INTERNET

Virtual bank's Second Life scheme raises real concerns

Vanished deposits spur questions about the need for regulation.
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Stephanie Roberts knew Second Life was just a computer game, but she couldn't resist the virtual world's promise of a real-world interest rate of more than 40%.

The 33-year-old from Chicago, who played the game as a raven-haired vixen called Zania Turner, deposited $140 in Ginko Financial and waited for the money to grow. Instead, it vanished five months ago when Ginko, perhaps the first Ponzi scheme in history perpetrated by three-dimensional online avatars, left Second Life.

"I was foolish," Roberts said.

So were many others. Ginko took with it about $75,000 in real-money deposits, shaking faith in Second Life's venerated lawlessness -- no cops, no courts, no government -- and unnerving Linden Lab, the usually laid-back San Francisco company that created it.

Recently, Linden Lab banned all virtual banks from the online role-playing game, giving them until today to shut down, fearful that Ginko wasn't the only one paying crazy rates of return to some with the deposits of others.

Within moments, there was a meltdown. ATMs didn't work when players rushed to withdraw their Linden dollars, which can be exchanged for U.S. currency at a rate that hovers around 270 to 1. Stocks plunged and so did real estate prices.

Avatars, the players' digital doppelgangers, marched with signs saying "Give us our banks back NOW!!" and sent melancholy messages: "We're doomed."

It was nearly a 3-D insurgency.

"People are panicking," said Margaret, a British mother of two who in Second Life is Ragged Delec, an exotic dancer.

Margaret, who asked that her last name not be printed, hasn't been able to retrieve $400 that she had squirreled away. "This has done some serious damage to the Second Life financial industry," she said.

The Ginko debacle and Linden Lab's response to it is raising fresh questions about the need for regulation over -- not to mention the wisdom of -- financial transactions in a place that doesn't exist.

"The whole Second Life adventure encourages user freedom, but it's got so many users, and so much money is flowing in, that you have to face that the community needs some degree of control," said Stephan Martinussen, executive director of the global solutions department at Denmark's Saxo Bank, which had toyed with the idea of opening a virtual branch.

Ginko was able to skip town and leave virtually no trail for authorities to follow, if there had been any authorities. Even Linden Lab might not know the identity of the avatar who ran the bank. Company
executives declined to be interviewed for this article, but lawyers in contact with unhappy Ginko depositors said they weren't aware of any investigative action taken by the company.

No individual seems to have lost enough money to make filing a lawsuit worthwhile, said Robert Bloomfield, a Cornell University professor who has been following the Ginko case. Anyway, because Second Life members live in different countries, "it's not at all clear what jurisdiction you would file suit in," he said.

Multiplayer computer-based gaming environments such as Second Life aren't monitored by real-world regulators.

And before the recent announcement, Linden Lab had handed down only two other official bans against anything: It prohibited gambling and simulations of sexual activity involving minors.

"It's been this wild, Wild West kind of atmosphere," said Benjamin Duranske, a lawyer in Boise, Idaho, who runs Second Life Bar Assn. and blogs on the virtual world.

That's the allure. In Second Life players can be anyone (among the pro-bank demonstrators one day last week were a disco dancer, a tentacled human and a mermaid; on another day there was a storm trooper and a very large rabbit) and do nearly anything.

Most activity is tame, with avatars experimenting with interior design or sunning themselves on virtual beaches, although players do buy avatar genitals and use them.

"Usually, we don't step in the middle of Resident-to-Resident conduct," Linden Lab said in a Jan. 8 statement, which was posted on its blog. "But these 'banks' have brought unique and substantial risks to Second Life, and we feel it's our duty to step in."

Money and banks aren't necessary to play Second Life. All players need is a computer and access to the Internet so they can download the software and generate their role-playing avatars.

Without money, though, life in Second Life can be dull, and most of the game's 50,000 or so active players keep some cash on hand. They use credit cards or online payment systems such as PayPal to get Lindens and use them to buy things, including property. (There is an endless supply; Linden Lab makes money selling land and can put as much of it on the market as it likes, because in a virtual world there are no physical boundaries.)

The troubles began when banks started popping up.

"There were a few small, thieving institutions," said Sheffie Cochran, who ran a Second Life bank called LLB&T.

Cochran, a 26-year-old enrollment counselor at the University of Phoenix, spent about $10,000 to create LLB&T; the island on which it was located set her back $1,700 and the Internet-based system she needed to convert Lindens to U.S. dollars cost many thousands more.

To be able to pay interest -- the weekly rate was 0.1% -- Cochran converted her customers' Lindens and invested the dollars in money market accounts and stocks, including Electronic Arts Inc. and Vonage Holdings Corp. Her real-world profit turned into her virtual bank's interest outlays.

Cochran said she never failed her customers, but that others did. "It's the nature of anonymity," she said.

The most infamous was Ginko, whose brief history was detailed in an article two weeks ago in MIT's Technology Review titled "The Fleecing of the Avatars." It called the Ginko con "ominous for those who see such environments as future centers of e-commerce."

Second Life is popular with corporate America -- IBM Corp. holds meetings in an outdoor amphitheater on its sprawling virtual campus, members of Best Buy Co.'s Geek Squad hang out in a virtual store and visitors to Dell Inc.'s virtual island can build their own computers.

But none of the corporations that have set up shop in Second Life conduct any financial transactions there.
That may be because they have jitters about the unregulated nature of the space. In July, IBM, one of the earliest companies to establish a presence in Second Life, introduced official guidelines to govern how its 5,000 employees interact in the virtual world.

Linden Lab seems to see itself as no more responsible for what goes on in Second Life than an Internet provider like AOL is for illegal activities discussed over e-mail, said David Naylor, an attorney with British law firm Field Fisher Waterhouse, and that attitude crimps Second Life's potential.

"It's only when people have a reasonable level of confidence that the transactions they enter into are not fraudulent that you'll see transaction volumes really going up," he said.

There have been some calls for the government to step in, but Washington is pretty much scratching its head right now.

"Most members of Congress don't understand what this is all about," said Dan Miller, a senior economist with the Congressional Joint Economic Committee.

"Is a Linden real money? Is it an asset? Is this just a form of barter? Is this a form of capital gains? We just don't know. The courts haven't ruled on this, and the regulatory bodies haven't stepped forward to stake their claim," Miller said.

More than a few Second Lifers think Linden Lab should have kept its nose out of its world's money matters. Cochran, the banker, said the company destabilized the virtual economy by giving banks just two weeks to close.

"It's like asking Bank of America to cash out in 10 days," she said. "They should have just stayed out of it."

Cochran said she would have to liquidate $7,000 in real-world assets to pay her 900 customers, many of whom are demanding their money back. Other banks sold off real estate holdings or stocks at fire-sale prices to raise cash fast.

Margaret, the British mother, said she wouldn't be surprised if she never saw her $400 again. And she figures she has only herself to blame.

"This has lost a lot of people a lot of money," Margaret said. "But I think anyone who ignored the warnings of 'nothing is guaranteed' deserves all they got."

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