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NFTs have garnered significant attention as a unique form of digital assets, representing ownership and authenticity of various digital content ranging from collectibles and art pieces to more typical financial assets such as securities. As a relatively new and diverse asset class, NFTs are still evolving in an environment with limited legal certainty regarding their classification.

NON-FUNGIBLE TOKENS

FINANCIAL SERVICES

For those who have been following recent developments in crypto regulation, the adoption of the EU Markets in Crypto Assets Regulation (2019/1937) is undoubtedly one of the highlights of this year. While the new regulation introduces an extensive coverage of crypto-assets, NFTs are excluded from its principal scope. This does not entail however that NFTs are excluded from any other regulation; depending on their characteristics and the way they are distributed, their offer and the services related thereto might be subject to securities regulations, the MiFID regulatory framework, the DLT pilot regime or the provisions regarding crowdfunding.

1. NFTs AS FINANCIAL INSTRUMENTS

Due to the diversity of NFTs, qualifying them under the financial regulation is not an easy task and is case-by-case dependent.

Ever since their rapid market adoption through the art sector, NFTs have evolved and diversified. They are now used in many sectors, for different purposes - and can often serve an investment purpose. What used to be considered by many as a mere speculative bubble now more and more **leans towards something similar to traditional financial instruments**.

Two types of NFTs can (potentially) give rise to the application of financial regulations: tokenised securities and security tokens.

Because they are digital representations of securities on the blockchain, tokenised securities have a direct link with financial regulation. They are often issued in the context of a specific blockchain or Web3 project and represent the actual ownership of a traditional security. Typically, they aim to reproduce the same legal rights and protections for the investors as traditional securities, while offering the advantages of the DLT over their conventional counterpart such as enhanced transparency, accessibility, faster and cheaper transactions and increased liquidity. The option to fractionalise these tokenised securities with ease also offers an additional layer of flexibility.



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From a financial regulation perspective, they are in principle financial instruments subject to the full range of financial regulations applicable to those. For more information on the new EU DLT Pilot regime covering a.o. tokenised securities, check out our previous newsletter <u>here</u>.

Security tokens represent a variety of rights and obligations towards an issuer, without representing ownership of ("being backed by") underlying assets. Rights attached to the issued NFTs often include monetary return rights or rights to participate in the governance of an entity or a project typical to Decentralised Autonomous Organisation (DAO). A parallel can easily be done with dividend and voting rights that characterise securities.

NFTs providing for security-like rights with or without representing ownership of underlying assets may qualify as a financial instrument under EU regulations. This would trigger the application of the MiFID II regulatory framework (Directive 2014/6 and its implementing acts) to suppliers providing services involving this type of NFTs and of the EU and national regulations on public offerings on the NFTs issuers.

As the regulatory classification of NFTs can have important consequences for all stakeholders, it will be crucial for NFT issuers to conduct a **thorough case-by-case analysis** of their project. Considerations regarding rights and obligations, guarantee mechanism, transferability, and liquidity will be important attention point when designing and offering NFT products.

2. NFTs & CROWDFUNDING REGULATIONS

Another emerging trend over the past year is the increased use of NFTs as a method for **public fundraising**. Potential investors are given the option to purchase NFTs on the blockchain using cryptocurrency or directly through a credit card purchase.

The issued NFTs will usually **represent a right** to a share in the future profits of the project and/or a right of participation in the development of the project. Usually, the underlying project aims to offer products or services that are related to Web3 (such as NFT trading platforms), but in some cases the envisioned product or service is related to other use cases, such as mining operations, precious metal trading or music streaming. In most cases, the fundraising process is organised by the issuer of the NFT itself but it can also be outsourced to an online platform. In that last case, the question raises whether this fundraising can fall within the scope of crowdfunding regulations.

Under the EU Crowdfunding Regulation (2020/1503), a crowdfunding service is defined as the **matching of business funding interests of investors and project owners through the use of a crowdfunding platform** for the purpose of:

- the facilitation or granting of loans;;
- the placing without firm commitment basis of transferable securities and admitted instruments for crowdfunding purposes [...]..



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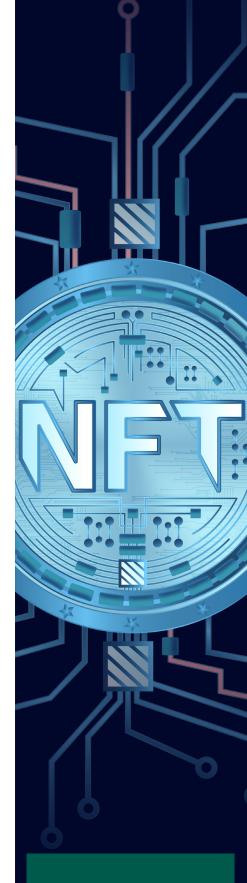
Based on the above, the crowdfunding regulations will only apply if the NFT issuer uses an intermediary platform to propose its NFTs; they will not apply to an issuer using its own platform (e.g. a landing page) to organise the sale. When NFT projects make use of marketplaces such as *OpenSea* to sell their NFTs to the public, this practice may fall under the definition of crowdfunding, but only if the rights and obligations linked to the NFT can be considered as a **loan** or a transferable **security**. Again, this **will highly depend on the particular nature of the NFT** and its potential qualification as a security.

3. CONCLUSION

In the last few years, the use of NFTs has grown exponentially, both as a utility and investment tool. The tokenisation of financial instruments, as well as the role that NFTs are playing in a new type of fundraising method, brings along various legal challenges. While largely unregulated, the offering of NFTs may fall under existing securities regulations, the new DLT Pilot regime or even crowdfunding regulations. It is therefore paramount to consider these elements in the design of NFTs and their distribution channels.

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