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Research Article

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Analysis of NFT (Non-Fungible Tokens) In Relation to Money Laundering

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Abstract: *In the development of information and communication technology, there are many developments that occur. One of them is the emergence of NFTs as the latest trend in digital trading. This, of course, is a new breakthrough in the digital world. However, this can also be a loophole in committing money laundering crimes. In this research, we are using a qualitative descriptive approach with analytical methods. The result of this analysis is thatThe main problem with money laundering via NFTs and cryptocurrencies is the lack of understanding of the role of cryptocurrencies in financial crimes. As long as this misunderstanding is not addressed, the potential for the use of NFTs as a new method of financial crime will increase sharply to the point of endangering national security.*

Keywords*:* *Cryptocurrency NFT, Relation, Money Laundering*

Introduction

Human life is inseparable from today's technological advances, given the rapid development of science and technology, it is undeniable that it has an immediate effect on the economy, especially in facilitating business economic activities and making financial services easier for the public. Without exception in terms of banking as well, we can see that the use of technology has provided convenience in financial services that look attractive, especially in terms of financial transaction services that require crossing borders between countries.

All lines in our lives cannot be separated from the internet. One of them is how to transact in buying an item, now there is a transfer of money on the internet in virtual form (Filipkowski, 2008). This is also included in getting entertainment that is widely available from the internet. In this case, these entertainments include movies, games, music, and other entertainment for free or for a fee. This has made many entertainment creators compete to create good content that sells well in the market. This is of course intended so that these creators get interest from the market to buy what they have made. As consumers, we can also download these entertainments and enjoy them.

One of the features on the internet, which can be a medium for crimes that can threaten national security, is NFT (Non-Fungible Tokens) transactions. NFT is a form of using cryptocurrency that comes from a cryptocurrency called Ethereum (Wood, 2015). NFTs were first proposed in Ethereum Improvement Proposals (EIP)-721 (Entriken, Shirley, Evans, & Sachs, 2018) and further developed in EIP-1155. NFTs differ from classic cryptocurrencies (Shirole, Darisi, & Bhirud, 2019) such as Bitcoin in their built-in features. Bitcoin is a standard coin, where all coins are equal and indistinguishable. In contrast, NFTs are unique and non-fungible (equivalent, non-fungible), making them suitable for identifying something or someone in a unique way. To be more specific, by using NFT on a work of art, creators can easily prove the existence and ownership of digital assets in the form of videos, art images, etc. NFT creators can also earn royalties whenever the work they create changes hands in any NFT marketplace or by peer-to-peer exchange. A complete trading history, easy liquidity and easy operation make NFTs a promising intellectual property (IP) protection solution. While NFTs essentially represent more than code, code provides buyers with value when considering their comparative rarity as digital objects. This secures the selling price of products related to this intellectual property well for non-fungible virtual assets (Yosafat et al, 2022).

NFT itself has various forms and forms. NFTs in this case can be collectibles such as CryptoKitties, CryptoPunks, SoRare and many other digital collectibles in the form of NFTs. Apart from that, NFTs can also be video games such as Axie Infinity, Gods Unchained, MyCryptoHeroes. Virtual worlds such as Decentraland, Somnium Space, and Cryptovoxels can also be used as NFT assets. However, this comes of course not without challenges. The easy access available on the internet, of course, also makes it easier and smoother for crimes that occur in cyber space. In this case, it is the crimes committed through cyber space that are the main focus. The perpetrators of crimes use the internet as a medium to carry out their crimes. With that, when this happens, the internet as a medium for their crimes is a latent danger for international economic security. This is what is known as Cyber Laundering.

Literature Review

What are NFTs?

Non-fungible tokens (NFT) are digital assets that act as proof of title for the underlying assets they refer to which can be digital (images, music, videos, virtual and in-game objects) or physical. The NFT starts by registering ownership of the asset referenced in the smart contract on*blockchain* public, usually on the Ethereum network (a process called "minting"). After that NFTs can be bought and sold like*cryptoasset* other, usually with*cryptocurrency*. NFTs are generally traded in niche markets such as Opensea for digital artwork, Rarible for digital collections (eg GIFs), and Decentralend for virtual real estate. Some marketplaces also offer NFT "printing" services (Jordanoska, 2021). A clear example is that a digital artist known as Beeple sold NFT digital images for a staggering $69 million dollars. While counterfeiting has been a long-standing problem in the traditional art industry, NFTs with their ability to validate ownership and authenticity are considered a possible solution. People can create and sell NFTs in online marketplaces. Many believe that NFTs are poised to change the world of art, changing not only how art is bought and sold, but also, what kinds of art people value (Sharma, Zhou, Huang, & Wang, 2022).

The NFT market is one of the fastest growing digital markets today, with sales during the third quarter of 2021 exceeding $10 billion. Nevertheless, these emerging markets - similar to traditional developing markets - can be seen as great opportunities for illegal activities (e.g., money laundering, sale of illegal goods etc.) (Pelechrinis, Liu, Krishnamurthy, & Babay, 2022). NFT trading can pose investor risks as well as risks of being misused to facilitate financial crimes such as fraud and money laundering. This risk is related to the nature of NFTs and their markets and especially concerns the volatility and anonymity in trading NFTs. Unlike other tokens such as Bitcoin or Ethereum, NFTs are non-fungible, indivisible and unique. This rarity adds to their appeal for collectors and investors alike. However, as is the case*cryptocurrency* and*cryptoassets* others (eg*Initial Coin Offerings*), NFT values may be highly volatile and subject to significant fluctuations (eg due to the hype surrounding the sale of certain NFTs). Therefore, NFT values are subject to unregulated supply and demand and this creates risks (Jordanoska, 2021).

Money Laundering

The term Money Laundering has actually not been used for a long time where for the first time it was used by newspapers in reporting on the Watergate scandal involving President Nixon in the United States in 1973. Meanwhile, as a legal term it appeared for the first time in 1982 in the US vs $4,255,625.39 case. (1982) 551 F Supp. 314. Since that year, according to Billy Steel, this term is used officially throughout the world. (http/www.laundryman.u-net.com).

According to Neil Jensen (Austrac) & Rick MC Donald in Edi Setiadi and Rena Yulia (2009, 152) Money laundering is the process of changing profits from being against the law into financial assets that appear to come from legitimate sources. Meanwhile, Amin Sunaryadi defines money laundering as a process of converting profits from unlawful activities into financial assets that come from sources that are not against the law. (BPK, 1999, 471).

According to Sutan Remy Sjahdaeni (2003.6), money loundering is a series of activities which is a process carried out by a person or organization against illicit money, namely money originating from crime, with the intention of hiding or disguising the origin of the money from the government or authorities. those who are authorized to take action against criminal acts by primarily entering the money into the financial system so that the money can then be taken out of the financial system as lawful money.

According to the Convention against Transnational Organized Crime, money laundering is a form of transnational organized crime, in addition to corruption, smuggling of foreigners (migrants), and trafficking in women and children. Meanwhile, according to Article 1 number 1 of Law Number 25 of 2003 concerning Amendments to Law Number 15 of 2002 concerning the Crime of Money Laundering, it provides an understanding, namely as an act of placing, transferring, paying, spending, granting, donating, depositing, taking abroad, exchanging, or other acts of assets which he knows or reasonably suspects constitute the proceeds of a crime with the intent to hide, or disguise the origin of the assets so that they appear to be legitimate assets.

Method

The research method is a procedure carried out in an effort to obtain data or information to obtain answers to research problems that have been proposed. Therefore, determining the following research stages, this type of research uses descriptive qualitative analytical methods. Bogdan and Taylor in Moleong (2010) argue that qualitative research is a research procedure that produces descriptive data in the form of written or spoken words from people and observable behavior. Qualitative research relies on a holistic natural background, positions humans as research tools, performs inductive data analysis, places more importance on process than on the results of the research conducted. It is agreed by the researcher and the research subjects used must reflect relevance to the research phenomenon.

The type of research method chosen is descriptive analysis, while the notion of descriptive analytical method according to (Sugiyono, 2009) is a method that functions to describe or give an overview of the object under study through data or samples that have been collected as they are without conducting analysis and making conclusions that applies to the public. In other words, analytical descriptive research takes problems or focuses attention on problems as they were when the research was carried out, the results of the research were then processed and analyzed to draw conclusions.

Results and Discussion

NFTs and Money Laundering

This technology can raise alarm bells from the perspective of money laundering and financial crime. NFTs are most often purchased with*cryptocurrency* on the online market. *Cryptocurrency* is routinely exploited for nefarious means, such as obscuring the source of criminal proceeds and although transactions can be traced, more sophisticated criminal actors use a variety of techniques to undermine investigations by law enforcement. Along with the risks that come from using*cryptocurrency*, money launderers can exploit the trading and selling of NFTs in a manner similar to that they exploit physical art (Owen & Chase, 2021). Anonymity issues can also create vulnerabilities for NFTs which are abused to facilitate money laundering. For example, criminal groups can create NFTs anonymously or pseudonymously, list them on a marketplace and then buy them from themselves. Traditional money laundering typologies can also find applications in this space, for example, NFTs can be bought and sold by criminal groups through third parties, including through shell companies or companies with suspected beneficial holdings (Jordanoska, 2021).

NFTs can be used for self-laundering, where criminals can purchase NFTs with restricted funds and proceed to transact with themselves to create sales records on the blockchain. The NFTs could then be sold to unwitting individuals who would compensate criminals with clean funds unrelated to previous crimes. It is also possible to have direct peer-to-peer transactions of NFT-guaranteed digital art without the involvement of intermediaries, and these transactions may or may not be recorded on a public ledger. These digital art assets are inherently more transferable between transacting parties than traditional art because, in most cases, parties do not need to physically move the art or pay for delivery services such as insurance, transportation, or customs, although users may incur transaction fees. The ability to transfer multiple NFTs over the internet regardless of geographical distance and across borders almost instantly makes digital art vulnerable to exploitation by those seeking to launder the proceeds of illegal crime, as the movement of value can be achieved without incurring the potential financial, regulatory, or investigative costs of physical delivery (Department of the Treasury, 2022).

Mitigating the risk of money laundering through NFTs

Cryptocurrencies are regulated at exchange points to reduce the risk of money laundering. The same basic rules apply to online auction houses for NFTs. Although larger markets are often associated with exchanges*cryptocurrency*, a baseline needs to be established for companies wishing to focus on the NFT industry. Policy system *know your customer* (KYC) and ongoing monitoring, similar to that used in traditional art markets and in exchanges*cryptocurrency* appropriate measures, need to be implemented to ensure that the risk of money laundering is mitigated. The NFT market needs to ensure that there is an option for two-factor authentication for consumers and confirm that cyber security measures are in place to protect against opportunistic hackers. In addition to the need for good cybersecurity, much can be learned from how traditional art markets are regulated (Owen & Chase, 2021).

With the development of guides for KYC best practices, security measures*cyber* strong and stolen arts registry, many of the money laundering risks of NFTs can be mitigated without limiting the growth of this new market. The adoption of this technique will ensure that consumers can trade freely in the market without fear of buying counterfeit NFTs or having their tokens stolen (Owen & Chase, 2021). The easiest way to detect potential trade-based money laundering is to see if the transaction price is in line with the fair market value of the goods being transacted. For art, that will usually be the price recommended by the appraiser. Given how new and how volatile the market for NFTs is today, it is hard to say what a fair market price should be, especially where there is no precedent to rely on for guidance (Cheek, 2022).

There are 7 policy recommendations by the Basel Institute on Governance, INTERPOL and Europol, in*5th Global Conference on Criminal Finances and Cryptocurrencies*, December 7-8, 2021. These recommendations are intended to guide law enforcement, judicial authorities, regulators and the private sector on the broad approach needed to protect citizens and the global economy from the risks of misuse of cryptocurrencies and other virtual assets. Here are 7 recommendations:

1. **International cooperation**. Make existing channels of international cooperation stronger, faster and more proactive, to counter the lightning-fast and hyperglobal nature of virtual assets. This includes efforts to strengthen formal and informal cooperation between law enforcement agencies and judicial

authorities, as well as between law enforcement and Virtual Asset Service Providers (*Virtual Asset Service Providers*/VASPs) based in other jurisdictions. International cooperation should extend to the development of standards and best practices.

2. **Virtual asset recovery**. Treat virtual assets like traditional assets – such as jewelery or works of art – to facilitate their freezing and confiscation. Reducing virtual asset recovery helps not only to recover stolen funds, but also to prevent future crypto-enabled crimes and virtual asset-based money laundering.
3. **Public-private cooperation**. Build trust and effective mechanisms for public-private cooperation to address virtual asset-based money laundering, particularly between law enforcement and VASPs. Cooperation can be bilateral, multilateral or through public-private partnerships, and must include sharing of operational and strategic information.
4. **Harmonised regulation and its effective implementation**. Ensure intelligent and harmonized regulation that draws on broad expertise and looks forward to future challenges. It is critical that all national authorities implement international regulations effectively, to prevent money laundering activities from simply moving to jurisdictions with weak regulations and less enforcement.
5. **Investigative techniques and technologies**. Rapidly develop, adapt and develop investigative technology and techniques to compete with criminals. In this endeavor, it is helpful to tap into the innovation capacity of the private sector.
6. **Capacity building**. Invest heavily in capacity building, particularly for those in law enforcement and the private sector in a position to detect virtual asset-based money laundering. Capacity building is not just about training existing staff, but about changing hiring practices to attract those who are already skilled in cyberspace.
7. **Multidisciplinary approach, including through specialised law enforcement units**. Combine the expertise of financial investigators, IT/forensics experts and specialists*cybercrime* to handle cases of virtual asset-based money laundering and related crimes*crypto-enabled*. In the law enforcement context, this means increasing intra-agency cooperation between different units. Where possible, specialist teams can also be formed to lead complex cases and provide internal support to other units (Basel Institute on Governance, INTERPOL & Europol, 2022).

Unless and until specific NFT guidance is provided, companies should consult guidance on analogue services and products. Given the shared risk of money laundering between NFTs and the art and antiques market, financial institutions should pay special attention to the opaque and often anonymous NFT market and should consider filing a SAR (suspicious activity report) if they detect suspicious activity related to an NFT transaction. In this fast-growing field, both financial institutions and cryptocurrency exchanges should also consider re-examining their existing anti-money laundering compliance programs to meet the needs of their clients (Hanson, et al., 2021).

Conclusion

The main problem with money laundering via NFTs and cryptocurrencies is the lack of understanding of the role of cryptocurrencies in financial crimes. As long as this misunderstanding is not addressed, the potential for the use of NFTs as a new method of financial crime will increase sharply to the point of endangering national security. Although criminal investigators use technology to solve crypto crimes, there is a lack of resources to uncover such illegal operations. The criminal justice system must enforce penalties against criminal organizations to prevent additional crimes. The specific problem is the large number of cryptocurrencies used on the black market. The coins and NFTs used enable anonymous transactions which makes it difficult for law enforcement to investigate crimes related to digital currencies.

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