U.S.: Online Payment Network Abetted Fraud, Child Pornography

By Brian Krebs

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The principal owners of E-Gold Ltd., an online payment system where users convert currency assets into equivalent amounts of precious metals, were indicted last week for allegedly allowing the service to be used by criminals engaged in financial scams and child pornography.

The indictment names the company's co-founders -- Douglas L. Jackson, of Satellite Beach, Fla., and Barry K. Downey, of Woodbine, Md., as well as Reid A. Jackson, of Melbourne, Fla. They are charged with conspiracy, money laundering and operating an unlicensed money transfer business. The company has offices in Melbourne, Fla., but is incorporated in the Caribbean island of Nevis.

"The advent of new electronic currency systems increases the risk that criminals, and possibly terrorists, will exploit these systems to launder money and transfer funds globally, to avoid law enforcement scrutiny and circumvent banking regulations and reporting," said James E. Finch, of the FBI's Cyber Division.

Founded in 1996, E-Gold is a unique take on Internet-based payment systems. Its 4 million registered users deposit funds into an E-Gold account and those funds are converted into equivalent amounts of gold and silver that is stored in banks in Europe and the Middle East. The company's business was designed to appeal to persons engaged in cross-border financial transactions, particularly for persons who prefer the relative stability of precious metals to fluctuations in currency systems.

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precious metals to fluctuations in the value of national currencies. Over the past 24 hours, the system processed a little more than $3.4 million in transactions, according to the E-Gold Web site.

The government charged E-Gold and its parent, Gold & Silver Exchange, with operating an unlicensed money transmitting business under federal law and one count of money transmission without a license under D.C. law.

The indictment follows a two-and-a-half year investigation by the FBI, the U.S. Secret Service and the IRS into E-Gold's operations. In December 2005, the Secret Service and FBI raided the company's headquarters and seized roughly $800,000 in assets. Last Friday, the government seized another $1.5 million in company assets, according to Jackson. The assets seized last week were in the form of E-Gold deposits.

At the heart of the government's case are allegations that E-Gold executives turned a blind eye to illegal activity on its networks, activity that allegedly ranged from the transfer of proceeds garnered from pyramid and investment scams to credit-card fraud and payments for child pornography materials.

According to the federal indictment unsealed last month, the company's directors monitored their users and were actively aware of which accounts were engaged in illegal activity. Yet the indictment alleges that company officials did little to stop transactions to and from these accounts. The government also noted that E-Gold does not include any statement in its user agreement prohibiting the use of its services for criminal activity.

The government also charges that E-Gold assigned only a single employee with no relevant experience to monitor hundreds of thousands of accounts for criminal activity, and that it encouraged users whose criminal activity had been discovered to transfer funds to other E-Gold accounts.

Jackson, who is slated to surrender before a federal magistrate in Washington on Thursday, strongly refuted the government's claims. He said that over the past three years his company had turned over information on more than 3,000 accounts that were used for either buying or selling child pornography. E-Gold also turned over information on more than 2,000 accounts thought to be connected to credit-card fraud, Jackson said.

He also asserted that his company has been working with the U.S. Postal Investigative Service and other law enforcement agencies to track hundreds of problematic accounts and that E-Gold was repeatedly asked not to block transactions to and from many of the accounts as it would interfere with ongoing federal investigations into credit-card fraud and child pornography rings.

"Quite frankly, the saddest element of all this is that because they designated us the bad guys, a lot of the worst criminals are still out there, when we could have helped haul them in," Jackson said. "Their decision to close ranks has directly resulted in a gross misallocation of resources, with the result that vicious criminals who might have been brought to justice remain at large."
Richard Field, an attorney and consultant in payment systems law, called the government's investigation of E-Gold "unusually intense."

"I haven't seen this level of focus or attention on other payment systems before," Field said. "This aggressive action against E-Gold appears to be intended to send a signal to others as well that you're responsible for setting up your system in a way that does not enable this kind of activity."

Experts say the global market for child pornography online is lucrative and thriving. Ernie Allen, president of the National Center for Missing & Exploited Children, in Alexandria, Va., said the demand for child pornography has fueled a multi-billion-dollar-a-year business that is increasingly Web-based.

Allen said roughly 90 percent of the U.S.-based payments industry has joined a coalition to police their networks for indications of commerce in child pornography, and that those efforts have forced child pornographers to almost exclusively use online payment services.

"We believe this kind of effort is at least disrupting the child pornographer's business model, and increasingly these individuals are evolving to use more customized and exotic online payment methods," Allen said.

The government strongly hinted that it plans to monitor online payment systems as part of a larger effort to crack down on child pornography. The FBI's Lynch said the agency "will continue to work closely with the Department of Justice and our federal and international law enforcement partners to aggressively investigate and prosecute any, and all, persons or organizations that use these systems to facilitate child pornography distribution, to support organized crime, and to perpetrate financial crimes."
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