THE FUTURE WILL BE TOKENIZED

Tokenization democratizes access to high-net-worth asset classes

By R Vivekanand, Vice President, TCS
For retail investors, the typical portfolio consists of a home mortgage on a primary residence; indexed mutual funds held in retirement accounts; cash or cash equivalents in a bank account; and maybe some stock options.

This portfolio is far from ideal. First, the mortgage is overly exposed to the specific risks involved with the property and local market conditions. Second, the investment options are largely limited to financial instruments issued by publicly listed companies, offering only indirect benefits from growth in huge segments of the economy. Third, bank accounts are yielding near-zero (or negative) returns.

High-net-worth investors have a much wider range of investment options, including residential apartment buildings, commercial real estate, illiquid assets, artwork, high-end collectibles, and private equity. These lucrative options provide access to significant opportunities for wealth creation in ways that are largely inaccessible to retail investors.

For example, real estate represents one of the most dynamic segments of the global economy, and yet retail investors are limited mostly to owning shares in listed companies that benefit indirectly from property appreciation. Although retail investors may also buy shares in real-estate investment trusts (REITs), these targeted investment vehicles typically involve high set-up costs, high maintenance fees, and limited choice in investment properties.

The reality is that investing in commercial real estate calls for a level of financial commitment beyond the reach of all but the wealthiest, high-net-worth investors. The same holds true for other large-ticket alternative assets such as artwork, jewelry, or prestige properties. The potential returns are massive, but those asset classes have limited access to all but the wealthiest investors.

**It doesn't have to be that way.**
What if any investor could invest small amounts directly into any number and any combination of high-value properties and assets?

What if anyone with surplus income, young and old, whether from a developing nation or an advanced economy, could participate directly in the income streams and appreciation of real estate, the world’s most popular asset class?

What if direct participation was available for other kinds of valuable assets previously available only to high-net-worth investors?

**That’s the promise of tokenization.**

Tokenization is a streamlined, blockchain-based approach to asset securitization. By making it possible for individuals to participate directly in asset classes otherwise beyond their reach, tokenization will democratize access to investments, unlock the value of sizeable asset classes, and deliver widespread economic and social benefits.

In the current investment environment, you’re obliged to involve a whole set of intermediaries for every single trade: an investment bank to assemble and price an offering; a brokerage firm to buy and sell listed assets; and custodians and depositories to keep track of the electronic records.

Tokenization would enable people to invest directly into high-value assets without being obliged to go through the entire chain of intermediaries.

Only minimal infrastructure would be required to create and run a distributed ledger for tokenization, which would be optimally run by a consortium of
trusted and responsible entities as a managed utility-style service, with a high security and provenance guaranty. With a tokenization utility in place, virtually any asset could be securitized. Tamperproof, blockchain-based distributed ledger technology (DLT) makes tokenization quick, easy to manage, and highly secure. Those tokens could be bought and sold in any fractional quantity, enabling frictionless participation in high-value asset classes.

A tokenization utility would allow any type of institution, whether real estate companies, museums, or municipalities, to issue tokens representing ownership stakes in their underlying assets. Moreover, an institution could make its own decisions as to subscription and pricing mechanisms, without needing to compensate investment bankers for privileged access to a small, concentrated group of buy-side investors.

Typically, high-value assets are exchanged solely between a limited pool of high-net-worth investors. With tokenization, the pool of buyers and sellers would expand to include the entire world of retail investors. Investors would participate in a low-friction, high-liquidity marketplace for trading tokens in any national currency and at every conceivable order size.

For the first time, retail investors would be able to purchase shares in high-value assets, in any denomination, with the ability to trade those tokens within a highly liquid, global marketplace. This would rewrite the rules for asset allocation, making it possible to create broadly diversified portfolios with higher levels of safety, appreciation, income, and liquidity than can be achieved through traditional methods.
The democratization of access to investment vehicles will transform entire economies, and the effect will be transformative in developing countries. All too often, ambiguities and irregularities in antiquated, paper-based recordkeeping systems still in use mean that inheritances and bequests go unclaimed. The transition to blockchain-based DLT will provide immediate benefits through improved recordkeeping for ownership claims, while at the same time, establishing the necessary foundation for tokenization of assets will spur rapid economic growth.

**A historical precedent for tokenization** can be found in the electronification of financial markets in the late 20th century. From 1970 to 2000, virtually every financial market in the world transitioned from paper to electronic recordkeeping. Those organizations are still with us today, such that if you want to own a share of just about any widely traded financial asset, you’re required to go through many of the same intermediaries who had made the early transition from paper to electronic records.

With tokenization, we expect an equally widespread transition, except that this time, a new class of low-cost, consortium-based utilities will enable the largest possible pool of investors to participate directly in high-quality investible assets with the lowest possible friction.

Moreover, tokenization of assets leads the way toward “smart contracts” that will replace expensive and time-consuming business processes such as property transfers and bequests. (We’ll talk more about smart contracts in a future issue.)

**We are at the beginning of an entirely new cycle in economic history. As we look ahead to how financial assets will created, held, bought and sold, the future will be tokenized.**
ASSETS
TOKENIZATION
SMART CONTRACTS
ART
REAL ESTATE
RECORDKEEPING
BLOCKCHAIN
DEMOCRATIZE