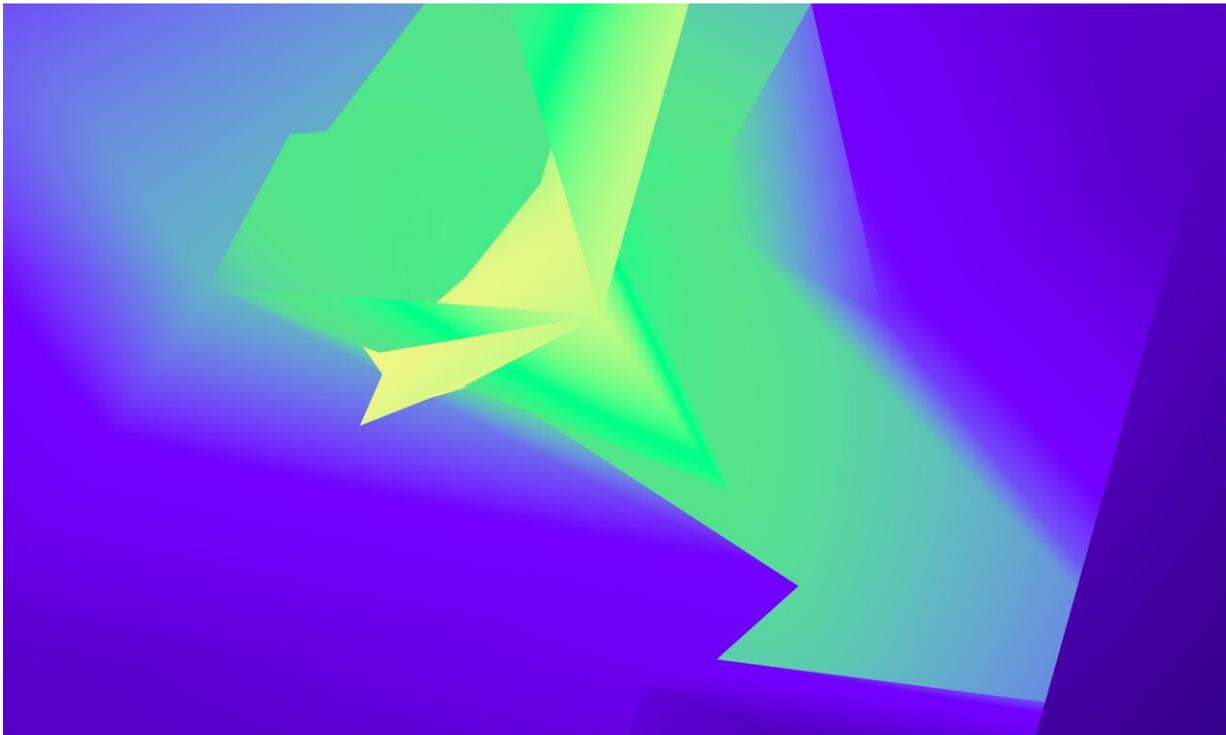


SEC's Peirce says agency guidance on nonfungible tokens is needed

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The growth of so-called nonfungible tokens has at least one Securities and Exchange Commission member thinking the agency needs to release guidance on the digital assets this year.

Commissioner Hester Peirce, a cryptocurrency supporter, said such

guidelines would help the public understand the agency's thinking.

"As a regulator, I mean it's something that I'm watching because the growth has been pretty astounding," Peirce said in an interview with CQ Roll Call. "I'm sure people are thinking about ways that they can use the idea of an NFT in the financial space."

Nonfungible tokens, or NFTs, came to prominence as a new form of ownership: A digital asset attached to a piece of artwork or music. The owner of an NFT, though, often doesn't own the original piece, only the digital marker that points to it. The idea has been touted for its potential to represent shares of a company or act as in-game currency for video games.

NFT trading volume surged in the third quarter of 2021, increasing by 704 percent from the previous quarter and more than 38,000 percent year over year, according to DappRadar, a data and analysis company. The surge came as soaring values gave rise to get-rich-quick thoughts among the public. Political candidates and celebrities alike have since launched NFTs.

Proponents say they hold value because they are nonfungible, meaning each of them is different from all the others, unlike other crypto assets such as Bitcoin. NFTs are also considered a bridge to virtual universes, according to crypto exchange Binance. Facebook, now renamed Meta Platforms Inc., is building a metaverse where people can work, meet and hang out, all virtually.

The assets can also be part of scams known as rug pulls, in which developers abandon a project and run away with investors' funds. For example, an NFT called the Baller Ape Club went live in October and its organizers deleted their websites and Twitter accounts, stealing about \$2 million, according to TRM, a blockchain intelligence company.

"It does make sense, in any of these emerging areas where there's a potential for securities laws to apply, for us to say here are some of the things people ought to be thinking about," said Peirce, who will be the sole Republican SEC commissioner after Elad Roisman leaves at the end of the month. Using them to represent shares in a company would likely touch the SEC's jurisdiction, she added.

Lawmakers and regulators have not spoken extensively about NFTs.

Sen. Cynthia Lummis, R-Wyo., called for more details on how intellectual property laws and taxes apply. Lummis is drafting a digital asset bill but it doesn't include NFTs.

"NFTs are an exciting new way for artists, creators and others to certify authenticity of a unique object," Lummis said in an email. "NFTs are relatively new, and I think we still have a lot to learn about how they are evolving."

The SEC declined to comment.

Security or not?

Virginia resident Jeeun Friel in May sued NFT company Dapper Labs Inc., the developer of NBA Top Shot, claiming the company was selling unregistered securities, according to CoinDesk. NBA Top Shot is a blockchain-based platform that allows fans to buy, sell and trade licensed video highlights. Dapper Labs places each highlight into digital packs, similar to packaging for trading cards, and sells them for \$9 to \$230, the NBA said in a post on its site.

Friel's suit argues the NFTs are securities and weren't registered as such before being sold, Mark Rasmussen, a partner at law firm Jones Day, said in an interview. He said the argument doesn't hold weight.

The SEC defines an investment contract as money put into a common enterprise with a reasonable expectation of profits to be derived from the efforts of others.

"It's easy to conflate [digital assets](#) and say one is a security because all these others are securities, but that's not the way the SEC looks at it," Rasmussen said. "They really bore into the details and really scrutinize how it's being offered, what the rights are that are attached to it, what the expectation is that the consumer is buying in, to make their determination as to whether something is a security."

SEC Chair Gary Gensler said in an interview with CNBC this month that if the investor anticipates a profit based upon a promoter's efforts, that falls within the securities laws.

Daniel McAvoy, an attorney at law firm Polsinelli in New York, raised another issue: That the SEC could have oversight over fractionalized NFTs if people split them.

"From the SEC's perspective, once you're selling off the pieces, you're owning something and managing it on behalf of other people, so that way they get the economic benefit, it starts looking more and more like a [security](#)," McAvoy said.

The SEC's Peirce also warned in March at a Security Token Summit that the agency may consider fractional NFTs to be securities.

NFTs that have the ability to convert into other tokens could also be viewed as securities, McAvoy said.

Jones Day's Rasmussen said there's a chance another regulator, the Commodity Futures Trading Commission, may decide NFTs are subject to its oversight to the extent they're being traded in deceptive or

manipulative ways.

Oversight also could come under the National Defense Authorization Act enacted in January 2021. It directed the Treasury and Justice departments to assess whether the Bank Secrecy Act ought to be extended to art dealers, Rasmussen noted. The issue is whether art deals facilitate money laundering or terrorism financing.

That could sweep up NFT art dealers or sellers, Rasmussen said.

The SEC has not publicly filed any enforcement cases against NFTs, said Andrew Lee, of counsel for Foley & Lardner LLP. Lee, a member of the firm's NFT Task Force, hopes guidance comes out to clarify some of the uncertainty over the assets.

"I think that is something that would be helpful for the SEC to try to do," Lee said.

Cleve Mesidor, public policy adviser at the Blockchain Association, said NFT creators are exploring the technology as a way to protect intellectual property, monetize their work and build their own marketplace. Creators are fueling this market, not [crypto](#), she said.

"So the notion that this should be further regulated is crazy," she said. "There are tons of intellectual property laws already in place that can deal with the issues that come about in terms of protections around this space."

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