Reading 84

INTRODUCTION TO DIGITAL ASSETS

1. (C) token.

Explanation

Tokens represent ownership rights to physical assets in a blockchain or distributed ledger technology. Smart contracts are computer programs that can execute contracts based on pre-agreed upon conditions.

(Module 84.1, LOS 84.a)

2. (C) link their value to other assets.

Explanation

Stablecoins are designed to provide price stability by linking their value to a collateralized basket of assets. However, they cannot be exchanged for fiat currency, and they do not have legal and regulatory backing.

(Module 84.1, LOS 84.a)

3. (B) Consensus protocols

Explanation

A distributed ledger is a shared copy of a database in which entries are recorded and stored. The consensus mechanism is how new entries are added, and the participation network determines who can perform the network functions. Proof of Work (PoW) and Proof of Stake (PoS) are types of consensus protocols that govern how blocks can join the chain. PoW requires a computer on the network to solve a complex algorithm to validate and add blocks to the chain; it earns cryptocurrency in the process. Proof of Stake (PoS) requires that the validator verifies the transaction and a majority of validators attest to the validity of the proposed block.

(Module 84.1, LOS 84.a)

4. (C) cryptocurrency.

Explanation

An ICO is a sale of cryptocurrency to investors in exchange for cash or another cryptocurrency.

(Module 84.1, LOS 84.a)

5. (B) **difficult to regulate.**

Explanation

The most popular type of cryptocurrency exchange are centralized exchanges. However, they are more vulnerable to attacks. In a decentralized exchange, there is no central source of control. This makes it harder to regulate but also makes it less vulnerable to attacks; if one computer is attacked, the others can still operate on the network.

(Module 84.2, LOS 84.c)

6. (B) **future cash flow.**

Explanation

The value of digital assets comes from anticipated price appreciation and features of the blockchain that may give them the ability to transfer value. They do not generate any cash flow (e.g., interest or dividend income).

(Module 84.2, LOS 84.b)

7. (A) **more liquidity for higher-priced assets.**

Explanation

Asset-backed tokens represent ownership of physical assets. They can provide more liquidity for higher priced assets through allowing fractional ownership. Since the token allows immutable ownership records and transfer, there is more transparency in the transactions and less transaction cost.

(Module 84.2, LOS 84.c)

8. (B) **may provide diversification benefits**

Explanation

It remains inconclusive whether digital assets provide diversification benefits based on correlations with traditional assets. They are a relatively new asset class with no clear legal protections, and are highly speculative in nature, characterized by high volatility and returns.

(Module 84.2, LOS 84.d)

9. (C) **Cryptocurrency coin trusts.**

Explanation

Cryptocurrency coin trusts invest in a large pool of a cryptocurrency. Cryptocurrency ETFs do not invest directly in cryptocurrencies but attempt to mimic their returns using cash or derivatives. Cryptocurrency futures contracts are based on cryptocurrency prices but are cash-settled.

(Module 84.2, LOS 84.c)

10. (B) projected cash flows.

Explanation

Cryptocurrencies do not generate cash flows. Their returns are driven by market adoption, network effects, technological advancement, regulatory development, speculation, and appetite for market risk.

(Module 84.2, LOS 84.d)

11. (C) lower issuance costs

Explanation

Compared to initial public offerings, initial coin offerings typically have lower issuance costs and longer capital raising periods, and usually do not have any voting rights.

(Module 84.1, LOS 84.a)

12. (A) are usually validated using permissionless blockchain networks.

Explanation

Transactions for digital assets are usually recorded on decentralized ledgers using permission less block chain networks. However, digital assets are rarely used as a direct medium of exchange due to transaction costs. Legal and regulatory frameworks are evolving, and digital assets can be illegal in some jurisdictions.

(Module 84.2, LOS 84.b)

13. (A) whales

Explanation

"Whales" are holders of a small cryptocurrency who control a large enough portion to manipulate its price. Two major risks of direct investment in a large cryptocurrency are fraud and loss of access. Fraud may include pump and dump schemes, market manipulation, theft, and attempts to gain access to credentials. Loss of access comes from losing the unique passkey to a cryptocurrency wallet; once the passkey is lost, the owner cannot retrieve the cryptocurrency.

(Module 84.2, LOS 84.c)

14. (C) tokenization.

Explanation

Tokenization refers to maintaining ownership records for physical assets on a distributed ledger. This might, but would not necessarily, use a blockchain, which is a subcategory of distributed ledgers. Smart contracts are computerized agreements designed to automatically carry out certain actions if defined conditions are met.

(Module 84.1, LOS 84.a)