

NOT JUST FUN AND GAMES

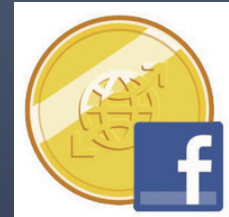
The Legal and Privacy Implications of Virtual Currency

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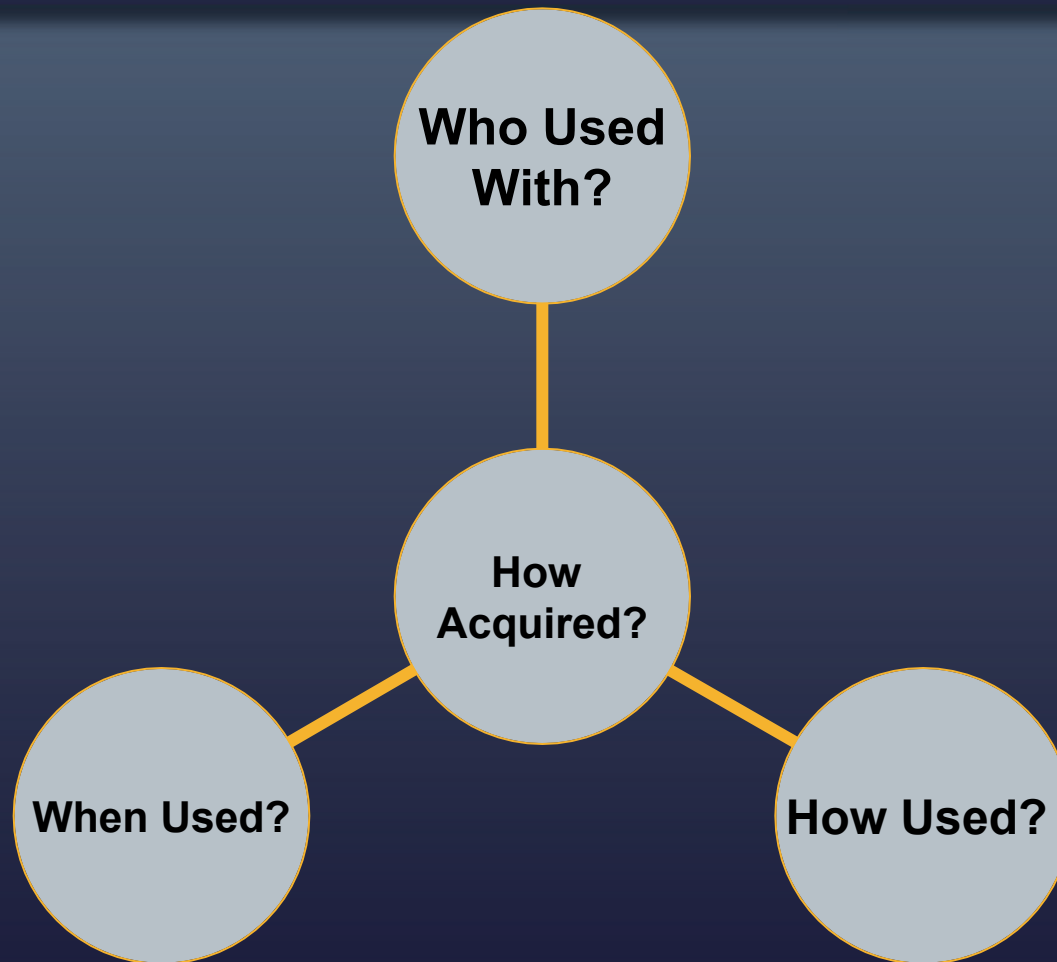
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What is Virtual Currency?

- **Virtual Currency**
 - “Currency”, points, vouchers and/or other forms of stored value used to purchase items (virtual goods, services, applications and real goods) or access features
- **Virtual Goods**
 - Digital representation of objects (real or imaginary)



Virtual Currency Business Model Components



Virtual Currency Business Model Components

- **How acquired:**

- Cash - Purchased with real money (from issuer/third party)
- Trade - Other Virtual Currency/Other Users
- No Cash
 - Earned by in-world actions/outcomes (games, etc.)
 - Sweepstakes, contests, “Gambling”
 - Acceptance of exposure to advertising
 - Release of user information
 - Survey participation
 - Gamification
- Gifting of currency from others
- Others

Virtual Currency Model Components

- **When Used:**
 - At time of purchase
 - Pre-purchased for later use (stored value)
- **Who used with: Virtual Currency Distributor vs. Others (Closed Loop/Open Loop)**
 - Virtual Currency distributor (game publisher, site operator)
 - Third party vendors/platforms
 - Real World Merchants
 - Internationally

Virtual Currency Model Components

- **How Used: Cash out vs. No cash out**
 - To buy in game goods
 - To buy goods, applications, etc. on platform
 - To access services/features
 - To buy real world goods/services
 - To acquire only (Zynga poker chips)
 - To exchange for other virtual currencies
 - Gifting/Donating
 - Redeem for cash

Virtual Currency Business Model Components

Based on these and other components, a wide variety of virtual currency business models can be adopted.

- **“Dual Currency” models**

- Acquisition - permit buying virtual currency for certain purposes; others must be earned
- Use - Certain types of virtual currency can be redeemed; others only accumulated (Zynga poker chips)

- **Market Places**

- Some vendors/platforms provide market/exchange
- Unauthorized secondary markets also abound

- **Many other variations exist**

Select Legal Issues with Virtual Currencies

- Federal and State Regulatory Issues
 - Stored Value/Gift Cards
 - Banking / Money Transfer / Anti-Money Laundering
 - Gambling Laws/Sweepstakes/Contest Law
 - Tax (Income, Sales and Use)
 - FTC Endorsement Guidelines – using points to compensate endorsers
 - Privacy
- Terms of Use - Property Rights (ownership vs. license)
- Intellectual Property (trademark currency name, copyright appearance, patent business models and functionality)
- Transacting with Minors
- Much more

Must Integrate Business and Legal Strategy

- Allowing users to buy, use and potentially redeem virtual currency raises a number of legal issues
- Must Strike a Balance
 - Maximize User Experience/Business Opportunities
 - Protect Assets and Users/Avoid Liability

NEW YORK VERIFICATION CODE

- 2011-053

Virtual Currencies – Legal Issues

- If money, value, or valid consideration is given, legal requirements trigger
- Law enforcement and regulators view virtual currencies as potentially high-risk products and services, especially for money laundering
- Analysis must consider specific structure/facts of program
- Gamers, players, users, friends, members, etc. may have legal protections – some of which cannot be waived
- More state/federal/foreign laws/regulations enacted every day

State Laws – Gift Card/Prepaid Card

- Almost every state has gift card laws – for many, there does not need to be a “plastic card” for the laws to apply
- If payment or valid consideration is given, any expiration date or any type of fees may be prohibited
- Special disclosures can be required
- Cash redemption is required by some states
- Special receipt requirements may apply
- Interesting variations with incentive, promotional, rewards, and loyalty programs
- Sweepstakes

State Laws – Unclaimed Property

- Can be millions of dollars
- If property belongs to another and owner has abandoned it, the “holder” must turn over the value to the state after specified periods of time
- Many states that prohibit expiration dates/fees on gift cards exempt them from unclaimed property requirements, but not all
- Many states require escheat of value, especially if there was any payment/consideration for the value
- Amount to escheat may be value paid
- Even if value paid by another corporation, still triggers escheat in many states
- Usual time frames for escheat: in general, 2/3/5 years depending on the state; 1 year if payroll
- Each state has its own requirements

State Laws – Licensure

- Often the most significant issue
- 48 states require licensure if you are holding or handling funds/value belonging to another
- License type – Money transmittal; bill payment; sales of checks; currency exchange; payment instruments, etc.
- Licenses are significant undertakings – can take months to years to get; significant capital requirements; surety bonds
- Need appropriate business plans, management expertise, etc.
- Technically a crime not to have a license if otherwise required

State Laws – Privacy

- Capture/use of personally identifiable data subject to privacy laws
- May require opt-outs or opt-ins
- Customer safeguarding systems
- Specific privacy disclosures
- Special laws regarding minors (e.g., California)

Other State Laws/Class Actions

- Unfair business practices
- Disclosure requirements
- Cash redemption requirements
- Recordkeeping/reporting requirements
- Special offers
- Not intended to be a comprehensive list
- Literally hundreds of state laws

Federal Laws – CARD Act

- Covers most products/services if prepaid
- Closed loop and open loop (except if reloadable and never, ever advertised as a gift)
- Limited exclusions:
 - Virtual value – definitional exclusion, but only where 100% has been converted to value
 - Loyalty/promotional – but only if special disclosures
 - Paper certificate
 - Redeemable only for admission to an event or a venue at a particular location and possibly services/goods at the event
 - Useable only for telephone services
 - Experiential – but cannot be linked to specific value
- Minimum 5-year expiration date (no preemption of stricter state laws)
- Most fees prohibited – some fees only after a year of dormancy and only one fee per month

Federal Laws – Electronic Fund Transfer Act

- Same law that controls your debit cards
- Mandatory disclosure requirements
- Mandatory receipt requirements
- Rights where transactions are unauthorized or erroneous
- Many types of e-wallets/prepaid products fall under EFTA and its implementing regulation, Regulation E

Federal Laws – Bank Secrecy Act/USA PATRIOT Act

- Federal laws and regulations
- Anti-money laundering/terrorism
- Law enforcement views prepaid access and virtual currencies as high-risk
- Extensive reporting/recordkeeping requirements
- Registration requirements for many
- Extensive anti-money laundering programs required if covered

Federal Laws – Prepaid Access Regulations (BSA)

- New regulations – some already in effect; most delayed until March 31, 2012
- Covers almost all prepaid access of any type of distribution method (e.g., cards, tokens, fobs, mobile numbers, etc.)
- Imposes significant new recordkeeping/reporting requirements
- Limited exception for closed loop if under \$2,000 access in one day for a defined merchant and can only be used for goods/services – no exception if cash redemption (other than legally required) or ability to transfer value to third party

Federal Laws – Prepaid Access Regulations (BSA) (cont'd)

- Limited exception for prepaid access with \$1,000 maximum value at any time – cannot be used internationally, cannot transfer value to third parties, and cannot have reloads from non-depository sources
- Limited exception for certain types of payroll cards – employee cannot load funds
- Limited exception for certain flexible health care and dependent care spending arrangements
- Limited exception for government benefit-funded plans

Federal Laws – Prepaid Access Regulations (BSA) (cont'd)

- Imposes many requirements on “provider” of prepaid access (every prepaid program must have an identified provider)
- Imposes many requirements on “seller” of prepaid access
- For products that do not fall within exemption, must capture name, address, date of birth, and identification number and verify the information before the prepaid access can be used
- Must maintain records for 5 years
- Any seller that sells more than \$10,000 of prepaid access in any day to any person or business is covered – limited exception where the seller has adopted appropriate anti-money laundering policies and procedures designed to ensure no sales over \$10,000
- Must file suspicious activity reports with federal government

Federal Laws – Money Services Business Registration

- Registration requirement for most money services businesses
 - Providers of prepaid access
 - Money transmitters
 - Currency exchangers
 - Issuers of payment instruments/travelers checks
 - Check cashers
 - Sellers/redeemers of monetary instruments
 - Others

Federal Laws – Cross-Border Monetary Instruments

- New proposed regulations under the Bank Secrecy Act requiring disclosure of any monetary instrument or prepaid access that is more than \$10,000 in the aggregate in a day that is taken across U.S. borders (into or out of the country)
- Can include mobile payments
- Can include game values

Federal Laws – OFAC Economic Sanctions

- Applies to every person and business in the U.S.
- Prohibits provision of services/goods to anyone on Specially Designated Nationals List or countries subject to economic sanctions (e.g., Iran, Cuba, etc.)
- Huge fines
- Interdict screening/reporting – if match, freeze value and place in interest bearing account

Federal Laws – Dodd-Frank Wall Street Reform and Consumer Protection Act

- Proposed regulations on international remittances
- Final regulations expected later this year
- Consumer Financial Protection Bureau

Federal Laws – Durbin Amendment to Dodd-Frank

- Imposes strict limitation on amount of interchange that can be charged on debit products – may be covered depending on the type of payment/funds
- Just came into effect
- Estimated \$ 6-10 billion shift of fees
- Make sure program economics are not impacted

Federal Laws – Gramm-Leach-Bliley Act

- Federal privacy law
- Applies to financial services provided to consumers
- Imposes disclosure obligations
- Mandates safeguarding of information
- Limits sharing of information
- Imposes opt-in requirements (state laws can impose stricter opt-out requirements)

Other Laws – Gambling Laws

- Federal and state laws prohibit most forms of gambling
- Department of Justice takes the position that any type of Internet gambling is illegal
- Laws are broad in scope
- Question of skill or game of chance
- Some proposed bills to soften laws, but it is unclear whether they will be enacted
- State laws can be even stricter than federal laws

Other Legal Issues – Tax Considerations

- Depending on program structure, you may have special reporting obligations (Form 1099)
- Deferral of recognition of income/revenue
- Impact on organizational structure of issuer
- Program structure may impact tax obligations and licensure requirements

Regulators/Enforcers of State Laws

- State banking departments
- State Attorneys General
- State Departments of Corporations
- Class action plaintiffs

Regulators/Enforcers of Federal Laws

- Federal banking regulators (OCC, FDIC, Federal Reserve System)
- FinCEN (Bureau of the U.S. Department of the Treasury)
- OFAC (Office of the U.S. Department of the Treasury)
- Consumer Financial Protection Bureau
- Internal Revenue Service
- U.S. Department of Justice
- U.S. Department of Commerce
- Federal Trade Commission

Possible Penalties

- Criminal penalties
- Civil penalties
- Class action lawsuits
- Regulatory actions
- Shutdown of program

Acquisition of Virtual Currency

- Will you be able to purchase the virtual currency?
- Will you be able to purchase the virtual currency at third parties other than the issuer?
- Will you be able to earn the virtual currency (e.g., by playing a game)?
- Will the virtual currency ever be issued as part of awards, loyalty, or promotional programs?

Use of Virtual Currency

- Can you use the virtual currency only with the issuer or with other merchants or gamers?
- Can you use the virtual currency only for merchandise or also for services?
- Can you use the virtual currency internationally?
- Can the virtual currency be “cashed out?”
- Can the virtual currency be transferred to others?

Features of Virtual Currency

- Does the virtual currency expire?
- Do any fees apply to the use or non-use of the virtual currency?
- Is there a minimum or maximum amount of virtual currency that someone can acquire in a day, week, month, quarter, or year?

Virtual Currency Records

- What type of identifying information do you collect, verify, and retain for purchasers of the virtual currency?
- What types of records do you maintain for transactions involving the virtual currency?
- What policies and procedures have you implemented to prevent the sale of virtual currency to any person during any one day in excess of established thresholds or amounts that would trigger recordkeeping requirements under applicable laws?