

Special Report: How China's official bank card is used to smuggle money

MACAU (Reuters) - Growing numbers of Chinese are using the country's state-backed bankcards to illegally spirit billions of dollars abroad, a Reuters examination has found.

This underground money is flowing across the border into the gambling hub of Macau, a former Portuguese colony that like Hong Kong is an autonomous region of China. And the conduit for the cash is the Chinese government-supported payment card network, China UnionPay.

In a warren of gritty streets around Macau's ritzy casino resorts, hundreds of neon-lit jewellery, watch and pawn shops are doing a brisk business giving mainland Chinese customers cash by allowing them to use UnionPay cards to make fake purchases - a way of evading China's strict currency-export controls.

On a recent day at the Choi Seng Jewellery and Watches company, a middle-aged woman strode to the counter past dusty shelves of watches. She handed the clerk her UnionPay card and received HK\$300,000 (\$50,000) in cash. She signed a credit card receipt describing the transaction as a "general sale", stuffed the cash into her handbag and strolled over to the Ponte 16 casino next door.

The withdrawal far exceeded the daily limit of 20,000 yuan, or \$3,200, in cash that individual Chinese can legally move out of the mainland. "Don't worry," said a store clerk when asked about the legality of the transaction. "Everyone does this."

Internal discussion documents prepared by UnionPay and by financial authorities in Macau and China show these fake sale cash-backs are widespread in such retail stores. The practice violates China's anti-money-laundering regulations as well as restrictions on currency exports, according to Chinese central bank documents reviewed by Reuters. Chinese authorities also fear the UnionPay conduit is being used by corrupt officials and business people to send money out of the country.

It's unclear why the central bank, the Peoples Bank of China (PBOC), hasn't cracked down harder on the practice, although the documents Reuters reviewed show the bank was aware it had become a growing problem.

Industry experts point to a weak enforcement culture in China, a reluctance to hurt Macau financially with 80 percent of the city's revenues drawn from gambling, and a willingness to tolerate some capital flight - especially if it can be tracked through names on bank cards. Moreover, the rapid growth of UnionPay, including the spread of its terminals at retail stores across the world, is playing a key role in China's strategy for making the yuan a global currency.

No one knows for sure how much Chinese money is being channeled illegally into Macau. Tam Chi Keong, an assistant professor at the Macau University of Science and Technology, puts the total at HK\$1.57 trillion (\$202 billion) a year through various channels.. Tam says his estimate is based on his analysis of Macau's finances and interviews with gambling industry participants.

A senior UnionPay executive said the Shanghai-based company has long been aware of the payment card abuse in Macau and elsewhere, but was limited in its ability to act. That's because the primary responsibility lies with authorities in Macau or any other country where the fraud is taking place, he said.

"The problem you are talking about has existed for several years," said the executive, who spoke on condition of anonymity. "We have continuously taken measures."

THE GOVERNMENT'S SON

Though relatively unknown in the West, UnionPay has quietly grown to become one of the biggest card brands and payment networks in the world, accepted in 142 countries. There are more UnionPay cards in circulation now than any other brand - 3.53 billion, or nearly a quarter of the world's total, according to the industry newsletter, the Nilson Report. Visa remains the world leader by transaction value with \$4.6 trillion in card transactions in the first half of 2013; UnionPay was second with \$2.5 trillion.

If UnionPay poses a problem for Chinese authorities, it is a problem of their own making. The card brand is often seen as an arm of Chinese state policy.

UnionPay was established in 2002 by the PBOC and the State Council or Cabinet. Its founding shareholders were 85 Chinese banks, led by the five biggest state-owned banks. Former senior PBOC officials still fill the company's top ranks, including UnionPay's current chairman, Su Ning, and its former president, Xu Luode. They declined requests to be interviewed.

UnionPay dominates the card market in China thanks to a central bank decree that requires all card issuers, including foreign ones, to process their yuan-based transactions through UnionPay's electronic payment network. All Chinese merchants and automated teller machines are required to process their yuan transactions through UnionPay. The World Trade Organization in July 2012 ruled that China was discriminating against foreign card brands, but it made no specific recommendations. Foreign card brands still have to use UnionPay for settlements in China.

UnionPay's increasing use overseas is part of Beijing's multi-pronged strategy

to eventually open up China's capital account and internationalize the yuan, which is formally known as the renminbi or yuan. Beijing also eased restrictions on many kinds of capital transfers as it gradually loosens up control over the currency, making it easier for money to leave China's borders. The efforts have paid dividends. The renminbi has already overtaken the euro to become the second-most used currency in trade finance, according to data from global transaction services organization SWIFT.

"(China) may be happy to see UnionPay sweeping different markets across the world in different countries and territories," said Yan Lixin, head of Fudan University's China Centre for Anti-Money Laundering Studies in Shanghai. "It is backed up by the government. It is the real son of the government."

At the same time, these changes have vastly complicated the compliance challenges for UnionPay. While the card system is helping monetary authorities open up the capital account, it is also enabling people to funnel their ill-gotten gains out of China, said Yan. "It's not the only tool" for money laundering, Yan says, "but it's a major tool."

Macau is a prime gateway for this activity. It is the only place in China where casino gambling is legal, and so Chinese gamblers bring vast sums of money here. Because Macau is administered separately from the mainland, there are restrictions on how much currency mainland Chinese can take into the gambling haven. But gamblers find ways of skirting currency controls when they cross into Macau. And much of the money these mainlanders ostensibly take to Macau for gambling, Chinese authorities believe, is actually going abroad into bank accounts.

Any steps to clamp down on UnionPay cashback transactions would likely rattle Macau, because the cash also feeds the casino sector on which the territory's \$43.6 billion economy overwhelmingly depends. Macau is now the world's biggest gambling hub, with revenues seven times those of Las Vegas. Last year, gambling revenue rose 19 percent to \$45.2 billion. Nearly 40 percent of that went to the government in taxes.

Beijing is particularly concerned about the role of this capital flight in the country's endemic government corruption scandals. An internal research report in 2008 by the PBOC identified UnionPay cards as one of the main tools for corrupt individuals to facilitate cross-border transfer of funds. The central bank report said the practice was growing rapidly.

Many card users follow their money abroad. Since the mid-1990s, an estimated 16,000 to 18,000 Communist party officials, businessmen, CEOs and other individuals have "disappeared" from China, according to a separate PBOC report prepared in 2008 - taking with them some 800 billion yuan (\$133 billion).

But the practice isn't limited to corrupt officials. The ubiquitous UnionPay card, with its instant access to piles of cash, has made the task of whisking money out of China far easier for ordinary Chinese.

CAPITAL FLIGHT

Today, the outflow is gathering pace.

In Macau, UnionPay card transactions reached 130 billion Macau patacas (\$16.77 billion) in just the first four months of 2012, up from 88.1 billion patacas in all of 2011, according to a confidential report by Macau's banking regulator, the Macau Monetary Authority reviewed by Reuters. Around 90 percent of those transactions were "highly concentrated in jewellery, ornament and luxury watch sales", the report said.

If that rate persisted for the full year, UnionPay sales in Macau for all of 2012 would have reached nearly \$50 billion - nearly \$45 billion of it for jewellery-related sales, a figure exceeding even Macau's total gambling revenues that year.

"Are these actual transactions? Where does this money come from?" the deputy head of the Monetary Authority, Wan Sin Long, asked in the document.

"Banks have not carried out good monitoring, nor earnestly handled the situation," Wan was cited as saying in the document. "If this continues, this could affect the question of the further opening up of the yuan."

All the counter-parties involved benefit from these cashback transactions, an industry source said. The retail merchant makes money on the exchange rate, the way a currency trader would. The Macau banks overseeing the merchant charge 1 percent to 2 percent on the transaction. And the UnionPay card-issuing bank back in China will generally charge around 1 percent on the transaction, the source said.

The cashback activity is spreading beyond Macau to other Chinese tourist destinations, including Taiwan, Japan and South Korea, people in the credit-card industry say.

UnionPay cashback transactions reached 9.78 billion yuan (\$1.59 billion) in 2012 in Taiwan, almost doubling from the year before, according to a report by Taiwan's government investigation agency. Taiwan authorities said in January, given the abnormal UnionPay transactions they found, they would consider setting up a cross-strait mechanism to ensure timely information exchange and prevent illegal money laundering, according to CNA, its semi-official news agency. Taiwan's cabinet is considering the proposal.

China isn't standing still. A decade ago, the government began trying to rein in money laundering, and since then it has amended criminal laws and strengthened commercial banking rules.

UnionPay officials say they are trying to stamp out the illicit transfers. One of the main steps the company took came in June of 2012, when it required UnionPay card-issuing banks to put a 1 million yuan (\$166,000) daily limit on any transaction in Macau, down from 5 million to 10 million yuan previously. That limit applies to actual sale transactions.

UnionPay's rivals, meanwhile, don't appear to be playing the cashback game. Macau jewellery stores visited for this article said Visa and Mastercard were not

generally used for cashback transactions.

A senior executive with a rival card brand said his company had "zero tolerance" for the kind of cashbacks allowed by UnionPay. "We don't allow jewellery stores to give any form of cash whatsoever," this person said. "That's completely illegal... Both as a bank and a (card) network, we're supposed to close it down immediately."

LOCAL AUTHORITIES RESPONSIBLE

In a written response to questions for this article, UnionPay said it "has always strictly prohibited the swiping of cards for cash without any goods being purchased and has collaborated from many sides to boost the investigation of such risks."

According to UnionPay's "Operating Regulations," overseas banks participating in the UnionPay system are required to close the accounts of merchants found to be engaged in fraudulent transactions.

But local authorities such as the Macau Monetary Authority have the primary responsibility for investigating suspicious cross-border transactions, the company says.

The Macau Monetary Authority said in a written response that bank card-related businesses in Macau have "been subject to very stringent ongoing supervision."

The authority noted it has "come across a couple of cases of supervisory concerns, and legal proceedings were taken against the parties concerned, including merchants." It didn't elaborate.

Deborah Ng, head of Macau's Financial Intelligence Office, said UnionPay has tried to take a more active role recently to "take care of whether there are some irregular activities involved."

But the card company can do more, she said in an interview. "They need to have some monitoring of abnormally large transactions, (and) frequent transactions from some commercial merchants," Ng said.

NO LIMITS

Despite the professed intensity in scrutiny, the practice continues openly.

At a jewellery outlet run by Hong Kong-listed Chow Tai Fook in the Grand Lisboa casino, staff said customers could swipe UnionPay cards to buy gold bullion of up to 10 million yuan (\$1.5 million) - then sell it straight back for hard cash.

A Chow Tai Fook spokesman confirmed that. He said the store had "no specific limits on the amount that our customers can buy using any form of payment, as long as the payment is approved by the bank when we swipe the card."

At a jewellery store inside the Venetian Macau casino run by Las Vegas Sands, a manager said card cashbacks constituted most of the shop's business. The shop was run by the owner of a VIP room or "junket" operator, which brings in

big gamblers from the mainland.

"I would say there's no upper limit for UnionPay," said the black-suited manager, who spoke on the condition he not be identified. "The credit limits aren't enforced at all."

An executive at Las Vegas Sands, speaking on condition of anonymity, said vendors with UnionPay card-swiping machines have been caught wandering around the casino.

"People walk around with mobile union pay card machines on the gaming floor," the executive said. "They are linked to China (computer) servers, not (ones in) Macau. So it is like they are getting cash out in China. When we see them on the floor we kick them out."

That practice also exists outside the casinos, too. Macau's merchants lately have tried to better disguise the UnionPay transactions by routing transactions electronically across the border to China to escape the scrutiny of Macau authorities, a banker in Macau said.

"They closed the Macau tap, but they've opened an even larger China tap," said the Macau banker with direct knowledge of the practice. "The merchants are always cunning."

A UnionPay memo to banks and counterparties in Macau, dated October 29 and reviewed by Reuters, said the company was aware of these practices and had initiated steps to stop it. It urged Macau banks and UnionPay counterparties to crack down by blacklisting such retailers and fining them.

UnionPay said in the memo it hoped that all parties with UnionPay linked business would make a "concerted effort to rectify Macau's UnionPay card transaction market discipline and sustain its stable longer term development."

A visit to Macau since the memo was issued, however, found cashback services to be flourishing.

Inside seven such stores, customers were observed swiping UnionPay cards at glass counters and receiving wads of cash without actually buying anything.

"We can remit as much money as you like with your UnionPay card," said a red-haired man surnamed Lai at one jewellery shop. A yellow sign carried the slogan: "Welcome Renminbi. Welcome UnionPay cards."

"You don't actually buy anything," said Lai, standing near a half-empty display case containing a messy spread of watches and jewellery. "We just help people get money out of China so they can gamble more."

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