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# A Primer: Understanding Tokenized Real-World Assets



By Lilya Tessler and Erika Cabo and Andrew Sioson



**A Primer: Understanding Tokenized Real-World Assets** *by: Lilya Tessler (Partner), Andrew Sioson (Partner), and Erika Cabo (Senior Managing Associate) at Sidley Austin, LLP*

Tokenization of real-world assets (RWAs) is revolutionizing the way we perceive and manage assets. This article aims to provide an overview of RWAs, debunk common myths, and outline the legal considerations and risks associated with tokenized RWAs.

## **What Are Tokenized RWAs?**

The term “tokenized RWAs” refers to the digital representation of physical or intangible assets utilizing a token recorded on a blockchain. This innovative approach allows for the efficient recording, trading, transferring, and management of tangible assets in a digital format.

A wide range of RWAs can be tokenized, including real estate, commodities, art, and intellectual property. By recording ownership of these assets using digital tokens, they can be more easily tracked and traded on blockchain platforms. This is similar to the e-commerce trend in the 1990s, when online shopping sites were developed to allow consumers to buy physical goods by seeing digital images on the internet, instead of physically going to a brick-and-mortar store in a shopping mall to see, feel, and buy the items.

The primary benefits of tokenizing real-world assets include increased liquidity, fractional ownership, and enhanced transparency. Tokenization allows for the division of assets into smaller, more affordable units, making it easier for a broader range of purchasers to participate. Additionally, the use of blockchain technology ensures a transparent and immutable record of ownership and transactions.

## **Debunking Myths: Tokenized Assets vs. TGEs and STOs**

Tokenization is not a new concept. Digital records have existed for years from digital shopping sites, digital concert tickets, and digital securities. Tokenization of RWAs is simply recording these digital records on a blockchain as opposed to other centralized databases. Tokenizing an asset does not change the nature of the asset and it is not to be confused with token generation events (TGEs) or security token offerings (STOs). Below are some of the common myths regarding asset tokenization that need to be clarified.

### Myth 1: Tokenizing an Asset Changes the Nature of the Asset

Tokenizing an asset does not change the nature of the asset itself. Tokenization is the process of creating a digital representation of a physical or intangible asset using a token recorded on a blockchain. This digital token serves as a record of ownership and can be traded or transferred on blockchain networks. However, the underlying asset

remains the same, whether it is real estate, art, commodities, or intellectual property. The token merely provides a more efficient and transparent way to manage and transfer ownership of the asset, without altering its fundamental characteristics or value.

### Myth 2: Tokenized Assets Are TGEs

TGEs are a mechanism used by new blockchain protocols to distribute tokens to potential users of the network. These tokens, such as ETH (Ethereum) and AVAX (Avalanche), are designed to provide functionality within the blockchain ecosystem, enabling users to interact with the network, pay for services, or validate transactions, among other uses. TGEs are not a form of fundraising, but they are also not tokenized RWAs, because the token associated with the TGE represents utility on the network and not a digital representation of an actual asset. In contrast, tokenized RWAs *are* digital representations of actual, tangible, or intangible assets. The value of these tokenized RWAs is directly linked to ownership of the underlying assets, which can be verified and audited.

### Myth 3: Tokenized Assets Are Just Another Form of STOs

STOs involve the issuance of tokens that are classified as securities and are subject to regulatory oversight. These tokens are backed by assets that generate income or have equity-like features, such as dividends, voting rights, or profit sharing.

Although tokenized RWAs can be tokenized equity or fund interest, they are not limited to securities and have many more benefits when representing a wide range of other physical or intangible assets. The primary focus of tokenized RWAs is on the digital representation and fractional ownership of these assets, rather than raising capital through the issuance of securities.

## **Legal Considerations**

***Regulatory Compliance:*** Navigating the regulatory landscape is crucial for tokenized RWAs. Compliance with U.S. securities and commodities laws, anti-money laundering regulations, commercial laws, and know-your-customer requirements is essential to ensure the legality and legitimacy of tokenized assets.

***Ownership and Transfer of Title:*** The digital representation of an asset must accurately reflect the legal ownership of the holder and their enforceable right to the underlying asset. Ensuring clear and enforceable ownership rights is critical to the success of tokenized RWAs.

**Smart Contracts:** Smart contracts are self-executing agreements encoded on the blockchain and triggered by predefined conditions. While they play a vital role in automating and streamlining the tokenization process, one must consider whether smart contracts are enforceable, comply with existing contract laws and regulations, and adequately address potential disputes and contingencies.

**Jurisdictional Issues:** Tokenized assets can be created and traded globally, raising questions about cross-border jurisdiction and applicable laws. Being aware of the roles of regulatory bodies such as the U.S. Securities and Exchange Commission, U.S. Commodity Futures Trading Commission, European Securities and Markets Authority, Monetary Authority of Singapore, Hong Kong Monetary Authority, and others globally is of paramount importance in navigating different legal frameworks and standards for tokenization.

## **Risk Considerations and Management**

**Security Risks:** Blockchain technology is not immune to cybersecurity risks, such as hacking, phishing, or malware attacks. Tokenized assets may be vulnerable to theft, loss, or manipulation if the private keys, wallets, or platforms that store and access them are compromised. Ensuring the security and integrity of the blockchain and the tokenized assets is paramount to protecting investors and maintaining trust in the system.

**Market Risks:** Tokenized assets are subject to market volatility and liquidity risks, depending on the supply and demand of the tokens and the assets, as well as the performance and stability of the blockchain platforms. Considering risk mitigation strategies is essential in order to protect investments and navigate the complexities of the tokenized asset market.

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## **Conclusion**

Tokenized RWAs represent a significant advancement in the management and trading of physical and intangible assets. They can unlock new value, efficiency, and innovation for both asset owners and investors. However, they also pose significant legal challenges and risks that need to be addressed and managed. Seeking guidance from law firms on regulatory compliance, ownership issues, and risk management, while engaging with experienced vendors and blockchain platforms, can provide the necessary technical knowledge and support to ensure the smooth operation of

tokenized RWAs. As the landscape continues to evolve, staying informed and proactive will be key to leveraging the full potential of tokenized RWAs.