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NON-FUNGIBLE TOKENS: COMPLIANCE RISKS AND BEYOND

In this article, the authors analyze the regulatory risks to companies dealing with non-fungible tokens (“NFTs”). They begin by providing a background on NFTs in the marketplace and review the relevant regulatory frameworks that may be applicable to NFTs. They then turn to how companies that deal with NFTs — including creating, buying, selling, exchanging, and storing NFTs — may be exposed to potential civil and criminal liability. Key issues include: (1) how NFTs are classified under the law; (2) compliance issues for fraud, anti-money laundering, and economic sanctions risks; and (3) consumer protection issues. The authors then provide some key takeaways for companies dealing with NFTs on how to manage those risks.

By Leo Tsao and Kenneth Herzinger *

In recent years, the market for NFTs has exploded. NFTs have taken many forms, including collectible pictures of digital sports trading cards, Bored Apes, YouTube clips, and entire music albums. Perhaps the most famous NFT was a piece of digital artwork called *Everydays: The First 5000 Days*, which was sold at auction for almost \$70 million. According to one estimate, between 2020 and 2021, the trading volume for NFTs increased by more than 21,000 percent, from \$82 million to more than \$17.6 billion.¹ The impact of NFTs as a cultural phenomenon was so great that the word “NFT” was

named Word of the Year by the dictionary publisher Collins.² While the growth in the market for NFTs has slowed in recent months, demand for NFTs is expected to continue to increase in the coming years, driven in part by the continued rapid innovation in the uses of NFTs.

Presently, NFTs are largely unregulated, but the high levels of consumer demand and the corresponding amounts of money being invested in NFTs have caught the attention of regulatory agencies. For example, the

¹ Ryan Browne, *Trading in Nfts Spiked 21,000% to More Than \$17 Billion in 2021, Report Says*, CNBC (Mar. 10, 2022), <https://www.cnbc.com/2022/03/10/trading-in-nfts-spiked-21000percent-to-top-17-billion-in-2021-report.html>.

² Jack Guy, *‘NFT’ is Collins Dictionary’s Word of the Year for 2021, Beating Out ‘Crypto’ and ‘Cheugy’*, CNN (Nov. 24, 2021), <https://edition.cnn.com/style/article/nft-word-of-the-year-collins-scli-intl-gbr/index.html>.

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