Why Tokenized Funds Will Scale Before Tokenized Projects

Institutional Adoption, Fiduciary Risk, and Market Design

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October 2024

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Abstract

Tokenization of real-world assets (RWAs) is frequently presented as a uniform technological shift across asset classes. In practice, adoption has followed a distinct and asymmetric pattern. Tokenized investment funds—particularly money market funds and similar pooled vehicles—have attracted early institutional participation, while tokenized infrastructure and project-level assets remain largely experimental. This paper argues that this sequencing is not accidental. It reflects differences in fiduciary risk, governance complexity, and market design requirements. Tokenized funds scale first because they inherit established legal structures, standardized governance, and familiar risk allocation frameworks, whereas tokenized projects introduce bespoke legal, operational, and governance challenges that institutional investors are structurally constrained to avoid.

Keywords: real-world asset (RWA) tokenization; tokenized funds; institutional adoption; market design; fiduciary risk; governance structures; legal standardization; regulatory compatibility; project finance; financial infrastructure.

How to cite this paper: Sing, C. H. 2024. Why Tokenized Funds Will Scale Before Tokenized Projects: Institutional Adoption, Fiduciary Risk, and Market Design. Working paper.

1. Introduction

Distributed ledger technology has made it technically feasible to represent ownership interests in financial and real-world assets through digital tokens. Proponents of tokenization often emphasize efficiency gains, programmability, and broader market access. Yet institutional adoption has been selective rather than comprehensive.

Empirically, early institutional traction has emerged in tokenized funds, particularly conservative, highly regulated vehicles. By contrast, project-level tokenization—including infrastructure assets, renewable energy projects, and bespoke real estate developments—has struggled to move beyond pilots. This paper contends that the observed adoption pattern is driven less by technological readiness than by institutional constraints embedded in fiduciary duty, governance, and market structure.

1.1 Why Sequencing Matters in Institutional Financial Innovation

Debates around real-world asset (RWA) tokenization are often framed in terms of technical feasibility or regulatory timing—whether distributed ledger infrastructure is sufficiently mature, or whether regulatory frameworks will eventually "catch up." This framing obscures a more fundamental issue: institutional adoption of financial innovation is inherently sequential, not simultaneous. New financial technologies rarely diffuse uniformly across asset classes. Instead, they are absorbed first in domains where existing legal, governance, and fiduciary structures already accommodate incremental change.

Historical precedents illustrate this pattern clearly. Exchange-traded funds scaled first in highly standardized public equity markets long before more complex or bespoke asset classes were incorporated. Securitization initially expanded through homogeneous mortgage pools rather than idiosyncratic commercial assets. In each case, institutional uptake followed governance compatibility, not technological novelty.

Tokenization follows the same logic. The question facing institutional investors is not whether assets *can* be tokenized, but where tokenization can be adopted without destabilizing established accountability, oversight, and risk-allocation mechanisms. Sequencing therefore matters. Misunderstanding this dynamic leads to repeated overestimation of project-level tokenization readiness and underestimation of fund-based adoption pathways.

This paper situates tokenized funds as the natural institutional entry point for RWA tokenization, not as a temporary compromise, but as a structurally coherent first phase in a longer process of financial integration.

2. Tokenized Funds as an Institutional Entry Point

Tokenized funds are investment vehicles whose shares are issued or recorded on a distributed ledger while remaining embedded within existing fund law, custody arrangements, and regulatory oversight. In these structures, tokenization alters the *form* of record-keeping and settlement, not the underlying allocation of rights and responsibilities.

Institutional Case Examples

Several high-profile cases illustrate why funds have emerged as the first scalable use case.

BlackRock – USD Institutional Digital Liquidity Fund (BUIDL)
BlackRock's launch of BUIDL demonstrates a governance-first approach to tokenization. The fund invests in traditional money market instruments and is structured to comply with existing regulatory and fiduciary requirements. Tokenization is used to enhance settlement efficiency and operational transparency rather than to redefine ownership or governance.

Franklin Templeton – On-Chain U.S. Government Money Fund (BENJI)
Franklin Templeton's on-chain money market fund represents one of the earliest sustained implementations of tokenized fund shares. Importantly, the fund operates within conventional securities law frameworks, with tokenization serving as an alternative transfer and record mechanism.

JPMorgan – Onyx Digital Assets and Tokenized Deposit / Fund Initiatives
JPMorgan's Onyx platform illustrates a bank-led, compliance-first approach. Tokenization initiatives are embedded within regulated financial institutions and rely on established governance, risk management, and supervisory engagement.

Across these cases, tokenization is additive rather than substitutive. Governance, fiduciary responsibility, and legal enforceability remain anchored in familiar institutional forms.

3. Fiduciary Duty as a Binding Constraint on Tokenization

While technological capability enables tokenization, fiduciary duty constrains it. Institutional investors—pension funds, insurers, banks, asset managers, and fiduciaries acting on behalf of beneficiaries—operate under legal and organizational obligations that fundamentally shape how and where innovation can be adopted. These obligations are not discretionary preferences; they are binding constraints embedded in governance frameworks, regulatory oversight, and professional standards.

Tokenization proposals that overlook fiduciary structure tend to misdiagnose the sources of institutional resistance. The limiting factor is rarely efficiency or operational capability. Rather, it is whether tokenized structures preserve clarity of responsibility, continuity of oversight, and enforceable rights under stress. Understanding fiduciary duty as a structural constraint is therefore essential to explaining why tokenized funds scale while tokenized projects do not.

3.1 Fiduciary Duty in Institutional Investment Practice

Fiduciary duty requires institutional investors to act with care, loyalty, and prudence in managing assets on behalf of beneficiaries. In practice, this entails more than return maximization. Fiduciaries must ensure that assets are held within structures that allow for ongoing oversight, risk monitoring, auditability, and intervention when conditions deviate from expectations.

Importantly, fiduciary responsibility is exercised through institutional mechanisms rather than individual discretion. Boards, trustees, investment committees, custodians, and regulators collectively form a governance ecosystem that distributes authority and accountability. Innovations that bypass or destabilize this ecosystem impose risks that fiduciaries are neither mandated nor equipped to absorb.

Tokenization initiatives that change the *form* of record-keeping without altering fiduciary relationships are therefore more readily acceptable than those that implicitly shift responsibility without establishing new accountability frameworks.

3.2 Why Tokenized Funds Fit Fiduciary Workflows

Tokenized funds integrate into existing fiduciary workflows because they preserve the core architecture of institutional oversight. Fund structures already define roles for managers, custodians, administrators, auditors, and regulators. Tokenization modifies how ownership interests are recorded or transferred, but not who is responsible for governance, compliance, or risk management.

From a fiduciary perspective, this continuity is decisive. Boards continue to exercise oversight, custodians retain safeguarding functions, and regulatory reporting obligations remain intact. Tokenization becomes an operational enhancement rather than a governance disruption.

As a result, fiduciaries can evaluate tokenized funds using familiar criteria: investment mandate alignment, counterparty risk, liquidity management, and regulatory compliance. This explains why conservative vehicles such as money market funds have emerged as early institutional use cases.

3.3 Why Tokenized Projects Violate Fiduciary Assumptions

In contrast to tokenized funds, tokenized projects involve the direct representation of claims on individual assets or ventures. These assets typically rely on bespoke legal structures, involve ongoing operational risk, and generate cash flows contingent on physical performance rather than pooled, portfolio-level exposure.

Evidence from multiple pilot initiatives—particularly in infrastructure and real estate—reveals recurring structural characteristics. Project-level tokenization frequently operates across fragmented legal jurisdictions, relies on project-specific governance arrangements, and lacks clearly defined authority for intervention, modification, or dispute resolution under stress. These deficiencies are compounded by limited and often illusory secondary market liquidity.

Even where project tokenization is technically functional, these structures impose fiduciary and operational risks that institutional investors are not positioned to absorb at scale. Tokenization in this context tends to obscure responsibility rather than clarify it, creating an asymmetry between exposure and control that fiduciary frameworks are explicitly designed to prevent.

4. Funds vs Projects: Structural Differences in Institutional Compatibility

The divergent adoption trajectories of tokenized funds and tokenized projects reflect deep structural differences rather than temporary market conditions. These differences span legal form, governance continuity, fiduciary risk, liquidity expectations, and regulatory treatment. Examining these dimensions in parallel clarifies why funds represent a lower-friction pathway for institutional capital.

4.1 Legal Standardization and Enforceability

Investment funds operate within mature legal regimes that standardize ownership rights, disclosure obligations, and investor protections. These regimes facilitate transferability and secondary trading without renegotiating underlying contracts.

By contrast, project assets rely on bespoke legal arrangements tied to specific assets, jurisdictions, and counterparties. Tokenization does not eliminate this complexity; it digitizes it. For institutions, legal standardization is a prerequisite for scale, not an optional enhancement.

4.2 Governance Continuity Across the Asset Lifecycle

Fund governance persists across market cycles, personnel changes, and technological upgrades. Boards, trustees, and regulators provide continuity even as operational systems evolve.

Projects lack this continuity. Governance resets at each refinancing, ownership transfer, or contractual renegotiation. Tokenization exacerbates this fragility by introducing new layers of abstraction without stabilizing authority.

4.3 Liquidity Expectations and Market Realism

Liquidity in institutional contexts is not absolute; it is structured. Funds manage liquidity through redemption rules, gates, and disclosure, aligning expectations with asset behavior.

Projects lack comparable mechanisms. Tokenized representations do not create liquid markets where none structurally exist. For fiduciaries, the risk of illusory liquidity is more problematic than illiquidity itself.

Table 1. Structural Differences Between Tokenized Funds and Tokenized Projects

Dimension	Tokenized Funds	Tokenized Projects
Legal structure	Established fund law	Bespoke contracts
Governance	Standardized (boards, custodians)	Project-specific
Fiduciary risk	Familiar	Elevated
Liquidity expectations	Defined	Uncertain
Regulatory fit	High	Fragmented

Taken together, these structural differences explain why institutional adoption consistently favors fund-level tokenization over project-level experimentation. Funds translate tokenization into a change in settlement and record-keeping, while projects attempt to tokenize governance, legal enforceability, and operational discretion simultaneously. For institutional investors, the former is an incremental adjustment; the latter represents a structural rupture.

5. Regulatory Posture and Geographic Patterns

Regulatory approaches further reinforce the sequencing of adoption. Across major financial hubs, tokenized funds are generally treated as extensions of existing financial instruments, while project tokenization receives greater scrutiny.

Table 2. Comparative Regulatory Perspective

Jurisdiction	Tokenized Funds	Tokenized Projects
United States (SEC)	Permissible within securities law	High scrutiny
European Union (MiCA / ESMA)	Structured framework	Evolving
Hong Kong (SFC / HKMA)	Sandbox and fund pilots	Limited
Singapore (MAS)	Institution-led experimentation	Selective
Middle East (ADGM / VARA)	Hub-oriented, fund-first	Pilot stage

Despite differences in regulatory philosophy, a common pattern emerges: fund-level tokenization is prioritized because it aligns with existing supervisory and fiduciary frameworks.

6. Common Counterarguments and Why They Fail

Advocates of project-level tokenization often advance recurring arguments to explain the slow pace of adoption. While intuitively appealing, these arguments underestimate the structural role of fiduciary governance and overestimate the substitutability of technology for institutional design.

6.1 "Technology Will Mature"

Technical maturation does not resolve governance ambiguity. Institutional markets already operate on mature, reliable systems. The binding constraint is authority and accountability, not throughput or programmability.

6.2 "Regulation Will Catch Up"

Regulation does not precede institutional form; it codifies it. Funds receive regulatory clarity because they align with existing fiduciary models. Projects do not lack regulation—they lack standardized governance that regulation can recognize.

6.3 "Retail Adoption Proves Viability"

Retail participation does not validate institutional suitability. Retail investors operate under different risk tolerances and governance expectations. Institutional capital requires enforceable oversight, not merely functional markets.

7. Implications for Market Design and Institutional Strategy

Understanding why tokenized funds scale before tokenized projects has direct implications for asset managers, regulators, and infrastructure providers shaping the next generation of financial systems. These implications extend beyond tokenization itself, offering insight into how institutional markets absorb innovation more generally. Tokenization succeeds where it reinforces existing accountability structures, and fails where it attempts to bypass them.

7.1 Implications for Asset Managers

Asset managers seeking to adopt tokenization should prioritize fund-based structures that preserve fiduciary continuity. Hybrid models—where tokenization enhances settlement, record-keeping, or transparency while governance remains conventional—are likely to dominate early adoption.

From an institutional perspective, this sequencing reflects liability rather than innovation aversion. Asset managers remain accountable for suitability, oversight, and risk outcomes regardless of technological form, making structures that preserve established governance pathways materially more attractive than those that redistribute responsibility without clear authority.

7.2 Implications for Regulators

Regulators rationally prioritize fund-level tokenization because it fits within existing supervisory frameworks and enforcement capabilities. Attempts to accelerate project-level tokenization without governance standardization risk regulatory fragmentation rather than innovation.

This pattern reflects regulatory path dependence rather than conservatism. Supervisory regimes evolve around identifiable entities, accountable managers, and auditable processes; tokenized funds preserve these anchors, while tokenized projects often diffuse them across contractual and technological layers that are difficult to monitor or remediate ex post.

7.3 Implications for Tokenization Platforms

Platforms that attempt to bypass institutional intermediaries face structural limits. Successful platforms will integrate with custodians, administrators, asset managers, and regulators rather than seek to displace them.

In institutional markets, scalability depends less on disintermediation and more on trust, liability alignment, and regulatory recognition. Platforms that embed themselves within existing governance ecosystems are therefore more likely to achieve durable adoption than those optimized solely for transactional efficiency.

Taken together, these implications reinforce three structural principles of institutional tokenization: governance must precede technological abstraction; standardized vehicles scale more readily than bespoke assets; and institutional adoption proceeds incrementally through existing systems rather than through wholesale replacement.

8. Conclusion

Tokenized funds scale before tokenized projects not because they are more technologically advanced, but because they are institutionally compatible. Funds preserve fiduciary clarity, governance continuity, and regulatory alignment, allowing tokenization to be absorbed incrementally rather than disruptively. Project-level tokenization, by contrast, introduces bespoke legal and operational risks that institutions are structurally constrained to avoid.

Recognizing this sequencing reframes tokenization not as a race toward disintermediation, but as a process of institutional integration. Tokenization succeeds not by replacing governance, but by conforming to it. For policymakers, asset owners, and market designers, the critical question is therefore not how quickly assets can be tokenized, but under what institutional conditions tokenization can endure.

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