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How tokenisation will disrupt fund governance

By Robert Van Egghen, Financial Times
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The shift towards tokenisation in the funds industry will bring a "tsunami" of change to fund boards, according to experts.

The UK financial regulator last week published a consultation paper on fund tokenisation – the digital representation of assets on distributed ledger technology such as blockchain.

The Financial Conduct Authority said: "Tokenisation can open new routes to distribute funds, broaden access to private markets and infrastructure investment, and reduce the costs of small transactions, while maintaining existing consumer protection."

The watchdog said these changes would mean "independent directors may need different skillsets / focus areas such as technology expertise".

Experts agreed that the tokenisation of real assets would require fund directors to acquire new expertise and skills.

Carlo Montagna, an independent director at the Directors Office, said: "Directors will face a brand new challenge when overseeing a tokenised fund."

Montagna said tokenisation would lead to significant changes in fund distribution and asset safekeeping.

He said: "Board members need to understand what's beneath and behind [tokenisation], seeing the surface will not be enough to make sure things are well managed.

"[Directors] are expert in the current world of physical assets and registers, but we sometimes have difficulties to understand how the same can be done in a virtual world."
Montagna said new training and potential certification would likely be required to ensure directors had sufficient understanding of tokenisation before they could be allowed to sit on the board of a tokenised fund.

Attilio Veneziano, founder of boutique law firm Veneziano & Partners, added that "the progressive tokenisation of more traditional assets" would bring a "tsunami" of change to fund boards.

Veneziano said tokenisation would allow funds to access a wider range of digital distribution opportunities and also lead to changes in fund marketing regulations.
"The skillset composition of boards will have to reflect these new realities," he said.

Michelle Kirschner, partner at law firm Gibson Dunn, added that while "the core fund governance responsibilities of [authorised fund managers] will persist", governance practices would have to "adapt to DLT-enabled operations and, potentially, the direct-to-fund (D2F) dealing model".

D2F is a potential model for tokenisation mooted by the FCA where investors can directly interact with a fund, bypassing the authorised fund manager.

Kirschner said boards would need to "expand oversight to encompass new forms of operational and technology risk", while ensuring "risk appetites, management information and assurance plans cover distributed ledger outages, smart contract failures and tokenised liquidity cycles".

But some advocates of fund tokenisation say the technology could make fund directors completely redundant.

Oskar Åslund, chief strategy officer at crypto fund platform AKJ, said: "The idea that multiple layers of costly, manual, oversight is what establishes trust and protection for investors is outdated."

Åslund said "financial assets should ideally be based on trustless infrastructure and have deterministic execution", while oversight of the fund "can come in the form of coded restrictions enforced by the technology".

"The practice of having intelligent apes as directors responsible for manual governance, should ideally be eliminated entirely," he said.