



Electronic Money Association
Surbiton
Surrey
KT6 4BN
United Kingdom
Telephone: +44 (0) 20 8399 2066
Facsimile: +44 (0) 870 762 5063
www.e-ma.org

Digital, Culture, Media, and Sport Committee

By online submission

06 January 2023

Dear Sir/Madam

Re: DCMS Committee inquiry into NFTs and the blockchain.

We welcome the opportunity to provide input on the MFSA's consultation on NFTs in the context of the VFA Framework. The EMA represents payments, crypto asset and FinTech firms, engaging in the provision of innovative payment services, including the issuance of e-money, e-money tokens, open banking payment services, and cryptoasset related services including stable coins. A full list of our members is provided in the appendix to this document.

The EMA was established some 20 years ago and has a wealth of experience in regulatory policy relating to payments, electronic money, and more recently crypto assets.

We would be grateful for your consideration of our comments, which are set out below.

Yours faithfully,

A handwritten signature in black ink, reading 'Thaer Sabri'. The signature is written in a cursive style with a long, sweeping underline that extends to the right.

Dr Thaer Sabri
Chief Executive Officer
Electronic Money Association

1 Is the UK's light-touch NFT regulation sufficient?

- 1.1 The NFT sector is a rapidly evolving and highly dynamic business, which at this stage is not sufficiently established or mature enough for full regulation.
- 1.2 A particular challenge is that NFTs comprise a broad variety of products. NFTs are not a homogeneous product category with clearly defined (or definable) features capable of informing a coherent regulatory approach. As with crypto-assets more generally, the underlying blockchain technology allows for a “digital packaging” of many assets ranging from the physical to the digital, having different purposes, and a spectrum of values. Accordingly, some refer to digital files generated as an integral part of an artistic or some other creative activity (e.g., photos, videos, musical recordings, etc.) while others represent rights to participate in events or enter venues, and some capture rights to and records of interest in real estate. Any regulatory approach would have to consider how it would respond to the specific features of the underlying asset or value and the related professional occupation. These considerations should inform whether a regulatory approach drawing on financial sector regulation is warranted.
- 1.3 For instance, Bandcamp and Soundcloud are well established digital platforms for the streaming, acquisition and downloading of digital audio files. These platforms have become a key distribution channel securing a revenue stream for a large number of musicians who have no or limited access to distribution by commercial music publishing companies. We cannot see a reason for (additional) regulation of these artistic activities and their output (beyond what is being applied at present) if the only change is that of audio files being issued as NFTs. It would most obviously go against the principle of technology-neutrality if audio files as traded for about a decade on the existing online platforms would now become regulated only because these same audio files are being packaged in NFTs. It could put the vibrant UK musical production at a major competitive disadvantage compared to their peers elsewhere and may negatively impact many musicians working and living under precarious circumstances. Much of the same applies to a range of other creative professions increasingly using NFTs as an additional distribution channel for their creative work.
- 1.4 That said, we fully acknowledge that the packaging of interests in digital audio, image, and video files as NFTs can facilitate large-scale trading including in some instances speculation, on digital trading platforms similar to the trading platforms for financial instruments. Where a significant risk of market manipulation does exist, this may warrant regulation similar to the regulation of markets for financial instruments. However, in most cases it does not.

- 1.5 Accordingly, the term NFT does not provide the requisite granularity for a focus of regulatory action. This is analogous to focusing regulation on blockchain, a technology that can be used to solve diverse problems, most of which do not warrant regulation. There is reason to consider regulatory action only if there is, or if the use of blockchain technology is aimed at giving rise to, trading on a digital trading platform exposed to and giving rise to risks associated with trading of, and with the operation of trading platforms for financial instruments. We, therefore, strongly believe that a debate on the regulation of NFTs is cast too widely. Regulation targeting NFTs would almost inevitably hamper innovation, adversely affect market development, and place the UK at a competitive disadvantage in particular regarding a range of creative professions and a cultural workforce that merits promotion and protection rather than stringent regulation aimed at containing risks that mostly does not arise.

2 What are the potential harms to vulnerable people of NFT speculation?

- 2.1 We reiterate that it is not a necessary and inherent feature of NFTs (and a range of similar possibly fungible and non-unique crypto-assets) to be used for speculative investment purposes. Where they are, the speculative activities can potentially inflate value, and vulnerable people could suffer losses. Accordingly, not the underlying NFTs but the speculative activities may warrant regulation to protect vulnerable people. However, any related regulatory response must target that speculative activity whether or not related to an NFT or some other asset or value. It must be emphasised again that for many NFTs the creation, distribution and transfer does not pose any of the risks associated with financial instruments, their trading on platforms exposed to market integrity risks, and their use for speculative investment purposes. Similarly, commodities are subject to financial sector regulation only as products traded on markets similar to markets with financial instruments with potentially speculative activities on these markets. That regulation does not apply to the production, and initial distribution and sale/purchase outside of these markets.
- 2.2 In addition, we note that the forthcoming financial promotion rules, which partly focus on how digital assets can be marketed to consumers and introduce safeguards, will help reduce the potential harm for vulnerable people in case of a potential speculative use related to the trading of crypto-assets including NFTs.

3 Do blockchains offer security to British investors?

3.1 By design, the blockchain architecture behind cryptoassets and NFTs has significant built-in security features and designs.

3.2 Some of these features include:

- Blockchain databases are immutable; they have safeguards to prevent them from being altered, damaged, or deleted.
- Transactions are verified according to consensus mechanisms that are intended to prevent fraudulent transactions and protect against attacks.
- Access to the blockchain database is protected by financial-grade public key encryption.

3.3 These features mean blockchain technology facilitates some of the most secure databases that are available. Thus, where investors use or rely on investment products which utilise blockchain architecture, there are discernible benefits from a security perspective.

4 What are the potential benefits to individuals and society of NFT speculation?

4.1 As in our response to question 2 we do not regard NFTs (and a range of similar possibly fungible and non-unique crypto-assets) as having inherent features or primary uses that are speculative in nature. NFTs can be subject to speculation in some circumstances, this could be indicative of maturing NFT markets where such markets emerge.

4.2 Notwithstanding the harm that speculation can cause, it has to be acknowledged that speculation is a part of well-functioning markets. It can provide increased liquidity and trading volume, thus contributing to the broadening and further growth of markets and to the reliability of the price determining mechanisms on these markets.

4.3 Accordingly, the benefit of such speculation is related to the benefits of maturing markets, which could facilitate growth and development of related business activities and spur product and market innovation.



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