



NFTs: Key Legal Considerations

—
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Presented by:
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Presenters



Michael Sorrell
HOST
Deputy General Counsel, FIA

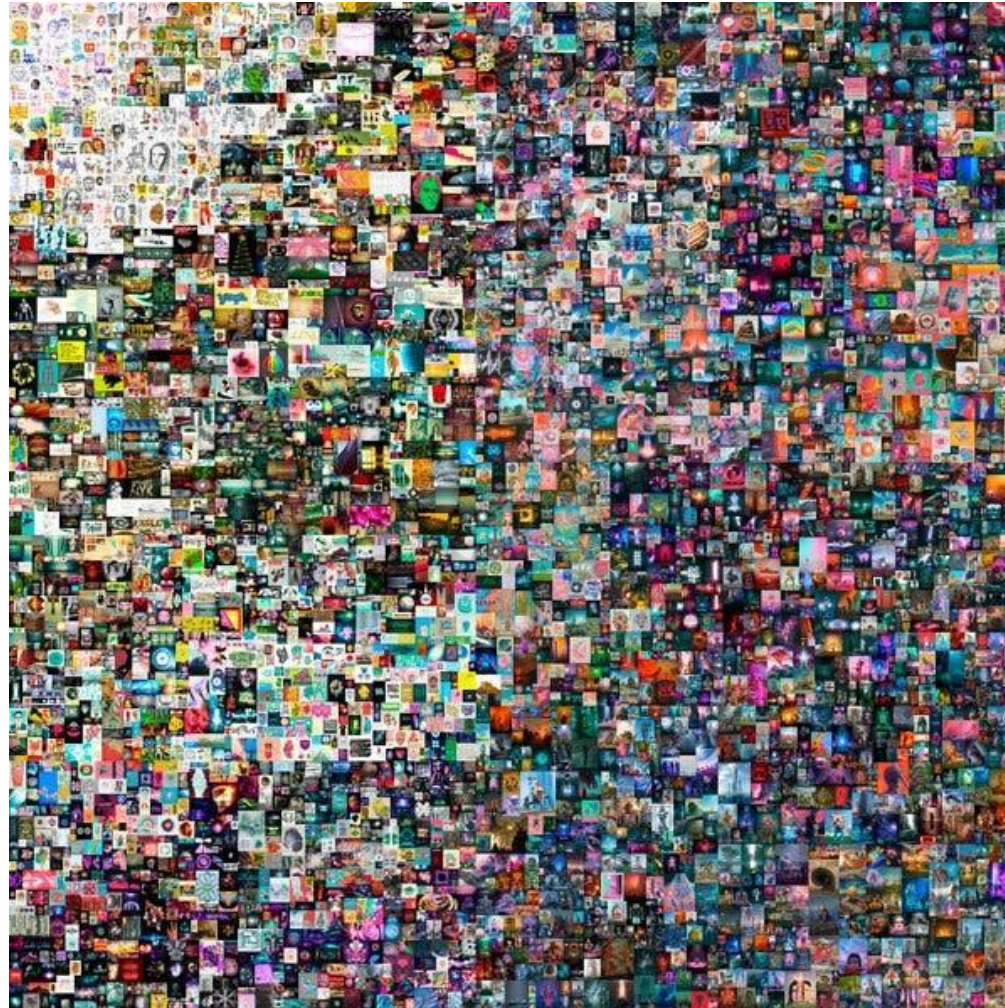


Mark Rasmussen
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Everydays: the First 5000 Days, by the artist known as Beeple, set a record for a digital artwork in a sale at Christie's.





What is an NFT?

- An NFT is a digital asset, based on computer code and recorded on a blockchain ledger to prove ownership and authenticity of a unique asset.
- NFTs are often created on the Ethereum blockchain through the ERC-721 token standard written in the Solidity programming language.
- NFTs are also being created on other blockchains, including EOS, Cardano, Flow, and Tron.
- Almost anything can be represented by an NFT
 - For example real property titles, cars, houses, and other merchandise, as well as digital assets such as images, documents, videos, and tweets.



Jack Dorsey's (CEO of Twitter) first tweet sold as an NFT for \$2,915,835.47

just setting up my twttr

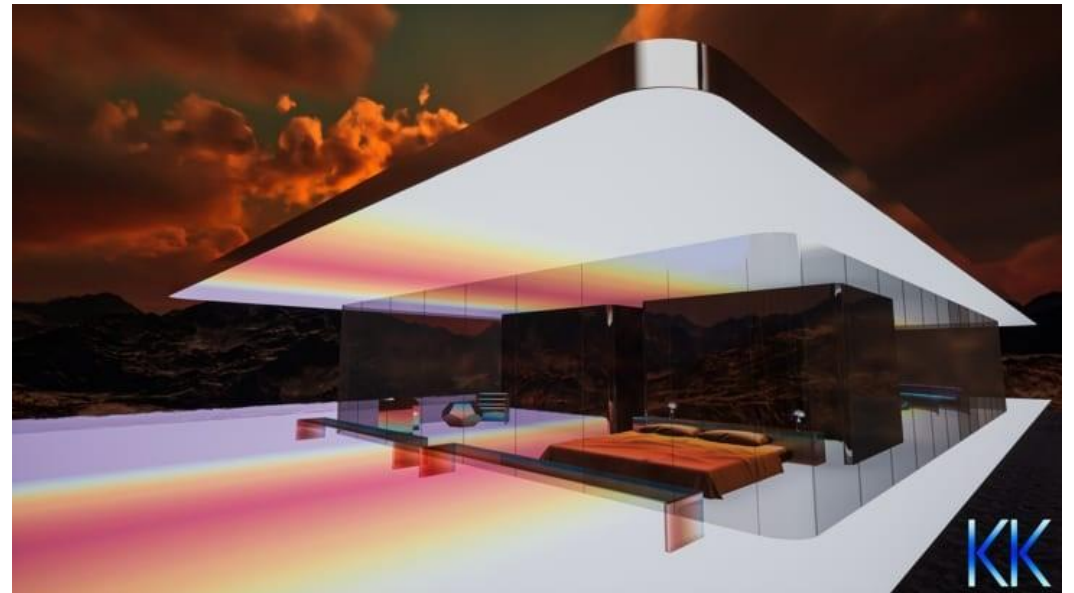
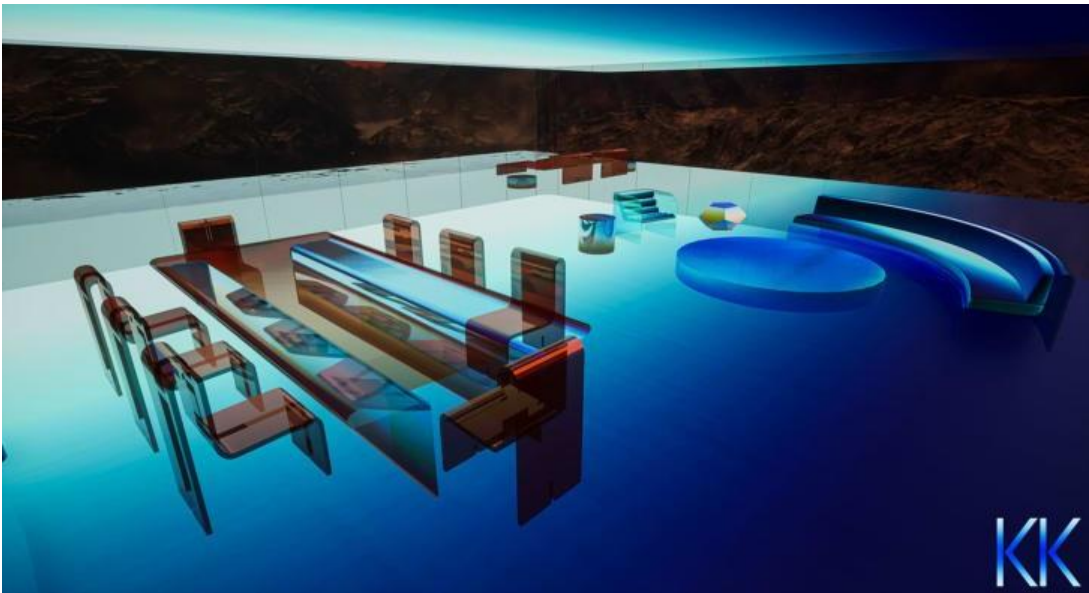
— jack (@jack) March 21, 2006

Why Did Someone Pay \$560,000 for a Picture of My Column?

Bidders say they had many different motivations, including fun, self-promotion and a signal of support for the NFT market.



The world's first digital NFT house sells for \$500,000





Key legal considerations surrounding NFTs

- Commodities law considerations
- Securities law considerations
- Intellectual Property considerations
- AML and sanctions considerations
- State law considerations
- Cybersecurity considerations



Commodities law

- Section 1a(9) of the Commodity Exchange Act (CEA) defines a commodity to include several specific items, such as various grains and oils, plus “all other goods and articles.”
- The CEA does not define “goods” or “articles” separately, but those terms are broad in their plain meaning.
- The CFTC has stated that the “commodity” definition includes cryptoassets.



Commodities law

- If an NFT is considered a commodity, the CEA may apply in the following ways:
 1. The CEA's general prohibitions on deceptive and manipulative trading may apply to NFT transactions effected on a "spot" basis.
 - CEA Section 6(c)(1) makes it unlawful to violate CFTC regulations prohibiting deceptive and manipulative devices in connection with a “contract of sale of any commodity in interstate commerce.”
 - CFTC Regulation 180.1 is the CFTC rulemaking that prohibits fraud, deception, and manipulation in the manner that Section 6(c)(1) contemplates.
 2. If an NFT is offered on a margined or leveraged basis additional, requirements to trade the NFT on a registered exchange may apply.
 - Section 6(c)(1) and Regulation 180.1 still apply.
 - CEA Section 2(c)(2)(D) would require the NFT to be traded on a “designated contract market” unless transaction results in “actual delivery” of the NFT to the purchaser within 28 days.



Securities law

- Section 2(a)(1) of the Securities Act defines a security to include an “investment contract.”
 - Howey Test:
 - Investment of Money
 - Common Enterprise
 - Reasonable Expectation of Profits
 - Derived from Efforts of Others
 - Depends on Facts and Circumstances
 - No guidance from SEC about NFTs



Securities law

- If an NFT is considered a security, then common securities laws issues would be present (15 U.S.C.A. § 78c(a)(10); 15 U.S.C.A. § 77b(a)(1)):
 - registration or exemption of the offering under the Securities Act of 1933;
 - registration of the sellers of those instruments as broker-dealers under the Securities Exchange Act of 1934 ("Exchange Act");
 - registration of the marketplaces on which the instruments are sold as securities exchanges under the Exchange Act;
 - securities law liability for material omissions or misstatements and insider trading.



Intellectual Property considerations

- When a creator creates content it has all rights in the content.
- When a buyer buys the NFT, they typically are purchasing the token itself, not the digital asset that is linked to the token.
- The transfer of any rights or obligations as to the asset is determined by matter of contract between the buyer and seller.
- Often times what is purchased is a limited license to use, copy, and display the images and/or video associated with the NFT for personal, non-commercial use only.



Sanctions law considerations

- OFAC has not issued guidance specific to NFTs.
- There have been enforcement actions involving the use of cryptocurrency, blockchain technology, and exchanges of artwork.
- Advisory and Guidance on Potential Sanctions Risks Arising From Dealing in High-Value Artwork, October 30, 2020.
 - OFAC has identified the purchase and sale of high-value artwork as an area that carries higher risks.



Sanctions law considerations

- Factors contributing to this risk identified by OFAC include:
 - the lack of transparency and high degree of anonymity and confidentiality;
 - the use of shell companies and intermediaries;
 - and the mobility, concealability, and subject value of artwork.
- The combination of these factors with those relating to blockchain technology increase the level of risk.



BSA and FinCEN considerations

- FinCEN has not issued guidance specific to NFTs.
- FinCEN has published guidance about how the Bank Secrecy Act (BSA) and FinCEN regulations relate to virtual currencies.
- Under the BSA and FinCEN regulations, banks and certain nonbank financial institutions such as money services businesses (MSBs) are required to register with FinCEN, establish anti-money laundering programs and policies, issue reports, and retain records.



BSA and FinCEN considerations

- If NFTs are considered substitutes for currency, then FinCEN could consider NFTs to be subject to the BSA and FinCEN regulations.
- FinCEN has issued guidance stating that certain businesses engaged in transactions involving convertible virtual currency (CVC) must be registered as money services businesses (MSBs).
 - Covered models identified in FinCEN’s guidance include custodial wallet services and currency or CVC exchange services, and others. (FIN-2019-G001)
 - “administrators” and “exchangers” of CVC are MSBs. (FIN-2013-G001)



State law considerations

- Some states, New York and Louisiana, have passed laws addressing the operation of companies engaged in virtual currency businesses.
 - Certain requirements can include a license to engage in virtual currency business activities, minimum capital requirements, and surety bond requirements.
 - Virtual currency business activities can include:
 - Receiving virtual currency for transmission or transmitting virtual currency;
 - Holding custody of virtual currency on behalf of others;
 - Buying and selling virtual currency as a customer business;
 - Performing exchange services as a customer business; or
 - Controlling, administering, or issuing a virtual currency.



Cybersecurity considerations

- Centralized NFT marketplaces are especially vulnerable to account takeovers by the unauthorized acquiring of private keys.
- One NFT marketplace recently was compromised.
- Care should be taken to adhere to existing cybersecurity laws and regulations such as Section 5 of the Federal Trade Commission Act.
- Also, NFT platforms should consider administrative, technical, and physical safeguards.



Questions?



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Thank you to our speakers



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Mark Rasmussen is a seasoned litigator and investigator with more than 15 years of experience representing clients in complex litigation and regulatory matters. Since 2016, Mark has advised clients on cryptocurrencies, blockchain technology, and fintech matters, including initial coin offerings (ICOs) and token issuances, money transmitter and virtual currency regulations, and litigation. In 2018, he was appointed by Chief Judge Barbara Lynn, of the Northern District of Texas, to be the first-ever receiver in a Securities and Exchange Commission (SEC) enforcement action involving an ICO promoter. In addition, Mark is coeditor and coauthor of the book *Blockchain for Business Lawyers* and is a frequent speaker on legal issues related to blockchain technology.



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Josh Sterling has 20 years of experience in the derivatives and securities markets, both as lead counsel to major companies and as a senior federal financial regulator. Josh represents clients that are active in the derivatives markets with matters before the U.S. Commodity Futures Trading Commission (CFTC), the U.S. Securities and Exchange Commission (SEC), and various self-regulatory organizations, including the National Futures Association (NFA) and the Chicago Mercantile Exchange (CME). Josh has particular experience assisting clients with the examinations and investigations relating to their trading practices and compliance with related registration, reporting, and other rule requirements. He helps financial services, fintech, energy, and other companies with CFTC registration, regulatory advice, and advocacy in support of their business objectives.

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The logo consists of the letters 'F', 'I', and 'A' in a bold, sans-serif font. The 'F' is dark grey. The 'I' is dark grey. The 'A' is formed by overlapping shapes: a light green triangle on the left, a darker green triangle on the right, and a blue triangle on the right side of the 'A'.