

Opportunities of tokenisation for issuers and investors

Working group on digital finance use cases

Introduction

Some issuers face uncertainties when seeking financing or during the life of their securities:

1. Many businesses are too small to access the capital markets, while relatively large financing requirements limit the ability of banks to finance them appropriately.
2. Once the securities have been issued, issuers generally have incomplete knowledge of their security holders, which makes it difficult to identify them, whether to optimise the processing of offers for their securities, the organisation of general meetings or simply to ensure more regular and targeted communication with their shareholders or creditors.

In addition, current post-trade operations still require a large number of reconciliations between counterparties, which generates processing and control costs, as well as operational risks.

Consequently, with the emergence over the last ten years of DLTs (Distributed Ledger Technologies) such as Blockchain, a new era is opening up in the digitisation of financial markets, characterised in particular by significant gains in efficiency and a greater ability to share information as to the identity of investors or concerning the characteristics of securities issued and traded.

The purpose of this document is therefore to explain how issuers and investors could benefit from these innovations in their activities as issuers and investors of digital, or tokenised, financial securities, i.e. shares, bonds or fund units issued, traded and settled in market infrastructures using DLTs.

1. Using blockchain for financial services: an overview

Blockchain technology, with its digital identity, transparency, ability to exchange value peer-to-peer and single transaction (trading and settlement in a single exchange), is seen as a catalyst for profound changes in regulated financial markets and services.

A blockchain is a new distributed and shared database technology for storing and transferring information and data in complete security. With blockchain, this transfer of value is made possible by cryptography and consensus mechanisms that enable the transfer of ownership to be securely certified. Blockchain creates digital property and is becoming the benchmark technology for transferring value.

Digitisation through blockchain therefore has clear advantages in terms of:

- Security: encryption of all recorded transactions ensures the security of information transfers;
- Immutability: the digital fingerprint of a recorded transaction cannot be modified or deleted without the agreement of the network participants;
- Resilience: validated transactions are automatically distributed across all the nodes in the decentralised network;
- Transparency: each new transaction is added to the chain of previous transactions, with an audit trail available for all recorded transactions;
- Programmability: so-called intelligent contracts automatically execute programmed rules when predefined conditions are met;
- Accessibility: 24/7/365 access to the blockchain is not subject to any location constraints or territoriality conditions.

In this way, blockchain is becoming the benchmark technology for transferring value, just as the Internet is for transferring information.

A. Opportunities for issuers ...

Digital securities offer several advantages over traditional securities when it comes to raising capital:

- Accessibility to a global investor base: securities issued on a blockchain can be bought and sold all over the world, enabling issuers to reach a wider and more diversified audience, provided they comply with the regulations in force;
- The smart contract creating the securities can be used to disseminate a wealth of information on the sustainability and other ESG characteristics of the proposed investment;

- Possibility of identifying holders at all times: blockchain makes it possible to automate the monitoring of transactions in securities and to identify custodians and end investors at all times;
- Lower processing costs, thanks in particular to the elimination of costs associated with reconciling transactions between counterparties, and the automation of securities transactions (payment of issue proceeds, distribution of coupons/dividends, repayment of capital, etc.), limiting error accounts.

B. ... and for investors

Digital securities offer investors a number of advantages:

- Easy trading and management of collateral and settlements: transactions can always be processed at any time;
- Greater transparency: transactions on a blockchain are recorded transparently and securely, enabling investors to track the development of their digital securities portfolios and verify the accuracy of all relevant information;
- Efficiency gains in information sharing between counterparties and intermediaries for pre- and post-trade processing: front, middle and back-office exchanges, eliminating the need for reconciliation and reducing transaction processing costs;
- Reduction in the cost of formalising and disseminating data, particularly non-financial data, if this information is included in the smart contract.

2. Tokenised securities compared with traditional securities

There are a number of important points to bear in mind:

- A tokenised or digital financial instrument gives its holder the same rights over the issuer as holding an instrument in its traditional form. Both forms of security are perfectly fungible and have the same ISIN code;
- The digitisation of securities can be applied to new issues as well as to securities already issued, provided that the documentation of the security authorises the conversion of the traditional security (circulating via a central securities depository) into a digitised security (circulating on a blockchain);
- The European pilot regime allows digital financial securities to be listed and traded under the same conditions as traditional bearer securities;

- Ownership of securities held by investors is evidenced in the issue registers by entries either directly in the name of the holders or in omnibus nominee or segregated intermediary accounts held by investors.

- **For unlisted companies**

- Less costly market access for issues benefiting from the simplified prospectus and less complex with a digitised IPO process,
- Dedicated infrastructure for SMEs (simplified prospectus only) and rules for growth MTFs (trading platforms),
- Listing of SMEs to facilitate secondary transactions,
- Simplified management of securities and shareholder relations.

➔ Objective: to make it easier to channel savings into SMEs

- **For listed companies**

- Optimisation of the traditional management of 'pure' registered share registers by issuers or administered registered share registers via issuer services providers,
- Better identification of shareholders (in terms of voting rights and percentage of capital held) on an ongoing basis,
- Optimising the management of general meetings (voting on resolutions),
- Shareholder communication could be more frequent and not limited to "major" shareholders only.

3. Main use cases

Examples of use cases include :

- SLBs (Sustainability-Linked Bonds), whose coupon depends on performance indicators (KPIs) linked to the issuer's sustainable development efforts. The smart contract that creates the security is programmed to check that the issuer has achieved the sustainability KPIs and to automatically adjust the coupon on payment.

- short-term bonds such as commercial paper;

- shares, making it easier to identify shareholders on an ongoing basis (capital held, voting rights) and to manage general meetings (when resolutions are voted on) and shareholder communication (more frequent and not limited to major shareholders).

4. Next steps:

Various experiments have shown the effectiveness of digital securities, with no change in rating and ISIN code and give the same rights to investors. Even if liquidity is not here yet, the European pilot regime and the reversibility options offset this impediment.

In a near future, the next steps are:

- a. a wholesale digital euro. It will provide an instant and secure cash settlement; ECB, in order to encourage the tokenisation of financial assets, leads 3 experiments in 2024 (May to November) on cash settlement (via T2S, commercial bank money or wholesale CBDC),
- b. development of interoperability with other DLT platforms or traditional infrastructures as well as data standardization

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In conclusion, in France, we have a solid financial ecosystem to support issuers wishing to test this new form of fundraising. All the major financial institutions and financial market infrastructures have developed the capacity to support issuers and investors in developing the financial markets of the future. The successful adoption of blockchain in the financial market requires :

- mobilising all players in contact with issuers to make them aware of its potential,
- effective communication by market infrastructures on possible ways of trading digital securities and improved settlement services,
- the effective development of secondary markets, an essential condition for the asset management industry to embrace the movement towards tokenisation of financial instruments.

Blockchain is a unique opportunity to reconcile individual investors with project financing in line with their sustainable investment preferences, and for businesses, investing in digital securities means being part of tomorrow's innovative world. It is also an issue of economic and financial sovereignty in the context of the global race to digitise, and thus preserve the driving role of financial markets in financing the economy.