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NFTs: How Nonfungible Tokens Fit into Preexisting Regulatory Policies Globally Analysis of the Legal Implications

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NFTs: How Nonfungible Tokens Fit into Preexisting Regulatory Policies Globally Analysis of the Legal Implications

By: Mary Katherine Nix¹

Nonfungible tokens (NFTs) represent the latest and perhaps most controversial form of cryptocurrency. Due to their unique nature and ability to implicate multiple legal rights, it is unclear how NFTs should or can be regulated. The lack of regulatory guidance globally has caused some investors to avoid them at all costs and issuers, advisers, and purchasers of NFTS at risk of litigation. But creating a new regulatory framework for this new form of crypto could take years. As such, countries should mold NFTs into existing cryptocurrency framework.

I. Introduction

The latest form of cryptocurrency, nonfungible tokens (NFTs), have taken the world by storm and left issuers, advisers, and purchasers of NFTs uncertain and at risk of litigation with no current regulatory framework to follow. Governments are slow to regulate cryptocurrency, in general, but NFTs come with a whole new set of complications.² Fungible tokens implicate all different kinds of legal rights and liabilities like security, currency, and utility, making them difficult to regulate.³ But NFTs go even further because they can implicate multiple rights at once such as both security and intellectual property rights.⁴ Further, not all NFTs should be regulated.⁵ These unique challenges make it necessary for regulators to provide overarching guidelines, but creating a new regulatory framework would come with its own set of challenges.⁶ Thus, the U.S. and other countries should mold NFTs into existing cryptocurrency framework, rather than creating new regulations for NFTs specifically, to create a seamless transition into the latest digital frenzy of NFTs.

II. NFTs and Ownership

A. What are NFTs and how do they work?

1. Defining NFTs

An NFT is a digital asset based on blockchain technology.⁷ This digital asset is like a certificate of ownership that records the ownership of tangible items like artwork and sports tickets, and intangibles like images, videos, and tweets.⁸ NFTs provide access to digital works and act as proof of ownership of such works.⁹ An NFT is a nonfungible asset, meaning it is unique and its units

¹ J.D. Candidate, SMU Dedman School of Law, 2024; Staff Editor for the International Law Review Association.

² Adrian Krion, *NFT Regulation Looms Large, So Let's Start With the Proper Framework*, NASDAQ (Nov. 9, 2021), <https://www.nasdaq.com/articles/nft-regulation-looms-large-so-lets-start-with-the-proper-framework>.

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ Abhishek V & Gautam Kathuria, *The Rise of NFTs: Need for a Progressive Regulatory Framework*, OUTLOOK, (April 16, 2022), <https://www.outlookindia.com/business/the-rise-of-nfts-need-for-a-progressive-regulatory-framework-news-191436> [https://perma.cc/33T2-CQUR].

⁷ Sharon Urias, *Trademark and Copyright considerations for NFTs*, THOMSON REUTERS (May 2, 2022 9:35 AM) <https://www.reuters.com/legal/legalindustry/trademark-copyright-considerations-nfts-2022-05-02/>.

⁸ Raesah Chohan & Jeannette Paschen, *NFT marketing: How marketers can use nonfungible tokens in their campaigns*, BUSINESS HORIZONS, 43-50 (2023).

⁹ Ruben Mendes, *Luxembourg: NFTs, Metaverse And Their Regulation*, MONDAQ, (May 24, 2022), <https://www.mondaq.com/fin-tech/1187334/nfts-metaverse-and-their-regulation>.

are noninterchangeable or replaceable with one another.¹⁰ They are comprised of distinct and separate units, known as tokens, with a software code attaching them to underlying assets.¹¹ Tokens affect an NFTs valuation through things like differences in appearance, scarcity, and utility among other things.¹² For example, a pair of shoes worn by an Olympic athlete when they won a gold medal has more value than the same pair of shoes worn by a random person, despite the shoe being the same model.¹³ Further, this software code, or “smart contract,” details the intellectual property rights associated with the NFT.¹⁴ This is opposed to fungible assets like cryptocurrency, which embodies individual units that are substitutable with one another and identical in value.¹⁵ For example, cryptocurrency, such as Bitcoin, is fungible because a person can interchange one bitcoin with another bitcoin while the value of the two bitcoins remains the same, just as one can exchange a \$100 bill for two \$50 bills.¹⁶ Thus, while NFTs are a form of cryptocurrency, their uniqueness renders them distinct and hard to fit into the existing cryptocurrency regulatory framework.

Once NFTs are created they are recorded using distributed register/ledger technology, or DLT, which often gets interchanged with blockchain, even though the two are distinct.¹⁷ A DLT is a shared database where NFTs can be “recorded in a structured manner, managed by multiple participants, through a network that is spread across different locations (decentralized digital database).”¹⁸ Thus, a DLT is an “approach to recording and sharing data across multiple data stores (or ledgers)” and “allows for transactions and data to be recorded, shared, and synchronized across a distributed network of different network participants.”¹⁹ Blockchains are a specific type of data structure used in some DLTs.²⁰ Although a blockchain is a DLT, “the data stored and transferred through a blockchain is grouped into ‘blocks’ locked by immutable cryptographic signatures called ‘hash.’”²¹ Hash acts as proof of transfers, so each time a cryptoasset or NFT is transferred, a new hash is added to the block.²² Moreover, “each new block in a blockchain includes a hash of the previous block, and all blocks are linked to each other in a digital chain of blocks (or blockchain).”²³ In the NFT context, one author noted that the blockchain resembles a published open book that lists everyone’s properties, like a deed published by the notary.²⁴ Once created, NFTs are permanently displayed on a blockchain’s public ledger for all to verify.²⁵ Today, most NFTs are recorded on the Ethereum blockchain, one of the largest blockchain systems in the world.²⁶

¹⁰ Chohan & Paschen, *supra* note 7, at 43.

¹¹ Urias, *supra* note 6.

¹² Chohan & Paschen, *supra* note 7, at 44.

¹³ *Id.*

¹⁴ Urias, *supra* note 6.

¹⁵ Chohan & Paschen, *supra* note 7.

¹⁶ *Id.*

¹⁷ Mendes, *supra* note 8.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ Mendes, *supra* note 8.

²⁵ Urias, *supra* note 6.

²⁶ *Id.*

2. *How NFTs are being used in today's digital world.*

Because of their uniqueness, NFTs have helped solve the issue of original ownership in digital markets.²⁷ In the context of digital content, many creators and consumers struggled with how to trade original content before the rise of NFTs.²⁸ Because an indefinite number of identical copies of a piece of content like a photograph can exist, original and exclusive ownership was difficult to regulate.²⁹ Thus, clear ownership rights are critical for content creators and consumers for effective and secured trade.³⁰

Three attributes make NFTs effective in solving the problem of original content ownership in the digital world.³¹ First, as previously explained, NFTs are unique and thus, noninterchangeable.³² Accordingly, each individual NFT is linked to a tangible or nontangible asset “specifying the asset’s value, ownership, trading rights and other properties” through the smart contract.³³ Second, NFTs are immutable, meaning they cannot be altered or forged because each one is recorded on the blockchain.³⁴ This recording process is called minting.³⁵ When a person mints an NFT it creates a unique data file of the digital version of the work using blockchain.³⁶ After this process, “NFTs cannot be edited or deleted, and can be viewed publicly and freely traded with verifiable security of exclusive ownership and transaction traceability.”³⁷ The blockchain is “a decentralized network of computers and algorithms that validate and authenticate each record on the network,” thus ensuring each NFT is authentic, making it valuable for both the seller and buyer.³⁸ Finally, NFTs are transparent because they are recorded on the blockchain and can be verified, and specify the ownership properties so that both buyer and seller are aware of what is being traded.³⁹ NFTs are mainly used to verify ownership of digital goods because of their unique attributes and act as certificates of authenticity.⁴⁰ For example, if someone purchases digital art, the NFT acts to verify ownership and authenticity of the artwork.⁴¹ Just like if someone bought a painting in real life, the authenticity is verified by the artist’s signature or a certificate of authenticity.⁴²

Similarly, NFTs are becoming more prevalent in other areas and industries.⁴³ For example, brands are now using NFTs to create an authentication system for customers.⁴⁴ Now brands can verify

²⁷ Chohan & Paschen, *supra* note 7.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ Chohan & Paschen, *supra* note 7.

³⁴ *Id.*

³⁵ *Non-Fungible Tokens: The Global Legal Impact*, CLIFFORD CHANCE (June 2022)

<https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/06/non-fungible-tokens-the-global-legal-impact.pdf>.

³⁶ *Id.*

³⁷ *Id.*

³⁸ Chohan & Paschen, *supra* note 7.

³⁹ *Id.*

⁴⁰ Urias, *supra* note 6.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

the authenticity of one-of-a-kind pieces and catch counterfeit goods using NFTs.⁴⁵ The events and ticketing industry is also capitalizing on NFTs inherent certificate of authenticity to address ticket fraud.⁴⁶ Further, some companies are releasing NFT packages which include brand licenses.⁴⁷ For example, musicians can use NFTs to license their trademarks by releasing exclusive digital content for fans to purchase.⁴⁸

B. What are the rights associated with NFTs?

While the rights attaching to NFTs are still unclear, commentators have analyzed NFTs under property, copyright, and trademark laws.

2. *How NFTs fit into property law*

The property rights underlying the assets of NFTs can be misleading. Although NFT promoters advertise that the token can be used to establish “an immutable record of ownership” and thus ownership of the token conveys ownership of the underlying asset, no such law exists currently to give an NFT owner that right.⁴⁹ Accordingly, “creating an NFT of another thing—whether tangible or intangible—creates no legal link or tethering effect.”⁵⁰ NFTs do not embody property rights in a reference thing, like for instance, a deed does.⁵¹ Because a deed has a legal connection to the land it describes, ownership of the deed conveys ownership of the land.⁵² There is no current law that would give NFTs that tethering effect.⁵³ This is in contrast to other examples of legal tokenization like negotiable instruments, securities, deeds and bailments which are tied to an existing underlying law like Article 3 of the UCC, state corporate law and Article 8 of the UCC, or the common law of property and state statutes.⁵⁴ According to scholars, “[t]he problem with NFTs, is that the only property right to protect is in the token itself, not the underlying asset.”⁵⁵

a. How NFTs fit into copyright law

When a person purchases an NFT, they do not automatically also obtain the copyright associated with it.⁵⁶ Copyrights protect “original works of authorship including literary, dramatic, musical, and artistic works, such as poetry, novels, movies, songs, computer software, and architecture.”⁵⁷ Like the purchase of a physical painting in real life, the purchaser acquires the right to display the work and resell it, but ownership of the copyright is not automatically conveyed.⁵⁸ Similarly, in the context of digital art, the “artist owns the copyright unless the artist assigns it to the

⁴⁵ *Id.*

⁴⁶ Urias, *supra* note 6.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ Juliet M. Moringiello & Christopher K. Odet, *The Property Law of Tokens*, 74 FLA. L. REV. 607, 641 (2022).

⁵⁰ *Id.* at 642.

⁵¹ *Id.* at 641.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.* at 642.

⁵⁵ *Id.* at 643.

⁵⁶ Urias, *supra* note 6.

⁵⁷ *What Does Copyright Protect?*, US COPYRIGHT OFFICE, (last visited March 8, 2023),

<https://www.copyright.gov/help/faq/faq-protect.html#:~:text=Copyright%2C%20a%20form%20of%20intellectual,%2C%20computer%20software%2C%20and%20architecture.>

⁵⁸ Urias, *supra* note 6.

purchaser.”⁵⁹ Copyright law “grants the author of an artistic work the right to reproduce, create derivatives, distribute copies, publicly perform, and publicly display work.”⁶⁰ Thus, the artist keeps the copyright even if the original art or a copy is sold through NFTs, unless the copyright is granted in the smart contract.⁶¹ Practically speaking, even though the buyer now owns the NFT, they do not have the right to sell copies of the artwork or digital asset associated with the NFT or to display images of the artwork on merchandise for example.⁶² Thus NFTs rarely transfer intellectual property ownership rights.⁶³ But it is common for NFT sellers to license intellectual property rights to buyers for specific limited purposes.⁶⁴

3. *How NFTs fit into trademark law*

The biggest litigation risk with NFTs so far has come from trademark law, where company’s face legal risks by infringing on minted NFTs. Trademarks are another form of intellectual property rights which protect words, phrases, symbols, or designs that identify goods and services.⁶⁵ With the growth of NFTs, so have lawsuits as brands grapple with unsteady laws. NFTs that are linked to expressive content like images, videos, and words, can unintentionally infringe on an existing trademark by incorporating the trademark into the underlying asset linked to the NFT leading to lawsuits.⁶⁶

For example, in an ongoing lawsuit, *NIKE, INC. v. StockX LLC*, Nike sued StockX, a company which operates an online resale platform for various brands, claiming it infringed on its trademark by minting NFTs that utilize Nike’s trademark without its permission.⁶⁷ Nike argues that StockX is selling assets at inflated prices to consumers who believe the digital asset is authorized by Nike.⁶⁸ StockX claims that each NFT is a key to accessing the underlying store item asset that purchasers can either leave with StockX or take possession of at which point the NFT would be removed from circulation.⁶⁹ A big issue in the case is whether trademark legal doctrines protects a seller or whether the NFTs are new, distinct products that are trying to capitalize on the trademark owners’ trademarks.⁷⁰

Similarly, in *Hermès Int’l v. Rothschild*, Hermès sued a digital content creator for infringing on its trademark by selling digital images of Hermès Birkin handbags, titling them “MetaBirkins” and selling them as NFTs.⁷¹ Rothschild has a disclaimer on his website that he is not affiliated with Hermès and asserts that under the First Amendment he has a right to make and sell art that depicts

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ Urias, *supra* note 6.

⁶⁵ Michael D. Murray, Trademarks, NFTs, and the Law of the Metaverse (July 2022) 1, 6 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4160233.

⁶⁶ *Id.*

⁶⁷ *NIKE, INC., Plaintiff, v. STOCKX LLC, Defendant.*, 2022 WL 340664 (S.D.N.Y.).

⁶⁸ Murray, *supra* note 64 at 10.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Hermes Int’l v. Rothschild*, 603 F. Supp. 3d 98, 100 (S.D.N.Y. 2022).

branded products and to call them “MetaBirkins.”⁷² Both parties filed cross-motions for summary judgment, but the Judge denied both, making several key findings of fact, including that jurors could disagree on whether Rothschild’s MetaBirkins “stemmed from genuine artistic expression or, rather, from an unlawful intent to cash in on” Hermes Birkin handbags.⁷³ On February 8, 2023, the jury returned a verdict in favor of Hermes, “finding that the ‘MetaBirkins’ are more like consumer products, which are bound by trademark laws, than art protected by the First Amendment,” and that “Rothschild capitalized on Hermes goodwill for profit.”⁷⁴ The jury awarded Hermes \$133,000 in total damages for trademark infringement and cybersquatting, broken down to \$110,000 for Rothschild’s profits and resale commissions and \$23,000 for cybersquatting.⁷⁵

Another ongoing lawsuit comes from the blatant use of another’s trademark in *Yuga Labs, Inc. v. Ripps*.⁷⁶ Yuga Labs is the creator of one of the world’s most successful NFT collections called Bored Ape Yacht Club (BAYC).⁷⁷ Only 10,000 of those NFTs exist, which upped the value of the BAYC NFTs, causing them to resell for millions of dollars.⁷⁸ The defendant, Ripps, created their own NFT collection called Ryder Ripps Bored Ape Yacht Club (RR/BAYC) and copied every aspect of the BAYC brand’s artwork including the actual registered number of each digital image, but used a unique entry on the Ethereum blockchain.⁷⁹ Ripp argues that even though he has copied the trademarks and trade dress of the BAYC digital art, since he listed them in a new NFT listing for a different NFT, he has “recontextualized” the artwork.⁸⁰

Because NFTs are a separate thing from the items they tokenize, they cannot automatically be characterized as expression.⁸¹ Trademark issues arise when consumers interpret the marketing in certain NFTs as conveying promises that the ownership of the NFT is the ownership of the item linked to the NFT.⁸² The legal landscape of NFTs in the context of trademark issues is still developing.

C. What are the legal implications of NFTs globally?

While the use of NFTs is growing rapidly, globally the legal and regulatory treatment of NFTs remain uncertain. Because NFTs are available and traded globally, issuers, advisers, and purchasers of NFTs must consider the implications of such across multiple jurisdictions. While most countries have broader regulatory plans for cryptoassets, most jurisdictions have not yet developed regulatory frameworks specifically for NFTs.⁸³

⁷² Muzamil Huq, Alyssa Mahatme, & Ani Oganessian, *Hermes Successfully Defends its Trademark in the Metaverse*, JDSUPRA, (Feb, 10, 2023), <https://www.jdsupra.com/legalnews/hermes-successfully-defends-its-9059942/>.

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ *Yuga Labs, Inc. v. Ripps*, No. CV 22-4355-JFW(JEMX), 2022 WL 18024480, at *1 (C.D. Cal. Jan. 16, 2022).

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ Murray, *supra* note 64 at 17.

⁸² *Id.*

⁸³ *Non-Fungible Tokens: The Global Legal Impact*, CLIFFORD CHANCE (June 2022) 1, 8 <https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/06/non-fungible-tokens-the-global-legal-impact.pdf>.

1. Licensing

Besides the implications of NFTs for property, copyright, and trademark laws, NFTs carry big considerations. For example, will NFTs be subject to licensing requirements?⁸⁴ The answer is not necessarily, since again, most jurisdictions do not have specific NFT regulations.⁸⁵ However, NFTs can easily fall into the cryptoasset regulations under this category.⁸⁶ For example, in the United Kingdom (UK), under their cryptoasset regulations, the Money Laundering Regulations set out a list of activities that when performed, trigger a registration requirement.⁸⁷ An NFT won't always meet the definition of a cryptoasset as defined. For example, in the Money Laundering Regulations, a cryptoasset is defined as "a cryptographically secured digital representation of value or contractual rights that uses a form of DLT and can be transferred, stored or traded electronically."⁸⁸ But where an NFT does not meet this definition, this would not apply.⁸⁹

2. Tax Implications

Another important consideration is whether NFTs have any tax implications. Most countries consider cryptoassets to be property for tax purposes.⁹⁰ But even with cryptoassets, let alone NFTs, it is far from clear under existing regulatory guidance what the tax treatment is and requires looking at multiple factors "including the nature of the cryptoasset, what it represents, its intended use and whether any analogies can be drawn from the relevant jurisdiction's existing approach (if any) on taxation of cryptocurrencies."⁹¹ Due to these unclear issues, scholars expect a large amount of transactions involving NFTs and even cryptocurrencies in general to go unreported and untaxed.⁹² To solve these problems, the Organisation for Economic Co-operation and Development (OECD), an intergovernmental organization with 38 member countries including the US, is developing proposals for reporting and information exchange for cryptoassets that could make exchange platforms responsible for compliance along with taxpayers.⁹³

3. Money Laundering

Another question arises around the NFTs with regard to anti-money laundering concerns.⁹⁴ To address this concern, The Financial Action Task Force (FATF) which is the global standard setter for anti-money laundering issues, is calling for further regulation due to the risk that the anonymous purchases of NFTs through things like expensive art can be used as a tool for money laundering.⁹⁵

While most countries do not have specific regulations for NFTs, the regulations in place in other countries for cryptocurrencies should be adapted to include NFTs.

⁸⁴ *Id.* at 4.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.* at 4-5.

⁹¹ *Id.* at 5.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Id.* at 6.

⁹⁵ *Id.*

III. How NFTs Can and Do Fit into the Current Regulatory Framework

A. Countries that have regulatory frameworks conducive to NFTs

1. European Union Regulatory Framework

NFTs are not regulated under current EU regime, but could fall under a number of existing regulations.⁹⁶ For example, the European Commission published the Markets in Crypto-assets Regulation (MiCA) on September 24, 2020.⁹⁷ The European Parliament is expected to vote on the bill in early 2023, then after formal approval by the Council of the EU, MiCA will be published in the EU's official journal and enter into force 20 days later.⁹⁸ MiCA is intended to “close gaps in existing EU financial services legislation by establishing a harmonized set of rules for crypto-assets and related activities and services.”⁹⁹ The Bill regulates activities involving crypto-assets, defined as any “digital representation of a value or a right which may be transferred and stored electronically, using distributed ledger technology or similar technology.”¹⁰⁰ Under MiCA, cryptoassets include NFTs.¹⁰¹ Although not yet in effect, MiCA will apply to “any person issuing or providing cryptoasset services across all Member States, as well as any non-EU firm seeking to trade in EU member states.”¹⁰²

In its proposal, the Commission described the need for a regulatory framework of crypto-assets, specifically in the financial services realm.¹⁰³ The Commission noted that “[s]ome crypto-assets fall within the scope of existing EU financial services legislation, in particular those that qualify as financial instruments within the meaning of Directive 2014/65/EU of the European Parliament and of the Council.”¹⁰⁴ But others “fall outside of the scope of Union financial services legislation.”¹⁰⁵ For those crypto-assets that fall outside the scope of existing legislation, there are “no rules, other than AML rules, for services related to these unregulated crypto-assets, including for the operation of trading platforms for crypto-assets, the service of exchanging crypto-assets for funds or other crypto-assets, or the custody of crypto-assets.”¹⁰⁶ Accordingly, the lack of such rules “leaves holders of crypto-assets exposed to risks, in particular in areas not covered by consumer protection rules.”¹⁰⁷ Moreover, the lack of a consistent framework can lead to substantial risks in market integrity, such as market manipulation and financial crime.¹⁰⁸ The Commission went on to list numerous reasons why a consistent regulatory framework is necessary for all the member states of the UN because the lack of one could:

⁹⁶ *Id.* at 8.

⁹⁷ *Id.*

⁹⁸ Benjamin Beck et al., *EU Markets in Crypto-Assets (MiCA Regulation Expected to Enter into Force in Early 2023)*, MAYER BROWN (Dec. 14, 2022), <https://www.mayerbrown.com/en/perspectives-events/publications/2022/12/eu-markets-in-crypto-assets-mica-regulation-expected-to-enter-into-force-in-early-2023#:~:text=The%20much%2Ddebated%20Markets%20in,and%20related%20activities%20and%20services.>

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ CLIFFORD CHANCE, *supra* note 34, at 8.

¹⁰² *Id.*

¹⁰³ *Council Proposal for a Regulation of the European Parliament and of the Council on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 (MiCA)*, at 5, COM (2022) 293 final (Oct. 5, 2022).

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 6.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

- Lead to a lack of crypto-user’s confidence in those assets, hindering development of a market and causing missed opportunities of digital innovation¹⁰⁹
- Companies using crypto-assets would have no legal certainty on how their crypto-assets would be treated in different member states¹¹⁰
- Lead to regulatory fragmentation, distorting competition and making it more difficult for crypto-asset service providers to function on a cross-border basis.¹¹¹

Thus, the Commission found a harmonized framework necessary to provide specific rules for crypto-assets and to clarify the applicable legal framework.¹¹²

Such a framework should support innovation and fair competition, while ensuring a high level of protection of retail holders and market integrity in crypto-asset markets. A clear framework should enable crypto-asset service providers to scale up their business on a cross-border basis and should facilitate their access to banking services to run their activities smoothly. A union framework should provide for proportionate treatment of issuers of crypto-assets and crypto-asset service providers, thus allowing equal opportunities for market entry and ongoing and future development. It should also promote financial stability, the smooth operation of payment systems, and address monetary policy risks that could arise from crypto-assets that aim at stabilizing their price in relation to a currency, an asset or a basket of such. While increasing protection of retail holders, market integrity and financial stability through the regulation of offers to the public of crypto-assets or services related to such crypto-assets, a Union framework on markets in crypto-assets should not regulate the underlying technology. Union legislation avoids imposing unnecessary and disproportionate regulatory burdens on the use of technology, since the Union and the Member States seek to maintain competitiveness on a global market. Proper regulation maintains the competitiveness of the Member States on international financial and technological markets and provides clients with significant benefits in terms of access to cheaper, faster and safer financial services and asset management.¹¹³

But despite this, MiCA specifically excludes NFTs from coverage under the regulation.¹¹⁴ Under the proposal, the Commission notes that the regulation “should not apply to crypto-assets that are unique and not fungible with other crypto-assets, including digital art and collectables, whose value is attributable to each crypto-assets unique characteristics and the utility it gives to the token holder.”¹¹⁵ Because “[w]hile these crypto-assets might be traded in market places and be accumulated speculatively, they are not readily interchangeable and the relative value of one crypto-asset in relation to another, each being unique, cannot be ascertained by means of comparison to an existing market or equivalent asset.”¹¹⁶ These features limit the extent to which crypto-assets can have a financial use, so the Commission did not see it as a great enough risk to

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Council Proposal, supra* note 102, at 6.

¹¹² *Id.* at 7.

¹¹³ *Id.*

¹¹⁴ Beck, *supra* note 97.

¹¹⁵ *Council Proposal, supra* note 102, at 10.

¹¹⁶ *Id.*

users and the system.¹¹⁷ But NFTs that are issued in a large series or collection could be considered fungible, and thus, be covered by MiCA.¹¹⁸ But commentators note the discussion is not over with respect to NFTs and MiCA in the EU.¹¹⁹ With more and more NFTs being issued in a large series or collection, and the continuous growth of NFTs, the Commission could consider the same reasons for adopting a consistent regulatory framework for financial crypto-assets to NFTs.¹²⁰

2. U.S. Regulatory Framework

Similarly, NFTs are not currently specifically regulated in the U.S., but multiple considerations must be taken into account.¹²¹ First, NFTs could fall under securities laws Under Section 2(a)(1) of the Securities Act, a security is:

“any note, stock, ... in any profit-sharing agreement, collateral-trust certificate, preorganization certificate of subscription, transferable share, investment contract, ... or, in general, any interest or instrument commonly known as a ‘security.’”¹²²

Under the four-part, substance-over-form test that the US Supreme Court announced in *SEC v. Howey*, the court determined that an investment contract is: (1) an investment of money, (2) in a common enterprise, (3) with an expectation of profits, (4) derived from the efforts of others.¹²³ NFTs could be considered investment contracts, which is a type of security, where an NFT is marketed as a financial investment “whose holders have been led to expect profits from an entrepreneurial venture involving the NFT, or the managerial skills of the NFTs promoter.”¹²⁴ In fact, litigants have filed civil class actions against NFT issuers in the U.S. alleging the issuance of their NFTs was an unregistered securities offering under U.S. law.¹²⁵ But an NFT should not be deemed a security where it is presented as a collectible with a public assurance of authenticity on the DLT and relates to an existing asset.¹²⁶ On the other hand, an NFT is a security where it has been marketed as an asset that will give a return on investment due to the efforts made by others.¹²⁷ Thus, if an NFT merely represents the ownership of an item like a digital photograph, it would arguably not fall under the realm of the SEC as a security.¹²⁸ But where an NFT is promoted as a speculative investment along with the suggestion that the NFT will increase in value as a result of the promoter, the NFT is much more likely to be considered an investment contract, and thus, a

¹¹⁷ *Id.*

¹¹⁸ Beck, *supra* note 97.

¹¹⁹ *MICA (Markets in Crypto Assets) Regulation*, RUE, (last visited March 1, 2023), https://rue.ee/blog/mica-markets-in-crypto-assets-regulation/?gclid=EAIaIQobChMIhcG89ITN_QIVWmpvBB1DYQVhEAAYAiAAEgI4N_D_BwE.

¹²⁰ *Id.*

¹²¹ CLIFFORD CHANCE, *supra* note 34, at 13.

¹²² *The Regulatory Considerations of NFTs in the United States*, COINTELEGRAPH (last visited Feb. 8, 2023) <https://cointelegraph.com/cryptocurrency-regulation-for-beginners/the-regulatory-considerations-of-nfts-in-the-united-states>.

¹²³ Andrew James Lom & Rachael Browndorf, *Anatomy of an NFT*, NORTON ROSE FULBRIGHT, (April 2021), <https://www.nortonrosefulbright.com/en-it/knowledge/publications/5995f99d/anatomy-of-an-nft>.

¹²⁴ Clifford Chance, *supra* note 34, at 8.

¹²⁵ *Id.*

¹²⁶ Cointelegraph, *supra* note 121.

¹²⁷ *Id.*

¹²⁸ Lom, *supra* note 122.

security.¹²⁹ Further, fractionalized NFTs can be regarded as securities where NFT platforms are facilitating the sale and secondary trade of assets, and will need to register with the SEC.¹³⁰

Second, although The Financial Crimes Enforcement Network (FinCEN) has yet to issue guidance on NFTs, they could implicate anti-money laundering laws.¹³¹ FinCEN regulates money services business models involving digital currency.¹³² Under FinCEN, digital currency is defined as a “medium of exchange that can operate like a currency but does not have all the attributes of real currency, including legal tender status.”¹³³ NFTs are likely not considered a “medium of exchange” or “convertible virtual currency” because of their non-fungible characteristics, unlike Bitcoin and other virtual currencies.¹³⁴ Thus, NFTs currently are not likely to fall under anti-money laundering regulations.¹³⁵ However, the Bank Secrecy Act in the Anti-Money Laundering Act of 2020 included “businesses engaged in the exchange or transmission of currency, funds, or value that substitutes for currency as financial institutions that are subject to AML requirements.”¹³⁶ So, if NFTs are viewed as engaged in money transmission activities, they could be subject to Bank Secrecy Act regulations.¹³⁷ Further, since NFTs can also be redeemed for fiat, they could be considered a convertible virtual currency.¹³⁸

Third, NFTs can be seen as commodities.¹³⁹ The US Commodity Futures Trading Commission, or CFTC, defines a commodity to include cryptocurrencies and other intangible items.¹⁴⁰ A commodity includes “all goods and articles, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.”¹⁴¹ These future sales of commodities are included in the definition of a “swap” subject to regulation by the CFTC.¹⁴² But the sale of non-financial commodities, which could encompass many NFTs may be excluded from the definition of swaps “if the commodity is: (1) meant to be physically delivered even though delivery or shipment is deferred; and (2) the forward contract qualifies as a commercial merchandising transaction.”¹⁴³ But can NFTs be physically delivered?¹⁴⁴ This depends on whether what is being delivered is the asset represented by the NFT or the NFT itself.¹⁴⁵ Deceptive and manipulative trading regulations could be applied to NFT transactions in regard to unleveraged, fully funded transactions.¹⁴⁶ Where leveraged transactions occur, additional requirements could be imposed based on whether an NFT has been traded solely on a registered derivatives exchange.¹⁴⁷

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ Clifford Chance, *supra* note 65.

¹³² Cointelegraph, *supra* note 121.

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ Cointelegraph, *supra* note 121.

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ Lom, *supra* note 122.

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ Lom, *supra* note 122.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

Additionally, U.S. federal sanctions laws may be implicated as NFT transactions occur across multiple jurisdictions between U.S. and non-U.S. persons, which could implicate compliance with the U.S. Office of Foreign Assets Control (OFAC) regulations.¹⁴⁸ Although OFAC has not yet issued any NFT guidelines, they have noted that the sanctions apply to digital transactions.¹⁴⁹ Moreover, the OFAC has enforced sanctions regarding blockchain-based transactions, which could mean they are likely to enforce sanctions on NFT transactions.¹⁵⁰ Going further, the OFAC could do more than just impose sanctions, but also initiate an action if persons penalized by them benefit from activities related to NFTs and have identified NFTs as a possible factors in the violations.¹⁵¹

Finally, US consumer protection laws, both at the federal and state level, could be implicated in the exchange of NFTs.¹⁵² Sellers cannot engage in deceptive, unfair, or misleading practices, regardless of whether the sale occurs physically or digitally.¹⁵³ Moreover, would NFTs be governed by Article 2 of the UCC?¹⁵⁴ Article 2 governs the sale of tangible goods and although NFTs are by definition, intangible, what if the NFT is tied to a tangible object?¹⁵⁵ Additionally, there are still questions remaining regarding the tax implications of NFTs.¹⁵⁶ The IRS has stated that digital assets, including NFTs are considered property for tax purposes.¹⁵⁷ But it is unclear whether certain NFTs would be considered collectibles, implicating additional requirements under the IRS's tax regime.¹⁵⁸

3. Germany's Regulatory Framework

Although last year the German Government made a statement that no change would come to the regulatory framework because of the emergence of NFTs, they still may fall under the scope of existing German legislation.¹⁵⁹ Under the German Banking Act (KWG), cryptoassets are considered financial instruments and defined as “digital representations of a value that (a) have not been issued or guaranteed by a central bank or a public body; (b) do not have the legal status of currency or money, but (c) are accepted by natural or legal persons as a means of exchange or payment or for investment purposes on the basis of an agreement or actual practice; and (d) can be transferred, stored and traded electronically.”¹⁶⁰ Because NFTs can be used for investment purposes because of their unique, value-creating character, an NFT may qualify as a cryptoasset

¹⁴⁸ Cointelegraph, *supra* note 121.

¹⁴⁹ *Id.*

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² Lom, *supra* note 122.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ Lom, *supra* note 122.

¹⁵⁹ Sunny J. Kumar, Jeremy M. McLaughlin, Amigo L. Xie, Lucas Nicolet-Serra, Andreas Müller, & Georgina Rigg, *The NFT Collection: A Brave NFT World – A Regulatory Review of NFTs (Part 2)*, THE NATIONAL LAW REVIEW (June 30, 2022)

<https://www.natlawreview.com/article/nft-collection-brave-nft-world-regulatory-review-nfts-part-2>.

¹⁶⁰ Francisca Ducos, *NFTs and German Law: Rights and Duties of NFT Holders*, MEDIUM, (Sept. 13, 2021), <https://medium.com/@datash/nfts-and-german-law-rights-and-duties-of-nft-holders-83f1bb86d9bd>.

and thus, a financial instrument under the German Banking Act.¹⁶¹ But another interpretation reads “tradability” to imply that fungibility is needed, which would exclude NFTs from the scope of the Act.¹⁶² If an NFT is considered a financial instrument, it would likely be subject to a licensing requirement.¹⁶³

Moreover, the law in Germany pertaining to NFTs, and the rights and obligations that apply, “differs depending on whether the token can be characterized as an investment asset (under the VermAn1G); a unit of account (under the BaFin); or a fund (under the KAGB).”¹⁶⁴ Notably, German property law only applies to tangible objects, so the digital works underlying an NFT will not fall under the scope of property law in Germany.¹⁶⁵ But NFTs could fall under rights of use, which are “unrestricted in terms of time, territory and content, which can be sub-licensed and leased.”¹⁶⁶ These can be supplemented by additional types of use and it is expected that the NFT industry will come up with standards allowing buyers to decide what they are entitled to.¹⁶⁷ Legal commentators on German law have noted that the regulation of NFTs under German law “may call for drastic measures, such as a reconceptualization of important notions like that of ‘ownership,’” and “will also likely need to make provisions broader, so as to keep up with and encompass new technological advances, which will inevitably take place at a faster pace than the development of the applicable law.”¹⁶⁸ Thus, because of the slow pace of legislation, regulators and officials should clarify definitions such as ownership and cryptoasset, as well as make provisions in the existing law broader to embody NFTs.¹⁶⁹

4. Luxembourg Regulatory Framework

Like the U.S., and the EU, Luxembourg does not specifically regulate NFTs.¹⁷⁰ The European Court of Justice and the Luxembourg Direct Tax Administration have issued decisions on virtual currencies, but none specifically address NFTs.¹⁷¹ However, under existing regulation, multiple frameworks in Luxembourg could be implicated.¹⁷² For example, like the EU, an NFT could qualify as a financial instrument, and thus the buying and selling of such could trigger a licensing requirement.¹⁷³ A licensing requirement could also be triggered where an NFT qualifies as electronic money.¹⁷⁴ Finally a licensing requirement could be triggered where the issuance of NFTs qualify as units of a collective investment.¹⁷⁵ Under MiCA, NFTs would likely fall into the catch-all category of crypto-assets which would require a license for a Crypto-Asset Service Provider.¹⁷⁶ More specifically, however, the Luxembourg Law on the fight against money

¹⁶¹ Kumar et al., *supra* note 158.

¹⁶² Ducos, *supra* note 159.

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ Ducos, *supra* note 159.

¹⁶⁹ *Id.*

¹⁷⁰ Clifford Chance, *supra* note 34 at 9.

¹⁷¹ Mendes, *supra* note 8.

¹⁷² Clifford Chance, *supra* note 34 at 9.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ Mendes, *supra* note 8.

laundering and terrorist financing, known as the AML/CFT Law, provides definitions that could implicate NFTs: virtual assets and virtual currencies.¹⁷⁷ A virtual asset is defined as “a digital representation of value that can be digitally traded, or transferred, and can be used for payment or investment purposes” and specifically includes virtual currencies.¹⁷⁸ This broad definition could encompass NFTs and leave it open to obligations under different aspects of Luxembourg law.¹⁷⁹ For example, under Luxembourg law, a person who provides specific services listed by law that are related to virtual assets, thus possibly implicating NFTs, on behalf of clients, must comply with regulations such as applying for a Virtual Asset Service Provider authorization before the Luxembourg authority supervising the financial security (CSSF).¹⁸⁰

Moreover, income tax under Luxembourg law applies “regardless of whether the income is realized in a real or virtual world,” which would seem to implicate the sale and trading of NFTs.¹⁸¹ Although there is no income tax provision that expressly applies to NFTs, the Luxembourg Direct Tax Administration Circular has stated that “concerning the income tax, business tax and wealth tax, virtual currencies, such as Bitcoin, shall constitute intangible property.”¹⁸² Although it is still unclear whether NFTs would be considered virtual currencies, they do constitute intangible property, making it likely to be subject to income tax.¹⁸³

5. UK’s Regulatory Framework

Like most countries, there are no specific regulations on NFTs in the UK.¹⁸⁴ But notably instead, NFTs are considered as a type of cryptoasset.¹⁸⁵ The Financial Conduct Authority provides guidance for NFTs and distinguished between three types of crypto-assets: a security token, an e-money token, or an unregulated token.¹⁸⁶ To qualify as a security token, the NFT must “provide rights and obligations specified investment which include shares, deposits, and insurance.”¹⁸⁷ To be an e-money token, the NFT must be an “electronically stored monetary value.”¹⁸⁸ If the NFT has the characteristics of a security token, it will be considered a specified investments for the purpose of the Financial Services and Market Act 2000.¹⁸⁹ If the NFT meets the criteria of an e-money token, it will be regulated by the Electronic Money Regulations 2011.¹⁹⁰ Thus, if the NFT falls under either a security token or e-money token, marketing them will require authorization from the Financial Conduct Authority.¹⁹¹ This means they will be subject to the money laundering

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.*

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² Mendes, *supra* note 8.

¹⁸³ *Id.*

¹⁸⁴ Sunny J. Kumar, Jeremy M. McLaughlin, Amigo L. Xie, Lucas Nicolet-Serra, Andreas Müller, & Georgina Rigg, *The NFT Collection: A Brave NFT World – A Regulatory Review of NFTs (Part 2)*, THE NATIONAL LAW REVIEW (June 30, 2022)

<https://www.natlawreview.com/article/nft-collection-brave-nft-world-regulatory-review-nfts-part-2>.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ Kumar, et. al, *supra* note 158.

¹⁹¹ *Id.*

regulations.¹⁹² But the great majority of NFTs will not fall under the criteria of either a security token or e-money and thus is still left unregulated.¹⁹³

The UK is in the process of proposing and amending regulatory changes including the idea of extending the scope of cryptoasset regulations to include out-of-scope cryptoassets like NFTs.¹⁹⁴ Currently, under the UK's anti-money laundering legislation, a cryptoasset is "a cryptographically secured digital representation of value or contractual rights that uses a form of DLT and can be transferred, stored, or traded electronically."¹⁹⁵ Under this definition, an NFT would likely fall under the regulations because an NFT is a secured digital representation of value that uses a form of DLT and can be transferred.¹⁹⁶

6. Italy's Regulatory Framework

Although there are no specific regulatory requirements for NFTs in Italy, NFTs could qualify as investment products under the Italian Consolidated Financial Act.¹⁹⁷ Investment products is a broad category of instruments which include "any other form of investment of financial nature" and would imply additional requirements on the seller of an NFT, such as being licensed.¹⁹⁸ Further clarification has shown that "investment of a financial nature" includes "the use of capital; the expectation of return; and the risk involved."¹⁹⁹ The CONSOB, the government authority of Italy responsible for regulating the Italian securities market, has stated a three-part test to determine whether a financial instrument be regarded as a financial product: "(1) funds must be deployed; (2) a promise or expectation of financial return; and (3) the relevant investor takes up a risk that is directly connected to the funds' deployment."²⁰⁰ NFTs are often "(1) offered against the payment of funds, (2) with the express or implicit promise or expectation of a financial return, and (3) with the relevant investor accepting the risk of losing the deployed funds."²⁰¹ Thus NFTs could easily fall under this definition when being bought and sold.²⁰² Therefore, if the NFT met the requirements, then the regulations attached to investment products would apply.²⁰³

Further, an NFT could qualify as virtual currency under Italian regulations, which would trigger anti-money laundering requirements.²⁰⁴ Although no general definition of cryptocurrency exists in Italy, a legislative decree which was amended to transpose in Italy the EU Anti-Money Laundering Directives, defined virtual currencies.²⁰⁵ Virtual currency under the legislation was defined as

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ Clifford Chance, *supra* note 34 at 12.

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ Kumar, et. al, *supra* note 158.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

²⁰⁰ Massimo Donna & Ferdinando Matteo Vella, *Blockchain & Cryptocurrency Laws and Regulations 2023 Italy*, GLOBAL LEGAL INSIGHTS, (last visited March 6, 2023), <https://www.globallegalinsights.com/practice-areas/blockchain-laws-and-regulations/italy>.

²⁰¹ *Id.*

²⁰² Kumar, et. al, *supra* note 158.

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ Donna, *supra* note 199.

A digital representation of value, which has not been issued or backed by a central bank or a public authority and which is not necessarily pegged to a legal tender, but which is used as a means of exchange for the purpose of goods or services or for investment purposes, and may be transferred, stored or negotiated electronically.²⁰⁶

Virtual currency is defined broadly, and would likely include NFTs, because “the aim of the statute including the definition was to capture the wider possible range of digital assets to prevent them from being used for money-laundering and to facilitate terrorism.”²⁰⁷

7. Singapore’s Regulatory Framework

Singapore has taken a slightly different regulatory approach.²⁰⁸ Singapore’s central bank announced that it would not regulate NFTs because it is an emerging market and it presently “does not wish to regulate something people are investing money in.”²⁰⁹ Thus, the approach is to look beyond a token’s label and examine its characteristics.²¹⁰ If the characteristics fall within an existing regulatory framework, the NFT will be subject to regulation under that existing framework.²¹¹ Under this approach, there are generally three types of digital tokens: security tokens, payment tokens, and utility tokens.²¹² For example, if an NFT had the characteristics of a capital markets product under the Securities and Futures Act, it would be subject to those regulatory requirements.²¹³ Furthermore, if an NFT had the characteristics of a digital payment token under the Payment Services Act, restrictions and obligations on the seller of that NFT would be imposed.²¹⁴

But because Singapore has no plans to regulate activities in relation to NFTs, and NFTs do not clearly fall into existing regulatory framework, the practical effects of this are unclear.²¹⁵ For example, with regard to the Payment Services Act, if an NFT is considered a digital payment token, or DPT, then the issuer of that NFT would be subject to a payment service provider license.²¹⁶ But DPTs are defined as “a medium of exchange accepted by the public, or a section of the public, as payment for goods or services or for the discharge of a debt.”²¹⁷ So, do NFTs fit the characteristics of DPTs enough to fall under the Payment Services Act? Even if it did, NFTs could be considered modes of payment, categorizing it as a limited purpose digital payment token, which is exempt from regulation under the PSA “where the purpose of their use involves nonmonetary consumer loyalty, reward points, in-game assets, or similar digital representations of value that cannot be returned to the issuer or sold, transferred or exchanged for money.”²¹⁸ Similarly, with regard to

²⁰⁶ *Id.*

²⁰⁷ *Id.*

²⁰⁸ Clifford Chance, *supra* note 34 at 11.

²⁰⁹ Kumar, et. al, *supra* note 158.

²¹⁰ Clifford Chance, *supra* note 34 at 11.

²¹¹ *Id.*

²¹² *Id.*

²¹³ Kumar, et. al, *supra* note 158.

²¹⁴ *Id.*

²¹⁵ Leon Yee, Patrick Ong, & Jacob Low, *Understanding consumer protections for NFTs in Singapore*, IFLR (July 26, 2022), <https://www.iflr.com/article/2aeqwlfu6uwg4b815phxc/sponsored/understanding-consumer-protections-for-nfts-in-singapore>.

²¹⁶ *Id.*

²¹⁷ *Id.*

²¹⁸ *Id.*

NFTs as capital markets products subjecting it to regulations under the Securities and Futures Act of 2001, it is unclear what characteristics an NFT would have to have to qualify as a capital markets product.²¹⁹ One commentator noted that maybe it would be close enough to a capital markets product if the NFT had characteristics of a security in which the holder is granted voting rights in the issuer.²²⁰ But once again, we cannot be certain without regulatory guidance. Thus, although the characteristics approach is a sound one, without additional regulatory guidance and clarifications, NFT issuers and purchasers are left in the dark.²²¹

IV. Spain's Regulatory Framework

Spain, as member state of the European Union, is subject to the regulatory regimes of MiCA, previously discussed.²²² But Spain has a few main regulatory considerations when it comes to crypto assets.²²³ First, NFTs in Spain will be subject to anti-money laundering regulations if they fall under the category of virtual currency.²²⁴ The Prevention of Money Laundering and Terrorist Financing directive amended a law to extend anti-money laundering obligations to “platforms for the exchange of virtual currency into legal tender (“exchanges”) and electronic wallet custody service providers (“custodians”).²²⁵ This significantly made it so that “companies or individuals that exchange, transfer, or provide custody services of NFTs that constitute as investments will need to be registered as a Virtual Asset Service Provider.”²²⁶ This requirement is also imposed in Portugal.²²⁷

Further, NFTs will be regulated by the laws of its underlying asset in Spain.²²⁸ Additionally, Spain has been open about its consideration of adopting regulations surrounding cryptocurrencies.²²⁹ For example, in 2022 the Spanish Ministry of Consumer Affairs stated it was considering regulation of crypto-games.²³⁰ Moreover, the Spanish Ministry of Consumer Affairs has already imposed regulations regarding advertising of cryptoassets and cryptocurrencies, so that investors are made aware of the risks before getting into business with cryptocurrency.²³¹ Accordingly, Spain's National Securities Market Commission, or CNMV, will monitor that advertising material includes the message: “investment in crypto-assets is not regulated may not be suitable for retail investors and the entire amount invested may be lost.”²³² This would likely apply equally to NFTs, as a form of cryptoasset, however no guidance has been given on this point by regulators in Spain.²³³

²¹⁹ *Id.*

²²⁰ *Id.*

²²¹ *Id.*

²²² Cris Carrascosa, *Blockchain 2022: Spain Trends and Developments*, CHAMBERS & PARTNERS, (Oct. 7, 2022), <https://practiceguides.chambers.com/practice-guides/blockchain-2022/spain/trends-and-developments>.

²²³ *Id.*

²²⁴ Kumar, et. al, *supra* note 158.

²²⁵ Carrascosa, *supra* note 221.

²²⁶ Kumar, et. al, *supra* note 158.

²²⁷ *Id.*

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ *Id.*

²³¹ *Id.*

²³² Carrascosa, *supra* note 221.

²³³ *Id.*

A. Countries that actively regulate NFTs

1. People's Republic of China (PRC) Regulatory Framework

Alternatively, cryptocurrencies and cryptoassets are strictly regulated in the PRC even in the absence of a regulatory framework.²³⁴ The Circular on Preventing Risks related to Initial Coin Offerings (ICO) was issued in 2017 by seven Chinese governmental agencies.²³⁵ This marked an “unprecedented regulatory clampdown on cryptoassets which has been sustained in practice.”²³⁶ The National Internet Finance Association of China, the China Banking Association and the Payment and Clearing Association of China issued a joint statement backing the ICO and making clear that member institutions, including banks and payment firms, should not offer any crypto-related services in the PRC.²³⁷ However, there is not a clear definition of cryptocurrency or cryptoasset, and NFTs may or may not fall under the definition.²³⁸ Despite this, nothing prohibits PRC nationals from trading or investing in NFTs.²³⁹

Moreover, in April of 2022, National Internet Finance Association of China, Securities Association of China, and China Banking Association jointly issued an initiative focused on the prevention of NFT-related financial risks.²⁴⁰ All three associations are supervised by the central bank, the banking regulatory authority, and the security regulatory authority, so although the initiative is not a regulation under PRC law, the initiative reflects the position of the regulators in China.²⁴¹ Under the initiative, NFTs are not treated as cryptocurrencies or virtual currencies.²⁴² However, the initiative includes a code of conduct to be followed that reflects the negative and strict mentality of regulation over NFTs.²⁴³ For example, the code provides:

1. Not to include securities, insurance, credit, precious metals and other financial assets as underlying items of NFTs, to prevent an issuance or trading of financial products in substance;
2. Not to weaken the non-fungible characteristics of NFTs by dividing ownership or through batch creations etc., to prevent an initial coin offering (ICO) in substance;
3. Not to provide centralized transactions (such as centralised bidding, electronic matching, anonymous transactions, market makers etc.), continuous listing transactions, standardized contract transactions and other similar trading services for NFTs, to prevent setting up trading venues in substance;
4. Not to use virtual currencies such as Bitcoin, Etheruem and Tether as pricing and settlement tools for issuance and trading of NFTs;
5. To conduct real name authentication of the issuing, selling and purchasing parties, and to properly preserve customer identity information and records of issuance and trading of NFTs, and to actively cooperate with anti-money laundering work; and

²³⁴ Clifford Chance, *supra* note 34 at 10.

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ *Id.*

²³⁸ *Id.*

²³⁹ *Id.*

²⁴⁰ Kumar, et. al, *supra* note 158.

²⁴¹ *Id.*

²⁴² *Id.*

²⁴³ *Id.*

6. Not to invest in NFTs directly or indirectly, and not to provide financing support for NFTs investments.²⁴⁴

Because of the PRC's strong stance against NFTs and the initiatives mention of them as seen above, the PRC will likely come out with heavy regulation on NFTs.²⁴⁵

V. United Arab Emirate's Regulatory Framework

The United Arab Emirates is one of the leading countries in regulatory efforts with regard to crypto currencies.²⁴⁶ The ESCA, or Securities and Commodities Authority in the UAE, issued a regulatory decision in 2020 concerning the Crypto Assets Activities Regulation, noting that the Regulation aims "to regulate the offering, issuing, listing, and trading of crypto assets in the state and related financial activities."²⁴⁷ While it was unclear under this decision whether NFTs were included, other regulations in the UAE seem to make clear that NFTs are meant to be included in the definition of cryptocurrency, which the UAE is attempting to regulate.²⁴⁸

For example, on March 9, 2022, Dubai established a new regulator for cryptocurrency called the Virtual Asset Regulatory Authority, or VARA.²⁴⁹ VARA's regulatory authority specifically includes NFTs.²⁵⁰ Additionally, the UAE government issued a cabinet resolution regulating Virtual Assets and Service Providers on December 12, 2022, which went into effect February 14, 2023.²⁵¹ The law requires people or entities engaged in virtual asset-related activities to obtain approval and license from the Financial Regulator.²⁵² Virtual assets include "any crypto token that is digitally traded and transferred and can be used for investment purposes," so NFTs are covered by the law.²⁵³

Moreover, the Abu Dhabi Global Market published "Proposals for enhancements to capital markets and virtual assets in ADGM," a consultation paper, in 2022 to provide guidance on NFT regulations.²⁵⁴ One of its proposals suggests that "companies will need a license from the free zone's financial regulator" to be permitted to facilitate NFT trading.²⁵⁵ The paper further discusses that NFTs may trigger anti-money laundering regulations and sanctions, and depending on the nature of the underlying asset, could be subject to Crypto Asset Regulations.²⁵⁶

VI. Recommendations & Conclusion

The U.S. and other countries should mold NFTs into existing cryptocurrency framework, rather than creating new regulations for NFTs specifically, to create a seamless transition into the latest digital frenzy of NFTs. Regulating nonfungible tokens is a challenge because as mentioned above,

²⁴⁴ *Id.*

²⁴⁵ *Id.*

²⁴⁶ Irina Heaver, *Op-Ed: The Web3 Regulatory Landscape in the UAE*, CRYPTOSLATE, (Jan. 14, 2023), <https://cryptoslate.com/op-ed-the-web3-regulatory-landscape-in-the-uae/>.

²⁴⁷ *Id.*

²⁴⁸ *Id.*

²⁴⁹ *Id.*

²⁵⁰ *Id.*

²⁵¹ *Id.*

²⁵² Heaver, *supra* note 245.

²⁵³ *Id.*

²⁵⁴ Kumar, et. al, *supra* note 158.

²⁵⁵ *Id.*

²⁵⁶ *Id.*

they are unique and thus, different than other types of cryptocurrencies.²⁵⁷ Further, a regulatory body has trouble distinguishing between the different types of cryptocurrencies.²⁵⁸ With a rapidly growing NFT market, it could take years before countries caught up and made specific legislation in regard to NFTs.²⁵⁹ Although not a perfect fit, if regulators clarify the definitions of NFTs and include them in pre-existing regulations, it will make it easier for issuers, advisers, purchasers, and regulators to make sure they are following the law and avoid litigation.

Scholars argue governments could assume a wait-and-see approach to regulation.²⁶⁰ Some argue that NFTs are just a fad that will die down in the next few years and affect less and less investors.²⁶¹ For example, one expert noted:

Governments could just assume a wait-and-see approach to regulation. If NFTs are here in a couple of years and are affecting a significant portion of retail investors, then there could be a draft regulation proposed by the industry participants already. Government bodies should just assess such initiatives and move accordingly.²⁶²

This mindset could be why regulatory bodies across the globe have made no action towards trying to regulate NFTs.²⁶³ However, this approach creates problems in the sense that it will create chaos in the judiciary with lawsuit after lawsuit as no one knows how NFTs will be treated or what their rights are.²⁶⁴ On the other hand, if existing regulations were amended or the application of regulations differentiated between different forms of cryptocurrency and different forms of NFT, it would lead to NFTs being subject to a lengthy and complicated application or approval process.²⁶⁵ This would defeat the easy purpose and stifle creatives and investors from free trade.²⁶⁶

But as it stands now, the current legal framework globally, mostly only considers cryptocurrencies, cryptoassets, and NFTs in the spectors of financial instruments and securities.²⁶⁷ Under this framework, NFTs would be required to be generically standardized to be traded and generate a financial return.²⁶⁸ Thus, trying to fit NFTs, which already have a plethora of types that require different treatment, into a regulatory framework that is, by its nature, standardized, is challenging due to the unique nature of nonfungible tokens. But what is the alternative? For countries to create a new regulatory framework specifically for NFTs could take years, and by then, will anyone be trading NFTs anymore? The only real solution, although far from perfect, is for regulating bodies

²⁵⁷ *The Regulatory Considerations of NFTs in the United States*, COINTELEGRAPH (last visited Feb. 8, 2023) <https://cointelegraph.com/cryptocurrency-regulation-for-beginners/the-regulatory-considerations-of-nfts-in-the-united-states>.

²⁵⁸ *Id.*

²⁵⁹ *Id.*

²⁶⁰ Felipe Erazo, *How to Address the Regulation of NFTs*, FINANCE MAGNATES, (May 31, 2022), <https://www.financemagnates.com/cryptocurrency/how-to-address-the-regulation-of-nfts/>.

²⁶¹ *Id.*

²⁶² *Id.*

²⁶³ *Id.*

²⁶⁴ *Id.*

²⁶⁵ *Id.*

²⁶⁶ Erazo, *supra* note 259.

²⁶⁷ *Id.*

²⁶⁸ *Id.*

to put out statements offering guidance on how NFTs will be construed and fall under existing regulations.