

CONCEPT NOTE

ASSET FRACTIONALIZATION



SECURITIES
AND EXCHANGE
COMMISSION
OF PAKISTAN



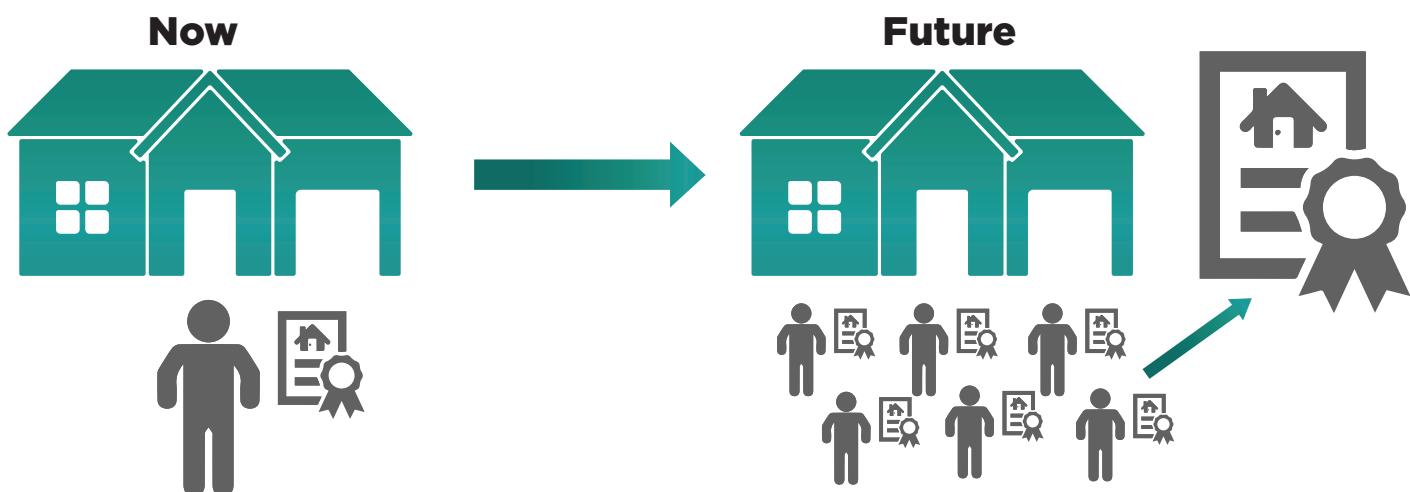
1. PURPOSE

This Concept Note is drafted and placed on Securities & Exchange Commission of Pakistan (the Commission)'s webpage to seek feedback of the stakeholders on new concept "Asset Fractionalization".

Comments/input/queries can be emailed at the following address:feedback@secp.gov.pk

2. WHAT IS ASSET FRACTIONALIZATION

Fractionalization of real assets, is a process through which an asset is fractionalized in smaller denominations for the purpose of creating liquidity and tradability of an otherwise less liquid asset. Real estate assets; commodities like metals (gold, silver, etc.); fleets of assets among others can be probable subject of this business model.



3. WHY INTRODUCE THE CONCEPT OF FRACTIONALIZATION?

The Commission in past, has witnessed surge in certain unregulated activities involving fund raising from the public. Multi-level marketing and Ponzi Schemes are few amongst them.

Accordingly, in the interest of the general public and to address gullibility, the Commission believes that it is prudent to regulate and provide mechanics and guidance around the business model being discussed herein. With the same approach, the Commission has allowed this business model currently being tested in sandbox testing environment.



Bringing Asset fractionalization into regulatory domain would entail multiple benefits including but not limited to:

- a. Democratizing ownership of high value real assets;
- b. Additional investment avenue for investors;
- c. Channelizing savings into economy;
- d. Bringing investments, like real estate, into formal domain;
- e. Eliminating fraudulent operations;
- f. Enhanced security, visibility and transparency.

4. GLOBAL ADOPTION

Similar business models exist in number of countries like: Malaysia, Singapore, USA, UAE etc., Few common regulatory aspects in subject countries are summarized below:



A. It is a regulated activity under the regulatory ambit of securities market regulators.



B. The issuer has to be in the company structure



C. The fractions issuance and trading platforms are licenced/registered by the securities market regulators



D. A white paper/detailed document is submitted by the issuer to the issuing platform as well as to the regulator for seeking comments/observations. Thereafter, the final proposal is placed on the platform for seeking investments from public



5. PROPOSED - CONCEPT OF FRACTIONALIZATION OF ASSETS

(I) PARTIES TO THE TRANSACTION

- a) **Asset Fractionalization Issuer (AF Issuer):** A company that issues fractions through AF Platform for the purposes of seeking Investment from the Investor.
- b) **Asset Fractionalization Operator (AF Operator):** A company duly licensed to run the AF Platform.
- c) **Asset Fractionalization Platform (AF Platform):** A platform based on distributed ledger technology, cryptographically secured at which fractions of an asset by the AF issuer are initially issued and subsequently traded.
- d) **Escrow Agent:** A financial institution or such other entity approved by the Commission, holding the Investment on trust in the Escrow Account on instructions of the AF Issuer;
- e) **Custodian:** Central Depository Company (CDC) or debt security trustee licensed by the Commission.

(II) IMPORTANT TERMS

a) 'Asset'

Any physical asset free from encumbrances but does not include rare collectibles. Few examples of assets could be real estate; commodities; fleets of transport assets etc.

Properties of Karachi Development Authority (KDA), Capital Development Authority (CDA), Gulberg Lahore and DHA's of Lahore, Karachi & Islamabad shall initially be considered for real estate fractionalization.

For all other assets, the applications shall be processed on case to case basis.

b) 'Proposal'

A document prepared by AF Issuer comprising of all requisite details required for an informed decision by the investor and uploaded on the AF Platform for the purposes of seeking Investment from the Investor.



6. ASSET FRACTIONALIZATION PROCESS FLOW

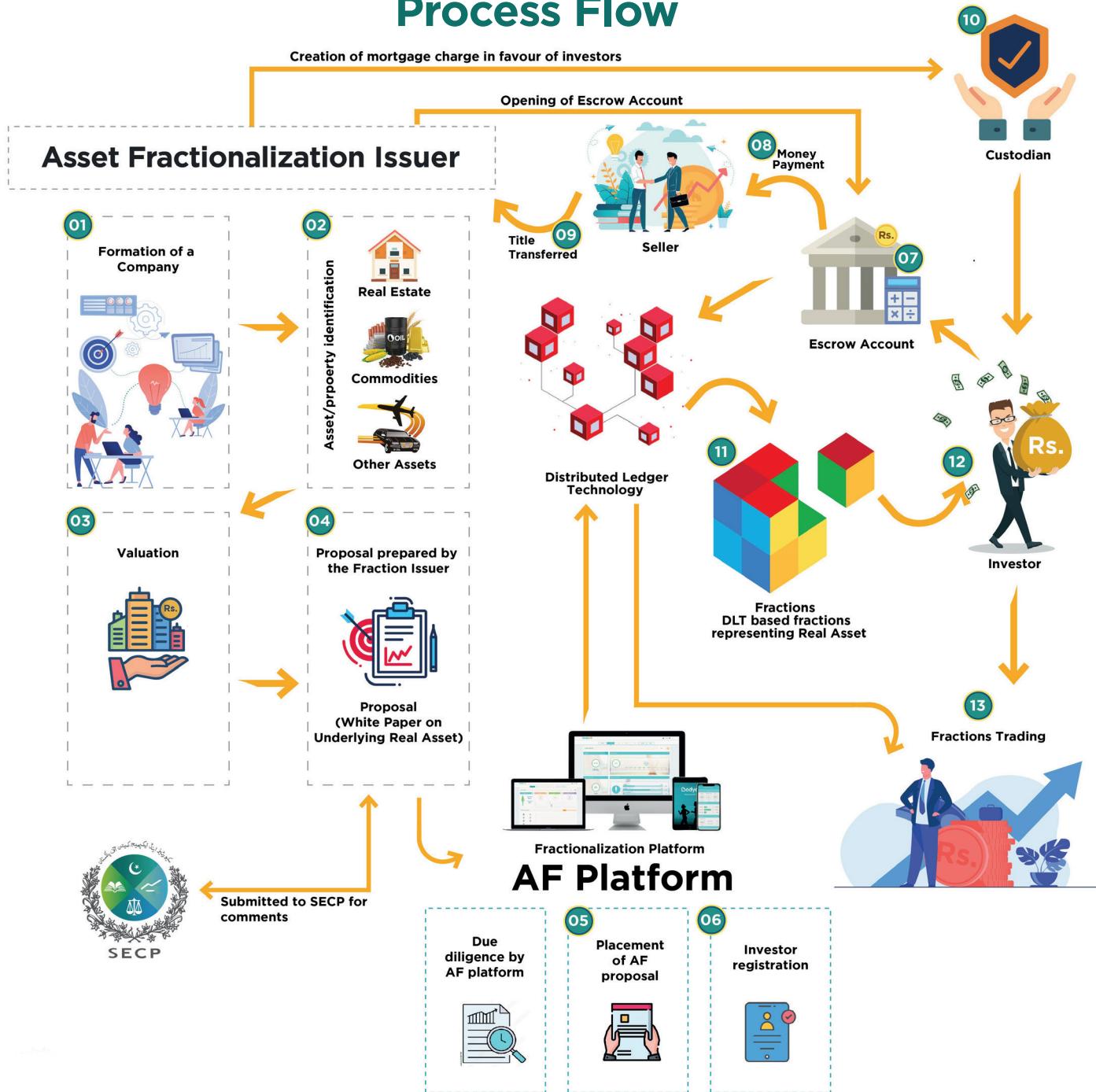
Proposed process includes:

- (i) AF Issuer shall
 - a) Identify the asset to be fractionalized;
 - b) Appoint an independent valuer (valuation not to be older than 6 months at the time of issuance);
 - c) Invite claims, if any, on the assets through advertisement in the newspapers;
 - d) Appoint a custodian - licensed by the commission to ensure management and maintenance of fractionalized asset on behalf of the investors; and
 - e) Prepare asset fractionalization proposal and submit it for public comments, regulator's comments and approval of the platform operator.
- (ii) AF Platform operator shall perform due diligence and critical assessment of the issuer's proposal.
- (iii) Approved proposal shall be placed on AF Platform for seeking investments.
- (iv) All funds received from investors against asset fractionalization shall be kept in escrow account.
- (v) Funds in the escrow account can only be utilized for:
 - a) Purchasing the identified asset or completing the development project;
 - b) Payment of gains and/or rental income to investors;
 - c) Expense related to the specific asset;
 - d) Fee and charges imposed on investors; and
 - e) Payment to investors on maturity.
- (vi) Cumulative value of fractions issued against any asset should not exceed the amount stated in the valuation report.
- (vii) Once, the requisite amount is received, the title of the asset is transferred in the AF Issuer's name.
- (viii) Fractions shall immediately be issued through AF Platform in the name of respective investors.
- (ix) Mortgage shall be registered in the name of custodian on behalf of the investors.



- (x) Fractions so issued can then be traded through AF platform. Trading, clearing and settlement shall be done electronically on real-time basis through the AF Platform.
- (xi) In case of income generating asset, the sponsors and directors of the AF Issuer shall at-least own 25% of the fractions for at least a period of twelve months from the date of fraction issuance.
- (xii) In case of asset under development stage the issuer shall at least own 25% till completion of the development stage.
- (xiii) Income generated against the specific asset during life of the asset on AF Platform shall be deposited in the specific escrow account and the distributable portion as referred to in the proposal shall be electronically transferred to respective fraction holders' accounts on the pre-determined dates as referred to in the proposal.
- (xiv) In case fraction holder becomes owner of all the fractions required to own the asset, the issuer shall then arrange for vacation of mortgage and transfer of asset in the name of such fraction holder.
- (xv) If the issuer at any time during the life of the asset on AF Platform intends to dispose the asset, the issuer will open an electronic poll (invitation for which shall be communicated to all the fraction holders at least 7 days before the poll date, both through the AF platform and their contact numbers) for a specific time, inviting their polls. If 3/4th of the participants agreed with the disposal of asset, the issuer shall then announce a period of at least 10 days wherein fraction holders not agreeing can record their dissent and take exit. Dissenting fraction holder shall be provided an opportunity to exit by offering a price that shall be average of the market price from first day of trading in such fractions and market price of specific fraction on the date of the result of electoral poll.
- (xvi) No trading in the specific fractions on AF Platform shall be executed during exit opportunity window other than acquisition of the fractions by the AF Issuer.
- (xvii) Capital gain arising as a result of disposal of the asset net of tax along with the principal shall be distributed among the respective fraction holders. The respective asset and the fractions issued against it shall then stands cancelled
- (xviii) After completion of every asset fractionalization transaction, the AF Platform operator shall submit a report to the Commission.

Asset Fractionalization Process Flow





**Securities and Exchange
Commission of Pakistan**

WWW.SECP.GOV.PK