Transforming a Solid into a Liquid

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Central Issue of the Paper

The rapid pace of technology has helped the democratization process of financial markets, benefiting the end investor in my ways. This is especially true for investors that buy and sell shares in public markets; transparency has increased while transaction costs and investment minimums have decreased. However, the same cannot necessarily be said for investors in private markets, specifically real assets. Investors who wish to participate in private real assets often must have deep wallets and a high tolerance for long lockup periods. What if there was a way to democratize private markets in a manner analogous to what's happened in public markets? "Tokenizing Real Assets," by Jeroen van Oerle of Robeco explores this concept.

Approach Employed by Paper

First, van Oerle provides a short history of the impact of electronic trading on financial markets. Before electronic trading was adopted, executing transactions was expensive and inefficient. Often times, investors who wished to make a transaction were required to be near a physical trading floor or branch and find someone, such as a broker, to help them execute the trade. With the advent of electronic trading, physical locations became less relevant, and transaction costs quickly became a fraction of what they once were. Still, electronic trading has been most effective in markets where the underlying securities or contracts are homogenous, such as futures contracts or shares of equity and fixed income.

Real assets, more specifically *physical* assets, on the other hand, are much harder to trade electronically. In fact, van Oerle describes ownership as being "binary" – typically, you own all of it, or you own none of it. Real estate is a good example of this, as an investor is often required to purchase an entire building, requiring a substantial amount of up-front capital. Selling that building could also take months to execute, and transaction costs could eat into profits if that investor uses a broker to execute the transaction. Also worth mentioning is the lack of diversification that an investor experiences by committing their capital to one building in particular.

But what if technology allowed that investor to buy a fraction of that building instead of the whole thing? This is where tokenization comes into play. Using blockchain technology could lower the barriers to entry for smaller investors, decrease transaction costs, and increase liquidity and therefore price discovery. Let's take it beyond real estate – what about artwork or intellectual property? Rather than requiring one investor to

pony up $120 million for one painting, what if there were 120 million tokens, priced at $1 per piece? The implications of this are huge!

These are all great ideas, but there are some barriers to tokenization. According to van Oerle, there are hurdles related to the asset and related to regulation. Regarding the asset, there are four big hurdles: ownership rights, safekeeping of the link to the underlying asset, cybersecurity, and IT infrastructure. Regarding regulation, there are five: ownership rights, governance and maintenance, reporting requirements and consumer protection, tax implications, and regulatory mandates. Some of these hurdles will have to be cleared before tokenization could truly go mainstream.

Findings of the Paper

For the most part, van Oerle's ideas are simple: find ways to use technology to further democratize real assets, an asset class with high barriers to entry for investors. Tokenization would provide a higher level of liquidity for investors, which would allow them to own pieces of tangible assets, such as artwork and real estate, and intangible assets, such as copyrights and royalties. However, there are many hurdles to implementing tokenization programs that must be cleared before investors can begin to enjoy the benefits of it.