

The Research of NFT Money Laundering Risks and Regulatory Measures

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Abstract: Due to the imperfect laws and regulations, China's NFT is still in its infancy. But with the growth of the NFT trade and various digital collections, use NFT carry out crimes that have been quietly carried out around the world, and with them comes the risk of money laundering. At present, there are no clear legal constraints and regulatory regulations for NFT in china. This paper is aimed to disclose the risks behind NFT trading via NFT applications and trade system, the insecure NFT market can be improve by 3 measures: 1. Enhance the reliability of identification for each NFT trading platform. 2. Having access to every transaction on the platform, monitoring trade to promote security. 3. Enhance the entry standard for new trading platform to prevent illegal trade.

Keywords: Money Laundering, NFT, Cryptocurrency trading.

1. Introduction

According to a new report from NFT trading platform OpenSea, NFT transactions reached \$17.6 billion in 2022, a 200-fold jump from \$90 million in 2020. One of the famous work of art : "Everyday, The First 5000 Days" sold for \$6,936,250 on Christie's website, making it the most expensive NFT ever sold (and one of The most expensive works of art ever sold). The main reasons for the high transaction price of this work are as follows: First, for the work, the author and the work itself have certain popularity, and the NFT gives the work a unique Token ID, which has the collection value and the ownership of the work can be verified; Second, for the auction market, because NFT is a new thing, the market lacks valuation and experience; Third, there is the possibility of speculation, the transaction price of works will attract more people's attention to NFT, blockchain and other related topics.

2. The Characteristics of NFT

Each NFT is unique, just like a work of art, and they cannot

be interchanged with each other. Just like everyone has an ID number, NFT have a unique code, so they are called non-fungible tokens or non-homogeneous tokens. The nature of NFT makes each one unique and authentic, which solves a big problem for the art and luxury industries.[4] For example, LV is preparing to launch NFT to prove the authenticity of its luxury goods, or to track the life-cycle journey of a single backpack. Another characteristic is that ownership belongs to the user. In a normal game, for example, the player doesn't really own anything in the virtual world. However, in blockchain-based games, the assets in the game are owned by the player. Even if the server is shut down, the player still holds the NFT assets, which can also be converted into tokens for use in other games. In theory, anything that exists online can be purchased as an NFT. An NFT is "a crypto token". The biggest difference between NFT and cryptocurrencies is that NFT are not homogeneous, they are not interchangeable and they are not divisible. Think of Pokemon cards, although each card can be traded, essentially they are different, and for comparison, one bitcoin and another are essentially the same and interchangeable.

Table 1. Comparison between NFT and Cryptocurrency

	NFT/Cryptocurrency	
	NFT	Cryptocurrency
Value	It's related to digital Art Product, music, film and television, with humanistic value	It is only used as currency, and the transaction form is limited
interchangeability	Cannot be exchanged. Each NFTS has its own ID	Can be exchanged,

3. A Variety of Major Applications of NFTS

NFTS are mainly used for art collection and copyright protection and are also currently available. The most closely watched is the art NFTS due to the rising price of NFT arts ; NFTS can also be used for blockchain-based decentralized finance, the typical application scenario is the use of NFT loan ; In games area, game users can create NFTS for free trade; The following describes the application scenarios of

NFT in the above fields.[4]

3.1. Copyright Protection of artworks

NFT can provide a unique Internet record supported by blockchain technology for each work of art. Based on its characteristics of non-mass reproduction and non-homogeneity, it can help each work to register its copyright through timestamp and smart contract technology to better protect copyright. Typically, NFT platforms explicitly limit the rights of the buyer's NFT through specific agreements.

Some NFT platforms require users to purchase the copyright when selling NFT. Some NFT platforms also require that users not be able to purchase NFTS for commercial sale. Since each NFT is unique, buyers need to carefully read the rights restrictions associated with the platform and specific NFTS when purchasing an NFT, and the risk of copyright theft is greatly reduced because NFTS are unique and difficult to copy. Digital rights protection became one of the main early NFTS, with the CEO of artist Twitter selling his first tweet as an NFT for \$2.9 million. Even the New York Times has converted a column into an NFT. At the same time, more and more artists publish their works in the form of NFT, which also represents that they are optimistic about the protection of copyright of works by NFT.

3.2. Application of blockchain finance

The application scenarios of NFT-based blockchain finance are mainly in asset digital mortgage and asset mobility promotion; In terms of asset digital mortgage, NFT allows people to convert assets into NFT tokens and upload them to the blockchain, and then mortgage them through the platform. Different from traditional bank loans, the mortgage loan process of NFT is more simplified and faster. In terms of promoting asset mobility, it is different from traditional asset liquidity, which is susceptible to multiple influences such as regulation, logistics and transaction efficiency. NFTS greatly improve asset mobility by making the asset itself a token on the blockchain. At present, the technology is mainly used in the circulation of collectibles, as long as the artist has fully registered and authorized the work on the platform, they can trade freely. In the long term, asset mobility in the form of full NFTS can be realized in all sectors, facilitating the digitalization process in all sectors.

3.3. NFT game trading

Currently, the primary use of NFTS in games is "monetisation", which is to increase long-term engagement through the digital economy in games, especially with the help of Play to Earn, P2E. The P2E model allows players to earn money with in-game tokens. These in-game tokens can be used in the game, traded on public exchanges, and cashed in as the player's local legal tender. In the video game New World, for example, players can earn items through daily missions, which can then be traded or cashed in. Earn New World coins through in-game rewards and then trade coins for a profit. All of these proceeds can be traded on public exchanges, such as OpenSea, or cashed in as legal tender.

4. The Risk Exist in the NFT Trading System

Currently, the most popular platforms are OpenSea and Bigverse. Overseas NFTS only allow cryptocurrency transactions, while domestic NFTS only allow fiat currency transactions. In order to gain a deeper understanding of NFT platforms, From the research on OpenSea, the most representative overseas NFT trading platform in the world. Surprisingly, the registration of an account requires the creation of an "electronic wallet" by mobile phone or email for binding, and the transaction of less than 20,000 yuan does not require identity verification, while the transaction of more than 20,000 yuan requires simple identity verification. The key problem is that the platform is completely blind to the identification of the actual controller. That is to say, for the

completion of large and suspicious NFT transactions, you can register multiple mailboxes to sell and buy, and use two or more different accounts to repeatedly and frequently trade a certain NFT to carry out money laundering. Although China's blockchain does not have the characteristics of decentralization, and the platform has certain supervision rights over the transaction, the platform's identification of the customer's identity only stays on the provision of basic identity documents. It is not clear whether the identity card is the person or not and whether the transaction is the person or not, which is far from the requirements of anti-money laundering. The platform has no way of knowing who actually controls the NFT account. NFT transactions only take place in the virtual online world, and they can be immediately successful without going through customs and transportation companies, making it difficult to check and examine beforehand or trace the crime after it has occurred.

4.1. The irrationality of NFT prices can be used to disguise illicit funds

Because NFT have unique ID identification systems, price bubbles can result. The value of art itself is very subjective, so long as the form of buying and selling is legal, even if the price is high, it is normal. So NFT are hard to detect when done properly. Money launderers only need to disguise themselves as crypto art collectors, and they can use black money to hype NFTS by buying, selling and other means to achieve the purpose of money laundering.[3]

4.2. NFTS can be quickly liquidated and are difficult to regulate

NFT are easy to buy and sell and can be sold or traded for cash at any time. In the NFT market, virtual assets can be converted through online payments, and criminals can use stolen money to buy encrypted art, and then resell it, so that the black money is successfully laundered.[2] On April 1, 2022, the Boring Ape NFT given by Jay Chou's friend was stolen. Its wallet address signed to authorize the transaction at 11:02, granting access to the NFT to the hacker wallet, who then transferred the Boring Ape NFT to his wallet address at 11:07. It can be seen that when NFT is transferred between different accounts, once cracked by hackers, the platform is unable to protect the legitimate rights and interests of NFT account holders. At the same time, although the NFT platform does not allow cross-platform transactions, virtual currency can be transferred immediately through the wallet of virtual currency. According to Opensea, the stolen NFTS were being transferred from Chou's address and quickly changing hands multiple times at LooksRare for 130ETH and 155ETH (equivalent to 2.74 million yuan to 3.27 million yuan)

4.3. NFTS cover a plethora of areas and are currently unregulated

At present, most countries have no clear legal provisions on the supervision of NFT. There is a need for anti-money laundering regulation in NFTS for three reasons. First, as a unique digital asset, NFTS have no exchange rate fluctuations compared with virtual assets such as bitcoin. Second, the transaction price of NFT depends on the transaction between buyers and sellers, and its price will have subjective fluctuations. Third, a series of NFT digital art works have fetched huge sums at auction. While distributed ledger technology and NFTS bring opportunities to the art market, they also bring potential money laundering risks. The

characteristics of NFT determine that it covers regulatory issues in many fields. For example, NFT is related to digital art, music, film and television and other fields, which has humanistic value and involves the copyright of digital collections. It may need to obtain the platform operation qualification of online publications, audiovisual programs or online cultural products. NFT has casting and resale links, and has certain homogeneity with traditional publications, limited commemorative items and other commodities, so it involves the production, sale, transfer of ownership and other links of digital collections. NFT is operated by the platform, which involves the application and supervision of the blockchain technology optimization algorithm on the trading platform. The casting, purchase and circulation of NFT are carried out through legal currency. During the transmission link of NFT, illegal funds may flow in, and black money may become white money, so it needs to be included in the anti-money laundering financial supervision.

5. NFT Regulatory advice

5.1. Strictly perform identification

The trading platform shall strictly adopt the real-name system, identify the identity of customers, verify the identity of customers using reliable and independent documents, data or information, and understand and obtain information about the purpose and true intention of the business relationship.^[1] Conduct ongoing due diligence to scrutinize transactions occurring throughout the business relationship to ensure that ongoing transactions are consistent with the client profile, risk profile, source of funds, and other information available to the organization

5.2. Monitor platform trading information

Strengthen the supervision of the whole process of NFT from access, transaction and exit. Improve the technical means of crypto asset monitoring, and realize the full-chain tracking and full-time information backup of digital collection trading. Banks, payment institutions and NFT trading platforms should continuously monitor suspicious transactions related to NFT, especially Alipay, which is currently supported by the domestic NFT platform for fund flow. Supervision of the interface between the third-party payment platform and NFT platform should be strengthened to ensure the traceability of transaction data and real-time monitoring of suspicious fund transactions. Continuously improve the anti-money laundering monitoring ability. If the system warning of large and suspicious transactions is triggered, it should be reported to the anti-money laundering monitoring center in time, and cooperate with banks and public security organs to carry out anti-money laundering investigation activities

5.3. Establish barriers to entry on trading platforms

I suggest to formulate the access standards of digital collection trading platforms and raise the threshold of administrative approval for the establishment of trading platforms. The access standards should cover many aspects, such as digital art ownership, network technology security and anti-money laundering monitoring requirements. The whole transaction process of the platform will be incorporated into the multiple regulatory systems involved, the security of the system, all the warrants of digital artworks and the technical security of the platform will be strengthened, the platform will be strengthened to guard against phishing website attacks, and every NFT transaction will be recorded, so as to realize the supervision of transaction data. Prevent criminals from money-laundering and other illegal operations through the NFT platform. At the same time, improve the monitoring of large and suspicious funds, ensure that every link of the transaction can be traced, improve the identity of both sides of the transaction

6. Conclusion

In a nutshell, non-fungible token is a unit of data based on blockchain. Each token represents a unique piece of digital information. It has the characteristics of interchangeability and non-homogeneity. With the spread and popularity of NFTS, the risk of money laundering is born. Presumably, the casting, distribution, sales and circulation of NFT in the future will be involved in the supervision, although at present there are no strict legal regulations and restrictions on the NFT in our country, but this is only a matter of time.

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