

# Are Nonfungible Tokens Subject to US Anti-Money Laundering Requirements?

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Rapidly growing interest in nonfungible tokens (NFTs) has been fueled by recent headlines of multimillion-dollar transactions, such as the \$69 million sale of an NFT by digital artist Beeple – the third-highest price ever paid for the work of a living artist. An NFT is a certificate of ownership stored on a blockchain typically associated with a digital asset, such as art, videos, music, games, or tweets. Unlike certain other virtual assets on the blockchain, such as cryptocurrencies, NFTs are unique or “nonfungible.” While the U.S. Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN)<sup>1</sup> has not yet indicated whether certain NFT market participants (e.g., creators, sellers, dealers, marketplace operators) are or may become subject to U.S. anti-money laundering (AML) regulatory requirements, recent developments and concerns of U.S. lawmakers and regulators regarding the financial crime risks associated with virtual assets make regulatory scrutiny of NFTs likely.

## Recent Developments

In March 2021, the Financial Action Task Force (FATF) – an intergovernmental organization that develops standards to combat money laundering and terrorism financing – issued draft updated virtual asset guidance,<sup>2</sup> which could have potential implications for the regulation of NFTs. While FATF is not a regulatory agency, its membership is comprised of 37 countries, including the United States, and two regional bodies, and it has played an active role in proposing a regulatory framework for virtual assets. In its updated draft guidance, FATF replaced a previous reference to “assets that are fungible” with “assets that are convertible and interchangeable,” in defining the scope of virtual assets that in FATF’s view warrant regulation. FATF further stated that “[f]lexibility is particularly relevant in the context of [virtual assets] and [virtual asset] activities” and that “some items – or tokens – that on their face do not appear to constitute [virtual assets] may in fact be [virtual assets] that enable the transfer or exchange of value or facilitate [money laundering or terrorism financing].” FATF’s latest stance may represent an effort to pave the way for the regulation of certain NFTs that have currency attributes or function as stored value.

Similarly, U.S. AML legislation passed earlier this year provides regulators flexibility and wide latitude to regulate a quickly evolving virtual asset industry. In particular, the Anti-Money Laundering Act of 2020 (AMLA) expanded the definition of “money transmitting business” and “financial institution” under the BSA to include businesses involved in the exchange or transmission of “value that substitutes for currency.”<sup>3</sup> While this amendment aligns with the existing position regarding virtual currencies taken by FinCEN, Congress’s expansion of these definitions provides FinCEN with additional statutory authority to regulate not only existing virtual currencies, but also other emerging payment methods or novel asset classes. To date, FinCEN has not issued any guidance or rules specifically on NFTs. However, given the wave of interest in NFTs, the high value of recent NFT sales and AML-related risk factors, we anticipate NFTs will attract U.S. regulatory scrutiny.

## Could NFTs Be Treated Like Virtual Currencies?

While the regulatory classification of NFTs is sure to be the subject of much discussion, to the extent that FinCEN were to treat a particular NFT or certain types of NFTs as “value that substitutes for currency,” FinCEN could potentially seek to regulate such activity under its money transmission regime. However, given that NFTs may not readily be classified as a currency substitute as in the case of convertible virtual currencies, FinCEN’s determination to classify an NFT as such may depend on the specific characteristics of the NFT, how it is used, and the apparent money laundering risks involved.

In the United States, persons that accept currency, funds, or other “value that substitutes for currency” from one person and transmit it to another location or person by any means fall within the federal definition of “money transmitter.” FinCEN has made clear in its guidance that virtual currency “has an equivalent value in real currency or acts as a substitute for real currency” and that “[a]ccepting and transmitting anything of value that substitutes for currency makes a person a money transmitter.” In its May 2019 virtual currency guidance, FinCEN expressed a broad view of money transmission and advised that “if assets that other regulatory frameworks define as commodities, securities, or futures contracts were to be specifically issued or later repurposed to serve as a currency substitute, then the asset itself could be a type of value that substitutes for currency, the transfer of which could constitute money transmission.”<sup>4</sup>

A money transmitter is a type of money services business (MSB). MSBs are required to register with FinCEN and must comply with extensive requirements under the BSA, including implementing a risk-based AML compliance program, filing suspicious activity reports and maintaining certain records. Foreign-located companies that do business as an MSB wholly or in substantial part within the United States are also required to register with FinCEN and comply with the BSA’s requirements. Violation of these

1 - FinCEN is the Treasury Department bureau responsible for administering and enforcing the Bank Secrecy Act (BSA) – the main AML legislative and regulatory framework applicable to U.S. financial institutions.

2 - FATF, Public Consultation on FATF Draft Guidance on a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers (March 2021).

3 - See our January 2021 client alert “US Enacts Historic Legislation To Strengthen Anti-Money Laundering and Counterterrorist Financing Legal Framework” for additional discussion of this legislation.

4 - Fin. Crimes Enf’t Network, FIN-2019-G001, Application of FinCEN’s Regulations to Certain Business Models Involving Convertible Virtual Currencies at 6 (May 9, 2019).

obligations can result in substantial civil and criminal penalties.<sup>5</sup>

## Focus on Risks in Art Trade

Growing concerns regarding money laundering and sanctions evasion risks in the art trade could have potential implications for persons that deal in certain NFTs, to the extent regulators perceive similar financial crime risks in digital art. FinCEN issued guidance in March 2021 emphasizing that financial institutions with existing BSA obligations “*should be aware that illicit activity associated with the trade in antiquities and art may involve their institutions.*”<sup>6</sup> The Office of Foreign Assets Control (OFAC) similarly issued an advisory in October 2020 highlighting the sanctions risks associated with dealings in high-value artwork involving sanctioned persons.<sup>7</sup> In OFAC’s view, the opacity of the art market can make it especially vulnerable to sanctions violations.

Although participants in the art trade currently are not subject to the BSA, recent legislative developments suggest that this may change in the near future. Specifically, as part of the AMLA, Congress commissioned the secretary of the Treasury to perform a study of how trade in artwork facilitates money laundering and the financing of terrorism and to report its findings to Congress by January 1, 2022. The AMLA’s extension of the BSA to “*persons engaged in the trade in antiquities*” might be a bellwether of forthcoming change in AML regulation of the art trade.

While it is too early to say whether traders of artwork may become subject to AML regulatory requirements, any such expansion of the BSA could capture traders of digital art or similar items on the blockchain.



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- 5 - In addition to complying with federal AML requirements, money transmitters may also be required to obtain a license in each state in which they conduct money transmission activities. Each state defines money transmission differently, and some states have developed licensing and regulatory schemes that specifically apply to virtual currency businesses.
  - 6 - Fin. Crimes Enf’t Network, FIN-2021-NTC2, FinCEN Informs Financial Institutions of Efforts Related to Trade in Antiquities and Art (March 9, 2021).
  - 7 - Dept. of the Treasury, Advisory and Guidance on Potential Sanctions Risks.