

T R  C E

# Money Laundering with Non-Fungible Tokens: A myth or reality?

CEPOL European Research and Science Conference

**Dr Dimitrios Kafteranis**

**Prof. Dr. Umut Turksen**

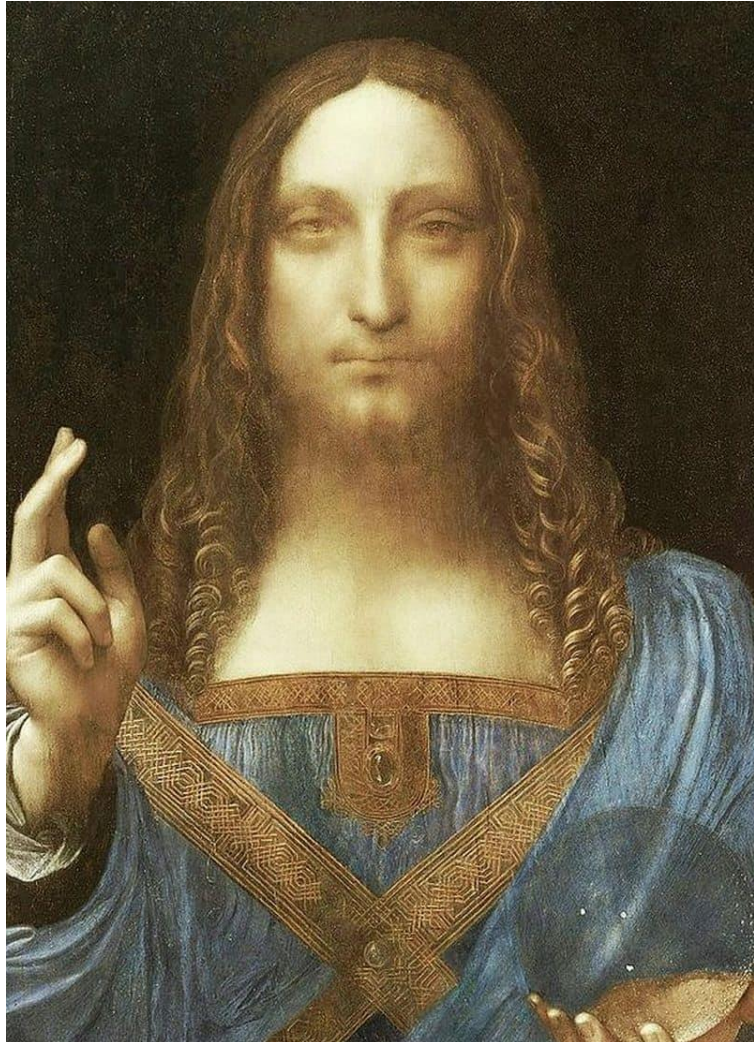
**CFCI – Coventry University**



- Introduction
- Art market and Money Laundering (ML)
- What is a Non-Fungible Token (NFT)?
- Why are NFTs susceptible to ML?
- What may be the EU legal answer?
- Training for Law Enforcement Authorities (LEAs)
- Proposals and Recommendations

# Introduction

T R  C E



Salvator Mundi by Leonardo Da Vinci

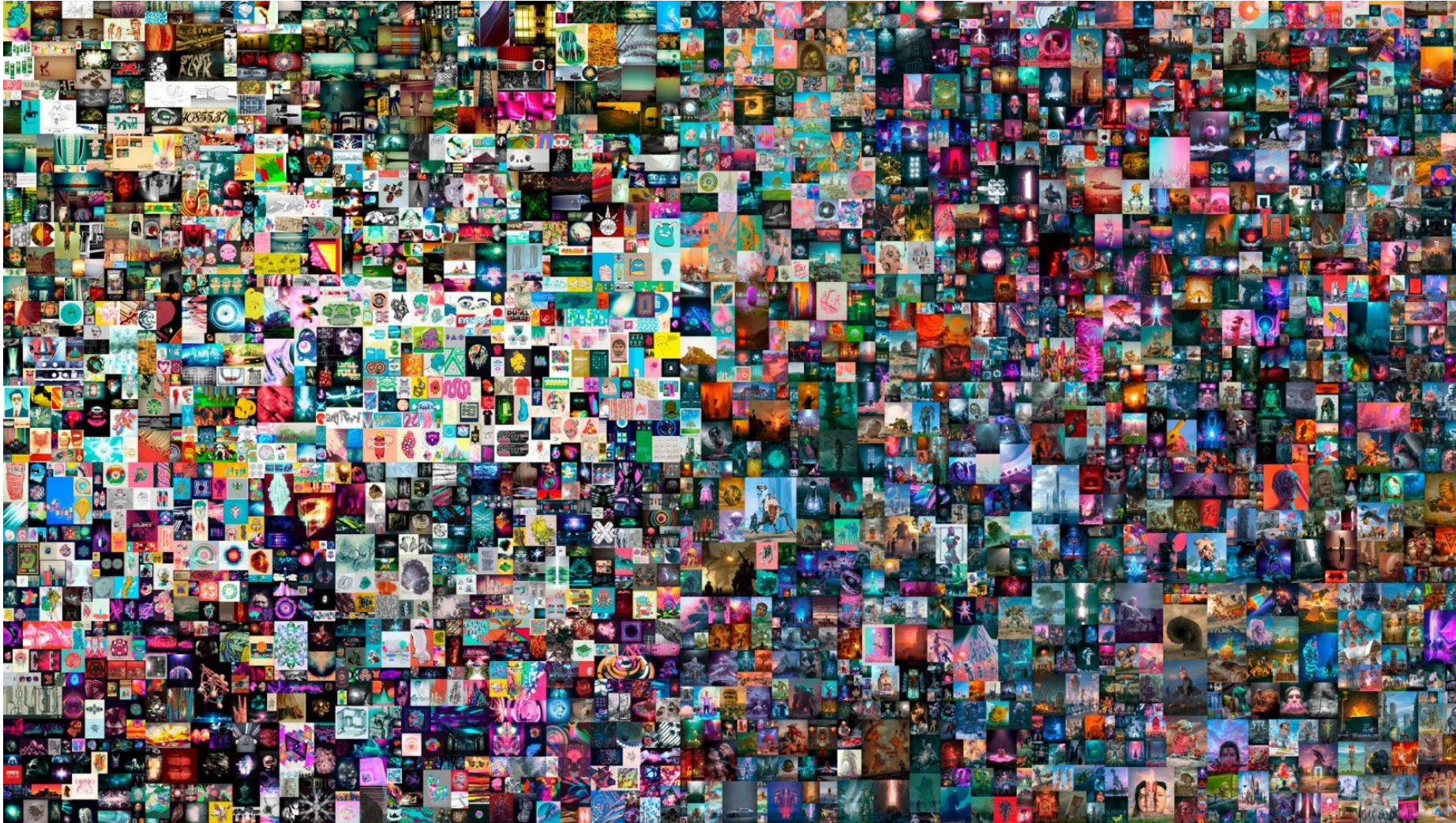
In 2017, the painting was sold by Christie's in New York for USD 450,312,500

The painting was described as "the greatest artistic discovery of the 20<sup>th</sup> century"



# Introduction

T R  C E



Beeple's collage,  
Everydays: The First  
5000 Days was sold  
by Christie's for USD  
69 million in 2021

This is not a painting  
but a Non-Fungible  
Token

**Is it art or not?**



# Art Market and ML

- Criminals continue to find new ways to launder their proceeds of crime
- Art market became such a place for criminals
- Lack of regulation, secrecy and anonymity in NFT trade have created an ideal place for money launderers
- FATF warned for high-risk of ML in the art market as well as the US Department of Treasury

# Art Market, ML and EU response

EU reacted to this issue by enacting the 5<sup>th</sup> AML/CFT Directive which requires “persons trading or acting as intermediaries in the trade of works of art, including when this is carried out by art galleries and auction houses, where the value of the transaction or a series of linked transactions amount to EUR 10000 or more” to conduct due diligence searches and, when needed, to file suspicious activity report (STR).

T R  C E

# What is a Non-Fungible Token?

T R  C E

- NFTs can be various types of digital assets
  - Objects in virtual worlds
  - **Artworks**
  - Digitalised characters from sports, music or other artistic activities
- NFTs are non-fungible; unlike cryptocurrencies which are fungible, NFTs are unique and non-replaceable
- NFTs are blockchain-based tokens which securely map ownership rights to digital assets
- Ownership of NFTs is often registered on an Ethereum network
- They are traded on specialised marketplaces such as Opensea and transactions are made usually by using the Ethereum cryptocurrency

# Legal issues and challenges raised by NFTs

- Copyright problems
- SMART contract issues
- Estate and succession planning
- Taxation
- Wash Trading
- Price manipulation
- Property

**Our focus in on ML**

T R  C E



# Why are NFTs susceptible to ML?

T R  C E

- Volatile prices
- NFTs, suspiciously, started gaining popularity when the art market became subject to AML rules (at the EU level)
- Anonymity offered by the use of cryptocurrencies
- Grey legal area (No regulation for NFTs) – KYC/AML grey area as well
- 2022 Crypto Crime Report by Chainalysis highlighted that, during the third and fourth quarter of 2021, value sent to NFT marketplaces by illicit addresses jumped significantly, stolen funds were used and transactions were made from addresses in countries with sanctions

# What may be the EU legal answer?

T R  C E

- Are NFTs considered as art or not?
  - If they are considered as digital art, repercussions occur in the fight against ML
  - The 5<sup>th</sup> AML/CFT Directive will be relevant
  - BUT there is no legal authority confirming that they are considered as “digital art”
- Establishing what NFTs are is a major challenge:
  - Are they virtual currencies, securities, crypto assets, digital art or collectibles?
- The 5<sup>th</sup> AML/CFT Directive fails to provide solutions (NFTs were not an issue back in 2018 when the Directive was proposed and subsequently adopted)

# What may be the EU legal answer?

T R  C E

- Markets in Crypto-assets Regulation (MiCAR) proposal
  - Definition of crypto-assets
  - “Three main categories of token proposed in MiCAR”
    - NFTs may fall under the last category: “other crypto-assets”
    - In this category, issuers do not have any specific licensing obligations but are required to be a legal entity (even with being established outside the EU) and to comply with certain business and governance conduct requirements
    - BUT under Article 4(2) of the proposed Regulation “issuers of crypto-assets that are unique and non-fungible” are not required to publish or register a whitepaper – exceptions for certain categories of NFTs (NFTs owners related to fractional ownership of third assets, rights linked to financial assets where regulators might assess those as security tokens)
    - Not clear whether NFTs will fall under MiCAR

# Training for Law Enforcement Authorities (LEAs)

T R  C E

- Need for training was highlighted by the report of the US Department of Treasury on February 2022
- Limited training available on an academic and professional level.
- Public Private Partnerships (PPPs) is a possible solution
  - Specialisation on NFTs can be found in academia, industry, and independent actors
  - These experts should be brought together to offer their expertise and produce work that will assist LEAs in this new and fast evolving field
- If PPPs are not possible, police academies should create their own training for manuals (and they should develop their own expertise by initially contracting external experts)
- Comparative analysis: inspiration should be taken not only from EU law but also from national legal system either in Europe or in the US.



# Proposals and Recommendations

T R  C E

- Need for regulatory answers
  - Legal uncertainty is counter productive
- Recommendations to be developed by regulators (waiting for the legislator to enact specific legislation)
- Legislation can be inspired by Member States laws and/or other countries such as the United Kingdom, the US and/or Japan
- Guidelines for crypto-illiterate users (investors protection)

T R  C E



This project has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 101022004

T R  C E



Hochschule für den öffentlichen Dienst in Bayern



This project has received funding from the European Union's Horizon 2020 research and innovation programme under grant agreement No 101022004