

MACAU AND HONG KONG

HEARING

BEFORE THE

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

**ONE HUNDRED THIRTEENTH CONGRESS
FIRST SESSION**

THURSDAY, JUNE 27, 2013

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UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

WASHINGTON: 2013

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

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The Commission was created on October 30, 2000 by the Floyd D. Spence National Defense Authorization Act for 2001 § 1238, Public Law No. 106-398, 114 STAT. 1654A-334 (2000) (codified at 22 U.S.C. § 7002 (2001), as amended by the Treasury and General Government Appropriations Act for 2002 § 645 (regarding employment status of staff) & § 648 (regarding changing annual report due date from March to June), Public Law No. 107-67, 115 STAT. 514 (Nov. 12, 2001); as amended by Division P of the “Consolidated Appropriations Resolution, 2003,” Pub L. No. 108-7 (Feb. 20, 2003) (regarding Commission name change, terms of Commissioners, and responsibilities of the Commission); as amended by Public Law No. 109-108 (H.R. 2862) (Nov. 22, 2005) (regarding responsibilities of Commission and applicability of FACA); as amended by Division J of the “Consolidated Appropriations Act, 2008,” Public Law No. 110-161 (December 26, 2007) (regarding responsibilities of the Commission, and changing the Annual Report due date from June to December).

The Commission’s full charter is available at www.uscc.gov.

July 9, 2013

The Honorable Patrick J. Leahy
President Pro Tempore of the Senate, Washington, D.C. 20510
The Honorable John A. Boehner
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR LEAHY AND SPEAKER BOEHNER:

We are pleased to notify you of the Commission's June 27, 2013 public hearing on "Macau and Hong Kong." The Floyd D. Spence National Defense Authorization Act (amended by Pub. L. No. 109-108, section 635(a)) provides the basis for this hearing.

At the hearing, the Commissioners received testimony from the following witnesses: Daniel Glaser, Assistant Secretary for Terrorist Financing, Office of Terrorism and Financial Intelligence, Treasury Department; A. G. Burnett, Chairman, Nevada State Gaming Control Board; I. Nelson Rose, Wittier Law School, Encino, California; James H. Freis Jr., Cleary Gottlieb Steen & Hamilton LLP; Sophie Richardson, China Director, Human Rights Watch; and Madeline Earp, Research Analyst, Freedom House. This hearing examined two of China's special administrative regions, Macau and Hong Kong. The Commission focused on money laundering and financial fraud related to casino gambling in Macau and issues related to democracy, press freedom, and human rights in Hong Kong.

We note that prepared statements for the hearing, the hearing transcript, and supporting documents submitted by the witnesses will soon be available on the Commission's website at www.USCC.gov. Members and the staff of the Commission are available to provide more detailed briefings. We hope these materials will be helpful to the Congress as it continues its assessment of U.S.-China relations and their impact on U.S. security.

The Commission will examine in greater depth these issues, and the other issues enumerated in its statutory mandate, in its 2013 Annual Report that will be submitted to Congress in November 2013. Should you have any questions regarding this hearing or any other issue related to China, please do not hesitate to have your staff contact our Congressional Liaison, Reed Eckhold, at (202) 624-1496 or via email at reckhold@uscc.gov.

Sincerely yours,



Hon. William A. Reinsch
Chairman



Hon. Dennis C. Shea
Vice Chairman

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MACAU AND HONG KONG

THURSDAY, JUNE 27, 2013

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Washington, D.C.

The Commission met in Dirksen Senate Office Building, Room 608, Washington, D.C. at 9:00 a.m., Commissioners William Reinsch and Dennis Shea (Hearing Co-Chairs), presiding.

**OPENING STATEMENT OF WILLIAM REINSCH
HEARING CO-CHAIR**

CHAIRMAN REINSCH: Good morning, everyone. Thank you for joining us. Today's hearing on Macau and Hong Kong is the last hearing of the Commission's 2013 Annual Report cycle. Our next event will be a July 11 roundtable discussion on cyber security policy. Our roundtable events, in which we invite experts to talk in a more informal discussion format about a specific topic, are also open to the public, and details about that will be on the Web site later on.

Today's hearing will examine the two special administrative regions of China: Macau and Hong Kong. The former Portuguese colony and former British colony reverted to Chinese rule in the late 1990s, but under the agreement to grant China sovereignty over the two, they are for 50 years supposed to enjoy certain freedoms denied to other parts of the People's Republic.

My co-chair in this hearing, Commissioner Dennis Shea, will talk about Hong Kong and its guarantees of democracy, freedom of speech and the press, and other rights. And I'll outline the Commission's interest in Macau.

Macau is a small island city whose most well-known characteristic is its network of legalized gambling casinos. It is the only place in the People's Republic where gambling is legal other than in state lotteries. Macau derives considerable benefits from gambling in terms of employment and tax revenues. The \$38 billion in casino revenue in Macau last year was six times that of Las Vegas.

But with its bonanza of riches have come problems, some of which affect the United States. As we will hear, Macau has a lax regulatory system for its casinos, which has allowed traditional Chinese organized crime figures to operate in Macau with impunity.

Of even more concern for the United States is the use of Macau's casinos for money laundering. China has strict capital controls that restrict

the convertibility of Chinese currency, limit its citizens' ability to take it out of the country, and limit its use in international investment. The structure of the casino system in Macau effectively allows people to use the casinos to circumvent these capital controls.

Corrupt Chinese officials move embezzled funds across the border, drug smugglers and human traffickers move large sums of cash about, and lawbreakers seek to escape prosecution of the tax authorities by laundering money through gambling.

In addition, Macau banks, as has been made public in the past, have been implicated in a variety of financial crimes. For example, the Macau-based Banco Delta Asia was once the transit point for counterfeit currency from North Korea--action that the Treasury Department has dealt with in the past.

American authorities at the state and federal level want to make sure that the three U.S.-based casino companies licensed to operate affiliate casinos in Macau do not get drawn into activities that would be considered illegal or improper in the United States.

We will hear from several experts and regulators at both federal and state government levels about the challenge of regulating casinos that operate on two continents. I would also note for the record that a representative of the casino companies was invited to appear today, but we received no response.

The fact that the PRC does not permit the legal collection of gambling debts appears to be the most significant factor in creating a unique chain of circumstances in which casinos effectively sublease a substantial portion of their gaming operations to VIP rooms, many of which we will hear today are controlled by Chinese organized crime groups.

We hope today to gain a better understanding of how the money laundering chain works, the role of Chinese criminal groups in it, the implications for the gambling industry in the United States, and the potential national security threats this poses for the United States.

Let me now turn to my colleague Vice Chairman Shea for his opening comments, and then we'll go directly to the first panel.

**PREPARED STATEMENT OF WILLIAM REINSCH
HEARING CO-CHAIR**



U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION

Hearing on Macau and Hong Kong

**Opening Statement of Chairman William A. Reinsch
June 27, 2013
Washington, DC**

Good morning and thank you for coming. Today's hearing on Macau and Hong Kong is the last hearing of the 2013 Annual Report cycle. Our next event will be a July 11 roundtable discussion on Cybersecurity policy. Our roundtable events, in which we invite experts to talk in a more informal discussion about a specific topic, are also open to the public.

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employment and tax revenues. The \$38 billion in casino revenue in Macau last year was six times that of Las Vegas.

But with this bonanza of riches has come problems, some of which affect the United States. As we will hear, Macau has a lax regulatory system for its casinos which has allowed traditional Chinese organized crime figures to operate in Macau.

Of even more concern for the United States is the use of Macau's casinos for money laundering. China has strict capital controls that restrict the convertibility of Chinese currency, limit its citizens' ability to take it out of the country, and limit its use in international investment. The structure of the casino system in Macau effectively allows people to use the casinos to circumvent these capital controls. Corrupt Chinese officials move embezzled funds across the border, drug smugglers and human traffickers move large sums of cash about, and lawbreakers seek to escape prosecution or the tax authorities by laundering money through gambling. In addition, Macau banks have been implicated in a variety of financial crimes. For example, the Macau-based Banco Delta Asia was once the transit point for counterfeit currency from North Korea.

American authorities at the state and federal level want to make sure that the three U.S.-based casino companies licensed to operate affiliate casinos in Macau do not get drawn into activities that would be considered illegal or improper in the United States. We will hear from several experts and regulators at both federal and state government levels about the challenge of regulating casinos that operate on two continents. I would also note that a representative of the

casino companies was invited to appear today, but we received no response.

The fact that the PRC does not permit the legal collection of gambling debts appears to be the most significant factor in creating a unique chain of circumstances in which casinos effectively sublease a substantial portion of their gaming operations to VIP rooms, many of which we will hear today are controlled by Chinese organized crime groups. We hope today to gain a better understanding of how the money laundering chain works, the role of Chinese criminal groups in it, the implications for the gambling industry in the United States, and the potential national security threats this poses for the United States.

Let me now turn to my colleague Vice Chairman Dennis Shea for his opening comments.

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**OPENING STATEMENT OF DENNIS SHEA
HEARING CO-CHAIR**

VICE CHAIRMAN SHEA: Thank you, Bill, and thanks again to our witnesses for joining us. We greatly appreciate them taking the time to testify and provide some expert insight to the Commission.

It our afternoon panel, we will address a different set of issues in China's other special administrative region, Hong Kong. The panel will examine Hong Kong's universal suffrage plan, the state of press freedom, and police surveillance.

First, we'll examine Hong Kong's pledge for universal suffrage in the election of its chief executive and legislature as an "ultimate goal" under Hong Kong's Basic Law. We will then look at the current state of freedom of press and freedom of speech in Hong Kong, a right also granted by Hong Kong Basic Law. Finally, we will look at police surveillance in Hong Kong and the implications it may have for freedom of speech and other human rights. Our panel of distinguished human rights activists will elaborate on these issues this afternoon.

We will begin the hearing this morning with an administration witness addressing money laundering, financial crimes, and the threat they pose to the United States, which will lead into our second panel on related issues in Macau.

Before we start, however, I would first like to express our sincere gratitude to the Senate Budget Committee, its chairman, Senator Patty Murray, and to the staff of the Budget Committee, for helping us to secure this room today. I would also like to remind panelists to keep his or her remarks to seven minutes so that we have ample time for questions and answers.

Our first panel today will provide a general overview of money laundering and the threat it poses for U.S. national security. We look forward to hearing from the Honorable Daniel L. Glaser, Assistant Secretary for Terrorist Financing at the U.S. Department of the Treasury.

As Assistant Secretary, Mr. Glaser is responsible for helping to formulate and coordinate the counterterrorist financing and anti-money laundering policies and strategies for the Treasury Department's Office of Terrorism and Financial Intelligence.

During his tenure at Treasury, he has served as Deputy Assistant Secretary for Terrorist Financing and Financial Crimes and was the first Director of the Treasury Department's Executive Office of Terrorist Financing and Financial Crimes.

Since 2001, Mr. Glaser has also served as the head of the U.S. Delegation to the Financial Action Task Force, the premier international anti-money laundering and counterterrorism financing body in the world.

He is a graduate of the University of Michigan and the Columbia University School of Law. Mr. Glaser, the floor is yours.

**PREPARED STATEMENT OF DENNIS SHEA
HEARING CO-CHAIR**



U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION

Hearing on "Macau and Hong Kong"

**Opening Statement of Vice Chairman Dennis C. Shea
June 27, 2013
Washington, DC**

Thank you, Chairman Reinsch, and thank you again to our witnesses for joining us. We greatly appreciate our witnesses taking the time to testify and provide expert insight to the Commission.

In our afternoon panel, we will address a different set of issues in China's other special administrative region, Hong Kong. The panel will examine Hong Kong's universal suffrage plan, press freedom, and police surveillance.

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Today, our panel of distinguished human rights activists will elaborate on these issues relating to Hong Kong after the lunch break.

We will begin the hearing this morning with an administration witness addressing money laundering, financial crimes, and the threat they pose to the United States, which will lead into our second panel on related issues in Macau. Before we start, however, I would first like to express our sincere gratitude to the Senate Budget Committee, its Chairman Senator Patty Murray, and their staff for helping us to secure this room today. I would also like to remind witnesses to keep remarks to 7 minutes so that we have ample time for our question-and-answer session.

**OPENING STATEMENT OF MR. DANIEL GLASER
ASSISTANT SECRETARY FOR TERRORIST FINANCING
OFFICE OF TERRORISM AND FINANCIAL INTELLIGENCE
TREASURY DEPARTMENT**

MR. GLASER: Thank you, Mr. Chairman.

In my remarks today I would like to focus on the U.S. Treasury Department's long-standing efforts to promote implementation of effective money-laundering and counterterrorist financing measures worldwide.

Treasury works closely with international counterparts to combat global money laundering, terrorist financing, proliferation financing, and all other forms of illicit financial activity. By working through various multilateral bodies, we have improved transparency throughout the international financial system and have integrated robust systemic AML/CFT safeguards into the international financial architecture.

This global AML/CFT architecture assists us in systemically identifying and addressing illicit financing vulnerabilities in the international financial system on an ongoing basis. That, in turn, enhances our ability to both protect the integrity of the international financial system and undermine the financial networks that support organized criminal groups, terrorist groups, and other forms of illicit activity.

I would like to take a moment to explain how this unique and effective global AML/CFT system works, and then I will turn briefly to Macau and explain how risks in Macau's financial system have been identified and addressed through this process.

Global financial flows are growing rapidly and greatly exceed the trade in goods and services. Free financial flows enhance the economic security and prosperity of people in this country and around the world, but bad actors seek to abuse this global financial system to support their illicit purposes.

Because of the growing international nature of the financial system, we must work continuously with other financial centers around the world to establish and maintain effective international standards to protect the international financial system from various sources and conduits of illicit financing.

In coordination with our counterparts from across the government, the Treasury Department primarily advances this strategic objective through the Financial Action Task Force, or the FATF, the multilateral body that sets international standards for AML/CFT safeguards and works for their global adoption and implementation.

Established by the G7 in 1989, the FATF is the preeminent anti-money laundering body in the world. It comprises 36 members, covering the world's major financial centers. FATF sets international AML/CFT standards--known as the FATF 40 Recommendations--and works for their universal adoption and implementation.

FATF additionally serves as a forum for countries to share

experience and coordinate global policy in combating money laundering and other forms of illicit finance. The U.S. has played a leading role in the development of this organization as the primary forum for advancing international efforts to combat the misuse of the financial system.

FATF works to protect the international financial system from abuse through three primary and interrelated lines of effort: first, standard setting; second, establishing a global network; and, third, mutual evaluation and coordination of collective action.

First, standard setting. The FATF Recommendations--initially established in 1990 and updated in 1996, 2001, 2003, and most recently in 2012--comprise the legal, supervisory, enforcement, and international cooperation criteria that taken together form a comprehensive framework to combat money laundering and the financing of terrorism.

The Recommendations specify the laws necessary to criminalize illicit finance; the authorities required for effective financial supervision and law enforcement; the customer identification, recordkeeping, and reporting obligations for financial institutions to deter illicit finance and ensure law enforcement has information they need to pursue financial crimes. The Recommendations also prescribe the essential elements of international cooperation to facilitate civil and criminal enforcement actions.

The FATF Recommendations have been recognized by the IMF and the World Bank as one of the key standards and codes within the international financial system and have been fully integrated into their financial sector monitoring programs.

The FATF Recommendations have also been endorsed by the G20 and the United Nations Security Council, which in its Resolution 1617, urged the international community to implement the FATF Recommendations.

With respect to the second component of what FATF does--the first is standard setting--the second would be building a global network. FATF, as I said, today comprises 36 members--that's 34 countries and two supranational bodies, the GCC, Gulf Cooperation Council, and the European Commission--36 members representing financial centers across the globe.

Though FATF has sought to limit its membership expansion to strategically significant financial centers, it has worked toward a global adoption and implementation of its standards through the development of a network of FATF-Style Regional Bodies, or FSRBs. There are currently eight FSRBs with a collective membership that encompasses 180 countries. There are two FSRBs in Latin America and the Caribbean, two in Africa, one in the Middle East, one in Europe, and two in Asia.

The role of the FSRBs is to improve regional financial security by member countries working together to implement the FATF standards in addition to identifying and addressing specific regional illicit financial concerns. They also provide an avenue for all countries to participate in the global FATF process. So essentially the FSRBs are mini-FATFs within a particular region that function for that region as FATF functions for the global community, for the international community.

And third--and this is the key line of action for FATF--it is meant to establish standards, to ensure that those standards are endorsed worldwide--and then it conducts mutual evaluations and organizes collective action.

Countries upon joining FATF or an FSRB commit to working towards full implementation of the 40 Recommendations and to have their level of compliance assessed through a unique peer review process. The FATF, FSRBs, the IMF and the World Bank working together have established a global process to assess individual country compliance with the FATF recommendations using a common methodology for all countries.

These assessments provide a road map for countries to improve their AML/CFT regimes, and they likewise provide the basis for FATF to organize collective international action with respect to countries that do not take steps to address significant deficiencies.

Creating a common set of anti-money laundering and counter-financing standards, assessing compliance of countries with those standards, publicly reporting the results, and applying collective pressure on non-cooperative countries has proved extraordinarily successful in raising global capacity to combat illicit finance.

The most recent round of mutual evaluations assessed countries against the 2003 FATF standards. Those standards were revised and updated, as I said, in 2012.

The next round of assessments, getting underway next year and focusing on the revised 2012 standards, will include a new feature. This new feature will include an assessment of both technical compliance with the FATF Recommendations and an assessment of the effectiveness of the country's anti-money laundering and counterterrorist financing efforts.

Technical compliance and effectiveness will each be scored according to distinct criteria, and I think this is a really important innovation that FATF has adopted, and the U.S. has really led the charge in seeking.

If I could say very briefly, with respect to Macau, the Asia Pacific Group on Money Laundering is the FSRB that covers the Asia-Pacific region. It has 41 members, including the United States. Macau is a member as well. The APG conducted a mutual evaluation of Macau in 2007. The mutual evaluation acknowledges that Macau has taken steps to establish a legal Anti-Money Laundering/Counterterrorist Financing framework. The mutual evaluation occurred at the end of 2006. The laws that it was assessing were basically enacted immediately before that assessment.

The assessment was in many ways inconclusive with respect to the effectiveness of those measures, on the implementation of those measures, because they were so new at the time. Nevertheless, the mutual evaluation did identify several deficiencies, including: deficiencies relating to Macau's ability to freeze assets; to comply with U.N. sanctions; cross-border currency reporting; and then a variety of deficiencies within the gaming sector.

Since that time, Macau reports regularly to the APG on the steps it's taken to address the deficiencies identified, and it has addressed many of them although the deficiencies that do still remain include: continued problems with respect to their ability to freeze assets; continue to have challenges with respect to customer due diligence; a particularly high threshold for reporting suspicious activity within casinos; and continued problems establishing a cross-border currency reporting requirement.

So with that, Mr. Chairman, I know I ran slightly over. I apologize for that. But that concludes my remarks. I'd be happy to take any questions.

**PREPARED STATEMENT OF MR. DANIEL GLASER
ASSISTANT SECRETARY FOR TERRORIST FINANCING
OFFICE OF TERRORISM AND FINANCIAL INTELLIGENCE
TREASURY DEPARTMENT**

**Daniel L. Glaser
Assistant Secretary for Terrorist Financing, U.S. Department of the Treasury
Testimony before the U.S.-China Economic and Security Review Commission
Hearing on Macau and Hong Kong
June 27, 2013**

My remarks today will focus on the U.S. Department of the Treasury's long-standing efforts to promote implementation of effective anti-money laundering and countering the financing of terrorism (AML/CFT) measures worldwide. Treasury works closely with international counterparts to combat global money laundering, terrorist and proliferation financing, and other forms of illicit financial activity. By working through various multilateral bodies, we have improved transparency throughout the international financial system and have integrated robust systemic AML/CFT safeguards into the international financial architecture. This global AML/CFT architecture assists us in systematically identifying and addressing illicit financing vulnerabilities in the international financial system on an ongoing basis. That in turn enhances our ability to both protect the integrity of the international financial system and undermine the financial networks that support organized criminal and other illicit groups. I would like to take a moment to explain how this unique and effective global AML/CFT system works. I will then turn to Macau and briefly explain how risks in Macau's financial system have been identified and addressed through this process.

Global AML/CFT network

Global financial flows are growing rapidly and greatly exceed the trade in goods and services. Free financial flows enhance the economic security and prosperity of people in this country and around the world, but bad actors seek to abuse this global financial system to support their illicit purposes. Because of the growing international nature of the financial system, we must work continuously with other financial centers around the world to establish and maintain effective international standards to protect the international financial system from various sources and conduits of illicit financing. In coordination with our counterparts across the government, Treasury primarily advances this strategic objective through the Financial Action Task Force (FATF), the multilateral body that sets international standards for AML/CFT safeguards, and works for their global adoption and implementation.

Established by the G-7 in 1989, the FATF is the preeminent anti-money laundering body in the world. Comprised of 36 members, covering the world's major financial sectors, FATF sets international AML/CFT standards – known as the FATF 40 Recommendations – and works for their universal adoption and implementation. FATF additionally serves as a forum for countries to share experience and coordinate global policy in combating money laundering and other forms of illicit finance. The United States has played a leading role in the development of this

organization as the primary forum for advancing international efforts to combat misuse of the financial system.

The FATF works to protect the international financial system from abuse through three primary and interrelated lines of effort: 1) standard setting; 2) establishing a global network; and 3) mutual evaluation and collective action.

1. Standard Setting: The FATF Recommendations – established in 1990, and updated in 1996, 2001, 2003, and most recently in 2012 --comprise the legal, supervisory, enforcement, and international cooperation criteria, that taken together, form a comprehensive framework to combat money laundering and the financing of terrorism. The Recommendations specify the laws necessary to criminalize illicit finance; the authorities required for effective financial supervision and law enforcement; and the customer identification, recordkeeping, and reporting obligations for financial institutions to deter illicit finance and ensure law enforcement has the information needed to pursue financial crime. The Recommendations also prescribe the essential elements of international cooperation to facilitate civil and criminal enforcement actions. The FATF Recommendations have been recognized by the International Monetary Fund (IMF) and the World Bank as one of the key standards and codes within the international financial system, and have been fully integrated into their financial sector monitoring programs. The FATF Recommendations have also been endorsed by the G20, which in 2012 acknowledged that the Recommendations, in addition to combating money laundering and terrorist financing, also are relevant to deterring corruption, improving the transparency of corporate vehicles, and increasing cooperation against tax crimes. Additionally, the U.N. Security Council urged, in its Resolution 1617, that the international community implement the FATF Recommendations.

2. Building a Global Network: The FATF today has 36 members, 34 countries and two supranational bodies, representing financial centers across the globe. Though FATF has sought to limit its membership expansion to strategically significant financial centers, FATF has worked toward the global adoption and implementation of its standards through the development of a network of FATF-Style Regional Bodies (FSRBs). There are currently eight FSRBs with a collective membership that encompasses 180 countries. There are two FSRBs serving the countries of Latin America and the Caribbean; two in Africa; one in the Middle East; one in Europe; and two in Asia. The role of the FSRBs is to improve regional financial security by member countries working together to implement the FATF standards, in addition to identifying and addressing specific regional illicit finance concerns. They also provide an avenue for all countries to participate in the global FATF process.

3. Mutual Evaluations: Countries, upon joining the FATF or an FSRB, commit to working toward full implementation of the 40 Recommendations and to have their level of compliance assessed through a unique peer review process. The FATF, FSRBs, as well as the IMF and World Bank have established a global process to assess individual country compliance with the FATF Recommendations using a common methodology for all countries. These assessments provide a roadmap for countries to improve their

AML/CFT regimes. They likewise provide the basis for FATF to organize collective international action with respect to countries that do not take steps to address significant AML/CFT deficiencies. Creating a common set of anti-money laundering and counter terrorist financing standards, assessing the compliance of countries with those standards, publicly reporting the results, and applying collective pressure on non-cooperative countries has proved extraordinarily successful in raising global capacity to combat illicit finance.

The most recent round of mutual evaluations assessed countries against the 2003 FATF standards. Those standards were revised and updated in 2012. The next round of assessments, getting underway next year and focusing on the revised 2012 standards, will include both an assessment of technical compliance with the FATF Recommendations and an assessment of the effectiveness of the country's anti-money laundering and counter terrorist financing efforts. Technical compliance and effectiveness will each be scored according to distinct criteria.

The Asia Pacific and Macau

The Asia Pacific Group on Money Laundering (APG) is the FSRB that covers much of the Asia-Pacific region. It has 41 members, including the United States. The APG conducted a mutual evaluation of Macau in 2007. The mutual evaluation acknowledges that Macau had taken steps to establish a legal AML/CFT framework. Given, however, that much of that framework had been put in place immediately before the assessment occurred, it was often impossible for the APG to assess its implementation or effectiveness. Nevertheless, the mutual evaluation did note the following deficiencies:

- Macau lacked asset freezing provisional measures in cases of suspected money laundering;
- Macau was unable to respond to foreign requests on freezing orders;
- Macau lacked legal authorities to effectively implement UN Security Council Resolutions 1267 and 1373 on the financing of terrorism;
- Cross-border currency movement was a significant issue for Macau, but it did not enforce a disclosure or declaration system on cross border currency, nor did the Macau Customs Service have the authority to investigate ML or FT cases;
- Most key aspects of customer due diligence (CDD) obligations were not adequately incorporated into law and regulation;
- The gaming sector, while incorporated in the jurisdiction's legal AML/CFT framework, presented a substantial money laundering risk and featured a number of gaps, including:
 - Lack of a risk-based assessment of gaming customers and operators;
 - Inadequate inspection and oversight of casinos and junket operators and promoters;
 - A lack of communication between the Gaming Inspection and Coordination Bureau (DICJ) and Macau's Financial Intelligence Office (GIF); and
 - A high monetary threshold for reporting large transactions at casinos.

Since 2007, Macau has reported that it has taken a number of steps to address the deficiencies

detailed in its mutual evaluation, including:

- Requiring the DICJ to regularly perform risk assessments of gaming operators and junkets;
- Enhancing the DICJ's oversight over junket operators and promoters in order to improve the quality of large and suspicious transaction reports and provide further practical guidance on customer due diligence (CDD) and other AML/CFT obligations;
- Enhancing collaboration between the DICJ and the GIF to share information and update procedures in order to have a better knowledge of the risks and trends in the casino sector; and
- Enacting a new gaming law regulating admission to casinos, including enforcing bans on high-risk banned patrons and exclusion requested by third parties.

Despite these steps, Macau has yet to address a number of deficiencies in its AML/CFT framework that were identified by the APG, most notably:

- Although work continues on draft legislation, Macau still has not incorporated a freezing mechanism into its legal AML/CFT framework;
- While a number of legal enhancements to Macau's CDD requirements have been drafted, they have not yet been passed or enacted;
- Macau continues to allow a very high threshold of 500,000 MOP (approximately USD 62,000) for reporting large transactions at casinos. Macau has been asked to lower its large transaction reporting threshold for casinos to USD 3000 as recommended by the FATF.
- Although Macau has begun to draft legislation that would improve the jurisdiction's cross-border currency controls, it has yet to implement an effective cross-border cash declaration system.

The APG will conduct a mutual evaluation of Macau against the 2012 FATF Recommendations using the new methodology in 2015 or 2016.

PANEL I QUESTION AND ANSWER

VICE CHAIRMAN SHEA: That's quite all right. you very much. The first question will go to Chairman Reinsch.

CHAIRMAN REINSCH: Thank you.

Let's start with what is probably the obvious but sort of the big picture. We know this is a crime, and we know it is associated with a lot of criminal activity. It violates many laws.

Can you say a little bit about the national security implications of this? Why do we care as a country? What is at risk from a national security perspective through the activities that you're trying to deal with?

MR. GLASER: Thank you, Chairman.

We obviously, at the Treasury Department, think that there are huge international security implications for money laundering and for illicit finance in general. I should note that the office that I'm a part of, the Office of Terrorism and Financial Intelligence, is unique in the world. There is not a finance ministry in the world that is set up like the Treasury Department is set up with one of its main policy offices focusing on taking all the authorities' data, information, contacts that we have throughout the world, and applying them to create and implement strategies to undermine illicit finance. We're the only finance ministry in the world that has an office set up like that and prioritizes it like that, and it's because we take it quite seriously.

There are a number of reasons why we regard illicit finance and money laundering and terrorist financing to be a national security threat. Obviously, the financial networks that we're concerned about are the backbone of the illicit organizations we're concerned about. Examples of illicit organizations we're concerned about are: narcotics organizations, terrorist organizations, transnational crime organizations, proliferation networks, and the networks that support regimes like Iran and North Korea. These financial networks enable bad actors around the world to accomplish their nefarious purposes. And by taking the actions that we do, both defensively to safeguard the international financial system and proactively to directly interfere with those networks, we're hampering the ability of these bad actors to accomplish their purposes, and that is directly linked to U.S. national security.

More broadly, as we build an international financial architecture, as we try to create an international financial system that works for all the countries and people in the world, a fundamental component of that is the integrity of that system, the transparency of that system, and the safeguards that we put into place with respect to money laundering. These ensure that that system is robust, that system is transparent, and that system functions the way it's supposed to without the corrupting influences of these actors, of these individuals, and of these causes within the system.

So it's really one of the pillars, if you will, of the international architecture that we're working so hard to create.

CHAIRMAN REINSCH: Thank you.

Zeroing in a little bit more on Asia, is China a FATF member?

MR. GLASER: Yes.

CHAIRMAN REINSCH: And are they a constructive part of the process?

MR. GLASER: Yes, China is represented at the FATF by the People's Bank of China (PBOC), which is their central bank, and we at the Treasury Department have a very close relationship with the PBOC. I have a very close relationship with my Chinese counterparts in that regard, and I do consider them to be a constructive productive member of FATF.

One of the primary mechanisms through which we at the Treasury Department, well, actually, we in the entire United States government, coordinate with the Chinese is through the Strategic and Economic Dialogue. The next round of which, I believe, is next week in Washington D.C.

CHAIRMAN REINSCH: Yes.

MR. GLASER: And one of the subgroups of the S&ED is Anti-Money Laundering and Illicit Finance subcomponent of which I lead for the United States and my counterpart at the People's Bank of China, Deputy Governor Li, leads for the Chinese.

I was actually just in China last week meeting with Deputy Governor Li discussing the S&ED. We have a very, very close relationship with them. We try to improve information exchange with them, and I'm very pleased about the relationship that we've developed over the years between Treasury and the People's Bank in that regard.

CHAIRMAN REINSCH: Have you discussed Macau with them and the relationship between Chinese authorities and Macanese authorities?

MR. GLASER: No. What we've focused on to date within that channel of cooperation with the Chinese is (a) coordination and cooperation within the FATF to ensure that the FATF operates smoothly, and that's something that we work closely with them on. We have worked with them on sharing our experiences with respect to certain technical aspects of anti-money laundering compliance, customer due diligence, beneficial ownership, things like that, things that we struggle with, and we work hard on, and we try to help the Chinese work on as well.

And something that we're working on most recently is information exchange, regulatory information, anti-money laundering information, looking for cases that we could work jointly with the Chinese to advance our cooperation on anti-money laundering, but none of those have involved Macau.

CHAIRMAN REINSCH: Thank you. My time is up.

VICE CHAIRMAN SHEA: Commissioner Tobin.

COMMISSIONER TOBIN: Thank you, Chairman, and thank you, Mr. Glaser.

I have a number of questions, but let me start with the one that troubles me the most. Has anyone looked at what happens to the laundered

money, and I'm talking about the VIP rooms, and how it's spent? Is it used by whoever is gaining from it, and since a large portion of those there would be the Chinese, is it used by the Chinese or their agents for intelligence operations, or to attain economic advantages or political advantages?

MR. GLASER: Thank you, Commissioner.

I would be the wrong person to ask questions about sort of operational issues such as exactly what happens with illicit money that's laundered through casinos in Macau or frankly most other places. So I don't think I could give you a satisfactory answer to that question.

I can say that one of the reasons why working through the FATF and working through the APG we try to establish these global anti-money laundering standards is to ensure that countries put in place systems to ensure that at a casino, for example, there is transparency, and that the authorities can understand what money is coming in and what money is going out, and who the casino is dealing with. But I would have to leave my answer at that.

COMMISSIONER TOBIN: And since it may be high volumes of money being transacted, as I understand it, from Mr. Burnett's testimony, there is likely a mix of legitimate and possibly illegitimate monies passing through. Is anyone in the government watching this closely? And have we seen any progress due to the actions that you've taken with your task force?

MR. GLASER: I do think we've seen progress in Macau with respect to the legal system they've put in place. Before the end of 2006, there was not much of a money laundering regime to speak of within Macau, and over the years, starting at the end of 2006 and moving on to present, they've taken steps to address many of those issues, including issues relating to the casinos, frankly, including issues relating to junkets and the junket industry with respect to the casino.

As I said, the initial FATF review of Macau was really not in a position to assess the implementation of that because much of it was so new when--and actually a lot of it wasn't even in place yet when the assessment occurred.

The next assessment will occur within the next couple of years, and, as I said, it's going to be focused more than ever before on effectiveness and implementation, and I think, at least from my perspective, we'll have a better sense of that after that assessment occurs.

COMMISSIONER TOBIN: And that assessment once again is this year?

MR. GLASER: That assessment is scheduled, I believe, for 2015 to 2016.

COMMISSIONER TOBIN: And is where your attention goes related to--you talked about standard setting and kind of best practices--is it looking at banks largely or does it get beyond that?

MR. GLASER: It absolutely gets beyond banks. I mean to have an effective anti-money laundering system, you need to be looking at all methods of value transfer. Banks are certainly an important, perhaps even

the most important, component of that, but they're certainly not the only component both against international standards and the way the U.S. regulates our own financial system. We cover the full range from banks to non-bank financial institutions, security dealers, casinos, all the way to entities you wouldn't even think of ordinarily as financial institutions like car dealerships.

And then, of course, you have informal systems of value transfer--money service businesses, systems that in other parts of the world are referred to as hawala. All of these types of systems have to be accounted for in a comprehensive anti-money laundering program. The international standards account for them. In the U.S., we try to account them for as well.

COMMISSIONER TOBIN: Thanks you, I may have other questions.

VICE CHAIRMAN SHEA: I'll take a question. My question, in part, is informed by a question submitted by Commissioner Brookes, who is unable to be here today. In my understanding, in 2005, you were directly involved in the investigation of Banco Delta Asia and its involvement in money laundering proceeds on behalf of the North Korean government related to counterfeit activities, narcotics trafficking, and my question--is that correct? I think you were personally involved; is that correct?

MR. GLASER: Yes, I mean I was involved directly in discussions relating to Banco Delta Asia with the Chinese and with the North Koreans, yes.

VICE CHAIRMAN SHEA: Great, then my question is: has the U.S.' ability to monitor North Korean activities in Macau improved since that time? And, secondly, is North Korea using Macau as a means to launder money or engage in financial transactions?

MR. GLASER: I think one of the things we've learned from Banco Delta Asia, and what we know independently from Banco Delta Asia, is that North Korea is constantly using all forms of financial deception to access the international financial system, and they do it through a number of sophisticated money laundering methods. They look throughout and beyond the Asia region to gain access to the international financial system, and one of our challenges, one of my challenges, is to coordinate with countries to try to deny them that access, both pursuant to the U.N. Security Council resolutions, which limit North Korea's access to the financial system and through independent steps that we take.

For example, within the last couple of months, the Treasury Department has designated Foreign Trade Bank, a North Korean Bank, under WMD Proliferation Finance Sanctions Program. In fact, I was just in Asia, in Russia and China and Hong Kong discussing that designation with the authorities there and discussing steps that we think countries should be taking to protect themselves from illicit North Korean activity, to include cutting off Foreign Trade Bank from the international financial system.

One of the things I will note is that the international financial system has already reacted to that. I mean we can see that North Korea has

far less access to the international financial system today than they've had in previous years. Shortly after our designation of Foreign Trade Bank, Bank of China, the commercial bank, not People's Bank of China, announced that it was cutting off its relationship with Foreign Trade Bank, and other banks have taken similar action.

So I do think North Korea enjoys far less access to the international financial system today than they did back in 2005, and I think that's for a number of reasons. I think that countries take anti-money laundering, terrorist financing regulation more seriously with each passing year. I think the financial, the actual commercial banks understand the risks that they face from the authorities, including U.S. authorities, if they don't take them seriously, and so they sometimes even go beyond what's required of them by their host governments.

And I think that people are more and more wary of doing business, in general, with North Korea. That said, North Korea is an isolated country without a very sophisticated financial economy so they need relatively little access. It's not like dealing, when you're trying to apply financial pressures say on a country like Iran, which needs broad access.

VICE CHAIRMAN SHEA: Well, then, this is Commissioner Brookes' question. Is Iran using Macau to any extent to skirt international financial sanctions?

MR. GLASER: You said Iran?

VICE CHAIRMAN SHEA: Iran using Macau.

MR. GLASER: Iran uses the entire international financial system. I don't think one of our biggest problems with respect to Iran would be Macau.

VICE CHAIRMAN SHEA: Okay, thank you.
Commissioner Wessel.

COMMISSIONER WESSEL: Thank you, Mr. Secretary, for being here today, for your testimony, and also for all the work you've done. I'm always amazed when it comes to money laundering and these types of financial transactions, the complexity of it and how you pull the threads everyday and try and identify where it's coming from and do the tracing. It's like a spy movie.

I'm troubled, though, and appreciate, again, all that you've done. When I look at your testimony and understand it is with all good intent, Macau hasn't been reviewed against the new standards. They were reviewed against the old standards and had just put in some new laws in place, as you said.

And in your testimony, it says since 2007, Macau has reported that it has taken a number of steps, and then you talk later about not doing a review until 2015 and 2016. So there's essentially a ten-year gap during which we really don't know what Macau has done, and, in fact, in your testimony, you identify a number of deficiencies. What can you tell us about what's happening really on the ground?

I mean Commissioner Reinsch raised questions about national

security, which you've identified. I heard between the lines of the last comment that while Macau is not the priority, that doesn't mean that Iran or North Korea or others are not using it as a venue for illicit money laundering.

How does Macau deal with you? Where do you put this problem on the radar screen? Again, as Mr. Reinsch talked about the gambling revenue alone in Macau is six times that of Las Vegas, it seems like we have a huge issue here that we're not yet really dealing with because of the way the timing of the reviews, et cetera, are being scheduled.

MR. GLASER: Thank you, Commissioner.

Yeah, I mean I wish we could do a comprehensive review of all 180 countries that are involved in the FATF process every year against whatever the most updated version of the standards are.

I do invite you to take a look at some of these mutual evaluations. The mutual evaluation report on Macau is 200 pages long. They're quite comprehensive. The mutual evaluation report on the United States is even longer. I know the U.S. response--as I led sort of the U.S. side during that mutual evaluation process for us--our initial response to FATF was in excess of a thousand pages long.

COMMISSIONER WESSEL: I don't doubt, and, again, I appreciate all that you've done and the complexity of the issue, but the question is, and we as a Commission haven't looked at Macau yet and this issue, so we're sort of jumping into this late, but the volume of money would appear to me to say that this should, Macau should be a higher priority than say Brunei.

I don't know that. I haven't looked at their money laundering issues. But shouldn't there be a risk-based approach as well that's injected into this process, you know, again, six times the size of Las Vegas in terms of gaming alone? We've heard earlier and have looked at the question of what's happening with the VIP rooms and the triad involvement there.

It seems to me we have a huge problem here that's waiting for a review that may not happen for another couple of years.

MR. GLASER: Well, again, I do think Macau is an important jurisdiction, and it is a jurisdiction that we care about, and it is a jurisdiction that we interact with, and as I said, I do think that Macau hasn't taken steps to address some of the issues. They haven't addressed all of the issues, and they need to work on that.

But clearly there's no question that Macau has an enormous gaming sector, probably the largest gaming sector in the world, and that that presents certain risks to the authorities there, and that presents certain risks to the region, and it's something that I do think the Macanese authorities should be focusing on, and it's one that we will continue to monitor.

COMMISSIONER WESSEL: And I appreciate that. Are you, as with any jurisdiction, part of this, I guess, is also FCPA and other issues relating to the conduct of U.S. companies.

Some of the largest gaming enterprises in Macau are U.S.

enterprises. Do they assist you in terms of the investigatory approach that you're taking? What's their kind of reporting? What's your interaction with them, and how should we view them as part of this process? Are they sort of a passive participant or an active player in trying to help you?

MR. GLASER: I know that you have a representative from the Nevada Gaming Commission that's going to be testifying later. I think that would be a good question to put to that individual.

With respect to federal obligations on casinos, casinos in the U.S. have obligations to report suspicious transactions and to otherwise comply with U.S. federal anti-money laundering laws within the United States, and I have no reason to suspect that they're not doing that.

With respect to their operations abroad, their operations abroad would be regulated by the host regulator. I do understand, again, that when Nevada issues a license to a casino, one of the conditions of that license is certain access to their foreign operations so, again, think that would be a good question to put to the Nevada authorities.

COMMISSIONER WESSEL: Thank you. If there's another round, please. Thank you.

VICE CHAIRMAN SHEA: Commissioner Bartholomew.

COMMISSIONER BARTHOLOMEW: Thank you very much, and Secretary Glaser, I join Commissioner Wessel in thanking you both for appearing today and for the work that you're doing on behalf of the American people. The more I look at this, the more of a maze it is, and you must be quite a puzzle solver.

I just want to go through a few of the facts because I'm just really trying to get a handle on this. So we know about these VIP room operators that are, as far as I understand it, essentially operating outside the regulatory framework.

There are good reports that they're responsible for 75 percent of Macau's gaming profits. In 2012, Macau's gaming revenue was reported to be \$38 billion U.S. The illicit flow of money out of China generally was estimated to total \$2.83 trillion between 2005 and 2011. And we know that billions and billions of dollars in wealth is being held by family members of Chinese government officials.

The New York Times, of course, was shut down in China. The Web site was shut down in China because of some of the reporting that they've done.

So I guess one of the questions I have for you is what incentive do Chinese government officials have to stop this? I mean I understand that there are PR campaigns against corruption. We can see those. But what incentive do they really have if people who are associated with them are benefiting, getting money out of China, for example, or benefiting from this somehow?

MR. GLASER: I'm not sure I understand the question. I can't speak for the Chinese government. I would imagine that the Chinese government has an interest in enforcing their own laws, and to the extent

that there are illicit financial networks, including those reaching into Macau, that are facilitating crime within China, I would imagine that the Chinese government would have an interest in preventing that.

You cited a very large number of funds coming out of China. I assume that part of that number is violating capital controls because I don't know how you'd get to a number that high unless you were violating capital restrictions.

I would assume that the Chinese government would assert that they have an interest in enforcing their own capital restrictions, but again I can't really speak for the government of China. But I think as a general proposition, we could assume that countries are interested in enforcing their own laws.

COMMISSIONER BARTHOLOMEW: Are you getting as much cooperation from the government of China to seriously crack down on these problems as you would like?

MR. GLASER: Again, I can only speak for the Treasury Department, and the issues that I work on with the government of China. With respect to the Treasury Department, the issues that I work on with the government of China, I'm very pleased with the cooperation I get from them, particularly from the People's Bank of China.

I think they're professionals. I think they're interested in building a transparent and effective financial system within China, and I regard them as partners in doing that. And we work very closely with them. You could very well have a host of other agencies here from, say from law enforcement, who might not be as happy with the cooperation they get from their Chinese law enforcement counterparts. I don't know. I can't speak for them.

But with respect to the systemic work that the Treasury Department does on anti-money laundering, we work very closely with the People's Bank of China.

COMMISSIONER BARTHOLOMEW: Okay, thanks. I'll actually also join Commissioner Wessel just in wondering, you know, U.S. businesses that are involved in businesses where there is so much evidence of engagement, if not control, by organized crime raises a lot of questions. I wonder your thoughts on whether the Foreign Corrupt Practices Act is sufficient in the right places in order to help address concerns that Treasury might have come across in looking at these matters in Macau?

MR. GLASER: Yeah, I'm sorry. That would be a question for the Department of Justice. We don't enforce the Foreign Corrupt Practices Act at Treasury, and I'm frankly not an expert on it at all.

COMMISSIONER BARTHOLOMEW: Let me ask that question a different way. Are you worried about what U.S. businesses might be inadvertently getting involved in in their dealings in Macau?

MR. GLASER: I suppose U.S. businesses need to be careful wherever they go to make sure that they're always complying with all aspects of U.S. law, including the Foreign Corrupt Practices Act, but I really don't

have any insight into the issue.

COMMISSIONER BARTHOLOMEW: Okay, thank you.

VICE CHAIRMAN SHEA: Commissioner Slane.

COMMISSIONER SLANE: I think Commissioner Bartholomew may have already asked this question, and you may have already answered it, but one of the issues with the Chinese government is trying to control the amount of extortion that's going on with their officials and taking the extorted money to Macau and then using Macau to get it out of the country.

My question to you is are the Chinese government officials working with you to try to help control their problem?

MR. GLASER: The Chinese government officials that I work with are working with us to try to establish an effective anti-money laundering system within China, particularly through the regulation of Chinese financial institutions. To the extent that they're able to accomplish that would certainly make it harder for corrupt officials to launder their money, and I'm quite confident that the Chinese government as an entity, at least, has set that as a policy that they would like to achieve, as a goal they would like to achieve.

And we work with them. We work with them on that. So I don't know if that answers your question, Commissioner, but that's been my experience. I don't have any particular insight for you into the level of corruption within the Chinese government or with the specific methodologies that a Chinese corrupt official might use to launder money.

All I could tell you is that we work with the People's Bank of China to try to make the Chinese financial system and the international financial system less vulnerable and more of a hostile environment to any criminal who's trying to launder funds.

COMMISSIONER SLANE: Thank you.

What they're doing is they're taking the money and going to an American casino in Macau and gambling there and then trying to transfer to an American fund in the U.S. It's obvious from their salaries that they have a huge amount of money that they ship--at least it raises a lot of questions about where they're getting that from.

And I'm just wondering whether the Chinese have come to you and said can you help us with this problem, but it doesn't sound like they have.

MR. GLASER: The Chinese have not come to me and said could you please help us with a problem relating to corruption. They have not asked for my assistance in fighting corruption within China. What they have sought to work with us on, and what we do work with them on very closely, is making their financial system, as I said, less vulnerable to abuse by any type of criminal activity, and that would certainly include laundering by corrupt officials.

COMMISSIONER SLANE: Thank you.

VICE CHAIRMAN SHEA: Before I call on the next Commissioner, I just wanted to thank you for representing Treasury here.

We really appreciate it. Thank you very much.

We did ask that the FBI come and we asked for a witness from the State Department, and they both said no, and we also asked for a witness from the DOJ, and they did not respond. So we are immensely grateful to you, Mr. Glaser, for stepping up to the plate and being here with us today.

Commissioner Talent.

COMMISSIONER TALENT: You shouldn't have mentioned all those other agencies that turned us down because Secretary Glaser is thinking he made a mistake.

[Laughter.]

VICE CHAIRMAN SHEA: No, he didn't.

COMMISSIONER TALENT: It just seems to me that the truth is we really don't have any idea what's going on in Macau, and it's not your fault. I mean the whole system is operated in a way so that nobody who's in a position of authority has to officially take cognizance of what's happening there. Now why they're operating it that way, we don't know, but that's the way it's operating. So there is really no way to know what's happening with that money there.

I mean isn't that correct? You can't say with a high level of confidence that you know how much laundering is going on or counterfeit money being laundered or whatever in Macau. Isn't that the case?

MR. GLASER: Well, that's certainly the case. I'm not trying to defend anybody, Commissioner.

COMMISSIONER TALENT: Right.

MR. GLASER: But I can tell you I can't say with confidence how much money is being laundered anywhere in the world. If you're looking for number of magnitude of money laundering, those are hard numbers to come by.

COMMISSIONER TALENT: I understand that, but it's a different problem in Macau, isn't it? In other parts of the world, they have an official system of reporting and regulation, and there are attempts to enforce it. I'm talking Singapore, the rest of it. I think this is an historical accident. I don't even know that I blame the Chinese authorities for this. I mean they've got a lot of other things to do, and there's probably a lot of different reasons why they haven't cracked down there, but we just don't know what's happening in Macau, is my point, and you've said you don't have a high level of confidence.

So I appreciate that and also your work on behalf of the people, thank you.

VICE CHAIRMAN SHEA: I'm going to a second round of questions. Commissioner Wessel.

COMMISSIONER WESSEL: Thank you, and to jump off of what Commissioner Talent said, thank you for representing the U.S. government here today. We do appreciate it.

Let me follow up on some other questions, and going back to the review process, within the system, is there an ability to ask for an expedited

review? Again, if Macau has this volume of money, if public reports talk about, I believe it is, of the seven major operators there, six of them have triad relationships. That's not any investigation we've done, that's publicly reported. Shouldn't it seem that that's pretty much a high value target that we should be going after?

MR. GLASER: We sit down with the IMF and the World Bank and other stakeholders in the system as we try to come up with a schedule for mutual evaluations, and of course the countries involved, they need to accept these, they need to be consulted, as well, as to the appropriate time.

Macau is certainly a priority within Asia, as is the Philippines and Indonesia and Thailand and Burma and Japan and South Korea and China and Hong Kong and Australia and New Zealand. I suppose we could sit here-

COMMISSIONER WESSEL: You're almost a full list of countries.

MR. GLASER: --and have a discussion about where we would rank each individual country and whether Macau is more important than Indonesia in the area of terrorist financing.

But we try, the important thing for me is that the system overall works, and that we get to all these countries, and the assessments are solid and accurate and tough, and that there is tough follow-up to those assessments, but--

COMMISSIONER WESSEL: And we support that, but, again, is there an ability within the system if there is a high value, high priority target, to request an expedited review, meaning out of cycle, not waiting for 2015? Say we have other concerns, join with other members, the coalition. Does the U.S. government have that ability?

MR. GLASER: We have the ability. The system doesn't work exactly the way that you're articulating it, but we have the ability to impact the order of the reviews. A country also has the ability to go to the IMF or World Bank and ask them to come in and do a targeted review, and I know the IMF and the World Bank have done that in certain instances.

COMMISSIONER WESSEL: I assume Macau has not asked for that.

MR. GLASER: Not to my knowledge.

COMMISSIONER WESSEL: Okay.

Also, going back to the question I had raised earlier just about U.S. companies, et cetera, and I will ask some questions of the Nevada gaming official, but from a national perspective, your office, what kind of cooperation, if any, do you get out of the U.S. entities operating in Macau? Have you sought it? Have they provided it? If we need to go into a different setting to have a further discussion, we can do that.

But it seems to me as such large players in terms of, again, the \$38 billion, 75 percent of which is in these VIP rooms, six of the seven major ones having triad relationships, that to me just rings a bell that I should be talking to those companies and saying what's going on here? Are

our companies feigning surprise about what's going on under their roofs?

MR. GLASER: The entities, the components of the U.S. Treasury Department that would have interaction with casinos would be the FinCEN, the Financial Crimes Enforcement Network, and the IRS. And I know that they do have outreach to casinos, and I know that they do discuss with them what risks they face with respect to anti-money laundering.

And, again, I have no reason to believe that they have not been cooperative in those engagements, but I frankly have not been a party to those engagements and wouldn't really feel comfortable in commenting on them.

COMMISSIONER WESSEL: Okay. Thank you.

VICE CHAIRMAN SHEA: Commissioner Tobin.

COMMISSIONER TOBIN: Secretary Glaser, help us understand. In your testimony you outlined and today orally shared the framework that you're taking to the world, and so I'm going to ask a few questions related to that to see if I can understand how this would work in Macau.

You said there's a mutual evaluation. Does that mean that Macau and then some members of your team are together looking at data? Who's looking at the data? And let me maybe ask the next question, too. As it relates to any of the casinos in Macau with the VIP rooms, how does the framework or the standards setting play out specifically connected to those VIP rooms?

Thank you.

MR. GLASER: I'm happy to answer that. So let me start with the first question. So the way the mutual evaluation process works is it's a process of peer review. So to become a member of FATF-Style Regional Body, a country or jurisdiction has to make a high level political commitment to work to come into compliance with the FATF standards and agree to subject themselves to mutual evaluation against those standards.

What mutual evaluation--and so then, FATF has worked with the IMF and the World Bank to create a methodology for assessing countries against those standards--a common methodology. I really don't think there is anything like this in the world.

COMMISSIONER TOBIN: Could we take a look at that at some point?

MR. GLASER: Absolutely, it's public. We'd be happy to provide it to you, but it's a public document. And before it's filled out, there is a questionnaire that goes along with that mutual evaluation. That initial questionnaire runs upwards of 60, maybe even more than 60 pages long.

It's a highly technical document, and then depending on who's conducting the mutual evaluation, some of them will be conducted by FATF, some will be conducted by the FSRB, some will be conducted by the IMF and the World Bank. But in this case, APG, let's say APG is conducting the mutual evaluation.

What APG will do is put together a team of experts from APG countries, not from Macau if Macau is the country being assessed, but they could come from the United States, from Australia, from Thailand, from a

group of countries. There will be legal assessors, regulatory assessors, assessor folks in international cooperation, and they will receive the answers that the country has, including documentation, review that, and then go on site, sometimes for a few days. I'll tell you the on-site team that came to the United States was here for two weeks.

And they will go to all the relevant agencies. Again, in the United States mutual evaluation, they went all over the country meeting with relevant authorities, asking questions, getting answers, collecting data. And then they will write a report. That report will then be discussed, in this case, by the APG, amended by the APG plenary, and adopted, and they will have scores.

The best grade to get is compliant with a particular standard, largely compliant, partially compliant, and noncompliant.

COMMISSIONER TOBIN: And do these standards relate to things that are transacting in the casino and in--

MR. GLASER: Absolutely. A casino under--

COMMISSIONER TOBIN: --the VIP rooms?

MR. GLASER: Under the FATF standards--in the U.S., a casino would be considered a financial institution. Under the FATF standards, a casino is a DNFBP, a Designated Non-Financial Business or Profession. And there are very specific standards, requirements under the FATF standards that relate to Designated Non-Financial Business or Professions, and they would include recordkeeping, reporting--your standard slate of anti-money laundering requirements.

And we require those of casinos in the United States. My understanding is under Macanese law, they do have a framework that applies those types of requirements. Now, exactly where the loopholes are in that and where they excel or don't excel with respect to that is an important question, and again that goes to the effectiveness of the system.

You reference VIP rooms, and I think that's a very interesting question. I don't have a good answer for you on VIP rooms. I do understand with respect to junkets because that is something that the APG has been following with respect to Macau, that at least according to the APG reports that I've read, because there are annual updates, the Macanese authorities do conduct on-site inspections of the junkets to ensure that they're complying with the laws.

Again, I'm not here today testifying on the effectiveness of that system. And I cannot endorse it or not endorse it. I can just tell you what's been reported, and so that's how that system sort of plays out from top to bottom with respect to a particular jurisdiction, in this case, Macau.

COMMISSIONER TOBIN: Thank you for being here and educating us as we dig in and look at this.

VICE CHAIRMAN SHEA: I'm going to take the next one, and then a longer question. Are you aware of anyone in the U.S. government who monitors capital flight from China on a regular basis?

MR. GLASER: I'm not.

VICE CHAIRMAN SHEA: Is there anyone in the U.S. government that pays attention to this as a normal course of business?

MR. GLASER: I don't know if anybody is monitoring capital flight from China.

VICE CHAIRMAN SHEA: Okay. Thank you.

Now, I'm going to cite a couple people. It's always easier to talk more openly when you're out of government than within government, and these are probably people you used to work with--Juan Zarate and David Asher from State. Juan Zarate, who was a senior counterterrorism official in the Bush administration, he says anyone who knows anything about anti-money laundering understands both the inherent and the real risks in Macau.

You have an admixture of commercial financial activity, a way station for people and goods, a casino sector, all in a potentially volatile regional environment.

And then David Asher, who was in the Bush State Department calls Macau a "cesspool" of financial crimes. "It's gone from being out of a James Bond movie to being out of The Bourne Identity."

It sounds pretty bad, and as a number of Commissioners have said, we really don't know what's going on there, and I'm just wondering have you ever sat down with your colleagues from Justice, other people in Treasury, FBI, maybe the Nevada state officials, and said let's get a handle on what's going on in Macau?

MR. GLASER: So, yes, David and Juan are both very close friends of mine, and Juan is actually my former boss. VICE

CHAIRMAN SHEA: Do you agree with what they said?

MR. GLASER: I certainly agree that there's a high risk of money laundering in Macau. I don't know how anyone can disagree with that. I wouldn't associate myself with the more colorful language that David used, but of course there's a high risk of money laundering in Macau.

Again, and it's something that we care about. Again, I don't know that it would be worth going into internal discussions we have on prioritizing various threats to the U.S. within the U.S. government, but there is no doubt that there is a high risk of money laundering in Macau, including through the Macanese casinos.

VICE CHAIRMAN SHEA: And could you tell us what is being laundered? Proceeds from what activities?

MR. GLASER: I don't really feel that I have the expertise to go into exactly that. You all have cited numbers to me about large flows that are going into Macau from throughout the region. I'm sure much of those flows are legitimate. I'm sure that there is a percentage of those flows that come from criminal, that constitute criminal proceeds. Again, I'm sure that in any financial center where there's a large amount of capital inflow, there's a percentage of it that comes from criminal proceeds.

The challenge for each jurisdiction is to, again, try to minimize its vulnerability as an attractive destination for those illegitimate proceeds while maintaining an open financial system, and that's the challenge of anti-

money laundering.

But what percentage of those flows constitute legitimate versus illegitimate? And within the illegitimate proceeds, what is the composition of the pie chart? The amount coming from corruption, drugs, fraud, etc., I don't have numbers on that.

VICE CHAIRMAN SHEA: It sounds like you have a lot on your plate. You're looking at a global situation, and I'm not getting the impression that what's happening in Macau is a big focus of your work, but it may not deserve to be a big focus of it when you look at the big picture of all that you have on your plate.

But that's sort of the impression I'm getting. I may be wrong on that, but anyway, Commissioner Reinsch.

CHAIRMAN REINSCH: Thank you.

You've alluded to one of the witnesses on the next panel, a representative from the Nevada Gaming Control Board, and we'll be pursuing a number of questions about casino regulations directly with him.

We also have a witness on the next panel, a former Director of FinCEN, so some of the questions that you've put into his purview, we'll be able to ask him as well.

But I want to ask you the other side of the question that we're going to ask Mr. Burnett from Nevada. The question for him will be do you need any help from the Feds? And the question for the Feds is: are the states doing the regulatory job that they need to do? Is there anything you should be doing to help them? Is there any legal authority that you don't have that you would like to have to facilitate that?

MR. GLASER: Legal authority that we would like in the U.S.?

CHAIRMAN REINSCH: Yes.

MR. GLASER: I don't think there is specific legal authority in the U.S. that we're seeking with respect to casinos. I can tell you that just last week at the G8 Summit, the U.S. did issue an action plan with respect to a number of anti-money laundering issues that we're looking at, one of which is to do a better job in this country of having a regime in which we could identify the beneficial ownership of corporate vehicles. That's something that President Obama identified in his transnational organized crime strategy, and it's something that we've identified again in our action plan from the G8.

So that's something that we're going to be working on as we move forward. But that would be the types of things that we're thinking about in trying to improve our system, because we don't have a perfect system by any stretch.

I'll also respond to Commissioner Shea's final comment. I don't want to leave anybody with the impression that we don't care about what's going on in Macau or that we don't think it's important to target criminal activity that impacts the United States anywhere we find it. We do think it's important.

And we are constantly looking around the world, and, as has

been alluded to, I think our actions in the past have demonstrated that when we find someplace, anywhere in the international financial system, including in Macau, that threatens the U.S. financial system, we will take action. We have taken action in the past, and we reserve the right to take action in the future.

So I don't want to leave you with the impression that we're not constantly monitoring the entire international financial system to try to keep the U.S. safe.

VICE CHAIRMAN SHEA: Well, can I just say something, Mr. Chairman?

CHAIRMAN REINSCH: Please.

VICE CHAIRMAN SHEA: I appreciate that comment, appreciate all the really good work that you and your organization do, and I wasn't trying to suggest that at all. I was just trying to point out that in the broad set of issues that you have to deal with, this may not be up there at the top of the list, but you don't need to say anything beyond that.

But, again, I appreciate your good work.

COMMISSIONER BARTHOLOMEW: Just a comment, which is just to note again with appreciation, Secretary Glaser, that you appeared to testify, and to acknowledge that you and the people that you work with are dealing with threats on a regular basis, most of which never meet the public eye unless something goes terribly wrong. So we recognize all of the work that you're doing and appreciate it, and I would be worried and wondering about what keeps you awake at night, but we don't have to go into that.

But thank you. Thank you very much for the work that you do, and thank you for appearing today.

CHAIRMAN REINSCH: There are additional questions if I can pick back up.

VICE CHAIRMAN SHEA: Sure.

CHAIRMAN REINSCH: Commissioner Brookes left us two more questions, and I think in an effort to accommodate him, I need to ask them. I think one has been addressed already, but if you could just make a short comment I'd appreciate it.

His first one is, is the U.S. aware of any terrorist money flowing through Macau?

MR. GLASER: I can't speak for everything that the United States is aware of. I can say that when I think about the jurisdictions that we need to focus on most intensely with respect to terrorist financing, I would not include Macau in that list.

CHAIRMAN REINSCH: Okay. The second question was are there any entities that you see using Macau for weapons proliferation purposes? Probably a little outside your field, but there it is.

MR. GLASER: Using Macau for weapons proliferation purposes?

CHAIRMAN REINSCH: Yes.

MR. GLASER: I don't have anything I could speak to on that.

CHAIRMAN REINSCH: Okay.

VICE CHAIRMAN SHEA: I think we have time for two more questions. Commissioner Wessel.

COMMISSIONER WESSEL: And, again, let me add my voice to thanking you for the job that you do. None of us are questioning your integrity and the diligence which you apply to this job. We're looking myopically here, whether it's myopic, as the U.S.-China Commission, on a small slice of what you have to deal with on a daily basis, so we appreciate what you do.

Let me go back though to the question of the evaluations just so I can understand, and also if you'd be willing to answer questions afterwards because I know a lot of us have them, and we'll submit them in writing. If that would be appropriate, we'd appreciate that.

When you do an evaluation, the evaluation is supported on the other side by the government. You don't have investigatory opportunities in those markets to do books and records or anything else? Do you?

MR. GLASER: Books and records of the--

COMMISSIONER WESSEL: If you had questions, for example, about gaming or any other kind of financial institution, when you do the evaluation, you go to the government and say what kind of processes, what kind of systems do you have to look at all of the various questions that you raised in your testimony? What are the levels/thresholds for money laundering? You're not then doing, if you will, an individual audit of a particular sector, et cetera, to say, to verify what the government is telling you?

MR. GLASER: Well, an assessment team will meet with the private sector, but, no, there would not be an audit of an individual private entity.

COMMISSIONER WESSEL: Okay.

MR. GLASER: But certainly a mutual evaluation--I could tell the mutual evaluation in the United States certainly included meeting with private sector entities.

COMMISSIONER WESSEL: So as part of this, the next evaluation, you could be going to the gaming sector in Macau, say we want to see how you are responding, how you are abiding by the various strictures in the Macanese law to make sure that what the government says is also flowing down and being properly abided by?

MR. GLASER: Yes.

COMMISSIONER WESSEL: Okay. Great. Thank you.

VICE CHAIRMAN SHEA: Almost finished. Last question. Commissioner Slane.

COMMISSIONER SLANE: Again, I wanted to acknowledge our gratitude for your coming. Thank you so much.

Our job is to make recommendations to Congress. Is there anything that you would like us to do in that area, any tools that you need or laws changed, those sorts of things? And you may want to respond later. I'm just curious as to whether there's anything you would like us to do on

that side?

MR. GLASER: Yes, as I said, I think you guys decide for yourselves. I think this might go a little bit beyond what you all are looking at, but the U.S., last week, issued an action plan in the context of the G8 where we identify things that we need to do in order to better fight money laundering, and those are certainly things that we're going to be working on for the next couple of years.

These steps that we're trying to take would make us better at fighting money laundering. It would also put us in a stronger position as we go to places like Macau and insist that they make changes because we all have things that we need to do.

So I think if you take a look at the action plan that the U.S. just issued, I think you'd have a good sense of where we think we need to improve. But I don't think that there's any specific authority that we need that we don't have with respect to our ability to deal with foreign jurisdictions.

VICE CHAIRMAN SHEA: Well, that wraps up the panel. Again, Secretary Glaser, thank you very much for being here and for your testimony. Thank you for putting up with us, and thank you for the good work that you do on behalf of the people of the United States.

We will adjourn until 10:25 for a second panel. We're going to move it up by five minutes. So 10:25. Thank you.

[Whereupon, a short recess was taken.]

PANEL II INTRODUCTION BY CHAIRMAN REINSCH

CHAIRMAN REINSCH: Let's reconvene for the second panel. Our second panel today will continue the discussion on money laundering in the Macau Special Administrative Region and examine its implications for the United States. On multiple occasions, gaming and financial institutions in Macau have come under scrutiny by U.S. regulators for facilitating the laundering of dirty money.

Today our panel of experts will provide insights to the current state of Macau, its gaming industry, and the potential risks it poses for the United States.

First, we look forward to hearing from Mr. A.G. Burnett, Chairman of the Nevada Gaming Control Board. Mr. Burnett is an expert on legal matters in the international gaming industry. During his tenure at the Gaming Control Board, Mr. Burnett has traveled extensively to Asia and is credited for strengthening relationships with regulatory counterparts.

He recently traveled to Macau and Hong Kong to meet with gaming regulators and law enforcement. Mr. Burnett also serves as trustee and treasurer for the International Association of Gaming Regulators. He received his J.D. from Gonzaga University School of Law and his B.A. in International Affairs and Political Science from the University of Nevada at Reno.

We also look forward to hearing from James Freis, former Director of the U.S. Treasury Financial Crimes Enforcement Network, popularly known as FinCEN.

Mr. Freis is an expert in the development and enforcement of regulations combating financial crimes. He has over ten years of experience working with the Federal Reserve Bank of New York and the U.S. Department of Treasury in financial regulatory and enforcement matters.

From 2007 to 2012, Mr. Freis led the development and enforcement of regulations combating money laundering, terrorist financing, fraud and other financial crimes as Director of FinCEN.

Mr. Freis received his bachelor's degree from Georgetown and his J.D. from Harvard and graduated with honors at both institutions.

Finally, on our panel, we have Professor I. Nelson Rose, who is Professor of Law at the Whittier School of Law. Professor Rose is an internationally known scholar, author and public speaker, and is recognized as one of the world's leading experts on gaming law. Since 2007, Professor Rose has been a visiting professor at the University of Macau, teaching gaming law to lawyers from China and around the world.

He has also published scholarly papers on Macau's gaming history, regulation, and presence of U.S. operators in his internationally syndicated column "Gambling and the Law."

Professor Rose received a J.D. from Harvard in 1979 and a B.A. from the University of California at Los Angeles prior to that.

Gentlemen, we're honored to have this level of expertise here.

We will proceed in the order in which I introduced you: Mr. Burnett; Mr. Freis; and then Professor Rose. Your full statements will be entered in the record anyway so please feel free to abbreviate or summarize. We hope you will stick to seven minutes each or at least do your best to do that, but we will not cut you off in mid-sentence.

So let's begin with Mr. Burnett.

**OPENING STATEMENT OF MR. A.G. BURNETT
CHAIRMAN, NEVADA GAMING CONTROL BOARD**

MR. BURNETT: Thank you, Mr. Chairman, Mr. Vice Chairman, members of the Commission. It's indeed an honor and a privilege to sit before you today and discuss these issues with you that are of mutual concern and importance to both the federal government and the state of Nevada.

I'm the Chairman of the Nevada State Gaming Control Board, and my name is A.G. Burnett. Perhaps I can start with an introduction to the Nevada regulatory scheme, particularly as it relates to what we call "foreign gaming."

Foreign gaming is the conduct of gaming outside of Nevada's borders by a Nevada-licensed gaming operator. In other words, foreign gaming can be the conduct of gaming in Missouri or it can be the conduct of gaming in Macau. Generally, our statutes indicate that we have the ability to discipline a Nevada licensee if that licensee in a foreign gaming operation knowingly violates any law other than Nevada's laws concerning the conduct of gaming.

Further, a violation can arise if an event or association causes some harm to Nevada's reputation or control of gaming in the state of Nevada. There are other mechanisms by which we regulate and monitor foreign gaming, especially in the context of large publicly-traded corporations, such as those doing business in Macau today. That would be the joint venture of MGM and the Ho family, Wynn, and the Las Vegas Sands or Venetian. I may use those terms interchangeably.

These include, in terms of mechanisms for regulatory oversight, what we call orders of registration, which are essentially a contract between the Nevada Gaming Commission and a Nevada licensee that defines how they will conduct themselves in a foreign gaming operation and how they will conduct their compliance activities.

The second mechanism of extracurricular regulatory oversight, if you will, is a compliance program, which is very similar to compliance programs that financially-regulated companies on the stock exchange are required to have.

These compliance programs require that the licensee conduct due diligence on its vendors, suppliers, and purveyors of goods and services, as well as tangential relationships that they have with outside suppliers, to ensure that the Nevada gaming industry is operated appropriately.

I'll give you a brief overview of gaming in Macau. I'm sure that you already know most of this, but I will just summarize briefly. Prior to the SAR turnover of Macau back to the People's Republic, there was one operator, Stanley Ho, who created a large conglomerate of casino operations in Macau.

In March of 2002, the government of Macau granted three gaming concessions: one, to Mr. Ho's conglomerate known as Sociedade de

Jogos de Macau, S.A. (SJM); second, to Wynn Resorts, Ltd.; and, third, to a partnership between Galaxy Casino Company, Ltd. and the Las Vegas Sands, Inc.

Galaxy Casino Company, Ltd. and Las Vegas Sands, Inc. subsequently sought to dissolve their partnership. As a result, the government of Macau allowed for this initial gaming concessionaire to conduct a split through the means of a sub-concession. This structure set a precedent, enabling the other two concessionaires to conduct a split of their gaming concessions. Those concessionaires ultimately sold their sub-concessions to other interested gaming parties as follows:

In 2005, Stanley Ho's group, SJM, sold its sub-concession to a partnership between MGM Mirage and Stanley Ho's daughter, Pansy Ho, which became the MGM Grand Paradise Macau.

In March 2006, Wynn Resorts sold its sub-concession to Melco-PBL, a joint venture between the Australian media company, Publishing and Broadcasting Limited, and Melco International. Melco is a gaming company based in Macau that's operated by Mr. Ho's son, Lawrence.

As a result, Macau currently has six autonomous licensees which operate approximately 35 casinos. Three of the licensees are subsidiaries of Nevada gaming companies: Wynn Resorts, Ltd.; Las Vegas Sands, Inc.; and MGM Resorts International. Through restructurings in recent years, all three of these majority-owned subsidiaries are now publicly-traded entities listed on the Hong Kong Stock Exchange.

While Macau currently has a population of just over 560,000, the outlying areas, as you know, are heavily populated. Within a very short driving time through the city of Zhuhai in Guangzhou Province, or through a very short radius in terms of flying time, the Macau gaming operations have the ability to reach billions and billions of customers.

As this Commission is probably more aware than I, culturally, Chinese love to gamble. They're very serious in their play, and when casinos opened up in Macau, they were very serious places compared to what we're used to seeing around the United States and in Las Vegas. That atmosphere is changing a little bit; however, it is a very serious endeavor for a Chinese national to come and play baccarat in Macau.

A common misconception about money laundering in casinos is that to participate, one must help process dirty money through a system that essentially makes it clean. Rather, under U.S. federal laws, one needs only to accept money suspected of being dirty into the financial system to be a participant in money laundering.

Of concern to the United States is that in the legitimate system, that once dirty money can be moved elsewhere for illegitimate purposes. While transactions facilitated directly with casinos have robust anti-money laundering procedures, vulnerability exists where illegitimate money enters the system, possibly through VIP rooms outside of the casino's purview. That was indeed the case prior to the Nevada licensees coming into Macau, and it is my testimony today that that is changing somewhat.

Jurisdictional requirements dictate that we, the Gaming Control Board of Nevada, maintain excellent relationships with our overseas gaming and law enforcement counterparts, including U.S. federal agencies and the DICJ, our counterparts in Macau. Indeed, we are working very hard towards maintaining that relationship.

Macau also has a strict data privacy law pursuant to the Macanese Privacy Act 8/2005, which took effect in February 2006 and has caused some issues in regards to the translation of documentary evidence from Macanese operators to the U.S. However, we in Nevada have opened a dialogue with that office and are working with them to facilitate the inter-transfer of documentation and information to us, which would, of course, remain privileged and confidential.

Macau is an ancillary foreign jurisdiction outside of the state of Nevada and thus operates outside of our direct regulatory oversight. However, it is our hope that we will continue to utilize our Nevada licensed gaming operators in an effort to obtain transparency and information, which they also wish to have.

I'm over my allotted time, and I will conclude there. I'm not sure how the Chairman would like to proceed, but I'm happy to answer any questions you may have.

**PREPARED STATEMENT OF MR. A.G. BURNETT
CHAIRMAN, NEVADA GAMING CONTROL BOARD**

June 27, 2013

A.G. Burnett

Chairman, Nevada State Gaming Control Board

Testimony before the U.S.-China Economic and Security Review Commission

Hearing on Macau and Hong Kong

Chairman Reinsch, Chairman Shea, and other members of the Commission, thank you for the opportunity to testify. From the standpoint of a gaming regulator in Nevada, I hope to share with you my perceptions of gaming in Macau as it relates to your concerns of money laundering and the implications for the United States.

Background of Gaming in Macau

I should start with an overview of gaming in Macau. Beginning in 1962, the right to exclusively control Macau's legal casinos was retained by Stanley Ho Hung Sun and his companies. In 1999, the Portuguese colony of Macau returned to Chinese control as a Special Administrative Region (SAR) under the "one country, two systems" model exemplified by Hong Kong, SAR, PRC. In 2001, the Government of Macau ended Ho's monopoly by opening a tender process allowing bids for a total of three gaming concessions. Numerous gaming companies bid for these concessions, including casino companies licensed in Nevada.

On March 31, 2002, the Government of Macau, granted three gaming concessions to:

- Sociedade de Jogos de Macau, S.A. (SJM) (Stanley Ho)
- Wynn Resorts, Limited
- Galaxy Casino Company, Limited
in partnership with the Las Vegas Sands, Inc.

Galaxy Casino Company, Limited and Las Vegas Sands, Inc., subsequently sought to dissolve their partnership. As a result, the Government of Macau allowed for this initial gaming concessionaire to conduct a split through means of one "sub-concession." This structure set precedence enabling the other two concessionaires to conduct a split of their gaming concessions. Those concessionaires ultimately sold their sub-concessions to other interested gaming parties as follows:

- In April 2005, SJM sold its sub-concession to a partnership between MGM Mirage and Stanley Ho's daughter, Pansy Ho (MGM Grand Paradise Macau).

- In March 2006, Wynn Resorts sold its sub-concession to Melco-PBL, a joint venture between the Australian media company, Publishing and Broadcasting Ltd. (PBL) and Melco International (Melco). Melco, a Macau gaming company, was initially controlled by Stanley Ho until March 2006, but is now controlled by his son, Lawrence Ho.

As a result, Macau currently has six autonomous licensees which operate approximately 35 casinos. Three of the licensees are subsidiaries of Nevada gaming companies: Wynn Resorts, Limited, Las Vegas Sands, Inc., and MGM Resorts International. Through restructures in recent years, all three of these majority-owned subsidiaries are now publicly-traded entities, listed on the Hong Kong Stock Exchange.

While Macau currently has a population of almost 560,000, the outlying areas surrounding Macau, namely those that include the nearby population centers of Hong Kong and Guangzhou, have millions of residents. The potential visitors' market from the rest of mainland China, however, can reach into the billions. This Commission is more expert than I on Chinese culture, but I think all of us will agree that traditionally the Chinese love to gamble and play gambling games.

Therefore, by 2007, Macau overtook the Las Vegas Strip in gaming revenues, and in 2012, Macau gaming revenue was reported to be US \$38 billion, eclipsing Nevada's gaming revenues of \$10.8 billion.

Working in conjunction with these Macau casino licensees, are VIP Room Operators. These entities, licensed in Macau as "Gaming Promoters," work in combination with the casinos to satisfy a niche market of high-rollers. By most public accounts, this niche is responsible for approximately 75% of Macau gaming profits.

VIP Room Operators

Understanding these VIP Room Operators is paramount in understanding the gaming industry in Macau.

While VIP Room Operators are often referred to as "Junket Operators," they are distinct from how junkets operate in Nevada. Junket Operators in Nevada, called "Independent Agents," act primarily in a capacity of marketing or travel agents who secure customer visits to certain casinos. In Nevada these individuals are registered (not licensed) to bring business to specific casinos. Though the Independent Agent might be the facilitator between the casino and the customer, all transactions are conducted under the purview and control of the licensed casino.

In contrast, Macanese law allows for VIP Operators to participate in casino operations. For example, Stanley Ho's casinos essentially sublease casino space to the VIP Room Operators who operate all gambling functions. In a lesser extension, the Nevada affiliates in Macau maintain control of the gambling game, but still relegate certain cage, cash transactions, reporting, and

loan issuance and collections to these third-party VIP Room Operators. Thus, The VIP Room Operators conduct their transactions with the casino, but the VIP Room Operator's customers will conduct their cage transactions with the VIP Room Operator.

Financing these VIP Operations requires substantial capital. While the majority of these VIP Room Operators are licensed as individual operators, analysis confirms the vast majority of these operations are associated with major VIP Room Operator groups via complex corporate structures, financial guarantees, and third-party assignments. These gaming groups are just as prominent in the Macau gaming scene as are the six licensees. From our perspective, there are seven VIP Room Operator groups of interest which are responsible for the majority of all VIP Room Operations in Macau. Most of these groups are publically traded companies.

Niche

While the casinos still exercise efforts towards the mass market and procuring their own VIP clientele, employing the third-party VIP Room Operators allows for the casinos to participate in a gambling niche that would otherwise be elusive. As imaginative as you wish to be, there are legitimate and illegitimate reasons for various wealthy gamblers to keep a degree of anonymity and relegate trust only to a familiar VIP Room Operator rather than dealing directly with a casino. Further solidifying this niche is that Macanese law allows not only the casino, but also the VIP Room Operators to issue gambling credit to players.

The majority of these high-rollers are from mainland China. Various laws restrict the money transfer out of mainland China as well as hinder incentives to loan gambling funds or exert collection efforts. Chinese citizens are barred from carrying more than the equivalent of about US\$3,000 on any single trip to Macau, and it is illegal to try and collect a gambling debt there. The licensed casinos are highly incentivized to abide by these laws. However, the third-party VIP Room Operators act more autonomously in their decisions to adhere to these laws and they allegedly circumvent these restrictions, or likewise affiliate with parties that can facilitate such transactions.

As a result, the casinos are not necessarily privy of the nefarious reputations, allegations, associations, dispositions and sources of funds transacted by VIP Room Operators.

Concerns

Our analysis indicates that the Nevada affiliated casinos in Macau offer robust compliance with anti-money laundering protocols. That robust compliance, however, is only up to a point. That point is where the VIP Room Operators assume responsibility.

Though VIP Operator transactions conducted directly with the casino are tightly controlled and regulated, criminal transactions are widely alleged to take place just out of the direct purview of the casino. Such activities include back-betting, side-betting, loan sharking, violent loan collections, underground banking, and money laundering.

Furthermore, it is common knowledge, the operation of VIP Rooms in Macau casinos had long been dominated by Asian Organized Crime (AOC), commonly referred to as “triads.” With the evolution of gaming in Macau, the same AOC figures are allegedly still working the VIP Operations; only now they do it behind a façade of “legitimate” public corporations, complex corporate structures, financial guarantees, and third-party assignments. Public media and intelligence sources have affiliated all but one of the seven VIP Room Operator groups of interest with reputed AOC figures. Many of these associations are linked through documented public records. As such, since March 2010, the industry has been facing an increasing deluge of media scrutiny concerning the Nevada gaming companies’ ties to organized crime in Macau.

In its purest form, the operation of VIP Rooms is legitimate and lucrative for all parties. It is only in the ancillary affiliated activities that the model is vulnerable to perpetration of illegitimate activities. For example, VIP Room Operators are in a position to offer money laundering and underground banking transfer “services” for other criminal activities, especially when comingled with legitimate funds.

Money Laundering

A common misconception about money laundering is that to participate, one must help process “dirty” money through a system that makes it “clean.” Rather, under US Federal laws, one needs only to accept money suspected of being dirty into the financial system to be a participant in money laundering. Of concern to the United States is that once in the legitimate system, that once dirty money can be moved or used for legitimate or illegitimate purposes.

While transactions facilitated directly with casinos have robust anti-money laundering procedures, a money laundering vulnerability exists whereby illegitimate money enters the system through VIP Room Operator transactions facilitated outside of the casino’s purview. In addition, no one can count the methods and means utilized by criminal enterprises to facilitate laundering of money, and indeed, while the concern and the activity exists worldwide, there is a special concern with Chinese officials attempting to bring state money out of the mainland and possibly through casinos or other businesses in order to land it elsewhere for future use.

Our ability to monitor, investigate, and eventually discipline our Nevada licensees for foreign violations is discussed next.

Limitations

From our perspective of regulation in this matter, we have limitations.

The first is evident. We are the Nevada State Gaming Control Board. We regulate gaming within our borders, but have neither the authority nor the desire to regulate gaming in another jurisdiction. The authority we have granted to us in this regard is in our own Foreign Gaming

Statute, Nevada Revised Statute 463.720¹.

Second, jurisdictional requirements dictate that we maintain excellent relationships with our overseas gaming and law enforcement counterparts, as well as the various US Federal agencies, as we investigate issues and allegations that arise. We also place a heavy burden on the Nevada affiliates that operate overseas, as they are held to be acting in the State's best interests in Macau. While we know many of the associations, and understand much of the money flow, we stand in the same position as other law enforcement agencies such as the FBI and DOJ when attempting to investigate nefarious allegations or sources and disbursements of funds facilitated through various parties removed by many degrees of separation in foreign jurisdictions. I must pause here to indicate the excellent working relationships we have overseas, particularly in Asia, with said counterparts, and other American officials, such as those in various Embassies throughout the region.

Third, Macau has a strict data privacy law. The Macanese Privacy Act 8/2005, which took effect February 2006, has varying degrees of interpretation. It essentially forbids businesses there from transferring data on individuals to any other country. In general, therefore, it has precluded us from obtaining information from our operators to the degree we are accustomed to. We have opened a dialogue with the data protection office, but as you know, relationships in Asia are built on foundations of long term trust, and we must continue to nurture that relationship.

Finally, as with most government entities, we are limited in resources. Macau is an ancillary foreign jurisdiction outside of the State of Nevada, and thus outside of our direct oversight. Limitations dictate that resources are best expended towards matters within our jurisdiction. We do not have the manpower to staff agents in Macau, and nor would we ever do so. We do, however, routinely send agents not only to Macau, but throughout all areas of the world as they conduct their investigative activities.

Conclusion

Nevada has long enjoyed a formidable reputation for strict and effective regulation. The

¹ **NRS 463.720 Prohibited practices.** A licensee shall not, in a foreign gaming operation, knowingly:

1. Violate a foreign, federal, tribal, state, county, city or township law, regulation, ordinance or rule, or any equivalent thereof, concerning the conduct of gaming;
2. Fail to conduct the operation in accordance with the standards of honesty and integrity required for gaming in this state;
3. Engage in an activity or enter into an association that is unsuitable for a licensee because it:
 - (a) Poses an unreasonable threat to the control of gaming in this state;
 - (b) Reflects or tends to reflect discredit or disrepute upon this state or gaming in this state; or
 - (c) Is contrary to the public policy of this state concerning gaming;
4. Engage in an activity or enter into an association that interferes with the ability of this state to collect all license fees imposed by this chapter; or
5. Employ, contract with or associate with a person whom the Commission or a court in this state has found guilty of cheating or to whom the Commission has denied a gaming license, or finding of suitability, on the ground of unsuitability.

globalization of gaming beyond our borders brings challenges, however, as we do not have the authority nor the resources to either regulate gaming or conduct criminal investigations in a foreign jurisdiction.

When Nevada licensees first entered the Macanese jurisdiction, the industry, federal agencies, international regulators, and the Nevada State Gaming Control Board watched with anticipation that the licensees would bring Nevada's standards of gaming to the enclave battling a nefarious reputation of rampant AOC infiltration. While certain elements of the business model have indeed been "westernized," in effort to compete; however, the business model of the west has also become somewhat "easternized." Nonetheless, we feel that the business model itself is not an issue, nor do we believe that the casinos, themselves, are an issue; it is what the business model allows to occur outside of the casino's purview that may pose problems.

Thank you for the opportunity to testify today.

**OPENING STATEMENT OF MR. JAMES H. FREIS, JR.
COUNSEL, CLEARY GOTTLIEB STEEN & HAMILTON LLP
FORMER DIRECTOR, U.S. TREASURY FINANCIAL CRIMES ENFORCEMENT
NETWORK (FinCEN)**

MR. FREIS: Thank you, Mr. Chairman, and thank you for inviting me to testify before the Commission today.

I currently serve as counsel at the law firm of Cleary Gottlieb Steen & Hamilton LLP here in Washington, D.C., but much of what I will be talking about and drawing upon is from my previous experience, as you mentioned, at the U.S. Treasury Department, including the last six years as the Director of the Financial Crimes Enforcement Network, FinCEN, the anti-money laundering regulator of financial institutions, including casinos, in the United States. FinCEN also serves as the financial intelligence unit of the United States, which is the authority that exchanges information with foreign counterparts, including those in Macau, in furtherance of law enforcement investigations of financial crimes.

With respect to Macau, I think you are already aware of some of the unique factors involved in a small jurisdiction--the growth, the reliance on junkets, and the VIP rooms that, of course, create some risks in terms of gaming activity outside of the more regulated sector of the casinos themselves.

What I hope that I can add to the discussion today is a little bit more of the anti-money laundering framework that we have in the United States, which draws from global principles that Danny Glaser discussed earlier. I worked very closely with him on a lot of those initiatives at the Treasury Department, specifically how some of those principles are applied to the casino sector so that we can help better understand the risks and, therefore, some of the risk mitigation efforts.

So with respect to anti-money laundering, the principles are really quite simple, and that is because criminals are motivated by money. Almost every type of crime is motivated by money, and criminals will use any way that one can move or intermediate money to make the proceeds of those crimes look legitimate. That's the source of the word "laundering." Also, successful criminals, over time, will want to save and invest their money.

So that's basically what we're talking about in terms of the risk. For that reason, any way one can intermediate funds can be abused by criminals. Congress has taken the view and expanded, through several pieces of legislation generally promulgated together and referred to as the "Bank Secrecy Act," to allow the Treasury Department, through my former agency, FinCEN, to put out specific regulations on a variety of institutions. With respect to regulating casinos, Congress added that specific authority in 1994.

Anti-money laundering regulations themselves fall within a couple basic categories. First, any regulated institution should have an anti-money laundering program. Generically, it's referred to as, "know your

customer," but basically it's vigilance against criminals coming in and abusing the otherwise legitimate services that an institution is making available to the public.

So that's the first level, an anti-money laundering program. The second is a recordkeeping requirement to keep ledgers or electronic records of transactions, so that when a law enforcement agency has an investigation, they can subpoena those records and follow the money by piecing together the trails of who was involved.

You don't send money to people you don't know! That's why anti-money laundering efforts and those records produced are some of the most important tools for law enforcement.

And the third aspect is reporting to FinCEN and, through FinCEN, making available to other government authorities certain types of information. The reporting started with large cash transactions, in excess of \$10,000, because the sense of Congress was that cash was the vehicle of choice by criminals, tax evaders, and almost anyone involved in financial crimes.

The second major type of reporting is with respect to suspicious activity. All that needs to be understood in this context is any financial services providers, including casinos, know what is normal business for their customers and the services that the institutions provide. When a financial services provider sees someone that's engaged in activity that doesn't make any commercial sense or doesn't fit the profile for that customer, the financial services provider needs to inform the government.

That's basically what it boils down to. Congress has taken the position that these financial intermediaries must be in partnership with the government to combat the scourges of financial crime.

But it is important in that context to recognize that, unlike other types of financial intermediaries, the primary role of casinos is not to move money through the casinos to other parties. I'll be pleased to answer more questions in terms of how the regulatory framework fits with casinos, because it is important to understanding how gaming services are provided to the public. The casinos--frankly, the odds are in their favor--would be happy that the money stays with them in the casinos, while providing the services customers expect as part of their gaming experience.

But, again, that's very different, and I think that's important, especially with respect to questions about how money goes in and out of casinos, whether they can be this alternate vehicle for money laundering like banks or money transmitters.

Another particular aspect is that casinos themselves operate through financial institutions that are regulated for anti-money laundering. Specifically, they rely on banks. If you want to wire money in or out of a casino, you do that through a bank. If you get a casino check or want to bring a check in from a bank to get credit, there are other regulated financial intermediaries involved.

So the question of how one launders money through casinos goes

beyond the traditional aspect, the assumption of bags of cash, which still exists in certain cases, especially in a cash-based economy. It's much more complicated than that in practice, and there are happily some other levels of control.

The last thing I'll just say in my international experience (not to repeat what Danny Glaser mentioned earlier), in the cross-border aspects of cooperation, the Macanese authorities also have a financial intelligence unit that carries out functions analogous to those of FinCEN here in the United States.

That financial intelligence unit is also a member of the international group known as the Egmont Group, which has representatives from over 130 jurisdictions around the world. I think one important thing for your understanding is that this group of financial intelligence units (FIUs) even recognizes entities from jurisdictions that are not sovereign states.

So in the China context, the Hong Kong and Macau Special Administrative Regions are directly represented with respect to their respective FIUs. The People's Republic of China's FIU has applied for membership in the Egmont Group, but is not yet an active participant in that group that follows up on cross-border investigations of anti-money laundering. I think we would all welcome that aspect of greater participation.

Please let me offer a final note, as Danny Glaser mentioned a little bit earlier, in terms of the experience with Banco Delta Asia and some of your questions related to the Section 311 authority that was exercised by my former agency FinCEN. That action by the U.S. Government was one of the factors that spurred some of the substantial reforms undertaken in Macau around 2006 to implement some of the global standards with respect to anti-money laundering.

Again, thank you for your time. I'll be pleased to answer questions.

**PREPARED STATEMENT OF MR. JAMES H. FREIS, JR.
COUNSEL, CLEARY GOTTLIEB STEEN & HAMILTON LLP
FORMER DIRECTOR, U.S. TREASURY FINANCIAL CRIMES ENFORCEMENT
NETWORK (FinCEN)**

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.¹ 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

¹ 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>.

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

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.³ These actions directly affect Macau's economy, which obtains its revenue from a 40% tax on casinos gambling revenues.⁴ In 2011, the Macanese government brought in \$23.5 billion in revenues, 72% of which was gained from taxes on gambling.⁵

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."⁶ 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.⁷

The junket operators in many instances operate a type of casino within the casino. Junkets attract

² 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.

³ 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>.

⁴ *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).

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

⁶ 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).

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

gamblers into VIP rooms in significant part through the extension of credit.⁸ 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 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 operation⁹ have consolidated over the years. In recent years, approximately 80% of revenues has been reported to go to the top 40 firms.¹⁰ 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.¹¹ In some capacity, the involvement of organized crime groups such as China's triads is likely.¹²

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."¹³ 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,

⁸ 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).

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

¹⁰ *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.

¹¹ 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.

¹² 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'").

¹³ 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.

commonly known as the Bank Secrecy Act (BSA).¹⁴ 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 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".¹⁵ 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.¹⁶

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."¹⁷

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).¹⁸ 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.¹⁹

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

¹⁴ 31 U.S.C. § 5311 et seq.

¹⁵ 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.

¹⁶ 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.*

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

¹⁸ *Id.*

¹⁹ Financial Action Task Force, RBA Guidelines for Casinos 18 (2008).

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

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

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

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

In 2006, Macau implemented Law 6/2006, which establishes the basis for legal cooperation in criminal matters between Macau and other jurisdictions.²³ 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.²⁴ 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,²⁵ 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.²⁶

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”.²⁷ 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.

²¹ www.egmontgroup.org/about. (last visited Jun. 21, 2013).

²² “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 (last visited Jun. 20, 2013).

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

²⁴ *Id.* at 34-35.

²⁵ *Id.* at 25.

²⁶ *Id.* at 25.

²⁷ *Id.* at 102-103.

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 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.²⁸

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.²⁹ 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.³⁰

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

²⁸ *Id.* at 28.

²⁹ 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.

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

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

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.³³

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,³⁴ 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’.”³⁵ 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.”³⁶ 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

³¹ *Id.* at 90.

³² Jorge Godinho, *supra* note 12 at 273.

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

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

³⁵ Jorge Godinho, *supra* note 12 at 264.

³⁶ 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.

* * *

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

**OPENING STATEMENT OF PROF. I. NELSON ROSE
PROFESSOR OF LAW, WHITTIER LAW SCHOOL**

MR. ROSE: Thank you, Mr. Chairman, and thank you, members of the Commission, for inviting me to testify.

In preparing, I reviewed the statute that created the Commission, and it seems that your responsibility is basically not to determine whether China's accidental creation of the world's largest casino market in the history was right or wrong, but whether there are risks to the United States.

And when you look at risks, you also have to look at benefits. There are some benefits. The most obvious is, simply, money. There are now three major casino companies that make the majority of their revenue from their casinos in Macau. At least two of them, the Las Vegas Sands and MGM, were on the verge of bankruptcy during the Great Recession.

MGM, in particular, if it had gone under, would have been devastating to the state of Nevada. It is either one of the largest or the largest employer in the state. There have been other changes, though, that have occurred. I first visited Macau in 1981 and China in 1987. And if you see what is going on, as you know, in China, but also in Macau, it's because they've opened the door to the West, and, of course, the West is getting information and learning things from China and Macau.

But there definitely are risks, and the risks come from this enormous cash industry. Macau is one-sixth the size of the District of Columbia. This year it will win more in its casinos than all of the privately-owned casinos in the United States, but what I think is most important to understand is the complicated situation comes from the history and complex legal relationship both within Macau and between Macau and the PRC.

For example, Macau has had legal gambling for centuries. In the PRC, in China, I should say, gambling has always been considered a sin. I think it's one of the seven sins or eight sins that you can be--actually used to be--executed for.

They still have severe restrictions not only on advertising but on the collection of gambling debts. Of course, the United States does also, but we tend not to execute people for gambling. The last person executed for gambling in China was in 2004, but he was a government official who also embezzled money.

The problem is that, of course, Macau is now part of China, and China has those restrictions on taking currency out. So if the casinos are winning \$40 billion, that means that hundreds of billions of dollars are being gambled. Given the currency restriction, there is no legal way that money can get from the mainland to Macau. So you have what are called the junket operators. In my prepared paper, I carefully called them VIP gaming promoters because they're nothing like the traditional casino junkets.

These VIP gaming promoters not only lend money and get the players to Macau. In many cases, they run the VIP rooms. They're literally mini-casinos within the big casinos.

But probably the most important thing to take away from my testimony is there are two completely different systems of control in Macau. We have three companies that are licensed by Nevada, and, in fact, they're licensed by other states as well. Those companies are not involved, as best I'm able to tell, with--they certainly stay away from-- any tainted operator. They don't have the problems of the casinos that are not state-licensed.

There are, what are called, legacy casinos in Macau. These are casinos that come under the Stanley Ho umbrella. Technically, he is the licensee, but he never steps, or none of his people step, in those casinos. It's widely known that the casinos are owned, actually owned and operated by other people, some of whom would never get a license in Nevada, and they simply give Stanley Ho's company some percentage. It's believed to be 15 percent for the right to continue.

We have the question, obviously, if gambling debts are not collected, how then do these junket operators collect? If they collect through force and threat of force, and that's where you have the tie-in with the triads.

The question, and I feel like I've got to come to Macau's defense a little bit here, Macau actually does have in place currency transaction reports. They're too high. They're \$62,000 and up rather than \$10,000, but, in fact, there are hundreds and thousands of reports filed in Macau. They have suspicious activity reports. There have been, in fact, successful prosecutions, but there's no way to know really what's going on with not just the VIP rooms, but with their high rollers, and what secret arrangements they have.

When they go back to the mainland, one of the common suspicions is a person who's betting say 10,000 Hong Kong dollars a hand, when he goes back to the mainland, it turns out he was actually betting 100,000 dollars a hand.

The casinos don't like this. The government of Macau doesn't like this. I don't think China likes this. They certainly don't like government officials absconding with money. They're not even supposed to be in Macau, and they are. They're embezzling and losing it in Macau. Occasionally, the government in Beijing will simply restrict travel because of bad press. So there are issues.

But I think we have to very carefully distinguish between the state-licensed operators and the American companies and those that aren't. Should there be additional federal law? I was teaching in China in 2004 when the first casino opened. I was very skeptical and very surprised--I have to admit--to see that Nevada allowed its operators to operate in Macau given the history and even the system that was in place then.

But I do also have to say I think Nevada has done a pretty good job of keeping its companies clean. They do have some additional problems. Macau has these strict privacy controls. So sometimes you can't get information--Nevada can't even get the information it needs from its own licensees, but that's really rare.

More importantly, it looks like the state is doing okay. I don't

think there's a whole lot the United States can do about the legacy casinos-- they're simply not under U.S. control--or VIP operators who have no dealings whatsoever with American licensed companies.

I've looked at the federal laws. I think the Foreign Corrupt Practices Act, in particular, but also controls by the SEC, are probably adequate for at least the American companies. What you can do about the non-state licensed casinos and VIP operators in Macau, I don't know. That would be probably interfering with China's sovereignty.

Thank you for inviting me, and I will answer any questions you may have.

**PREPARED STATEMENT OF PROF. I. NELSON ROSE
PROFESSOR OF LAW, WHITTIER LAW SCHOOL**

Testimony before the U.S.–China Economic and Security Review Commission

Hearing on Macau and Hong Kong
Thursday, June 27, 2013

Professor I. Nelson Rose
Full Professor with Tenure, Whittier Law School, Costa Mesa, California
Visiting Professor, University of Macau

**Gambling and the Law®:
Macau and China's Gambling Problem¹**

Macau is by far the largest gaming jurisdiction in the world. This year, the casinos in this Special Administrative Region of China are projected to win more than all of the privately owned casinos in the United States – about \$40 billion. And Macau is not only smaller than the U.S., or Rhode Island; even with its reclaimed land, it would fit inside the District of Columbia six times over, with room to spare.

Imagine how much gambling there would be if it were 100% legal.

The casinos are not necessarily violating any Macanese laws. But restrictions in its main feeder market, Mainland China, mean that inevitably some laws are being broken by individuals and companies who have made this small gaming enclave such a success.

It starts with the patrons. It is against the law for anyone from the Mainland to take out more than 20,000 yuan renminbi, or about US\$3,150, in cash. That's less than \$25,000 in Hong Kong dollars: A typical bet in the high-roller rooms in Macau casinos. But casinos are a cash business. So, somehow, Mainland Chinese are getting billions of dollars in cash across the border.

One of the most common ways for Mainland players to get their cash to Macau is through straight smuggling. One Macau executive told me about a farmer who walked into his casino in dirty, torn clothes and took HK\$50,000 in cash out of his sock. After he lost it, he took another HK\$50,000 out of the other sock.

Mainland Chinese like cash, and they don't trust banks. They even buy houses with cash. Of the 28 million visitors to Macau each year, more than half come from the Mainland. Not coincidentally, more than half also stay for less than one day. Millions arrive carrying shopping bags, and many of those bags have wads of yuans hidden at their

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bottoms. And not all the shoppers who cross the borders with Zhuhai, the connecting city on the Mainland, are carrying the cash only for themselves.

Guards at most border crossings now just wave you through, if they are even there at all. Spot checks at Macau's borders with Zhuhai and at the two ferry terminals and the Macau Airport are extremely rare. Players are coming to Macau to gamble. They know they have a better chance of winning a life-changing jackpot on a slot machine than of losing a life-changing conviction for violating PRC currency laws.

Of course, wealthier visitors are also getting their money out in other ways. Stores in Zhuhai and other cities near the border provide money lending and cash transfer services. For a fee, they call their counterparts in Hong Kong and Macau, who meet the Mainland visitor in the casinos with any amount of cash the visitor wants. There may be no paper records. And a large operation does not even have to actually transfer the money across the border. It simply keeps millions of dollars in cash on the Mainland and in the S.A.R.s.

Pawn shops have always been associated with casinos. There does not appear to be any law against a player intentionally taking expensive personal merchandise out of the Mainland and selling it in Macau for cash for gambling. The Venetian last year had an auction of extremely expensive ceramics, art and jewelry, with many pieces coming from "private collections."

But there are a growing number of high-end jewelry and watch stores popping up in Macau, even as booths right on the floors of the casinos. These stores are not buying, but selling. At least, that's what they pretend to be doing. What they are actually doing is transferring funds out of Mainland China.

The most common scam is to create a credit card sale of a very expensive item, like a watch. But no actual watch is involved. The seller gets a small percentage off the top, while the bulk of the money goes to the money-lender. The credit card sale may not even be recorded. It can be held, like a casino marker, for 24 hours so that it can be cancelled if the player wins.

This is done openly and blatantly. During a recent trip to Macau I watched a player sign papers and receive bundles of cash from jewelry stores located directly on the casino floor. No actual jewelry changed hands. The players are obviously getting the cash to use in the casinos while creating a credit card transaction that appears to have nothing to do with gambling and is thus enforceable under Mainland Chinese laws.

I had assumed that if the player won, he would return to the jewelry store with the cash to pay off the jewelry store before the credit card transaction went through. But when I asked an insider with knowledge of this business, he told me that the jewelry stores are part of a much more complicated arrangement. There are third-party companies involved with the lending and shipment of money for these jewelry stores. The operators do not

want the Mainlander to pay off the loan quickly, because they are charging outrageous interest: often 10% a month or more.

Probably the most common way to get cash to gamble in a casino in Macau is through a junket operator. This is the generally accepted term used in the Western English language press. But the title is misleading. They are actually called “VIP gaming promoters,” which is slightly more accurate. They are nothing like the traditional junket operators associated with American casinos, who were often paid a flat fee per head to bring in players. The Macau VIP gaming promoters can do virtually every part of the gambling transaction: recruit players, arrange transportation, provide credit, operate the gaming room in the casino, and collect the gambling debt.

Some of the VIP gaming promoters are large and sophisticated. One, Asia Entertainment & Resources Ltd. (Stock symbol AERL) is traded on NASDAQ. Its website, <http://ir.aerlf.com/>, explains how the system works and even details what arrangements it has with which casinos.

Of course, some the VIP gaming promoters are small and undoubtedly have ties with organized crime. The problems arise mainly from the archaic gambling laws of the PRC.

Much of what the VIP gaming promoters do is completely legal. There is no law in the PRC against making arrangements for travel, although there are restrictions on advertising or promoting gambling. Under the laws of Macau, VIP gaming promoters are allowed to share directly in both the theoretical and actual losses of the high-rollers they bring to Macau's casinos. It appears that China does not care if VIP gaming promoters loan money for gambling, so long as only paperwork, not currency, crosses the border.

VIP gaming promoters are at the heart of gaming revenue for Macau's richest casinos. They are so important, in fact, that VIP gaming promoters used to get a much larger share of money lost by high-rollers than the actual casinos. It is not clear, however, whether this money is all profits. VIP gaming promoters complained when the Macau government, at the urging of its casinos, put a cap on commissions, claiming that they have to give large kickbacks to losing high-rollers.

How do the VIP gaming promoters get their profits out of China? Some invest in other legitimate businesses on the Mainland, which are allowed to wire funds to Hong Kong and elsewhere. But some turn to those millions of shopping bags, or other, more nefarious, means.

The VIP gaming promoters supply Mainland visitors with the cash they need to gamble in Macau. The arrangements between the player and the promoter are secret and unknowable. A commonly heard allegation is that when a player shows up with what appears to be, say, a HK\$1 million line of credit and makes bets of HK\$25,000 per hand at baccarat (and the game is always baccarat), when the player returns to the Mainland to settle up he actually had a HK\$10 million line of credit and was making bets of

HK\$250,000 per hand. There is no way to know.

Casinos and the government obviously are not happy with these side agreements. Casinos make their money by having a small percentage advantage on every bet made. And the Macau government is losing the tax revenue that the players' actual losses would generate.

But the VIP gaming promotion system persists because it serves many functions, including for the casinos. Visitors from the mainland still have trouble getting their money to Macau; gambling debts are still not legally collectable; and there is still very little fiscal infrastructure, since most Chinese do not have bank accounts, let alone credit cards and credit histories. So the junket operators bear the risk when they lend money for gaming.

Business in China is mainly conducted informally among people who know each other, or the personal contacts of personal contacts. So it is extremely difficult for a U.S. company to break into this market without junkets, with their agents and subagents.

Anonymity works for casinos as well. PRC officials are not allowed to gamble in Macau. In fact, they are not even supposed to visit the S.A.R. without prior approval. Casino operators can truthfully say that they do not know if a government official is making bets in their casinos, because they do not have the names of the high-rollers brought in by the VIP gaming promoters.

The problem of the VIP gaming promoters will not be solved until the PRC modernizes its laws. There has been some movement, but the PRC is still far behind the admittedly outdated laws of the U.S. (where gambling debts are still generally legally unenforceable). As an example, gambling in mainland China used to be punishable by death. Today, an operator can still get three years in prison.² But the PRC still punishes regular citizens for merely making bets. Gambling is lumped in with pornography in Article 32 of the Regulations of the PRC on Administrative Penalties for Public Security. It provides, "The following acts are strictly forbidden: (1) gambling or facilitating gambling . . . Whoever commits one of the above acts shall be detained for a maximum of fifteen days, fined simply or concurrently a maximum of three thousand yuan or given re-education through labour according to regulations. Criminal responsibility shall be investigated if the actions constitute a crime."

The PRC's restrictions on promoting gambling apply to advertising casino gaming in Macau. The casinos themselves have found it difficult to know what is allowed, even when they don't directly mention gambling.³

² Article 303 of the Criminal Law of the People's Republic of China

³ "Marketing casinos in China," Asian Gambling Brief, June 7, 2013, <http://asiagamblingbrief.com/component/k2/490-marketing-casinos-in->

Similarly, gambling debts cannot be collected through the court systems of the mainland, although they are enforceable in Macau and Hong Kong. Because gambling debts are not legally enforceable on the Mainland, casinos are extremely reluctant to directly lend money to players.

So, how do the VIP gaming promoters collect?

The most recent development has been the creation of licensed micro-finance companies on the Mainland. There are now more than 4,000 licensees, lending at least 180 billion yuan, or more than US\$30 billion, each year. Loans are supposed to go to small businesses. But VIP gaming promoters and their agents are getting licensed and taking the position that it is none of the government's business what the loans are for. They even believe, or at least state publicly, that being a licensed micro-lender somehow makes their business of loaning money for gambling legal.

There is no way China can check every loan. Yuan-denominated loans now total 7.47 trillion yuan, or US\$1.18 trillion.

Chinese law, of course, would not allow a lender to turn a non-enforceable gambling debt into one that the courts would enforce simply because the lender has a micro-finance license. There is also the possibility of criminal charges being raised for promotion of gambling. Of course, all this would require that the player declare publicly that he and everyone else involved knew that the money was being lent for him to gamble in Macau.

How would an agent of a lender make sure the player does not talk? For that matter, how have agents been collecting those hundreds of billions of yuans over the years, when gambling debts were, and are, not legally enforceable?

That is the greatest risk of China's outdated laws against gambling. Because gambling debts cannot be collected through the legal system, they are sometimes collected through illegal means. In a 2008 study by Macao Polytechnic of 99 high-rolling Mainlanders who made the Chinese newspapers for excessive gambling, seven died "extra-judicially," meaning they committed suicide or were murdered.⁴

One interesting side-note of this study: The argument is often raised that the VIP gaming promoters are necessary, because only local agents on the Mainland can know whether an individual is a good credit risk. This study showed that many of the "high-rollers" who got in enough trouble that they were reported in Mainland newspapers, were actually bookkeepers for large companies, who were relatively poor. This means the VIP gaming promoters, or its agents, or its agents' subagents, knew exactly that the player was good

china.html?utm_source=Asia+Gambling+Brief&utm_campaign=2e72eb1c2e-AGBrief%2300020-7June13&utm_medium=email&utm_term=0_51950b5d21-2e72eb1c2e-60695561

⁴ Another 15 were sentenced to death, usually for embezzlement. Zhonglu Zeng and David Forrest, "High Rollers from Mainland China: A Profile Based on 99 Cases," <http://digitalscholarship.unlv.edu/grrj/vol13/iss1/3/>.

for the money, because he was in a position to embezzle it.

The biggest potential problem for American companies involved with a scandal in Macau is that they are all, by definition, licensed by at least one state of the U.S. The current problems involving Las Vegas Sands and MGM are typical of the type of trouble casino companies can face when they are associating with VIP gaming promoters or partners who bring unwanted scrutiny from state regulators.

Examples were the startling headlines of three years ago: From Reuters, the source of the original story: “SPECIAL REPORT-High-rollers, triads and a Las Vegas giant.”⁵ Others picked it up: “Las Vegas Sands (LVS) Accused Of Mob Ties;” “LV Sands ‘linked to Macau gang;’” and the worst, “Macau Murder for Hire Tie-ing Las Vegas Sands.” Reuters then ran the inevitable, “Nevada regulators analyzing Macau casino activity.” Even the hometown newspaper, the *Las Vegas Sun*, jumped onboard: “Macau giving fits to Nevada regulators: Organized crime said to run rampant where state giants do business.”

The murder-for-hire was real. Four men were convicted in Hong Kong of a plan to have a dealer at the Sands Macau killed, for supposedly helping a high-roller cheat a VIP room out of millions of dollars. But the other ties to LVS were weak. Reuters reported that a witness, not a gang-member but only a “regular casino patron,” testified that a man who was alleged to have been running the high-roller room was also, allegedly, a member of organized crime, and, allegedly, the mastermind of the plot. This alleged mastermind also was a major investor in a publicly traded junket operator.

It is important to note that the testimony was not strong enough to get the Hong Kong police, or anyone else, to arrest the alleged mastermind. As I wrote at the time: “It is doubtful there is enough here for the Macau government to do much in response to this news story, other than tighten its procedures and increase background checks on junket operators.”⁶ But there certainly was enough to cause major headaches for LVS, and for the other companies associated with Macau’s casinos: MGM Mirage, Wynn Resorts, Galaxy Entertainment, Melco Crown Entertainment, SJM Holdings; and even Hard Rock, Hyatt Regency, Four Seasons and Mandarin Oriental. It also put pressure on Nevada and other U.S. state regulators to take another look to see whether licenses will be pulled, or at least more stringent restrictions should be placed on Macau junket operators.

Murder-for-hire and casinos obviously made this a major story, and sexy enough to be published far and wide. The timing was particularly bad, coming on top of the ruling in New Jersey that MGM's Macau partner, Pansy Ho, was unacceptable due to the alleged organized crime ties of her father, Stanley Ho.

⁵ <http://www.reuters.com/article/2010/03/29/us-casinos-macau-sands-idUSTRE62S34020100329>.

⁶ I. Nelson Rose, “Gambling and the Law®: Macau Junkets Trouble Nevada,” <http://www.gamblingandthelaw.com/columns/248-macau-junkets-trouble-nevada.html>.

Problems in one jurisdiction always lead to problems in others. State governments in the U.S. cannot ignore news like this. American casino companies in Macau have licenses in Nevada, Michigan, Mississippi and other states, that are now at risk, if any tie at all with organized crime is discovered.

Nevada has laws on the books that already require regulators to look at the operations of its licensees wherever they may be. The state's "foreign gaming" law has gone through a number of changes over the years.

Nevada's original policy was to forbid its operators to open casinos anywhere else. This was obviously designed to keep Nevada the only game in town. And it worked, until the voters of New Jersey approved amending their State Constitution in 1976 to allow casinos in Atlantic City.

The Nevada Legislature reacted by passing a law in 1977 allowing Nevada licensees to open casinos outside the state, but only if the gaming regulators gave their prior approval. This included evaluating the foreign government's controls. I still have a copy of the "Report on Gaming Control in New Jersey," dated April 19, 1979. The Report concludes, "the Nevada State Gaming Control Board finds that a comprehensive, effective government regulatory system exists in New Jersey."

Although New Jersey might have been okay with Nevada evaluating its laws and regulations, politically, it became difficult for the United States when Nevada declared itself the arbiter of other nations' governmental controls. The U.S. Ambassador to the Bahamas told me the leaders of that independent country did not like being judged by a mere state. There were also legal questions of whether Nevada was creating trade barriers in violation of U.S. treaties.

The proliferation of legal gaming eventually made it too costly for Nevada to investigate every foreign regulatory system in advance. And Nevada operators complained that the delay allowed their competitors to get a new jurisdiction's casino licenses first. So, the law was changed, in 1987, 1993 and 1997, to ease the standards and eliminate the requirement of prior Nevada approval.

Now Nevada licensees only have to notify state regulators within 30 days of signing a deal for a foreign casino and apply for a "finding of suitability." And those regulators have been given the impossible job of continuously monitoring activities around the world. Even with contacts, reports filed by licensees, and occasional visits, there is no way a Nevada regulator can always be sure that there were not secret agreements made on the Chinese mainland.

New Jersey does not have a specific foreign gaming law. But the Casino Control Act, like similar statutes in all casino licensing states, requires that its licensees show they are

of “good character, honesty and integrity” on a continuing basis.⁷ This expressly includes a licensee's “business, professional and personal associates,” “to the extent that they may reflect upon actual character and present fitness to either hold a casino license or participate in gaming operations.”⁸

Casinos in New Jersey have to meet a tough standard: rather than proof by a mere preponderance of evidence, found in other states and regular civil suits, New Jersey requires applicants and licensees to prove their worthiness by clear and convincing evidence. As New Jersey demonstrated in finding that Pansy Ho was unsuitable, and that MGM had to sever its ties with her or leave the state, the standard is equally tough in practice as in theory. Nevada regulators had the same information, but reached a different conclusion.

Part of the difference could be the more relaxed attitude Nevada has toward gaming. So long as an operator or its partner has not been charged, let alone convicted, of a crime, Nevada regulators will normally not suspend or revoke a license.

New Jersey, on the other hand, took the license for the Tropicana Casino in 2007 without a specific finding of criminal wrongdoing, or even of charges having been filed. The New Jersey Casino Control Commission found numerous problems, including management's “abysmal” regulatory compliance and a “lack of business ability . . . and a lack of good character, honesty, and integrity.”

Although New Jersey found violations sufficient to deny the renewal of the casino license, Nevada regulators never seriously threatened the many Nevada casinos owned and operated by the same company, Columbia Sussex.

Other states are more likely to follow New Jersey than Nevada if a license is actually revoked. Some, in fact, make it automatic. Indiana law, for example, required Columbia Sussex to give up its license for the riverboat Casino Aztar, because Indiana law does not allow the state to license anyone who has had its licensed revoked in another state.

History is a factor here. When Nevada legalized casinos in 1931, it imposed no regulatory controls. The state allowed convicted felons to obtain gaming licenses. The theory was that since gambling was illegal in all other states, the only individuals with experience would be people involved in illegal gambling. Nevada, fearing federal intervention, only began regulating its casinos after the Kefauver televised Congressional hearings in the early 1950s focused on organized crime's ties with gambling, including Nevada casinos.

New Jersey took a completely different approach. When it legalized casinos in the 1970s, it expressly stated that it did not want anyone with a background tainted in any

⁷ N.J.S.A. 5:12-84(c).

⁸ *In re Resorts Casino Application*, 10 N.J.A.R. 251 (CCC 1979).

way. Its theory was that training schools and foreign gaming jurisdictions would fulfill the industry's demand for skilled individuals. This proved to be correct.

Today, the children of these original Nevada licensees are sometimes now running the casinos in that state. Nevada regulators are thus not in a position to revoke gaming licenses simply because an individual's father allegedly had ties with organized crime. On the other hand, the state is still concerned with possible federal criminal investigations or developments in other states that would show Nevada does not adequately regulate its licensees.

Times may be changing. Macanese law was amended a few years ago to allow casinos to loan money directly to players. Hong Kong courts issued a ruling that allow Macau casinos to collect there.

But, until the PRC allows the enforcement of gambling debts through its legal system, and loosens its restrictions on the transportation of cash across its borders, the "junket" system will continue. And who the VIP gaming promoters are remains a problem. It is significant that not a single Macau VIP gaming promoter has been approved by the government of Singapore. The two casinos in Singapore do even more business than the largest casino in Macau. But Singapore requires disclosure of financial information and finger-printing of VIP gaming promoters, and it won't approve one of these junket operators until it is sure that the real owners of the VIP gaming promoter are actually who they say they are.

U.S. state and federal investigations are the most obvious danger for American casino companies doing business in Macau. But the other potential problem comes from the PRC itself. As a totalitarian government, the PRC is not overly concerned with legal niceties, like holding hearings before changing its rules. But its leaders do care about bad publicity, such as stories of government officials embezzling money and losing it in the casinos of Macau.

Nobody knows for sure why the PRC has occasionally put restrictions on travel from the Mainland to Macau. But when the PRC changed the rules for residents of the provinces nearest Macau from daily visits to only being able to enter Macau once every three months, the impact was immediate. I was teaching Gaming Law at the University of Macau. One of my students was in charge of the frequent visitors program for an American casino. When visa restrictions were imposed from Beijing, she lost her job, because there were no more frequent visitors.

There is a fear that other American companies will become reluctant to partner with casinos in Macau, and that investors will get scared off if there are more rounds of bad news. But the major threat and unknown question is whether the Beijing government will once again impose visa restrictions on mainlanders' visits to Macau. If the PRC closes the border it would be shooting itself in the foot. But the bullet would kill the casino industry in Macau.

END

I. NELSON ROSE

Professor I. Nelson Rose is a Full Professor with Tenure at Whittier Law School in Costa Mesa, California, and a Visiting Professor at the University of Macau. He is an internationally known scholar, author and public speaker, and is recognized as one of the world's leading experts on gaming law.

Prof. Rose is best known for his internationally syndicated column and 1986 landmark book, "GAMBLING AND THE LAW®." He is the co-author of INTERNET GAMING LAW (1st and 2nd editions), BLACKJACK AND THE LAW, the first casebook on the subject, GAMING LAW: CASES AND MATERIALS (LexisNexis), and the recently published GAMING LAW IN A NUTSHELL (West). Prof. Rose is co-editor-in-chief of the *Gaming Law Review & Economics*.

Harvard Law School educated, Prof. Rose is a consultant to governments and industry. He has testified as an expert witness in administrative, civil and criminal cases throughout the United States, in Australia and New Zealand, including the first NAFTA tribunal on gaming issues. Prof. Rose has acted as a consultant to major law firms, international corporations, licensed casinos, tribes and local, state and national governments, including the provinces of Ontario and Québec, the District of Columbia, the states of Arizona, California, Delaware, Florida, Illinois, Michigan, New Jersey, Texas, and the federal governments of Canada, Mexico and the United States.

With the rising interest in gambling throughout the world, Prof. Rose has addressed such diverse groups as the National Conference of State Legislatures, Congress of State Lotteries of Europe and the National Academy of Sciences. He has taught classes on gaming law to the F.B.I.; at universities in Spain, France, Slovenia and China; and as a Visiting Scholar for the University of Nevada-Reno's Institute for the Study of Gambling and Commercial Gaming. Prof. Rose has presented scholarly papers on gambling in Nevada, New Jersey, Puerto Rico, Canada, England, Australia, Antigua, Portugal, Italy, Argentina and the Czech Republic.

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PANEL II QUESTION AND ANSWER

CHAIRMAN REINSCH: Thank you. That gives us a lot of material to work with, and I appreciate the comments from all of you.

Commissioner Wessel, you're first on my list.

COMMISSIONER WESSEL: Thank you, gentlemen, and for all of your testimony, for appearing today, and all that you do.

And Mr. Burnett, I have to tell you that I am a fan of your work and what goes on in Las Vegas being, I don't want to say a frequent participant there, but I enjoy participating there, and certainly over the last years Las Vegas has really grown to be a family attraction. I brought my family there. So thank you for what you do.

MR. BURNETT: You're always welcome to come.

[Laughter.]

COMMISSIONER WESSEL: We'll talk later. Talk to my wife.

I left for you at your seats a chart that I had prepared because I'm a visual thinker, and this is so complex, it reminds me of a Rube Goldberg style equation. When I look at the interaction of the various players, those you regulate, Mr. Burnett, and the sub-entities, there's a lot that falls outside of your purview, and their sub-licensing, how they do the profit participants.

And so what may be happening at the top and the goodwill that Mr. Rose talked about in terms of the American gaming companies, your reach is severely limited because of the way these entities operate. And we heard earlier, we've heard from you, in your prepared testimony, a lot of articles we've looked at, and what you've each said about what goes on there. We know what's going on there.

We know there are triad relationships. It's been in the press. We know that there are enormous sums of money, \$38 billion in profits, \$100s of billions, if not more, in terms of actually that which is being gamed because of the house's take. It appears to me that there is so much slipping through the cracks. This is dirty money that's in the house, in an American house, an American casino operator.

They may not be the one operating the specific VIP rooms or be the junket financier, but it's happening under their roof. If we're aware of it, they're aware of it. How do we reach that? How do you with the state secrecy laws and all the various other things that we're all aware of with the limits in terms of books and records and getting at some of these subplayers--we know there is dirty activities going on, everyone does--what do we do about it?

MR. BURNETT: Thank you, Commissioner.

I'll try to answer your triad question first. You mentioned the triad activities, and as I believe the Commission is very expert in China, triads are--I hate to use the word "infiltrating," because that word has a negative connotation--but, as you know, there are triad activities that are bad. However, there are triad activities that are good.

There are a lot of philanthropy activities related to some of the triads. In fact, I see that you were on the board of directors for Goodyear Tire. If Goodyear Tire did business in China in any capacity, Goodyear Tire probably touched a triad-related organization, be it a laundromat, be it some philanthropy service, or be it an actual triad group that might be attempting to conduct some illegal activities. And that's the case in Macau.

There are triads in Macau. However, it would be my opinion that with the entrance of our Nevada gaming licensed operators, much of those triad activities have actually decreased in one fashion or another. This goes to the second part of your question, I believe, which is the VIP room operators and the junket promoters and how casino operations have been conducted, and I think there is a dichotomy right now that's going to become obvious and evident as time progresses.

Prior to the entrance of Nevada licensed gaming operators and other regulator operators from around the world, you had one monopolist, and that monopolist was SJM. And the way casino activities were conducted in the Far East, in that part of the world, was vastly different than how casino operations were conducted in the West, such as places like Nevada and many of your home states.

In Macau, the owner of the house, if you will, the licensed gaming establishment may receive a license to operate. However, there may be sub-concessions or sub-casinos that are operating in that same establishment, which is an interesting model.

But I think it's a model that developed over the years in Macau and Macau only. It is unique to Macau, and it was a function of the business at the time, and it was an evolved process that occurred over the course of 20 years.

COMMISSIONER WESSEL: But let me understand, if I can. So investors can purchase a stake in the profits of a junket over in Macau. If these people were subject to the licensing in Nevada, would they be able to operate in a similar fashion?

MR. BURNETT: The junkets?

COMMISSIONER WESSEL: Correct. Or in the profit pools, et cetera? Are they allowed to do that in the U.S.?

MR. BURNETT: I can't speak to the entire U.S. However--

COMMISSIONER WESSEL: In Nevada. Excuse me.

MR. BURNETT: --generally speaking, in the U.S. and in Nevada, no. If you were to participate in what we call GGR, gross gaming revenue, if you were to receive any percentage of the gross revenue from a gaming operation, you need to get a license. That's true in Nevada, and I think it's probably true throughout--

COMMISSIONER WESSEL: Doesn't that create a huge loophole then in terms of how the Macanese, the entities operating in Macau are operating their participants?

MR. BURNETT: Absolutely, and I think that's what Professor Rose testified to earlier as far as his skepticism of the Macau market when it

opened up, and whether Nevada would allow its licensees to enter into that jurisdiction. What is happening now, and this is the dichotomy I was referencing, what's happening now is essentially what I would call, and this is my own personal opinion, a westernization of the gaming element in Macau.

Our operators, Wynn, MGM, and Venetian, are all attempting to do their best to operate under Nevada standards because they know, as my testimony referenced, that what they do overseas or in any other state may affect their license in Nevada. We have had full transparency with those licensees as they have gone into that jurisdiction and worked to create a gaming climate that's compliant not only with our regulations, but what former Director Freis testified to on FinCEN requirements, IRS requirements, and the Macanese laws related to gambling and accounting for gambling games.

To sum up, you had the system where you did have the VIP rooms and the junket operators, and I think at present, the gaming economy in Macau is still largely dependent upon that system. However, the Nevada licensees are required to conduct due diligence with those VIP room operators because they're essentially what we would deem lessees, tenants to the gaming operation, and thus we require them through their gaming compliance programs to conduct due diligence on those entities.

Some of the entities that have more public triad affiliations, junket reps or VIP room operators, are not doing business with our Nevada licensees.

COMMISSIONER WESSEL: And I see my time is up, and I'll seek another round if there is one. Where you see transparency, I see more opacity. And because of the various levels that exist, we're talking, even in your VIP room there may be some insight, because of all the other levels, there's a whole threshold here which we're not dealing with in terms of what's going on.

Thank you.

MR. BURNETT: Sure, Commissioner, and if I can just touch on that briefly. My last visit to Macau was earlier this year, and I was escorted to some of the VIP rooms at all of our Nevada licensed properties. The Nevada licensees have staff in the VIP rooms that monitor the gaming activities. They also have an observation capability, where much like the eye in the sky at a Nevada licensed establishment, they are also able to observe what's going on in the VIP rooms, and there are, I should say, there is a very strong implementation of strict standards by our operators. I'm very pleased with the way that they're trying to make sure that there is no nefarious activity, at least with their own VIP operators.

COMMISSIONER WESSEL: Again, and I apologize, they may be able to have the eye in the sky to see what's happening at the table, but they don't get to see what's happening in people's pockets or with the flow of money.

Thank you.

CHAIRMAN REINSCH: Commissioner Tobin.

COMMISSIONER TOBIN: Thank you, Mr. Chairman.

Let me start with Mr. Burnett. What information sharing relationship, specifically, do you have with Macau? And then, are there occasions when due to the information sharing, when the Nevada Gaming Control Board rings up and connects with the FBI? And how often do you send them a name, and have you had instances where you've seen organized crime, not personally, but through your chain?

MR. BURNETT: Thank you, Commissioner.

I'll take your last question first, speaking strictly as a Nevada regulator who regulates casinos that do business in Macau. To date, we have not seen any organized crime occur with our Nevada gaming licensees.

To your first--

COMMISSIONER TOBIN: In the VIP rooms also?

MR. BURNETT: In the VIP rooms, yes, there are always allegations. There are always hints in the press of untoward activities. However, our licensees have a duty to report to us any issues that may arise, and we've got a continuous dialogue going on with them on those issues.

Your first question related to our relationship with Macau, our fellow regulators there are known as the DICJ, and in my last meeting in Macau, I sat down with my counterpart who is a Macanese individual. He is half Portuguese, half Chinese, and very proud of Macau.

They are attempting to work with us. They are reaching out to us. We have hosted them over the years, we have gone over there to work with them. Relationships in that part of Asia, as you know, are a very delicate thing, and it's something that we are working very hard at building. It is a slow process.

But I think that things are going well. In addition, I should note that Macau regulators are also being visited by other regulators around the world. I'll just give you a brief example. One of our sister jurisdictions is Singapore, which we have a very good relationship with, and Singapore has one of the licensees, the Las Vegas Sands, in its jurisdiction as in Macau. They have an equal interest.

So together, the three of us are attempting to sit down for tripartite talks, if you will, and begin the discussion to bring Macau into the regulatory fold.

To your second question, regarding federal agencies, we work with the FBI and the Department of Justice, FinCEN, all the time, and we do have an ongoing dialogue with them. I noted that one of the questions of the Commission earlier was in regards to enforcement of federal laws overseas, such as the Foreign Corrupt Practices Act. In Nevada, our policy is to watch those proceedings and watch to see whether our sister agencies in the federal government prosecute those, and, of course, we always have the option to prosecute a violation of the FCPA Act if one is found after that occurs.

COMMISSIONER TOBIN: And how regular or active is that? I mean I'm certain the monitoring is constant, but--

MR. BURNETT: Our discussions with federal agencies? Technically speaking, they probably occur every week in one form or another. My interaction directly with our federal counterparts probably occurs once or twice every week with any federal agency. However, we have 400 staff at the Gaming Control Board, and more than half of those are agents who do frequently travel to Macau and also travel to various other parts of the United States and the world in their investigations, and part and parcel of those conversations are always with state and federal authorities.

COMMISSIONER TOBIN: And for the other two gentlemen, I'll come back in the second round with questions. Mr. Burnett, if you could think, as you heard Commissioner Slane say before, we put together recommendations, and you mentioned you have limited resources there as you try to regulate. So think on what recommendations you wish would be made.

Thank you.

MR. BURNETT: Thank you, Commissioner.

CHAIRMAN REINSCH: Thank you.

Let me take a turn. I have a question for Mr. Burnett, but I'm going to give him a rest and ask the other witnesses a couple of questions, and then we'll come back to you.

Mr. Freis, can you give us some insight on how Chinese gamblers get their money out of China in the face of Chinese capital controls? We already established that there's substantial money that's evading Chinese controls. Can you tell us how they do it and how they get their money back into China, if they have any left after they gamble, and/or how they park the money overseas, which would include Hong Kong for this purpose?

MR. FREIS: Thank you, Mr. Chairman.

As has been mentioned a number of times, primarily we're talking about cash-based economies, and we're talking about an internal border that is not necessarily controlled in such a way that would prevent people from moving cash across those borders. So movement of cash is still very common and can be expected to be a primary way in which funds are moved in and out of Macau.

CHAIRMAN REINSCH: Sure, but hundreds of billions of dollars that's apparently being gambled, that's a lot of bags of money. I mean there must be other elements to this.

MR. FREIS: There are certainly other elements. I'll come back to another one in a second, but I think it is important to talk about it in the gaming context. Generally you have a fair bit, especially for high rollers, of gaming that is done on marker or on loan--essentially, on a line of credit, as we would understand it--and this is an aspect that is very well understood by the big institutions.

The casinos perform a type of due diligence on the credit-worthiness of their customers, because if they are essentially extending a loan/a line of credit to them while they're playing, the casinos will want to have the ability to recover those loans.

As Professor Rose said, it is problematic, in a way that is somewhat unique to the China situation, that gambling debts--if we consider them as a type of contractual debt that's occurred vis-a-vis the service provider, the casino, and the gambler in Macau--are not recognized and therefore not enforceable as a matter of law in China. So that leads casinos/junkets to look to extralegal means to try and enforce those debts. So that's part of the problem that we're discussing.

But it is important to think not just about physical cash moving for every transaction, certainly not in notional values of revenues of funds that are played.

The other aspect that I think is very important to understand globally in terms of money laundering movements across borders, which is nothing unique to the Macau or China situation, but is a vulnerability based on the nature of those economies, is what we refer to as trade-based money laundering.

Essentially, when you are involved in a situation of importing or exporting goods, the physical movement of goods has value. The physical movement of goods is disassociated from the payments for those goods, and it's very easy to manipulate the payments to have a result in value moving to one jurisdiction or staying in one jurisdiction.

To give you a more concrete example of this, if an importer in the United States is buying clothing produced in China (which, of course, is a huge economic business), I personally, as a layman, would not know if this shipping container worth of apparel coming in was designer apparel worth \$100 million or if it was T-shirts worth \$100,000.

But I could take the invoice corresponding to the shipment to my bank and initiate a payment of either of those amounts of funds. So if I wanted to get more money into China from outside of China, I could overpay the actual value of the shipment underlying the invoice. If I were trying to get Chinese value outside of China, I could ship goods out, make a nominal payment back to China, then sell those goods on the streets or in legitimate commerce here in the United States and then have the resulting excess value here in the United States. In each example I have been able to transport value across borders.

That trade-based money laundering mechanism is estimated to be the biggest way globally that value moves across borders. It certainly dwarfs in any way physical movement of cash.

CHAIRMAN REINSCH: Thank you.

That leaves me with more questions, but let's go on to Commissioner Shea.

VICE CHAIRMAN SHEA: Well, thank you all for testifying today.

I find the subject very interesting but also very confusing. Mr. Rose, did I hear you say, I thought I heard you say in your testimony, that there are two different systems, completely different gaming systems in Macau. You have the three Nevada-based licensed companies, and then you

have the legacy companies under the Stanley Ho umbrella. But did I hear you say that there is no VIP gaming promoters operating in the U.S.-based companies?

MR. ROSE: No. What I meant to say--I may have said it, but what I meant to say was that in practice, it's obviously not in writing, but in practice, there are two different systems. The Nevada regulators are going to be very careful about who they associate with. They have to do due diligence.

If they are found to be in business with anyone who is unsuitable, they could lose their Nevada license, and in fact they could end up losing their license to do gaming everywhere in the world.

VICE CHAIRMAN SHEA: Okay. So there are VIP gaming operations, sort of subtle sessions, in VIP baccarat VIP rooms in U.S.-based-

MR. ROSE: Yes. Of course.

VICE CHAIRMAN SHEA: In Macau?

MR. ROSE: Yes, and also the U.S. companies, probably the greatest risk here, it may be the VIP rooms, but it's probably the fact that they feel they have to deal with the junket operators to get people in.

VICE CHAIRMAN SHEA: Okay. Are these junket operators--so these rooms in the U.S. Just talk about the U.S.

MR. ROSE: Yeah.

VICE CHAIRMAN SHEA: They're run by, not by Sands or the Venetian or MGM, but by the junket operator, the VIP promoter; is that correct?

MR. ROSE: Well, I had always thought they were actually run by the U.S. companies, but they have agreements with a VIP operator who is also on site. Now from Chairman Burnett's testimony earlier, it sounded like I may have been wrong, that maybe, in fact, they actually are VIP operators.

VICE CHAIRMAN SHEA: Maybe Mr. Burnett could help. Are these rooms run by the Sands or are they run by, do they sub-licensee?

MR. BURNETT: Vice Chairman, one thing I do want to clarify, and I know there is no misunderstanding, but there are no VIP rooms in the United States or in Las Vegas.

VICE CHAIRMAN SHEA: No, I understand that.

MR. BURNETT: You're referring specifically--

VICE CHAIRMAN SHEA: Just in Macau. The U.S. casinos that are in Macau.

MR. BURNETT: Yes. Professor Rose is right. There are VIP rooms that are operated by others than the Nevada licensees. However, the Nevada licensees who house them, who lease the premises to them, have through their agreements with them due diligence procedures, abilities to observe, abilities to look at the cash inflow and outflow.

They have crafted their own regulatory capabilities with those operators. Does that answer your question?

VICE CHAIRMAN SHEA: Yeah, so what I heard you say is that

some folks, some of these VIP gaming promoters who are operating in the Macau legacy casinos, have been turned down potentially or are unacceptable to the U.S.-based companies; is that correct?

MR. BURNETT: Yes, Mr. Vice Chairman, and further to my previous testimony, I believe that there is a bit of a shift away from VIP room operators by the Western casinos because this goes to the historical activities of gaming in Macau.

You needed those VIP room operators or the junket promoters to help bring in high rollers, to help bring in players to the casino, and that's been the case. However, it's my theory, and this was especially evident to me after my last visit to Macau, that there will come a point where the Nevada operators, at least, may not need to utilize junket promoters to the extent that they are today.

VICE CHAIRMAN SHEA: So most of the players in some of those VIP rooms in the U.S.-based casinos operating in Macau are Chinese nationals; is that fair to say?

MR. BURNETT: Yes, absolutely.

VICE CHAIRMAN SHEA: And we have these capital controls of \$2,000 per day you can't take out of China, in RMB, you can't take \$50,000 a year out. Clearly, the stakes that are being wagered in those VIP rooms in the U.S. company based casinos are higher than those numbers.

I'm having a little trouble understanding. Someone is violating the Chinese law here. And to get that money into the U.S.-based casino, someone is violating Chinese law. And that then goes to the question of suitability. You have a suitability standard in Nevada, and U.S. companies cannot be interacting with unsuitable characters.

So if someone is violating Chinese capital controls, violating Chinese laws, and operating in your casino, does that raise a suitability issue?

MR. BURNETT: To answer your question directly, absolutely, it would. However, we have not seen any evidence of such a violation occurring. When you look at the Macau numbers, again, as I testified earlier, including the VIP rooms, but just the massive, if I can put it colloquially, the mass of humanity that is very, very close to Macau, they can't help but make that kind of money.

And indeed there would be something vastly wrong if they weren't making that kind of money. Even with the monetary restrictions and compliance with those monetary restrictions, they will be cash flowing a vast amount. What can slow that down would be visa restrictions by the People's Republic.

VICE CHAIRMAN SHEA: Okay. Thank you very much.

CHAIRMAN REINSCH: Commissioner Bartholomew.

COMMISSIONER BARTHOLOMEW: Thank you. I really appreciate all of you coming to testify as we try to get a handle on this.

I was heading down one path in my head, but now I have a separate set of questions. I think I want to start out with the statistic that

VIP room operators, again, which are essentially outside the regulatory framework, are responsible for 75 percent of Macau's gaming profits.

And Mr. Burnett, I think I just heard you say that the U.S.-based casinos may not need to utilize the junket operators and the VIP room over a period of time, but there's an awful lot of money at stake there, and a lot of money at stake there for the triads.

And I'm just wondering how the U.S. companies can disentangle themselves. What kind of leverage they have in a process where they would try to step away from doing that?

MR. BURNETT: Thank you, Madam Commissioner.

I'll answer that from my own personal experience as a gaming regulator for 15 years. This goes to the westernization of what's happening in Macau. Again, this is my opinion. This is what I see, and I'll just give two examples. When I first visited Macau, it was right after the first concession was granted to Galaxy and Las Vegas Sands.

The Sands was built, a very small casino that did not have a hotel. When you went into that casino floor, there was only baccarat, and it was a very serious, quiet, almost somber atmosphere because the Chinese mind-set regarding gambling is one of seriousness. I'm going to get one over on the house; I'm here to win. There's a lot of superstition, and it's a very serious atmosphere. It's not a party atmosphere or a fun type of enjoyable atmosphere where you bring your wife and kids, and there's shows, there's dinners to go to like you would find in Las Vegas.

My last visit was earlier this year. Those days that I just referenced are becoming a thing of the past. There's been an introduction of slot games and slot technology on to the casino floors that has reinvigorated the slot model, which was absolutely unheard of previous to the Nevada licensees entrance.

In addition, now when I return to casino facilities in Macau, they essentially mirror what you find in Las Vegas with the dining, the shows. Now, they're bringing in Western acts, Cirque du Soleil, things of this nature. It's changing the dynamic that occurred while gaming was operated by one monopolist into a competitive environment that is attracting multitudes from Asia.

One other item to note is there's a growing convention business in Macau. The convention business has been very helpful to the Las Vegas economy over the years, and the Las Vegas operators that are doing business there are attracting businesses not only from the People's Republic but from other parts of Asia to come and have conventions at their facilities. So I think that's the change that's occurring.

And, again, this is my own speculation, but there may come a time when the junket promoters aren't needed in the same context as they were previously.

COMMISSIONER BARTHOLOMEW: I guess one of the things I'm having trouble believing or thinking about is that the organized crime that is making an enormous amount of money out of these operations would

easily or willingly walk away from what has been a profit center for them. I'm finding myself wondering if as this westernization happens, if there's a westernization of organized crime tactics that take place?

Mr. Freis, I don't know if you have any observations or thoughts on that. I mean I don't think that they're going to sit still. I think they're going to figure out how to do business in another way, but I don't know. I'm not an expert on these things.

MR. FREIS: I don't have a specific view on that point as it relates to Macau, but anyone will tell you that criminals evolve very readily, and they certainly will look at the changing circumstances. It's always difficult for either regulators or law enforcement just to keep up with the criminals, much less get ahead of them.

COMMISSIONER BARTHOLOMEW: Mr. Rose, do you have anything you want to add?

MR. ROSE: Yes, actually, we do have a history that when Green Felt Jungle was written, which was like 1959, one of its premises was that literally every casino in Las Vegas was controlled by organized crime, with one or two exceptions. Part of the problem at that time was that no corporation could own a casino because you have to license every owner, which means every shareholder.

Howard Hughes came in during the 1960s, and at that time everybody thought he was a genius, and all the other hotel companies started wanting to get into Las Vegas. Nevada changed the laws, allowed legitimate financing by corporations, the reputation changed, so it wasn't just teamsters' money, it became banks. I think it would be pretty safe to say that there is no mob involvement with the ownership of the big casinos in Las Vegas now. So in other words, they were literally bought out. They were driven out.

What happened in Macau, in 2004, the Las Vegas Sands opened. Steve Wynn was building his casino at the time, and he told the Macanese government he would not open his casino unless they changed the law to allow casinos to directly lend money, and so they did. So the casinos want to be in this business. They don't want the VIP operators.

Up until about five years ago, the VIP operators actually got more profit from the players than the casinos did, and then the government put a cap on it, but it's still very large--it's like 40 percent of every dollar that is lost goes to the VIP operators. The casinos want to get rid of them. They want to be the VIP operators. So they need to be able to have the right to advertise in China. Collectability of gambling debts would help although they've done very well in the United States without gambling debts being collectable.

Probably the biggest hurdle is that the Chinese want to do business with people they know. So the VIP operators have agents and subagents in villages and in cities, and there the subagents are the ones who go out and go to the owner of a company and say, "I can arrange it for you, you want to gamble a million dollars? Just show up in Macau, my friend and I will give you the million dollars."

If the American operators can overcome that reluctance of the Chinese mainlanders who want to do business with people they know and start, and it seems to be happening this way in the acceptance of slot machines, the acceptance of banking, and credit cards seems to be developing on the mainland.

COMMISSIONER BARTHOLOMEW: Mr. Chairman, I have one observation, and then I'd have a second round. Mr. Rose, I hope you're right, I mean both of you, in terms of this concept of the westernization, but I would note that sort of comparison to western processes with things having to do with China has some pretty significant limits. It's not a country that's known for having a system of a rule of law, and it's not a country that's known for having a regulatory system that is easily non-corruptible. So I think we have to be careful as we watch all of this unfold because I have a tough time seeing Macau moving along a path that Las Vegas itself or that Nevada might have moved along.

Thanks, and I'll have other questions, Mr. Chairman.

CHAIRMAN REINSCH: I've got you down.

Commissioner Talent.

COMMISSIONER TALENT: Thank you, Mr. Chairman.

Mr. Burnett, just so I understand your personal theory, and I know you've said it was a theory, is it your view that as time goes on, gaming in Macau, that more and more of it will go over to the American casinos? Or is it your theory--I shouldn't say American--the Nevada licensed, or is it your view that the non-Nevada-licensed casinos are going to have to start operating more like the Nevada-licensed casinos?

Do you see what I'm saying? I mean are those licensed under your jurisdiction going to get a bigger and bigger share of the business because they're operating in a way consumers like or are the others going to become more and more like yours, in your view?

MR. BURNETT: Thank you, Senator.

Yes, that would be my theory. I feel that some of the legacy casinos that are still operating in Macau are having a tough time struggling to keep up with how the Nevada operators are doing business.

The Nevada operator model will have shows, dining that is unmatched around that region of Asia. I see new shopping locations. None of these items are present in some of the major legacy casinos. However, I think that they're under construction, and they're trying to compete in that regard.

I also see, and this is interesting, when I was first in Macau, I saw mainly mainlanders in my opinion coming in from Zhuhai, working class Chinese citizens coming in with probably a small amount of money, coming in and daytripping, and maybe doing that multiple times.

Now, I see the nouveau riche from China coming down from the mainland, perhaps places like Shanghai. Young people who obviously have made a lot of money, who are walking around with Versace and Gucci shopping bags and buying the suits and the clothes and returning back to

their home. It's becoming more of a tourist mecca.

I did want to follow up earlier. I don't want to give the impression that we as Nevada gaming regulators feel that everything is perfect and rosy in Macau. We have ongoing dialogue, almost daily, to ensure that whatever happens there, the risk is on them, as they know, and that there is no embarrassment to the state.

So going to Commissioner Bartholomew's last point, it's not my testimony that things are perfectly beautiful and wonderful like they are perhaps in other places of the world, but we are working on it, and it is my testimony that we are working on it together with the industry.

COMMISSIONER TALENT: And one more thing. For those who are getting money out of China in violation of the currency regulations there, are they able then to patronize your licensed facilities? And, if so, I know you don't want to be part of that, but is some of that money ending up in your facilities or licensed facilities, and if so, how do they do it? And have you spotted any of that, any of your operators spotted any of that?

MR. BURNETT: Thank you, Senator.

Yes, some of the operators have spotted that. One of the terms that was referenced by my colleagues is KYC, "Know Your Customer," and there is a fairly hefty attempt by the Nevada operators to know their customer.

If they find that the person coming in is a PEP, under the Foreign Corrupt Practices Act, a politically exposed person, perhaps a general or a Politburo official or some person of a government capacity, they are to refuse business with that person, simply because there may be an embezzlement taking place from the state or an attempt to launder money throughout the casino.

It's interesting. When you're in Macau, and this is outside of the casino context, and this may occur in other places, other parts of Asia that politically exposed persons from China may go to, but there are watch shops or gold shops, for example, that we don't have any regulatory capability with, that a person can probably access easier and embezzle money, state-owned money, through those entities than they can a casino. But those businesses also do exist, and I believe they exist in other parts of Asia as well.

COMMISSIONER TALENT: Thank you.

MR. ROSE: May I answer that? I actually was making a list of ways, for the previous question, on how money gets out, and in my written comments I have more details on it. Probably the two most common ways are straight smuggling, and I have a story about the farmer who had \$50,000 in his socks, and the second way is the VIP rooms where they make the arrangement on the mainland, and then when they show up in Macau, they gamble and then they go back to the mainland.

So it's the VIP operator who's making the loans, but a couple of other ways that have developed fairly recently, there are stores in Zhuhai, which is the city right across the border, and whatever they pretend to be,

they're basically moneylenders. So you go there and say I want a million Hong Kong dollars, I'm going to Macau, and the operator in Zhuhai simply calls his friend--they don't even need to have paper records--to say, okay, this guy is coming in. He'll be here at this place at this time, deliver the money to him.

And maybe no cash actually goes across the borders. They simply reconcile their records.

One I saw, which I think could involve Nevada operators, are jewelry stores. One was actually on the floor of a casino, and I just stood there and watched, and a person probably pretending to buy a watch, signs with a credit card. He didn't buy a watch. He gets a wad of cash, and the transaction is recorded as buying expensive jewelry, therefore it's enforceable in China.

By the way, I asked an insider this, and I assumed that if the player had won, he would then take the money, go back to the jewelry store that's on the floor of the casino and have the credit card transaction ripped up. They don't do that because the lending of money is a factor here.

Lenders are lending sometimes at ten percent a month. So they don't want the player to pay it off real fast. They like being able to have usurious rates.

CHAIRMAN REINSCH: Okay. Commissioner Wessel.

COMMISSIONER WESSEL: Thank you.

Mr. Burnett, I want to dig a little deeper into one of your responses, and I take in good faith your comment about the question of triads although I--and I have been to favelas in Brazil where I've seen the poorest people in the country living in shacks, some made out of packing boxes, who are able to have some benefits because of the gangs that operate there, but I don't condone what the gangs do in terms of the prostitution, the money and everything else.

You said there are some good things that triads do. I think that's a question that needs deeper understanding from your views, but if I was seeking a gaming license in Nevada, and I owned a business with a known mafia boss, you know, a convicted mafia boss known to be continuing to engage in the kind of activities that the mob is involved in, would I be able to get a license in Nevada?

MR. BURNETT: What would your association be?

COMMISSIONER WESSEL: Business partners with that mafia boss.

MR. BURNETT: We would probably not be happy with that. We would explore that relationship. We would look to see what that individual did if that individual is, as you state, and I think that that would be very problematic from a licensing standpoint for yourself.

And let me flesh out my statement on the things triads do.

COMMISSIONER WESSEL: Please.

MR. BURNETT: The Asian triads, as you know, go back thousands of years. They are actually an offshoot of anti-government

movements that occurred. I'm by no means condoning triads in any fashion. They are very similar in their worst capacities to the U.S. mob that we work so hard to get rid of, especially in Las Vegas. They conduct illegal business, drug trafficking, money laundering, and my testimony is by no means to say that they are good.

What I meant to say is that in that part of Asia, and I think, as you know, having been there probably more times than I, is that if you step into a cab, or if you take a ferry, or if you go drop your clothes off at a laundry, you may be doing business with a triad. They may not be extorting money from you, they may not be enabling you to conduct a criminal enterprise, but I think that speaks to the opacity, as you put it earlier, as to what's going on in Macau.

It's very hard to discern when our licensees or any licensee is doing business with an individual or an entity, whether that is some criminal enterprise that's going on, or whether that person might be a member of the triad, which is, as I understand it, almost like being in some cases at the lowest, lowest levels, like being a member of the Elk's Club or the Elk's Lodge. That individual may not have any say or authority or conduct any illegal business, but they may be touching that triad in some fashion. That's what I meant by that.

COMMISSIONER WESSEL: And I understand your point although I see a difference. If I go and step into a cab, I have no reason to believe, nor am I doing due diligence, about the cab driver. I don't ask him for his resume and his legal documents and everything else.

We're talking with the junket promoters and all the various other entities of tens of billions of dollars, and it seems to me the duty of care for these casino operators is much different than me jumping into a cab.

And I understand there's sort of a hierarchy that they may look in their licensing at the first level, but they know that everything else is going on below that. They just don't want to say anything about it or do anything about it.

And again our involvement here is the U.S.-China Commission, and some of the largest players in China, in Macau, are U.S. gaming operators. And so the question is are they aiding and abetting these triads? Are they facilitating money laundering? And are they turning a blind eye to it?

And as a result, are we seeing a huge influx of dirty money into these U.S. companies that are publicly traded? Are their boards looking at this and wondering the same question you asked me earlier, whether a board that I may be involved in, I'm going to ask the question. Are they asking the questions? How deep can you go? You have limited resources. You're, as you talked about, all over the world, you have U.S. entities, Singapore, et cetera. What kind of support do you need? When are we going to stop turning a blind eye to what everyone says is happening?

Mr. Rose talked about the collection issue. There's a high suicide rate, it turns out, from what I've been told among those people who

own gambling debts. I don't know if that's suicide or provoked activities. It seems to me that there is something that we're not doing well enough. We need to look deeper. What tools do you need to do that? Do you have the resources? Do you need the help of the Feds so that we can get deeper into this?

MR. BURNETT: Thank you, Commissioner.

The state of Nevada's debt is about \$400 million right now, and we are trying to struggle our way out of that, absolutely. However, I am happy with the way that our Gaming Control Board can essentially monitor and work with our counterparts overseas, wherever they may be in the world. Would we benefit by anything that you might recommend? I think that's probably more for the entities that would be under your jurisdiction, such as FinCEN, such as the FBI, the DOJ, who we work with very closely.

I think, if I can at least sum up the way I think of things right now, if there was an event to occur, our licensees, the Nevada licensees are on strict notice that their license is up for essentially execution, which is, as Mr. Rose, Professor Rose, pointed out, the death penalty throughout the world because of the repercussive effects that that would have.

They are working hard to implement whatever they can and take whatever measures they can, and I think that your counterparts on the various boards of directors of those companies are very concerned, and, in fact, the individuals who run those companies, who I have spoken with personally, are also very concerned.

They are trying to mirror in each operation the compliance activities that they do in Las Vegas that I referenced earlier in my testimony regarding compliance programs. For example, where they conduct due diligence on not only the high risk, and I agree with you 100 percent, the risk with the triad association is at that VIP room and that junket room level, and that has caused us concern since Macau welcomed our licensees into the fold.

But their compliance programs are also attempting to touch those others that I guess I was alluding to when I mentioned that do "not so bad" criminal enterprises, such as conducting due diligence on the groundskeepers who cut the lawns in front of the hotels, who may in some fashion be connected in one way or another to an improper organization. They're working on doing that.

Our sensitivity at the Nevada Gaming Control Board level is to not offend the Macanese regulators, and it's a relationship that I think is taking us some time and is a slow one.

COMMISSIONER WESSEL: And I appreciate it. What I'm hearing today is I think we need to go deeper into this; we need to assist you. You have relationships to maintain. You have a huge job, and I appreciate all that you're doing.

But I'm not sure the companies are looking as deep as they need to in their operations, that the profits are driving their activities, and it's worth some stricter scrutiny.

CHAIRMAN REINSCH: Okay. We're running low on time. Let me urge Commissioners to keep their questions short, and let me urge the witnesses to keep the answers short so everybody who wants to have a second round will have an opportunity.

Commissioner Tobin.

COMMISSIONER TOBIN: Thank you.

Mr. Freis, I've heard that American casino operators maintain bank accounts in Asia, in most Asian countries, the purpose being to facilitate money transfers for gamblers when they come to say Las Vegas or Reno, and they send that money to their accounts in California. Do you know anything about this, and why don't they send it to Nevada?

MR. FREIS: Sorry. That might be a better question for Chairman Burnett, but there certainly are arrangements that casinos have made of which I'm aware in terms of collection of debts that they do through service companies. Sometimes, from my own personal experience, having bought a sandwich at a casino in Las Vegas, the credit card bill showed up as an entity that was based in California for billing purposes.

That could have been their corporate connection of that concessionaire who is not that casino itself. But there are some practices in terms of how things are billed in the gaming industry generally to avoid the impression that people are involved in gambling. That obviously can raise money laundering concerns because part of the whole money laundering framework is to get greater transparency into the flows of funds.

But more broadly in terms of casinos having bank accounts, again, banks watch those very closely in terms of the expected activity, knowing for what purpose transactions are being processed. It would not be out of the normal for patrons of a casino to transfer funds from their own bank account to a casino bank account, again, either to fund their gaming activity or to pay off a debt from that casino.

COMMISSIONER TOBIN: So are you saying it might be just for sheer image sake that they keep in, that they move it to California?

MR. FREIS: Yes, I'm told, but Professor Rose could talk more about some of that or historical practices that developed in terms of enforceability of gambling debts even in the United States.

COMMISSIONER TOBIN: Mr. Burnett or Professor Rose, do you have anything to say?

MR. ROSE: Well, I think it is important to understand that gambling debts are not collectable in the United States generally either. It's based from the Statute of Anne of 1710, which is part of the common law of every state of the United States, including in Nevada.

Nevada will, by statute, allow a casino to sue on a written marker that is in the form of a check. A player, for example, cannot sue a casino if a casino refuses to pay. They just have to go to a regulator and make the complaint.

There is a history here. I got a solicitation for a Caesars Palace credit card, and I read the fine print, and it said cannot be used at Caesars

Palace because it's a gambling debt. You could use it--so there probably are historical or other regulatory, maybe tax issues.

I did want to make a recommendation. I've looked at this, the collectability of gambling debts for a long time. The gambling industry is actually better than almost every other industry in terms of its actual collections even when technically they can't go to court, and that's mainly because the players want to be invited back. If they don't pay, they're blackballed.

So probably that's only a small part of the problem. I think the biggest part of the problem is the PRC's currency restrictions, and if I was going to urge the Commission to do anything, I would say, and I don't know how you do it, but to put pressure on that. That limit is so small, and whenever you have currency restrictions like that, it's going to cause all sorts of distortions. And we also know from prohibition when something is illegal but people want it, then criminals will fulfill that need. So they will find ways to get the money out of China.

COMMISSIONER TOBIN: And just one very brief question, Mr. Burnett, you mentioned that these companies are under a lot of pressure to do the right thing, the Nevada companies. Does their audit committee have to be Sarbanes-Oxley compliant, and does that touch this picture of the VIP rooms?

MR. BURNETT: Short answer, yes. However, if they're listed on the Hong Kong Exchange, arguably Sarbanes does not apply, and so technically I'm not sure of the answer to that question.

However, the companies have, at least in my understanding, have undertaken the same policies and procedures in their Asian operations over in Asia that they have here. So I would believe that the audit committees do get that information.

COMMISSIONER TOBIN: Okay, that's a key tool.

CHAIRMAN REINSCH: Thank you.

Let me take a turn. Mr. Burnett, what's the difference between how your board judges suitability and how your counterparts in Macau do?

MR. BURNETT: I would submit that the difference is vast. The way the sub-concessions were granted I think is the licensing regime. In other words, when Macau opened up, and they were going to add the concessions to the monopolist that was already there, they just received offers and tenders, and I believe that they did conduct some due diligence.

I'm not sure the extent of it or what type that was, and then they granted the concessions, and those concessionaires can then grant sub-concessions.

I can explain the Nevada process, but it is vastly different than that.

CHAIRMAN REINSCH: I think that's sufficient. Just let me take that a step further. May I also, or may we also, infer that there are differences in the way the two regulatory bodies conduct due diligence? Or what they expect the casino operators to conduct due diligence on?

MR. BURNETT: Yes, those differences are vast. However, in my communications with the DICJ, they're really at least seeming to try to make an attempt to understand how we do things in addition to our partners in Singapore, for example, and it looks like they're making some steps towards more of our model.

CHAIRMAN REINSCH: Mr. Freis, when you were at FinCEN, I can't ask you what concerns they have now, but I can ask you what concerns they had then. Were you concerned about Chinese gamblers in Las Vegas, or in Nevada generally, laundering their winnings or just moving ungambled cash into the United States economy?

MR. FREIS: That was not a major preoccupation of ours, and I can say in part that was due to the very good cooperation we had with Chairman Burnett--though, he was not yet chairman the last time he visited me in my office in his prior capacity, or the number of times that I've been out to visit his predecessors.

There is close cooperation. As he said, for issues--particularly in terms of corruption--proceeds are watched very closely. There are a lot of people coming who have an interest in the gaming industry and want to spend their funds, too.

The difficult issue is, again, trying to differentiate those who are using criminal proceeds. Regarding the aspect of actually laundering funds through casinos--meaning bringing in dirty funds and trying to get out something that looks like clean funds--there is a history of controls in Nevada under their previous framework before the application of federal money laundering laws.

After Congress passed the money laundering laws, basically they were applied first in all states except Nevada, because Nevada already had an arrangement it had worked out a number of years ago. In 2006, because the federal framework had matured, the Nevada entities were again subject to the federal frameworks under FinCEN's background.

But, for instance, some of the standards under the former Nevada Rule 6A were that if you wired funds in to a casino from a bank account, and if you had any funds left over after gambling, then the casino would wire the remaining funds back to that same bank account. If you walk in with \$20 bills, then after gambling when you cash in your remaining chips, you get \$20 bills back.

So there are a lot of controls in place so that you cannot effectively bring in cash and then wire out to a bank account in a different name. That's been prohibited, and that's a practice that, to my knowledge, the casinos still practice here.

CHAIRMAN REINSCH: Thank you.

This is for all three of you--my last question. In contrast to Mr. Rose's suggested recommendation of dealing with the capital transfer requirements, listening to all this, it seems to me that in terms of at least the involvement of organized crime, the critical factor may be the fact that you can't collect gambling debts in China.

If the Chinese were to change their law to permit using the legal system, such as it is in China, to collect gambling debts, wouldn't that have the effect of reducing the role of organized crime in China and reducing the way, changing the way that the VIP rooms operate, or am I missing something here?

MR. BURNETT: Mr. Chairman, I guess I can start, and this goes to Commissioner Wessel's earlier comments. I think the answer to that is yes, and I think that in terms of what, if Nevada needs anything or if the federal government needs anything, it's my thought as I sit here today, that the relationships that we have and the relationship that former Director Freis just spoke of is solid and intact and working very, very well.

I think the risk, if I can speak frankly, is China's. I know that they are trying to crack down on corruption and items that may bring disrepute to them, but that is one area that they could probably change that may reduce that risk.

CHAIRMAN REINSCH: Professor Rose.

MR. ROSE: I think it will over time make things better, but the Chinese like to deal with cash so they want a way to get the cash out. Also, they like, as I mentioned, the personal relationship. They don't know Steve Wynn. If Steve Wynn says I'm going to lend somebody a million dollars, I mean, so he can come and gamble, the Chinese mainlander is going to rather deal with somebody they know. That's the way the relationships are built.

I also have to say it would be very difficult for the United States to tell China to change its law on gambling debts when our law is that gambling debts are not collectable, and we have legal gambling in 48 of the 50 states. And then ours is based on a morality principle also, although it's from 1710. So I don't know how you could do that politically.

CHAIRMAN REINSCH: Okay. We're about out of time. We have two people that want to continue. Commissioner Bartholomew.

COMMISSIONER BARTHOLOMEW: Thanks very much.

CHAIRMAN REINSCH: And then Commissioner Shea.

COMMISSIONER BARTHOLOMEW: And again thanks to all of you. It's very enlightening.

Chairman Burnett, I've seen that there was a 2009 report done by the New Jersey Division of Gaming Enforcement that noted that your board wouldn't license Stanley Ho, largely because of his use of the triad-linked VIP room operators.

You've stated that some of the same Asian organized crime figures are still involved in the VIP rooms and the junket operations. Some Nevada-based casino operators utilize some of those same VIP operators. And in your testimony, you discussed, and we haven't talked about this at all, some fairly formidable obstacles limiting the board's ability to actually effectively monitor illegal activity and nefarious associations in Macau's gaming industry.

I know you've talked about the strong developing relationship that you have in the work that you're doing. But my question is has the

Board ever taken any action, be it disciplinary or preventative, against a Nevada-based casino's potentially unsuitable associations in Macau?

MR. BURNETT: Sorry, Madam Commissioner. No, we have not taken formal disciplinary action against a Nevada operator in Macau for anything that's occurred in Macau. However, I would say that they probably have suffered to some extent, because they have to pay our costs for the work that we do. The state doesn't come out of pocket for our agency. We frequently travel there to meet with our counterparts and to audit the operations that are ongoing in Macau.

So travel to China is not cheap, and we are routinely sending agents there now. That's probably the first time that's ever been said publicly by the chairman of the Gaming Control Board. However, the expenses are fairly large for those companies to comply with what we're doing.

COMMISSIONER BARTHOLOMEW: Do you guys have the authority to take preventative action against the casino, and have you ever done that?

MR. BURNETT: There is a statutory mechanism for doing that, and it's too long to explain here. It would be essentially what we would call a call forward to see if that relationship is suitable, but we do take preventative action everyday essentially in our dialogue with the casinos.

Again, our agents are speaking with their CEOs, CFOs, CTOs, COOs, compliance personnel, pretty much on a daily basis. In addition, we've got one agent that is assigned to monitor each company fulltime, as part of their regular job.

COMMISSIONER BARTHOLOMEW: Great. And I was just pleased to see in your testimony that you acknowledged the good cooperation you get from U.S. government agencies as you're doing all of this.

MR. BURNETT: It's excellent.

COMMISSIONER BARTHOLOMEW: Great. Thank you.

CHAIRMAN REINSCH: Thank you.

Commissioner Shea, the last word.

VICE CHAIRMAN SHEA: I'm going to ask some very specific questions. It's been a lively discussion. Question for Mr. Rose. Is it illegal in China to collect a gambling debt, or can you not get a judicial order enforcing the collection of a gambling debt?

MR. ROSE: It's actually an excellent question. China, like other countries, like Portugal, actually have two systems. They have a criminal system so you can get three years in prison if you are running gambling. At least you don't get the death penalty.

But if you are merely betting, if you're just a player in China, you can still be put in a labor camp for 14 days. That's not considered criminal. That's called administrative. That's their safety. And the gambling restrictions come right under the same as pornography.

It appears, as best I'm able to tell, that it is not a crime to lend money. It's simply that it's not enforceable.

VICE CHAIRMAN SHEA: So it's not illegal if I have a bet with someone for five bucks on a basketball game in China, and I win and you lose, and I say you owe me \$5, that's not illegal?

MR. ROSE: Yes, it is. It's the gambling part that will put you in a labor camp, a reeducation camp, for up to 14 days, but they don't consider that a crime.

VICE CHAIRMAN SHEA: Okay.

MR. ROSE: But the debt part, in other words, I think that the person who is promoting gambling in China is a crime. So the VIP gaming promoters possibly are violating that law.

VICE CHAIRMAN SHEA: That's what I'm going to ask next. So to extend the model, you say with the VIP, the main model with these VIP gaming promoters is they extend a line of credit to someone in China--right?

MR. ROSE: Yes.

VICE CHAIRMAN SHEA: --that could be tapped to do gambling in Macau, and then when they get back to China, they settle up with the individual; is that basically the model?

MR. ROSE: Yes.

VICE CHAIRMAN SHEA: Okay. Is that illegal in China, technically illegal in China?

MR. ROSE: It may or may not be. Because--

[Laughter.]

MR. ROSE: Well, you do have--again, we have the dual system of both criminal and then what they call administrative. So it may be simply a bad moral issue so you might end up in a labor camp for 14 days, but it's not technically a crime. Similar for advertising Macau casinos on the mainland. They are not allowed to do that.

If they do it, the ads are pulled, but nobody, nobody is talking about--that's not the same as running the gambling operation on the mainland.

VICE CHAIRMAN SHEA: Okay. But the fact is the business model of these VIP gaming promoters under Chinese law is murky at best.

MR. ROSE: Yes.

VICE CHAIRMAN SHEA: Okay. So I mean for me--you don't have to comment-- that raises questions of suitability. If you're engaged in a business, if you have licensing arrangements with people who are doing things that are murky under another--whose legal status is murky--that to me would raise a suitability issue.

MR. ROSE: It is undoubted--I would say that if the gaming promoter is careful, they're not going to be violating any mainland Chinese law. The same thing actually goes all over the world. South Carolina has a statute that says you can't advertise an activity that's illegal in South Carolina, so if a casino advertises in South Carolina, they could technically be violating that statute. So there is an enormous number of restrictions on gambling. First of all, it's not the same as somebody operating gambling on the mainland. That clearly is a crime.

If we're talking about promoting on the mainland an activity that is legal outside of the mainland, that's probably not a crime.

VICE CHAIRMAN SHEA: Yes.

MR. ROSE: And so I think we have to distinguish between those type of people and the ones that are connected with the mobs, that are lending money, running the rooms and using violence to collect.

One thing I do want to say before we end is that I go to Macau once or twice a year, and I've been teaching both at the University of Macau and Macau Polytechnic once, and since 2004, and the Macau government does care. It is moving in the direction of more and more regulations and reporting. It is susceptible to public relations pressure for bad stories appearing in the press.

Interestingly, what Chairman Burnett said is in one of the largest casinos, the Grand Waldo, more than half of the high roller rooms are closed. The small operators, the market is forcing change. But despite the fact that this is an enormous business, and there clearly are really bad guys who I don't think are associated with the American licensed operators, I don't want it all be dumped on the head of the Macau government. They are at least trying to move in the right direction.

VICE CHAIRMAN SHEA: Okay. Thank you very much.

COMMISSIONER WESSEL: Is there a possibility, just a clarification? Mr. Burnett, in response to Mr. Rose's comments on suitability, what was your view? I saw that you might agree in terms of that could raise suitability issues in response to Commissioner Shea's comment?

MR. BURNETT: Yes, absolutely.

COMMISSIONER WESSEL: Okay.

MR. BURNETT: You know there are bad individuals, and there are bad individuals. The Gaming Control Board, we're used to that, I guess I should say. I think in any context, the hammer of discipline would come down fast and swift if there was an issue that we became aware of.

COMMISSIONER WESSEL: Great. Thank you.

CHAIRMAN REINSCH: Thank you to all three. Your expertise and vast knowledge in the area is evident, and we're appreciative of all the information you've provided. We may have follow-up questions in writing, and we'd appreciate it if you would be so kind as to respond.

As you probably know, we conduct these hearings for ultimately producing an Annual Report to Congress with any recommendations. It may well be on an issue of us having to conduct further research because of how complicated the issue is. We may want to get back to you on a one-on-one basis for comments and advice prior to our work on the Annual Report, which will be in the fall. But that will be something we'll address later.

In the meantime, thank you very much for your testimony. We will now recess for lunch and reconvene at 1:00 o'clock with the panel on Hong Kong.

[Whereupon, at 12:11 p.m., the hearing recessed, to reconvene at 1:04 p.m., this same day.]

PANEL III INTRODUCTION BY VICE CHAIRMAN SHEA

VICE CHAIRMAN SHEA: Good afternoon, everyone. We'll now begin our third panel, which is on Hong Kong press freedom, universal suffrage, and police surveillance in Hong Kong.

We are very privileged to have two distinguished witnesses with us this afternoon.

First, we look forward to hearing from Dr. Sophie Richardson, who is China Director at Human Rights Watch. Dr. Richardson is the author of numerous articles on domestic Chinese political reform, democratization, human rights and issues related to Hong Kong.

She's a prolific testifier. She has testified before the European Parliament, the U.S. Senate, U.S. House of Representatives on the state of human rights in China. Dr. Richardson is a graduate of the University of Virginia, the Hopkins-Nanjing Program, and Oberlin College.

We also look forward to hearing from Ms. Madeline Earp, Research Analyst at Freedom House. Ms. Earp's research focuses on censorship and press rights in China. She has also testified before us in the past.

Prior to joining Freedom House, Ms. Earp worked at the Committee to Protect Journalists and Human Rights in China. She has a stellar educational background, received a master's degree in East Asian Studies from Harvard University and a bachelor's in English literature from Cambridge University in the UK, and has studied Mandarin Chinese in mainland China and Taiwan.

And before we go to Dr. Richardson, I just want to thank Paul Magnusson and Owen Haacke of the Commission staff for their fine work in putting together this hearing, and I just remind you that seven minutes is what we request so that we have plenty of time for questions.

Dr. Richardson.

**OPENING STATEMENT OF DR. SOPHIE RICHARDSON
CHINA DIRECTOR, HUMAN RIGHTS WATCH**

DR. RICHARDSON: Thank you very much for inviting us to join you here this afternoon.

Since its return to PRC sovereignty in 1997, Hong Kong has remained the only part of China with a robust and independent legal system, relatively strong protections on the freedom of expression, and limited but regular elections. But there have been some very worrying developments of late, including remarks by senior officials from Beijing suggesting that the central government would approve candidates for election to senior offices in Hong Kong via litmus tests for loyalty to the PRC and the Chinese Communist Party.

And there have been clumsy attempts to impose nationalist sentiment on Hong Kong's population through efforts such as a proposed "patriotic education" campaign in schools in which the government's version of recent history is presented without mention of human rights violations.

The proposal was withdrawn in the face of remarkable public opposition. That large numbers of Hong Kong residents continue to object to what are considered intrusions on Hong Kong's autonomy and rally in remarkable numbers to remember events like the Tiananmen massacre suggests that they take the exercise of their rights very seriously.

In recent years, we have focused on three key issues in Hong Kong: universal suffrage; press freedom; and the freedom of assembly. Because my esteemed panelist will be talking about press freedom, I'm going to focus on the other two issues.

With respect to universal suffrage, the International Covenant on Civil and Political Rights, which does continue to apply in Hong Kong, stipulates that elections be conducted on the basis of universal and equal suffrage, and that the vote of one elector should be equal to the vote of another.

Yet the processes of selecting Hong Kong's Chief Executive, Executive Council, and Legislative Council, or LegCo, do not meet these standards because these positions are not all elected through direct representation. Hong Kong's LegCo consists of 70 members, but not all members are elected equally. 35 members are directly elected through geographical constituencies in which members of the general population cast one vote.

Another 35 LegCo members are elected through functional constituencies in which people in certain professions are allowed to cast a vote in addition to their vote in their geographic constituency.

As there are far fewer electors in the functional constituencies, each of these votes can weigh far more heavily towards generating representatives in the functional constituencies. In 2012, the Hong Kong government introduced changes to the LegCo elections. Five seats were to be added to the LegCo through geographical constituencies and five to be

added through so-called "super seats" to enable the general population to cast a second vote in a functional constituency. But these changes are, in our view, largely cosmetic because they do not mitigate the underlying problem of unequal votes.

As important, although the central government in Beijing has stated via 2007 National People's Congress Standing Committee decision that there "may be" universal suffrage for Hong Kong's next Chief Executive election in 2017 and LegCo in 2020, neither the Hong Kong government nor the Chinese government has outlined clear plans on how universal suffrage might be instituted.

Currently, the Chief Executive is selected, not even really elected, by a 1,200 member body. Those people are largely chosen by the central government in Beijing. Although the Hong Kong government stated in 2012 that it will begin consultations on the electoral methods of the 2016 LegCo and the 2017 Chief Executive elections, the question of universal suffrage was conspicuously absent in the current Chief Executive's first policy address in January 2013.

The next watch point on the horizon really is October of this year when there will be another policy address, but signs suggest that there isn't clarity yet. We can come back to that more.

With respect to the freedom of assembly, which I think is actually probably the most interesting issue to watch in the next year, demonstrations and protests in Hong Kong are governed by the Public Order Ordinance. The Public Order Ordinance stipulates that organizers of public assemblies of more than 30 protesters have to notify the police seven days in advance and to receive a notice of no objection from the government before they can be held.

In 1995, after the passage of Hong Kong's Bill of Rights Ordinance, the Public Order Ordinance was revised to allow protests to take place without prior permission, and therefore in conformity with international law, which stipulates that permission be given only on very narrow public order circumstances.

Unfortunately, immediately after Hong Kong returned to Chinese control, the Provisional Legislative Council established by the PRC government again revised the ordinance and again instituted the regime of prior permission.

Recent reports suggest an increasing number of arrests and prosecutions against protesters. According to the Hong Kong organization Civil Human Rights Front, in 2011 alone, 444 protesters were arrested by the police, which surpassed the total number of protesters arrested since 1997.

According to police figures, out of those arrested, 44 were charged with unlawful assembly under the ordinance. The police argued that this is due to increased violent incidents during protests, but protesters allege that the government is using parts of the Public Order Ordinance, which includes vague standards such as whether at a given protest "a breach of the peace is likely to be caused" to punish and deter protesters.

Human Rights Watch is also concerned about the use of cameras and video recording devices by the Hong Kong police to film demonstrations with close-up shots of demonstrators even when there is no criminal behavior during the demonstrations, and even when protesters have explicitly told the police that they do not wish to be filmed.

Official surveillance is not only intrusive on privacy but can inhibit exercise of the right to assemble and associate publicly. They should have to be justified on a case-by-case basis in law by some threat to public safety or public order rather than imposed unilaterally on every gathering.

A number of individuals and organizations in Hong Kong have proposed that if meaningful democratic reforms are not made over the course of the coming year, they will hold nonviolent sit-ins in the heart of Hong Kong, the so-called "Occupy Central" campaign, in the summer of 2014. Government officials have already publicly stated that there will be no possibility that such gatherings will be lawful or peaceful, warning that the government would not tolerate it, and that it will "end in bloodshed."

Such rhetoric raises concerns that the authorities are trying to suppress plans for assembly because of the issue at stake rather than public order concerns. These statements also raise concern as to whether the police are being primed to use force in inappropriate ways. Human rights standards, both local and international, require that the authorities use force only when necessary for the maintenance of public order and in a degree strictly proportional to the threat posed to public safety and order.

Overall, Hong Kong does continue to enjoy the rule of law and a high level of press freedom, but the lack of universal suffrage, reports of government interference, and self-censorship of the press, increasing numbers of arrests and prosecutions against protesters, as well as surveillance of protesters, are issues that pose serious threats to Hong Kong's citizens' enjoyment of their civil and political rights.

Thank you.

**PREPARED STATEMENT OF DR. SOPHIE RICHARDSON
CHINA DIRECTOR, HUMAN RIGHTS WATCH**



June 27, 2013
Sophie Richardson
China Director, Human Rights Watch

**Testimony before the U.S. – China Economic and Security Review Commission
“Hearing on Hong Kong and Macao”**

Human Rights Watch appreciates the opportunity to testify at this timely discussion on the status of human rights in Hong Kong.

Since its return to People’s Republic of China (PRC) sovereignty in 1997, Hong Kong has remained the only part of the PRC with a robust and independent legal system, relatively strong protections on the freedom of expression, and limited but regular elections. The status of human rights in Hong Kong matters not just for the people of Hong Kong but for China.

Yet there have been some worrying developments of late, including remarks by senior officials from Beijing suggesting that it would identify candidates for election to senior offices in Hong Kong via a litmus test for loyalty to the People’s Republic of China and the Chinese Communist Party. And there have been clumsy attempts to impose nationalist sentiment on Hong Kong’s population through efforts such as proposed “patriotic education” campaigns in schools, in which the Chinese government’s version of recent history is presented without mention of human rights violations; the proposal was withdrawn in the face of widespread public opposition. That large numbers of Hong Kong residents continue to object to what are considered intrusions on HK’s autonomy, and to rally to remember events like the Tiananmen Square Massacre, suggests that they take the exercise of their rights very seriously.

In recent years, Human Rights Watch has focused on three key human rights issues in Hong Kong: universal suffrage, freedom of assembly, and press freedom. Because my fellow panelist will address issues around press freedom, I will focus on the first two topics.

Universal suffrage. The International Covenant on Civil and Political Rights (ICCPR), which continues to apply in Hong Kong, stipulates that elections be conducted on the basis of “universal and equal suffrage” and that “the vote of one elector should be equal to the vote of another.” Yet the processes of selecting Hong Kong’s Chief Executive, Executive Council, and Legislative Council (LegCo) do not meet these standards because these positions are not all

elected through direct representation. And an important step forward for political rights in Hong Kong — the means of electing the chief executive — continues to hang in the balance.

Hong Kong's Legislative Council consists of 70 members, but not all members are elected equally. 35 members are directly elected through geographical constituencies, in which members of the general population cast one vote. Another 35 LegCo members are elected through "functional constituencies," in which people in certain professions are allowed to cast a vote in addition to their vote in their geographic constituency. As there are far fewer electors in functional constituencies, each of these votes can weigh far more heavily towards generating representatives in these functional constituencies. In 2012, the Hong Kong government introduced changes to the LegCo elections: five seats were to be added to the LegCo through geographical constituencies and five more to be added through "super seats" to enable the general population to cast a second vote in a functional constituency. But these changes do not mitigate the underlying problem of unequal votes.

Equally important, although the central government in Beijing has stated via a 2007 National People's Congress Standing Committee decision that there "may be" universal suffrage for Hong Kong's next chief executive election in 2017 and LegCo in 2020, neither the Hong Kong nor Chinese governments have outlined clear plans on how universal suffrage might be instituted. Although the Hong Kong government stated in 2012 that it will begin consultations on the electoral methods of the 2016 LegCo and 2017 Chief Executive elections, the question of universal suffrage was conspicuously absent in the current Chief Executive's first policy address in January 2013.

Human Rights Watch has urged the Hong Kong government to ensure that the new electoral methods developed for 2016, 2017, and beyond are in compliance with international standards on political participation.

Freedom of assembly. Demonstrations and protests in Hong Kong are governed by the Public Order Ordinance, which stipulates that organizers of public assemblies of more than 30 protestors have to both notify the police seven days in advance and receive a "notice of no objection" from the government before they can be held. In 1995 after the passage of Hong Kong's Bill of Rights Ordinance, the Public Order Ordinance was revised to allow protests to take place without prior permission; only organizers of assemblies of more than 50 protestors need to notify the government a week in advance. However, immediately after Hong Kong returned to Chinese control, the Provisional Legislative Council established by the PRC government again revised the ordinance, and again instituted the regime of prior permission. International law does not require prior permission except in very narrow public order circumstances.

Recent reports also suggest an increasing number of arrests of and prosecutions against protestors. According to the Hong Kong organization Civil Human Rights Front, in just one year in 2011, 444 protestors were arrested by the police, which surpassed the total number of protestors arrested since 1997 (314 protestors were arrested in this period). According to police figures, 45 out of the 444 arrested were charged with "unlawful assembly" under the Ordinance. The police argued that this is due to increased violent incidents during protests, but protestors

allege that the government is using parts of the Public Order Ordinance, which includes vague standards such as whether at a given protest “a breach of the peace is likely to be caused,” to punish and deter protestors.

Human Rights Watch is also concerned with the use of cameras and video-recording devices by the Hong Kong police to film demonstrations, with close-up shots of demonstrators, even when there is no criminal behavior during demonstrations and even when protestors have explicitly told the police that they do not wish to be filmed. Official surveillance is not only intrusive on privacy, but can inhibit exercise of the right to assemble and associate publicly, and should have to be justified on a case-by-case basis in law by some threat to public safety or public order, rather than imposed on every gathering.

A number of individuals and organizations in Hong Kong have proposed that if meaningful democratic reforms are not made over the course of the coming year, they will hold nonviolent sit-ins in the heart of Hong Kong—the “Occupy Central” campaign—in the summer of 2014. Government officials have already publicly stated that there “will be no possibility” that such a gathering would be “lawful or peaceful,” warning that the government would not tolerate it, and that it would “end in bloodshed.” Such rhetoric raises concerns that the authorities are trying to suppress plans for assembly because of the issue at stake rather than public order concerns. These statements also raise concern as to whether the police force is being primed to use force in inappropriate ways. Human rights standards, both local and international, require that the authorities use force only when necessary for the maintenance of public order and in degree strictly proportional to the threat posed to public safety and order.

Hong Kong authorities should be questioned about their views on possible reactions to “Occupy Central,” and on police surveillance practices in light of the right to freedom of assembly and association. In addition, Human Rights Watch urges the Hong Kong government to revise the Public Order Ordinance to ensure that the Ordinance is in accordance with provisions of the International Covenant on Civil and Political Rights and Hong Kong’s Bill of Rights Ordinance.

Overall, Hong Kong continues to enjoy the rule of law and a high level of press freedom, but the lack of universal suffrage, reports of government interference and self-censorship of the press, increasing number of arrests and prosecutions against protestors as well as surveillance of protestors, are issues that pose serious threats to Hong Kong citizens’ enjoyment of their civil and political rights.

**OPENING STATEMENT OF MS. MADELINE EARP
RESEARCH ANALYST, FREEDOM HOUSE**

MS. EARP: Thank you for inviting me to testify on press freedom in Hong Kong as part of today's hearing.

I am a researcher with Freedom House's annual Freedom on the Net report. So my focus is on Internet and digital media freedom in China and the rest of Asia. My comments today draw on three Freedom House resources: the 2013 Freedom of the Press report on Hong Kong specifically, which is appended with my written testimony; the China Media Bulletin, which is a biweekly news digest; and the upcoming China country chapter for the Freedom on the Net report, 2013, which includes Hong Kong, and of which I am the author.

Freedom of expression is protected by law in Hong Kong, but political and economic pressures are threatening the media's ability to sustain their traditionally lively criticism of the local government and the Central Communist Party leadership in China. A poll by the Hong Kong Journalists Association last year found that 87 percent of journalists believe press freedom had eroded during the seven-year tenure of Chief Executive Donald Tsang, who stepped down in 2012.

In particular, Beijing's Liaison Office continues to exert a negative influence on press freedom. The Office's past interventions in Hong Kong generally involve mainland political issues, but, in 2012, it played a uniquely aggressive role in the run-up to the Chief Executive election, effectively ordering news outlets to support the eventual winner, Chief Executive Leung. Local officials, business interests, and criminal groups have also tried to restrict coverage of Hong Kong - specific issues in the past two years.

Freedom House data reflects this increasingly difficult environment for the press, showing Hong Kong's press freedom in a gradual decline over several years. The Freedom of the Press index assesses print, broadcast and Internet freedom in 197 countries and territories. It produces numerical scores and overall rating of free, partly free or not free.

Hong Kong started out as free in 2005, with a score of 29 out of the worst-possible 100, but it has slipped in subsequent years and is ranked as only partly free since 2009. The score dropped a further two points in the latest report from 33 to 35.

That decline reflects two main trends. The first is physical and technical attacks against reporters, Web sites and media entities. In one example, a vocal citizen-journalism platform, In Media, was raided by four masked men who trashed computers in their offices last August. This April the same Web site was forced temporarily offline by a malicious cyber attack shortly after it reported on a strike by Hong Kong dockworkers.

Earlier this month, the owner of iSun Affairs magazine was beaten up in the street one day before the anniversary of the 1989 Tiananmen massacre. The magazine is known for reporting on issues that are politically

sensitive, and it did say that the attack was related to its coverage although it's not clear whether it was motivated by the timing of the sensitive anniversary or by a critical article that it had published on the Hong Kong leadership.

Just yesterday, the Journalists Association reported that three people associated with the Next Media Group have been attacked in the past week, including the owner, Jimmy Lai. Police are investigating these incidents though some journalists do question their commitment.

The second trend behind the score decline involves local government restrictions on access to information. Tightened security surrounding the Legislative Council makes it much harder for journalists to interact with lawmakers than it has been in the past. Reporters note that government press conferences are held less often, they're either replaced by formal statements or by ad hoc off-the-record briefings that make productive questioning and engagement much more challenging.

The Hong Kong Journalists Association in the same poll found that more journalists expressed concern about this issue than about self-censorship, which has been the primary press freedom concern since China resumed sovereignty. That is not to say that self-censorship is less prevalent.

In particular, after a former employee of the mainland's state-run China Daily newspaper was appointed as the chief editor at Hong Kong's South China Morning Post in January 2012, staffers accused him of downplaying stories that might defend Beijing and refusing to renew the contract of a veteran human rights journalist. These are really troubling signs of caution at such an influential news outlet.

I'll end on a more positive note. Despite these developments, journalists and activists in Hong Kong are still free of the overt and systematic censorship found in the rest of China, and they're still much better able to withstand pressure than their colleagues on the mainland.

In one recent success with major implications for economic transparency, they petitioned against a January 2013 legislative proposal to restrict information about corporate directors, the kind of data used by the New York Times and Bloomberg to trace the family assets of top Communist Party leaders in last year's high-profile exposes.

So while the Financial Services and Treasury Bureau is still rewriting Hong Kong's Companies Ordinance, it has agreed to cut the proposed restriction following the public outcry. Achievements like this one help explain why Freedom House ranks Hong Kong 71st in the world for media freedom. China, on the other hand, is among the worst aggressors in 179th place.

Maintaining this critical measure of independence even as political and economic ties with the mainland continue to strengthen is the biggest challenge now facing Hong Kong's press.

Thank you.

**PREPARED STATEMENT OF MS. MADELINE EARP
RESEARCH ANALYST, FREEDOM HOUSE**

**Testimony before the U.S.-China Economic and Security Review Commission
Hearing on Macau and Hong Kong
June 27, 2013**

**Madeline Earp
Research Analyst, Freedom House**

Thank you for inviting me to testify on press freedom in Hong Kong as part of today's hearing. I am a researcher with Freedom House's annual *Freedom on the Net* report, where I focus on internet and digital media freedom in China and the rest of Asia. My comments today draw on three Freedom House resources: the 2013 *Freedom of the Press* report on Hong Kong, which covers the calendar year 2012 and is appended in full at the end of my written testimony; the *China Media Bulletin*, a biweekly news digest; and the upcoming China country chapter for the 2013 *Freedom on the Net* report, of which I am the author.

While freedom of expression is protected by law in Hong Kong, political and economic pressures are threatening the media's ability to sustain their traditionally lively criticism of the local government and the central Communist Party leadership. A poll by the Hong Kong Journalists Association found that 87 percent of journalists believed press freedom had eroded during the seven-year tenure of Chief Executive Donald Tsang, who stepped down in 2012. In particular, Beijing's Liaison Office continues to exert a negative influence on press freedom in the territory. Whereas its past media interventions in Hong Kong generally involved mainland political issues, the office played a uniquely aggressive role in the run-up to the chief executive election last year, effectively ordering news outlets to support the eventual winner, Leung Chun-ying. Local officials, business interests, and criminal groups have also tried to restrict coverage of Hong Kong-specific issues in the past two years.

Reflecting this increasingly difficult environment, Freedom House data show Hong Kong's press freedom in a gradual decline. Our annual *Freedom of the Press* index assesses print, broadcast, and internet freedom in 197 countries and territories, producing numerical scores and an overall rating of Free, Partly Free, or Not Free. While the index rated Hong Kong as Free in 2005, with a score of 29 out of worst-possible 100, it slipped in subsequent years, and has ranked as only Partly Free since the 2009 edition. The score dropped a further two points in the latest report, from 33 to 35.

That decline reflected two main trends. The first is physical and technical attacks against reporters, websites, and media entities. A vocal citizen-journalism platform, In Media, was raided by four masked men who destroyed computers last August; this April, a malicious cyberattack forced the same site temporarily offline, shortly after it reported on a strike by Hong Kong dockworkers. Earlier this month, the owner of *iSun Affairs* magazine was beaten up in the street one day before the anniversary of the 1989 Tiananmen Square massacre. The magazine, known for reporting on issues that are considered politically sensitive in mainland China, said

the attack was related to its coverage, although it is not clear whether it was motivated by the sensitive anniversary or by its critical articles on the Hong Kong leadership. Police are investigating these incidents, though some journalists question their commitment.

The second trend behind the score decline involves local government restrictions on access to information. Tightened security surrounding the Legislative Council makes it much harder for journalists to interact with lawmakers than it was in the past. Reporters also note that government press conferences are held less often, replaced by formal statements or ad hoc, off-the-record briefings that minimize journalists' chances of productively engaging officials. The Hong Kong Journalists Association found that more journalists expressed concern about this narrowing access in 2012 than about self-censorship, which had been the primary press freedom concern since China resumed sovereignty. That is not to say that self-censorship is less prevalent. After a former employee of the mainland's state-run *China Daily* newspaper was appointed as editor in chief at Hong Kong's *South China Morning Post* in January 2012, staffers accused him of downplaying stories that might offend Beijing and refusing to renew the contract of a veteran human rights journalist—troubling signs of caution at such an influential outlet.

Despite these developments, journalists and activists in Hong Kong are still free of the overt and systematic censorship found in the rest of China, and they are much better able to withstand pressure than their counterparts on the mainland. In one recent success, they petitioned against a January 2013 legislative proposal to restrict information about corporate directors, the kind of data used by the *New York Times* and Bloomberg to trace the family assets of top Communist Party leaders in high-profile exposés last year. While the Financial Services and Treasury Bureau is still rewriting Hong Kong's Companies Ordinance, it agreed to cut the proposed restriction following the public outcry. Achievements like this one help explain why Freedom House ranks Hong Kong 71st in the world for media freedom, while China is among the worst aggressors in 179th place. Maintaining this critical measure of independence even as political and economic ties with the mainland continue to strengthen is the biggest challenge now facing Hong Kong's press.

Freedom of the Press 2013

Hong Kong

Status: Partly Free

Legal Environment: 11

Political Environment: 15

Economic Environment: 9

Total Score: 35

Survey Edition	2008	2009	2010	2011	2012
Total Score	30	33	33	32	33
Status	Free	Partly Free	Partly Free	Partly Free	Partly Free

Freedom of expression is protected by law, and Hong Kong media remain lively in their criticism

of the territory's government and to a lesser extent the Chinese central government. However, political and economic pressures have narrowed the space for free expression. According to a poll published in June 2012 by the Hong Kong Journalists Association (HKJA), 87 percent of the journalists surveyed believed that press freedom had eroded during the seven-year tenure of Chief Executive Donald Tsang, who stepped down in July. Over the course of the year, growing government restrictions on access to information, violent attacks on the offices of two media entities, and heightened intrusiveness by Beijing's Liaison Office further threatened press freedom in the territory.

Under Article 27 of the Basic Law, Hong Kong residents enjoy freedoms of speech, press, and publication, and these rights are generally upheld by the territory's independent courts. However, they risk being undermined by the power of the National People's Congress (NPC), China's rubber-stamp parliament, to make final interpretations of the Basic Law; Chinese surveillance in the territory; and the mainland economic interests of local media owners. Hong Kong has no freedom of information law. An administrative code is intended to ensure open access to government information, but official adherence is inconsistent, prompting local journalists and watchdog groups to urge the government to give freedom of information requirements the force of law. A number of legislative items proposed by the Hong Kong government during 2012 could threaten free expression, though none had passed by year's end. The HKJA expressed concern that proposed antistalking legislation could be used to limit reporters' movements by classifying legitimate journalistic activity as stalking. Critics also argued that draft amendments to the Copyright Ordinance could be used to penalize political parodies, including those circulated online.

Press freedom advocates continue to question the selective application of the Broadcasting Ordinance and the constitutionality of existing procedures for granting licenses to new media outlets. Decisions to grant or refuse licenses are made by the executive branch rather than an independent body. To date, only two broadcast companies, Television Broadcasts Limited (TVB) and Asia Television Limited (ATV), have licenses to compete in the free-to-air television market. The lack of competition has led to doubt about the diversity of news coverage and unfair advantages in attracting advertising. In early 2012, the government appeared ready to issue more free-to-air television licenses. No new licenses had been issued by year's end, although three prospective broadcasters had received initial approval from the Broadcasting Authority. Some observers speculated that the delay stemmed from the Chinese central government's hesitation to expand public access to new stations beyond its control. The prodemocracy station Citizens' Radio, having operated for years without a license, has faced repeated raids and prosecutions on charges of illegal broadcasting. The activists who run the outlet argue that the prosecutions are illegitimate because the licensing procedure is unconstitutional. A magistrate dismissed charges against the station on those grounds in January, but an appellate court reversed the ruling in April. The activists planned a final appeal, and the station continued broadcasting during the year. Separately, in November, five lawmakers from Hong Kong's Democratic Party won a final appeal against their conviction for speaking on the radio station. The defendants had each been fined HK\$1,000 (US\$129) in 2009 for participating in a 2008 Citizens' Radio forum. In a case that raised questions about Chinese journalists' ability to work in the territory, the Hong Kong immigration department continued to delay a 2011 work visa application by outspoken mainland journalist Zhang Ping (pen name Chang Ping), who had been hired as editor of the online magazine *iSun Affairs*. Observers reported that replies are typically obtained within four weeks.

In recent years, Beijing's efforts to influence the news, publishing, and film industries have increased. This trend intensified in 2012, particularly in the run-up to the chief executive election in March, during which the central government shifted its support from candidate Henry Tang to the eventual winner, Leung Chun-ying, prompting an unusual split in the pro-China camp. Press freedom groups reported that staff from the Liaison Office of the Central People's Government, mainland China's representative agency in Hong Kong, contacted newspaper publishers, owners, and even editors by telephone or in person to castigate them for articles that were critical of Leung or pressure them to report favorably on the office itself. In most cases, the targeted outlets appeared to stave off the pressure, at least in the immediate term. However, in what was perceived as a serious infringement on press freedom, *Sing Pao* altered an opinion column by commentator Johnny Lau that had rejected both Tang and Leung, reframing it as a virtual endorsement of Leung. Although the paper's chief editor initially apologized, it later discontinued Lau's column after he submitted a piece about the death of prominent U.S.-based Chinese democracy advocate Fang Lizhi. These incidents represented a change from the past, when the targets of Chinese pressure were primarily voices and topics perceived as politically sensitive on the mainland, rather than related to internal Hong Kong politics. In April and May 2012, the newly elected Leung sent four letters to the *Hong Kong Economic Journal* and *Apple Daily*, complaining about their critical reporting. In a positive development, however, he signed a pledge presented to him by the HKJA, promising to defend press freedom and not enact laws banning treason, sedition, and other such offenses—as called for in Article 23 of the Basic Law—without first reaching public consensus.

Media self-censorship continues to pose a serious threat to free expression. Among the respondents to the June 2012 HKJA survey, nearly 36 percent admitted to self-censorship, citing the following practices in order of most to least common: downplaying information unfavorable to conglomerates that wield strong influence over advertising, downplaying information unfavorable to the central government, downplaying information detrimental to the media owners or their interests, slanting news in favor of a chief executive candidate, and downplaying information unfavorable to the Hong Kong government or slanting news in its favor. Some self-censorship stems from the close relationship between local media owners and the central government. Several owners sit on the Chinese People's Political Consultative Conference (CPPCC), an advisory body that has little real influence over government policy but is used by China's ruling Communist Party to co-opt powerful members of society. A number of Hong Kong media owners are also current or former members of the NPC, and many have significant business interests in mainland China. The appointment of editors with ties to China has also prompted accusations of self-censorship, even in otherwise well-respected outlets. In January 2012, Wang Xiangwei, a mainlander who had once worked for the state-run *China Daily*, was hired as chief editor of the influential English-language *South China Morning Post*. Controversy surrounded Wang after he reportedly downplayed an article on the suspicious death of mainland activist Li Wangyang, prompting a backlash from senior staff, and discontinued the contract of award-winning journalist Paul Mooney, who had been responsible for many of the paper's hardest-hitting stories on human rights violations in China.

The Hong Kong government has tightened control over journalists' access to information in recent years. Indeed, in the HKJA survey, an overwhelming majority of journalists said this had contributed to a decline in press freedom. Over the past two years, officials have increasingly shifted to off-the-record briefings to announce policies and released official footage for news events rather than opening them to the press. In addition, the police and fire

departments have released less detailed and timely information about newsworthy incidents. One example of withheld information that provoked particular criticism in 2012 was the government's concealment of a trip to Beijing by the education minister at the height of a controversy over a proposed national education curriculum. Separately, after the Legislative Council moved to a new complex in 2011, the government issued new security rules that restricted journalists' ability to interact with lawmakers; these regulations remained in place throughout 2012.

Violence against journalists is rare in Hong Kong. However, several attacks against journalists and their property occurred in 2012. In August, four masked men entered the offices of the citizen journalism and commentary website In-Media, destroying computers and other equipment. The Sing Tao media group suffered two attacks: a stolen car rammed into its headquarters in Shau Kei Wan in August, and in September men wielding axes attacked the company's offices in southern Kowloon. The motives remained unclear, though organized crime involvement was suspected in the Sing Tao attacks. On December 30, at a pro-Hong Kong government rally, several participants attacked two journalists, leading to minor injuries. One of the perpetrators was arrested and later fined based on video footage of the assault. During a visit by Chinese president Hu Jintao in June, a journalist from *Apple Daily* was briefly detained after yelling out a question regarding the 1989 Tiananmen Square massacre. Although restrictions on media access were more stringent than during past visits by Hu, they were not as heavy-handed as those imposed during Vice Premier Li Keqiang's trip in 2011, which had sparked a large public outcry.

Online media are sometimes disrupted by attackers with apparent political motives. Two days before the chief executive election in March 2012, administrators of an online election poll organized by Hong Kong University reported that the website was brought down by a massive denial-of-service attack. The poll aimed to gauge the general public's opinion of the candidates, as only the 1,200 members of an elite electoral committee are able to participate in the official vote.

Hong Kong journalists face restrictions and intimidation when covering events on the mainland, limiting their ability to provide national news to the local population. Chinese authorities require journalists to obtain temporary press cards from the Liaison Office in Hong Kong prior to each reporting visit to the mainland, and to obtain the prior consent of interviewees. Even with accreditation, journalists from the territory have repeatedly been subjected to surveillance, threats, beatings, and occasional jailing when reporting on the mainland. In September 2012, Felix Wong Chi-keung of the *South China Morning Post* sustained severe bruises to his face and legs after police in Shenzhen beat him as he tried to photograph anti-Japanese protesters, despite the fact that he identified himself as a journalist.

Hong Kong's media are outspoken. There is a high degree of professionalism, and political debate is vigorous. Dozens of daily newspapers are published in Chinese and English, and residents have access to satellite television and international radio broadcasts from services like the British Broadcasting Corporation. Radio Television Hong Kong (RTHK) operates as an independent department in the government and earns high public-approval ratings for its critical coverage of the authorities. After rejecting proposals to turn RTHK into an independent public broadcaster in 2009, the government issued a new charter in 2011 that redefined its mission to include promotion of the official "one country, two systems" policy on Hong Kong's autonomy within China, among other changes. Also that year, Roy Tang Yun-kwong, previously the deputy secretary of the Labour and Welfare Bureau, was appointed as the new director of broadcasting.

The choice marked the first time since the 1930s that an outside civil servant was “parachuted in” to lead RTHK; directors were typically appointed from within the station. Some feared this could threaten the station’s editorial independence. RTHK was also criticized in November 2011 for discontinuing the contracts of two popular current affairs talk-show hosts. Such criticism eased somewhat in 2012 after the station introduced a new television program, *Face to Face*, featuring a young host who aggressively questioned government representatives. Publications known for their criticism of the Chinese central government, such as *Apple Daily* and the *Epoch Times*, have reported difficulties in attracting advertisers in recent years because of fears among private business owners that the association would damage their economic interests on the mainland.

There are no restrictions on internet access in Hong Kong. The territory has one of the highest internet usage rates in Asia, with nearly 75 percent of the population accessing the medium during 2012.

PANEL III QUESTION AND ANSWER

VICE CHAIRMAN SHEA: Thank you very much, Ms. Earp. I will start with the first question, and it's going to be very high level, and maybe a little bit unfair, but we are the U.S.-China Economic and Security Review Commission. You're both human rights activists. I think that's a fair description of both of you.

Explain to me how promoting human rights in the U.S.-China relationship furthers the economic and security interests of the United States.

DR. RICHARDSON: Let me give you my favorite recent example of how human rights are not simply a boutique issue for the State Department. I think it is difficult to find any issue in the bilateral relationship, whether it's economic, whether it's security, diplomacy, that doesn't somehow fundamentally rest on the free flow of information, a functioning independent judicial system in China, and/or the ability of people inside China to express their views freely.

If you want better product safety, the Chinese press has to be able to write on scandals, on tainted formula. If you want better commercial relations, you need a legal system that operates according to precedent rather than Party whims.

The case that's mesmerized me lately involves audits, which I have never in my life cared about. I don't understand what the SEC does all day, however, the SEC has grappled of late with a very complicated issue that had threatened to halt the work of the Big Four U.S. auditing firms in dealings with their Chinese subsidiaries. It was because the Chinese subsidiaries were refusing to open their books to the kind of review that's necessary in order to remain in compliance with the law here.

What law, what grounds were the Chinese companies and Chinese subsidiaries resorting to in making this claim? It was the state secrets laws; the same law that so often is used to silence dissidents or to prosecute people the government wants simply to shut up was all of a sudden proving to be a challenge for the Big Four auditing firms.

I think there are many examples of where what's often perceived to be our world versus your world intersect. There's a lot of room to suggest that many parts of the U.S. government have a stake in better human rights protections in China. I think they don't want to talk about it because they think it's uniquely complicated or catchy, but there is just as much in it for them as there is frankly for human rights activists in China.

VICE CHAIRMAN SHEA: Thank you.

Ms. Earp.

MS. EARP: I would absolutely echo that, and I would return to the example that I closed with in my testimony. When the New York Times and Bloomberg published these really startling exposes about the financial assets of Wen Jiabao and Xi Jinping, there were repercussions in mainland China. Their Web sites were blocked. Bloomberg reported that sales of its

terminal service, so not its news site, but what makes it financially viable as a source of economic information, reported that sales at that terminal service had declined in China, possibly in a reflection of the pressure from authorities trying to squeeze them out in punishment for this report.

The proposal in Hong Kong to try and remove identifying data about corporate directors from the public domain was a very direct attempt to extend that kind of restriction into Hong Kong, which is obviously an essential economic center worldwide. So the fact that Hong Kong was able to withstand this attempt is really critical and that is right now the difference between what we see on the mainland, what the mainland would like to see in Hong Kong, and what Hong Kong is just about clinging on to for the benefit of the U.S. and anyone else who has a stake in economic transparency.

VICE CHAIRMAN SHEA: I have 34 seconds. When President Obama and Xi Jinping met, what was your take from a human rights perspective? Was there anything that came out of that discussion that you felt was favorable or were you disappointed about it?

DR. RICHARDSON: I wish I was in a position to give you a very clear answer to that. I mean obviously it was not meant to be an interaction that was about specific deliverables in the way that you would expect of the Strategic and Economic Dialogue, for example.

At the same time, I do think it was yet another, and it's getting to be a long list, of missed opportunity for the administration to put down markers about either specific human rights issues or an intention to talk to a much broader Chinese audience. We are talking after all about a government that is manifestly not representative, and at a time when there is an increasing amount of contention inside China, and I think the administration's failure to acknowledge that audience and talk more directly to it continues to be short-sighted.

VICE CHAIRMAN SHEA: Thank you.

I'm going to go over to Commissioner Wessel.

COMMISSIONER WESSEL: Thank you both for being here, and I think Chairman Shea was asking a broad policy issue when he has been a great advocate for human rights. So he was waiting for your answer, not that he didn't share the views, which is why in part we're doing this hearing here today.

I'd like to follow up on what Commissioner Shea was asking, in part, about President Obama and the attitude towards human rights because some of us grew up on Capitol Hill in the old days of Wei Jingsheng and Harry Wu and all the well-known democracy activists. It appears that in past years, that our economic interests, cybersecurity has pushed human rights aside, if you will, in terms of being near the top of our policy agenda, and there may be a lot of missed opportunities.

What do you think Congress could be doing better? What could the administration be doing better to promote these American ideals which I agree are connected to our economic interests as well?

MS. EARP: I would like to see more specific support of individual cases. There are a number of groups, both ours and others, that are vetting these cases and assessing which ones we believe deserve support.

They're, as Dr. Richardson mentioned, representative of the larger community in China so by naming one case and asking for specific deliverables in one case, whether it be someone who is imprisoned or someone who has been driven into exile, someone who has been otherwise harassed, that signals to a much broader constituency that the U.S. supports their activities.

I appreciate that it's a challenge because as soon as you mention one individual, then that in some ways invites contentious debate about whether that was the right case or whether that was an appropriate level of engagement. But I think it's been much too easy to, as you say, put these cases below the economic interests because everyone can generally agree on some economic steps forward. Whereas the individuals who are suffering as a result of human rights abuses, that tends to result in a kind of stonewall. I think that we have to keep raising those cases.

COMMISSIONER WESSEL: I haven't been on the Hill for some time, but there was always prior to any of the codels, any of the delegations going over, discussion with the human rights communities and often letters brought over, et cetera.

Has that level of interaction stayed the same, gone down, gone up? Are people reaching out to you in Congress to have those discussions?

MS. EARP: I would say my impression is that people have been relying on this phrase, "oh, we'll raise it, you know, behind closed doors," rather than providing the media or human rights groups with specific examples that they can then follow up on and say, well, according to this discussion that you had on this date, you said you would do this. That's the kind of detail that really helps.

Dr. Richardson may have more.

DR. RICHARDSON: To answer the question that you just raised a moment ago, no, it doesn't happen the way it used to in certain times. I mean there is a very stalwart set of members of Congress who are utterly devoted to this issue for which we are extremely grateful. But they are few in number.

To try to answer the broader question, the first Obama administration very early on planted a flag saying that they would take a whole-of-government approach to human rights promotion. Maybe I misunderstood what they meant by that because I don't see it.

I see actually a less-of-government approach. I see an inter-agency process that is not what it could be, especially for human rights issues. Look, I don't see a clear expectation from the President, from the leaders of the House and the Senate, the leaders of both parties, that every single Cabinet member, every single committee head, every single member of Congress not only will go to China or will meet with Chinese officials armed with at least one human rights talking point, but that they will be expected to

report back on how that discussion went.

The number of times people say to me, oh, we raised it, we talked about that, you know, I would be a rich woman if I had a nickel for every time somebody said that to me. But when you asked for details, when you asked them to talk about that publicly, when you asked them to follow up, it gets to be a very much less clear, tangible conversation.

COMMISSIONER WESSEL: Thank you.

VICE CHAIRMAN SHEA: Commissioner Tobin.

COMMISSIONER TOBIN: Thank you.

I was going to ask what your thoughts are concerning how we as a Commission can best highlight the issues, but I think you've addressed that in your response to Commissioner Wessel.

What you were talking about, Dr. Richardson, is that there needs to be an accountability mechanism from the executive branch. Would that be a fair statement?

DR. RICHARDSON: Roughly, yes.

COMMISSIONER TOBIN: Okay. And would there be material from the scoring process you discussed? Could you both imagine a framework where we could say these are the issues, integrate them, and then have accountability?

DR. RICHARDSON: Off the top of my head, that could be anything, including asking for briefings from Cabinet Secretaries who have been to Beijing recently to ask them what human rights issues they raised. Such as, what did Secretary Lew raise when he was there? Even Secretary Kerry made a few passing comments at the end of his visit, but wasn't quite as clear as one might have liked, and, frankly, it's not the State Department I'm especially concerned about. That's a sort of accessible institution. It's others.

But I think creating an expectation, whether it's through regular hearings, whether it's the party leadership calling members in and asking what's been done, simply, I think creating the expectation is half the battle and reporting back is the other piece of it.

COMMISSIONER TOBIN: And does your organization provide the data downward to the Cabinet agencies?

DR. RICHARDSON: Both of our organizations produce huge amounts of research material that is all in the public domain. On the occasions when I have tried taking that material out to sort of the "unusual suspects," meaning taking information about press freedom, for example, to the Department of Agriculture to say your issues and this issue are related--I don't mean to single out the Department of Agriculture, this is a hypothetical--the reaction tends to be that's an issue for the State Department. They're the ones who deal with human rights, not us. This is not really salient to our portfolio, and there's usually a sense of real discomfort in being asked to take up a human rights issue as opposed to something that's perceived as being much more or much less touchy or problematic.

COMMISSIONER TOBIN: And, yet, as you're both saying, if it became commonplace, then it does create the repetitive pressure. I think we can use what you've just shared. At least I'll have it in mind as we do prepare the report. And I have other questions, but I'll wait for the next round.

Thank you.

VICE CHAIRMAN SHEA: Commissioner Slane.

COMMISSIONER SLANE: Thank you to both of you taking the time to come here. We really appreciate it.

MS. EARP, you talked about the deterioration of the freedom of the press, and do you see that as a trend? Do you see that as the Chinese Communist Party incrementally tightening the noose?

MS. EARP: Do I see it as a trend? Yes. Do I see it as all coming from the Communist Party? Not necessarily. I think the situation has become incrementally more complex. The fact that we see local officials and local actors trying to restrict press freedom on issues that are only relevant in Hong Kong and do not have an immediate impact on the mainland is a sign that the Communist Party's example may be causing other actors to seek to control the press, but it's not all coming directly from them.

I would say they are the principal aggressor in this case. It's the Beijing Liaison Office. The fact that these other local institutions and individuals are observing that, taking on some of those practices, is actually making the effects even worse than it would be otherwise if it was all related to what was happening on the mainland.

COMMISSIONER SLANE: Commissioner Bartholomew and I think Commissioner Shea have on occasion met with some politicians in Hong Kong, and my sense is that the despair is pretty palpable in terms of the situation getting worse. Would you agree with that Vice Chairman Shea?

VICE CHAIRMAN SHEA: You're right. We've met with various figures within the pan-democratic movement in Hong Kong, and I kind of would agree with you, Dan, that a little bit, certainly beleaguered, but I would be curious from the panelists what your assessment of the state of the democratic element in Hong Kong is--the political element? How are they doing?

MS. EARP: I would say beleaguered is not necessarily a bad thing when it results in the kinds of civic actions that we still see in Hong Kong on a very regular, almost surprising basis. That is a sign to me that however assailed they feel, they still have resources that are the hallmarks of a democratic society to fight back. Whether they'll continue to be able to do so at the level that they now can is really the question that we're all grappling with.

DR. RICHARDSON: I agree entirely. I think the only point I would add to that is especially with the decision about whether there will be steps towards universal suffrage in 2017. I mean this is arguably the hardest deadline we've come up against since 1997, and I do think it's causing a certain amount of anxiety, not just for politicians themselves but across the

population as a whole. People are very engaged on this issue, but I also think that has often been the case in the past, there's plenty of room for the U.S. and others to signal support and make clear an expectation that there will be universal suffrage.

There used to be much more frequent discussions about Hong Kong, and it's fallen a bit off the radar, and I think the kind of attention that even doing a session like this brings to those issues helps to some extent with that sense of beleaguerment. It's within your grasp to help relieve that a bit.

VICE CHAIRMAN SHEA: Commissioner Bartholomew.

COMMISSIONER BARTHOLOMEW: Thank you very much.

Commissioner Tobin, I can talk to you, and I'm sure our witnesses will be able to talk to you, about the many ways that they actually do have a very active presence, advocacy presence, working with people on Capitol Hill. I think one of the challenges is to both come up with tools that members can employ and also just trying to get members to pay attention at a time when there are so many other demands. So I'd be pleased to talk to you more.

Mr. Chairman, you mentioned that these two witnesses are old hands. I also would acknowledge that they are black hands. But thank you both for coming to testify.

I am going to get back to Hong Kong. I've been concerned for a number of years about what I see as the long arm of Chinese censorship here in the United States, and it's a much shorter arm for Beijing to be trying to influence what's going on in Hong Kong, and the creeping Chinese influence, which we're all concerned about.

There's been anecdotal evidence over the course of the past couple of years that there are people from the mainland going to Hong Kong to participate in things like the June 4th gathering, that people have the June 4th assembly, so I wonder, is that a trend that's growing? Are people from the mainland indeed going to Hong Kong to be able to voice their own concerns about some of the things that are going on?

MS. EARP: I would say it's hard to assess whether it's growing, but certainly among the sort of very engaged dissident communities, especially in southern China. It's a very sort of porous border. There's a lot of exchange both digitally and physically between those two spheres, and I've certainly met with dozens of mainland Chinese activists in Hong Kong, as sort of a matter of course, that they're going all the time, I'm going, and then that's where we sort of meet in the middle, as it were.

So Hong Kong definitely has a very positive role to play there, and I don't see it declining as of right now. I think that's why it can be easy to, as Dr. Richardson suggested, forget that Hong Kong still needs a lot of attention because it's so easy for us to compare it to China and think, well, Hong Kong, you know, it's doing okay. And it is doing okay, but it's in a very vulnerable position.

DR. RICHARDSON: I would just add to that that even on the

occasion of Chen Guangcheng's visit to the Taiwanese Parliament a few days ago, which created a certain amount of attention and discussion on the Chinese blogosphere and twittersphere, that there were some very evocative comments made essentially saying there are opportunities for democratic rule in Hong Kong and Taiwan; clearly they're not incompatible with Chinese culture; why don't we get to enjoy those rights ourselves?

So I couldn't give you an exact figure of the numbers or even the kinds of people who are crossing the border to participate. But I do think there is quite a real sense of comparison and of what people on the mainland don't get access to.

COMMISSIONER BARTHOLOMEW: And there have been some interesting articles lately about people from the mainland and the publications that they are buying when they come to Hong Kong. Which raises to me an interesting question about why the Chinese government is tolerating this in Hong Kong, and a second piece that would go along with that is what leverage do the people of Hong Kong have in order to be able to maintain the openness that is currently in Hong Kong?

MS. EARP: I think they're tolerating it in part because they have to. It would just be too challenging to launch the kind of crackdown that would require closing off those avenues of information. When it comes to sort of black market publications, for example, that are getting into China from Hong Kong, I don't see Chinese officials really that concerned about that in terms of the bigger picture.

In some ways, it even kind of fits in with China's information model, which is not to keep everything out, but just to keep what's kind of a dissenting viewpoint at a manageable level.

In terms of resources the people in Hong Kong have, what I see them having is this ability to assemble that is missing on the mainland. That's why Dr. Richardson's assessment is so significant because if that is something that is potentially going to be eroded, then I think they're left with much fewer options.

DR. RICHARDSON: I think the changes that Beijing may have attempted to effect in Hong Kong, the ones that have been moderately successful, and I don't use that term in the normative sense--they're not a good thing--have been done extremely gradually, very quietly. I think when they really overstep with things like the proposed patriotic education program in the schools, and there's such a remarkable push back from the Hong Kong population, it's a reminder that there are limitations.

COMMISSIONER BARTHOLOMEW: This statement that Chinese, that Hong Kong officials have made about Occupy Central campaign ending in bloodshed is really very chilling. I mean that would change the character and the nature of everything that we're talking about. I'm having a tough time believing that somebody in Hong Kong would say that on his or her own without getting some sort of signal or guidance from Beijing.

DR. RICHARDSON: It's hard to know some of these comments

ultimate providence, but certainly for a place that's had a police presence and police practices that have generally been very transparent, very consistent, very much in keeping with international law, even just a rhetorical shift I think is quite jarring to people. For a population that embraces regularly the freedom of assembly, the idea that restrictions would be put on this particular gathering in response to a failure to make progress on democratic reforms, I think, is one of the big issues to watch in the coming year.

COMMISSIONER BARTHOLOMEW: Dr. Richardson, as you were talking about this prior permission regime, I just found myself thinking about the protests that sprung up recently when Edward Snowden was taking refuge there. Do you have any idea if anybody got prior permission for those protests?

DR. RICHARDSON: I've asked my colleagues to look into that. I don't have a clear answer to that, but I would be happy to come back to you.

COMMISSIONER BARTHOLOMEW: And would your presumption be if there was no prior permission, that this would not have happened without the government allowing it to happen?

DR. RICHARDSON: Unclear.

COMMISSIONER BARTHOLOMEW: Okay. Thank you.

VICE CHAIRMAN SHEA: Commissioner Talent.

COMMISSIONER TALENT: I have a question, Ms. Earp. You referred to this before, but maybe you could clarify, or Dr. Richardson. One of the things we know that the mainland government is concerned about is their legitimacy with their own people, and that is a constraint on the crackdowns there although, unfortunately, not enough of a one.

So how do the people on the mainland feel about liberties in Hong Kong? In other words, how would they respond if there were a sudden crackdown on the right of assembly in Hong Kong? Would it engender a response on the mainland? Would they not care? Is it someplace in between?

MS. EARP: It would be deeply shocking to the kinds of people who are engaged on political issues in China, certainly because of the role that Hong Kong currently plays as a sort of haven.

I think for the rest of the population, it's a little harder to assess how strongly they feel about Hong Kong and how much they even know about what's different in Hong Kong.

In some ways, there's a lot of interchange just in terms of popular culture between Hong Kong and the rest of China, and there is a lot of sort of awareness of how Hong Kong operates. In other ways, for people in China who are not politically engaged, who may see Hong Kong as posing a challenge to central authorities in the same way that they view sort of other outlying administrative regions or provinces as somehow challenging sort of Chinese nationalism, there may not be the kind of support from those people if Hong Kong were to suffer in that way.

DR. RICHARDSON: I can't improve on that.

COMMISSIONER TALENT: Thank you, Mr. Chairman.

VICE CHAIRMAN SHEA: A question about Article 45, the Universal Suffrage Provision of the Basic Law, and as I read it in the briefing book or the excerpt, it reminded me of Iran a little bit.

It says here that the ultimate aim is the selection of the Chief Executive by universal suffrage upon nomination by a broadly representative nominating committee in accordance with democratic procedures.

So what I see as one potential outcome is what you have in Iran, where you have three or four candidates who are acceptable, broadly acceptable, to the Ayatollahs, and then you put them up for universal suffrage. Am I right to be a little bit concerned about that, or is that where you think this might head if the Chinese authorities move forward with providing universal suffrage?

DR. RICHARDSON: I can't speak to the Iran part of the question, but the principle certainly makes sense. Look, this is the concern about, first of all, the current process since clearly the way the group of people who currently elect the Chief Executive essentially function, they are chosen for their perceived political loyalty to then amongst themselves choose the Chief Executive.

And to the extent that strategies for a nominating committee have been articulated, and this is all still quite murky. It leaves open precisely that question that will the nominators themselves be so easily controlled that the only people who are allowed to stand are effectively preselected vetted candidates who are acceptable to Beijing. Recent remarks by senior Chinese officials have suggested that that would be the case, that these decisions will be made on the basis of people's sense of patriotism and nationalism, and by that, they don't mean being patriotic Chinese people or lovers of Chinese culture. They mean fealty to the Chinese Communist Party.

MS. EARP: I would just add as a point of comparison to that, when I study the way that the word "democracy" is censored in China, those controls were relaxed in 2005 around the same time that a government white paper began defining democracy as the Chinese Communist Party ruling on behalf of the people. So I think that's an interesting point of comparison.

VICE CHAIRMAN SHEA: Two questions. If the process unfolded this way, where you had sort of a rigged system, where you had people put up for election who are precleared and then put up for universal suffrage, what would be the reaction within the Hong Kong population to that kind of process? Can you speculate about that?

And, secondly, what can the United States do? I mean you mentioned, Dr. Richardson, that we ought to be saying this is a hard deadline, this is something the international community expects to happen. What can the United States do to ensure that an election occurs in 2017 that meets, broadly speaking, democratic standards?

DR. RICHARDSON: Well, quickly, on the second point, I think simply stating that expectation, that this time period between 1997 and 2017,

that the United States' expectation has been over that time, there would be a move progressively towards universal suffrage, not leaving it until the very last minute without a clear plan to go forward. The expectation is that those elections will take place in conformity with international standards.

VICE CHAIRMAN SHEA: And the United States has not made that clear to date?

DR. RICHARDSON: It does periodically. I mean that is the U.S.' position, but it's one that I think now tends to get articulated only as a reactive matter, not as a proactive one, and I think this is a really good time to be proactive. We needn't get into all the details of the process, but essentially it is such that between October and January, the Chief Executive is expected to give another policy address in which this issue specifically will be addressed.

And that was why there was so much concern when it was not addressed in the one January of this year. So that's one answer. I mean it's very difficult, I think, to speculate about the future, but I think the broad expectation amongst people in Hong Kong is that governance there will become progressively more democratic.

And if you go back and read some of the press, for example, around the establishment of these super seats, which were meant clearly to sort of soften some of the opposition to retaining certain kinds of constituencies that had limited participation, logically, you might think give people more seats, give people more opportunities to participate, and their frustration over the other issues will lessen. I don't think it necessarily had that effect at all.

I think the addition of those seats was seen as a ploy, as sort of a way of lowering expectations, of giving people something else as opposed to actual progress towards fully universal suffrage.

MS. EARP: And just to--

VICE CHAIRMAN SHEA: About my first question--my first question, do you have?

MS. EARP: Yeah, just to very briefly address the potential reaction in Hong Kong. A lot of extremely engaged journalists, engaged political observers in Hong Kong, would not take this lying down, but this is one of the reasons why I'm particularly concerned to note the role of the Beijing Liaison Office in the run-up to the Chief Executive elections. They had examples where, for example, a commentator wrote an article basically saying that neither candidate was really all that hot, and when it came out in print, it had been sort of edited to lean towards the candidate who eventually won.

And so it's not quite clear whether that was at the newspaper level, whether that was the Liaison Office calling it in. What you're seeing is these people who would object are potentially having their voices manipulated or otherwise restricted so that that message would not be heard by the broader population.

VICE CHAIRMAN SHEA: Thank you.

Commissioner Wessel.

COMMISSIONER WESSEL: Thank you.

Over sometime we have been periodically looking at the Confucius Institutes here in the United States which have been on the rise. I'd be interested in your thoughts, if any, about the role of those Institutes, and what the curriculum might or might not be with regard to the Hong Kong issues?

Do you have any idea whether, as part of that curriculum and teachings, the problems in Hong Kong are being raised, and the risks and opportunities that might arise?

MS. EARP: I actually don't, but I would be very interested to look into that further.

COMMISSIONER WESSEL: Okay. If you hear anything, please let us know.

MS. EARP: Yes.

COMMISSIONER WESSEL: Dr. Richardson?

DR. RICHARDSON: I can't speak to the specifics about the curriculum. I haven't looked at all the Confucius Institutes and other Chinese government funded programs systematically. I think it seems clear that some of them are highly problematic and clearly come with fairly shocking expectations about what will be taught and how. Some of them strike me as being completely unproblematic, and we're in a time when funding for language programs in the United States is on decline, and it's a little hard to argue against the ones that are unproblematic.

But it may be worth noting, I think it was last month, three Canadian universities decided to effectively sever ties to Confucius Institutes because they felt that they were much too aggressive in demanding certain kinds of curricular concessions and the voicing of certain kinds of political views. So clearly some of them continue to be problematic.

COMMISSIONER WESSEL: If you hear anything else--again, this is going to be a long-term issue that we look at--as to any intervention, any self-censorship, any of the various other things that might influence attitudes on this issue, we'd be interested.

DR. RICHARDSON: Of course. I think academic freedom, broadly speaking--which it's not a black letter issue under international law--we consider it a sub-set of the freedom of expression. But I think both for Chinese government-funded programs here and for American, European, Australian institutions that are trying to run programs or set up campuses in China, there is a lot to look at in terms of restrictions imposed, restrictions agreed, restrictions assumed, what people think they need to do in order to get permission to teach there.

COMMISSIONER WESSEL: Thank you.

VICE CHAIRMAN SHEA: Commissioner Bartholomew.

COMMISSIONER BARTHOLOMEW: Thanks.

Several of us are going to be in Hong Kong for a few days within the next few months, so I ask, if you are willing, to please talk to our staff

about some of the issues you think we really need to be raising in meetings.

I want to build off of Dennis' question about universal suffrage and how it could unfold. Dr. Richardson, please talk about examples of how Beijing has already either tried or succeeded in influencing elections in Hong Kong?

DR. RICHARDSON: I think it's everything from discouraging certain kinds of participation, both in the popular sense but also with respect to the kinds of people who decide to run for office. It's about the process and what opportunities it affords. I think it's about signaling what kind of candidates will be most acceptable and likely to be able to act in the best interests of Hong Kong, as those are perceived by Beijing. It's, I mean dissertations could be, tomes could be written on this subject, which is not to say that the Chinese government I think feels compelled to try to control all aspects of all elections.

Lots of politics in Hong Kong, as is the case all over the world, remain quite local. And I think at the district level, there is not a great deal of interference. I think it really does tend to be at the LegCo and up level. But the rhetoric and the suggestions that someone else in Beijing will continue to decide what's possible as opposed to leaving it to the views of people in Hong Kong and the people who should be fully enfranchised to vote equally is alarming to people.

MS. EARP: I concur.

COMMISSIONER BARTHOLOMEW: Great. Thank you.

VICE CHAIRMAN SHEA: Commissioner Tobin.

COMMISSIONER TOBIN: Thank you.

You can count on the fact that I will sit down with Commissioner Bartholomew and learn more. A couple of us are new to the Commission, and so today's gathering is an opportunity for me to read the supportive material and hear your testimony. I come with a business background, and that's why I was commenting on the power of your statistics.

I would encourage you, Ms. Earp, to think about the two points in time that you gave numbers for, and consider looking back maybe five years before 1997 to see the historical pattern, if you were in fact monitoring then.

The second thought I want to share is since Hong Kong was part of the extended British Empire, to what extent today is Britain paying attention as it converses with your organization and looks at Hong Kong? What are you each seeing, and where within their government, if at all, are they doing the kind of dialogue that you were encouraging?

MS. EARP: So, unfortunately, Freedom House data doesn't stretch back quite that far, but I agree it would be very interesting to kind of observe a longer-term development of the trends that we're talking about.

In terms of the British government, I can't speak to specifics because I, despite my accent, I have not been in communication with them on this issue specifically. What I would say is that officials in the UK often feel certain sensitivity to intervening in Hong Kong in a way that in the U.S., the U.S. doesn't have that history, and so should feel more empowered to push

Hong Kong in the right direction than maybe some people in the UK are able to.

COMMISSIONER TOBIN: So as far as you know, there's not much conversation going on with, in diplomatic ways with China?

MS. EARP: There's definitely not enough specific to Hong Kong given the historical relationship. I think that there might be reasons for that. There should be more.

DR. RICHARDSON: My experience working with the British government on China and human rights issues generally is that the analysts and the quality of research and the knowledge of everything from individual cases to very byzantine legal issues is exceptional. They're very, very sophisticated analysts of political trends.

Tragically, that does not seem to feed into robust diplomacy, and I do think there is sort of a unique neuralgia when it comes to Hong Kong that produces precisely the wrong effect, which is that they're actually less likely to speak up about it. But that is also consistent with our critique of them China-wide. I'd be happy to share with you a submission that we just did to the Foreign Affairs Commission on Human Rights in UK-China Policy, and that essentially the assessment is quite good, and that it's not put to good public consistent use in expressing concern.

COMMISSIONER TOBIN: I would very much welcome that.

DR. RICHARDSON: Be happy to.

COMMISSIONER TOBIN: Thank you.

VICE CHAIRMAN SHEA: Commissioner Slane.

COMMISSIONER SLANE: Maybe you could confirm my feelings here. My sense is that Hong Kong is really critical to mainland China as the entity exists today for a number of commercial, economic reasons, and this restrains Beijing from pushing too hard.

And while I think that there's a line in the sand that they're not going to let people cross, but there's a certain safety net here. I mean would you agree with that?

MS. EARP: I would say that the Communist Party always has a little less influence where it's talking about a very large and successful economic entity than it does when it's dealing with an entirely sort of state-owned institution. So Hong Kong represents those kinds of interests, those kinds of business interests, and in that sense, you can talk about the conversation sort of going both ways. It's not all Beijing to Hong Kong. There are some cases where Hong Kong's freedoms are something that are necessary for it to continue operating the way it does, and it does have resources to kind of channel back into China.

That said, what we're seeing overall is a trend for the Chinese authorities to remain involved but do so in a less obvious, more behind the scenes way. So I can see how it would be very easy for any sort of potential influence that Hong Kong has to gradually erode in ways that are not obvious to outsiders, and we may continue believing that they represent a counterweight to Beijing, whereas, in fact, Beijing has been encroaching on

that over time.

DR. RICHARDSON: It's a hard question to answer. I guess the way I would think about it is more to wonder what in 1997 Hong Kong's GDP was as a percentage of the mainland's as opposed to what those figures would be now. I mean 20 years ago, Hong Kong really was much more of the golden goose for the mainland, and it's less so now that there is so much more direct investment going into the mainland and enormous affluence in other mainland coastal cities.

I do still think it has a unique role that in some ways, or a unique profile that in some ways the Party quite values, and is probably loath to tinker too much with it, but it's not, I think, the financial mothership that it once was, and it's a little bit less important in that sense.

VICE CHAIRMAN SHEA: Commissioner Talent.

COMMISSIONER TALENT: Just take a minute and describe more about how self-censorship with the press works, and why they're doing it. Is it just because of a sense that things are drifting in a direction, and if you're in the press, you know, you ought to trim your sails, or are there concrete things that they're afraid of if they don't self-censor or concrete things they get if they do?

MS. EARP: I should just preface this by saying self-censorship is one of the hardest things to measure because there are no outward signs. Having said that, there is a definite sense that you are risking your livelihood if you talk about certain issues, and there are concrete cases that we can point to where we don't know 100 percent that someone lost their job because of something that they were willing to publish. We do know that, for example, a very prominent Chinese journalist who used to operate in Guangzhou and then was forced to leave China because of fear of arrest and subsequently ended up in Europe, and has been trying to get a visa to return to Hong Kong and work there, hasn't been able to get a visa, has been working remotely, you know, eventually resigned.

That is a sign of the sort of worst-case scenario that I think Hong Kong journalists look to and think while I might not get thrown in prison, but I might not have a job, and I might not be able to continue in this profession.

When you talk about Hong Kong journalists going into China to report, which is also something that is worth remembering, they're in this sort of slightly gray area between international reporters and local Chinese press. There are sometimes more concrete examples of physical attacks. So those are the sorts of fears that people have. It's not all self-censorship. There is also phone calls made by the Beijing Liaison Office direct to owners, direct to publishers, direct to editors saying, you know, pull this story.

So there's sort of a broad spectrum of ways that it manifests. I think I would point again to the South China Morning Post as being somewhere that we have viewed as sort of very much above those kinds of petty concerns. So when you have someone who used to work for China

Daily stepping in, when you have staffers accusing him of pulling their stories, that's a sign that it's getting to a sort of much higher level.

VICE CHAIRMAN SHEA: Commissioner Bartholomew.

COMMISSIONER BARTHOLOMEW: Thanks.

Just when I think I've run out of questions, somebody asks one that raises another one. Is there any interaction between sort of Hong Kong-based journalists and mainland Chinese journalists in the mainland as we're seeing some examples of some of the mainland journalists doing more investigative reporting in some of the scandals, food safety, things like that? Are there lessons learned? I mean is there information or tools or how to do this being shared back and forth at all?

MS. EARP: There's definitely a lot of interaction, and traditionally Hong Kong has been a place where mainland journalists can publish stories that they won't get out on the mainland. I mean that's been going on for years.

To the extent that some journalists in China have even been imprisoned on the basis of things that they published under a different name out of the Hong Kong newspaper or magazine, it's hard to point to again sort of any differences or changes in that trend. I would say that when journalists from Hong Kong and from Taiwan go into China, they're in this kind of very difficult position because they look ethnic Chinese so they're not afforded the kind of whether it's respect or whether it's like excessive surveillance that you get, if you're obviously an international journalist.

So they do tend to get pushed around. They tend to get sidelined. They're in a slightly less strong position than their colleagues who have worked domestically and just kind of know a little bit more about the actors that they're dealing with.

COMMISSIONER BARTHOLOMEW: Thank you.

VICE CHAIRMAN SHEA: Commissioner Tobin.

COMMISSIONER TOBIN: Just because you've both spoken about the recent election and the new Chief Executive and it's coming to be a critical time, a run toward a critical time, what's the sense of this new leader and his effect on the assembly freedoms and the press freedoms?

DR. RICHARDSON: I can't say that I've got a terribly well-developed view on him, in particular, and I honestly can't even think of remarks that, specific remarks that he's made about either of these issues. It's an interesting dimension of Hong Kong that many of these changes have been talked about in terms of legal reforms or a tweak to a regulation there rather than in terms of a particular leader changing a particular law. But it tends to be a very bureaucratic or legislative discussion.

Would one necessarily want to rely on him as the person to carry the torch for universal suffrage? I can't say that if you put the question that way, that we've seen what we would want to see. He's not staked out an unambiguous pro-universal suffrage position.

COMMISSIONER BARTHOLOMEW: Can I get some clarification? Katherine, were you asking about the Hong Kong Chief

Executive, not about Xi Jinping?

COMMISSIONER TOBIN: The Hong Kong chief executive.

COMMISSIONER BARTHOLOMEW: Okay. Yes.

DR. RICHARDSON: That's what I assumed.

COMMISSIONER TOBIN: Yes.

COMMISSIONER BARTHOLOMEW: Okay.

MS. EARP: I would just add to that, we have one example of Leung sending letters to newspapers in April and May 2012 objecting to their critical reporting, but that's, you know, it's early days, I think, to take that as a sign of a position in one respect or another.

COMMISSIONER TOBIN: And how long is that term? Do you know?

DR. RICHARDSON: It's five years, I believe.

MS. EARP: Yeah.

DR. RICHARDSON: Yeah. '97 to 2003. 2008 to 2013.

COMMISSIONER TOBIN: So it's a key time for that reason, too.

DR. RICHARDSON: Yes.

COMMISSIONER TOBIN: Thank you.

VICE CHAIRMAN SHEA: I guess I'll close it up with a couple of questions. One, about a year ago, there was a flurry of stories, news stories, about tension between Hong Kongers and people from the mainland coming to Hong Kong to give birth to their children, to take over Hong Kong, use Hong Kong services. There's a professor at Beijing who called people in Hong Kong a bad name, and that got a lot of attention. What is the state of the people-to-people relations between Hong Kong and the mainland? That's the first question.

Then the second question I guess is for Dr. Richardson. What is happening with Liu Xiaobao? Could you update us on that case?

MS. EARP: So as I mentioned earlier, it's hard to really generalize about the entirety of people in China and their beliefs about people in Hong Kong. I would say that the services issue is very much on the radar in China. I know this from my research into Internet access. It's very well-known in mainland China that Hong Kong Internet access is streets ahead of the kind of access that you get even in major cities in China.

And there is a lot of frustration. People, having pages taking ages to load and then they see these figures in Hong Kong, which has some of the highest speeds in the world, and it's considerably cheaper. So that's an example that I've seen of people in China. There is some contention between just regular Chinese people and Hong Kong Chinese people, but there is also this sense of kind of why do they get all these great things, and I don't get them here?

DR. RICHARDSON: On the question about Liu Xiaobo, he is now four years into an 11-year sentence he's serving in a prison in the northeastern part of the country.

The most recent developments around his wife, Liu Xia, who has

been held under ludicrously legally baseless house arrest since the Prize was announced in October of 2010, was recently briefly allowed out to attend the trial of her brother who had been alleged to have committed certain kinds of business fraud, was somewhat unsurprisingly found guilty, but given an extraordinary 11-year sentence himself on those charges. She has on that occasion and on one other when she was allowed out essentially said to the press and diplomats that she's not free, that she is being held against her will, that she wishes to be able to communicate.

There are a couple of points on the horizon. At least technically speaking, Liu Xiaobo could be eligible for parole next summer. We were stunned and horrified when the heads of the European Union on the occasion of accepting their Nobel Prize in Oslo failed to mention him by name, which struck us as being a remarkably cowardly thing to do, even by EU standards. They're not known for vigorous human rights diplomacy.

But I think absent ongoing international pressure in his case, and the case of his wife, he's got another seven years to go.

VICE CHAIRMAN SHEA: Well, that's a sad note to end on, but we want to thank both of our witnesses for their illuminating testimony, and I call the hearing to a conclusion.

[Whereupon, at 2:18 p.m., the hearing was adjourn