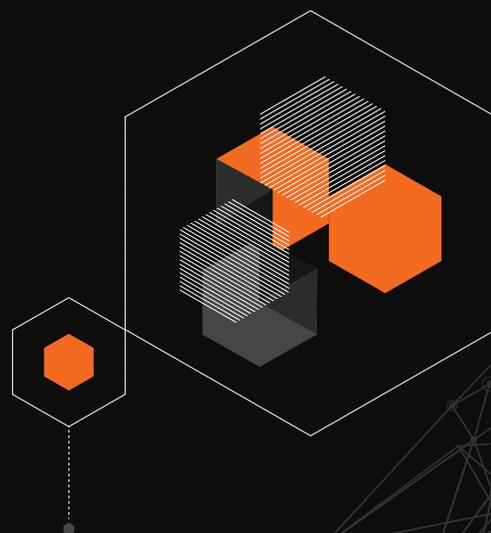

The Metaverse: What Businesses Need to Know



What is the metaverse?

It seems like not a day goes by without a newspaper article covering a business that has entered the metaverse. Is this all just corporate hype, or are we witnessing the beginnings of a truly revolutionary change in the way that people engage with the digital world? Digital investment house Grayscale Investments estimates the metaverse may be worth over US\$ 1 trillion in annual revenues¹. But what exactly is it?

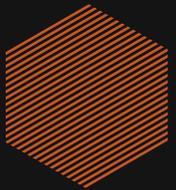
The metaverse is generally defined as a collective virtual space promising an immersive 3D digital world where we can work, play, socialise and do business together while at the same time owning our assets enabled by augmented reality (AR), virtual reality (VR), and non-fungible tokens (NFTs).

Companies here in Hong Kong have been quick to jump into the metaverse. Major brands from a diverse range of industries – including banking and financial services, transportation, media, entertainment venues, shopping malls and hotels – have all made public statements about the purchase of land plots in the metaverse.

What does the metaverse mean for businesses?

It is important to recognise that businesses that decide to explore the metaverse do so for different reasons and with different strategies in mind. Some are looking to sell virtual versions of their products that people can buy for use within virtual worlds. Others aim to create fun experiences that help people to connect with or learn about their brands. It can also be an opportunity to make connections with new groups of customers (or future customers) particularly younger demographics. This is a new medium and you are only really bound by your creativity.

¹ https://grayscale.com/wp-content/uploads/2021/11/Grayscale_Metaverse_Report_Nov2021.pdf



What should companies consider when entering the metaverse? What can go wrong?

While creating exciting new opportunities, entering the metaverse also involves having to deal with new risks and operational considerations. All of this requires careful consideration by a variety of different stakeholders within an organisation, covering areas as diverse as risk and regulation, legal and compliance, finance, tax and accounting, IT security, and marketing. Some of the issues that arise relate to the buying and holding of cryptocurrencies and NFTs (for example via the purchase of virtual land), others from the issuance of NFTs. Further issues arise from allowing your customers to interact with your brand in new, social and immersive 3D environments that can share aspects of both digital and physical worlds.



Buying crypto currencies and purchasing and holding virtual land

Many of the popular public metaverse platforms are blockchain-based virtual worlds, where the assets, including the land, are represented as NFTs. In order to purchase and utilise these land NFTs and publish content on your land, the owner needs to hold these assets in a crypto wallet. Often such plots of land are offered for sale on marketplaces where the sales price is denominated in cryptocurrency. So, companies will also need to establish the means to buy and sell crypto, or find a trusted party to do this on their behalf in order to acquire the land. You may also need to own a small balance of the platform's native crypto token in order to be able to pay for transaction fees (referred to as "gas") when you wish to make on-chain transactions involving your land or other assets. Based on our experience, key questions that will be asked by various stakeholders around the purchase of virtual land include the following:



Legal will want to know the terms and conditions of the platform you are buying virtual land on. What will be the ownership and economic rights attached to the land NFTs to be purchased? How will your IP rights be protected (if at all)? Which jurisdictions' laws will apply to the purchase transaction, and what contractual obligations and liabilities might you have if something goes wrong? What rights do you have to ultimately remove yourself and your brand from the platform if you change your mind? Which legal entity in the group should purchase the assets? Are NFTs subject to any regulatory requirements in the respective jurisdictions from the perspective of purchasers / customers?



IT security will likely be concerned about both the safety and security of the private keys to the crypto wallet, but also about the IT security of the platform that you have bought land on.



Compliance will be concerned about the counterparty that you are buying the land from. Are you able to identify them or are they anonymous? How can you be sure that you are not buying something that is stolen or purchased from the proceeds of crime? Can you prove that the seller actually owns the asset to be sold to you?



Risk management may want to know how the asset will be custodied. Should you use a third-party custodian and, if so, who? If you decide to self-custody the asset, how do you manage who holds the private keys and how do you ensure that these are kept safe?



Finance will want to know how you would account for the asset. How will you fund the purchase of the asset using cryptocurrency? Do you need to set up an account at a brokerage or crypto exchange, and how do you go about doing this? Alternatively, should you use one of the payment services providers that enable payment for tokens in fiat currency? How do you select the right vendors? What will be the tax implications of holding these assets? What will your auditors want to know and be able to check?



Issuing NFTs

If your metaverse strategy involves issuing your own NFTs, either as part of a product targeting the metaverse, or as a means of building out customer loyalty and engagement, then there are a number of other factors that will need to be considered. Firstly, all of the issues identified above from holding and operating a crypto wallet will need to be addressed. A non-exhaustive list of other considerations could include:



What are the legal and IP rights that you are selling with the NFT? How do you ensure that the IP rights you retain and royalty entitlements are not negatively impacted by the sale? Does your NFT have any attributes of a security token or a financial asset² and is it therefore subject to regulatory requirements? What are your obligations under consumer protection laws?



Are you comfortable with the commitments you have made in terms of the benefits or “utility” your NFT will provide to its holders? Have these been properly budgeted and built into the price?



What is the right blockchain platform to use to mint your NFT? What is the right marketplace to run the sale from? Are you comfortable that the smart contracts you will use to mint the NFT do what you think they do and that vulnerabilities do not exist? Are you able to adopt reasonable measures to avoid or deter attempts at counterfeiting (especially if your NFTs become a hit)?



Will you charge for these NFTs and, if so, do you have the systems in place to accept payment in crypto? How do you book the revenue from the sale? What are the tax implications? Which legal entity should be used to issue the NFTs?



Do you need to run Know Your Customer (KYC) checks on the customers you sell NFTs to? What other checks should you run to make sure that you are not going to be accepting the proceeds of financial crime?



Are you comfortable that your customers are able to operate their own digital wallets safely or do you need to offer up some kind of training to them to adopt safe and secure practices for owning NFTs?

² In a public statement issued on 6 June 2022, the Hong Kong Securities and Futures Commission (SFC) is of the view that NFTs as pure representation of digital collectibles do not fall within its regulatory remit. On the other hand, if the NFTs are structured with features similar to regulated financial products (e.g. fractionalised or fungible NFTs, managed investment interests in property with pooled-in contributions and profits in the form of collective investment schemes, or other types of securities alike attributes), then dealings in such NFTs may potentially be subject to regulatory and licensing requirements in Hong Kong.



Operating in immersive virtual worlds

The final group of business risks that brands and companies will face as they explore the metaverse arise from immersing in realistic 3D environments. In many cases these issues are similar to those in the real world. However, the ways in which companies need to mitigate these risks can often be different. Examples that will need to be considered are:



From a diversity and inclusion perspective, does the platform enable users to select avatars with a diverse variety of forms, taking into account gender, race, skin colour, body shape and clothing?



Are you able to monitor your land 24/7 to ensure that disruptive users can be evicted or blocked in a timely manner? What are the procedures needed to evict a person? What systems does the platform have to prevent the harassment of other users?



Are procedures in place to manage users' personal data?



What are the system requirements for accessing the platform and will your target customers be able to do this?

Since the early days of technology, people have dreamed of an immersive digital world. Many of the pieces are coming together to turn this into reality. Companies are taking notice and acting. The metaverse is an exciting area overflowing with creativity – though also with much corporate hype. Businesses need to be aware of the risks and to make sure that they have strategies and means for dealing with them. If your organisation is thinking of a move in this direction, it's essential that you have a plan to help your team upskill and explore so that you can maximise this opportunity and manage the risks.

Contact us

Peter Brewin

Partner, PwC Hong Kong
p.brewin@hk.pwc.com

Duncan Fitzgerald

Partner, PwC Hong Kong
duncan.fitzgerald@hk.pwc.com

Guy Parsonage

Partner, PwC Hong Kong
guy.parsonage@hk.pwc.com

Anuj Puri

Partner, PwC Hong Kong
anuj.puri@hk.pwc.com

William Gee

Partner, PwC Hong Kong
william.gee@hk.pwc.com

Thomas Crasti

Partner, PwC Hong Kong
thomas.m.craستي@hk.pwc.com

Jeff Guo

Senior Associate, PwC Hong Kong
jeff.ct.guo@hk.pwc.com

Joyce Tung

Partner, Tiang & Partners*, Hong Kong
joyce.hs.tung@tiangandpartners.com

* Tiang & Partners is an independent Hong Kong law firm with a close working relationship with PwC.