

Non-Fungible Tokens in Malaysia – Are they legal?

What is an NFT?

In 2021, Twitter founder Jack Dorsey's first ever tweet "just setting up my twttr," was sold as a non-fungible token ("**NFT**") to Sina Estavi, the chief executive of technology firm Bridge Oracle for US\$2.9m (RM11.9m).

The "Nyan Cat" GIF was sold as an NFT earlier this year for about US\$590,000 (RM2.5m).

The above examples invite curiosity as to "what is an NFT?" and "how does an NFT function?". A key aspect of an NFT, is that it is 'non-fungible', which essentially means 'unique'. Tokens, in the context of an NFT, are cryptographic assets on a digital ledger called blockchain with unique identification codes and metadata that distinguish them from each other, such as the tweet and GIF mentioned above. This can be compared to Bitcoin which is fungible. This means that one can trade a bitcoin for another, whereas NFTs can be traded for something completely different because each unit has unique qualities.

An NFT property could be found online in the form of a virtual real estate or it could also be something real like an actual real estate property or concert seats for example. An NFT could also be a hybrid of those two things – an example of this is something a San Francisco entrepreneur did where he tried to sell the rights to decide who can lease a room in a cooperative living space, though he did this with little success.

How does an NFT function and what makes it so special?

When you pay for an NFT, you obtain the right to transfer the token to your digital wallet. This serves as a form of proof that a digital file is original and can be viewed as a digital 'certificate of authenticity'. This is because NFTs typically include an automated and self-enforcing set of rules (in the form of software code elements) which cannot be denied or ignored. These are known as smart contracts which are able to automatically perform and take actions under certain conditions and allow ownership of the NFT to be verified and facilitates the management of NFT transfers.

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Practical Aspects of NFT usage

NFTs can be seen as a technology that may promote business efficiency. Transactions are said to be done quicker and easier through its adoption, and as a result, NFTs could have numerous practical aspects which may be beneficial for businesses.

Documentation: Personal identity management via the use of NFTs is a developing area. It is thought that NFTs can be used to tokenize documentation such as licenses, degrees or other qualifications, as well as medical records and birth or death certificates. The unique features of an NFT would allow it to identify or certify a document which can be traced to the original owner. This in turn prevents identity theft and can potentially be used digitally to protect the authenticity of medical history, personal profiles, and facilitate a more efficient control of data. It could also be used for passports if countries decide to adopt them and would eliminate issues such as visa frauds.

NFTs can be used to help authenticate certificates and prevent fraud and usage of counterfeit certificates. They can also similarly be used for vaccine passports. A real-world example of this is the Republic of San Marino which announced its adoption of NFT-based COVID-19 vaccination passports to reduce counterfeits.

Real Estate Properties: There are a myriad of digital applications which are being developed to sell real estate both in the real world and virtually. Virtually, digital real estate applications centre around games, and buyers can purchase as well as create virtual world properties. The original in-game creators can be traced back through NFT technology. An example of virtual real estate is the digital "Mars House", which is a framed glass home. It was sold for USD\$500,000, but the owner is not able to live in it physically as it is virtual. Rather than using a traditional deed or title, virtual real estate ownership is recorded via an NFT and is more transparent.

It is thought that NFTs can introduce a more efficient way to verify property titles and ownership in the real world when it comes to actual/physical real estate – though applications such as these are still in nascent development stages. It also remains to be seen whether the traditional pen and paper-based approach to title documentation encapsulated in the current legal frameworks will evolve and adopt the use of such novel digital verification methods.

Ownership of Domain Name: Blockchain domain names are kept permanently in a public registry and cannot be deleted or changed by a third party. This helps to eliminate concerns such as censorship and security. Blockchain domain NFTs allows for easier trading and personalised domain names. The Ethereum Name Service (ENS) and Unstoppable Domains (which are decentralized alternatives to the standard DNS framework) provide crypto-addresses that are similar

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to an Instagram or Twitter handle, with a condition that each name has to be unique. ENS and Unstoppable Domains allow users to buy and sell crypto-addresses.

Art, Sports and Other Memorabilia: NFTs are used primarily in the art and virtual spaces. Sports tickets and other collectibles are also being tokenized. Examples include the legendary footballer Lionel Messi launching his own exclusive NFT collection after his recent exit from Barcelona FC. The NFT range, titled "The Messiverse x Bosslogic" saw the footballer teaming up with Ethernity Chain to create a "futuristic AI-driven bionic semblance" of himself reflecting his "achievements, moments and future accomplishments."

Crypto-art and other entertainment applications are also able to utilize NFTs to authenticate ownership and prevent counterfeiting and fraud that are prevalent in markets such as art or other collectibles. NFTs also help to elucidate the originality and rarity of digital art in a manner similar to physical art. An added benefit is that NFTs also function as a method to observe the selling price and the number of times it has been sold.

Supply chain and Logistics: NFTs in supply chains can be used for authenticating products, ensuring their quality and verifying their origin. Supply chain data may become more reliable, especially in industries such as food and beverage, as knowledge of where the goods have been and how much time has passed since the original shipment of such goods is important. Again, NFTs could also eliminate counterfeiting and fraud which can help to track the movement of goods along the supply chain and assure buyers as to the uniqueness of such goods.

Legality in Malaysia

Cryptocurrencies and digital tokens in Malaysia fall under the purview of the Malaysian Securities Commission ("SC"). The Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 ("2019 Order") recognises digital currencies and digital tokens as "securities" thus attracting the applicability of the Capital Markets and Services Act 2007 ("CMSA"). Prior to this, Bank Negara Malaysia ("BNM") declared that digital currencies are not legal tender in Malaysia. However, this does not mean that the trading of digital currencies or digital tokens is illegal.

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Under Regulation 2 of the 2019 Order:

- (a) “digital currency” is defined as a digital representation of value which is recorded on a distributed digital ledger whether cryptographically-secured or otherwise, that functions as a medium of exchange and is interchangeable with any money, including through the crediting or debiting of an account; and
- (b) “digital token” means a digital representation which is recorded on a distributed digital ledger whether cryptographically-secured or otherwise.

Under Regulation 3 of the 2019 Order, a digital currency which:

- (a) is traded in a place or on a facility where offers to sell, purchase, or exchange of, the digital currency are regularly made or accepted;
- (b) a person expects a return in any form from the trading, conversion or redemption of the digital currency or the appreciation in the value of the digital currency; and
- (c) is not issued or guaranteed by any government body or central banks as may be specified by the Commission, is prescribed as a “security” for the purposes of the securities laws of the country.

A digital token which represents a right or interest of a person in any arrangement made for the purpose of, or having the effect of, providing facilities for the person, where—

- (a) the person receives the digital token in exchange for a consideration;
- (b) the consideration or contribution from the person, and the income or returns, are pooled;
- (c) the income or returns of the arrangement are generated from the acquisition, holding, management or disposal of any property or assets or business activities;
- (d) the person expects a return in any form from the trading, conversion or redemption of the digital token or the appreciation in the value of the digital token;
- (e) the person does not have day-to-day control over the management of the property, assets or business of the arrangement; and

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- (f) the digital token is not issued or guaranteed by any government body or central banks as may be specified by the Commission,

is prescribed as securities for the purposes of the securities laws.

This can be seen to be in line with the announcement made by then Finance Minister of Malaysia, Johari Abdul Ghani in 2018 when he stated that BNM will not impose a blanket ban on cryptocurrencies, including bitcoin, as such action will only curb innovation and creativity in the financial sector, particularly financial technology. In an interview with The Malaysian Reserve, he said that although BNM does not regulate digital currencies presently, it will ensure digital currency exchanges comply with requirements to conduct customer due diligence and report suspicious transactions to the authorities.

Besides requiring authorization from the SC, digital assets will also be subject to the provisions in the Anti-Money Laundering and Counter Financing of Terrorism – Digital Currencies (Sector 6) Standards and Guidelines issued by BNM.

NFTs and Intellectual Property Rights in Malaysia

Intellectual Property Rights (“IPR”) in Malaysia are generally subdivided into the following categories:

- (a) Copyright: the exclusive and assignable legal right, given to the originator for a fixed number of years, to print, publish, perform, film, or record literary, artistic, or musical material.
- (b) Trademark: a symbol, word, or words legally registered or established by use as representing a company or product
- (c) Patent: a government authority or licence conferring a right or title for a set period, especially the sole right to exclude others from making, using, or selling an invention.
- (d) Design: protects the visual appearance of a product or item and gives you exclusive rights for that appearance to the extent that, if necessary, there is a legal right to stop an unauthorised party from producing or using your design

As for whether an NFT in itself can be considered as having IPR attached to it, it can be argued that as an NFT is essentially a ledger in a block chain containing unique code, an NFT may fall under the purview of the Copyright Act 1987 (“CA”) as a “computer program” under Section 3 of the CA, which is defined as “an expression, in any language, code or notation, of

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a set of instruction intended to cause a device having an information processing capability to perform a particular function". It is therefore arguable that an NFT would attract copyright protection under the CA. If such is the case, then the first owner of the copyright in an NFT would be the 'author' of the NFT under Section 26(1) of the CA unless the author was commissioned to create the NFT or the creation of the NFT was done in the course of the author's employment.

There is a distinction between the NFT itself and the underlying work that it relates to. A person may sell an NFT, but copyright privileges in the underlying work to which the NFT relates is not automatically granted to the buyer when the NFT is sold. An NFT can therefore be seen as merely a proof of ownership of a work, which is separate from copyright in the work itself. In this regard, the copyright owner of the underlying work would be able to create more NFTs in respect of the same work if the copyright is not assigned to the buyer.

Effectively, an NFT merely verifies that the owner of the NFT owns the "original" of the digital asset. As ownership of an NFT does not by default grant rights to the work to which the NFT relates, and as this is certainly a fairly novel field, questions as to whether moral rights exist in relation to NFTs, whether termination of copyright amounts to termination of the IP ownership in the NFT, and the specific rights and remedies of an NFT owner, amongst other pertinent IPR-centric questions remain to be explored and answered.

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