

January 2025

Tokenization

Tokenization, the digital representation of real-world assets on blockchain technology, has the potential to transform financial markets by increasing liquidity, efficiency, transparency, and financial inclusion. It allows traditionally illiquid assets like real estate or fine art to be fractionalized and traded globally on digital platforms, unlocking new opportunities for investors and reducing transaction costs through smart contracts. Policymakers under the Trump administration should embrace this innovation by crafting regulatory reforms that foster the growth of tokenized markets, ensuring that the U.S. remains competitive in this rapidly evolving space while protecting investors and promoting innovation.

What Is Tokenization?

Tokenization is the process of creating a unique, digital, and anonymous representation of an asset. Real World Asset (RWA) tokenization encompasses the digital representation of legal ownership, rights, or indicia of control for “real world” physical assets using distributed ledger technology. RWA tokenization applies not only to financial assets such as currencies and securities, but also can encompass traditionally illiquid assets, such as art, commodities, intellectual property, and real estate, allowing these assets to be tokenized, fractionalized, and traded on digital platforms.

Tokenized RWAs can take a variety of forms. *Stablecoins*: Stablecoins are financial instruments whose value is tied one-to-one to that of another currency, commodity, or financial instrument – often to a government-issued fiat currency, such as the dollar. Similar to money market funds, stablecoin issuers typically hold reserves to back the value of the stablecoins. *Tokenized securities*: Traditional securities such as stocks, bonds, and securitized instruments may be tokenized and represented on the blockchain. *Tokenized bank deposits*: A tokenized deposit is a type of financial asset that represents traditional bank deposits, such as savings or checking accounts, that have been converted into digital tokens. *Real estate*: Tokenized real estate is when a real estate property or its cash flows are represented as a blockchain token or tokens. *Non-fungible Tokens (NFTs)*: NFTs are blockchain-based representations of ownership of unique items, such as a piece of art, video, or other digital content.

These are just a few examples of RWAs that can be tokenized. Innovation in the tokenization space is evolving rapidly and tokenization projects are moving from “pilot” programs to large-scale institutional adoption.

What Are The Benefits of Tokenization?

Tokenization has the potential to introduce revolutionary enhancements to our financial markets. For example:

Liquidity: Tokenization can greatly enhance liquidity by converting traditionally illiquid RWAs such as real estate or fine art into digital assets that can be traded on digital platforms.

Efficiency: Tokenization can also reduce costs and improve efficiency because it automates transactions through the use of smart contracts, eliminating the need to rely on intermediaries and the attendant costs they impose.

Transparency: Tokenization enhances transparency because blockchain technology provides an immutable record of ownership and transactions, which reduces fraud and enhances audit functions.

Fractionalization: Tokenized RWAs also facilitate fractional ownership of assets, democratizing access for retail investors' ownership of assets traditionally only available to institutions or high-net-worth individuals, and offering enhanced tools for portfolio diversification.

Financial Inclusion: Relatedly, tokenization can promote financial inclusion, allowing individuals to access traditional banking and investment management services which were previously unaffordable or otherwise unavailable.

24/7 Trading and Faster Settlement: Tokenization also facilitates 24/7 trading and substantially faster settlement of transactions because of the efficiencies of smart contracts and blockchain technology. Faster settlement means that executing transactions can be less capital and liquidity intensive.

Global Reach: Finally, tokenized assets are not constrained by geographical limitations, facilitating global transactions and extending the potential investor pool for RWAs.

Demand for tokenized assets is rapidly growing. Several major financial institutions have either launched or have disclosed an intention to actively pursue the development and utilization of blockchain networks to facilitate the tokenization and transfer of RWAs. For example, in March 2024, Blackrock announced the launch of BUIDL, a fund that tokenizes U.S. Treasuries.¹ Digital asset firm Ripple has tokenized hundreds of millions of dollars of RWAs on

¹ Business Wire, BlackRock Launches Its First Tokenized Fund, BUIDL, on the Ethereum Network (Mar. 20, 2024), available at <https://www.businesswire.com/news/home/20240320771318/en/BlackRock-Launches-Its-First-Tokenized-Fund-BUIDL-on-the-Ethereum-Network>.

the XRP Ledger (XRPL).² Goldman Sachs has announced several tokenization projects focused on real estate and money market funds.³ McKinsey & Co. estimates that the market capitalization of tokenized funds could approach \$2 trillion by 2030, not including cryptocurrencies or stablecoins.⁴

U.S. Approach to Tokenization To Date Has Hindered Innovation and Competition

The United States is far behind its international counterparts in advancing legislative and regulatory initiatives related to tokenization, threatening U.S. competitiveness in this space. Multiple international jurisdictions have been proactive in establishing blockchain-specific regulatory regimes, including the EU's Markets in Crypto-Assets (MiCA) regulation,⁵ which harmonizes the approach towards tokenized assets and digital currencies across EU member states. Other international market centers such as Hong Kong, Singapore, and Abu Dhabi have implemented comprehensive regulatory frameworks for security token offerings and digital exchanges to facilitate the trading of tokens.

Under the current U.S. regulatory framework, the vast majority of tokenized RWAs are treated as securities. Unlike our international peers, U.S. regulators have yet to implement a regulatory framework for issuing securities on the blockchain. Accordingly, the vast majority of tokenized RWAs issued or traded in the U.S. are required to be structured in compliance with the existing securities law framework.

The only viable option currently available in the US is to offer tokens to “accredited investors” and to rely on Regulation D, an exemption from the registration requirements of the federal securities laws. As a consequence, the potential investor pool in tokenized RWAs is limited to high net-worth individuals (“accredited investors”) and qualified institutions, blocking the vast majority of retail investors in the U.S. from accessing this potentially beneficial market. This severely impacts the potential for large-scale adoption and trading of tokenized RWAs in the U.S. capital markets.

To date, the SEC has declined to adopt a regulatory framework that would facilitate the trading of tokens. Despite efforts by many market participants to work with the SEC

² Markets Media, Ripple Targets Institutional Grade DeFi with Tokenization (Aug. 13, 2024), available at <https://www.marketsmedia.com/ripple-targets-institutional-grade-defi-with-tokenization/#:~:text=Ripple%20Targets%20Institutional%20Grade%20DeFi%20with%20Tokenization%20%2D%20Markets%20Media>.

³ CCN, Goldman Sachs Sets Sights on Launching Three Tokenized Funds by Year-End (July 11, 2024), available at <https://www.ccn.com/news/crypto/goldman-sachs-sets-sights-on-launching-three-tokenized-funds-by-year-end/>.

⁴ McKinsey & Co., From ripples to waves: The transformational power of tokenizing assets (June 20, 2024), available at <https://www.mckinsey.com/industries/financial-services/our-insights/from-ripples-to-waves-the-transformational-power-of-tokenizing-assets>.

⁵ Regulation (EU) 2023/1114 of the European Parliament and of the Council on markets in crypto-assets (May 31, 2023), available at <https://eur-lex.europa.eu/eli/reg/2023/1114/oj>.

collaboratively to develop a framework for exchanges and broker-dealers, the SEC has refused to advance any initiatives that would allow for tokens to be listed on exchanges or traded by broker-dealers. For example, the “Special Purpose Broker-Dealer” statement⁶ issued by the SEC is an inadequate construct that is time-limited and not fit for purpose in that it does not permit an entity to custody or offer trading in both digital asset securities and non-securities. To date, only two entities have qualified as SPBDs and their business models are limited. Other regulatory impediments include the SEC’s Safeguarding Proposal,⁷ which would make it virtually impossible for an investment adviser to transact in digital assets without violating SEC rules, and Staff Accounting Bulletin 121,⁸ which requires banks and non-SPBD broker-dealers to reflect digital assets as liabilities on their balance sheets, effectively eliminating such financial institutions from participating as intermediaries in the tokenization space.

Potential Opportunities to Advance Tokenization

It is critical for U.S. regulators to recognize the benefits of RWA tokenization and take steps to foster innovation in this space so that the U.S. does not fall farther behind its international counterparts and lose a critical competitive edge in a digital asset class that has the potential to revolutionize our capital markets and expand access to financial opportunities for retail investors. Provided below are several steps that U.S. regulators should consider taking in crafting a regulatory framework that will make RWA tokenization viable.

Registration of Tokens:

The SEC has articulated its position that the registration of digital assets on digital ledger technology must comply with the current securities laws. However, the current SEC securities registration regime is incompatible with the tokenization of real-world assets because it relies on frameworks designed for traditional securities, which assume centralized structures, standardized offerings, and established intermediaries. Tokenized assets, however, are decentralized, often involve fractional ownership, and may be traded on blockchain networks that operate outside traditional market infrastructure. These features challenge the application of existing registration and reporting requirements, which are ill-equipped to handle the fluid, global, and automated nature of tokenized ecosystems.

Regulation CF and Regulation A

Regulation Crowdfunding and Regulation A are securities offering and registration regimes that apply to smaller companies and offerings and include less burdensome reporting

⁶ U.S. Securities and Exchange Commission, Custody of Digital Asset Securities by Special Purpose Broker-Dealers (May 21, 2021), available at <https://www.sec.gov/files/rules/policy/2020/34-90788.pdf>.

⁷ U.S. Securities and Exchange Commission, Safeguarding Advisory Client Assets (Feb. 15, 2023), available at <https://www.sec.gov/files/rules/proposed/2023/ia-6240.pdf>.

⁸ U.S. Securities and Exchange Commission, Staff Accounting Bulletin 121 (Mar. 31, 2022), available at <https://www.sec.gov/regulation/staff-interpretations/accounting-bulletins/old/staff-accounting-bulletin-121>.

requirements. Regulation CF allows companies to raise up to \$5 million in a 12-month period through crowdfunding and is offered to a limited number of non-accredited investors. Regulation A is a “mini IPO” offering regime that allows companies to raise up to \$75 million. Given the limited size of capital raised in Reg CF and Reg A offerings, the SEC could use these provisions as “regulatory sandboxes” allowing for tokenized offerings. Some tokenized offerings of digital asset securities are likely already permissible under these provisions. However, the SEC could issue guidance articulating the parameters required to successfully meet the requirements of a tokenized offering under Reg CF and Reg A.

Form S-1

In order for RWA tokenization to evolve at scale, the SEC needs to adopt changes to the requirements for registrations filed on Form S-1, the registration statement from the SEC that U.S. issuers must file prior to offering a new securities product. SEC Commissioner Mark Uyeda has called on the SEC to adapt registration requirements under Form S-1 to accommodate digital asset securities, noting that the SEC has made similar adaptations for other products such as index-linked annuities.⁹ Creating a separate Form S-1 for digital asset securities would allow the SEC to impose disclosure requirements unique to the digital asset space and address potential investor protection concerns that may be unique to such offerings.

Trading of Tokens:

There are several potential steps the SEC could take to adapt its current regulations to accommodate tokenization.

Alternative Trading Systems (ATSs)

ATS platforms, which operate differently than traditional exchange systems, are ideally suited to facilitate the trading of tokenized assets. They can match buyers with sellers for a wide variety of tokenized assets and facilitate trade execution without the operational frictions and costs of intermediaries. ATS can also be customized to address the unique features of tokenized assets, making them better suited for tokenization than traditional exchanges. The SEC should tailor Regulation ATS to provide a streamlined path to becoming registered as an ATS that handles tokenized assets and establishes trade execution rules specific to tokenized assets.

National Securities Exchanges

After assessing the operational, technological, and regulatory implications of allowing the trading of tokenized assets on ATSs, the SEC should consider expanding its regulatory framework to facilitate trading of such assets on national securities exchanges. This phased approach would enable the SEC to gather valuable insights and address potential challenges

⁹ CCN, SEC Needs a New Approach to Crypto Securities, Commissioner Mark Uyeda Argues (Sept. 3, 2024), available at <https://www.ccn.com/news/crypto/sec-new-approach-crypto-mark-uyeda/>.

while maintaining investor protections, ensuring a smooth transition that balances innovation with market integrity.

Special Purpose Broker Dealer

The SEC's SPBD guidance, issued under former Chairman Jay Clayton, is the only meaningful step the agency has taken to address the regulation of digital asset securities. However, it has significant limitations. Most notably, SPBDs are only allowed to transact in and maintain custody of digital asset securities. They cannot also transact in or maintain custody of non-securities, such as stablecoins or Bitcoin/Ether. What's more the guidance is time-limited and set to expire in 2026.

The SEC should amend and make permanent its SPBD guidance in a rulemaking that provides a clear path for a broker-dealer to register as an SPBD. Critical to any such rulemaking is allowing an SPBD to hold both digital asset securities and non-securities, including stablecoins, which are essential to the transfer of funds in and out of the digital asset ecosystem.

Custody

The SEC should withdraw its Safeguarding proposal, which would prohibit the transfer of digital assets out of a qualified custodian into an account with an exchange or trading venue that does not qualify as a qualified custodian for purposes of transacting. If adopted, investment advisers would in effect have no legally compliant means of investing client funds in digital assets. The SEC should instead amend its custody rules to provide for the custody of tokens by banks, broker-dealers, and other qualified custodians on the blockchain.

Revoke SAB 121

The SEC should revoke Staff Accounting Bulletin (SAB) 121 because its stringent accounting requirements create significant liabilities for banks, making them reluctant to custody tokenized assets. This discourages financial institutions from supporting the growing demand for tokenization, stifling innovation and limiting investor access to secure custody solutions for digital assets. Revoking SAB 121 would promote broader adoption of tokenized assets while ensuring a balanced regulatory framework that encourages participation by trusted financial intermediaries.

Clearance and Settlement

Blockchain technology has the potential to eliminate the need for central counterparties through the use of secure, self-executing smart contracts. Tokenization on the blockchain can make settlement instantaneous, meaning there is no need to post collateral as part of the clearing and settlement process. The SEC, in coordination with the Depository Trust and Clearing Corporation, should undertake a comprehensive review of clearance and settlement rules to



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accommodate the post-trade process applicable to tokens on the blockchain, thereby eliminating the costs and frictions of multiple intermediaries.