



GLOBAL BRAND: China UnionPay has become one of the largest bank card brands in the world with more cards in circulation than any other.

REUTERS/STRINGER

CHINA

China's card-carrying money smugglers

Chinese are evading currency restrictions when travelling abroad by conducting phony sales on their UnionPay bank cards to get mounds of cash.

BY JAMES POMFRET

CHINA CARD-CARRYING MONEY SMUGGLERS

MACAU, MARCH 12, 2014

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

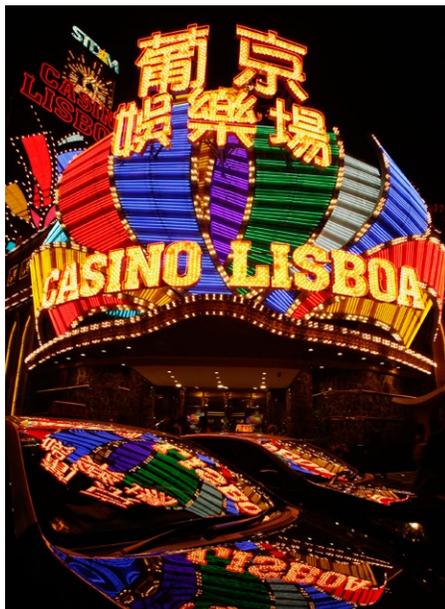
This underground money is flowing across the border into the gambling hub of Macau, a former Portuguese colony that like Hong Kong is an autonomous region of China. And the conduit for the cash is the Chinese government-supported payment card network, China UnionPay.

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



NUMBER ONE: Macau is now the world's largest gambling hub with annual gaming revenues seven times that of Las Vegas.

REUTERS/BOBBY YIP

3.53
billion

The number of UnionPay bank cards in circulation, the most in the world

Source: The Nilson Report

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 channelled 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. 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 organisation 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.

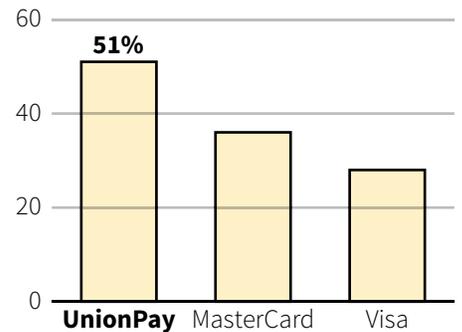
Many card users follow their money abroad. Since the mid-1990s, an estimated 16,000 to 18,000 Communist party officials, businessmen, CEOs and other individuals have "disappeared" from China, according to a separate PBOC report prepared in 2008 – taking with them some 800 billion yuan (\$133 billion).

Plastic cash

UnionPay, the world's largest card issuer and the second-largest commercial card brand by transaction volume, raked in \$2.5 trillion worth of card purchases in the first half of 2013.

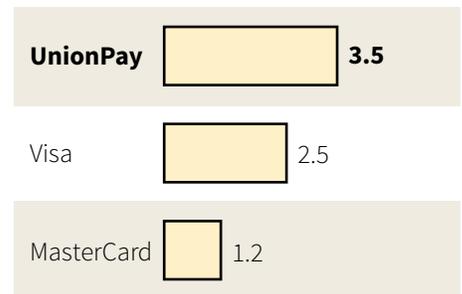
CARD CIRCULATION GROWTH

Percent change, 2012 vs. 2017 forecast



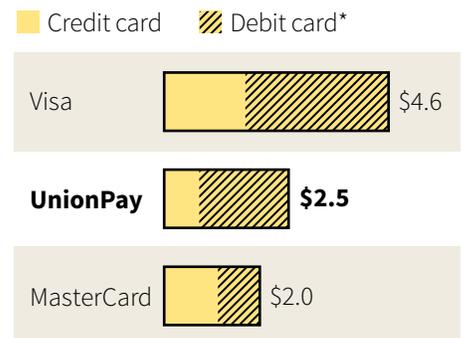
NUMBER OF CARDS IN CIRCULATION

Billion cards, 2012



TOTAL CARD PURCHASE VOLUME

Trillion dollars, first half 2013



*Includes prepaid cards for Visa and MasterCard. MasterCard excludes Maestro and Cirrus data.

Source: The Nilson Report.



FAKE SALES: Jewellery and pawn shops around Macau's casinos do a brisk business giving customers piles of cash by ringing up phony sales on their bank cards. Many of the shops have signs saying they welcome UnionPay cards. **REUTERS/TYRONE SIU**

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,"

“It is backed up by the government. It is the real son of the government.”

Yan Lixin

Head of Fudan University's Anti-Money Laundering Studies in Shanghai

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-straits 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.

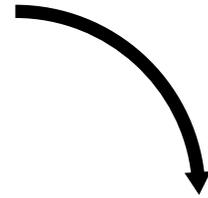
UnionPay's rivals, meanwhile, don't appear to be playing the cashback game. Macau jewellery stores visited for this article said Visa and Mastercard were not generally used for cashback transactions.

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



CASH PLEASE

Zhang visits one of the jewellery shops clustered around Macau's casinos to get HK\$300,000 (\$38,600) in cash using her debit card. That's well over the \$3,200* daily limit China allows for citizens travelling abroad.

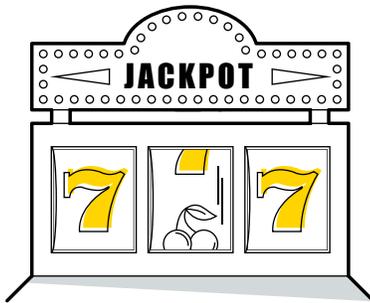


FORGET THE JEWELS

Zhang ignores the jewellery, and presents her UnionPay debit card to the store clerk who then performs a fake sale.

**THE
FAKE SALE
SCAM**

A scenario of how mainland Chinese are smuggling money out of China using their UnionPay debit cards



OFF TO THE SLOTS

Zhang then makes her way to a casino to spend the cash.



COLD HARD CASH

About HK\$320,000 worth of yuan is deducted from her bank account in China; the amount includes commission for the cashback service. The store then hands her HK\$300,000 in cash.



TRANSACTION APPROVED

Once the transaction is approved, Zhang signs a store receipt describing the transaction as a generic "sale".



CLEARING SYSTEM

After entering her pin number in a UnionPay point-of-sale machine, the transaction goes through the UnionPay clearing system and Zhang's bank to determine if she has sufficient cash in her account to proceed.

*Limit imposed by China, capped at RMB20,000. RMB1 = HK\$1.27 or US\$0.16. Source: Reuters.

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 <1929.HK> in the Grand Lisboa casino, staff said customers

Coming to a store near you: world’s biggest bankcard

In UnionPay’s curved glass headquarters in Shanghai’s financial hub of Pudong, a plaque commemorates a visit by former Chinese President Hu Jintao in 2010. Emblazoned on it is a quote from Hu urging the company to “step up the effort to internationalize and strive to build UnionPay into a major global brand for bankcards”.

China’s renminbi or yuan is not yet an international currency - it is not freely convertible. Yet China’s official bank card has achieved Hu’s dream of global dominance.

China UnionPay has become the world’s largest card brand with 3.53 billion cards in circulation, just over a decade after it was founded in 2002. Its \$2.5 trillion in transactions in the first half of last year was second to Visa Inc’s <V.N> \$4.6 trillion, says industry newsletter the Nilson Report.

UnionPay has achieved this kind of dominance by having a virtual monopoly on bank card transactions in China, and according to its rivals, offering low fees to retail merchants at home and abroad.

In China, foreign rivals such as American Express, MasterCard Inc and Visa must use UnionPay’s yuan settlement network.

Credit and debit card settlement is a big, profitable and growing business in China. Interbank card transactions jumped 37 percent from 2011 to 21.8 trillion yuan (\$3.58 trillion) in 2012. Central bank regulations also give UnionPay the rights to settlements for all online transactions in China.

UnionPay transactions overseas show equally impressive growth, rising 30 percent year-on-year in 2012, according to the official Xinhua news agency. Overseas revenue now accounts for around 5 percent of UnionPay’s total, according to a Hong Kong fund manager briefed by UnionPay executives.

UnionPay, which is not a public company,

does not disclose financial results or details.

The United States, home to UnionPay’s biggest rivals, has complained long and often about its privileged status in China.

In 2012, following complaints by Washington, the World Trade Organization ordered China to stop discriminating against foreign bank card rivals such as Visa and Mastercard, but did not make any specific recommendations.

“A more efficient payment card system in China would be more beneficial for both merchants and consumers,” U.S. Trade Representative Ron Kirk said at the time.

China has yet to open the bank card market.

UnionPay regularly waives fees that its rivals charge and is known for having the lowest fees in the market overseas, said the head of bank card operations at a Hong Kong-based bank who deals regularly with UnionPay.

“It seems they’re at an expansion phase, so anything goes,” said the executive. “They don’t mind losing money to gain market share. Visa and Mastercard <M.N> don’t offer anything like that.”

“When we asked (UnionPay), ‘Are your international operations making a loss?’ We were told: We don’t look at those numbers,” he added.

UnionPay said in a written response to questions about this assertion that its overseas operations were profitable. “UnionPay’s international business growth momentum remains good, and at the moment, it remains in a profitable state,” the company said.

Third-party installers such as EasyLink have helped UnionPay’s expansion by installing its terminals in overseas retail stores. Merchants are eager for them: Chinese are now the world’s largest consumers of luxury goods.

- James Pomfret

CHINA CARD-CARRYING MONEY SMUGGLERS

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.”

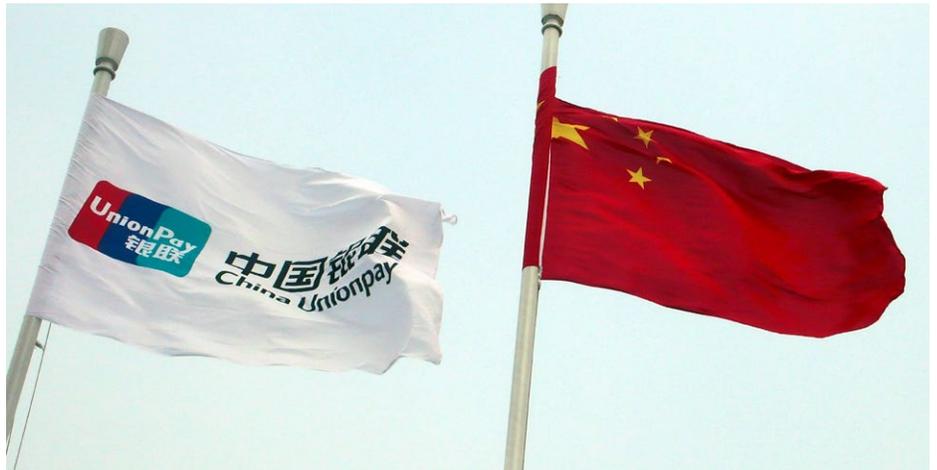
At a jewellery store inside the Venetian Macau casino run by Las Vegas Sands, a manager said card cashbacks constituted most of the shop’s business. The shop was run by the owner of a VIP room or “junket” operator, which brings in big gamblers from the mainland.

“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



GLOBAL EXPANSION: The UnionPay flag flies next to a Chinese national flag at the company’s Shanghai headquarters. UnionPay is playing a key role in China’s strategy for internationalising the yuan. **REUTERS/STRINGER**

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 Oct. 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.”

- Additional reporting by Farah Master and Yimou Lee; Editing by Michael Williams and Bill Tarrant

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