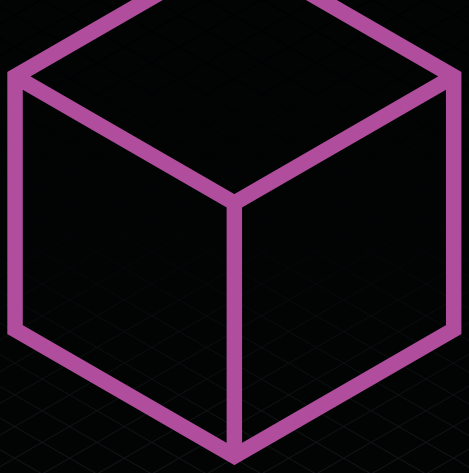
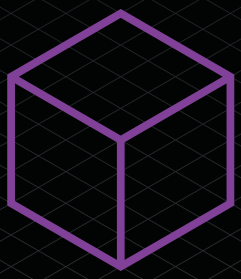
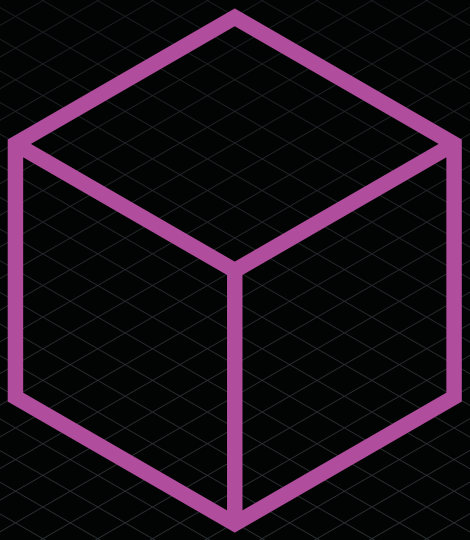


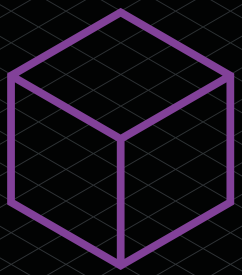
Part 1: Developing Technologies

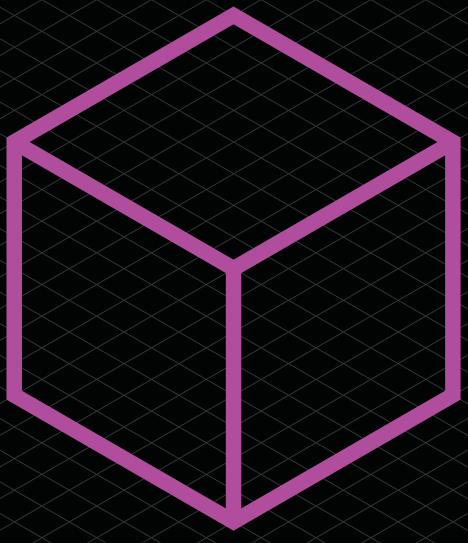
Section 5

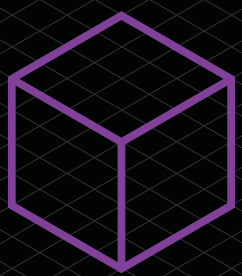
Non-fungible tokens











Section 5: Non-fungible tokens

Anne Rose (Mishcon de Reya LLP), Will Foulkes and Gareth Malna (Gunner Cooke), and Omri Bouton (Sheridans)

Introduction

A non-fungible token **(NFT)** is a unique, non-divisible token, often linked to an object (e.g. a collectable, digital art or in-game asset) which uses blockchain technology to record ownership and validate authenticity. Fungible tokens, such as Bitcoin, are not unique and therefore do not qualify as an NFT. NFTs utilise token standards supported by blockchains such as Ethereum, Algorand and Solana.

Currently used predominantly for digital collectables, digital art and, more recently, interactive entertainment, NFTs leverage the inherent characteristics of DLT to introduce scarcity and enable demonstrable exclusive ownership to digital information assets. Thereby, NFTs address one of the challenges posed by digital assets: replicability.

In Part A we look at some practical and legal issues with regards ownership rights and intellectual property issues related to NFTS. In Part B we do a deep dive to look at whether an NFT could ever be fall within the remit of a financial regulatory asset or within the United Kingdom Gambling Act 2005.

Non-Fungibility

To understand NFTs it is important first to understand the difference between fungible and non-fungible items.

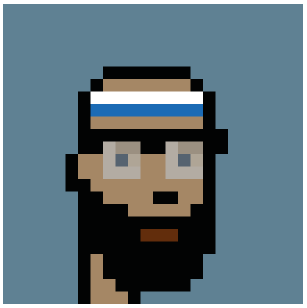
According to the Cambridge Dictionary (https://dictionary.cambridge.org/dictionary/english/fungible), a fungible item can be defined as "something such as a currency, share, or goods, that can easily be exchanged for others of the same value and type". Fiat money, and cryptoassets used similarly to or in lieu of fiat money (for example Bitcoin, Ethereum etc) fall under this category.

Conversely, non-fungible items are not easily exchangeable for other items of the same value and type. Non-fungible items, as well as the value associated with it, are unique. A painting or sculpture is an example of a non-fungible item.

NFTs versus associated assets

It is important at the outset to properly conceptualise an NFT. NFTs are cryptoassets, which in turn are merely database entries on a distributed ledger, created and recorded according to the properties of the underlying rules (token standard). They contain metadata that defines their object by providing details regarding them. This typically includes, amongst other things: the name of the NFT; the smart contract address which manages the ownership and transferability of the NFT; and an associated asset **(an Associated Asset)**.

The Associated Asset contained in the NFT metadata is typically a url which points to the asset that is associated with the NFT, e.g. the artwork, digital collectible, music or video asset. The metadata itself does not usually contain this asset, for reasons explored below.



Part A:
Legal and regulatory areas of focus for NFTs Ownership

It is often unclear what rights the purchase of an NFT gives to the purchaser. NFT holders do not generally enjoy full rights over the particular assets (such as digital images) that are associated with their NFTs.

By way of example, the image to the left represents one of ten thousand LarvaLabs' CryptoPunks - specifically CryptoPunk #6013. Each of the ten thousand tokens forming part of the CryptoPunks collection is represented by a distinct CryptoPunk having different attributes (from the particular species, such as apes, aliens and humans, to hairstyle and accessories).

However, the holder of this particular CryptoPunk is not entitled to the intellectual property rights **(IPR)** in the image that it is associated with and used for the purposes of representing and identifying the relevant NFT; what the holder has a claim to is the NFT itself: the token. (For more on IPR see Section 11.)

Anybody can download a copy of the file or link relating to whatever asset the NFT is tokenising, but only the NFT owner holds the contract stating their ownership rights. The NFT declares you as the official owner.

Transferring the IPR in the Associated Asset to the NFT holder is possible but requires formal assignment (i.e. it must be in writing and signed by the assignor). With regards to the IPR in the NFT itself, as an NFT is purely metadata it is not protected as the NFT is neither the actual original work nor a copy of the work, but only a tokenised version of it, which does not incorporate the full work into the blockchain, but contains only a URL linked to it. The idea that an NFT holder is the de facto "owner" of the Associated Asset, absent an explicit contractual matrix assigning the relevant IPR, is a common current misconception around NFTs,

As best practice, we recommend defining the rights vesting on the holders of their NFTs (and incorporating them in dedicated public-facing terms) so as to avoid market confusion and reputational harm to any project.

Management of rights in distributed (and semi-immutable) file storage systems

As mentioned above, NFT metadata usually incorporates a url pointing towards an Associated Asset. To facilitate prompt identification, the Associated Asset is normally accessed and displayed as a representation of the NFT associated with it, through the platform used to access the NFT (for example, one of the dedicated marketplaces through which NFTs are exchanged).

While the Associated Asset is not normally stored on-chain, due to data storage limitations and other impractical aspects, it is common practice for the creators/issuers of the NFTs **(Issuers)** to store it on other forms of decentralised and distributed file storage systems **(DFSS)** – for example, the InterPlanetary File System better known as IPFS.

While storing Associated Assets on DFSS is attractive to the holders, as it provides trustless access to any such Associated Assets, it does represent a risk on the part of the Issuer, particularly where the Associated Asset does not belong to the Issuer. Because of the semi-immutable character of distributed and decentralised solutions, it can be very difficult, if not virtually impossible, to take down Associated Assets once uploaded onto a DFSS. Therefore, it is important for legal advisors to ensure that the scope of the legal authority by which the Issuer uploads the Associated Assets onto DFSS is explicit, which mitigates this particular risk in light of the specific characteristics of each type of DFSS.

Interaction of NFTs with the financial services regulatory landscape in the UK

NFTs and FATF

The regulatory treatment of NFTs is potentially relatively broad.
As discussed previously, FATF publishes standards for regulation and supervision of financial intermediaries. With regard to NFTs, in its 'Updated Guidance for a Risk Based Approach: Virtual Assets and Virtual Asset Service Providers'[162] published on 21 October 2021, FATF states at paragraph 53:

"[NFTs], depending on their characteristics, are generally not considered to be VAs under the FATF definition. However, it is important to consider the nature of the NFT and its function in practice and not what terminology or marketing terms are used. This is because the FATF Standards may cover them, regardless of the terminology. Some NFTs that on their face do not appear to constitute VAs may fall under the VA definition if they are to be used for payment or investment purposes in practice. Other NFTs are digital representations of other financial assets already covered by the FATF Standards. Such assets are therefore excluded from the FATF definition of VA, but would be covered by the FATF Standards as that type of financial asset. Given that the VA space is rapidly evolving, the functional approach is particularly relevant in the context of NFTs and other similar digital assets. Countries should therefore consider the application of the FATF Standards to NFTs on a case-by-case basis."

In October 2018, FATF required that VASPs be regulated for anti-money laundering and countering the financing of terrorism purposes, that they be licensed or registered, and subject to effective systems for monitoring or supervision. There is a risk, therefore, that in future NFT platforms may be subject to regulation as VASPs under relevant local laws implementing the FATF standards as they apply to VASPs. This analysis will be fact-specific and involves consideration of the types of NFTs the platform deals in and whether they are offered or intended to be investments (as opposed to, say, collectibles which appeal to fans or collectors) Legal practitioners should consider local regulatory requirements as they may apply to NFT ecosystem participants (such as those operating an NFT drop or exchange platform, Issuers or other activities involving promotion of NFTs in a jurisdiction).

UK-specific regulation

There are also situations in which the rights attributable to an NFT will cause that NFT to become regulated under the UK regulatory regime

At present there are no NFT- or crypto-specific regulations in the UK. Under existing rules, NFTs have, broadly, four main touch points with the UK regulatory regime as implemented by the FCA and PRA. They are:

under the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 **(RAO)** if tokens amount to "specified investments";

under the Markets in Financial Instruments Directive **(MiFID)** if the tokens amount to 'financial instruments';

under the Electronic Money Regulations 2011 **(EMRs)** if the tokens amount to e-money; and

within the scope of the Payment Services Regulations 2017 **(PSRs)**.

Activities carried out by persons involved in cryptoasset activity, including where such activities involve NFTs, are also captured by the UK's money laundering regime, regulated by the FCA. We consider that regime in more detail below.

162 https://www.fatf-gafi.org/media/fatf/documents/recommendations/Updated-Guidance-VA-VASP.pdf

In lieu of NFT- or crypto-specific legislation and regulations, participants in the NFT arena are required to assess their project against the above regimes utilising guidance provided by the FCA in its policy statement 'Guidance on Cryptoassets: Feedback and Final Guidance to CP 19/3', PS19/22.

In PS19/22 the FCA sets out an overlapping framework under which the various types of crypto-product in the market are to be categorised as either "regulated tokens" or "unregulated tokens". In this context, regulated tokens include:
security tokens, which are tokens that amount to specified investments (except e-money) under the RAO. This includes those tokens that amount to "financial instruments under MiFID"; and

— e-money tokens, which meet the definition of e-money under the EMRs.

As the name and description implies, regulated tokens fall within the regulatory perimeter and firms carrying on regulated activities in relation to those tokens will need to comply with the relevant regulatory regime, including seeking authorisation to carry on those regulated activities.

All tokens that do not fit into the two types of regulated token are considered to be unregulated tokens for which there is no interaction with the UK regulatory regime. This category includes 'utility tokens', cryptocurrencies and other types of payment tokens which can be used primarily as a means of exchange.

In that way, NFTs are governed in the same way as their token forebearers such as bitcoin, ETH and other altcoins.

The key exercise, therefore, is to consider whether each token is one of the types of regulated token by reason of it falling within the RAO, MiFID, or the EMRs. It will be a separate exercise to consider whether activities involving tokens could also amount to the provision of payment services under the PSRs.

1. Specified investments under the RAO

For a token to amount to a specified investment, it must meet the definition of any of the 25 (at the time of writing) defined investment types specified in the RAO. Many of these, including regulated mortgage contracts, funeral plan contracts, consumer hire agreements and the like can be dismissed out of hand. But there is some analysis to be done against other specified investments such as shares, options, futures, contracts for difference, units in a collective investment scheme, etc., on a case by case basis.

Where, for instance, an NFT represents a fractionalised ownership of assets, it is possible that the NFT could, as a matter of fact, amount to the representation of *"shares or stocks in the share capital of any body corporate (wherever incorporated) and any unincorporated body constituted under the law of a country or territory outside the United Kingdom"*, thereby satisfying the definition of "shares" under article 76 RAO. Similarly, an NFT representing fractionalised ownership of an underlying asset could amount to a kind of derivative in the event that it is either an option, future or contract for difference as defined under the RAO. That is, the NFT either:

a. grants the holder a right to acquire or dispose of
   i. a security or contractually based investment
   ii. currency of the United Kingdom or any other country or territory
   iii. palladium, platinum, gold or silver
   iv. an option to acquire or dispose of an investment of the kind specified in (a), (b) or (c)
   v. subject to certain stipulation sin reg 83(4), an option to acquire or dispose of an option to which paragraphs 5, 6,7 or 10 of Section C of Annex I to the MiFID read with Articles 5, 6, 7 and 8 of the Commission Regulation applies, (thereby making it an option under Art 83 RAO);

b. is a right under a contract for the sale of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed on when the contract is made (thereby making it a future under Art 84 RAO); or

c. subject to certain exclusions, rights under
   i. a contract for differences, or
   ii. any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in
      — the value or price of property of any description; or
      — an index or other factor designed for that purpose in the contract

   (thereby making it a contract for differences under Art 85 RAO).

The FCA has also been keen in recent times to apply a rigorous analysis as to whether a cryptoasset,(including NFTs) might amount to a unit in a collective investment scheme rendering the issuer of that token a firm that would be managing a collective investment scheme, which is an activity that would also require FCA authorisation under Part 4A Financial Services and Markets Act 2000 ("FSMA").

In the event that the rights underlying the NFT cause that NFT to meet the definition of a specified investment, then it will also be necessary to consider whether the issuer or holder (or any other party involved in the NFT project) is carrying on a regulated activity under the RAO.

Regulated Activities Under the RAO

Under s19 of the Financial Services and Markets Act 2000 **(FSMA)**, "no person may carry on a regulated activity in the United Kingdom, or purport to do so unless he is (a) an authorised person, or (b) an exempt person". This is known as the **general prohibition**.

Per s22 FSMA: *"An activity is a regulated activity for the purposes of this Act if it is an activity of a specified kind which is carried on by way of business and (a) relates to an investment of a specified kind, or (b) in the case of an activity of a kind which is also specified for the purposes of this paragraph, is carried on in relation to property of any kind."*

On that basis, if the rights attaching to an NFT cause it to be identifiable as a specified investment (pursuant to s22(a) FSMA), then it is important to understand whether the activity being performed in relation to that NFT is itself one of the types specific in the RAO.

The most relevant specified activities include, but are not necessarily limited to, "dealing in investments as principal" (art 14 RAO), *"dealing in investments as agent"* (art 21), *"arranging (bringing about) deals in investments"* and *"making arrangements with a view to a person who participates in the arrangements buying, selling, subscribing for or underwriting investments"* (art 25), *"safeguarding and administering investments" (art 40), and "establishing a collective investment scheme"* (art 51).

The article 25 activities are particularly broad, and it is necessary to work through them and the relevant exclusions carefully in order to reach the correct conclusion in each case. Failing to properly carry out this analysis could cause the persons engaging in the activities to be in breach of the general prohibition, which carries both civil and criminal penalties. Specifically, under s23 FSMA: *"A person who contravenes the general prohibition is guilty of an offence and liable – (a) on summary conviction, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both; (b) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine, or both."*

2. MiFID activities

MiFID activities are broadly aligned with FSMA and the RAO in the UK and, therefore, if an NFT meets the definition of a financial instrument under MiFID then it will also fall within the UK's regulatory regime, and the General Prohibition, described above.
Under MiFID, financial instruments include those things set out in Section C, nnex I of Directive 2014/65/EU, including transferable securities, money-market instruments, units in collective investment undertakings and any of the seven specific definitions of derivative contracts, which are:

(i) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash;

(ii) Options, futures, swaps, forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event;

(iii) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled;

(iv) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in point 6 of this Section and not being for commercial purposes, which have the characteristics of other derivative financial instruments;

(v) Derivative instruments for the transfer of credit risk;

(vi) Financial contracts for differences;

(vii) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event, as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market, OTF, or an MTF.

If an NFT has rights in an underlying asset which looks and feels like any of these definitions then a full analysis should be undertaken to see whether any of the following MiFID activities (set out in Section A, Annex I of Directive 2014/65/EU) are being carried on in relation to that NF

i. Reception and transmission of orders in relation to one or more financial instruments;
ii. Execution of orders on behalf of clients;
iii. Dealing on own account;
iv. Portfolio management;
v. Investment advice;
vi. Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis
vii. Placing of financial instruments without a firm commitment basis;

viii. Operation of an MTF;
ix. Operation of an OTF.

If a MiFID activity is being carried on in relation to a financial instrument then it will be necessary to obtain authorisation in the relevant jurisdictions to carry on that activity. In the UK that will also mean obtaining authorisation for the relevant FSMA activity.

3. Electronic Money Regulations (EMRs)

Where a token meets the definition of electronic money in the EMRs then the FCA will consider that token to be an e-money token and, therefore, a regulated token. The definition of electronic money is:

— electronically stored monetary value that represents a claim on the issuer

— issued on receipt of funds for the purpose of making payment transactions

— accepted by a person other than the issuer

— not excluded by regulation 3 of the EMRs

Regulation 3 excludes
monetary value stored on instruments that can be used to acquire goods or services only—

i. in or on the electronic money issuer's premises; or

ii. under a commercial agreement with the electronic money issuer, either within a limited network of service providers or for a limited range of goods or services;

iii. monetary value that is used to make payment transactions executed by means of any telecommunication, digital or IT device, where the goods or services purchased are delivered to and are to be used through a telecommunication, digital or IT device, provided that the telecommunication, digital or IT operator does not act only as an intermediary between the payment service user and the supplier of the goods and services.

As with the activities under FSMA and MiFID, it is an offence to issue electronic money in the UK without being appropriately authorised.

Unlike under FSMA or MiFID, if the amount of e-money issued per month will on average amount to less than €5m then it will be possible to apply to become a Small Electronic Money Institution with the FCA, which means a lighter touch regulatory regime is imposed on the firm than on a firm subject to full authorisation as an Electronic Money Institution (EMI).

4. Payment Service Regulations

The final category of regulated activity potentially engaged by NFTs is payment services as regulated by the PSRs. A payment service is any of the following when carried out as a regular occupation or business activity:

services enabling cash to be placed on a payment account and all of the operations required for operating a payment account;

a. services enabling cash withdrawals from a payment account and all of the operations required for operating a payment account;

b. the execution of payment transactions, including transfers of funds on a payment account with the user's payment service provider or with another payment service provider—

i. execution of direct debits, including one-off direct debits;
ii. execution of payment transactions through a payment card or a similar device;
iii. execution of credit transfers, including standing orders;

c. the execution of payment transactions where the funds are covered by a credit line for a payment service user—

i. execution of direct debits, including one-off direct debits;
ii. execution of payment transactions through a payment card or a similar device;
iii. execution of credit transfers, including standing orders;

d. issuing payment instruments or acquiring payment transactions;

e. money remittance;

f. payment initiation services;

g. account information services.

The provision of payment services in the UK will also require the business to obtain authorisation from the FCA. As with the EMRs, businesses with an average payment transactions turnover that does not exceed €3 million per month and which do not provide account information services **(AIS)** or payment initiation services **(PIS)** can register with the FCA as small Payment Institutions **(small PIs)** rather than seek full authorisation.

The analysis to be carried on then is to assess whether the issuance or holding of the NFT amounts to the provision of one of the payment services, the most likely of which would be as a money remittance tool depending on the underlying utility of the token in question.

NFTs and anti-money laundering legislation

For any business engaging in activities with NFTs it is also important to note that the existing anti-money laundering requirements may apply to their activities, separate to the recently published FATF guidance considered above, which may affect interpretation or application of existing anti-money laundering requirements in future.

Businesses who carry on cryptoasset activity in the UK need to register with the FCA before conducting that business. They must also be compliant with the Money Laundering, Terrorist Financing and Transfer of Funds (Information of the Payer) Regulations 2017 (**MLRs**). For the purposes of the MLRs, cryptoasset activities means, per regulation 14A MLRs:

"(1) a firm or sole practitioner who by way of business provides one or more of the following services, including where the firm or sole practitioner does so as creator or issuer of any of the cryptoassets involved, when providing such services.

1. *exchanging, or arranging or making arrangements with a view to the exchange of, cryptoassets for money or money for cryptoassets,*

2. *exchanging, or arranging or making arrangements with a view to the exchange of, one cryptoasset for another, or*

3. *operating a machine which utilises automated processes to exchange cryptoassets for money or money for cryptoassets.*

"(2) a firm or sole practitioner who by way of business provides services to safeguard, or to safeguard and administer

1. *cryptoassets on behalf of its customers, or*

2. *private cryptographic keys on behalf of its customers in order to hold, store and transfer cryptoassets, when providing such services."*

In this context, a cryptoasset means *"a cryptographically secured digital representation of value or contractual rights that uses a form of distributed ledger technology and can be transferred, stored or traded electronically"*.

As drafted, it is unlikely that the MLRs would capture an NFT artist or project utilising a centralised NFT exchange such as OpenSea but would instead capture the exchange or wallet providers themselves. However, legal practitioners should monitor and apply the interpretation and application of the FATF guidance referred to above which may change the position in future.

Future Developments
At the time of writing, HM Treasury is consulting on a "Future financial services regulatory regime for cryptoassets". Under the new regime, financial services activities will be regulated, not the assets themselves and so any activity involving NFTs that would otherwise amount to one of the types of activity brought under the regime will be regulated in the same way. It is anticipated that this new regime will be effected through amendments to FSMA.

The FCA and HM Treasury are also working on putting before Parliament secondary legislation relating to the promotion of cryptoassets in the UK. Under the proposed regime, only authorised persons or those registered with the FCA under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 will be permitted to issue promotions for cryptoassets in the UK. Importantly, however, NFTs will be excluded from the definition of cryptoassets for these purposes.

Part B:
NFTs and the regulation of gambling in Great Britain

Niki Stephens and Sian Harding (Mishcon de Reya LLP)

Introduction

The definition of "gambling" in the Gambling Act 2005[163] (the primary piece of legislation governing gambling in Great Britain[164]) **(the Act)** is relatively broad and the provision of facilities for gambling to persons in Great Britain without a licence, or an applicable exemption, is a criminal offence.

As such, whilst the creation, issue and sale of NFTs would not typically amount to the provision of facilities for gambling, it is important for issuers of NFTs to consider if the mechanics by which the NFTs are issued, awarded or sold, and/or any aspect of the ecosystem in which the NFTs may be utilised (for example, if the NFTs may be used to participate in tournaments, contests or other games), might constitute "gambling", and therefore require the provider of such facilities to hold a gambling licence issued by the Gambling Commission of Great Britain (the **Commission**).

"Facilities for gambling" – an overview

The pivotal concept in the Act is that of providing facilities for gambling, which is broadly defined in section 5 of the Act. The provision of facilities for gambling otherwise than in accordance with the terms of a licence (or an applicable exemption) is a criminal offence under section 33 of the Act. Importantly, this applies to anyone who provides facilities for gambling which are used by persons in Great Britain, irrespective of whether the provider of the facilities is based in Great Britain or elsewhere. It also applies to the provider of the facilities if they use relevant equipment that is located in Great Britain, even if the facilities are not used by persons in Great Britain.

163 As amended by the Gambling (Licensing and Advertising) Act 2014.
164 For the purposes of this section, Great Britain means England, Scotland and Wales and excludes Northern Ireland.

"Gambling", as defined in section 3 of the Act, means:
a. gaming (within the meaning of section 6 of the Act);

b. betting (within the meaning of section 9 of the Act); and

c. participating in a lottery (within the meaning of section 14 and subject to section 15 of the Act).

Meanwhile, section 339 of the Act provides that participating in a competition or other arrangement under which a person may win a prize is not gambling for the purposes of the Act (and therefore not regulated or licensable) unless it falls within the definitions of gaming, betting, or participating in a lottery under the Act.

Any analysis of a business that issues NFTs and/or that proposes to encourage consumer engagement by 'gamifying' the use of NFTs to ascertain whether it falls within the scope of the Act (and therefore may require a licence or adaption to seek to avoid the need for a licence) must therefore consider whether the activity falls within the definitions of gaming, betting and participating in a lottery.

1. Gaming

"Gaming" is defined in section 6 of the Act as follows:
"6 Gaming & game of chance
1. In this Act "gaming" means playing a game of chance for a prize.

2. In this Act "game of chance"—
a. includes—
i. a game that involves both an element of chance and an element of skill,
ii. a game that involves an element of chance that can be eliminated by superlative skill, and
iii. a game that is presented as involving an element of chance, but
b. does not include a sport.

3. For the purposes of this Act a person plays a game of chance if he participates in a game of chance—
a. whether or not there are other participants in the game, and
b. whether or not a computer generates images or data taken to represent the actions of other participants in the game.

4. For the purposes of this Act a person plays a game of chance for a prize—
a. if he plays a game of chance and thereby acquires a chance of winning a prize, and
b. whether or not he risks losing anything at the game.

5. In this Act "prize" in relation to gaming (except in the context of a gaming machine)—
a. means money or money's worth, and
b. includes both a prize provided by a person organising gaming and winnings of money staked.

[…] "

The Act does not define a "game". However, it is clear from the wording of section 6 of the Act that a game may be multi- or single-player, that there is no requirement for participants to pay to play and that a prize of money or money's worth is a necessary element. The relevant leading cases[165] also indicate that the participant must do some act, or exercise some decision-making process; a player cannot be passive.

Whether a game is a "game of chance" will be a question of fact in each case. The

165 DPP v Regional Pool Promotions Ltd [1964] 2 Q.B. 244 and Adcock v Wilson [1969] 2 A.C. 326 (both of which in fact relate to the definition of "game" contained under the Betting and Gaming Act 1960) and IFX Investment Co. and others v HMRC [2016] EWCA Civ 436 (which relates to the Gaming Act 1968).

definition in the Act is broad and, on the face of it, any game involving an element of chance, including one in which the chance may be eliminated by superlative skill, and even games that do not involve chance but are presented as involving an element of chance, may constitute a game of chance. The leading case[166] in this area established that *"the only circumstance where chance should not be taken to make a game of skill and chance a game of chance is where the element of chance is such that it should on ordinary principles be ignored – that is to say where it is so insignificant as not to matter"*. The example given by the Court of Appeal in the relevant case was a game in which chance is used only to determine who starts the game (for example, chess).

It is noteworthy that the Commission has since suggested[167] that random or chance elements can exist within a game to test the skill of the player without necessarily meaning that the game is a game of chance (which we suggest is a (marginally) more generous analysis than that adopted by the Court of Appeal in R v Kelly). However, limited reliance should be placed on this because, ultimately, it is for the courts to determine the meaning of the statutory provisions and, for the time being, Kelly provides the leading authority.

In relation to the meaning of a "prize" it is worth noting that the Commission has indicated[168] that, where in-game items or currencies can be converted into cash or exchanged for items of value, they will be considered money or money's worth for the purposes of the Act. As such, it is likely that the award of an NFT would constitute a prize for the purposes of section 6 of the Act.

2. Betting

"Betting" is defined in section 9 and section 11 of the Act as follows:

"9 Betting: general

1. *In this Act "betting" means making or accepting a bet on—*
   a. *the outcome of a race, competition or other event or process,*
   b. *the likelihood of anything occurring or not occurring, or*
   c. *whether anything is or is not true.*

2. *A transaction that relates to the outcome of a race, competition or other event or process may be a bet within the meaning of subsection (1) despite the facts that—*
   a. *the race, competition, event or process has already occurred or been completed, and*
   b. *one party to the transaction knows the outcome.*

3. *A transaction that relates to the likelihood of anything occurring or not occurring may be a bet within the meaning of subsection (1) despite the facts that—*
   a. *the thing has already occurred or failed to occur, and*
   b. *one party to the transaction knows that the thing has already occurred or failed to occur."*

The word "bet" is not itself defined in the Act, but is generally understood to involve an arrangement between two or more people who hazard something of value (money or money's worth) on the outcome of an uncertain matter. As such, if an arrangement involves participants risking/hazarding one or more NFTs on the outcome of an uncertain event, the arrangement may constitute betting.

166 R v Kelly [2008] EWCA Crim 137 (NB. Kelly concerned the provisions of the Gaming Act 1968, but the relevant provisions are considered sufficiently similar to those in the Act that it remains a key authority).
167 In its advice note on "skill with prizes" machines, published in July 2010. This advice note seems to accept that, where a random element is present for the purpose of testing the skill or knowledge of a player, that element may not cause a game to be a "game of chance" for the purposes of the Act, provided that the random element does not prevent a suitably skilful player from being able to win.
168 In its 'Virtual currencies, esports and social casino gaming - position paper', published in March 2017, available at <https://assets.ctfassets.net/j16ev64qyf6l/4A644HIpG1g2ymq11HdPOT/ca6272c45f1b2874d09eabe39515a527/Virtual-currencies-eSports-and-social-casino-gaming.pdf>

Section 11 of the Act extends the definition of "betting" for the purposes of section 9 to cover certain types of prize competition:

"11 Betting: prize competitions

1. *For the purposes of section 9(1) a person makes a bet (despite the fact that he does not deposit a stake in the normal way of betting) if—*
   a. *he participates in an arrangement in the course of which participants are required to guess any of the matters specified in section 9(1)(a) to (c),*
   b. *he is required to pay to participate, and*
   c. *if his guess is accurate, or more accurate than other guesses, he is to—*
      i. *win a prize, or*
      ii. *enter a class among whom one or more prizes are to be allocated (whether or not wholly by chance).*

2. *In subsection (1) a reference to guessing includes a reference to predicting using skill or judgment…."*

This section of the Act was included to cover certain types of prize competitions including fantasy leagues. Note that to be caught, players must be required to guess or predict (using skill or judgement) the outcome of a race, competition, or other event or process (or the likelihood of something occurring, or whether or not something is true). The following (non-binding, but persuasive) narrative was also included in the explanatory notes to the Act:

"The definition [in Section 11 of the Act] is intended to exclude prize competitions (such as prize crosswords) where the elements of prediction and wagering are not both present".

If the product in question appears to fall within the definition of betting in section 9 of the Act, it will then also be necessary to consider whether it falls within the definition of pool betting, which is defined as follows:

"12 Pool betting

1. *For the purposes of this Act betting is pool betting if made on terms that all or part of winnings—*
   a. *shall be determined by reference to the aggregate of stakes paid or agreed to be paid by the persons betting,*
   b. *shall be divided among the winners, or*
   c. *shall or may be something other than money.*

If the product meets the definition in section 12 of the Act, it will be treated as pool betting rather than general betting under section 9. Of particular interest in the fact that betting will be pool betting if all or part of the winnings shall or may be something other than money. This is likely therefore to include the award of NFTs as winnings in relation to arrangements that also meets the definition of betting under section 9 or 11 of the Act.

For completeness, it is also necessary to consider whether the provider of the facilities in question could be said to be a betting intermediary, in which case they will be providing facilities for betting. A betting intermediary is defined in section 13 of the Act as "a person who provides a service designed to facilitate the making or acceptance of bets between others". The definition is primarily intended to apply to betting exchanges, where the intermediary facilitates the making of bets between two people, where one wishes to lay odds and the other wishes to back them. In such circumstances, the intermediary usually takes no risk; instead making its profit from commission (usually charged to the person who wins the bet).

Participating in a lottery

Under section 14 of the Act, an arrangement is a simple lottery if:

— persons are required to pay in order to participate in the arrangement;

— in the course of the arrangement one or more prizes are allocated to one or more members of a class; and

— the prizes are allocated by a process which relies wholly on chance.

A complex lottery is defined similarly, save that the prizes are allocated by a series of processes and the first of those processes relies wholly on chance.

If there is no requirement for participants to pay to enter then the arrangements will not constitute a lottery. Schedule 2 of the Act makes provision about the circumstances in which an arrangement is or is not to be treated for the purposes of section 14 as requiring payment to participate and, for example, provides that paying includes paying money, transferring money's worth and paying for goods or services at a price or rate which reflects the opportunity to participate in the arrangement. As such, if a person is required to transfer an NFT in order to participate in an arrangement where a prize is allocated to a winner by a process which relies wholly on chance, then that arrangement is likely to constitute a lottery.

Note that a process which requires persons to exercise skill or judgment or to display knowledge will be treated as relying wholly on chance if (i) the requirement cannot reasonably be expected to prevent a significant proportion of persons who wish to participate in the arrangement from doing so; and (ii) the requirement cannot reasonably be expected to prevent a significant proportion of persons who participate in the arrangement of which the process forms part from receiving a prize[169].

It is also worth noting that a "prize" in relation to lotteries includes any money, articles or services whether or not described as a prize and whether or not consisting wholly or partly of money paid, or articles or services provided, by the members of the class among whom the prize is allocated. As such, it is likely, for example, that the award of an NFT would constitute a prize for the purposes of section 14.

Finally, it is important to note that the operation of lotteries is generally limited to raising funds for charitable causes and there are relatively limited exemptions that apply to lotteries run by private clubs, resident lotteries and workplace lotteries or for fundraising at commercial or charity events (and in each case, the lottery will be subject to specific regulations that restrict the terms on which such lotteries may be operated).

"Blurred lines" and financial products

Following a call for evidence and public consultation, on 27 April 2023 the Department for Digital, Culture, Media and Sport (the **DCMS**) (the Government department with responsibility for regulation of gambling) published a long-awaited white paper setting out the government's policy proposals for changes to gambling regulation in Great Britain (the **White Paper**)[170]. The White Paper repeats concerns previously raised by the Commission that there has been an increase in novel products that are *"blurring the lines between gambling and other markets such as financial investments and video games", including those that "use emerging technologies, such as non-fungible tokens"*.

The Commission's view is that products that push the boundaries with financial products pose a risk to consumers. Following the collapse of Football Index in 2021[171] (and the subsequent independent inquiry by the government), the

169 Section 14(5) of the Act.
170 High stakes: gambling reform for the digital age - UK Government
171 Football Index was a gambling platform operated by BetIndex Limited pursuant to a licence issued by the Commission, which enabled users to buy and sell "shares" in footballers. In March 2021, BetIndex entered administration and its licence was suspended, causing significant losses to consumers. Government subsequently commissioned an independent report into the regulation of BetIndex. The report was critical of both the Commission and the Financial Conduct Authority and made a series of recommendations for improvements to ensure better, more effective, regulation of novel products.

Commission is particularly sensitive to product 'novelty' in this regard (as well as generally with respect to products that involve the use of new technology, such as NFTs). In June 2022, the Commission changed its licensing policy to make explicit that it will not generally grant a licence to products whose name, branding, marketing or game rules contain language associated with financial products (such as 'stock'), or which may give the impression that they are an investment or financial product rather than a gambling product.

Therefore, in addition to considering whether a product might fall into the remit of gambling regulation, it is also important to be mindful of the Commission's sensitivity to 'novel' products generally, and in particular where a product might resemble a financial product or have elements of 'investment' in its design.

DCMS Committee Inquiry

Gambling regulation in the UK is currently the subject of a great deal of scrutiny and potential change. Separately to the publication of the White Paper by the DCMS, the DCMS Select Committee, a cross-party committee responsible for scrutinising the work of the DCMS, is conducting its own examination of the government's approach to the regulation of gambling.

The inquiry invited written evidence on: the scale of gambling-related harm in the UK; what the key priorities should be in the government's review of the Gambling Act (which, as above, has since been published); how broadly the term 'gambling' should be drawn; the possibility of a regulator staying abreast of innovation in the online sphere; and what additional problems arise when online gambling companies are based outside the UK jurisdiction. The DCMS Select Committee will receive written and oral evidence on these topics.

Although the findings of the DCMS Select Committee's inquiry are unlikely to result in any immediate changes to the Act, they may well influence the government and Commission's approach to gambling regulation, including as the policies set out in the White Paper are developed and implemented. It is therefore noteworthy that the terms of reference of the inquiry include an examination of the definition of 'gambling', and into the ways the Commission regulates innovative products.

Conclusion

As set out above, the *"provision of facilities for gambling"* under the Act is broadly defined, and sometimes the smallest of changes to a business model or product can bring it within, or take it out of, the scope of the Act. As described above, regulators, including the Commission, are increasingly sensitive to novel business models and products, especially where those involve digital assets. Gambling regulation is also the subject of heightened political interest in the UK, and significant changes are likely to now be made following the publication of the White Paper, although the extent to which the Commission's approach to NFTs and other 'Web3' products may change in the future remains to be seen.

It is therefore critical that any business that issues NFTs and/or that proposes to encourage consumer engagement by 'gamifying' the use of NFTs should seek specialist advice in order to understand the potential impact of gambling regulation. Seeking specialist advice at an early stage can help in identifying potentially problematic elements and provide an opportunity for adjustments to be made, particularly if the intention is for the business to remain outside the scope of the Act. It also has the benefit of readying the business for any potential interest and enquiries by the Commission.