

**TESTIMONY OF JAMES H. FREIS, JR.**

**Before the U.S.-China Economic and Security Review Commission**

**Hearing on Macau and Hong Kong**

**PANEL II: “MONEY LAUNDERING IN MACAU AND  
IMPLICATIONS FOR THE UNITED STATES”**

**June 27, 2013**

Distinguished members,

Thank you for inviting me to testify at this hearing. My name is James H. Freis, Jr.; I work as counsel at the Washington office of Cleary, Gottlieb, Steen and Hamilton, LLP. In testifying before you today, I will draw primarily upon my prior experience while working at the United States Department of the Treasury, which I joined in 2005 as the Deputy Assistant General Counsel for Enforcement and Intelligence. From 2007 to 2012, I served as Director of the Financial Crimes Enforcement Network (FinCEN), a bureau of the Treasury Department responsible among other things for implementing, administering, and enforcing U.S. anti-money laundering regulations over casinos and a range of other financial institutions, as well as working with counterpart “financial intelligence units” (“FIUs”) around the world in sharing information in furtherance of law enforcement investigations of possible money laundering and terrorist financing.

**I. General Overview of Macau’s Gaming Industry**

Gambling has been legal in Macau for the past 150 years, predating the former Portuguese colony’s transfer to Chinese rule in 1999. Along with Hong Kong, the jurisdiction of Macau is designated as a special economic zone within the People’s Republic of China (PRC), possessing the autonomy to govern itself as relates to economic and trade policies, monetary, tax and financial regulation.

Perhaps the most notable feature about Macau’s gaming industry has been its exponential growth in the past couple of years, reaping \$38 billion in revenue in 2012 alone.<sup>1</sup> Gaming and the tourism associated with it are critical to the economy. The jurisdiction’s growth has been fueled by casino gaming, especially since 2001, following the expiry of a forty-year monopoly granted to Hong Kong businessman Stanley Ho in the 1960s. New licenses granted to US companies in the past decade have enabled Las Vegas casinos to expand into the Macau gaming market, opening replicas on the Cotai peninsula. This expansion has been lucrative for American casino owners, Hong-Kong based capital markets, financiers, accountants and lawyers, which have benefitted from the ever-growing tourism from mainland China. The Macau market is

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<sup>1</sup> For perspective, this number reflects revenues six times the size of gaming revenue from Las Vegas casinos. In 2010, revenue increased by 57%, followed by a “slump” in 2011 of 42%. Bruce Einhorn, *Betting on a New Gambling Boom in Macau*, Bloomberg Businessweek, May 22, 2013, <http://www.businessweek.com/articles/2013-05-22/betting-on-a-new-gambling-boom-in-macau>.

understood to be focused on gaming, rather than more recreation-diversified tourism, with most visitors coming from the Chinese mainland.<sup>2</sup>

Note that Macau is not the only gambling destination in southeast Asia seeing growth. In recent years Singapore in particular has become established as a major gambling destination, while Vietnam and Manila, Philippines have also sought to attract wealthy Chinese gamblers.

## II. Unique Aspects of Macau's Casino Gaming Industry

As a special administrative region of the People's Republic of China (PRC), the Macanese gaming industry benefits from being the only place in China where gambling is legal. Gambling debts are also not enforceable in mainland China. This has implications for the structure of the gaming industry and the risks of involvement of organized crime.

Furthermore, at times the PRC has sought to restrict the outflow of money to Macau through restrictions on the amounts of money that can leave the mainland, or alternatively through the number of visas issued to Macau travelers.<sup>3</sup> These actions directly affect Macau's economy, which obtains its revenue from a 40% tax on casinos gambling revenues.<sup>4</sup> In 2011, the Macanese government brought in \$23.5 billion in revenues, 72% of which was gained from taxes on gambling.<sup>5</sup>

Another notable feature of the Macanese gaming industry is the heavy reliance on "junket operators" by casinos to recruit gamblers from the mainland into their establishments. "A junket is a term of art for a group of players who travel together for the purpose of gambling. A 'junket representative' is the person responsible for organizing the group."<sup>6</sup> In Macau, this structure lies at the heart of the recruitment of Chinese high rollers, where junket operators gain up to 40% commissions on the amounts spent by gamblers.<sup>7</sup>

The junket operators in many instances operate a type of casino within the casino. Junkets attract gamblers into VIP rooms in significant part through the extension of credit.<sup>8</sup> As noted earlier, gambling is prohibited in mainland China, and there are restrictions on how money can leave the country. Junket operators themselves supply the gambling money to Macau's visitors

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<sup>2</sup> Other oft-reported characteristics of visitors to Macau for gaming purposes is that the average length of stay is relatively short (1.1 nights); and the game of choice is baccarat. *See, e.g.,* Tony Wong, *Big Bets in Asia's Vegas*, Toronto Star, June 2, 2007, at B01.

<sup>3</sup> In 2008 and 2009, Chinese authorities restricted the number of visas being issued in Macau. *Macau's gambling industry A window on China*, The Economist, Dec. 10, 2011, <http://www.economist.com/node/21541417>.

<sup>4</sup> *Gambling tax 'stays in the family'*, South China Morning Post, Dec. 31, 2004 at 18. *See also* University of Nevada Las Vegas Center for Gaming Research, *Macau Gaming Summary* (June 24, 2013, 11:41 AM), <http://gaming.unlv.edu/abstract/macau.html> (providing a breakdown of taxation to effective tax of 38 to 39%, 35% on gross gaming revenue, 1.6% contribution to Macao Foundation, 1.4% for Sociedade de Jogos de Macau (subsidiary controlled by Stanley Ho), 2.4% contribution to the Infrastructure/Tourism/Social Security Fund).

<sup>5</sup> *Macau's gambling industry A window on China*, *supra* note 3.

<sup>6</sup> Financial Crimes Enforcement Network, Dep't of the Treasury, Guidance Frequently Asked Questions: Casino Recordkeeping, Reporting, and Compliance Program Requirements, FIN-2012-G004 (Aug. 13, 2012).

<sup>7</sup> *Macau's gambling industry A window on China*, *supra* note 3.

<sup>8</sup> Under Law 5/2004, the practice of credit extension by gaming promoters is made legal. *See* Jorge Godinho, *The Prevention of Money Laundering in Macau Casinos*, Gaming Law Review and Econ. Vol. 17 Num. 4, 264 (2013).

during their stay. I defer to others to provide more expert details about Macau's junket lending structure, but here are a few reported indicia. Referred to by some as a "shadow lending" structure, the 200 or so junkets in operation<sup>9</sup> have consolidated over the years. In recent years, approximately 80% of revenues has been reported to go to the top 40 firms.<sup>10</sup> Net winners at Macau casinos may be paid in Hong Kong dollars, which in turn are converted into Chinese yuan. Net losers must pay their debts if they wish to be invited to return to gamble again, and also are subject to efforts by junkets to collect upon amounts owed.<sup>11</sup> In some capacity, the involvement of organized crime groups such as China's triads is likely.<sup>12</sup>

### III. The U.S. Anti- Money Laundering Framework and Casinos

In general, casinos are considered to have risks for money laundering primarily because of the large amounts of money that flow in and out. A premise underlying anti-money laundering ("AML") regulation in the United States, which has since become accepted on a global basis, is that any way that money can be moved, or value can be intermediated, is subject to potential criminal abuse. The risks of different intermediation channels differ, and, accordingly, the steps taken to mitigate those risks should differ as well.

For AML purposes, one distinguishing characteristic of casinos from other entities more traditionally understood as financial institutions that operate through account-based relationships, the casino customer can conduct his transactions in relative anonymity. "Even when a person applies for 'credit' at a casino, neither government regulation, or the casino's normal business practice requires it to use the same in-depth inquiry used by other financial institutions to determine a person's ability to repay the debt established."<sup>13</sup> It should also be noted that one consequence of more stringent AML controls at banks and other more traditional financial institutions is that it may cause criminals to seek out other ways to attempt to launder criminal proceeds, such as through casinos.

Casinos and other gaming establishments are treated as "financial institutions" for the purposes of AML regulation under the Currency and Financial Transactions Reporting Act of 1970, commonly known as the Bank Secrecy Act (BSA).<sup>14</sup> The Money Laundering Suppression Act of 1994 extended the application of the BSA to gaming activities. FinCEN has issued implementing regulations with respect to casinos. The regulatory requirements consist essentially of an AML Program establishing policies and procedures to make the casino vigilant against criminal abuse; recording requirements; and reporting requirements, particularly with

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<sup>9</sup> *Macau's gambling industry A window on China*, *supra* note 3.

<sup>10</sup> *Hard habit to break: Can Macau's casinos cut their reliance on VIP junkets and draw in the mass market?* China Economic Review, April 9, 2012.

<sup>11</sup> Gambling debt enforcement through illegal means was thought to be the source of two hotel room murders in 2012 reminiscent of Macau in the 1990s. *See Crime Scene Macau receives a discomfoting reminder of its violent past*, Inside Asia Gaming, Aug. 3, 2012, <http://www.asgam.com/cover-stories/item/1722-crime-scene.html>. In some capacity, the involvement of organized crime groups such as China's triads is likely, despite falling figures in violent crime rates over the last decade.

<sup>12</sup> See *id.* (reporting that Junkets "have provided the triads with 'access to capital' and 'the ability to make money in a manner not previously available to them'").

<sup>13</sup> Financial Crimes Enforcement Network, Dep't of Treasury, *Issue 17 In Focus: The Casino and Gaming Industry*, The SAR Activity Review Trends Tips & Issues, BSA Advisory Group 2010, 57.

<sup>14</sup> 31 U.S.C. § 5311 et seq.

respect to transactions in cash in excess of \$10,000 as well as reporting suspicious activity. FinCEN enforces compliance with these regulations, and examines for compliance through dedicated staff at the Treasury Department's Internal Revenue Service.

Domestically, money laundering in casinos manifests itself in several ways. The large majority of activity reported by casinos as required when they have suspicion of money laundering is in the context of "structuring" whereby those seeking to launder money cash out their gambling chips at casino and follow these transactions by cash buy-in payments. In other circumstances, launderers use an agent to cash in large amounts of chips at different "cages".<sup>15</sup> Other forms of suspicious activity may be the exchange of small bills, followed by minimal or no play at the casino and a cash out for large amounts. Fraud and shared use of player rating accounts make up for the remainder of suspicious activity, as players use each others' accounts to conceal the wins and losses of each individual customer.<sup>16</sup>

Casinos that observe suspicious activities must file "suspicious activity reports" (SARs) for any transaction where they "know, suspect, or have reason to suspect involvement of \$5,000 or more in funds or other assets."<sup>17</sup>

#### **IV. Global Entities Addressing Money-Laundering**

At the global level, anti-money laundering principals have been developed in the recommendations issued by the Financial Action Task Force (FATF).<sup>18</sup> These FATF Recommendations in turn must be implemented by law in each respective jurisdiction. In the United States, this includes relevant provisions implemented in the Bank Secrecy Act. Overall, the approach adopted by FATF is "risk-based". This means that countries with any of a host of factors should be particularly careful in designing and implementing laws relating to money laundering and terrorism finance. Among the factors that should be considered, FATF lists 1) economic structure 2) concentration of criminal activity 3) size and activities carried out by designated non-financial businesses and professions 4) channels for money laundering and 5) underground or informal areas of the economy.<sup>19</sup>

FATF issues recommendations to financial institutions of its member nations to assist in policy construction and regulation of financial flows. In sum, the aim of this body is to make sure that financial institutions have properly identified, and know, their customer. Recommendations thus take the form of customer due diligence procedures and record keeping, including enhanced due diligence with respect to politically exposed persons, in order to mitigate risks of laundering proceeds from corruption. Correspondent banking, internal controls on foreign branches and

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<sup>15</sup> A "cage" refers to the cash depository in a casino. See Financial Crimes Enforcement Network, *Suspicious Activity Reporting in the Gaming Industry* "Glossary of Casino Terms", March 2012 at 24.

<sup>16</sup> Player rating accounts are a method by which casinos award complimentary services to attract and retain their customers. It is calculated using a number of factors, including the length of time the gambler plays. *Id.*

<sup>17</sup> Dep't of the Treasury, Guidance Frequently Asked Questions Casino Recordkeeping, Reporting, and Compliance Program Requirements at 9.

<sup>18</sup> *Id.*

<sup>19</sup> Financial Action Task Force, RBA Guidelines for Casinos 18 (2008).

subsidiaries, and the reporting of suspicious transactions are other tools at the disposal of these member institutions.<sup>20</sup>

One of the FATF principles, contained in Recommendation 29, is that each jurisdiction should establish a financial intelligence unit (FIU), which is the central agency responsible for the receipt, analysis, and dissemination in support of law enforcement investigations, of a range of information including reporting by casinos and other financial institutions of suspected money laundering and terrorist financing. As noted earlier, FinCEN is the FIU of the United States. Macau's FIU, is the Gabinete de Informação Financeira (GIF). Each of FinCEN and the GIF, together with counterpart FIUs from over 130 jurisdictions around the world, are members of the Egmont Group of FIUs. The Egmont Group establishes and shares best practices and develops common procedures to utilize their unique legal authorities to share intelligence information in support of cross-border law enforcement investigations of money laundering and terrorist financing.

It should be noted that the PRC is a member of FATF, but the FIU of the PRC does not currently participate as a member of the Egmont Group. The Egmont Group includes FIUs of jurisdictions that are not states, which in relevant part includes not only the GIF from Macau, but also the FIUs of Hong Kong and of Taiwan. Participation in the Egmont Group is one important indicator of the level of active cooperation in cross-border efforts to combat money laundering.

## **V. Macanese Laws Addressing Money-Laundering**

As discussed in the previous section, the threat of money-laundering and terrorism financing proceeds through various channels, including banking and other financial institutions. Nonetheless, because of the predominance of non-traditional banking and other “high risk” activities at the core of Macau's economy, discussion will be focused on designated non-financial businesses and professions (“DNFBPs”). These include casinos and other gaming institutions, accounting and legal services, pawn shop and jewelry dealers, those engaged in intermediary real estate services, and non-profit organizations. At the very least, discussion of Macau's legal framework will focus on its anti-money-laundering and combating the financing of terrorism laws (henceforth “ML/FT”) through the lens of gaming establishments. Macanese law addressing these sorts of crimes target practices on an international, local criminal and local regulatory level.

In the international arena, Macau has ratified the International Convention for the Suppression of the Financing of Terrorism as well as the Vienna and Palermo Conventions. Moreover, Macau is a member of the Asia/Pacific Group on Money Laundering (APG), established as a regional group aimed at coordinating implementation measures laid for ML/FT enforcement. As previously mentioned, its financial intelligence unit, the Gabinete de Informação Financeira (GIF), is a member of the Egmont group, whose goal is to “provide a forum for [financial intelligence units (FIUs)] around the world to improve cooperation in the fight against money

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<sup>20</sup> Financial Action Task Force, International Standards on Combating Money Laundering And the Financing of Terrorism & Proliferation The FATF Recommendations (2013).

laundering and financing terrorism.”<sup>21</sup> Macau has signed agreements with the FIUs of most countries in the region, as well as with Portugal.<sup>22</sup>

In 2006, Macau implemented Law 6/2006, which establishes the basis for legal cooperation in criminal matters between Macau and other jurisdictions.<sup>23</sup> This law applies most specifically to the surrender of fugitive victims, transfer of criminal proceedings, transfer of sentenced persons, and the surveillance of sentenced persons. In line with the Basic Law and its status as a special administrative zone within China, however, extradition agreements are not handled by the Macanese government, but with the PRC. Still, formalized channels of communications and information sharing exist between the judiciary police (PJ) and their correlates in the PRC, Hong Kong and Portugal.

Within the past decade, Macau’s local laws have been redesigned to criminalize money laundering and terrorism finance, marking these as stand-alone crimes. This is supplemental to the existent Article 166 provision of the legal code that makes seizure of assets legally possible if related to the commission of a crime or important to an investigation.<sup>24</sup> A similar and relevant provision 6/97/M is targeted as a law against organized crime. More recent provisions of the criminal code have been even more specific. Laws 2/2006 and 3/2006 “Prevention and Repression of Crime of Money Laundering” and “Prevention and Repression of Crime of Terrorism” respectively,<sup>25</sup> have broad application. The prosecution must prove “beyond a reasonable doubt” that property was forfeited from an unlawful activity, except in circumstances of unjustified wealth offenses among public servants. Each of these laws has a minimum punishment term above 3 years. Those facilitating the commission of these offenses are punished as accomplices, with “conspiracy to commit” being considered an autonomous offense.<sup>26</sup>

In addition to the criminalization of ML/FT activities, Macau has several regulatory laws in place aimed at ameliorating the monitoring and supervision of financial transactions to avoid money-laundering and terrorism financing. The most comprehensive of these is 7/2006 Administrative Regulation: “Preventive Measures Against Money Laundering and Financing Terrorism”.<sup>27</sup> First among its primary goals is to improve customer identification records and record-keeping procedures to retain transaction information for at least five years. Moreover, it creates a process by which casinos report suspicious transactions (STRs), denying the performance of certain transactions if identification obligations have not been fulfilled. The law also allows for fines for non-compliance.

There were three main objectives to Macau’s regulatory reforms in 2006 to bring the jurisdiction more in line with global AML expectations. First, disclosure rules attempt to ensure that large

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<sup>21</sup> [www.egmontgroup.org/about](http://www.egmontgroup.org/about). (last visited Jun. 21, 2013).

<sup>22</sup> “Understanding/Cooperation Agreements” have been signed with China, Portugal, Hong Kong, Korea, Indonesia, Philippines, Thailand, Japan, Malaysia, Singapore and Fiji. See [www.gif.gov/web1/en\\_memorandum.html](http://www.gif.gov/web1/en_memorandum.html) (last visited Jun. 20, 2013).

<sup>23</sup> Asia/Pacific Group on Money Laundering, Mutual Evaluation Report on Macao, China 25 (2007).

<sup>24</sup> *Id.* at 34-35.

<sup>25</sup> *Id.* at 25.

<sup>26</sup> *Id.* at 25.

<sup>27</sup> *Id.* at 102-103.

cash transactions are being reported to the appropriate bodies. The bulk of the concern lies with cross-border disclosures and the movement of money from China to Macau and out from Macau to various parts of the world. Second, “know your customer” policies were imposed on casinos, with special guidelines intended for “politically exposed persons” (PEPs). This is meant to prevent the gambling of public funds; Macanese officials are likewise prohibited from engaging in gaming activities either directly or indirectly. Third, record-keeping was expanded to ensure that monitoring is adequate and up to date, requiring businesses to keep their records until at least 10 years after the closure of their business.

Enforcement of anti-money-laundering laws is within the purview of the judiciary police (PJ). A specialized subdivision of the PJ is dedicated to money-laundering related crimes. Under 7/2006, they have the authority to apply administrative penalties to gambling concessionaries when they do not comply with the law. In fact, this is the only group that can enforce and investigate ML/FT offences. These officers are specially trained and are placed within the Macau casinos themselves.<sup>28</sup>

Several regulatory authorities within Macau share responsibility for the vigilance of AML/CFT criminal activity. The two primary authorities will be discussed here, though it should be noted that there are a total of 8 regulatory agencies that carry out supervisory functions relating to money laundering activities.<sup>29</sup> The main entity bearing these duties is the Macanese financial intelligence unit (GIF), established in 2006. It seeks primarily to collect, analyze, and disseminate information on suspicious transactions. Suspicious transaction reports must be filed by financial institutions and DNFBPs.

The Monetary Authority of Macao (AMCM), the jurisdiction’s central bank, is the financial regulatory authority. It also possesses the power to seize documents and assets that constitute the object of offenses. In recent years, AMCM’s primary focus has been the expansion of customer due diligence (CDD) procedures in line with the generalized goals across agencies of record-keeping and improved disclosure rules.<sup>30</sup>

The Macanese government has designated the Gaming Inspection and Coordination Bureau (DICJ) as the supervising regulatory authority over casinos. Above all, the focus of this entity is to ensure compliance with the recording of suspicious and large transactions ( \$62,500 or higher). The DICJ is also charged with the supervision of junket promoters and CDD, ensuring that customers have fulfilled all the proper identification requirements under Macanese law. Suspicious activities should be reported within two working days to the GIF. Casino operators are also encouraged to train their employees to watch for money laundering both through “know

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<sup>28</sup> *Id.* at 28.

<sup>29</sup> The full list is 1) Monetary Authority of Macao 2) Gaming Inspection Coordination Bureau 3) Macao Trade and Investment Bureau 4) Financial Services Bureau 5) The Macao Lawyers Association 6) The Independent Commission for the Exercise of Disciplinary Power over Solicitors 7) Legal Affairs Bureau 8) Macao Economic Service. [http://www.gif.gov.mo/web1/en\\_org.html](http://www.gif.gov.mo/web1/en_org.html).

<sup>30</sup> Asia/Pacific Group on Money Laundering, *supra* note 23 at 46.

your customer policies” and through the use of their existing surveillance infrastructure.<sup>31</sup> The internal procedures set up by the DICJ set a minimum amount of regulation and procedure.<sup>32</sup>

Suspicious transaction reports have increased three-fold in the past four years. This has paralleled a growth in that same time period by about three times.<sup>33</sup>

## VI. Money-Laundering in Macau

At the basic level, the risks of money laundering through casinos in Macau are analogous to those in the United States and elsewhere. According to Jorge Godinho, an associate professor at the University of Macau,<sup>34</sup> money laundering through casinos generally has two types of objectives. “The main objective is to pass funds through the casino, typically taking as an entry point the buying of gambling chips, followed by the placing of bets, usually of reduced values...in order to avoid significant amounts losses. The gaming session ends with the redemption of the chips through the issuance of a casino check. A secondary objective may be to ensure that the transactions are split or divided so that each does not exceed the value that triggers the automatic recording of operations, a practice known in the jargon as ‘smurfing’.”<sup>35</sup> The factors unique to Macau as a jurisdiction, related to the gaming customer base coming from outside Macau and primarily China where gambling is illegal, are more dominant considerations.

Outside of the gaming industry, but an important aspect of the U.S. historical perspective in assessing money laundering risks related to Macau, is the following. In the USA PATRIOT Act of 2001, Congress amended the Bank Secrecy Act to significantly expand the U.S. anti-money laundering framework. One of the tools entrusted to the Treasury Department and administered by FinCEN is Section 311 of the Patriot Act, codified at 31 U.S.C. § 5318A. This provision grants FinCEN the power to prohibit US financial institutions from maintaining or operating correspondent accounts in foreign jurisdictions when it deems a jurisdiction, financial institution, or certain transactions to be of “primary money laundering concern.” Before acting to do so, FinCEN considers several factors, including the extent to which the institution has facilitated or promoted money laundering, the extent to which it may have a legitimate business purpose, and any undue burdens or disadvantages associated with such compliance.

In September 2005, FinCEN identified Banco Delta Asia (BDA), a small bank with eight branches in Macau as a financial institution of “primary money laundering concern.”<sup>36</sup> In March 2007, FinCEN finalized a rule imposing the fifth special measure authorized by Section 311 to prohibit U.S. financial institutions from maintaining correspondent accounts for BDA, or directly or indirectly processing transactions on its behalf. Among the money laundering issues identified at BDA were intentionally negotiated low standards of due diligence, suppressed

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<sup>31</sup> *Id.* at 90.

<sup>32</sup> Jorge Godinho, *supra* note 12 at 273.

<sup>33</sup> Jorge Godinho, *supra* note 12 at 273-274, *compare* Table 1 and Table 2.

<sup>34</sup> Jorge Godinho is an academic that has written extensively on the subject of financial regulation in Macau.

<sup>35</sup> Jorge Godinho, *supra* note 12 at 264.

<sup>36</sup> Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Imposition of Special Measure Against Banco Delta Asia, Including Its Subsidiaries Delta Asia Credit Limited and Delta Asia Insurance Limited, as a Financial Institution of Primary Money Laundering Concern, 72 Fed. Reg. 52, 12730 (Mar. 19, 2007).



customer identity, routine use of cash couriers, and repeated transfers of round-figure sums with no apparent licit purpose as dubious practices assumed by BDA. Upon further investigation, BDA was revealed to have been aiding in the laundering funds from Daedong credit bank, a North Korean bank holding over \$25 million in funds for the financing of its nuclear weapons program through illicit sources such as narcotics and counterfeiting. The United States acted in cooperation with Macanese authorities, which froze the funds, began implementing AML compliance efforts at BDA, and closed all of BDA's North-Korea related accounts.

This experience with BDA provides important context as to the timing of some of the AML reforms in Macau described above.

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Thank you again for inviting me to testify before the Commission today. I would welcome the opportunity to respond to your questions.