Tokenization in Europe

Between strategic hesitation and systemic risk

→ Europe has built one of the world's most advanced regulatory frameworks for tokenized finance, but the real obstacles lie in entrenched financial infrastructures and the hidden systemic risks of digital liquidity.

→ Tokenization could strengthen Europe's capital markets, or trigger instability, depending on whether policymakers address fragmentation, information asymmetries, and the dangers of rapid adoption in illiquid asset classes.

Introduction

The development of tokenization in Europe is not only a technological challenge but is also shaped by political economy and financial risk. The regulatory framework is well-designed, but the ecosystem it seeks to transform remains driven by incumbent institutions that move cautiously to preserve their position. At the same time, the enthusiastic narrative that tokenization will "unlock liquidity" risks underestimating how quickly artificial liquidity can turn into systemic instability.[1]

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Europe's regulatory framework and fragmented market

The Distributed Ledger Technology (DLT) Pilot Regime gives market participants a controlled environment to test blockchain-based trading and settlement platforms.[2] In parallel, Markets in Crypto-Assets (MiCA) establishes a harmonized system for the issuance, custody, and exchange of crypto-assets.[3] Together, they aim to be a serious attempt to bridge regulation and experimentation.

Europe's market remains fragmented not just by technology, but by the incentive structures of its central securities depositories, notably Euroclear and Clearstream, which anchor the European post-trade system. Their role as custodians, clearinghouses, and settlement providers has long been underpinned by centralized infrastructure and steady fee income.[4] Tokenization challenges that model by making near-instant settlement and direct asset ownership possible.[5]

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To manage this shift, both institutions have chosen strategic adaptation over disruption. Clearstream's DLT Securities Connectivity pilot, for example,

allows tokenized issuances to be recorded on a distributed ledger but finalized within the existing Clearstream banking infrastructure.[6] Similarly, Euroclear's Digital Financial Market Infrastructure platform in the DLT Pilot framework keeps central bank money settlement off-chain.[7] These designs demonstrate the cautious model: innovation that coexists with, rather than supplants, legacy architecture.

In this light, what policymakers label as fragmentation is really a by-product of strategic hesitation by actors that benefit from the current system. European incumbents are ensuring that new distributed systems remain interoperable with the old ones, preserving control, limiting disruption, and slowing the pace of transformation.[8] The result is a steady, careful evolution, not a disruptive transformation.

The liquidity illusion

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Tokenization is most attractive for illiquid asset classes, such as private credit, real estate, or infrastructure, where fractional tokens make high-value assets more accessible to investors.[9] Yet these assets are illiquid for structural reasons: they lack deep secondary markets, involve complex valuations, and often require long holding periods. Converting them into digital tokens does not change those fundamentals; it merely allows more frequent trading of claims on assets that remain hard to sell.[10]

Under normal conditions, this can foster an appearance of market depth. Under stress, however, it can magnify volatility. If investors try to liquidate holdings simultaneously, token markets will reprice sharply, because the underlying assets cannot be sold at the same speed. What appears as seamless digital liquidity may be a fragile interface hiding structural illiquidity.

Information asymmetries and exposure

Tokenization also reshapes information dynamics, heightening retail exposure. In traditional markets, trading hours, fund gates, and regulatory disclosures impose a rhythm that moderates panic. Tokenized markets, by contrast, operate 24/7, allowing instantaneous reaction to sentiment changes, sometimes triggered automatically by smart controls or programmatic redemptions.[11]

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Retail investors entering tokenized private markets thus face an environment of real-time reflexivity: price declines trigger withdrawals, which execute automatically on-chain, further pushing prices down. Unlike traditional funds, there are few circuit breakers or supervised liquidity buffers to absorb shocks.[12] Fractional ownership also blurs accountability — many small holders acting simultaneously amplify volatility in ways institutional concentration historically mitigated.

Episodes, such as the "10/10 Flash Crash" in 2025, reflect how these technological and behavioral features combine.[13] Although the crisis occurred in the crypto sphere, it revealed how automated mechanisms, continuous trading, and fragmented disclosure can foster herd behavior and turn localized stress into widespread market contagion.

When success becomes systemic risk

Europe's greatest vulnerability may arise if tokenization succeeds too quickly, especially in illiquid asset classes that are unsuited to high-frequency trading. Widespread adoption could lead to large capital reallocations from regulated funds and deposits into tokenized vehicles promising higher yields. Rising inflows might inflate valuations, compress risk premiums, and ultimately form asset bubbles whose apparent liquidity disappears under pressure.

The technological layer adds further uncertainty: interoperability between blockchains, smart contract flaws, and cybersecurity vulnerabilities all compound systemic fragility in ways that are poorly understood today. Tokenization could thus shift risks from intermediaries to market infrastructure.

Conclusion

Europe stands at the frontier of digital finance, combining regulatory foresight with institutional depth. Yet its leadership will not be measured by how quickly it legalizes tokenization, but by how well it anticipates its consequences. The continent's established market infrastructures are pragmatic, proceeding with deliberation.

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EXHIBIT 4.0 – COMPARISON OF THE DLT PILOT REGIME AND MICA FRAMEWORK

Dimension	MiCA	DLT Pilot Regime
Adoption Date	Adopted 2023; fully applicable from December 2024	Effective March 2023; extended through 2026
Policy Objective	Establish a single EU rulebook for issuance, custody, and trading of crypto-assets and service providers	Test the use of distributed ledger technology in trading and post-trade infrastructure under controlled conditions
Main Participants	Issuers of crypto-assets, stablecoins, and crypto-assets service providers	Regulated trading venues and central securities depositories experimenting with blockchain-based systems
Scope of Assets	Unbacked crypto-assets, asset-referenced tokens, and e-money tokens	Tokenized traditional financial instruments: shares, bonds, Undertakings for Collective Investment in Transferrable Securities
Duration and Limits	Permanent framework with binding requirements across all EU member states	Temporary (6 years, extendable); limited transaction volumes; sandbox under regulatory supervision
Limitations	Excludes tokenized securities and deposits (covered under other EU financial laws)	Restricted market participants; no retail investors; limited cross-border interoperability
Strategic Role	A harmonized regulatory backbone for Europe's crypto-asset and digital finance ecosystem	A controlled testbed bridging traditional finance and future digital infrastructures

Source: Funcas.

Notes

[1] https://www.garp.org/risk-intelligence/technology/tokenization-momentum-spreads-260123

[2] https://www.esma.europa.eu/esmas-activities/digital-finance-and-innovation/dlt-pilot-regime

[3] https://www.esma.europa.eu/esmas-activities/digital-finance-and-innovation/markets-crypto-assets-regulation-mica

[4] https://www.afme.eu/media/w42la5dt/afmetheroleofthecustodyindustry2025.pdf#:~:text=Custodians%20provide%20a%20means%20for,in%20order%20to%20facilitate%20settlement.

[5] https://www.bis.org/cpmi/publ/d225.pdf

[6] https://www.clearstream.com/clearstream-en/newsroom/251104-4757900

[7] https://www.euroclear.com/services/en/primary-issuance/digital-financial-market-infrastructure.html#:~:text=D%2DFMI%20is%20connected%20to,venues%20and%20liquidity%20management%20facilities.

[8] https://clearstream.com/caas/v1/media/4972364/data/f8479edfc9253e19a48a4f2ad9b27698/wp-building-the-path-towards-digital-asset-securities-operability.pdf

[9] https://www.sec.gov/files/ctf-written-antonio-lanotte-global-blockchain-business-council-051425.pdf

[10] https://www.fsb.org/uploads/P221024-2.pdf

[11] https://www.elibrary.imf.org/view/journals/068/2026/001/article-A001-en.xml#:~:text=Tokenization%20departs%20from%20this%20model,executed%20automatically%20without%20human%20intervention.

[12] *Ibid*.

[13] https://www.forbes.com/sites/greatspeculations/2026/02/17/why-the-1010-crypto-crash-still-haunts-bitcoin/