

Tokenised gold

Is the product tokenised gold?

Asset-backed blockchain tokens are a new phenomenon. Also known as digital assets, crypto tokens or digital coins, tokens are recorded on a blockchain or a distributed digital ledger and may represent actual physical assets or an interest in physical assets. The process of digitally representing an asset on a distributed ledger or blockchain is called tokenisation. Typically, asset-backed tokens can be traded and transferred between different parties.

Asset-backed blockchain tokens sometimes represent ownership in physical gold. Such tokens could be used to beneficial effect in the Internet Investment Gold sector because information may be stored on a blockchain, thereby creating extra transparency around proof of ownership and transfer of ownership of investment gold.

However, the market for asset-backed tokens is nascent and lacks standardisation. Many challenges still need to be overcome, and an investment in tokens presents unique risks which should be considered.

- 1 The transfer of a gold token requires a 'private key' – a cryptographic key or code – which belongs to the token's owner. If you lose your private key, you cannot access or transfer your tokens and thereby your gold. And if someone else gains access to your private key, they can permanently take possession of your tokens. Private keys can be stored by investors, product providers or exchanges. Custodians of private keys may be unregulated wallet providers or regulated custodians such as broker-dealers or banks. Safekeeping is essential. In recent years, several crypto exchanges have been successfully hacked and customers have lost significant investment sums that were held in custody on their behalf.
- 2 Asset tokens are often traded on specialised markets which function like traditional exchanges. However, many exchanges that trade blockchain tokens do not meet the same standards as regulated exchanges, such as stock exchanges. The exchanges may be subject to market manipulation and arbitrage due to lack of standardisation. This could significantly disadvantage investors.¹⁵ In addition, tokens are also traded on "decentralised" exchanges, which do not have a central authority and function like peer-to-peer marketplaces further lacking investor protections.
- 3 A key aspect of any tokenised gold offering is the specific rights that the tokens give you. They may confer outright ownership of gold or just a claim against an entity. If you acquire physical gold, it should be investment gold (as defined earlier). Tokens may also be backed by gold-related securities, such as gold futures. These are quite different from investment gold, so it is important to know the rights you acquire by purchasing a gold token and to make sure they meet your individual requirements.
- 4 If a token gives you ownership of physical gold, you should be able to take possession of that gold, even if this involves a fee. This can avoid liquidity issues, if for example, tokens become hard to sell. Tokens often have no guarantee of liquidity or transferability, and there may be no secondary market in the token.
- 5 It is also important to know how the price of the gold-backed tokens is determined, how many there are in the market and whether more are likely to be created. In certain cases, the price of the gold-backed token may deviate from the gold price. Demand for tokens may be greater than the ability to create them. Conversely, supply may exceed demand.

¹⁵ The U.S. Securities and Exchange Commission has urged investors using online digital asset trading platforms to use caution. www.sec.gov/news/public-statement/enforcement-tm-statement-potentially-unlawful-online-platforms-trading

- 6 Companies in the crypto space may conduct an Initial Coin Offering (ICO) as an alternative to traditional debt or equity fundraising from investors. As mentioned above, tokens may give purchasers a variety of rights, and there is no standard set of rights inherent in digital assets. For example, tokens sold in an ICO may provide investors with an interest in the company's revenues or profits. But an ICO may also be structured as a sale of gold-backed tokens, with each token giving investors actual ownership in allocated physical gold. There is a significant difference. The former would give you a stake in a company. The latter may give you outright ownership of gold (i.e. IIG), or it may give you an interest in an unallocated pool of gold. There is also a significant difference between these two.
- 7 Tokens are a novel asset, and regulatory treatment around the world is still developing. In the United States, the SEC has indicated that most blockchain tokens may, potentially, be treated as securities. However, the CFTC has also exerted regulatory oversight over blockchain tokens and digital assets. The rights associated with a specific token will determine whether that token will be treated as a particular type of financial instrument and which regulators may regulate it. It is important to fully understand the rights associated with the purchase of tokenised gold, and whether the provider offering tokenised gold is operating within the applicable law.

According to the Commodities and Futures Trading Commission (CFTC) in the United States, a large number of token offerings have been fraudulent. Many announced projects were never fully implemented or fail or shut down in less than a year.¹⁶ The Securities and Exchange Commission (SEC) in the United States has also issued a statement on cryptocurrencies and ICOs, addressing both the risks for investors and potential regulatory treatment of digital assets as securities. The Financial Conduct Authority in the United Kingdom states: "You should only invest in an ICO project if you are an experienced investor, confident in the quality of the ICO project itself (e.g. business plan, technology, people involved) and prepared to lose your entire stake."¹⁷

¹⁶ www.cftc.gov/PressRoom/PressReleases/7756-18, www.sec.gov/news/public-statement/statement-clayton-2017-12-11

¹⁷ www.fca.org.uk/print/news/statements/initial-coin-offerings