The ledger as record: the digital twin

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In the second model the token is a digital twin of an asset held elsewhere. A gold token represents gold bars in a vault. A tokenised fund unit represents a unit recorded in the fund's register. A tokenised bond on a public chain represents a bond held by a depository. A tokenised property represents shares in a company that owns the property, or a beneficial interest under a trust. In every case two records exist, so the question is which one governs.

The answer is always the one the law recognises as the register for that asset. Land is owned by the person entered in the land register, in Switzerland under Art. 656 CC and in Singapore under the Land Titles Act 1993.[1] Shares are held by the registered member. Gold is owned by whoever has possession or a documented title. The token, by contrast, is a claim against the person who controls the underlying asset, or a representation that has whatever effect the parties have contractually given it. If the token holder and the registered owner are different people, the registered owner owns the asset and the token holder has, at best, a contractual claim or a beneficial interest.

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This "digital twin problem" is the central legal risk of real-world asset tokenisation. It can be managed in three ways. The first is to make the ledger the register, which only Swiss law allows and only for securities. The second is to interpose a trust or similar structure under which the registered owner holds the asset for the token holders, so that the token represents a beneficial interest that the law will enforce against the trustee and, in insolvency, against the trustee's creditors. Singapore's trust law makes this route workable, as Part J, Chapter II explains. Swiss law has no domestic trust and uses a foundation, a nominee company or a direct contractual claim instead, with weaker protection in the nominee's insolvency. The third is to accept that the token is a contractual claim and price the counterparty risk accordingly, which is what the holders of most gold tokens and tokenised money-market funds have in substance done.

Practice note

When a client presents a tokenised real-world asset, draw the ownership chain on one page. Start with the asset and the register that establishes title to it. Identify the registered owner. Identify every legal relationship between the registered owner and the token holder. Then ask what the token holder receives if the registered owner becomes insolvent. If the answer is "a pro-rata share of the estate", the token is a claim and should be described as one in every document. If the answer is "the asset", identify the legal mechanism that produces that result and verify that it has been validly created under the law of the place where the asset and the register sit. The quality of the token's smart contract is irrelevant to this analysis.

Notes

1. Civil Code, SR 210, Art. 656 para. 1 (acquisition of land ownership by entry in the land register); Land Titles Act 1993 (Singapore), s. 46 (indefeasibility of the registered proprietor's title). ↩

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