NFTs: the future of ownership, or a passing fad?

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While NFTs — non-fungible tokens — have been around in some shape or form since 2012, they've exploded over the past year. In 2020, the market grew by 229%, reaching $250 million in value. And, in February 2021, more NFTs were traded in 24 hours than in the entirety of 2020.

In the crypto space, hype is par for the course.

But this feels different.

The mainstream hasn't just taken notice. They have skin in the game. The media have been abuzz with news of high-profile NFT adopters — from Nike and the NBA, to Kings of Leon, Grimes, and Linkin Park singer / guitarist / keyboardist Mike Shinoda.

So could this be a glimpse of what the future will look like? Or are we witnessing the making of one of the biggest bubbles of all time?

What are NFTs?

Like other types of cryptographic tokens, NFTs are digital representations of value that live on the blockchain. They have three distinguishing characteristics:

- They're unique. Every single NFT represents a specific asset and is tracked on the blockchain separately, even if the asset is one of a series
- They're hard to copy, but easy to verify. To get recorded on the blockchain, an NFT has to be validated using mathematical proof. At the same time, their full history is publicly available. Anyone can see it and confirm an NFT's authenticity
- They're tradeable, but not interchangeable. Because every NFT is unique, you can't exchange one for another, as you would Bitcoin or Ether. That said, you can buy, sell, and resell them

It's helpful to think of NFTs as special, one-of-a-kind items. A rare stamp, for example. Or a piece of digital art. The difference is that literally anything can be converted into an NFT — even a screenshot of a tweet.

Once the asset is tokenized, it's assigned a unique ID and metadata, so the blockchain can identify it. This allows those who are interested in acquiring it to track it, bid for it, and own it.

The evolution of NFTs

NFTs as we know them today became technically possible in 2018, when William Entriken, Dieter Shirley, Jacob Evans, and Nastassia Sachs created the ERC-721 protocol for the Ethereum blockchain. But the concept dates back to 2012, when eToro CEO Yoni Assia proposed 'colored Bitcoin' — Bitcoin embedded with code that linked them to real world assets.

In many ways, colored Bitcoin are the precursors of NFTs. They proved it was possible to tokenize real world assets. And they even inspired us. When we originally conceived the idea for METACO in 2014, we wanted to provide infrastructure that would facilitate tokenization, which led us to become one of the first businesses to promote colored Bitcoin.

Unfortunately, because Bitcoin was only ever intended to be used as an alternative currency, colored Bitcoin had many limitations. Case in point, valid tokens could be invalidated at a later stage, for example in the event of a fork.

By contrast, because Ethereum is a multipurpose platform, ERC-721's creators were able to resolve many of the issues inherent in colored Bitcoin.

In particular, the protocol enables the blockchain to identify individual NFTs, track their movements, and keep tabs on ownership. NFTs can also be tied to smart contracts, so ownership can pass automatically when an obligation is fulfilled.

Untapped potential

To date, much of the mainstream coverage of NFTs has focused on the silly crazes that have come out of them, because that's what attracts clicks. But beyond memes, selfies, or live videos of art being burned, NFTs have practical use cases with far-reaching implications.

This is most evident when it comes to intellectual property rights.

Where the likes of Britney Spears or Taylor Swift have emerged from the digital revolution — and the new business models it has created — relatively unscathed, for instance, 'middle class' artists have been short-changed.

The characteristics of NFTs enable these artists to recreate scarcity, control who can use their work and how, and even generate revenue without involving middlemen. For example, an artist could tie their work to smart contracts that trigger royalty payments every time ownership transfers.

Linkin Park's Mike Shinoda has explained it this way:

> "[Creators have been] commodified by platforms forever. Here, the value of your work/art/idea is defined by the market. This NFT started at $0. Apparently, people think this creation is worth a lot more…"

But the possibilities extend much further. Consider real estate.

At its core, buying and selling a house is a transaction between two parties. Yet, it involves a web of middlemen — banks, estate agents, solicitors — that makes things more complex and inflates the cost.

NFTs could greatly simplify the process, replacing middlemen with a smart contract that allows the holder to open the front door once a number of pre-agreed conditions are met.

Similarly, by converting into NFTs items that are illiquid or unbankable — items, such as stamp or coin collections, which traditional banks wouldn't consider to be suitable collateral — individuals can raise financing and realise value more quickly and easily. Again without resorting to middlemen.

A looming threat

Of course, this begs an important question.

In the traditional financial system, banks are the suppliers and the producers. They create products like loans and mortgages, sell them to customers, and assess and manage risk.

But if individuals can go directly to the market to raise financing, complete a commercial transaction, or realise value, doesn't this mean it's no longer necessary for banks to fulfill these roles?

This has been the reality in other industries for decades. Globalisation and digitalization have meant that, nine times out of ten, specialization is more efficient and cost-effective than vertical integration.

To date, the banking system has been the notable exception. But decentralised finance promises to change this.

So what does this mean for banks' future?

From vendors to facilitators

Clearly, it's time for banks to rethink their role.

The biggest benefit of NFTs — and, indeed, of the blockchain — is that you don't have to go through a bank if you don't want to.

The flipside is that being able to directly access a service also comes with responsibilities. You need to have the proper knowledge, understand the risks, and have access to the right infrastructure.

And this is where the opportunity for banks lies.

As much as NFTs and blockchain technology have the potential to democratize finance, the average customer will still need help navigating the technical complexities, whether it's tokenizing assets, accessing marketplaces, or something as simple as secure storage.

Banks can create a new place for themselves in the value chain by bridging this gap. Acting as expert advisors and facilitators, they can help customers to reap the benefits of these new technologies without having to understand what's going on under the hood.

Beyond the bubble: the future of NFTs

Back to runaway NFT trading, it's clear that it's early days.

So far, trade in NFTs has been largely speculative. And this means that there still are many unknowns. Let's say you want to resell your NFT of a meme. Will you find a buyer who will pay enough for you to at least make your money back?

With this in mind, it would not be surprising if the market crashed. Indeed, this seems likely to happen at some point.

But while it might well be that we're witnessing a bubble, it doesn't follow that NFTs are a fad.

Bubbles are a normal, even essential part of technological development. But the market eventually corrects. And the money generated by the bubble provides essential funding for the crucial phase in which the technology is improved, refined, and matures.

What's more important is that there's much more to NFTs than meets the eye.

It's estimated that there are currently around $78 trillion worth of unbankable assets globally. NFTs are a fantastic revolution that could replace many laws and practices with a simpler, more transparent way of unlocking and interacting with these assets.

So the real question isn't whether NFTs are here to stay.

It's this. Will banks take steps to adapt, or will they continue believing that the world can't move on without them?