

The Bank of the Future – NFTs as Financial Investments?

The trend is growing,
but it's still a niche sector

Roger Furrer

Director, ERI Bancaire Zürich



Two years ago, only a few crypto enthusiasts had heard of NFTs. By the end of 2021, the market was already worth around \$41 billion, according to data from Chainalysis. Despite this meteoric growth, market volume remains insignificant when compared to the cryptocurrency market – which has a total capitalisation of almost \$2 trillion – and even more so compared to the gold market, worth around \$12 trillion.

Despite the flurry of hype surrounding NFTs the past few years, as with cryptocurrencies, that excitement has been curtailed by rising inflation, interest rate hikes, tightening of monetary policy, and demands to repay COVID loans.

In addition, there are a number of risks that cannot be ignored: cyber attacks, copyright theft, the duplication of popular NFTs, and infrastructure or its providers disappearing or becoming obsolete.

Nevertheless, many experts predict they will breakthrough to the general public in the near future. What is still uncharted territory for most has already been used for years by others as a financial investment.

The financially secure Generation Y (Millennials), digital natives familiar with new technologies such as blockchain, NFTs and metaverse, are some of the primary investors. This will continue in the future with Generation Z, as a result of wealth inherited from the baby boomer generation.

NFTs are widely used in the art market, as they solve some of the specific problems of the sector. For example, they serve as a certificate of authenticity and prevent counterfeiting,

can include resale royalties programmed into smart contracts, and offer a greater market openness with the potential of reaching extraordinary prices.

Some of the world's most famous and expensive NFTs currently include artist Mike Winkelmann's (aka Beeple's) "Everydays: The first 5000 days", which fetched nearly \$70 million. His BAYC (Bored Ape Yacht Club) collection includes 10,000 unique ape NFTs, the most expensive of which sold for over \$3 million. Other players have also discovered the market for themselves, including FinTech investors like Deutsche Börse and Commerzbank, sporting good manufacturers such as Adidas and Nike, the automotive industry with Mercedes-Benz and Lamborghini, in addition to many other domains englobing music, videos, memes, certificates, gadgets in games and digital worlds.

NFTs as asset tokens?

For banks and asset managers, it is important to know how NFTs are classified by FINMA. FINMA currently categorises them into payment tokens, utility tokens and asset tokens, with mixed forms also possible. As NFTs are not issued for payment purposes and cannot be subdivided, they are not payment tokens. Nor are they intended for digital use or a service. Nor are they utility tokens. That still leaves the asset tokens.

The requirements for asset tokens are:

- they make physical valuables tradable on the blockchain or represent an asset, specifically a debt claim against the issuer (e.g. shares in future earnings or future cash flows) or a membership right

- they are standardised and suitable for mass trading (= publicly offered in the same structure and denomination or placed with more than 20 clients, provided they are not created specifically for individual counterparties (Art. 2 para.1, FinfraV)).

An NFT is a unique token that cannot be divided, unified or adapted to mass trading. Therefore, NFTs cannot be qualified as asset tokens either. This means that currently, NFTs must be considered individually, depending on the design of the smart contract.

Conclusion

It remains to be seen how quickly and to what extent the NFT market will develop, whether it's just a short-term fad or whether it will last, and to what extent NFTs will be suitable for widespread asset investment.

In any case, FINMA and the authorities will have to establish clear guidelines in this area, especially in terms of taxation.

Whatever the possibilities offered by the metaverse, it is essential for us as a banking solution provider to keep abreast of new developments.

We continue to be proactive in ensuring that our state-of-the-art OLYMPIC Banking System solution responds quickly and nimbly to any new market developments that may arise.