

# CLARE CHAMBERS-JONES



## VIRTUAL ECONOMIES AND FINANCIAL CRIME MONEY LAUNDERING IN CYBERSPACE



# Virtual Economies and Financial Crime

Money Laundering in Cyberspace

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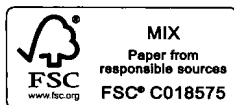
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# 1. Introduction

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You may be forgiven for wondering why virtual worlds are worthy of investigation. You may be forgiven, even more so, for wondering why virtual world economies and financial crime should even be considered in the same breath. However, these are real and worthy subjects for investigation. Why? Because they are real and have real world effects. Do not be confused by the name virtual worlds; these worlds are ever present in society and can have both positive and negative effects. For example, virtual worlds are used by a large demographic of the population. There are 1.4 billion registered accounts (Kzer World Wide 31 August 2011) of people participating in virtual worlds and these people are from all backgrounds, of both genders and racially diverse. More importantly, there is a huge part of this demographic, roughly just under half,<sup>1</sup> who are teenagers or young adults, who will sooner rather than later move into the adult world of work and business and they will want commerce to move as quickly and as diversely as the virtual world games they have grown up with.

Nardo states that, 'The issue of combating economic and financial crime at a global level has become progressively critical in the international arena over the decades which marked the transition from the twentieth century to the twenty-first'.<sup>2</sup> Nardo demonstrates that past work in the area of financial crime in virtual worlds has been largely focused on structure and method approach and not the socio-legal workings of the crime. He states, 'it seems therefore useful to increase the analysis by opening the quest to economic and sociological aspects',<sup>3</sup> and this is where this book is theoretically positioned. Virtual economic crime may appear to be small in comparison with other illicit crimes such as drug trafficking, but it is now emerging that there is a strong connection between organised crime in the real world and economic crime via the internet. 'Illegal markets knowledge is indeed generally very poor', and as such this book aims to add to the research being conducted in this ever growing area. What is widely accepted is that 'the purpose of combating economic and financial

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<sup>1</sup> Read Write Web, <http://www.readwriteweb.com/>, accessed 1 October 2011.

<sup>2</sup> Nardo (2011).

<sup>3</sup> Ibid.

crime must confront a multifaceted situation, where numerous and different components interact in a highly complex dynamics'.<sup>4</sup>

Despite the increase in criminal activity via the internet, business and governments can and do take advantage of the advancement of virtual worlds in cost cutting. With the use of the internet becoming more prevalent, uptake for online courses is increasing. More people can attend and effective interaction online is being created. Virtual worlds are also being used as training and educational environments and social places where new economic, political and social theories can be devised within controlled simulations. Furthermore, virtual worlds could also be used as a mechanism for continuing business in times of social hardship or environmental health issues such as swine flu or the recent economic crisis.

This book will explore the realms of the virtual world, exposing its reality and its contributory effects on the real world and real people. In this, the virtual world of Second Life will be explored and detailed as a case study on the background concept of financial crime in a virtual world. Financial crime shall encompass any financial crime committed online and which pertains to a broad real world definition of a criminal activity, such as illicit gambling, financial fraud and money laundering. Money laundering shall be focused upon as the main criminal activity within virtual worlds, but this is not to say that it is the only financial crime occurring.

Academics have explored the topic of money laundering and terrorist financing and it has been shown by Levi<sup>5</sup> that despite international efforts, it is hard to show any improvements in reducing risky finance such as money laundering and organised crime. The leap from virtual money laundering to organised crime has become increasingly recognised. Criminals who are committing economic crime are using the internet as a means of gaining, storing and using valuable information.<sup>6</sup> Virtual money laundering can therefore be seen to be even harder to reduce due to the complexities surrounding detection and prosecution, as well as jurisdictional matters.

The purpose of this book as just outlined is to portray the virtual world as being a mere continuum of the real world and therefore worthy of falling under the real world legal remit. The question is how this can be proved so that legislators and law enforcement agencies can create a legislative provision which is not only international but that covers the necessary interlinking crimes within virtual financial crime whilst

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<sup>4</sup> Ibid.

<sup>5</sup> Levi (2010).

<sup>6</sup> Di Nicola and Scartezzini (2000).

balancing basic human rights. This book is not intended to be the answer to all these issues, but is merely a stepping stone towards growth in acceptance and awareness of the crime as a real issue. Many law enforcement agencies already acknowledge virtual financial crime as a real world crime, but they lack the technological investigatory powers and tools necessary to detect and locate virtual financial crimes taking place. They also lack the necessary legislative provisions to ensure that effective legal measures are in place to ensure prevention, detection and prosecution of virtual world criminals.

Each chapter is designed to demonstrate and build a collective argument that the real world and the virtual are by default governed by some of the same rules and standards that one would expect in a real world situation. Of course, not all rules and laws apply in virtual worlds as they do in virtual worlds. For example, if the virtual world is about fighting each other, then no real world laws apply, unless, that is, there is a detrimental effect on a real world person. Therefore if the virtual world crosses over and touches, influences or affects the real world, then it should be governed by the same standards that the real world expects.

Chapter 2 examines the virtual world of Second Life, given the ubiquitous way in which virtual worlds can evolve and dominate a generation's perception. Second Life is a web-based land which has been developed by Linden Labs. The game requires people to register and become residents of the world 'Second Life'. A player of the game is called an avatar and these can be created in the likeness of any person. Therefore you can be six foot tall and blonde or dark with blue eyes. You can also develop your avatar's personality and personal surroundings. For example, if desired, the avatar could become a successful business person, living in a mansion, who rides around in a sports car all the time. Alternatively, you could be a rugby player or a football star dressed head to foot in Nike clothing and footwear. For big real world brands are also big in the virtual world. Second Life is also governed by Second Life rules and regulations, which is interesting given the cyber jurisdictional debate that occurs in Chapter 6 of this book. Second Life also has its own currency called Linden Dollars. These can be exchanged via the Linden E exchange through PayPal or credit cards for real world money. Linden Dollars can therefore be used to purchase virtual goods within Second Life. The birth of the virtual economy has therefore occurred. What is more important is the economic effects it has on the real economy and how real world criminals take advantage of loopholes in the virtual economy.

Chapter 3 considers the evolution of virtual economies and how law and economics have always played an important part in each other's development and evolution. The chapter also focuses on some of the virtual world

economic crimes that have taken place which have affected the real world. It is important to show that it is not simply a matter of detecting money laundering, but that there are a multitude of financial crimes taking place. An example which is used within the chapter is the use of gold farming, which is prolific in Asian countries and is something which can affect the real world economy. The chapter also examines the synergies between the real and the virtual economies, for example the case study of Ginko Financial and Eve Online. Ginko Financial was a successful banking business within Second Life, but due to rule changes specified by Linden Labs, Ginko was unable to meet the demands of the rule changes and as a consequence there was a run on the bank. This was the first run on a virtual bank in history and since its collapse, it has been discovered that it was also a Ponzi scheme. Financial crimes were already taking place before the onset of the bank run. The lack of regulation and clear banking guidance meant that a lot of people lost real money in Ginko's collapse. This book questions whether tighter regulation and control from the real world would have made the virtual investment a safer place for people's real money.

Chapter 4 examines the history of money and the evolution of what we see as being defined as money. The purpose of this chapter is to suggest to the reader that what was once considered overwhelmingly unrealistic and impossible soon becomes reality and accepted as the norm. As society and technology develop, so do people's perceptions and accepted attributed norms and customs. The chapter looks back at how bartering used to be a means of monetary and goods exchange before the use of notes and coins. The use of card payments and electronic, mobile and internet banking are now generally accepted means of monetary interaction, whereas once these were considered to be an exception and not a normally accepted means of transacting. The evolution of money is also charted through the use of regulatory development. The use of regulation to maintain control over an economic system is important not only for the banking system but for society as well. Monetary transactions which are intangible, such as internet payments, are built on trust and the confidence of the transacting parties. Trust and confidence in the real world are built on solid regulatory foundations, where parties know there is legal recourse should any problem arise with a financial transaction. In virtual economies there is no such reassurance and therefore the chapter illustrates the need in the case of a virtual economy which wants to grow, for a real and solid legal infrastructure. Money is important to people and money can be the cause of many legal disputes; therefore it is important to create a foundation on which a stable virtual economy can be built. The chapter also focuses on the many banking and financial regulations that are in place around

today's modern banking structure, demonstrating the importance of maintaining an ever closer link with the real world so that when financial crises do occur in either sphere, the effects of the crisis can be maintained and minimised.

Chapter 5 examines case studies of virtual financial crimes. It begins by looking at how virtual money laundering can take place by examining the process of how real world money can be placed in the virtual world. The chapter looks at the technology behind this transactional process, such as PayPal, the virtual wallet and virtual automated telling machines (ATMs), to name but a few mechanisms.

Chapter 5 also moves on to discuss the real world anti-money laundering regulations and examines which are applicable to the virtual world. It is not ideal to have real world regulations bent to fit virtual world financial crime, but it is a starting point and one which is very necessary. The chapter chooses to look at the UK, USA, China and Korea as another starting point for a country analysis. The reason for these countries being selected is because of their interaction with virtual economies and the use of virtual worlds. Though most of the financial crimes that have taken place stem from these countries, that is not to say that other countries are not also prolific in virtual financial crimes, but this is the selection I have chosen to make in this book.

Chapter 6 forms the heart of the book. It looks at laws and virtual worlds and grapples with how to fit virtual financial crimes into an archaic set of real world laws. In places these laws do not even acknowledge the presence of the internet and cyber laws within them. The chapter looks at past judiciary decisions applying the law to virtual world crimes, such as the *Yahoo* and *Zippo* cases examining jurisdictional issues as well as the application of laws within cyberspace and the internet. The chapter further examines the rule of law within virtual worlds and how real world laws can be extrapolated to extend to virtual worlds, as well as more generally to the internet as a whole. A vast discussion on the application of how jurisdiction is measured is also outlined within this chapter.

Chapter 7 is the concluding chapter of this book and paves the way for future research and further questions which must be asked if there is ever going to be a successful and effective virtual economy which commands the trust and confidence of society and law enforcement agencies. Rules and regulations must surely play a part in creating a sound infrastructure in which the virtual economy can grow. Regulating the internet is not about restricting people's freedom of information or impacting on rights of privacy; it is merely about ensuring a safe financial market which could benefit many people in society. We have an opportunity to create



a new means of economy which could benefit many people globally. The chance we have is to create a solid platform created out of sensible and realistic laws, providing an opportunity for a virtual economy to grow. International cooperation is essential and Chapter 7 outlines a possible solution to these issues.