EUCI - Final comments on potential NFT inclusion in MiCA

NFTs are not identical to other fungible tokens and should be regulated with a dedicated regime. We consider it inefficient to regulate NFT platforms like OpenSea, and others as crypto-assets service providers (CASPs) because, 1) the CASP regime does not provide sufficiently significant protection for NFT buyers/sellers and 2) OpenSea and similar platforms are not operating similarly as other CASPs and MiCA postulates that all the platform it regulates are purely centralized operators. Some of the obligations it sets forth are therefore not compatible with the platform's model (e.g. asset due diligence, whitepaper, own fund requirements…). Furthermore there will be a severe limitation in interoperability between existing platforms that will significantly limit the use cases for NFTs. 3) Copying the CASP regime (inspired by the financial regulation) ment for fungible tokens to regulate non-fungible tokens does not follow the logic of the financial regulations strictly focusing on fungible assets.

We conclude that extending the scope of the CASP regime of MiCA to NFT platforms would be highly detrimental to the EU market without providing any significant protection for the consumers.

Providing for a threshold for application of the CASP regime to the platforms is not the best compromise solution as it does not solve the inefficiency and inadaptability of MiCA to a platform like OpenSea and smaller platforms can operate maliciously.

However, we believe that including all the NFT platforms, without a minimum threshold, in the scope of Title VI (prohibition of insider dealings) would be a meaningful amendment to the text. 1) The inclusion means that it would, nevertheless, need significant adjustment to the specific provisions drafted in MICA, which are drafted with fungible assets in mind. 2) Or alternatively, our suggestion is to apply it to NFTs that have the characteristics of financial instruments and can be used as means of payment or exchange.

Please find below the details of our reasoning.

1. **NFTs are not identical to fungible tokens and should be regulated with a dedicated regime.**

"NFT" is a technical definition that covers a very wide range of applications. This covers all the unique representations registered on a blockchain. NFTs are widely used today to represent digital art or collectibles, but this is in no means representative of the wide range of potential applications of the concept. There already exist NFTs that represent domain names (e.g. Ethereum Name Service), entrance tickets (e.g. Unlock), and personal identifiers. The only common denominator of all those NFTs is that they are not fungible with each other. For this reason, NFTs should be regulated with a dedicated regime, and not covered by a regime, tailored around fungible tokens and the CASPs that operate with them. Likewise, NFT exchange platforms are operating very differently from other crypto trading venues and should be regulated with a dedicated regime. The MiCA regulation is not adapted to handling such specific use cases and its application to NFTs will be detrimental to both the industry and future legal enforcement.

2. **CASPs definition should not be extended to include NFT trading platforms**

We consider it unproductive to regulate NFT platforms like OpenSea, as CASPs because, 1) the CASP regime does not provide sufficiently significant protection for NFT buyers/sellers and 2) OpenSea and similar platforms are not operating the same way as other CASPs, as MiCA postulates that the platform it regulates is a purely centralized operator. 3) Copying the CASP regime (inspired by the financial regulation) ment for fungible tokens to regulate non-fungible tokens does not follow the logic of the financial regulations strictly focusing on fungible assets. Therefore, the obligations MiCA put in place are not suitable due to the following:

- First, the CASP regime does not provide for obligations that would help prevent the most significant abuses in the NFT market such as insider dealings and wash trades. In fact, the only meaningful protection that MiCA provides for NFT sellers/buyers is related to insider dealings (Title VI), which scope can be completely dissociated from the CASP regime itself.

- Second, a platform like OpenSea is not operating similarly to other CASPs. All the trades are registered on-chain directly by the users, the platform takes a cut on-chain on each transaction, and because of the public nature of blockchain the level of transparency and accountability is very high compared to centralized platforms. Conversely, it operates without client accounts; anyone can plug its wallet to such platforms and bid / sell an NFT without any delay. This is one of the main reasons for the platform's success - facilitating onboarding and usage.

  MiCA is designed for centralized entities that onboard all their clients and all the assets listed on the platform. If this approach is applied to the NFT platforms without adjustments, it would make their operation cumbersome and force re-centralization of all the operations. Examples include:

  - Obligation to examine and control each asset listed, provide for a white paper, and provide some form of guarantees for them is unsuitable for NFTs, as each new NFT is a new asset. Mandating a pre-examination of all the NFTs would not be feasible and would not provide additional protection for the consumers.
  - Own fund requirements are not suitable for a platform that does not have the custody of any clients' funds (OpenSea and the likes are operated from so-called « unhosted » wallets and the platforms never touch clients' funds, but the smart-contracts automatically distributes the platform's margin to their account).
  - KYC/AML checks that the CASPs need to do with the revision of AMLD (as it is very likely that both texts will have the same scope) are not suitable for a platform that is operated from an « unhosted » wallet. This would force re-centralization of the whole processes and will make the platform opaque, negating all the advantages of registering the exchanges on-chain.

3. A short term way forward with NFTs

We conclude that extending the scope of MiCA's CASP regime to NFT platforms would be highly detrimental to the EU market without providing any significant protection for the consumers.

Providing for a threshold for application of the CASP regime to the platforms is not a good solution, as:

- it does not solve the inefficiency and inadaptability of MiCA to a platform like OpenSea, and
- smaller platforms can still operate maliciously.

However, including all the NFT platforms in the scope of Title VI (prohibition of insider dealings) would be a meaningful addition to MiCA. In our opinion there are two possible options: 1) The inclusion means that it would, nevertheless, need significant adjustment to the specific provisions drafted in MICA, which are drafted with fungible assets in mind. 2) Or alternatively, our suggestion is to apply it to NFTs that have the characteristics of financial instruments and can be used as means of payment or exchange.

In the long run, there's an additional risk for platforms that would allow NFT sales in a purely centralized form. We have seen a few projects announced that would not be operated in the same way as OpenSea and similar platforms, but rather as purely centralized entities. In this case, subjecting those actors to MiCA requirements could make more sense (provided that e.g. listing obligations are amended). **However, in any case, such inclusion with a short notice in the final version of MiCA without allowing for further technical discussions seems premature.**