Asset Tokenisation

Disrupting the Funds and Real Estate Sector?

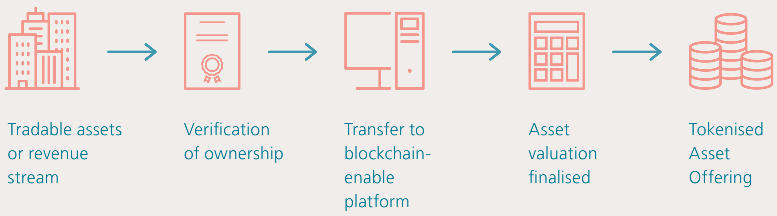
February 2020

For funds and the real estate sector, the new decade promises transformation through digitalisation, artificial intelligence (AI), blockchain and fintech. New technologies offer the promise to allow traditional and new asset classes to be digitalised or "tokenised" and processes and costs to be streamlined.

CMS has been at the forefront of discussing this digital revolution with a number of leading fund managers, technology specialists and real estate owners and is keen to play a pivotal part in the developments. Set out below is a summary of the opportunities, barriers and changes afoot.

The concept

Tokenisation is the process of issuing tokens on a blockchain that represents a tradeable asset or even a revenue stream. The token could be attached to a share in an asset such as a real estate asset, a company, a loan or specific revenues associated with those. Once issued, the tokens can then be traded freely in the secondary markets.



A true disruptor

There are many ways in which tokenisation could potentially disrupt the industry:

- **Accessibility**
  lower barriers to entry mean private and smaller investors are not blocked from the market
- **Liquidity**
  democratisation enables a freer flow of capital and a greater frequency of trades
- **Compliance**
  embedded and trackable data allows investors and financiers to perform rapid and conclusive due diligence
- **Customisation**
  the sub-division of assets and risk allocations will allow for more personalised trading options
- **Regulation**
  regulators and financial exchanges are already getting behind the technology, building trust amongst existing and potential market participants.
- **Fluidity**
  smart contracts and automation will enable faster trades and speed up execution
- **Market expansion**
  accessibility and liquidity will bring less fashionable assets into the frame

Real estate: building a case for tokenisation

This tokenisation technology will affect how assets are owned or operated. For example, buildings are increasingly exploiting Proptech, which in turn impacts on payments, reporting, insurance, compliance and the day-to-day administration and monitoring.

Tokenisation of real estate investment will increase liquidity and therefore lead to elevated transaction volumes. Jonny Fry, CEO and founder of TeamBlockchain, says that buildings with multiple tenants, including retail, office, hotel and apartments could become increasingly attractive to the investment community: By severing a building and isolating the allocated risk, asset managers can customise the way they sell funds. It is a totally different way of packaging risk for clients.

Tokens do not merely have to represent a share of the property itself but can represent the revenue associated with the asset.

Evolving regulation: bringing transparency and certainty

Laws, tax and regulations are being amended to accommodate the movement towards a more digital industry with the awareness that a digital world does not necessarily respect national boundaries or even currencies. The recent UK Jurisdictions Taskforce Legal Statement on crypto-assets and smart contracts recognised that crypto-assets should in principle be "property" and that smart contacts can be binding contracts. Similar legal and market developments have been taking place across Europe with increasing activity, for example, in France, Germany, Luxembourg, Poland, Spain, Switzerland and The Netherlands.

In addition, the 30 Recommendations on Regulation, Innovation and Finance set out in the Final Report dated 20 December 2019 to the European Commission by the Expert Group on Regulatory Obstacles to Financial Innovation (RUFIEG) is encouraging. It seeks to identify issues which may impede the scaling up of Fintech in the European Union (EU) so that a suitable framework can be developed.

Will technology reduce risks?

Research suggests blockchain technology should in theory reduce risk given its immutable nature. Technology itself can not entirely reduce risks for a particular sector or asset. It can, on the contrary, introduce new risks to the market, through the use of algorithms without human intervention, a lack of understanding, a blurring of relationships and responsibilities or regulatory supervision:

— **Regulation**
while the regulatory environment is evolving it is not established nor is it aligned across borders

— **Cyber and data security**
blockchain technology is supposedly robust and secure though additional safeguards should be put in place to mitigate against any potential breaches

— **Market volatility**
greater accessibility may encourage investors to make decisions without seeking expert advice or opinion, potentially creating greater volatility in the markets

— **Capricious investors**
with only small financial commitments, some investors could be less dependable in maintaining assets and ensuring their investments are properly safeguarded

— **Marginalisation**
asset managers and financial institutions will have to find their place in a market where their roles are set to shift and potentially narrow

New technologies offer the promise to allow traditional and new asset classes to be digitalised or "tokenised" and processes and costs to be streamlined.

Asset managers and financial institutions should not be overly anxious.

The disruptive effect of the technology will be the emergence of a new generation of investors, fund managers and real estate owners and to open up opportunities to a wider sphere of market participants and therefore a greater flow of capital.

Tokenisation definitely has some undeniable advantages in the future of investment, although the regulatory part of the equation could take time to evolve.

Christopher Luck, Funds and Indirect Real Assets Partner at CMS, concludes

"It is clear that tokenisation and use of technology for processes are transformational opportunities. Adoption and understanding are key but the benefits are potentially boundless." Watch this space.

Christopher Luck
CMS Funds and Indirect Real Assets
T +44 20 7524 6294
E christopher.luck@cms-cmno.com

Law.Tax

Your free online legal information service.

A subscription service for legal articles
on a variety of topics delivered by email.
cms-lawnow.com

CMS Cameron McKenna Nabarro Olswang LLP
Cannon Place
78 Cannon Street
London EC4N 6AF

T +44 (0)20 7367 3000
F +44 (0)20 7367 2000

2001-0120285-3