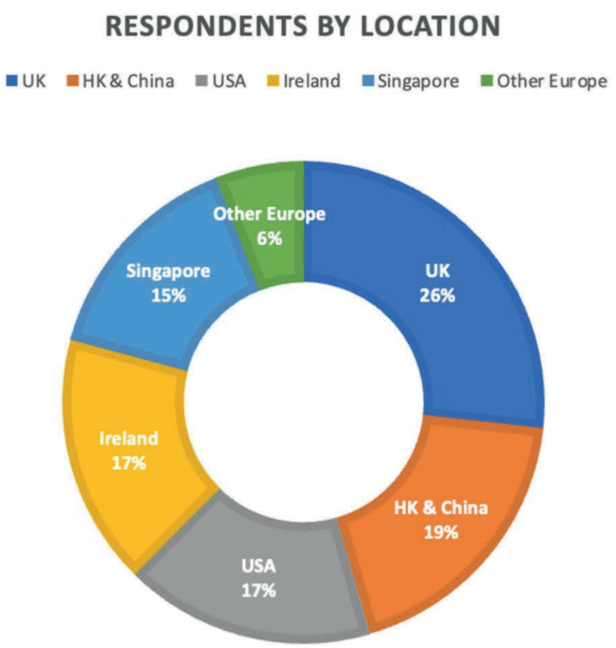
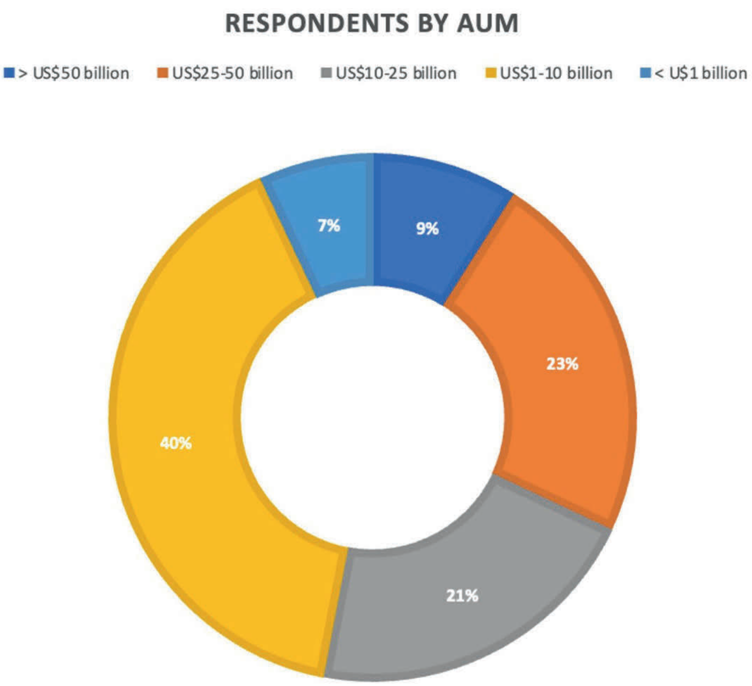


Fig 2: Response pool: size



activities. While a minority of survey participants (12%) do not currently see a role for tokenisation in their business, 54% claimed to be exploring its use in specific areas and one third of respondents claimed to be already in the process of implementing a tokenisation project.

Survey participants from the US and APAC markets were the most engaged in the current climate. Almost 57% of APAC respondents said they were exploring the use of tokenisation in their business, with 38% already in the process of implementing a tokenisation project. The latter figure was even higher among US respondents at 45% (See Fig 3).

The data is harder to parse by asset class, since the majority of respondents to the survey cover more than one than one type of fund. Nevertheless, Fig. 4 suggests that while managers across the board are engaged in exploring the potential of tokenisation, those engaged in fixed income and private asset investment are the most advanced in actual implementation of a tokenisation project.

Although the evidence remains anecdotal, the majority of projects appear to involve existing mainstream asset classes. Specific areas cited beyond construction and distribution of investment vehicles include trading and risk management among others. Interestingly, only a few respondents mentioned cryptocurrencies per se.

Why tokenise?

Much has already been written on the potential benefits of asset tokenisation to professional investors such as easier access to previously illiquid asset classes, fractionalised investments that lower the threshold of entry for investors and increased transparency of ownership.

When it comes to the perceived primary benefits of tokenisation, survey participants were asked to select what they personally regarded as among their top two. Opinion was more or less evenly split (See Fig 5) with roughly a quarter of total responses pointing to each of four perceived advantages on which a degree of consensus already seems to have formed in the industry: cost savings, access to new asset classes, improved liquidity management and greater opportunities for personalisation in the creation of investment frameworks.

While costs savings were seen as the top benefit of tokenisation by partici-

Fig 3: Attitudes to tokenisation by region

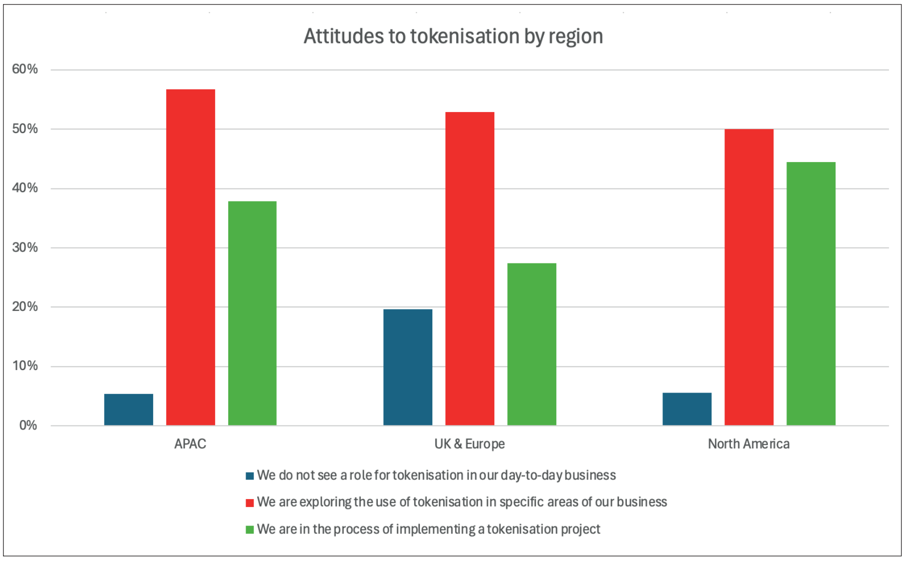


Fig 4: Attitudes to tokenisation by asset class

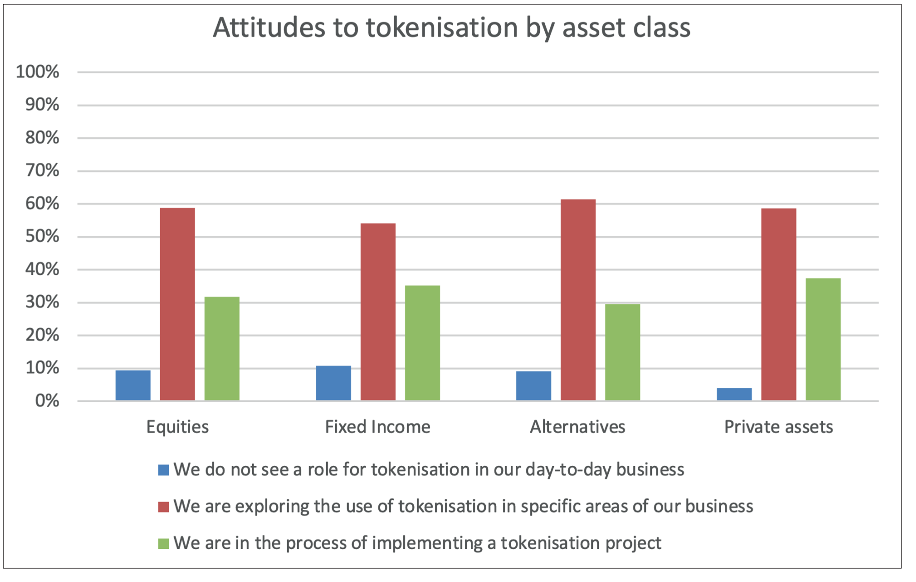
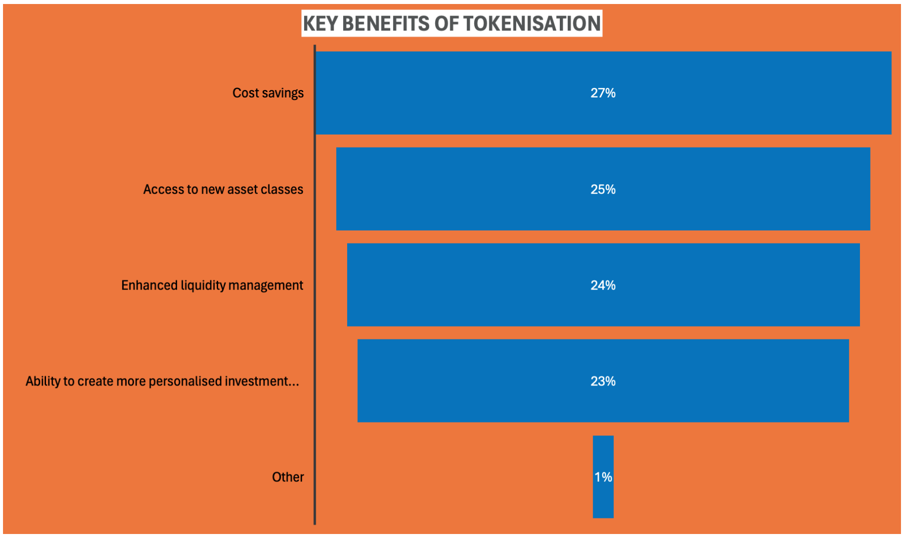


Fig 5: Perceived benefits of tokenisation

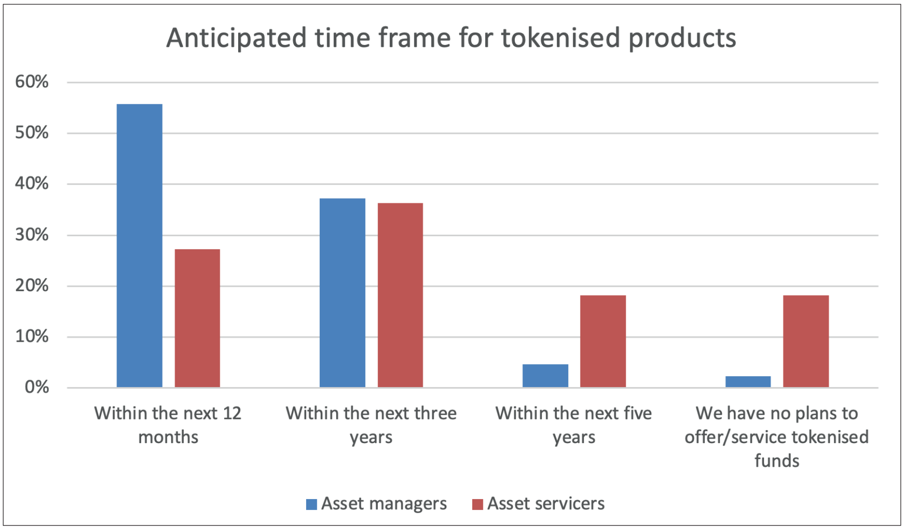


pants as a whole, almost 25% of APAC respondents saw the ability to develop more customised investment solutions as a key advantage of tokenisation, notably for ultra-high-net-worth clients. Amongst US survey participants, enhanced liquidity management and access to new asset classes were cited as the top benefits.

For less liquid asset classes such as private markets and certain fund structures, the potential for tokenisation to reduce friction in the market is higher. With growing participation by institutional investors in private asset opportunities, albeit to a limited extent and at one remove from the investment decisions themselves, this is likely to grow in importance.

A few participants identified other benefits including the automation and standardisation of processes and the 'de-siloing' of activities, allowing inter alia for cross-asset DvP, and more streamlined trade and collateral allocation.

Fig 6: Readiness for tokenisation – asset managers and asset servicers



Expectations over time

Just over half of fund managers surveyed say they expect to be offering tokenised funds as part of their product range within the next 12 months with 37% targeting the next three years. While there may be an element of FoMo (fear of missing out) in some of these estimations, such opportunities are clearly on the agenda of most firms. Only 2% of respondents say they have no plans at all for tokenised funds.

US respondents were the most bullish on practical implementation, with two-thirds expecting to integrate tokenised funds into their product range within the next twelve months. Amongst this group, 61% would themselves choose tokenised funds as a preferred investment vehicle, all things being equal.

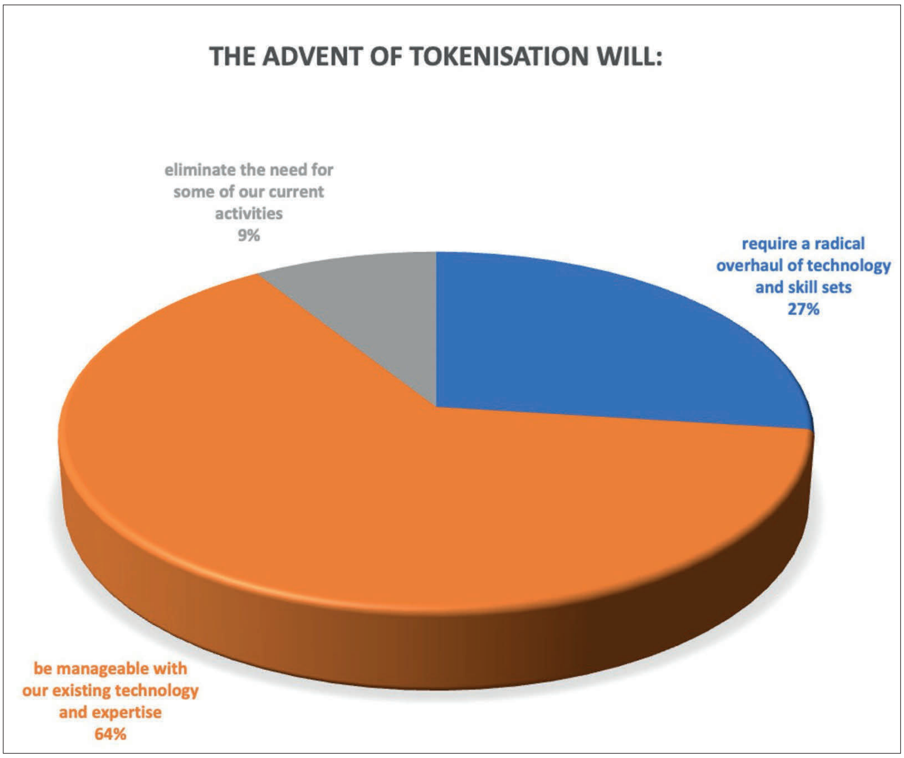
As in the US, APAC respondents were optimistic with regard to their ability to deliver tokenised products with just over 61% saying this is likely within the next 12 months. Regardless of timeframe, all respondents from the region had at least some plan to offer tokenised funds in the future.

By contrast, almost 20% of UK and European respondents were doubtful about any role for tokenization in their day-to-day business. Whether this was a reflection of scepticism about the technology itself or simply that smaller firms had a higher representation in these geographies is hard to tell.

Service providers, who comprised some 20% of the overall response base to the survey, were slightly more circumspect. Though 64% are still expecting to provide support services for tokenised funds within three years, only 27% expect to be offering these services within the next 12 months. Some 18% anticipate a five-year timeframe.

At a practical level, what is the impact of these expectations on resourcing? Optimistically, a majority of respondents say they expect to be able to manage the introduction of tokenised investment vehicles within their existing IT and expertise constraints (See Fig 7). The implicit expectation is most likely that the necessary capabilities will be added to the expanded offerings of their existing technology and administrative

Fig 7: Resourcing



service providers. At the same time, over a quarter of respondents to the survey foresee the need for a radical overhaul of technology and skill sets to handle forthcoming waves of tokenisation.

Those respondents based in North America appear the most confident about absorbing the challenges of tokenisation within their existing resource base (See Fig. 8). Perhaps counterintuitively, however, only 50% of respondents with AuM above $10 billion expected to be able to manage the advent of tokenised assets with their existing resources, possibly reflecting the challenges of operating at scale.

Though only 9% of respondents see tokenisation eliminating the need for certain activities, such elimination will presumably come with attendant cost savings. Asked to identify areas where this might be possible, survey participants pointed specifically to issuance, registry maintenance, reconciliation, and, more generally, the need for manual checks by staff.

Stones in the road

Prior research by Global Custodian undertaken in Q1 2023 identified areas of real interest for discussion as tokenisation of funds, digitalisation of transfer agency and optimisation of collateral usage. With a general recognition that tokenisation is coming to the funds industry in one guise or another and with multiple successful proofs of concept already unveiled, what if anything is holding the industry back? What impediments remain to further institutional engagement with digital assets in general?

The most frequently mentioned hurdles identified in the survey itself were lack of a central bank digital currency, rated by over 80% as the first or second most prominent obstacle, followed by regulatory uncertainty. Fewer than half of respondents placed insufficient distribution mechanisms or lack of platform Interoperability among the top two. The latter appears to be regarded as solvable in the relatively near future, despite it still being a work in progress.

To some extent, these obstacles should be seen in the context of a residual reticence in parts of the industry to engage with distributed ledger technology in general, albeit among a minority of funds industry professionals.

Fig 8: Resourcing expectations by region

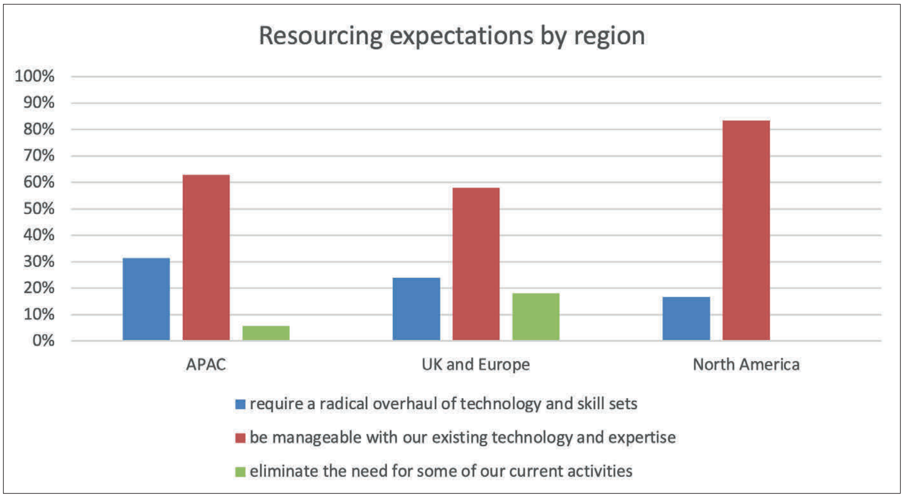
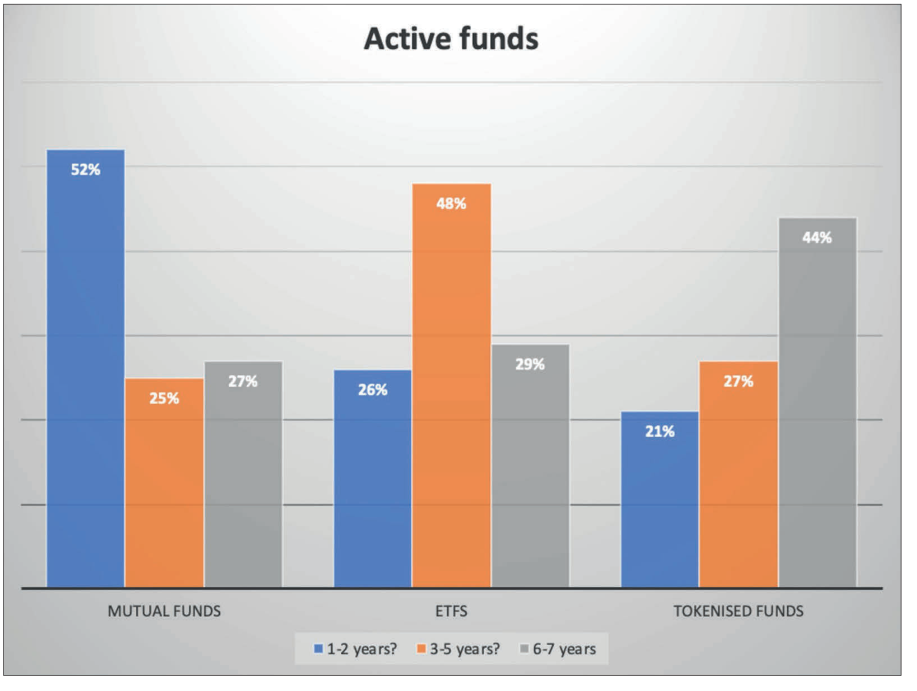


Fig 9: Expectations for launch of new ACTIVE fund vehicles



Impact on fund offerings

Just under 15% of survey respondents expressed some scepticism about its applicability to their day-to-day business tasks. Scepticism should not, however, be taken as rejection. Invited to speculate on what would be the main new fund vehicles – active and passive – launched or serviced by survey participants over the coming years, tokenised funds were in pole position in both segments by year seven. (See Figs 9 and 10)

The scepticism expressed in prior answers appears more driven more by doubts about logistical practicability than underlying distaste for the concept of tokenisation itself. Survey participants were asked, all things being equal, what investment vehicle they would personally choose to invest in. The responses in Fig 11 speak for themselves. Interestingly, only among respondents representing firms with assets under management above $10 billion were ETFs selected as the majority vehicle of choice.

In summary, the funds industry in general – both the creators of the investment vehicles and the firms that service

Fig 10: Expectations for launch of new PASSIVE fund vehicles

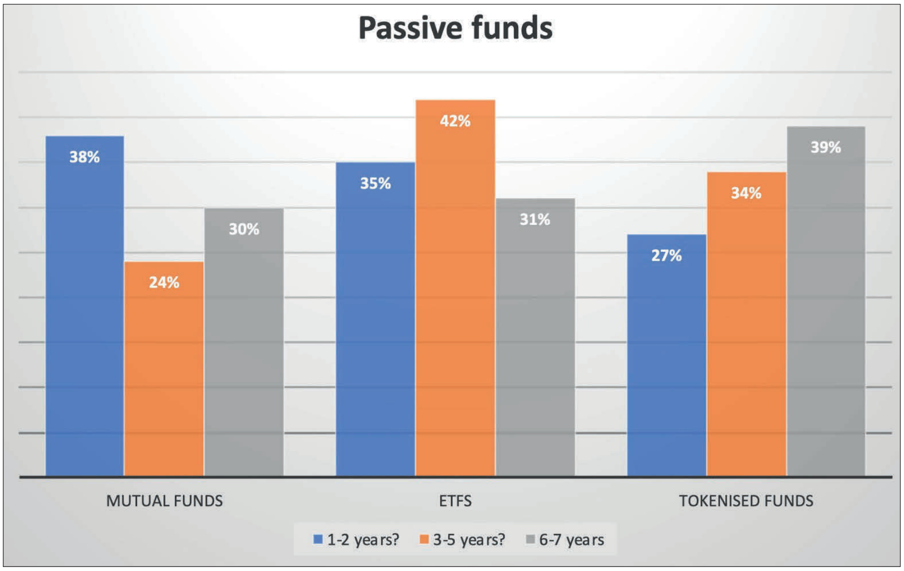
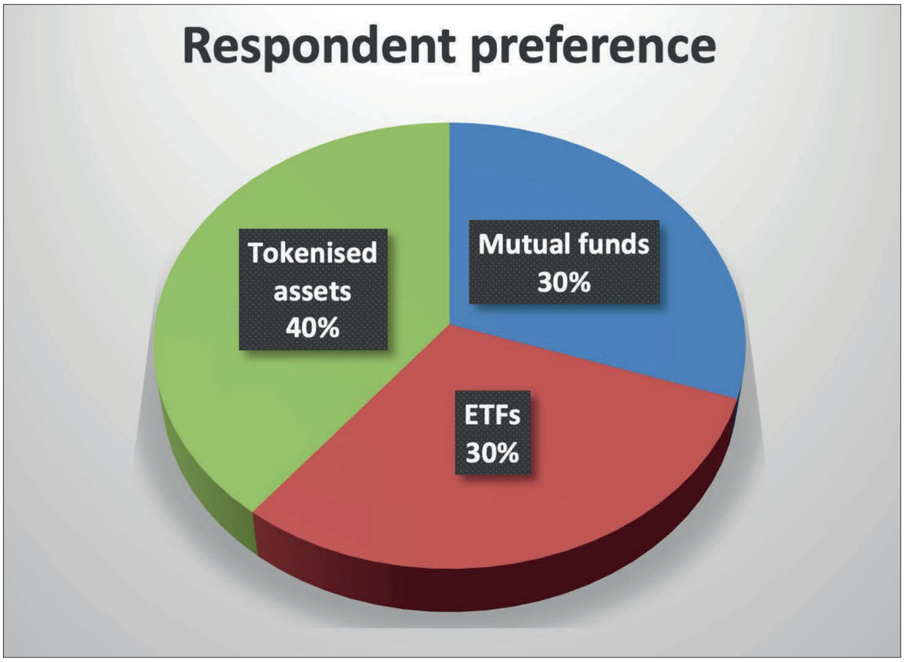


Fig 11: Preferred investment vehicle of survey respondents, ceteris paribus



them – are either enthusiastic about or at worst resigned to – the coming age of asset tokenisation and the investment vehicles that will enable their distribution.

To avoid complacency, the focus on tokenisation both by the industry as a whole and this survey in particular, does not imply that, having addressed the practicalities of its implementation, market participants will be able to rest on their laurels.

Before concluding the survey, respondents were asked: "Looking at the funds industry as a whole, what would you identify as the most significant client demand that remains to be tackled by you and your peers?" Responses, though unquantified, were instructive. They included among other things, standardisation, the efficient use of APIs and feeds, access to private markets, and a general need to "make it easier" for investors.

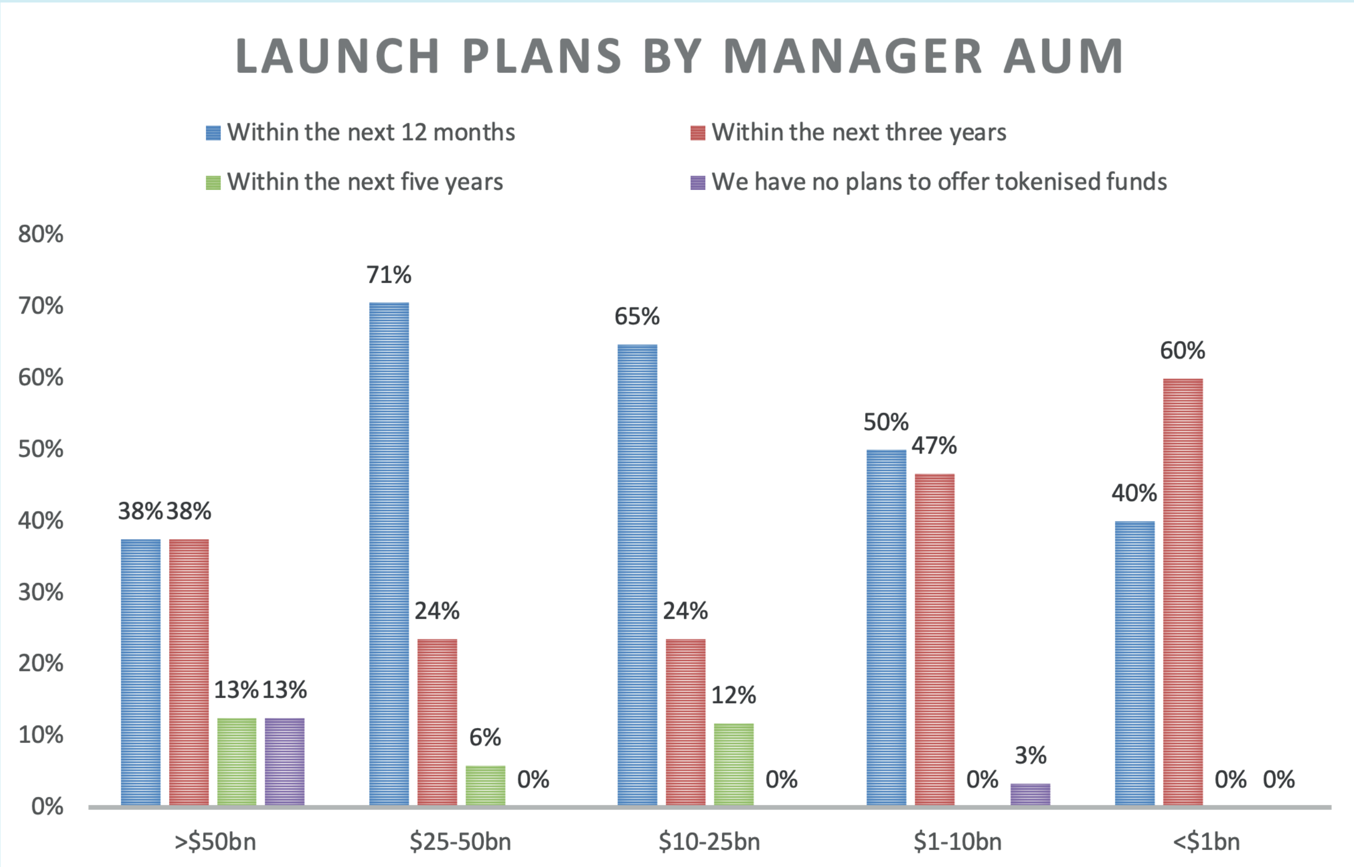
Cost too remains a perennial concern. As one respondent put it in relation to tokenisation, "We need to better clarify the impact on cost; in particular, actual cost reduction versus margin reduction versus passing costs to other actors (with the risk of a negative feedback loop at some point)."

Clearly, as opportunities for tokenisation translate into practical implementation, with fund managers, fund administrators and technology providers all playing their part, they will move the industry forward, but to keep the end-client onside, the various contributors to the value chain still have their work cut out.

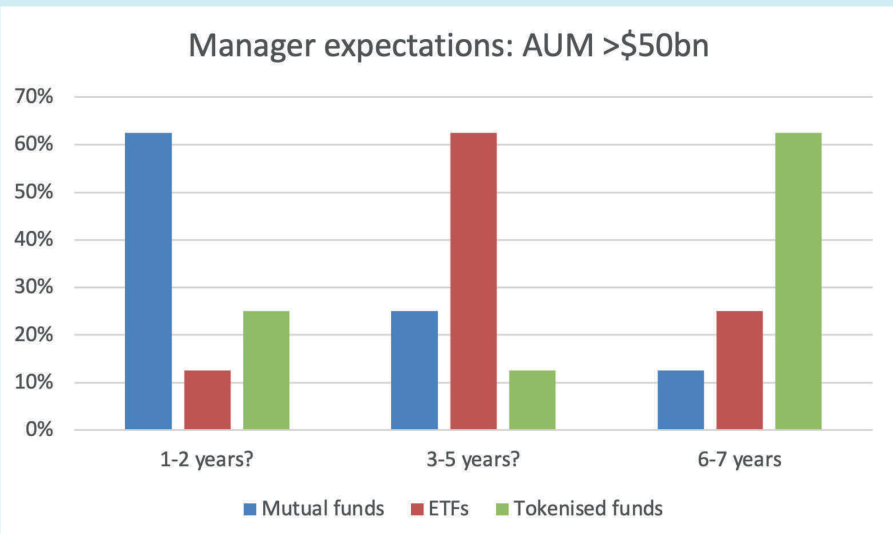
APPENDIX

The following charts explore whether size of firm is a significant influence on attitudes to tokenisations and expectations for fund issuance in the short-to-medium term. We asked respondents to assess both their own firm's current approach and expectations for the future. While differences can be observed, it would seem that the direction of travel for the industry as a whole is clear.

When do you expect to be offering tokenised funds as part of your product range?



What would you expect to be the main new ACTIVE fund vehicles you launch or service over the following time frames:



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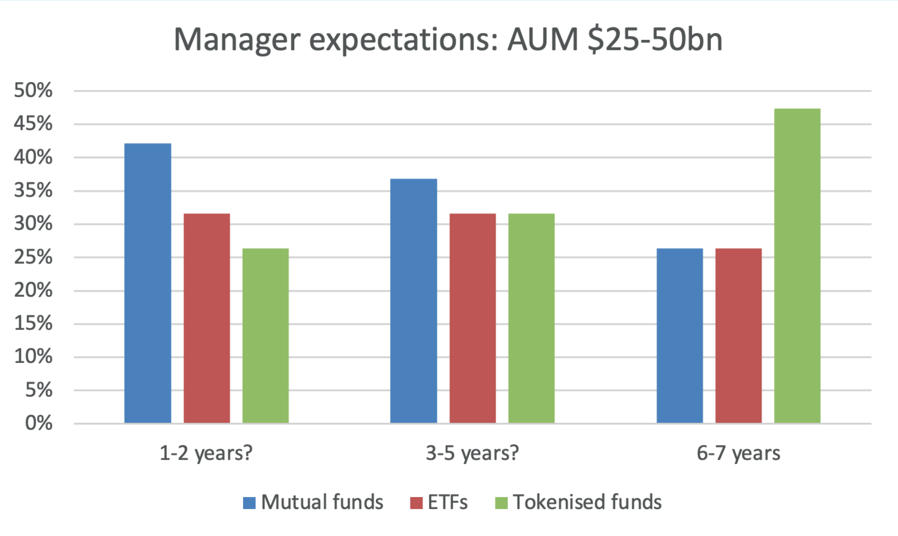

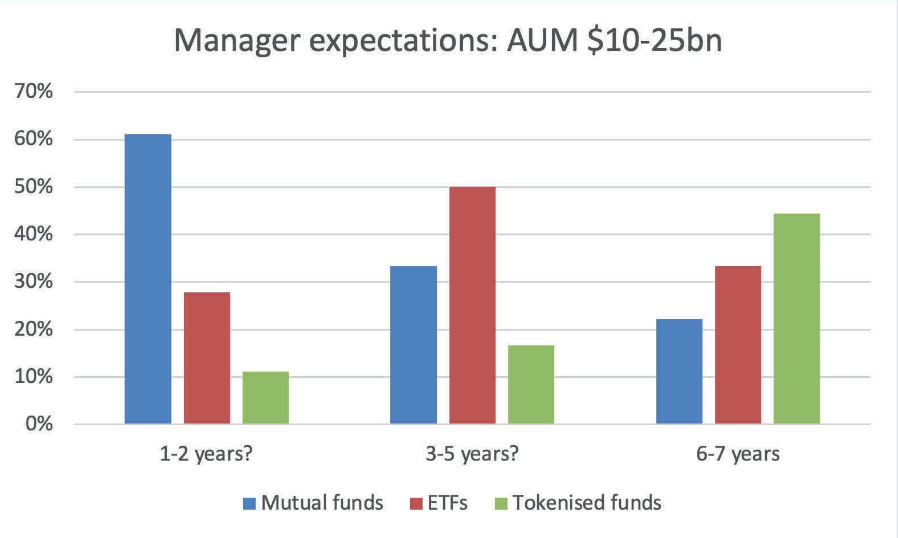

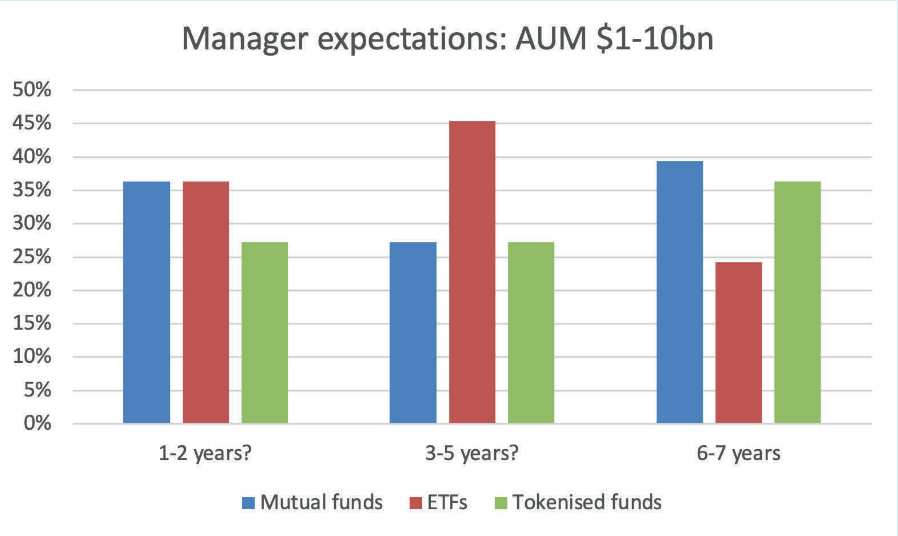

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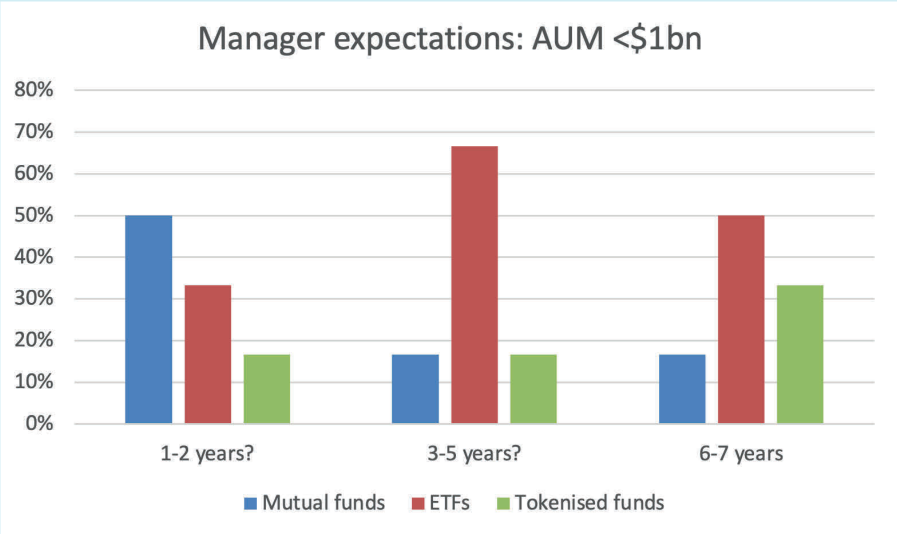

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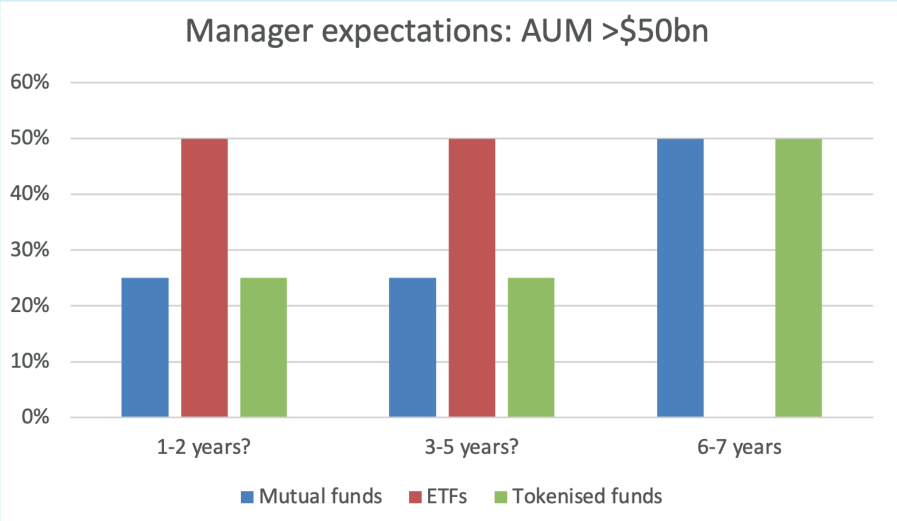

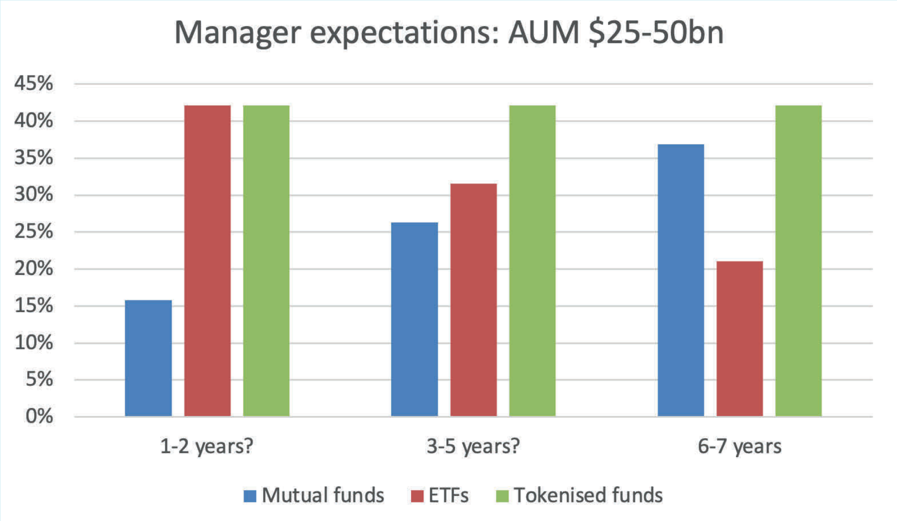

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