

# THE ART WORLD OF DIGITAL ASSETS: HOW NON-FUNGIBLE TOKENS CREATE A LOOPHOLE IN ANTI-MONEY LAUNDERING REGULATIONS

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## TABLE OF CONTENTS

INTRODUCTION.....	1180
I. BACKGROUND .....	1182
A. <i>The Bank Secrecy Act of 1970</i> .....	1182
1. Russian Oligarchs Case Study .....	1184
B. <i>The Art Market’s Vulnerability to Illicit Activity</i> .....	1186
1. Subjective Valuation of Artworks.....	1187
2. Anonymous Transactions.....	1188
C. <i>Emergence of NFTs</i> .....	1190
1. Art as a Self-Regulated Industry .....	1196
2. Real Estate: Legislative History .....	1198
II. ANALYSIS .....	1199
A. <i>Bank Secrecy Act Extended to Antiquities</i> .....	1200
B. <i>NFTs Are Not Currency Substitutes</i> .....	1202
C. <i>Securities Regulations and Fractionalized NFTs</i> .....	1205
III. PROPOSAL .....	1207
A. <i>Regulate NFTs Within the Scope of Antiquities</i> .....	1207
CONCLUSION .....	1208

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## INTRODUCTION

While anti-money laundering laws have evolved in most industries, art has remained a consistent exception.<sup>1</sup> Consequently, criminals have turned to art as an effective way to move illicit proceeds through an under-regulated market.<sup>2</sup> Coupled with the concerning lack of external control is the expectation of privacy rooted in the art world.<sup>3</sup> The acquisition of art can consist of a high-dollar purchase, and transactions involving prominent consumers and long-time collectors are often kept anonymous.<sup>4</sup> Given the confidentiality between transacting parties, investigative procedures are often underperformed or even utterly ignored.<sup>5</sup> The opacity of the art market is further characterized by valuation methods. Prices of artworks are highly dependent on subjective estimates and market trends, and the uncertainty surrounding art appraisals enables illicit behavior to go unnoticed.<sup>6</sup>

Though an established culture of secrecy and obscurity has long exposed the art world to money laundering tactics, the ability to exchange art in the digital space elicits far greater concern.<sup>7</sup> The emergence of non-fungible tokens (NFTs) presents an additional layer of secrecy and aggravates the course of identifying illegal transactions.<sup>8</sup> For example, users can buy NFTs with illicit funds or cryptocurrencies they own anonymously.<sup>9</sup> Moreover, given the extraordinarily high value of some NFTs, buyers could exchange numerous tokens using coins that are linked to different accounts.<sup>10</sup> The lack of scrutiny among art deals has

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<sup>1</sup> Allyson Shea, *Shooting Fish in a Bliss Bucket: Targeting Money Launderers in the Art Market*, 41 COLUM. J.L. & ARTS 665, 667 (2018).

<sup>2</sup> “Artworks are particularly suitable vehicles for money launderers . . .” Graham Bowley & William K. Rashbaum, *Has the Art Market Become an Unwitting Partner in Crime?*, N.Y. TIMES (Feb. 19, 2017), <https://www.nytimes.com/2017/02/19/arts/design/has-the-art-market-become-an-unwitting-partner-in-crime.html> (last visited Jan. 6, 2023).

<sup>3</sup> See *Hoffman v. L & M Arts*, 838 F.3d 568, 573 (5th Cir. 2016) (involving a case in which plaintiff inserted a confidentiality provision in his agreement to sell a Mark Rothko painting due to publicity concerns).

<sup>4</sup> See Shea, *supra* note 1, at 679–81.

<sup>5</sup> See *id.* at 671–72; see also Marilyn E. Phelan, *Scope of Due Diligence Investigation in Obtaining Title to Valuable Artwork*, 23 SEATTLE U. L. REV. 631, 688 (2000).

<sup>6</sup> Alessandra Dagirmanjian, *Laundering the Art Market: A Proposal for Regulating Money Laundering Through Art in the United States*, 29 FORDHAM INTELL. PROP., MEDIA & ENT. L.J. 687, 708–10 (2019).

<sup>7</sup> See *United States v. Rounsavall*, 115 F.3d 561 (8th Cir. 1997).

<sup>8</sup> Matthew Long, *The New Digital Art Trade Is Ideal for Criminals*, BLOOMBERG L. (Apr. 20, 2021, 4:00 AM), <https://news.bloomberglaw.com/white-collar-and-criminal-law/the-new-digital-art-trade-is-ideal-for-criminals> [<https://perma.cc/5H7D-BKD6>].

<sup>9</sup> Tom W. Bell, *Copyrights, Privacy, and the Blockchain*, 42 OHIO N.U. L. REV. 439, 464 (2016).

<sup>10</sup> See *infra* Section II.B (discussing coin tumbling).

been a long-standing issue, and transacting parties have taken advantage of this predisposed market to their financial benefit.<sup>11</sup> Although anti-money laundering regulations have now been extended to include antiquities,<sup>12</sup> NFTs remain unregulated.<sup>13</sup> The emergence of NFTs exacerbates the problem by creating loopholes in the law, thereby generating a novel money laundering platform.<sup>14</sup>

The nature of NFTs makes them particularly difficult to understand, and the rise of new marketplaces, cryptocurrencies, and blockchain databases further complicates the picture.<sup>15</sup> Therefore, lawmakers will inevitably face challenges when attempting to regulate NFTs under a defined body of law.<sup>16</sup> These tokens have made an astonishing impact in the context of art, yet they are a type of digital asset that is purchased with cryptocurrency.<sup>17</sup> Should NFTs be regulated in accordance with art laws or securities laws, or are they considered currency substitutions? Due to the foreseeability of increased illicit conduct, these ambiguities must be addressed.

This Note argues that the rapid development of NFTs should alert legislatures and administrative agencies to the foreseeable increase in money laundering activity. Part I of this Note discusses the history of the Bank Secrecy Act of 1970 (BSA) and illustrates how criminals can use art as an efficient money laundering tool.<sup>18</sup> It also describes certain aspects of the art business that influence its susceptibility to criminal activity.<sup>19</sup> Part I then turns to NFTs, providing a detailed explanation of their structure, valuation, and impact on the traditional art industry.<sup>20</sup> Finally, Part I ends by considering the lack of anti-money laundering regulations imposed on the art market.<sup>21</sup> Part II evaluates

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<sup>11</sup> Hannah Purkey, *The Art of Money Laundering*, 22 FLA. J. INT'L L. 111, 118–19 (2010).

<sup>12</sup> See discussion *infra* Section II.A.

<sup>13</sup> See William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6110(a)(1), 134 Stat. 3388, 4561–62 (to be codified at 31 U.S.C. § 5312(a)(2)); see also CLARE MCANDREW, ART BASEL & UBS, THE ART MARKET 2022, at 46 (2022).

<sup>14</sup> See *infra* Part II.

<sup>15</sup> Howard Gleckman, *Crypto Confusion Shows Why Congress Is Broken*, FORBES (Aug. 10, 2021, 3:08 PM), <https://www.forbes.com/sites/howardgleckman/2021/08/10/crypto-confusion-shows-why-congress-is-broken/?sh=73a1c0121398> [<https://perma.cc/MT5Q-XT6R>].

<sup>16</sup> See Hailey Fuchs, *NFTs Move to Influence Congress, Even If Lawmakers Have No Clue What They Are*, POLITICO (Jan. 5, 2022, 10:25 AM), <https://www.politico.com/news/2022/01/05/fads-crypto-lobbying-politics-526538> [<https://perma.cc/4KZA-TBGN>].

<sup>17</sup> See Jonathan Rohr & Aaron Wright, *Blockchain-Based Token Sales, Initial Coin Offerings, and the Democratization of Public Capital Markets*, 70 HASTINGS L.J. 463, 465 (2019).

<sup>18</sup> See *infra* Section I.A.

<sup>19</sup> See *infra* Section I.B.

<sup>20</sup> See *infra* Section I.C.

<sup>21</sup> See *infra* Section I.C.

how NFTs could be read into existing cryptocurrency<sup>22</sup> and securities regulations,<sup>23</sup> while identifying the advantages, disadvantages, and potential issues of each interpretation. Part III proposes that the Financial Crimes Enforcement Network (FinCEN)<sup>24</sup> should incorporate NFTs within the definition of antiquities<sup>25</sup> under the BSA for purposes of combatting money laundering.<sup>26</sup>

## I. BACKGROUND

### A. *The Bank Secrecy Act of 1970*

Money laundering is a process by which illegally obtained funds are made to appear as assets deriving from a legitimate source.<sup>27</sup> First, there is an underlying crime that generates proceeds (dirty money) and triggers the money laundering scheme.<sup>28</sup> Criminals then deposit the proceeds into financial institutions through wire transfers, checks, and other mechanisms.<sup>29</sup> To conceal the illicit money, the assets are often moved through the financial system (e.g., by placing the funds in multiple accounts) to disguise their true origin.<sup>30</sup> As a result, the criminal activity that produced the illegal funds becomes untraceable.<sup>31</sup>

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<sup>22</sup> See *infra* Section II.B.

<sup>23</sup> See *infra* Section II.C.

<sup>24</sup> Upon enacting federal anti-money laundering legislation, Congress delegated rulemaking authority to the Secretary of the Treasury. The Secretary then assigned this authority to FinCEN, the administrative agency that safeguards the financial system from money laundering schemes. See *infra* Section I.A.

<sup>25</sup> The scope and definition of the term “antiquities” is dependent on FinCEN’s forthcoming final rule regarding Congress’s decision to include the art market in the language of the BSA. Nevertheless, this Note will use “art” and “antiquities” interchangeably, as FinCEN’s post-amendment notice suggests that the term “antiquities” represents the broader concept of art as opposed to mere ancient works. See *infra* Section II.A.

<sup>26</sup> See *infra* Section II.A.

<sup>27</sup> The money laundering process typically involves three phases: placement, layering, and integration. *History of Anti-Money Laundering Laws*, FIN. CRIMES ENF’T NETWORK, <https://www.fincen.gov/history-anti-money-laundering-laws> [<https://perma.cc/2BBD-PM6Z>].

<sup>28</sup> Paul Kim, *Money Laundering: How Dirty Money Enters the Financial System*, BUS. INSIDER (Jan. 21, 2022, 3:57 PM), <https://www.businessinsider.com/personal-finance/what-is-money-laundering> [<https://perma.cc/ST3C-H6DT>].

<sup>29</sup> *Id.*

<sup>30</sup> *History of Anti-Money Laundering Laws*, *supra* note 27.

<sup>31</sup> See *id.*

In response to money laundering practices, Congress enacted the Bank Secrecy Act of 1970.<sup>32</sup> The BSA established a framework designed to detect and apprehend money launderers in the United States.<sup>33</sup> The BSA's main objective is to identify "the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States or deposited in financial institutions."<sup>34</sup> In 1974, the Supreme Court upheld the constitutionality of the BSA, and Congress has continuously amended the statute to expand the scope of its application.<sup>35</sup> In 1992, the reporting requirements were extended to include wire transfers and other suspicious transactions.<sup>36</sup> The Money Laundering Control Act of 1986 established money laundering as a federal crime.<sup>37</sup> Congress later ratified the Patriot Act in 2001 to combat terrorism financing through customer verification procedures.<sup>38</sup>

The BSA imposes reporting and recordkeeping requirements on financial institutions to oversee transactions.<sup>39</sup> The BSA delegates authority to the Secretary of the Treasury to issue regulations detailing the procedures for monitoring BSA compliance and specifying the financial institutions' responsibilities.<sup>40</sup> FinCEN enforces the BSA, offers interpretive guidance on satisfying the statutory requirements, and may seek civil or criminal action against violators.<sup>41</sup> Pursuant to the Secretary

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<sup>32</sup> 31 U.S.C. § 5311; *see also Bank Secrecy Act*, IRS (Apr. 5, 2022), <https://www.irs.gov/businesses/small-businesses-self-employed/bank-secrecy-act#:~:text=Congress%20passed%20the%20Bank%20Secrecy,%2C%20tax%2C%20and%20regulatory%20matters> [https://perma.cc/6CPE-3GCH].

<sup>33</sup> 31 U.S.C. § 5311.

<sup>34</sup> *History of Anti-Money Laundering Laws*, *supra* note 27.

<sup>35</sup> *BSA Timeline*, FIN. CRIMES ENF'T NETWORK, <https://www.fincen.gov/resources/statutes-regulations/bank-secrecy-act/bsa-timeline> [https://perma.cc/7KXX-79QJ].

<sup>36</sup> Annunzio-Wylie Anti-Money Laundering Act of 1992, Pub. L. No. 102-550, 106 Stat. 4044 (codified as amended at 12 U.S.C., 18 U.S.C., 31 U.S.C.).

<sup>37</sup> This Note will focus on the detection, as opposed to the prosecution, of money laundering activity. Therefore, it will not address the Money Laundering Control Act of 1986. The Act governs the laundering of monetary instruments and prosecutes individuals who conduct or attempt to conduct a financial transaction knowing that the property involved in the transaction constitutes proceeds of unlawful activity, with the intent to conceal the illicit proceeds. *See generally* 18 U.S.C. §§ 1956–1957.

<sup>38</sup> 31 U.S.C. § 5318.

<sup>39</sup> 31 U.S.C. § 5312(a)(2)(A)–(Z) (defining financial institutions, which lists entities and actors, including banks, credit unions, and investment and insurance companies, among others); *see also Bank Secrecy Act*, *supra* note 32.

<sup>40</sup> *Cal. Bankers Ass'n v. Shultz*, 416 U.S. 21, 21 (1974).

<sup>41</sup> BSA violations could result in civil penalties up to \$100,000 per transaction. Individuals who willfully violate the BSA face up to five years of imprisonment and may be fined up to \$250,000; financial institutions and agencies can be fined up to \$1 million per violation. *See* 31 U.S.C. §§ 5321–5322; *see also Law Enforcement Overview*, FIN. CRIMES ENF'T NETWORK, <https://www.fincen.gov/resources/law-enforcement-overview> [https://perma.cc/97R2-SMGE].

of the Treasury's regulations, banks must implement a BSA compliance program with adequate customer identification procedures<sup>42</sup> and conduct risk-based due diligence that is "reasonably designed" to enable the institution to identify suspicious activity.<sup>43</sup> Moreover, persons and entities within the scope of the statute are required to report monetary transactions over \$10,000.<sup>44</sup> These reports must include information detailing the kind of money, the amount, and its place of origin and destination, and must also contain the identities of all parties involved in the exchange, tracing the monetary instrument from the moment it leaves the hands of the seller to the moment it arrives at the hands of the buyer.<sup>45</sup> For transactions below the \$10,000 threshold, banks must only report those transactions that appear suspicious.<sup>46</sup> Prior to 2021, the BSA did not cover the art industry.<sup>47</sup> Therefore, players in the art market were not required to adhere to such stringent reporting requirements.<sup>48</sup>

### 1. Russian Oligarchs Case Study

Privately owned shell companies are one of the most common vehicles for money launderers because public exposure is limited, which in turn enables the concealment of beneficial ownership.<sup>49</sup> The art market in and of itself is a medium by which criminals can launder money with adequate certainty that their chances of success outweigh the potential risks.<sup>50</sup> Shell companies provide an extra level of security for buyers who intend to remain anonymous.<sup>51</sup> When a buyer wishes to conceal their

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<sup>42</sup> 12 C.F.R. § 21.21 (2014).

<sup>43</sup> 31 C.F.R. § 1010.610 (2011).

<sup>44</sup> *Id.* § 1010.311.

<sup>45</sup> *Id.* § 5316(b).

<sup>46</sup> *Id.* § 1010.311. Financial institutions should file a suspicious activity report (SAR) if a transaction is conducted solely for purposes of concealing illicit funds or attempting to avoid BSA requirements. *See id.* § 1020.320; *see also* FIN. CRIMES ENF'T NETWORK, U.S. DEP'T OF TREASURY, MONEY LAUNDERING PREVENTION: A MONEY SERVICES BUSINESS GUIDE 14, [https://www.fincen.gov/sites/default/files/guidance/msb\\_prevention\\_guide.pdf](https://www.fincen.gov/sites/default/files/guidance/msb_prevention_guide.pdf) [<https://perma.cc/D3DW-JMNG>].

<sup>47</sup> William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6110(a)(1), 134 Stat. 3388, 4561-62 (to be codified at 31 U.S.C. § 5312(a)(2)) (adding antiquities to the language of the BSA).

<sup>48</sup> *See infra* Section II.A.

<sup>49</sup> *See generally* Carl Pacini, Nicole Forbes Stowell, Irwin Jay Katz, Gary A. Patterson & Jerry W. Lin, *An Analysis of Money Laundering, Shell Entities, and No Ownership Transparency That Washes off and on Many Shores: A Building Tidal Wave of Policy Responses*, 30 KAN. J.L. & PUB. POL'Y 1, 2 (2020).

<sup>50</sup> *See infra* Section I.B.

<sup>51</sup> *See infra* Section I.B.

identity from the public eye, private dealers and other intermediaries have an interest in complying with the request.<sup>52</sup> The purchaser can then acquire art using a shell corporation to mask their name and personal information.<sup>53</sup> An individual purchasing art through a shell corporation can keep the transaction private unless it involves suspicious activity that would trigger an investigation of the company.<sup>54</sup>

When an experienced or sophisticated money launderer is the illicit source, it can take months, years, or a lifetime to identify such activity.<sup>55</sup> In the renowned lawsuit against Russian oligarchs Arkady and Boris Rotenberg, the United States Senate's Permanent Subcommittee on Investigations discovered that the Rotenbergs anonymously purchased high-value artworks from the United States art market despite being sanctioned by the United States.<sup>56</sup> The Subcommittee traced over ninety-one million dollars in transactions back to a shell company owned by the Rotenbergs.<sup>57</sup> However, the tracing process took years to complete because the oligarchs made every effort to cover their tracks.<sup>58</sup> The Rotenbergs hired an attorney to get the job done, and the attorney used his firm, Markom Group, to operate a shell company on behalf of the Rotenbergs.<sup>59</sup> The attorney also transferred title of one shell company to Arkady's son, who at the time was not sanctioned by the United States.<sup>60</sup> The sole purpose of the title transfer was to mask the Rotenbergs' identities.<sup>61</sup>

An art advisor, Gregory Baltser, played a large role in facilitating these purchases.<sup>62</sup> Before the Rotenbergs were sanctioned, Baltser would bid on artworks and purchase them for the Rotenbergs.<sup>63</sup> Once purchased, Baltser would assign title to a Belize company, which was later discovered to be using the Rotenbergs' funds to pay for the art.<sup>64</sup> After the

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<sup>52</sup> Art dealing is a competitive field where client retention is imperative. *See* Dagirmanjian, *supra* note 6, at 696 (“[A]rt dealers have little incentive other than good faith to flag possible money laundering schemes involving artwork for law enforcement.”).

<sup>53</sup> Pacini, Stowell, Katz, Patterson & Lin, *supra* note 49, at 10–11.

<sup>54</sup> *See* Dagirmanjian, *supra* note 6, at 724.

<sup>55</sup> *See* STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SEC. & GOV'T AFFS., 116TH CONG., THE ART INDUS. AND U.S. POL'YS THAT UNDERMINE SANCTIONS I (Comm. Print 2020).

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> *Id.* at 5–7.

<sup>59</sup> *Id.* at 4.

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.* at 4–5.

<sup>64</sup> *Id.* at 5.

Rotenbergs were sanctioned in 2014, Baltser continued to purchase artworks from auction houses, including Christie's and Sotheby's, for the Rotenbergs.<sup>65</sup> In compliance with their voluntary anti-money laundering policies, the houses only performed due diligence on Baltser and did not investigate the principal purchaser.<sup>66</sup> Sotheby's was aware that some of Baltser's clients were Russian oligarchs yet nonetheless continued to conduct business with Baltser.<sup>67</sup>

The auction houses, despite potential suspicions and warnings regarding Baltser's clients, did not engage in the deeper investigation that was required to discover a large-scale money laundering conspiracy.<sup>68</sup> Despite the operation of in-house programs that aim to combat money laundering, auction houses are not implementing a sufficiently rigorous system to address crimes that are happening under their supervision.<sup>69</sup> The Rotenberg case study demonstrates the willingness of auction houses to facilitate criminal exchanges and, in turn, contribute to the art industry's money laundering issue. Without proper agency scrutiny, auction houses, dealers, and other liaisons will inevitably continue to administer illegal art sales.<sup>70</sup>

#### B. *The Art Market's Vulnerability to Illicit Activity*

Money laundering practices are historically embedded in the art market.<sup>71</sup> The art world's appraisal process and general opacity make it an ideal means of concealing dirty money.<sup>72</sup> Valuation methods are subjective, which makes it difficult to identify suspicious transactions merely based on the sums involved.<sup>73</sup> Additionally, norms of anonymity and confidentiality between parties create challenges in determining who is behind a transaction, and the presence of intermediary actors

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<sup>65</sup> *Id.* at 6–7.

<sup>66</sup> *Id.* at 7.

<sup>67</sup> *Id.* at 6.

<sup>68</sup> *Id.*

<sup>69</sup> See Matt Egan, *The Art World Has a Money Laundering Problem*, CNN BUS. (July 29, 2020, 3:52 PM), <https://www.cnn.com/2020/07/29/business/art-money-laundering-sanctions-senate/index.html> [<https://perma.cc/Z7NW-T5MQ>].

<sup>70</sup> This Note will discuss the various types of agents acting as middlemen between buyers and sellers in art exchanges and explain why auction houses, as opposed to dealers, are more likely to investigate clients. While auction houses have stronger anti-money laundering systems in place, the Rotenberg case study sheds light on the inefficiencies of such systems. See *infra* Section I.C.1.

<sup>71</sup> Individuals may transfer proceeds derived from illicit activity to disguise them as earnings from an art transaction. See *e.g.*, *United States v. Rounsavall*, 115 F.3d 561 (8th Cir. 1997).

<sup>72</sup> See *infra* Sections I.B.1, I.B.2.

<sup>73</sup> See *infra* Section I.B.1.



disincentives proper inquiry.<sup>74</sup> These factors make art a particularly attractive market for criminals who wish to move illegal funds while escaping rigorous inspection.<sup>75</sup> The market's secrecy invites a range of illicit activity, with money laundering being one of the most prevalent crimes to date.<sup>76</sup>

### 1. Subjective Valuation of Artworks

Money launderers are particularly drawn to art because it is an obscure, unpredictable market that constantly fluctuates.<sup>77</sup> Supply and demand generally play a substantial role in determining price variations for a trendy market, but there are multiple factors that influence an artwork's value.<sup>78</sup> While some collectors are focused on the fashionable artists they notice in prominent galleries, others may solely invest in artists that have been admired since earlier eras.<sup>79</sup> A particular artist's works will vary in price as well. The works that best represent the artist's style—defined by certain shapes, color palettes, or the date of creation—are the most sought-after and expensive pieces.<sup>80</sup>

Art is often valued according to what the buyer is willing to spend, and prices can increase or decrease at any moment.<sup>81</sup> Since the cost of art is largely speculative, persons can exchange artworks for unreasonable sums of money, yet it would be difficult to identify such overvaluation by simply reviewing an invoice.<sup>82</sup> But even in the case of a visibly irrational

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<sup>74</sup> See *infra* Section I.B.2.

<sup>75</sup> See Charlie Pogacar, *How Money Laundering Works in the Art World*, ART & OBJECT (May 8, 2020), <https://www.artandobject.com/news/how-money-laundering-works-art-world> [<https://perma.cc/5XBG-YJ52>].

<sup>76</sup> See generally Pacini, Stowell, Katz, Patterson & Lin, *supra* note 49, at 9.

<sup>77</sup> Art, in its simplest form, is driven by the same factors that govern fluctuating markets such as real estate and high-cost collectibles. See Purkey, *supra* note 11, at 116, 118 (explaining that criminals often turn to real estate as a means to launder money because property valuation, similar to art, is largely speculative).

<sup>78</sup> See Henri Neuendorf, *Art Demystified: What Determines an Artwork's Value?*, ARTNET NEWS (June 29, 2016), <https://news.artnet.com/market/art-demystified-artworks-value-533990> [<https://perma.cc/5YXV-FXWB>].

<sup>79</sup> For example, if a powerful or respected gallery decides to represent an emerging artist, the artist's paintings will automatically increase in value. *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> Marianne James, *Art Crime*, AUSTL. INST. CRIMINOLOGY, Oct. 2000, at 4.

<sup>82</sup> When a gallery owner disclosed that prices for Hunter Biden's artworks would range from \$75,000 to \$500,000, experienced individuals voiced concerns. "[D]etractors[] includ[e] ethics experts as well as art critics who suggest that Hunter Biden's art would never be priced so high if he had a different last name." Matt Viser, *Deal of the Art: White House Grapples with Ethics of Hunter Biden's Pricey Paintings*, WASH. POST (July 8, 2021, 5:30 AM), <https://www.washingtonpost.com/>

transaction, authorities, such as customs agents and administrative officers, are ill equipped to comprehend the price of quality art or accurately recognize a suspicious deal.<sup>83</sup> For example, works from notable artists are known to be expensive collectibles, and therefore, the mere price of a prestigious artwork does not necessarily shed light on a questionable purchase.<sup>84</sup> Since art has been characterized by such uncertainty, overpaying or underpaying for a work is not correlated to criminal behavior and generally will not spark an immediate concern.<sup>85</sup> Enforcement officers do not have the appropriate familiarity to regulate art exchanges, and the professionals who do possess the required expertise are not encouraged to assist authorities in the reviewing process.<sup>86</sup> As a result, the absence of both internal and external investigations allows price manipulation to remain undetected.<sup>87</sup>

## 2. Anonymous Transactions

The obscurity of valuation methods, coupled with the anonymity involved in art transactions, causes money launderers to leverage the market favorably.<sup>88</sup> The presence of intermediary actors—such as gallerists, dealers, art advisors, and auction houses—advances a culture of strict client confidentiality.<sup>89</sup> For a client who prioritizes anonymity, using an intermediary to buy or sell art is an effective way to maintain a private identity.<sup>90</sup> As this is a frequent scenario, the market has become increasingly opaque—leaving most high-end deals undisclosed to the

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politics/deal-of-the-art-white-house-grapples-with-ethics-of-hunter-bidens-pricey-paintings [https://perma.cc/3QFY-CFMC]. Though matters related to President Joe Biden gain automatic attention from the press, other instances of overvaluation are rarely within the political sphere and the public eye.

<sup>83</sup> James, *supra* note 81, at 4.

<sup>84</sup> Purkey, *supra* note 11, at 118.

<sup>85</sup> James, *supra* note 81, at 4.

<sup>86</sup> *Id.*; see Jason-Louise Graham, *Art Exchange? How the International Art Market Lacks a Clear Regulatory Framework*, in ART, CULTURAL HERITAGE AND THE MARKET: LEGAL AND ETHICAL ISSUES 319, 334 (Valentina Vadi & Hildegard E.G.S. Schneider eds., 2014); see also Dagirmanjian, *supra* note 6, at 697 (“The art market itself maintains little oversight of its professionals in a way that would encourage them to help law enforcement prevent money laundering through art.”).

<sup>87</sup> See Shea, *supra* note 1, at 673.

<sup>88</sup> Dagirmanjian, *supra* note 6, at 704–06.

<sup>89</sup> See Shea, *supra* note 1, at 679–81.

<sup>90</sup> See, e.g., *In re Accent Delight Int’l Ltd.*, 869 F.3d 121, 124 (2d Cir. 2017).

public.<sup>91</sup> Such respect for a client's privacy makes it difficult to identify who exactly has owned a particular artwork and who will hold title next.<sup>92</sup>

Since intermediaries are not subject to recordkeeping or reporting requirements, they possess broad discretion to keep their internal records sealed.<sup>93</sup> As a result, individuals could successfully falsify an artwork's provenance.<sup>94</sup> However, it would be unreasonable for private dealers, such as small businesses, to implement comprehensive anti-money laundering programs.<sup>95</sup> Private agents have every interest in fostering strong relationships with their clients, especially affluent ones, and the ability to administer deals without federal supervision facilitates their effort.<sup>96</sup> This insulation eliminates any legal obligations that would otherwise create boundaries to an intermediary's relationship with its client.<sup>97</sup>

The societal acceptance of anonymity in the art world is most prevalent in the context of buyer and seller, but it extends to agents as well.<sup>98</sup> A lawsuit against Larry Gagosian exemplifies the issues involved in nondisclosure.<sup>99</sup> When a collector sued the gallery owner, Gagosian, for selling her Lichtenstein painting without her consent, there were concerns about conflicts of interest, particularly over whether Gagosian was a player on both ends of the transaction.<sup>100</sup> "In a deposition made public . . . Gagosian [testified] that he frequently represented both the

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<sup>91</sup> Jackson Pollock's painting No. 5 is among the most expensive paintings in art history; it was allegedly sold in 2006 for \$140 million through a private deal. The sale price was never confirmed because both the buyer and the seller chose to remain anonymous. See Olav Velthuis, *Art Markets*, in *A HANDBOOK OF CULTURAL ECONOMICS* 33, 36 (Ruth Towse ed., 2d ed. 2011).

<sup>92</sup> Phelan, *supra* note 5, at 688.

<sup>93</sup> Shea, *supra* note 1, at 671–72. Experts were less concerned with such "discretion" when high-end collectors were the only persons involved in the art business. See Graham, *supra* note 86, at 337.

<sup>94</sup> "Provenance" refers to an artwork's ownership history. Having access to an accurate, complete provenance would prevent a range of criminal activities—from money laundering to art theft and art fraud—yet to achieve this in an industry defined by secrecy is unfeasible. See *Provenance*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/provenance> [<https://perma.cc/6HA4-JRV6>]; see also Phelan, *supra* note 5.

<sup>95</sup> While auction houses have the proper resources to implement and enforce more rigorous due diligence systems, private dealers lack the same resources. Shea, *supra* note 1, at 681.

<sup>96</sup> *Id.* at 679.

<sup>97</sup> *Id.*

<sup>98</sup> "Few in the art industry consider it inappropriate for a dealer to represent both the buyer and seller during the same transaction, even if the dealer has opted not to inform either party about her dual interest." Gregory Day, *Explaining the Art Market's Thefts, Frauds, and Forgeries (and Why the Art Market Does Not Seem to Care)*, 16 *VAND. J. ENT. & TECH. L.* 457, 467–68 (2014).

<sup>99</sup> See generally *Cowles v. Gagosian*, No. 650152/12, 2012 WL 7869959 (N.Y. Sup. Ct. Aug. 22, 2012). See Randy Kennedy, *Gagosian Suit Offers Rare Look at Art Dealing*, N.Y. TIMES: ARTSBEAT BLOG (Nov. 7, 2012, 5:50 PM), <https://artsbeat.blogs.nytimes.com/2012/11/07/gagosian-suit-offers-rare-look-at-art-dealing> [<https://perma.cc/LK62-U4HQ>].

<sup>100</sup> Kennedy, *supra* note 99.

seller and buyer in a deal without disclosing that fact to either party.”<sup>101</sup> Gagosian further shared that he almost never gets asked whether he is representing both sides of a transaction.<sup>102</sup> Such disclosure would become common industry practice if dealers were required to conform with federal standards when conducting business.<sup>103</sup> With the appropriate administrative guides in place, unlawful behavior—such as Gagosian’s form of self-dealing—would be far less frequent among intermediaries.

Gagosian Gallery is one of the most prestigious galleries in New York City,<sup>104</sup> and this lawsuit could potentially have a strong deterrent effect. While federal agencies tend to impose reporting requirements on large institutions, like Gagosian, in hopes that they will cooperate in fostering market transparency, the absence of federal regulation addressing intermediaries—and the art world as a whole—proves to be particularly concerning when galleries become involved in illicit activity.<sup>105</sup> The lawsuit presents a scenario where a court could hold the gallery owner accountable for failing to disclose that he had a relationship with both the buyer and the seller, resulting in potential liability for self-dealing.<sup>106</sup> Such an outcome would likely discourage other similarly situated galleries, museums, and auction houses from abusing the anonymous market. With the rise of a digital art era, this is especially important as NFTs rapidly gain popularity in moving money.

### C. Emergence of NFTs

An NFT is a one-of-a-kind token stored on a digital ledger, such as a blockchain.<sup>107</sup> The blockchain is a decentralized, immutable record that

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<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> Currently, it is commonplace for dealers to create serious conflicts of interest. *See Day, supra* note 98, at 467–68.

<sup>104</sup> Jane Morris, *Top Galleries Have Never Been Bigger or More Influential. But What Will Happen When Their Founders Are Gone?*, ARTNET (Jan. 9, 2019), <https://news.artnet.com/market/art-dealer-succession-analysis-1433257> [<https://perma.cc/C82A-UUF6>]; Elisa Lipsky-Karasz, *The Art of Larry Gagosian’s Empire*, WALL ST. J. (Apr. 26, 2016, 9:24 AM), <https://www.wsj.com/articles/the-art-of-larry-gagosians-empire-1461677075> [<https://perma.cc/RT6Y-ZMVQ>].

<sup>105</sup> The BSA expects financial institutions to aid in combatting money laundering, although it remains unclear whether galleries are considered financial institutions. *See infra* Section IIA.

<sup>106</sup> *See generally* Cowles v. Gagosian, No. 650152/12, 2012 WL 7869959 (N.Y. Sup. Ct. Aug. 22, 2012).

<sup>107</sup> *NFT*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/NFT> [<https://perma.cc/SG9J-VUDU>].

verifies, registers, and stores transactions.<sup>108</sup> When an NFT is purchased, the transaction is stored via encryption codes.<sup>109</sup> Once the exchange is documented, it will exist permanently on the database unless there is consensus among all users to eliminate the entire blockchain network.<sup>110</sup> The blockchain database is a distributed spreadsheet, meaning that no single master copy exists.<sup>111</sup> Therefore, its community of users can conveniently access and display the record on their computers at home.<sup>112</sup>

NFTs are bought and sold using cryptocurrency coins.<sup>113</sup> They are most frequently exchanged with a coin called Ether (ETH) and stored on Ethereum's blockchain.<sup>114</sup> After buying the corresponding cryptocurrency coin (e.g., ETH), the purchaser must transfer the coins into their Ethereum wallet where they can manage their funds.<sup>115</sup> Each NFT transaction is governed by a smart contract that records ownership and intellectual property rights on the blockchain.<sup>116</sup> Since smart contracts essentially administer the terms of the exchange, NFTs can be acquired solely through digital ledgers that likewise support smart

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<sup>108</sup> Rohr & Wright, *supra* note 17, at 469 (“[B]lockchains are decentralized databases [that] . . . store tamper-resistant, resilient, and authenticated data, enabling users to engage in pseudonymous transactions.”). When a blockchain registers a transaction, it records intellectual property rights and other forms of data. See Zach Church, *Blockchain, Explained*, MIT SLOAN SCH. OF MGMT. (May 25, 2017), <https://mitsloan.mit.edu/ideas-made-to-matter/blockchain-explained> [<https://perma.cc/B8SV-AFEP>].

<sup>109</sup> Rohr & Wright, *supra* note 17, at 471.

<sup>110</sup> Kevin Werbach, *Trust, but Verify: Why the Blockchain Needs the Law*, 33 BERKELEY TECH. L.J. 487, 503 (2018).

<sup>111</sup> *Id.* at 500.

<sup>112</sup> See *id.* at 491.

<sup>113</sup> Some platforms allow credit card purchases, but this is uncommon. See Grace Kay, *People Are Buying and Selling Crypto Collectibles in a \$250 Million Market—Check Out the Sites Where You Can Browse and Bid on NFTs*, BUS. INSIDER (Apr. 2, 2021, 2:50 PM), <https://www.businessinsider.com/nft-marketplaces-where-to-buy-sell-non-fungible-tokens-online-2021-3> [<https://perma.cc/E6MA-ZYV4>].

<sup>114</sup> While the intricacies of blockchain technology are not the focus of this Note, a basic understanding of blockchain is useful. I refer to “Ethereum’s blockchain” because the ETH coin is linked to the Ethereum blockchain and therefore NFTs are generally stored there. However, there are multiple blockchain networks (e.g., Bitcoin and Ripple), each with different properties and capabilities. See Lynne Lewis, Jane Owen, Hamish Fraser & Rohit Dighe, *Non-Fungible Tokens and Copyright Law*, WOLTERS KLUWER INTELL. PROP. & TECH. L.J., Sept. 2021, at 1.

<sup>115</sup> See Rohr & Wright, *supra* note 17, at 478–79.

<sup>116</sup> See Lewis, Owen, Fraser & Dighe, *supra* note 114, at 2 (“The smart contract that governs an NFT could specify how proprietary rights, including copyright, are transferred upon sale of the NFT.”). As defined by the Ethereum website, “[s]mart contracts are a type of Ethereum account. . . . Smart contracts can define rules, like a regular contract, and automatically enforce them via code.” *Introduction to Smart Contracts: What Is a Smart Contract?*, ETHEREUM (Dec. 22, 2021), <https://ethereum.org/en/developers/docs/smart-contracts> [<https://perma.cc/7FYS-P67M>].

contracts.<sup>117</sup> While each Bitcoin represents an equal value to the other, Ethereum is compatible with the tokens' non-fungibility trait.<sup>118</sup>

The first NFTs were created in 2017 by the software company Larva Labs.<sup>119</sup> Larva Labs released a collection of "CryptoPunks"—10,000 editions of unique "Punks."<sup>120</sup> However, the rise of NFTs did not make a significant impact until early 2021.<sup>121</sup> The arrival of NFTs represented a novel, unknown addition to the art industry, and although it came as a surprise to many, both established players and newcomers in the art world are visibly adapting to the surfacing of tokenized digital art.<sup>122</sup> Christie's Auction House announced that it was including an NFT as a lot in its Spring 2021 auction and thereafter sold digital artist Beeple's work "Everydays: The First 5000 Days," a digital collage consisting of 5,000 single images, for \$69 million.<sup>123</sup> The Beeple sale was a momentous occasion for the art world that sparked curiosity and confusion among long-time collectors.<sup>124</sup> Controversially, there was a realization that NFTs were a permanent addition to the art business.<sup>125</sup> Throughout 2021,

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<sup>117</sup> *Introduction to Smart Contracts*, *supra* note 116; Vitalik Buterin, *Ethereum Whitepaper*, ETHEREUM (Jan. 13, 2023), <https://ethereum.org/en/whitepaper> [<https://perma.cc/4DWL-62N8>].

<sup>118</sup> "Each [NFT] has a digital signature that makes it impossible for NFTs to be exchanged for or equal to one another (hence, non-fungible)." Robyn Conti & John Schmidt, *What Is an NFT? Non-Fungible Tokens Explained*, FORBES (Feb. 15, 2022, 12:15 PM), <https://www.forbes.com/advisor/investing/nft-non-fungible-token> [<https://perma.cc/Y3CU-XYTB>]; *see* Buterin, *supra* note 117; *see also* Shane Wax, *A Primer on Non-Fungible Tokens and Smart Contracts*, LAW. MONTHLY (May 27, 2021), <https://www.lawyer-monthly.com/2021/05/a-primer-on-non-fungible-tokens-and-smart-contracts> [<https://perma.cc/E8G5-VAYG>].

<sup>119</sup> *See 10 Things to Know About CryptoPunks, the Original NFTs*, CHRISTIE'S (Apr. 8, 2021), <https://www.christies.com/features/10-things-to-know-about-CryptoPunks-11569-1.aspx> [<https://perma.cc/32FV-7SHS>].

<sup>120</sup> *Id.* Larva Labs's website explains that CryptoPunks were originally free and could be claimed by anyone with an Ethereum wallet. *See CryptoPunks*, LARVA LABS, <https://www.larvalabs.com/cryptopunks> [<https://perma.cc/QTA4-HA8M>] (last visited Jan. 16, 2023).

<sup>121</sup> *See* Seth Price & Michelle Kuo, *What NFTs Mean for Contemporary Art*, MOMA (Apr. 29, 2021), <https://www.moma.org/magazine/articles/547> [<https://perma.cc/7P9B-SJXA>].

<sup>122</sup> "The average age of buyers in this field is 42 (mere children in art collector terms) and 75% of NFT buyers were new to Christie's." Anna Brady, *Christie's 2021 Sales Total \$7.1bn, with \$150m from NFTs and \$103.4m from the Most Expensive Work Sold This Year, a Picasso*, ART NEWSPAPER (Dec. 20, 2021), <https://www.theartnewspaper.com/2021/12/20/christies-expects-2021-sales-to-total-dollar71bn> [<https://perma.cc/295R-9TJL>].

<sup>123</sup> Christie's sale of "Everydays: The First 5000 Days" set the record for most expensive work sold online. Press Release, Christie's, *Christie's Surpasses \$100 Million in NFT Sales* (Sept. 28, 2021), <https://www.christies.com/about-us/press-archive/details?PressReleaseID=10210> [<https://perma.cc/96XE-G58K>].

<sup>124</sup> Some long-time collectors, who are not interested in owning a work that is available for all Internet users to see, feel that art is meant to be hung on walls for exclusive enjoyment. Zachary Small, *As Auctioneers and Artists Rush into NFTs, Many Collectors Stay Away*, N.Y. TIMES (May 12, 2021), <https://www.nytimes.com/2021/04/28/arts/design/nfts-art-collectors-copyright.html> (last visited Jan. 16, 2023).

<sup>125</sup> *See* Price & Kuo, *supra* note 121.

auction houses continued to include the most sought-after tokens in their sales; houses benefited from staying up to date with market trends and indeed, the revenue guarantee.<sup>126</sup> Christie's reported over \$100,000,000 in NFT sales by September 2021 and continues to remain active in the digital art space.<sup>127</sup> The auction houses have generally collaborated with existing marketplaces to host their curated NFT auctions.<sup>128</sup> Yet, it did not take long for Sotheby's to launch its own NFT marketplace, Sotheby's Metaverse, in an attempt to stay ahead of the game.<sup>129</sup>

Nonetheless, auction houses will not play the same role in the NFT business as they do with traditional art. Because the blockchain is a secured and reliable network, it eliminates the need for centralized third-party actors.<sup>130</sup> After all, buyers are drawn to these tokens to benefit from decentralization, particularly the fact that they do not need to foster a connection with an auction house or important gallerist to obtain a valuable piece of art.<sup>131</sup> Instead, they can rely on a trustworthy system that operates directly between creator to investor and buyer to seller.<sup>132</sup>

On its face, blockchain technology adds transparency to the conventional art market because all NFT exchanges are automatically recorded on a database made publicly available to everyone on the network.<sup>133</sup> Users can view other people's wallet address but no personally identifiable information is displayed.<sup>134</sup> Since no third parties are involved in the transactions, there is technically no record of a

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<sup>126</sup> In May 2021, Christie's sold nine CryptoPunks for a total of \$16,962,500. Christie's (@ChristiesInc), TWITTER (May 11, 2021, 8:54 PM), <https://twitter.com/christiesinc/status/1392282036417728519?lang=en> [<https://perma.cc/B4XW-JQBQ>]. The NFT lots in Sotheby's 2021 auctions reached some of the highest sale records in online-only auctions. See MCANDREW, *supra* note 13, at 136.

<sup>127</sup> Christie's NFT sales have been the most successful among the auction house industry. Brady, *supra* note 122; Christie's, *supra* note 123.

<sup>128</sup> For example, in December 2021, Christie's collaborated with OpenSea to curate an NFT auction that was available to bidders on the marketplace website. *Christie's x OpenSea*, CHRISTIE'S, <https://www.christies.com/auctions/christies-x-opensea> [<https://perma.cc/Y9EU-57KW>].

<sup>129</sup> Sophie Haigney, *Next Stop: The Metaverse*, SOTHEBY'S, <https://www.sothebys.com/en/articles/next-stop-the-metaverse> (last visited Oct. 21, 2022). Sotheby's Metaverse represents "[a] massive moment for NFTs that adds an incredible amount of legitimacy to this expanding art genre." James Ellis, *Sotheby's Metaverse: The Art Auction House Opens Its Own NFT Marketplace*, NFT EVENING (Aug. 16, 2022), <https://nftevening.com/sothebys-metaverse-the-art-auction-house-opens-its-own-nft-marketplace> [<https://perma.cc/2KAW-ALR8>].

<sup>130</sup> See Rohr & Wright, *supra* note 17, at 469–70.

<sup>131</sup> The industry is expecting a "widening gap" between traditional art collectors and the new generation of digital users. Small, *supra* note 124.

<sup>132</sup> Wax, *supra* note 118; Iris H-Y Chiu & Jason G. Allen, *Exploring the Assetization and Financialization of Non-Fungible Tokens: Opportunities and Regulatory Implications*, 37 BANKING & FIN. L. REV. 401, 407 (2022).

<sup>133</sup> See Werbach, *supra* note 110, at 503.

<sup>134</sup> See Bell, *supra* note 9, at 464.

purchaser's name linked to a particular exchange.<sup>135</sup> The coin used to purchase the NFT may contain identifying data, but it is possible to take advantage of the cryptocurrency network and use it as an additional layer of obscurity.<sup>136</sup>

Conceptual artworks (e.g., digital art, videos, and films) are deep-rooted in art history and, theoretically, NFTs are an extension of this sector.<sup>137</sup> However, traditional art is priced at a significantly different scale than NFTs.<sup>138</sup> What explains this disparity? The community of interested buyers is continuously expanding, which triggers an increase in NFT artists and marketplaces, resulting in more transactions.<sup>139</sup> This rapid growth has brought attention to the class of NFT owners, revealing that millennials are highly involved in token exchanges.<sup>140</sup> The audience consists primarily of people who are new to the art world and were inactive in the art collecting business before NFTs gained recognition.<sup>141</sup> The same individuals who represented the early investors in cryptocurrency are now using their increased returns and putting massive amounts of funds into NFTs.<sup>142</sup> Alternatively, some established collectors and respected artists have been reluctant to join the NFT movement as they fear the legal issues that may arise in the future.<sup>143</sup> For

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<sup>135</sup> See Toshendra Kumar Sharma, *How Is Blockchain Verifiable by Public and Yet Anonymous?*, BLOCKCHAIN COUNCIL (July 11, 2018), <https://www.blockchain-council.org/blockchain/how-is-blockchain-verifiable-by-public-and-yet-anonymous> [<https://perma.cc/G8UY-R2W6>].

<sup>136</sup> See *infra* Section II.B.

<sup>137</sup> See Price & Kuo, *supra* note 121.

<sup>138</sup> As discussed earlier, traditional art (including conceptual works, videos, etc.) belong to a fluctuating market. However, unlike NFTs, the traditional art industry is less concerned about collectors' interests and instead focused on established artists, especially those receiving attention from prominent museums and galleries. See Brian Droitcour, *NFT as Joke*, ART NEWS (Apr. 2, 2021, 12:08 PM), <https://www.artnews.com/art-in-america/features/nft-joke-1234588596> [<https://perma.cc/82M6-3SWE>]; see also Neuendorf, *supra* note 78.

<sup>139</sup> See Yvonne Lau, *Sotheby's Posted Its Highest-Grossing Year Ever, Boosted by Millennials and NFTs*, FORTUNE (Dec. 16, 2021, 3:08 AM), <https://fortune.com/2021/12/16/sothebys-highest-grossing-year-nfts-auctions-millennial-sales> [<https://perma.cc/6JYL-2C68>]; Droitcour, *supra* note 138; MCANDREW, *supra* note 13, at 136.

<sup>140</sup> Lau, *supra* note 139.

<sup>141</sup> "The audience for NFTs could not be more different to that of the traditional art world. . . . [There is] a profound lack of 'high society' types or gallery-going culture vultures." Josh Tompkins, *NFTs Go Mainstream: Breaking Down the Global Audience*, FIFTY (Sept. 17, 2021), <https://fifty.io/us/resources/nfts-go-mainstream> [<https://perma.cc/93MG-S9PJ>].

<sup>142</sup> Elizabeth Howcroft, *The New Masters: How Auction Houses Are Chasing Crypto Millions*, REUTERS (Nov. 9, 2021, 3:14 PM), <https://www.reuters.com/business/finance/new-masters-how-auction-houses-are-chasing-crypto-millions-2021-11-08> [<https://perma.cc/L6DY-CJH3>] (explaining that the same people who bought into cryptocurrency and made a "fortune" are now the majority of NFT buyers).

<sup>143</sup> Small, *supra* note 124 ("Legal experts are quick to point out that questions of copyright and fraud in the NFT market have not been tested in the courts, creating an element of unknown risk for collectors.").



example, shortly after Japanese artist Takashi Murakami launched his first collection of NFTs, he decided to withdraw the works and educate himself on the various platforms and ownership implications.<sup>144</sup>

Due to the novelty of these tokens, it is difficult to reach a definite conclusion on their true market value.<sup>145</sup> Although NFTs are proving to be different from traditional artworks in several aspects, both traditional art and NFTs are subject to arbitrary pricing.<sup>146</sup> Similar to conventional art, the popularity of digital artists and the availability of an NFT will affect a token's stance in the market.<sup>147</sup> However, the non-fungibility feature makes all NFTs equally scarce and unique, causing NFT developers to focus on utility as a distinguishing factor that increases their tokens' price.<sup>148</sup> In an effort to add real life value to their NFTs, project developers are now marketing their tokens as assets that offer more than just official ownership on the blockchain.<sup>149</sup> The transaction also grants token holders access to certain benefits and opportunities that are shared exclusively among their NFT community.<sup>150</sup> The most successful NFT projects to date—including, but not limited to, Bored Ape Yacht Club (BAYC) and VeeFriends—offer significant perks, such as admission to private events and the ability to mint additional NFTs for the token holder's personal collection.<sup>151</sup> For example, persons who buy into the VeeFriends community gain a three-year access pass to VeeCon, a business event hosted by the NFT project.<sup>152</sup> BAYC is another sought-

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<sup>144</sup> For example, Murakami was considering different types of smart contracts and whether to launch a specialized NFT storefront. See Takashi Murakami (@takashipom), INSTAGRAM (Apr. 10, 2021), <https://www.instagram.com/p/CNgMKRbl2JJ> (last visited Oct. 21, 2022).

<sup>145</sup> See Michael Bentley, *What Are Utility-Driven NFTs and Why This Matters*, RITZ HERALD (Nov. 2, 2021), <https://ritzherald.com/what-are-utility-driven-nfts-and-why-this-matters> [<https://perma.cc/6KC2-9NU4>].

<sup>146</sup> *Id.*; see *How to Assess the Value of an NFT?*, BINANCE BLOG (July 15, 2021), <https://www.binance.com/en/blog/nft/how-to-assess-the-value-of-an-nft-421499824684902357> [<https://perma.cc/822F-YR7J>]; see also *supra* Section I.B.1.

<sup>147</sup> See *How to Assess the Value of an NFT?*, *supra* note 146.

<sup>148</sup> "Projects . . . are using utilities to give their NFTs value by turning them into a sort of VIP membership card." Bentley, *supra* note 145.

<sup>149</sup> In developing the Open Head NFT collection, the project's chief executive prioritized the tokens' long-term utility to attract valuable NFT collectors. See Oluwaseun Adeyanju, *New NFT Project Is Using Raffles to Create Long-Term Utility*, FORBES (Dec. 31, 2021, 6:56 AM), <https://www.forbes.com/sites/oluwaseunadeyanju/2021/12/31/new-nft-project-is-using-raffles-to-create-long-term-utility> [<https://perma.cc/7G2K-ABZ6>].

<sup>150</sup> See *How to Assess the Value of an NFT?*, *supra* note 146.

<sup>151</sup> "Both of these projects are great examples of how utilities can help create the real market value that is sorely missing in the NFT space." Bentley, *supra* note 145.

<sup>152</sup> *Frequently Asked Questions*, VEEFRIENDS, <https://veefriends.com/faqs> [<https://perma.cc/B8XK-LS4V>].

after NFT collection consisting of 10,000 avatars.<sup>153</sup> BAYC is notorious for implementing significant benefits and is recognized as one of the largest and most prestigious NFT communities to join.<sup>154</sup> The tokens were valued at approximately \$190 when they first launched.<sup>155</sup> A few months later, the digital Apes were being sold for well over \$200,000.<sup>156</sup> BAYC then gave its members the opportunity to create (mint) a bonus NFT free of cost.<sup>157</sup> These newly minted NFTs, collectively known as Mutant Ape Yacht Club, are valuable tokens that could generate substantial profits for their respective owners.<sup>158</sup>

### 1. Art as a Self-Regulated Industry

Art is a self-regulated industry, making it a business more susceptible to criminals successfully transferring dirty money through million-dollar art sales without legal consequences.<sup>159</sup> To offset the lack of external supervision, the four largest auction houses—Sotheby's, Christie's, Phillips, and Bonhams—have voluntarily implemented their own regulatory systems.<sup>160</sup> Although they actively attempt to combat money laundering among in-house transactions, the Russian oligarchs case study proves that their efforts are ultimately insufficient.<sup>161</sup> There

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<sup>153</sup> Daniel Van Boom, *The Insane Bored Ape Yacht Club NFT Collection Explained*, CNET (Jan. 3, 2022, 4:26 PM), <https://www.cnet.com/how-to/the-insane-bored-ape-yacht-club-nft-collection-explained> [https://perma.cc/53DJ-7DR4].

<sup>154</sup> *See id.*

<sup>155</sup> *Id.*

<sup>156</sup> *Id.* The price of the Bored Apes depends on the ape's unique attributes, including their facial expression, fur color, and wardrobe. *Id.*

<sup>157</sup> BAYC token-holders received mutant serums that could be "mixed" with their Ape to generate an additional NFT. *Id.*

<sup>158</sup> BI India Bureau, *NFTs Bored Apes and Mutant Apes Kick Off 2022 on a High with Floor Prices Jumping More Than 40%*, BUS. INSIDER: INDIA (Jan. 3, 2022, 5:22 PM), <https://www.businessinsider.in/investment/news/nfts-bored-apes-and-mutant-apes-kick-off-2022-on-a-high-with-floor-prices-jumping-more-than-40/articleshow/88667887.cms> [https://perma.cc/K9WS-SUCU].

<sup>159</sup> "In the United States federal money laundering statutes apply to nearly every major transaction through which illegal profits are disguised to look legal." Patricia Cohen, *Valuable as Art, but Priceless as a Tool to Launder Money*, N.Y. TIMES (May 12, 2013), <https://www.nytimes.com/2013/05/13/arts/design/art-proves-attractive-refuge-for-money-launderers.html?smid=pl-share> (last visited Jan. 16, 2023).

<sup>160</sup> STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SEC. & GOV'T AFFS., 116TH CONG., *THE ART INDUS. & U.S. POL'YS THAT UNDERMINE SANCTIONS* 9–10 (Comm. Print 2020).

<sup>161</sup> Auction houses are not legally required to implement anti-money laundering programs. The houses retain full discretion when designing programs and enforcement procedures. *See Egan, supra* note 69; *see also supra* Section I.A.

may be client transactions that are not deemed suspicious as to require further investigation, and the extra layer of due diligence inevitably falls through the cracks.<sup>162</sup> If the art industry continues to escape the BSA reporting requirements, auction houses will continue to rely exclusively on their voluntarily implemented programs.<sup>163</sup> Even under the assumption that their client investigations were to reveal criminal behavior, auction houses are responsible for merely a fraction of art exchanges in the United States and thus would only address a minor portion of art-related money laundering cases.<sup>164</sup> The power to tackle this issue lies in the hands of art dealers and small institutions.<sup>165</sup>

However, compared to larger entities, private dealers, small galleries, and other third parties lack the same incentives and resources to implement anti-money laundering practices.<sup>166</sup> Dealers often conduct business without examining questionable behavior and instead rely on their counsel's judgment—if such legal services are available to them—trusting them to search for inconsistencies and red flags.<sup>167</sup> Additionally, dealers and other agents are not in the best position to recognize suspicious transactions, especially when their careers are based on selling artworks that yield large profits.<sup>168</sup>

The foregoing explanation highlighting the insufficiency of in-house systems, together with the unrealistic expectation that the most vulnerable intermediaries would detect the presence of money laundering, leads to the conclusion that even if auction houses and galleries independently enforce certain reporting and recordkeeping guidelines, their procedures are inadequate to identify high-level criminal schemes.

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<sup>162</sup> The auction houses' anti-money laundering initiatives are not guaranteed to combat money laundering in the art market. They are "lax" and "easily circumvented." See Egan, *supra* note 69; see also *supra* Section I.A.

<sup>163</sup> See Egan, *supra* note 69.

<sup>164</sup> "Dealers and galleries were the most commonly used channel for purchasing in [2020 and 2021] (as they have been consistently in collector surveys over the last three years), with 82% of respondents having purchased through a dealer in the first half of 2021." CLARE MCANDREW, ART BASEL & UBS, RESILIENCE IN THE DEALER SECTOR 85 (2021).

<sup>165</sup> See *id.*

<sup>166</sup> Shea, *supra* note 1, at 678–81.

<sup>167</sup> Engan, *supra* note 69.

<sup>168</sup> Thomas W. Pecoraro, *Choice of Law in Litigation to Recover National Cultural Property: Efforts at Harmonization in Private International Law*, 31 VA. J. INT'L L. 1, 44 n.189 (1990) ("Art dealers are motivated primarily by self-interest in often preferring not to inquire into the nature of the goods they obtain.").

## 2. Real Estate: Legislative History

There are other industries that likewise have been historically insulated from federal oversight, one of the most prominent examples being real estate.<sup>169</sup> Real estate involves price variations that are mainly determined by the constant movement in the market.<sup>170</sup> Fluctuations in the value of real estate are difficult to flag, and the absence of uniform price tags allows money launderers to move their cash through the purchase of property.<sup>171</sup> Although FinCEN has made an effort to address these issues, criminals are still able to use real estate as a way to cleanse unlawful proceeds because, just like the art industry, real estate continues to be largely unregulated.<sup>172</sup>

The BSA regulates “persons involved in real estate closings and settlements,” yet agents, title insurers, and other major players in the real estate business are not within the purview of the BSA.<sup>173</sup> FinCEN has taken measures to impose specific reporting requirements beyond the vague language of the statute.<sup>174</sup> In 2016, an increase in real estate money-laundering activity led FinCEN to issue temporary Geographic Targeting Orders (GTO) in Manhattan and Miami-Dade County.<sup>175</sup> The GTO required title insurance companies to report all-cash transactions linked to high-end residential real estate.<sup>176</sup> In 2021, FinCEN renewed its temporary GTO, thereby obligating title insurance companies to identify buyers who used shell companies to purchase residential real estate through all-cash transactions.<sup>177</sup> However, the temporary nature and

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<sup>169</sup> Shea, *supra* note 1, at 670.

<sup>170</sup> See FIN. ACTION TASK FORCE, MONEY LAUNDERING & TERRORIST FINANCING THROUGH THE REAL ESTATE SECTOR 5 (2008), <https://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20through%20the%20Real%20Estate%20Sector.pdf> [https://perma.cc/WHS6-HZW4].

<sup>171</sup> *Id.*

<sup>172</sup> While the agency’s “de facto” regulation is a step in the right direction, it is ultimately in the hands of Congress to expand the law. Peter D. Hardy, Terence M. Grugan, Priya Roy & Mary K. Treanor, *The Intersection of Money Laundering and Real Estate*, BALLARD SPAHR LLP, May 2020, at 1, <https://www.ballardspahr.com/-/media/files/articles/intersection-of-money-laundering-and-real-estate.pdf?la=en&hash=CBF6D4BC82C0FAE004F26F4A64352889> [https://perma.cc/ET9U-CCSD].

<sup>173</sup> 31 U.S.C. § 5312(a)(2)(u); see also Hardy, Grugan, Roy & Treanor, *supra* note 172.

<sup>174</sup> Hardy, Grugan, Roy & Treanor, *supra* note 172.

<sup>175</sup> FIN. CRIMES ENF’T NETWORK, U.S. DEP’T OF TREASURY, FINCEN TAKES AIM AT REAL ESTATE SECRECY IN MANHATTAN AND MIAMI (2016), [https://www.fincen.gov/sites/default/files/news\\_release/20160113.pdf](https://www.fincen.gov/sites/default/files/news_release/20160113.pdf) [https://perma.cc/3RAA-UNN8].

<sup>176</sup> FinCEN defines all-cash transactions as non-financed purchases. *Id.*

<sup>177</sup> The renewed GTO now applies to cities beyond Miami-Dade County and Manhattan, including Boston, Las Vegas, and other metropolitan areas in the United States. FIN. CRIMES ENF’T

limited application of the orders suggest that they are simply a makeshift solution for the problem of shell companies.<sup>178</sup> Similar to art, purchasers of commercial real estate may continue preserving their anonymity by using shell companies to mask their identities as beneficial owners.<sup>179</sup> The exclusions from FinCEN's regulations imply that, despite an extension of the BSA to antiquities, much of the art world may fall outside the scope of the statutory language.<sup>180</sup>

The opacity in markets like real estate and art already offer an appealing mechanism to launder money, and criminals have been able to engage in illicit conduct due to a lack of government control.<sup>181</sup> This same rationale extends to the novel concept of virtual art, as the NFT business—particularly its abstract nature—provides assurance that illicit behavior will likely go undetected.<sup>182</sup> Now, criminals will surely thrive in a world of unregulated dealings.<sup>183</sup>

## II. ANALYSIS

In a short span of several months, NFTs have gained widespread attention, which indicates that the digital marketplace is bound to continue expanding rapidly.<sup>184</sup> The evolution of blockchain technology and NFTs generates serious apprehensions that the law simply cannot

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NETWORK, U.S. DEP'T OF TREASURY, GEOGRAPHIC TARGETING ORDER (2021), [https://www.fincen.gov/sites/default/files/shared/Real%20Estate%20GTO\\_Order\\_4.29.22\\_for%20Press%20Release.pdf](https://www.fincen.gov/sites/default/files/shared/Real%20Estate%20GTO_Order_4.29.22_for%20Press%20Release.pdf) [<https://perma.cc/4VXW-V9XT>].

<sup>178</sup> FIN. CRIMES ENF'T NETWORK, U.S. DEP'T OF TREASURY, ADVISORY TO FINANCIAL INSTITUTIONS AND REAL ESTATE FIRMS AND PROFESSIONALS I (2017), [https://www.fincen.gov/sites/default/files/advisory/2017-08-22/Risk%20in%20Real%20Estate%20Advisory\\_FINAL%20508%20Tuesday%20%28002%29.pdf](https://www.fincen.gov/sites/default/files/advisory/2017-08-22/Risk%20in%20Real%20Estate%20Advisory_FINAL%20508%20Tuesday%20%28002%29.pdf) [<https://perma.cc/NCY5-QRMB>] (“While real estate brokers, escrow agents, title insurers, and other real estate professionals are not required to, FinCEN encourages them to voluntarily report suspicious transactions involving real estate purchases and sales.”).

<sup>179</sup> Pacini, Stowell, Katz, Patterson & Lin, *supra* note 49, at 13–14.

<sup>180</sup> William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6110(a)(1), 134 Stat. 3388, 4561–62 (to be codified at 31 U.S.C. § 5312(a)(2)).

<sup>181</sup> See *supra* Section I.A.

<sup>182</sup> See *supra* Section I.A.

<sup>183</sup> See *supra* Section I.A.

<sup>184</sup> See Eric Hylton, *Legal Considerations in the Fight Against Cryptocurrency Tax Fraud*, 135 J. TAX'N 7, 9 (2021); An P. Doan, Mark W. Rasmussen, Courtney Lyons Snyder, Joshua B. Sterling & D. Grayson Yeargin, *NFTs: Key U.S. Legal Considerations for an Emerging Asset Class*, JONES DAY (Apr. 2021), <https://www.jonesday.com/en/insights/2021/04/nfts-key-us-legal-considerations-for-an-emerging-asset-class> [<https://perma.cc/D9EX-HRUD>].

catch up at an equal pace.<sup>185</sup> Since NFTs are a novel addition to the market, it remains unclear how exactly they fit into existing rules or whether they will be regulated at all.<sup>186</sup>

While the concept of intangible ownership continues developing across numerous industries, the difficulty in classifying these digital assets within the legislative regime is a growing concern.<sup>187</sup> This Note surveys several existing anti-money laundering laws that could potentially apply to NFT exchanges and explores the likelihood of including NFTs into statutes as currently enforced.<sup>188</sup> NFTs are technically a form of artwork, and their public attention surrounding the art business supports this classification.<sup>189</sup> However, NFTs are stored on the blockchain and represent an extension to the innovative trend of virtual currencies such as Bitcoin.<sup>190</sup> While the structure and presence of NFTs resemble cryptocurrency, their differences prove that federal agencies cannot regulate them under the same laws.<sup>191</sup> Others have considered whether these intangible tokens are securities or commodities, but their non-fungible configuration suggests that NFTs may fall outside the scope of securities law.<sup>192</sup>

#### A. *Bank Secrecy Act Extended to Antiquities*

On January 1, 2021, Congress enacted the FY2021 National Defense Authorization Act (NDAA),<sup>193</sup> which introduced the Anti-Money

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<sup>185</sup> See Garry Gabison, *Policy Considerations for the Blockchain Technology Public and Private Applications*, 19 SMU SCI. & TECH. L. REV. 327, 349–50 (2016); see Lewis, Owen, Fraser & Dighe, *supra* note 114, at 18–19.

<sup>186</sup> See Chris Bennett & Cody Koblinsky, *Non-Fungible Tokens: Emerging Issues in the Emerging Marketplace*, DLA PIPER (Mar. 30, 2021), <https://www.dlapiper.com/en/us/insights/publications/2021/03/ipt-news-q1-2021/non-fungible-tokens-emerging-issues-in-the-emerging-marketplace> [<https://perma.cc/VJK5-C9AL>].

<sup>187</sup> See *infra* Sections II.A–II.C.

<sup>188</sup> See *infra* Sections II.B–II.C.

<sup>189</sup> Sebastian Smee, *Will NFTs Transform the Art World? Are They Even Art?*, WASH. POST (Dec. 18, 2021, 6:00 AM), <https://www.washingtonpost.com/arts-entertainment/2021/12/18/nft-art-faq> [<https://perma.cc/KZQ2-7N6D>].

<sup>190</sup> Sylvia Jablonski, *Are NFTs the New Crypto? A Guide to Understanding Non-Fungible Tokens*, FORBES (June 9, 2021, 7:30 AM), <https://www.forbes.com/sites/forbesbusinesscouncil/2021/06/09/are-nfts-the-new-crypto-a-guide-to-understanding-non-fungible-tokens/?sh=458a57dc3d95> [<https://perma.cc/WZR7-UHRA>].

<sup>191</sup> “A common misconception is that NFTs are a type of cryptocurrency. The similarities between crypto and NFTs are that they both have a stored digital record on a blockchain.” *Id.*

<sup>192</sup> See Rohr & Wright, *supra* note 17, at 494–96. See generally Chiu & Allen, *supra* note 132, at 426–27.

<sup>193</sup> PAT TOWELL, CONG. RSCH. SERV., R46714, FY2021 NATIONAL DEFENSE AUTHORIZATION ACT: CONTEXT AND SELECTED ISSUES FOR CONGRESS 1–2 (2021).

Laundering Act of 2020 (AMLA) establishing significant amendments to the BSA.<sup>194</sup> Pursuant to Section 6110 of the AMLA, persons “engaged in the trade of antiquities, including an advisor, consultant, or any other person who engages as a business in the solicitation or the sale of antiquities” must comply with the BSA requirements.<sup>195</sup>

Through these amendments, the AMLA aims to increase federal scrutiny of the industry and address the grave lack of transparency.<sup>196</sup> This marks the first time that transactions involving antiquities will endure such rigorous levels of review.<sup>197</sup> “Antiquities” is not defined in the language of the amendment, as it is subject to regulations proscribed by the Secretary of the Treasury.<sup>198</sup> FinCEN has yet to issue a proposed rule to enforce the amendment, but the agency’s advance notice of proposed rulemaking<sup>199</sup> implies that “antiquities and art” will be treated as one and the same.<sup>200</sup> FinCEN intends to refine the broad statutory language and determine whether any exceptions apply.<sup>201</sup> This presents the ideal opportunity for FinCEN to include NFTs within the scope of antiquities and art.

The amendment indicates that money launderers who have been relying on shell companies and other layering methods will now face greater obstacles to avoiding federal investigation.<sup>202</sup> The AMLA expansion should serve as a warning to individuals who are abusing the art market to transform their dirty funds and have managed to escape the

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<sup>194</sup> See Barry Bendes, *Anti-Money Laundering Act of 2020 Requires Beneficial Ownership Filings by Businesses*, JD SUPRA (Jan. 5, 2021), <https://www.jdsupra.com/legalnews/anti-money-laundering-act-of-2020-2331020> [<https://perma.cc/STR6-385V>].

<sup>195</sup> William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6110(a)(1), 134 Stat. 3388, 4561–62 (to be codified at 31 U.S.C. § 5312(a)(2)).

<sup>196</sup> Anti-Money Laundering Regulations for Dealers in Antiquities, 86 Fed. Reg. 53021, 53021–24 (proposed Sept. 24, 2021) (to be codified at 31 C.F.R. ch. X).

<sup>197</sup> The due diligence conducted by auction houses is far from rigorous. See Egan, *supra* note 69.

<sup>198</sup> William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6110, 134 Stat. 3388, 4561–62 (to be codified at 31 U.S.C. § 5312(a)(2)).

<sup>199</sup> Anti-Money Laundering Regulations for Dealers in Antiquities, 86 Fed. Reg. 53021, 53021–24.

<sup>200</sup> See *id.*; FIN. CRIMES ENFT NETWORK, U.S. DEP’T OF TREASURY, FINCEN INFORMS FINANCIAL INSTITUTIONS OF EFFORTS RELATED TO TRADE IN ANTIQUITIES AND ART (2021), [https://www.fincen.gov/sites/default/files/2021-03/FinCEN%20Notice%20on%20Antiquities%20and%20Art\\_508C.pdf](https://www.fincen.gov/sites/default/files/2021-03/FinCEN%20Notice%20on%20Antiquities%20and%20Art_508C.pdf) [<https://perma.cc/7KJY-GAV7>].

<sup>201</sup> *Id.* (“The study will include an analysis of, among other things, which markets should be subject to regulations and the degree to which the regulations, if any, should focus on high-value trade in works of art, and on the need to identify the actual purchasers of such works, in addition to other persons engaged in the art trade.”).

<sup>202</sup> Eileen Kinsella, *Lawmakers Are Cracking Down on the ‘Unregulated’ US Art Market. Here’s How a New Anti-Money Laundering Law Will Affect Dealers*, ARTNET (Jan. 6, 2021), <https://news.artnet.com/art-world/what-will-stricter-us-oversight-of-the-antiquities-trade-look-like-1935081> [<https://perma.cc/RXF5-XAV5>].

legal repercussions thus far.<sup>203</sup> Some are questioning how the AMLA will impact a business that is driven by its clients, particularly ones who appreciate privacy.<sup>204</sup> If officials intend to enforce customer identification rules in an industry defined by confidentiality, cooperation may be an issue.<sup>205</sup>

### B. *NFTs Are Not Currency Substitutes*

NFTs are an addition to the established blockchain network, and a look at the legislative history of cryptocurrency regulations could shed light on a future timeline for the emerging NFT space. Decentralized exchanges as we know them today date back to the creation of Bitcoin in 2009.<sup>206</sup> Still, FinCEN did not address the implications of decentralized virtual currencies until 2013 when it released interpretive guidance clarifying their scope within the BSA.<sup>207</sup> Section 5330 of the BSA specifies that persons involved “in the transmission of currency, funds, or value that substitutes for currency” must comply with the statutory requirements.<sup>208</sup> However, the 2013 guidance established that Section 5330 only applied to persons engaged in “money transmission services.”<sup>209</sup> The concept of a money transmitting service is commonly known as a mixing (or tumbling) service.<sup>210</sup> A cryptocurrency tumbler combines diverse cryptocurrency funds to cause confusion in tracing the initial source of an illegal transaction.<sup>211</sup> Given that blockchain operates as a peer-to-peer payment system, numerous users could

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<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

<sup>205</sup> *See id.*

<sup>206</sup> Nathaniel Popper, *Decoding the Enigma of Satoshi Nakamoto and the Birth of Bitcoin*, N.Y. TIMES (May 15, 2015), <https://www.nytimes.com/2015/05/17/business/decoding-the-enigma-of-satoshi-nakamoto-and-the-birth-of-bitcoin.html> (last visited Jan. 17, 2023) (“Someone using the name Satoshi Nakamoto released the software for Bitcoin in early 2009 . . .”).

<sup>207</sup> *See* FIN. CRIMES ENF’T NETWORK, U.S. DEP’T OF THE TREASURY, GUIDANCE: APPLICATION OF FINCEN’S REGULATIONS TO PERSONS ADMINISTERING, EXCHANGING, OR USING VIRTUAL CURRENCIES (2013) [hereinafter FIN. CRIMES ENF’T NETWORK, GUIDANCE], <https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf> [<https://perma.cc/CQJ6-LMZV>].

<sup>208</sup> 31 U.S.C. § 5330(d)(1)(A); Matthew Hanson et al., *The Anti-Money Laundering Act and Crypto Collide: Non-Fungible Tokens*, JD SUPRA (May 19, 2021), <https://www.jdsupra.com/legalnews/the-anti-money-laundering-act-and-3117511> [<https://perma.cc/Z3YC-STEX>].

<sup>209</sup> *See* FIN. CRIMES ENF’T NETWORK, GUIDANCE, *supra* note 207 (“An administrator or exchanger that (1) accepts and transmits a convertible virtual currency or (2) buys or sells convertible virtual currency for any reason is a money transmitter under FinCEN’s regulations . . .” (emphasis omitted)). *Id.*

<sup>210</sup> *United States v. Harmon*, 474 F. Supp. 3d 76, 82 (D.D.C. 2020).

<sup>211</sup> *Id.*



participate in unsupervised dealings.<sup>212</sup> The cryptocurrency movement advanced at an impressive pace, and “[c]rypto laundering” became the black market of cyber criminals.<sup>213</sup>

In 2019, FinCEN issued an updated advisory memo where the agency reviewed the issues presented by convertible virtual currency (CVC) and reestablished that individuals and entities operating cryptocurrency-based exchanges (P2P exchangers) are expected to register as a money service business.<sup>214</sup> Moreover, the memo discussed the danger of darknet marketplaces, especially those that are only accessible through anonymous networks using special configurations.<sup>215</sup> On its face, this language could theoretically embody blockchain databases and, consequently, Ethereum.<sup>216</sup> However, based on FinCEN’s detailed descriptions and illustrations of the implicated darknet marketplaces, blockchain does not quite fit the title.<sup>217</sup>

NFTs are primarily sold through online platforms; most individuals trade tokens on OpenSea, Rarible, and Nifty Gateway.<sup>218</sup> These websites provide universal accessibility by linking NFT creators to consumers who are interested in purchasing their works.<sup>219</sup> These forums would not qualify as darknet marketplaces because they neither sell illegal goods or services nor directly support any type of illicit activity.<sup>220</sup> Furthermore, FinCEN explained that large “trading platforms” connecting buyers and sellers are not expected to register as

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<sup>212</sup> SATOSHI NAKAMOTO, BITCOIN: A PEER-TO-PEER ELECTRONIC CASH SYSTEM 1 (2008), <https://bitcoin.org/bitcoin.pdf> [<https://perma.cc/RRN9-6L46>].

<sup>213</sup> Nick Oberheiden, *Bitcoin and Money Laundering*, JD SUPRA (Oct. 5, 2021), <https://www.jdsupra.com/legalnews/bitcoin-and-money-laundering-2928902> [<https://perma.cc/46B4-KLLC>].

<sup>214</sup> FIN. CRIMES ENF’T NETWORK, U.S. DEP’T OF THE TREASURY, ADVISORY ON ILLICIT ACTIVITY INVOLVING CONVERTIBLE VIRTUAL CURRENCY (2019) [hereinafter FIN. CRIMES ENF’T NETWORK, ADVISORY ON ILLICIT ACTIVITY], <https://www.fincen.gov/sites/default/files/advisory/2019-05-10/FinCEN%20Advisory%20CVC%20FINAL%20508.pdf> [<https://perma.cc/VP49-THD2>].

<sup>215</sup> *Id.* at 3 (“Darknet marketplaces are websites that are only available in anonymized overlay networks that require specific software to access. Some require additional vetting or configurations to access.”).

<sup>216</sup> *See id.*

<sup>217</sup> *See id.* (describing darknet marketplaces as networks that support illicit activity such as buying and selling drugs and engaging in child exploitation).

<sup>218</sup> Grace Kay, *People Are Buying and Selling Crypto Collectibles in a \$250 Million Market—Check Out the Sites Where You Can Browse and Bid on NFTs*, BUS. INSIDER (Apr. 2, 2021, 2:50 PM), <https://www.businessinsider.com/nft-marketplaces-where-to-buy-sell-non-fungible-tokens-online-2021-3> [<https://perma.cc/5EBJ-YN8Y>].

<sup>219</sup> *Id.*

<sup>220</sup> FIN. CRIMES ENF’T NETWORK, ADVISORY ON ILLICIT ACTIVITY, *supra* note 214, at 3.

money transmitting businesses.<sup>221</sup> NFTs are not illegal assets, and thus OpenSea, Rarible, and Nifty Gateway do not risk potential liability under the FinCEN advisory.<sup>222</sup>

The advisory memo also offers a set of red flags to guide companies in identifying suspicious transactions.<sup>223</sup> For instance, the use of multiple virtual currencies as an attempt to intervene with tracing ownership on a blockchain triggers a deeper investigation of the source.<sup>224</sup> This same method of concealment could be utilized when buying and selling NFTs; the coins used to purchase an NFT could be distributed among several accounts, making it difficult to link the token to its owner.<sup>225</sup> Nevertheless, without a qualifying financial institution or money transmitting business, these activities will not be discovered.

Following the updated memo, FinCEN has demonstrated diligent enforcement of the AMLA against cryptocurrency exchanges.<sup>226</sup> The agency recently filed a \$100 million enforcement action against BitMEX, a long-standing cryptocurrency exchange platform, for noncompliance with reporting and recordkeeping requirements.<sup>227</sup> BitMEX failed to implement an anti-money laundering program with proper customer identification procedures and due diligence efforts and likewise refused to report numerous suspicious transactions.<sup>228</sup> Customers were solely required to provide an email address to participate in the cryptocurrency platform, and BitMEX did not take further steps to verify customers' identities, nor were they planning to take such measures in the near future.<sup>229</sup> BitMEX was only willing to adopt a more stringent customer information program as a response to governmental pressure.<sup>230</sup> Absent

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<sup>221</sup> *Id.* While high-volume trading platforms are not considered peer-to-peer exchangers, “[r]ecent cases suggest that CVC buyers and sellers involved in small-volume exchanges are increasingly used for money laundering purposes . . . .” *Id.* at 5.

<sup>222</sup> *See id.* at 7–10.

<sup>223</sup> *Id.*

<sup>224</sup> *Id.* at 9.

<sup>225</sup> Hanson et al., *supra* note 208.

<sup>226</sup> *See, e.g., FinCEN Announces \$100 Million Enforcement Action Against Unregistered Futures Commission Merchant BitMEX for Willful Violations of the Bank Secrecy Act*, FIN. CRIMES ENFT NETWORK (Aug. 10, 2021), <https://www.fincen.gov/news/news-releases/fincen-announces-100-million-enforcement-action-against-unregistered-futures> [<https://perma.cc/3UD5-9D26>].

<sup>227</sup> *Id.* (“These willful failures expose financial institutions to an increased risk of conducting transactions with money launderers and terrorist financiers . . . .”).

<sup>228</sup> Assessment of Civil Money Penalty at 4, HDR Glob. Trading Ltd., No. 2021-02 (Fin. Crimes Enft Network, Aug. 10, 2021).

<sup>229</sup> Kelly A. Lenahan-Pfahlert & Peter D. Hardy, *FinCEN and CFTC Reach Groundbreaking \$100 Million AML Settlement with BitMEX*, BALLARD SPAHR LLP (Aug. 25, 2021), <https://www.moneylaunderingnews.com/2021/08/fincen-and-cftc-reach-groundbreaking-100-million-aml-settlement-with-bitmex> [<https://perma.cc/9NDN-6PF4>].

<sup>230</sup> *Id.*

such pressure, customers were able to engage in unrestrained activities that inevitably resulted in illegal transactions totaling \$209 million.<sup>231</sup>

FinCEN has adapted to innovative platforms and products in the financial technology world, and their concerns regarding illicit activity in connection with convertible virtual currency may suggest that the agency is prepared to address NFTs. An NFT is not a currency substitute and thus cannot be regulated as such, but how long will it take to decipher what exactly is a digital token?

### C. Securities Regulations and Fractionalized NFTs

Unlike paintings, drawings, sculptures, or other concrete artworks that can be displayed in a collector's home, NFTs are wholly intangible.<sup>232</sup> Their abstract configuration is comparable to stocks and bonds in form, and hence, a token could potentially be treated as a security.<sup>233</sup> But NFTs ultimately do not meet the standard.<sup>234</sup> In *Securities and Exchange Commission v. W.J. Howey Co.*, the Court established a framework known as the *Howey* test to decide whether the Securities Act of 1933 and the Securities Exchange Act of 1934 apply to certain trades.<sup>235</sup> The test provides that securities law governs an exchange if there is an investment contract.<sup>236</sup> In 2019, members of the Securities and Exchange Commission's FinHub released their own analysis of digital assets under the *Howey* framework; this analysis does not discuss NFTs specifically.<sup>237</sup> NFTs are surely an investment of money, thus satisfying the initial

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<sup>231</sup> *FinCEN Announces \$100 Million Enforcement Action Against Unregistered Futures Commission Merchant BitMEX for Willful Violations of the Bank Secrecy Act*, *supra* note 226.

<sup>232</sup> See João Marinotti, *Tangibility as Technology*, 37 GA. ST. U. L. REV. 671, 676–77 (2021).

<sup>233</sup> Diana Qiao, *This Is Not a Game: Blockchain Regulation and Its Application to Video Games*, 40 N. ILL. U. L. REV. 176, 219 (2020) (“For example, a company could sell non-fungible tokens at different prices toward the potential buyers, the buyers are making an investment by buying the NFT, and expecting their token to increase in price (returning a profit), but it is debatable on whether or not the profits the buyers make off of the NFTs are supported by the efforts of the company's or blockchain developer's promoters (common enterprise). Under the broad vertical commonality test, one may argue that a common enterprise exists because the increase in the NFT's value could be attributed to the efforts of the company's promoters.”).

<sup>234</sup> *Id.*

<sup>235</sup> *Sec. Exch. Comm'n v. W.J. Howey Co.*, 328 U.S. 293 (1946).

<sup>236</sup> An investment contract is “an investment of money in a common enterprise with profits to come solely from the efforts of others.” *Howey*, 328 U.S. at 301.

<sup>237</sup> *Framework for “Investment Contract” Analysis of Digital Assets*, U.S. SEC. & EXCH. COMM'N (Apr. 3, 2019), <https://www.sec.gov/corpfin/framework-investment-contract-analysis-digital-assets> [https://perma.cc/3PR7-CBKF].

requirement of the *Howey* test.<sup>238</sup> Although regulators may not anticipate difficulties with the common enterprise prong, NFTs can complicate an analysis that otherwise seems simple when considering digital assets in a general sense.<sup>239</sup> In particular, it is unfeasible to classify individual investors as part of a common enterprise due to the non-fungibility and sole ownership aspects of NFT purchases.<sup>240</sup> Moreover, a buyer of digital assets likely does not have a reasonable expectation to derive profits from the efforts of others.<sup>241</sup> The purpose of a non-fungible token is that each NFT is one of a kind and hence, someone who buys an NFT is not depending on others to gain profits.<sup>242</sup> Finally, the value of an NFT, or any appreciation or depreciation that would occur, is not driven by the behavior of third parties, because the success of one investor is unrelated to and wholly independent from the success of another.<sup>243</sup>

Perhaps the only potential target for securities regulators are fractionalized NFTs.<sup>244</sup> Fractionalized NFTs (F-NFTs) represent partial ownership in a larger asset, in the same way that owning a share in a company grants the shareholder a fractional right to that company's profit.<sup>245</sup> From that perspective, the value of the NFT will fluctuate as a whole, and each investor of the F-NFT would obtain assets that are part

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<sup>238</sup> “The first prong of *Howey* is also the most straightforward: courts have held that an ‘investment of money’ need not be in the form of cash and thus, even though f-NFTs are bought using cryptocurrency, they likely satisfy the first prong.” Robert Anello, *Digital Art May Be Next in the SEC’s Crosshairs*, FORBES (July 15, 2021, 9:48 PM), <https://www.forbes.com/sites/insider/2021/07/15/digital-art-may-be-next-in-the-secs-crosshairs/?sh=f94081232dff> [https://perma.cc/7QAY-UYEJ].

<sup>239</sup> “[I]nvestments in digital assets have constituted investments in a common enterprise because the fortunes of digital asset purchasers have been linked to each other or to the success of the promoter’s efforts.” *Framework for “Investment Contract” Analysis of Digital Assets*, *supra* note 237, at n.11 (citing *Sec. Exch. Comm’n v. Int’l Loan Network, Inc.*, 968 F.2d 1304, 1307 (D.C. Cir. 1992)).

<sup>240</sup> Qiao, *supra* note 233, at 219.

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> *Id.* “Price appreciation resulting solely from external market forces (such as general inflationary trends or the economy) impacting the supply and demand for an underlying asset generally is not considered ‘profit’ under the *Howey* test.” *Framework for “Investment Contract” Analysis of Digital Assets*, *supra* note 237.

<sup>244</sup> Doan, Rasmussen, Snyder, Sterling & Yeargin, *supra* note 184 (“An NFT could be considered a security, however, if it were designed to provide an expectation of profit to the buyer based on the efforts of others and were marketed as such. One potential example of such an arrangement could be a ‘fractional’ NFT (‘f-NFT’), where an investor would share a partial interest in an NFT with others.”).

<sup>245</sup> See Karen J. Garnett, Jeffrey D. Neuburger & Frank Zarb, *NFTs Are Interesting but Fractionalized Non-Fungible Tokens (F-NFTs) May Present Even More Challenging Legal Issues*, NAT’L L. REV. (Apr. 22, 2021), <https://www.natlawreview.com/article/nfts-are-interesting-fractionalized-non-fungible-tokens-f-nfts-may-present-even-more> [https://perma.cc/8T3S-C9RD].

of a common enterprise.<sup>246</sup> While F-NFTs may independently qualify as securities, the current industry is not structured as a stock market.<sup>247</sup>

### III. PROPOSAL

#### A. *Regulate NFTs Within the Scope of Antiquities*

After decades of rampant crime in the art world, Congress has finally included “antiquities” in the language of the BSA, yet the scope of that language remains unclear.<sup>248</sup> An analysis of FinCEN’s advisory on the real estate market sparks concerns that certain actors in the art world will be excluded from federal supervision.<sup>249</sup> If FinCEN adopts a similar strategy when imposing restrictions on art, money laundering activity will inevitably skyrocket.

The strongest, most reasonable approach for regulating NFTs is to interpret them as antiquities under Section 6110 of the AMLA.<sup>250</sup> Treating NFTs as a form of art avoids the wide array of interpretations and uncertainties that would evolve if NFTs were labeled as a member of the cryptocurrency movement or as a security. It would be unsurprising for new forms of intangible art to join the market and make a similar impact. Therefore, this interpretation will avoid future ambiguities by setting the stage for transactions involving other digital variations regarded as art.

On the other hand, as this new digital asset class continues to emerge, it is stepping further away from the traditional art market. Creators are incorporating non-artistic features into their tokens, suggesting that NFTs may not be part of the art world after all.<sup>251</sup> NFTs have had an effect on the gaming industry—token holders have the

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<sup>246</sup> Chiu & Allen, *supra* note 132, at 416, 428.

<sup>247</sup> *Id.*; Garnett, Neuburger & Zarb, *supra* note 245. As FinHub suggests, an NFT investor’s reasonable expectation of profits derived from others will depend on whether: (i) they may be exchanged on a secondary market; (ii) a larger audience will eventually have (realistic) access to the asset; and (iii) they are marketed as an investment opportunity, among other considerations. *Framework for “Investment Contract” Analysis of Digital Assets*, *supra* note 237.

<sup>248</sup> See *supra* Section II.A; see also William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. No. 116-283, § 6110(a)(1), 134 Stat. 3388, 4561–62 (to be codified at 31 U.S.C. § 5312(a)(2)).

<sup>249</sup> See *supra* Section I.C.

<sup>250</sup> § 6110(a)(1), 134 Stat. 3388, 4561–62.

<sup>251</sup> See Ryan Browne, *Cash Grab or Innovation? The Video Game World Is Divided Over NFTs*, CNBC (Dec. 20, 2021, 3:20 AM), <https://www.cnbc.com/2021/12/20/cash-grab-or-innovation-the-video-game-world-is-divided-over-nfts.html> [<https://perma.cc/T6SY-S38H>].

opportunity to play for profit and sell their gaming tokens to others.<sup>252</sup> Musicians have minted their musical works into digital tokens and sold them for business, which has prompted questions about whether NFTs will challenge the music industry down the line.<sup>253</sup> Moreover, the NFT audience consists primarily of those who are interested in decentralized finance, technology, gaming, and sports—among other categories—and active investors often lack traditional experience in the art world.<sup>254</sup> This has led auction houses to detach from their typical procedures in reaching consumers, turning to Twitter and Discord to connect with their new digital audience.<sup>255</sup> Such changes may be taken into consideration when lawmakers attempt to categorize NFTs as belonging to a certain legal category. Despite these counterviews, NFTs are widely understood as a form of digital art, an asset that is most prevalent among the artistic community.<sup>256</sup> If NFTs are not considered antiquities, the existing loopholes will simply prevail for a longer period, and lawmakers will experience difficulties in attempting to interpret NFTs as a form of cryptocurrency or security. Either way, this new addition to the art market must be regulated.

#### CONCLUSION

Although art collectors have been trading Picassos, Warhols, and other high-value artworks for countless years, Congress did not subject the art market to anti-money laundering regulations until 2021.<sup>257</sup> The presence of money laundering through art has been proven on multiple occasions, and certain market practices have enabled that illicit activity to continue.<sup>258</sup> While auction houses have voluntarily placed anti-money laundering programs to combat criminal behavior in their

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<sup>252</sup> *Id.* (“Several cryptocurrency start-ups are betting NFTs will play a role in the world of video games. Axie Infinity, for example, is a blockchain-based game that lets users collect and breed creatures called ‘Axies’—kind of like ‘Pokémon’ but with NFTs. Instead of just being ‘pay-to-play,’ Axie Infinity also allows players to earn money by selling their Axie NFTs to other users.”).

<sup>253</sup> “While optimists talk of a new ‘creator economy’ and artistic autonomy, skeptics voice concerns about utility, and whether the current model of music NFTs will scale beyond a handful of artists who are heavily involved in the crypto community.” Andrew R. Chow, *Independent Musicians Are Making Big Money from NFTs. Can They Challenge the Music Industry?*, TIME (Dec. 2, 2021, 4:45 AM), <https://time.com/6124814/music-industry-nft> [<https://perma.cc/5U37-9K5D>].

<sup>254</sup> See Tompkins, *supra* note 141.

<sup>255</sup> Howcroft, *supra* note 142.

<sup>256</sup> See, e.g., Long, *supra* note 8; see *supra* Section I.C.

<sup>257</sup> William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. 116-283, § 6110(a)(1), 134 Stat. 3388, 4561–62 (to be codified at 31 U.S.C. § 5312(a)(2)).

<sup>258</sup> See *supra* Sections I.A–I.B.

institutions, such efforts have not sufficed for two reasons.<sup>259</sup> First, only some art exchanges happen within auction houses.<sup>260</sup> Others are facilitated through intermediaries including private dealers and galleries, which do not have the resources or the incentives to implement due diligence policies.<sup>261</sup> Second, the Russian oligarchs case study demonstrates that even though auction houses make every effort to conduct investigations, some money laundering schemes may never be exposed.<sup>262</sup>

Considering NFTs' rapid growth and expensive value, they must be regulated sooner rather than later because just as with the art industry, a continuing loophole in the law will attract criminals to use NFTs as a means of transferring unlawful funds. However, because NFTs represent such a unique type of transaction, it is unlikely that Congress would amend current laws to incorporate NFTs. Therefore, the tokens should be read into existing anti-money laundering laws. We should give a broad, comprehensive interpretation of the current regulations that address art transactions to encompass NFTs. Otherwise, history is bound to repeat itself.

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<sup>259</sup> See *supra* Section I.C.

<sup>260</sup> See MCANDREW, *supra* note 164, at 85–86.

<sup>261</sup> *Id.*; see also Shea, *supra* note 1, at 678–81.

<sup>262</sup> See *supra* Section I.A.1.