



Focus on: Fund Tokenization

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Disclaimer

The purpose of this document is to provide general information on Fund Tokenization. It must not be considered as an exhaustive presentation and no action should be taken or omitted based on this document. In all instances, proper legal or other advice should first be taken. Elvinger Hoss Prussen shall not incur any liability in relation to the information provided herein or in relation to any actions taken or omitted based on this document.

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Our FinTech practice

With a team of lawyers specialized in various practice areas, Elvinger Hoss Prussen possesses an unparalleled workforce and expertise to handle every legal facet of your FinTech business project:

- Investment Funds
 - Asset Management Regulatory
 - AML
 - DORA & ICT outsourcing
 - IP & Data Protection
 - Finance & Capital Markets
 - Corporate & M&A
- ➔ Digital ledger technology (DLT) and Blockchain
 - ➔ Fund tokenization and related regulatory advice
 - ➔ Financial sector regulatory aspects including payment services (payment services directive, PSD)
 - ➔ Crypto-assets, virtual currencies, tokenization, platforms (ICO, crowdfunding, crowdlending, capital raising, investment/funding methods)
 - ➔ Smart contracts and internet of things (IoT)



Issuance of fund units on DLT

THE RAISE OF THE DIGITAL TA

- Luxembourg fund vehicles issue securities mainly in **registered form**, i.e. the ownership is recorded in a shareholder register, kept at the registered office (Art. 430-3 Companies Act)
- The traditional setup: a regulated Transfer Agent maintaining the funds' share register
- The use case: maintain the shareholder register on the DLT – **the Digital TA**
- **Technological neutrality**: Digital TA = Traditional TA entity (specifically licenced PFS or CSSF authorisation of banks, IFM)
 - **Legal**: acceptance of DLT register as compliant with the Companies Act
 - **Regulatory (CSSF)**: same legal regulatory framework and authorization regime, but additional technical characteristics, factor DLT risks, adapt internal process and controls

HYBRID VS NATIVE MODELS

- The **“mirroring” model** relates to the tokenization of pre-existing assets on the DLT, e.g. an existing MMF share is tokenised, creating a ‘digital twin’ existing on-chain, the TA maintains a double-record
- The **“native” model** whereby funds shares are issued natively as tokens on the blockchain, the TA maintains a single, DLT-based register as the golden source of truth
- This enabled the first **fully tokenized funds** (typically, MMF)

“Tokenisation”: the digital representation of financial instruments on distributed ledgers or the issuance of traditional asset classes in tokenised form to enable them to be issued, stored and transferred on a distributed ledger

Issuance and transfer of fund units on DLT

LUXEMBOURG BLOCKCHAIN LAW IV

- Introduction of the **new status** of the control agent
- Control agent shall be **EU investment firm** or **credit institution**
- Using a control agent **shortens the custody chain** – custodians do not need to maintain custody accounts with the keeper of the issuance account (CAK/settlement organisation)
- **Control Agent** therefore:
 - maintains the **securities issuance account** (via DLT)
 - tracks the holding chain of dematerialised securities held in securities accounts (via DLT)
 - ensures **reconciliation** between the DLT-based issuance account and securities accounts

The Blockchain Laws* clarify the issuance and circulation of dematerialized securities by means of DLT

- **Blockchain I:** recognizes the use of DLT to hold, register and transfer securities (equal to traditional transfers between securities accounts)
- **Blockchain II:** recognizes the issuance of dematerialized securities via DLT
- **Blockchain III:** ensures that securities issued on DLT fall under the definition of 'financial instruments' and thus, can constitute financial collateral
- **Blockchain IV:** introduces the new status of the control agent

* A series of Laws issued between 2019 and 2024, amending notably the existing laws on the financial sector, the circulation of securities, dematerialized securities and financial collateral

Trading and settlement of DLT fund units

THE DLT PILOT REGIME*

- A sandbox regime for the trading and settlement of transactions in DLT financial instruments (incl. fund units) under certain individual and aggregate thresholds
- Provides for **exceptions** from certain requirements of CSDR or MiFID II that are not technically necessary due to DLT and other, such as intermediation requirements, settlement finality etc.
 - ➔ enables direct trading by retail investors on a DLT MTF (under certain conditions)
- **Authorization regime for new type of market infrastructures:**
 - DLT multilateral trading facilities (**DLT-MTF**)
 - DLT settlement systems (**DLT-SS**)
 - DLT trading and settlement systems (**DLT-TSS**)



* As per Commission statement of May 2024, the DLT Pilot continues to apply unless withdrawn.



Tokenisation of Luxembourg investment funds

LUXEMBOURG REGULATORY CONSIDERATIONS AND ADVICE

Investment funds

- Possible tokenization of all available fund structures – UCITS and AIF (Part II, SIF, RAIF) Typical use case - tokenized UCITS money market fund (MMF)
- We can guide you through the entire process of tokenizing a Luxembourg fund, notably advise and accompany you in relation to:
 - Advise on structuring, including legal as well as regulatory considerations
 - Presentation of your project to CSSF, as needed
 - Step-plans and check-lists to follow your project according to the agreed timeline
 - Drafting/adapting of fund documents to the use of DLT (offering documents, constitutional documents, investor notices etc.)
 - Preparing submission to CSSF
 - Securing CSSF approval and e-identification of prospectus

Tokenisation of Luxembourg investment funds

Tokenized fund operations – Legal & regulatory

- Operating a tokenized fund requires a specific, DLT-enabled environment, integrated both from operational and technical perspective into the life-cycle of the fund and the various service providers: AIFM/ManCo, Transfer Agent/Control Agent, Fund Administrator, Depositary, DLT operator etc.
- We can guide you through all legal and regulatory steps leading your project to success, including analysis and advice in relation to:
 - Feasibility of the target operational model, applicable legal and regulatory framework and main initial considerations
 - Technical means (Blockchain technology and other ICT systems/tools necessary) – legal and regulatory assessment
 - Roles and responsibilities of the various actors – operational and contractual set-up
 - Assessment of required CSSF licence, administrative authorizations, extensions or notifications and assistance with necessary application file(s) and CSSF authorization/notification process

Your dedicated Fundtech team



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