



Tokenisation

Reducing costs and building alpha for tomorrow

Adam Belding

Asset managers had a difficult 2022. Calastone's *Fund flows: Fighting the bear* report found that 2022 saw record fund outflows across the globe, with funds seeing the biggest fall in assets under management (AUM) since the Global Financial Crisis. Combined with rising interest rates, inflationary pressures and a retraction of fiscal stimulus, it makes for a tough macro environment.

In the face of these headwinds, asset managers must look for ways to enhance their proposition and increase profitability. Mutual funds have been the vehicle of choice for 100 years, and then exchange-traded funds (ETFs) arrived, offering investors more choice and accessibility.

Tokenisation (that is, representing the ownership of an asset, or pool of assets, as digital tokens) is the next stage in evolution. It offers asset managers a new opportunity to benefit their investors and the management of their assets.

The tokenisation (r)evolution

As an example of turning the promise of tokenisation into a reality, Calastone, in collaboration with Schroders, is building a new way of operating. That is, directly tokenising collectives of assets for distribution to the mass market, using its Distributed Market Infrastruc-

ture (DMI) technology. Just tokenising fund units will not provide the transformation that the industry is looking for. Operating collective investments on a native distributed ledger technology (DLT) platform, and applying DLT and tokenisation at all levels of the fund from trading, to administration and distribution, provides a much more fundamental transformation.

In essence, this entails building a marketplace. Here, investors, investment managers, and other participants can offer products and purchase the services required to support them. This model is not looking to recreate the mechanism of a mutual fund—it is purely digital; a multi-party structure where everyone collaborates.

The key benefit of this approach is that it leverages and builds on the scale of the existing Calastone network; instantly connecting nearly 4,000 members of the global asset management ecosystem—fund managers, transfer agents, distributors, platforms, and custodians.

Where other companies are building new products in isolation, Calastone can use all its existing connectivity and infrastructure to enable asset managers to distribute new, token-based collective investment products globally from day one.

It also means Calastone's platform can be accessed via the messaging rails and protocols that exist today. Customers on the network can realise new efficiencies and value immediately—without having to build to a new standard or undertake any costly re-platforming work.

This allows fund managers to focus on building where it matters—creating innovative new products and ways of working with customers that add tangible value. So rather than wasting resources on infrastructure changes, customers gain a first-mover advantage.

Managers can also still trade their existing funds with this model alongside building out new token-based collective investment products, helping manage risk and change at their own pace.

For investors, tokenisation can unlock a truly modern user experience, including:

- instant purchases
- better transparency
- access to a broader range of assets through fractionalisation, allowing more investors to access asset classes that previously carried high capital thresholds.

It also holds great potential for asset managers, facilitating new digitally native investment models and helping to defend margins. For instance, tokenisation digitalises the manual processes that exist today, end-to-end, creating a streamlined intermediary chain. This is all the more important in the current environment, where firms are looking for ways to deliver strong returns while removing friction from their operations.

The industry recognises the opportunity here, and there is a growing appetite for tokenisation and digital assets. In a 2022 Celent-BNY Mellon survey of global institutional clients, *Migration to digital assets accelerates*, every asset manager with more than US\$1 trillion in AUM was interested in investing in tokenised products, and 97% of the 271 institutional investors surveyed agreed that tokenisation will revolutionise asset management and be good for the industry.

Reducing the cost of investing with tokenisation

Tokenisation, and the DLT that underpins it, helps automate processes like pricing and fund accountancy. It brings greater visibility, instant settlement, as well as improvements in data and analytics, saving many basis points on the management of funds. This increases the potential for alpha generation across both existing and new propositions, handing asset managers the key to reduced costs and increased margins.

At the FT Future of Asset Management conference in September 2022, Jonathan Steinberg, Founder and CEO of fund management company WisdomTree, gave the example of a US Treasury fund from his firm using tokenisation to pass on zero management fees to the investor.

“[It] will not have an expense ratio. It will make its money on transactions, as well as net interest income ... We’ll be keeping more of the economics, and net-net for the end customer, they will be paying less,” he said.

Calastone’s model for tokenisation goes a step further. As mentioned, rather than tweaking the mechanism of a mutual fund and the existing intermediary chain, it involves

building a digital marketplace where investors, investment managers, and other participants can offer products and purchase the services required to support them—all while significantly lowering the cost of investing.

Business transformation through tokenisation

Tokenisation, however, offers more than simply reducing costs. It has the power to help asset managers achieve a wider transformation mission. That is, creating an efficient, scalable business, with a more flexible and controllable cost base.

First, tokenisation allows asset managers to expand their universe of products, without an increase in cost. With the appetite for fully digital investment products only increasing, and modern investors demanding access to a larger pool of assets, this is key.

While this would usually require a significant overhaul to an investment management system, Calastone’s tokenisation model is geography, distribution channel and product agnostic—it can handle traditional mutual funds and digital assets within the same infrastructure.

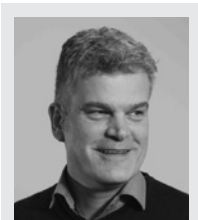
This is important because institutional investors expect to mix both traditional and digital assets in their portfolio, according to the Celent-BNY Mellon *Migration to digital assets accelerates* survey, with nearly three-quarters of those surveyed having a strong preference for a fully integrated provider for all their digital asset needs.

Rather than a Big Bang approach to digital transformation, asset managers can set their own pace, bringing their distributors and clients with them without asking them to make major technology investments to access the new tokenised products.

Second, tokenisation, by converting both the asset and the payment associated with the asset into individual digital tokens, streamlines reconciliation and settlement. It optimises core platform operations, reducing friction and increasing liquidity. Calastone’s network and settlement functionality help achieve this.

Third, a fully digital, tokenised model simplifies and automates many fund administration workflows. This not only boosts asset managers’ margins, but also frees up their time, so they can focus on what they do best. That is, research and execution. In addition, the immutability and transparency of data on an open ledger provides regulators and auditors with a single source of information from which they can request data on demand, shortening the supervision process.

Tokenisation, then, is a powerful tool that asset managers can leverage in their cost transformation strategy. According to EY’s 2022 *Future of asset management study*, a typical mid-tier asset manager with AUM in the US\$500 billion to US\$1 trillion range, and a total expense base of around US\$2 billion, stands to achieve cost savings of up to 15% with such a transformation. Tokenisation is not the only lever, but it touches on some of the key elements in creating a leaner, more innovative business model.



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Adam is Calastone’s chief technology officer, responsible for its technology platform operation, architecture, engineering and technology strategy. He has over 20 years’ experience across financial services, investment banking, payments, wealth management and asset management. His experience includes technology-related roles at Aegon and BNP Paribas, and as a consultant on enterprise engagements for JP Morgan Chase, Lloyds Banking Group and the London Stock Exchange. Adam holds bachelor’s and master’s degrees in computer science and artificial intelligence.

**The quote**

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A tokenised tomorrow

Tokenisation is the ultimate expression of a digitised, cost-efficient investment world, and should be a core focus for all asset managers trying to build alpha now, and for tomorrow. It ensures they can continue to deliver value for their investors in the face of the current macro headwinds, and capitalise on technological advancements and shifting investor demographics—all while streamlining operations and trimming costs.

Calastone's collaboration with Schroders to build a tokenised investment vehicle shows that this future could be much closer than some imagine. Used in the right way, DLT is a powerful platform for providing, managing, securing and distributing tokenised assets, helping to unlock meaningful improvements in operational efficiency and product innovation. **FS**