



NFTS IN 2022

NEW USE CASES, PREVENTING ILLICIT ACTIVITY, AND WHAT'S NEXT

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We have all heard about non fungible tokens (NFTs), but what exactly are they?

NFTs are blockchain-based digital items that are designed to be unique, with most NFT projects built on the Ethereum blockchain. Unlike traditional cryptocurrencies, NFTs are not interchangeable, typically giving the holder ownership over associated data, media, or physical objects. They are bought and sold on specialised marketplaces.

The first NFT was minted in 2014; they gained popularity in 2017 with Crypto Kitties, but 2021 was really the year the NFT shot to fame.

According to Chainalysis' 2021 NFT Market Report, in 2021, users sent at least \$44.2 billion worth of cryptocurrency to ERC-721 and ERC-1155 contracts: the two types of Ethereum

smart contracts associated with NFT marketplaces and collections - up from \$106 million in 2020.

In this article we will look at the evolution of NFTs and their uses over the last year.

As expected with any new technology, NFTs carry the potential for abuse. In late 2021 Chainalysis reported¹ that rug pulls accounted for 37% of all cryptocurrency scam revenue in 2021 totalling at least \$2.8 billion worth of crypto. A rug pull is when the founders of a crypto project pull the rug out from under its investors by disappearing with whatever funds they have amassed at the time.

While most rugpulls involved various DeFi projects, there are several examples of NFT rug pulls. Two individuals were charged² by the US Department of Justice in March 2022 for their involvement in the Frosties NFT rug pull, from which they allegedly

received \$1.1 million in sales. Law enforcement stated that they were about to embark upon another project, Embers, where they were expected to make a further \$1.5 million.

In April, another rug pull, Bored Bunny NFT, reportedly³ led to the loss of \$20.7 million. The Bored Bunny NFT was promoted extensively by well known celebrities such as Floyd Mayweather and DJ Khaled, a common occurrence in the NFT world. When the project launched, it sold out within hours, making the team an initial 2000 Ether.

But it's not all doom and gloom and dirty rugs, there has been a lot of legitimate market adoption of the technology in places you would and would not expect it.

In March 2021, auction house Christie's sold an NFT by digital artist Beeple aka Mike Winkelmann for \$69 million. This year, Christie's is paving the way with its Christie's 3.0⁴ platform. Christie's collaborated with three active companies in the Web3 community on the project: Manifold, Chainalysis, and Spatial. Auctions will take place

1 <https://blog.chainalysis.com/reports/2021-crypto-scam-revenues/>

2 <https://www.justice.gov/usao-sdny/pr/two-defendants-charged-non-fungible-token-nft-fraud-and-money-laundering-scheme-0>

3 <https://cryptoslate.com/investors-lose-20-7-million-in-bored-bunny-nft-promoted-by-multiple-celebrities/>

4 <https://www.christies.com/about-us/press-archive/details?PressReleaseID=10648&lid=1https%3A%3Awww.christies.com/about-us/press-archive/details%3FPressReleaseID%3D10648&lid=1>



on the Ethereum blockchain network from start to finish, meaning that all transactions will take place on-chain. Christie's is working with Chainalysis on the compliance side, allowing for security and safety for both NFT buyers and sellers.

The legal use cases and considerations around NFTs have been all over the press this year, showing both the risk of getting into new tech while the regulatory landscape is still being built, but also the great opportunity tech has presented to overcome other challenges posed by a digital world. Real estate is often considered to be a good investment, but what about virtual real estate? NFTs representing virtual land have become a hot topic since the advent of the metaverse. Some plots of land are selling for millions of dollars.

Between September 2019 and March 2022, blockchain-based virtual real estate prices grew by 879%. Meanwhile, in the real world, prices grew by 39% (Chainalysis⁵).

What are the benefits of owning virtual real estate? Once purchased you are 100% the owner of the real estate on that platform, solidified through an NFT. You can customise the real estate to your liking, and even host virtual events.

In the legal arena this year, both in the United States and the United Kingdom, we have seen the courts grant permission to serve proceedings on defendants (persons unknown) by NFTs, using the technology to overcome some of the hurdles posed by the pseudonymous nature of the blockchain. In one of the UK cases, the judge concluded⁶ that service by these means would likely lead to a greater prospect of those behind the fraud being put on notice of the order, and the commencement of proceedings.

We have even seen NFTs show up in asset recovery. February was witness to HMRC successfully securing a court order seizing three digital artwork NFTs. This was the first time a UK authority has seized NFTs in this way. The

ongoing investigation relates to a £1.4 million VAT fraud.

As can be seen above, there have been varied uses of NFTs over 2022, giving lawyers, accountants, regulators, developers, investors, and virtually all stakeholders in the industry food for thought. This flow of activity yields some interesting figures and statistics.

While the number of NFT transactions has only decreased 18% since December 2021, trading volume has decreased 82% during this same period. Some of this slump can be attributed to the broader crypto market decline, but the pace at which NFT trading volume has fallen shows that this market has been hit especially hard.

What does this mean for the future of NFTs?

The general trend for NFTs is likely to have been impacted by the state of the global economy. This article has touched upon some of its use cases during 2022. We haven't even started discussing using NFTs to combat the replica industry (a \$464 trillion industry), to make automatic royalty payments, or the film and TV industry which will be a topic of discussion in 2023. Scammers will always be attracted to areas of growing popularity and NFTs are unfortunately not an exception to this. Prevention through education and thorough investigation of cases will send a strong message to scammers. To this end, it is vital that industry participants who investigate and recover assets have the education and tools to implement a robust zero tolerance policy. The good news is that tools are now available not just to track the flow of funds in crypto, but which have been designed specifically to do this for NFTs and DeFi.

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5 <https://blog.chainalysis.com/reports/virtual-real-estate-blockchain-gaming-web3/>

6 <https://www.bailii.org/ew/cases/EWHC/Ch/2022/1723.html>