Digital Gold - The Concept and Risks

Mains: *GS III - Economy*

Why in News?

Recently, the Securities and Exchange Board of India (SEBI) has issued a strong caution to the general public about investing in digital gold and e-gold products.

What is Digital Gold?

- **Definition** – Digital gold refers to the process of buying and holding gold electronically without physically possessing the metal.
- The value of digital gold is directly linked to the price of physical gold, which means investors benefit from price appreciation similar to traditional gold holdings.
- **Creation** – These products are usually created using blockchain technology, which enables seamless buying, selling, and storage in a digital format.
- **Advantages** – One of the major attractions of digital gold is its accessibility.
    - Investors can start with very small amounts, unlike physical gold purchases that typically require a larger financial outlay.
    - Digital gold also offers quick liquidity, allowing investors to sell their holdings instantly in times of need.
    - Another advantage is the elimination of storage issues, which remain a major concern for physical gold owners.
    - Digital gold can also be converted into physical gold in the form of coins, bars, or jewellery if required.
- **Reasons for popularity** – The sharp increase in gold prices has further contributed to the popularity of digital gold.
    - **For instance**, MCX spot gold prices have risen by nearly 59% over the last year, increasing from Rupees.76,577 per 10 grams to Rupees.1.22 lakh per 10 grams.
- This substantial rise has attracted new investors, many of whom are turning to digital platforms for convenience and flexibility.
- However, SEBI has clarified that digital gold remains outside the regulatory framework, exposing investors to serious risks.
- This article explains what digital gold is, why SEBI has raised concerns, the risks involved, and what safer alternatives investors should consider.

Why Has SEBI Cautioned Investors About Digital Gold?

- **Raising online promotions –** SEBI has observed that numerous digital and online platforms are actively promoting digital gold as a convenient alternative to physical gold.

- **Different from gold securities** – SEBI has emphasised that these digital gold products are fundamentally different from gold-related securities regulated by the authority.
    - Digital gold is *not classified as a security*, nor is it regulated as a commodity derivative.
- **Absence of regulation and control** – Since digital gold is offered outside SEBI's jurisdiction, the regulator has no control over the manner in which these products are issued, traded, or stored.
- SEBI has clarified that these digital gold offerings fall entirely outside the securities market framework, which means that the usual investor protection mechanisms do not apply to them.
- The rapid rise in digital gold trading, particularly through mobile apps, fintech platforms, and jewellers, has prompted SEBI to alert investors about the potential dangers associated with unregulated investment products.

Why are digital gold products considered risky?

- **Absence of regulatory oversight** – According to SEBI, digital gold products operate entirely outside any established regulatory framework, which makes them inherently risky.
- **Counterparty risks** – Investors are exposed to counterparty risks because the platforms offering these products may not always have proper systems in place to guarantee the gold being sold.
    - Counterparty risk refers to the possibility that the entity selling or storing the gold may default on its obligations.
- If the platform faces operational issues, financial distress, or fraud, investors may lose their money.
- **No risk managements system** – Unlike regulated gold ETFs or commodity derivatives, digital gold transactions are not backed by clearing corporations or risk management systems.
- **Operational risks** – Some platforms might fail to store the gold securely or maintain adequate physical reserves.
- Experts say that digital gold behaves like an over-the-counter (OTC) exchange-traded product, where the biggest concern is the potential for default.
- Since there is no statutory body monitoring the issuance and storage of digital gold, investors are vulnerable if the provider fails to honour their claims.
- **Growing influence** – Social media promotes digital gold as a quick and easy investment option.
- Many investors, especially young users, are drawn to advertisements and promotions without fully understanding the underlying risks.

What are the SEBI – regulated alternatives to digital gold?

- **Gold Exchange-Traded Funds (Gold ETFs) –** Gold ETFs are mutual fund schemes that invest in physical gold of high purity.
- They can be bought and sold on stock exchanges and require a demat account.

- These products are regulated, backed by physical reserves, and offer transparent pricing.
- **Sovereign Gold Bonds (SGBs) –** SGBs are government-backed securities issued by the Reserve Bank of India.
- They not only track gold prices but also offer an additional interest rate of 2.5% per year.
- They are one of the safest and most tax-efficient ways to invest in gold.
- **Electronic Gold Receipts (EGRs) –** EGRs are tradeable instruments on stock exchanges representing gold stored in accredited vaults.
- They are fully regulated, provide transparency, and ensure safe storage through certified agencies.
- **Commodity Derivatives on MCX and NSE –** Commodity derivatives allow investors to trade gold contracts under strict regulations, daily settlement systems, margin frameworks, and guaranteed clearing processes.
- These features eliminate counterparty risk and ensure market integrity.

What lies ahead?

- Digital gold may appear to be a simple and modern way to invest in the precious metal, but SEBI's warning highlights the significant dangers associated with unregulated financial products.
- Without regulatory supervision, investors remain exposed to counterparty, operational, and security risks.
- To ensure safety and long-term financial stability, investors should choose regulated gold investment instruments such as Gold ETFs, Sovereign Gold Bonds, and EGRs.
- These options provide better protection, transparency, and reliability, making them far more suitable for informed investors.

Reference

[The Indian Express| Digital Gold]