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FCA Consultation (CP25/28) on Progressing Fund Tokenisation – Implications and Opportunities for the Loan Market

The Loan Market Association ("**LMA**") appreciates the opportunity to submit a response to this consultation.

Although this consultation focuses on authorised funds, the proposed model maps directly to loan markets: tokenised fund units and tokenised settlement assets are expected to operate on regulated rails with programmable transfer restrictions, audited smart-contract logic, and institution-grade custody.

For LMA members active in origination, distribution, secondary trading, and servicing, this represents a convergent infrastructure that can reduce friction across the loan value chain. For example:

- the digital register model aligns with loan agency and servicing functions. On-chain operational records with continuous depositary access and deterministic workflows reduce reconciliation breaks and support T+1 (and faster) settlement targets. For loan syndications, this means shorter allocation and closing cycles, improved certainty of settlement, and more robust audit trails;
- tokenised assets enable programmable eligibility and transfer controls. The same whitelisting and attestation features used in funds can embed facility-level restrictions and jurisdictional limitations (e.g., reducing operational risk in secondary assignments and participations);
- tokenised money market funds provide higher-quality, liquidity-friendly instruments that can be mobilised on demand as collateral. This supports intraday repo, margin, and treasury optimisation for lenders and arrangers and allows faster more controlled collateral movements against loan exposures. The combination of tokenised fund collateral and maturing digital settlement assets reduces counterparty risk through atomic settlement and enables just-in-time liquidity for closing and margin events;
- distribution expands through regulated digital rails. Portable KYC and embedded restrictions allow compliant cross-border participation while preserving investor protections. For private credit and CLO-adjacent strategies, tokenised wrappers and register standards can widen the investor base without undermining the established intermediated model; and
- operational resilience and transparency improve. Immutable audit logs, standardised token metadata, and on-chain disclosures (e.g., daily NAV or pricing oracles where appropriate) strengthen governance and facilitate depositary oversight. Over time, shared standards could reduce bespoke build costs and enable interoperability across custodians, agents, and trading venues.

Question 4: What role can regulators play in supporting the development of token standards that promote effective governance and positive consumer outcomes?

From a lenders' perspective, tokenisation should aim to replicate and, where possible, improve upon, the legal and operational characteristics of existing instruments. In particular, tokenised instruments (including fund interests) need to deliver legal enforceability of rights, settlement finality, robust operational resilience, safe custody and recoverability of assets, and transparent and fair governance. They should also facilitate effective client asset protection, including in insolvency.

Regulators can play a central role by setting clear, technology-neutral outcomes that token standards must achieve, while allowing industry to determine the most efficient technical implementation. This includes articulating baseline expectations around (in the case of fund interests): (a) the legal nature of the tokenised unit and the rights it confers, (b) eligibility criteria for platforms and participants, (c) KYC/AML and sanctions screening, and (d) data protection, confidentiality, and access to information. Clear regulatory expectations in these areas are a prerequisite for wholesale lenders to treat tokenised units as reliable collateral or investment exposures, and by analogy to tokenisation efforts in wholesale lending markets.

Much of the necessary groundwork has already been laid. The Law Commission's work on the legal foundations of digital assets (together with forthcoming legislation to clarify their status) provides an increasingly robust and predictable legal environment. Similarly, the Bank of England and the FCA's Digital Securities Sandbox offers a practical framework for testing token standards, custody models, and settlement arrangements in a controlled setting. Regulators can build on this by issuing targeted guidance on how existing rules apply in tokenised fund contexts, rather than attempting to design detailed technical standards themselves.

To avoid fragmentation and unnecessary systemic risk, regulators should actively support the development of interoperable token standards. For lenders and other institutional investors operating cross-border, the ability to transfer, pledge, and settle tokenised fund units across different infrastructures and jurisdictions is critical. Coordination among UK authorities and with overseas regulators on common data models, messaging standards, and minimum interoperability requirements will be important in ensuring that tokenisation enhances, rather than undermines, market integration.

We also see a significant competitive opportunity for the UK in this area. The common law framework of England and Wales, underpinned by the Law Commission's recent work, is already widely used in cross-border finance and is well suited to accommodating digital asset structures. UK financial regulators have deep experience supervising sophisticated wholesale firms and are generally open to innovation from entities already within the regulatory perimeter, as opposed to unregulated cryptoasset businesses. Much of the necessary groundwork on the buy-side has already been undertaken through industry initiatives and pilots. In that context, a clear, outcomes-based regulatory framework for token standards, combined with ongoing UK–US and other international technology collaboration, could help to accelerate innovation in tokenised funds; maintaining high standards of consumer protection and market integrity and permitting read across to tokenisation of loans.

<u>Question 7: Do you support the introduction of an optional regime to allow for direct dealing in authorised funds?</u>

Although lenders do not typically interact with funds at the dealing level, we see this proposal as relevant to our members in principle because any structure that broadens access to authorised funds and supports deeper secondary liquidity in fund interests is likely to be positive for fund finance markets.

Greater liquidity and transparency in fund units can support better pricing and risk management for lenders that provide financing to funds or that treat fund interests as collateral.

In our view it would be prudent for the initial scope of the DF2 regime to be limited to relatively simple fund structures with robust liquidity management and straightforward dealing arrangements. This would allow the operational model, including the use of tokenised units and wallet-based interactions, to be tested in a lower-risk environment. Clear standards around investor onboarding, KYC/AML checks, client asset protection, dispute resolution, and contingency arrangements will be essential if the benefits of direct dealing are to be realised without compromising investor protection or market integrity.

The FCA may also wish to consider committing to a formal review of the DF2 regime after an initial period, to assess its impact on costs, liquidity, and risk, and to determine whether a wider range of funds should be eligible.

Question 13: Do you agree with our proposals in respect of investor disclosures and communications? If not, why?

We recognise that the FCA's proposals on investor disclosures and communications are primarily aimed at retail and other less-sophisticated investors. Nonetheless, from a lenders' perspective we support the direction of travel and agree that clear, targeted disclosures will be important in the transition to tokenised authorised funds.

A key message for investors should be that tokenisation is a change in the form of record-keeping and transmission, not a change to the fundamental regulatory status of authorised funds. Tokenised authorised funds should remain subject to the same underlying regulatory framework, governance requirements, and prudential safeguards as their non-tokenised equivalents. Disclosures should therefore explain in simple terms what is different (e.g., the use of wallets, the reliance on distributed ledger technology, new types of service providers and associated operational/cyber risks) and what is unchanged (such as the investment strategy, risk profile, and core investor protections).

In the early stages of adoption, enhanced investor education and communications are likely to be necessary to avoid confusion between tokenised authorised funds and unregulated cryptoasset products. Clear, consistent messaging across industry participants about the nature of tokenised units should support confidence and, over time, greater participation. In turn, broader participation can deepen liquidity in tokenised fund units, which is beneficial not only for investors but also for lenders who provide financing to funds.

Finally, given that tokenised products will typically be accessed through digital channels, we would encourage the FCA to recognise and facilitate innovative, digital-first approaches to disclosure (e.g., layered or interactive disclosures) provided the core content requirements are met.

From the lender perspective, our view is that good practice in relation to funds can be relatively easily adopted as the market for tokenisation of loans proceeds.

Question 22: Are there other associated regulatory, operational or commercial barriers to investing in tokenised assets? What could we do to address these issues?

From the perspective of lenders and other wholesale market participants, we see a number of additional barriers to investing in, or taking collateral over, tokenised assets. Many of these are not unique to

authorised funds, but are particularly relevant if tokenised fund units are to be widely held and financed by institutional lenders.

- **Tax and accounting treatment**: unclear or inconsistent tax characterisation of tokenised instruments (e.g., in relation to stamp duties, VAT, and capital gains) can deter adoption, particularly for cross-border investors. Similarly, uncertainty about how tokenised assets should be recognised and measured for accounting and regulatory capital purposes makes it difficult for lenders to incorporate them into their current risk and finance models on a comparable basis with traditional instruments.
- **Conflict of laws and cross-jurisdictional recognition**: lenders often operate across multiple jurisdictions. Divergent approaches to the legal status of digital assets, and to conflict-of-laws rules governing title, security interests and insolvency treatment, complicate the issuance, settlement and use of tokenised assets as collateral. This can inhibit their use in cross-border financing, securitisation and derivatives transactions.
- **Interoperability and market fragmentation**: the emergence of multiple token standards, chains, and registries risks creating fragmented pools of liquidity and bespoke processes for each platform. This makes it harder for lenders to transfer, pledge, or net positions efficiently, and can impede the development of deep secondary markets.
- **Integration with market infrastructure and internal systems**: at present there is limited connectivity between token systems and core financial market infrastructure functions such as CSDs, CCPs, and payment systems. Within firms, tokenised assets often sit in parallel with existing books and records, creating duplication of processes. This increases reconciliation burden, operational risk, and cost, and undermines some of the efficiency benefits that tokenisation is intended to deliver.
- **Data, reporting and audit trails**: inconsistent alignment between on-chain and off-chain records, and the absence of standardised data schemas, make regulatory reporting, audit, and dispute resolution more complex. For lenders, reliable and consumable data on positions, valuations, corporate actions, and collateral status is essential for risk management and regulatory compliance.
- **Operational and cyber risk**: dependence on new technology providers, smart contracts, and key-management solutions introduces new failure modes and concentration risks. Until there is greater clarity on standards, liability allocation, and incident-response expectations, some lenders may be reluctant to use or implement tokenised asset models.

Many of these barriers can be reduced by continuing to build on the extensive work already undertaken by the buy-side and by industry bodies on common standards and reference architectures. We see a significant opportunity for tokenisation to enable greater automation and straight-through processing of lifecycle events, corporate actions, and regulatory reporting, which would benefit both investors and lenders.

To support this, we would encourage (a) the FCA to work with HM Treasury, HMRC, the FRC, and international standard-setters to provide more explicit guidance on the regulatory, tax, and accounting treatment of tokenised assets which would support industry-led development of interoperable technical and data standards, and (b) financial institutions to use initiatives such as the Digital Securities Sandbox and TechSprints to test how tokenised assets can integrate with existing infrastructure in a safe but ambitious way.

Question 23: How are changing investor habits and expectations influencing the design of tokenised products?

Changing investor habits and expectations are a key driver of how tokenised products are being designed. Across both funds and loan markets, investors increasingly expect digital-first access, faster settlement, richer data and the ability to tailor exposures more precisely.

From a user-experience perspective, investors are accustomed to intuitive digital interfaces, 24/7 access, and near-real-time information in other areas of their financial lives. Tokenised products that can be accessed through familiar digital channels (including the ability to view holdings in a wallet-like interface, receive real-time updates on valuations and corporate actions, and transact with shorter cut-off times) are likely to be more attractive. This is particularly true for younger and more digitally native investors, but the convenience benefits are increasingly valued by institutional investors as well.

In loan and private credit markets, we already see demand for shorter settlement cycles, improved secondary liquidity, and more granular, fractional participations. These same expectations carry over into tokenised fund products. Tokenisation can support lower minimum investment sizes, more flexible dealing frequencies, and easier transfer and pledging of interests, making fund exposures more accessible to a broader range of investors and more usable in financing structures.

Investors are also placing greater emphasis on transparency and alignment with their own mandates and values, including ESG considerations. Tokenised products can, in principle, embed richer metadata about underlying assets and ESG characteristics, and provide more timely, machine-readable reporting. Experience from early tokenised offerings by large global asset managers suggests that investors value these practical benefits (e.g., faster settlement, enhanced reporting, and operational efficiency) more than the underlying technology itself and expect tokenised products to deliver them without increasing complexity or risk.

These evolving expectations underscore the importance of designing tokenised products that are interoperable with existing portfolio, risk, and treasury systems, rather than entirely new and isolated ecosystems. For lenders, the most valuable tokenised products will be those that fit seamlessly into established credit, collateral, and risk management frameworks while delivering a better digital experience for clients.

Question 28: Do you foresee any other major changes to the role of asset managers or other market participants in a tokenised flows ‘end-state’? What are the opportunities and risks?

In a more fully developed tokenised ecosystem, we expect some roles in the investment value chain to evolve significantly, with a degree of disintermediation (fewer intermediaries rather than no intermediaries) but also the emergence of new types of intermediaries. This mirrors the direction of travel we see in lending markets as digital infrastructure improves.

For asset managers, tokenisation is likely to increase the importance of technology, data, and operational capabilities relative to purely distribution-focused activities. Certain functions traditionally performed by transfer agents, registrars, and other intermediaries (e.g. record-keeping, unit transfers, and aspects of corporate action processing) may increasingly be performed through the token infrastructure itself. At the same time, new roles will become critical, including platform operators,

node or validator operators, oracle providers, wallet and key-management providers, and specialist compliance-technology firms.

This may result in fewer intermediaries in some parts of the chain and reduced operational friction, particularly around dealing, settlement, and collateral management. However, the underlying functions (governance, risk management, client asset protection, and oversight) will still need to be performed. The challenge will be to ensure that responsibility for those functions is clearly allocated and appropriately regulated, even where the technology stack looks different.

Opportunities include lower issuance and dealing costs, faster and more predictable settlement, improved straight-through processing of lifecycle events and more efficient use of collateral, all of which are beneficial for lenders as well as investors. Tokenisation may also make it easier for asset managers to offer more tailored products (e.g., customised sleeves or share classes) without the same operational burden that would exist today.

The corresponding risks include greater concentration of operational risk in a small number of tokenisation platforms or technology providers, new cyber and resilience challenges, and potential conflicts of interest if an asset manager, or its group, controls key parts of the underlying infrastructure. There is also a risk that a two-tier market could develop if some investors have privileged access to analytics or data derived from on-chain transaction flows. Regulatory clarity on the status and expectations for these new types of entities will be important in managing these risks.

From a lending perspective, a tokenised end-state could allow for more direct and automated connectivity between funds and their lenders, including automated covenant monitoring, margining, and information flows. This could materially reduce friction and settlement times in fund finance transactions, provided that legal and operational frameworks keep pace.

Question 29: How might market integrity and financial stability risks evolve in the future tokenised portfolio management model?

Tokenisation has the potential both to mitigate and to transform market integrity and financial stability risks in portfolio management. From a lenders' standpoint, tokenised models that embed greater transparency and "compliance by design" would be welcome.

On the positive side, the increased transparency and auditability of on-chain records can enhance market integrity. Tokenised portfolios could provide near-real-time information on holdings, flows, and certain risk metrics; reducing information asymmetries and enabling more effective supervision by regulators. Smart contracts can be used to encode key regulatory and contractual constraints (e.g., eligibility criteria, concentration limits, leverage caps and dealing rules) so that breaches are prevented *ex ante* rather than detected *ex post*.

At the same time, tokenisation may amplify some existing risks or create new ones. Faster and potentially 24/7 dealing, combined with lower minimum investment sizes, could accelerate investor flows in stress, increasing the risk of runs on open-ended funds or correlated selling of similar tokenised portfolios.

There is a further tension between the benefits of transparency and legitimate needs for confidentiality, particularly in lending and other wholesale and private markets. If sensitive data is pushed off-chain or masked through privacy-enhancing technologies, it will be important to ensure that regulators and relevant counterparties retain appropriate visibility while protecting client confidentiality.

Overall, we believe tokenisation can support market integrity and financial stability if regulatory requirements and good-practice standards are deliberately embedded into technology and processes from the outset. This includes codifying dealing rules (such as swing pricing, anti-dilution mechanisms, and gates), automating certain risk controls and enabling regulators to access relevant data in a secure and timely way. The FCA's role in steering the development of such "compliance by design" approaches will be critical.

Question 32: What should the FCA's role look like in this future vision?

In our view, the FCA's role in a future tokenised ecosystem should be to act as a principled, technology-neutral standard-setter, and supervisor that actively enables safe innovation while maintaining its core objectives of consumer protection, market integrity and effective competition. This includes supporting the UK's position as a competitive and attractive jurisdiction for tokenised financial activity.

First, the FCA should continue to articulate clear, outcomes-based expectations that apply regardless of the technology used. Rather than specifying particular technical solutions, the FCA can set the parameters for acceptable token standards and operating models.

Secondly, the FCA has an important role as a convenor and coordinator. Working closely with HM Treasury, the Bank of England, the Law Commission, and international counterparts, the FCA can help to drive convergence on key legal, regulatory, and technical issues, including conflict-of-laws questions and cross-border recognition of tokenised instruments. This will be particularly important if the UK is to leverage its common law framework and existing reputation in international capital markets.

Thirdly, the FCA should remain an active facilitator of responsible innovation, through initiatives such as regulatory sandboxes, the Digital Securities Sandbox, and Tech Sprints.

Fourthly, we see a role for the FCA in encouraging and, over time, expecting "compliance by design". This means promoting the embedding of regulatory requirements into the architecture of tokenised products and infrastructures, including codified dealing rules, automated risk limits, and robust data and reporting standards. The FCA can also use the richer, more timely, data generated by tokenised markets to enhance its own supervisory capabilities.

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