

NFTs as Security: Cristiano Ronaldo sued for \$1 billion over NFT promotion in class action lawsuit

Insights - 07/05/2024

The question of whether non-fungible tokens constitute securities has once again been brought into sharp focus with the recent commencement of a class action lawsuit against global football icon Cristiano Ronaldo, who partnered with Binance Holdings Limited, a global cryptocurrency exchange for the release of a collection of NFTs associated with the footballer.

At the end of 2023, disgruntled holders of the Ronaldo-endorsed non-fungible tokens (NFTs) issued a class-action lawsuit in the United States of America seeking at least US\$1 billion in damages, alleging among other things that Ronaldo should have disclosed the terms of his compensation for promoting the NFT collection as required by the US Securities and Exchange Commission (SEC) for any celebrity endorsement regarding securities.

Having previously considered the legislative framework applicable to virtual assets in the context of Taylor Swift's refusal to accept a sponsorship deal from now-defunct crypto exchange FTX, this article considers the regulatory framework applicable to NFTs, in particular whether NFTs represent securities, and whether there are any additional regulatory requirements which apply to them as a matter of Cayman Islands law.

What is an NFT?

As Ogier's global Technology and Web3 team explains in our article, Revolutionising the "creator" economy: are non-fungible tokens "virtual assets" in Cayman?, NFTs (otherwise known as "niftys" and "crypto-collectibles") are virtual assets which can be considered as tokenised proof of title to a unique digital version of an underlying digital asset (such as images, videos or other digital content) or physical assets (increasingly tickets and art). Depending on their terms, NFTs can be freely tradeable on cryptocurrency exchanges and their value is based on market appetite.

The Cayman Islands established a legislative framework for virtual asset service providers pursuant to the Virtual Asset (Service Providers) Act (the **VASP Act**) which also addresses ancillary issues relating to virtual assets. The VASP Act represents the implementation of recommendations made regarding regulation of virtual assets by the Financial Action Task Force (**FATF**). In addition to the FATF recommendations, Cayman has also regulated the issuance of virtual assets.

| Defining a virtual asset

Under the VASP Act, a virtual asset is broadly defined to mean "a digital representation of value that can be digitally traded or transferred and can be used for payment or investment purposes but does not include a digital representation of fiat currencies".

In order to consider whether NFTs are virtual assets under the VASP Act they must be capable of being used for payment or investment purposes, requiring an analysis of the purpose of each NFT. FATF guidance published in 2023 further confirmed the need for such an analysis on a case-by-case basis.

In the absence of a standard approach to the treatment of virtual assets, stakeholders are able to seek assistance from the Cayman Islands Monetary Authority (**CIMA**) for determination of whether virtual assets which they anticipate issuing, or in respect of which they anticipate providing virtual asset services, are likely to be classified as or virtual assets. Our article on the Taylor Swift FTX case provides an oversight of the assistance process.

| When can a virtual asset also be a security?

The Security Investment Business Act (Revised) (**SIBA**) defines securities as:

"Security means assets, rights or interests contained in Schedule 1 to SIBA, including the following broad asset classes (with further guidance provided in the schedule to SIBA): shares, instruments creating or acknowledging indebtedness, instruments giving entitlements to securities, certificates representing certain securities, options, futures and contracts for differences."

SIBA specifically states that a "security" includes virtual assets which can be sold, traded or exchanged immediately or at any time in the future that (a) represent or can be converted into any of the securities listed in paragraphs one to 13 of Schedule 1 to SIBA; or (b) represent a derivative of any of the securities listed in paragraphs one to 13 of Schedule 1 to SIBA.

Further guidance as to the judicial treatment of the statutory definition of securities can be found in case law from the Grand Court of the Cayman Islands; see for example Paradigm Holdings Limited [2004-05 CILR 542] where the Court held that a wine forwarding contract was

classified as a security under SIBA.

Accordingly, to understand whether a virtual asset or NFT could be classified as a security, regard must be had to the nature of the asset and whether it represents or can be converted into, or is a derivative of, among others, shares in a company, interests in an exempted limited partnership or limited partnership or units of participation in unit trusts.

If the virtual asset represents an interest in an investment vehicle, advisors would need to consider the application of the Mutual Funds Act which places additional regulatory requirements on in-scope funds.

Is an NFT a security as a matter of Cayman Islands law?

In order to determine the appropriate treatment of an NFT, a key question highlighted in the [FATF Guidance](#) (which the Cayman Islands endeavours to follow) is whether the purpose of the NFT is to be digitally traded, or simply a means of recording or representing ownership of an asset:

"Digital assets that are unique, rather than interchangeable, and that are in practice used as collectibles rather than as payment or investment instruments, can be referred to as [an NFT] or crypto-collectibles. Such assets, depending on their characteristics, are generally not considered to be virtual assets 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 virtual assets may fall under that definition if they are to be used for payment or investment purposes in practice."

These types of classifications would be dealt with at the outset of registration under the VASP Act with CIMA. As part of the registration and consultation process, CIMA will review underlying contractual documents and the proposed business model to assess the individual circumstances of each application.

Based on the approach adopted in the latest FATF report, the approach of regulators is likely to be to "adopt a functional approach and look beyond the marketing associated with NFTs to determine if the product or service in question qualifies as a virtual asset, VASP, a financial institution, or a designated non-financial business or profession".

In circumstances where NFTs are marketed or traded in other jurisdictions, including the United States of America, significant care should be taken to ensure that applicable foreign regulatory obligations are satisfied. For instance, the SEC has classified NFTs as investment contracts (see articles: [SEC issues first NFT-related enforcement action](#), [SEC finds NFT to be a security in](#)

landmark action), a subset of securities, requiring issuers and exchanges offering NFTs to meet certain regulatory requirements.

Conclusion

The global regulatory landscape for NFTs, and virtual assets more broadly, is constantly evolving. While the VASP Act provides welcome certainty to those operating in the virtual asset space in the Cayman Islands, significant care should be taken in the classification of virtual assets given the potential regulatory penalties and exposure to liability for getting the classification wrong.

It should be noted that while Cayman Islands legislation defines securities to include certain virtual assets, activities relating to the offering, sale, issuance, dealing, brokerage, custody, exchange and trading of virtual assets may result in a different determination in different jurisdictions.

Ogier's global Technology and Web3 team is regularly instructed to provide structuring or regulatory assistance to stakeholders in the virtual asset industry, as well as advising on disputes arising from virtual assets. Please get in touch with your usual Ogier contact, or those listed below, should you have any further questions.

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