

## Macau Gaming Sector

### Can we really write off Macau's junket business?

- With Macau's renewed focus on resolving the Dore incident, we explore the legal obligations of casino operators over junket activities
- Macau legislator Mr. Jose Pereira Coutinho recently shared with us his views on the issue, as well as the legal considerations
- Casino operators may be found liable for junket operators' violations; risk is rising amid junkets' deteriorating fundamentals

Negative Neutral Positive


**Neutral**  
 (unchanged)

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**What's new:** Mr. Paulo Martins Chan, the new director of Macau's gaming regulator, the DICJ, has been vocal about the office's renewed efforts to resolve the Dore incident. Given increased scrutiny of junket activity, this report discusses whether the street's approach of dismissing the VIP segment is sensible. We recently spoke to elected Macau legislator Mr. Jose Pereira Coutinho about this issue. This is our second thematic piece on Macau policy.

**What's the impact: Wynn might be found liable for the Dore incident.**

By law, the gaming operators in Macau are obliged to monitor, supervise and regulate junket/junket-related activities, as well as being responsible for them complying with junket regulations. Mr. Pereira Coutinho said that Wynn faces a high risk of being found (at least partly) financially liable for what happened with Dore. In our opinion, the legal resolution of the Dore incident could set a precedent for how others might be handled by the regulators. It also underscores that the junket business (albeit shrinking) is not risk-free for the casino operators, as the potential financial risks could ultimately outweigh the perceived profitability of the VIP segment (see Appendix 1 on page 23 for written interpellations submitted by Mr. Pereira Coutinho on Wynn's legal standing on the Dore issue).

**Wynn and Melco Crown potentially most at risk.** The street seems to think the junket risks are well known and becoming less relevant to Macau's gaming industry. We find this perspective worrying. By our estimates, junket operators are still under significant operating pressure, with at least HKD30bn in bad debt still outstanding (a very conservative estimate). As most junket operators are barely breaking even (if not loss-making), it would not take much for a Dore-like incident to occur again, in our view. Likewise, these operating pressures also impact casinos' premium-direct businesses. Indeed, this does not pose a risk to the casino operators' short-term EBITDA, but rather puts them at risk from a legal, corporate governance, and balance-sheet perspective. We have updated our junket table count and analysed the casinos' relative business risks based on their existing junket exposure. We find Wynn [1128 HK, HKD11.78, Underperform (4)] and Melco Crown [MPEL US, USD16.73, Outperform (2)] to have the riskiest slice of the industry's junket business today.

**What we recommend:** While the risks discussed may not negatively impact the sector's short-term reported adjusted EBITDA (a metric we think the street still pays disproportionate attention to), significant business risks do exist for the operators. As such, we remain cautious on Macau, especially given the recent rally in share prices.

**How we differ:** We believe we are the first to highlight the legal obligations the casino operators carry for junket activities.

#### Mr. Jose Pereira Coutinho



Source: Daiwa

*Mr. José Pereira Coutinho's views are his alone, expressed in a personal capacity, and do not necessarily correspond those of Daiwa or the Macau Government.*

#### Wynn Macau's statement regarding Dore

"... Dore is an independent, registered and licensed company operating a gaming promoter business at Wynn Macau. Any matters related to Dore's alleged failure to honor the withdrawal of funds requests are related to Dore's direct financial relationships with the parties requesting such withdrawals and accounts maintained directly between Dore and such parties."

Steve Wynn, 14 September 2015"

Source: HKexnews, Daiwa

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Also see: *Macau Gaming Sector: Concessions renewal: prepare for an arduous journey*, published 17 March 2016. [click here](#)

## An overview of Macau's legal framework

### An introduction to Macau's gaming regulator

#### The DICJ is the governing body

The operation of casino games in Macau is subject to general administrative, civil and criminal laws along with the specific gaming laws.

The Direcção de Inspeção e Coordenação de Jogos (DIJC) is Macau's Gaming Inspection and Coordination Bureau. It is the primary regulator and a supervisory institution for Macau's gaming industry. According to the DICJ website, the bureau 'provides guidance and assistance to the Chief Executive of Macao SAR on the definition and execution of the economic policies for the operations of the casino games of fortune or other ways of gaming, Pari-Mutuels and gaming activities offered to the public'. Its key principal responsibilities are outlined in the table below. Particularly noteworthy is that DICJ is the government department responsible for monitoring, supervising and regulating and junket-related activities, as highlighted below.

#### DICJ's principal responsibilities

**DICJ is the primary regulator and a supervisory institution for Macau's gaming industry**

	Responsibilities
1.	To collaborate in the definition, co-ordination and execution of the economic policies for the operations of the casino games of fortune or other ways of gaming, Pari-Mutuels and gaming activities offered to the public;
2.	To examine, supervise and monitor the activities of the concessionaires, especially on their compliance with the legal, statutory and contractual obligations;
3.	To examine, supervise and monitor the eligibility and financial capability of the concessionaires or other parties stipulated by the law;
4.	To collaborate with the government in the process of locations and places authorization and classification for the operations of casino games of fortune or other ways of gaming;
5.	To authorize and certify all the equipment and utensils used by the operations of the concessionaires approved in the respective concession;
6.	To issue license for the junket promoters of casino games of fortune or other gaming activities;
7.	To examine, supervise and monitor the activities and promotions of the junket promoters, especially on their compliance with the legal, statutory and contractual obligations, and other responsibilities stipulated in the applicable legislations;
8.	To examine, supervise and monitor the eligibility of the single or collective junket promoter(s), their partners and principal employees;
9.	To investigate and penalize any administrative infractions practiced according to the appropriate substantial and procedural legislations;
10.	To assure the relationship of the concessionaires with the government and the public is in compliance with the regulations and provides the highest interest to the Macao SAR;
11.	To execute the competence which are not listed above but with similar nature according to the Chief Executive's order or the legal provisions.

Source: DICJ, Daiwa

#### Mr. Paulo Martins Chan is currently the director of the DICJ

Mr. Paulo Martins Chan is the new director of the DICJ and heads up the bureau. Mr. Chan stepped into this role by end November 2015, following the retirement of Mr. Manuel Joaquim das Neves, the former DICJ director. It was widely reported that Mr. Chan, the former Assistant Public Prosecutor-General of Macau, was selected by Mr. Lionel Leong (incumbent Secretary of Economy and Finance of Macau) due to his experience in the Public Prosecutor's Office, his legal knowledge and language proficiency.

## Highlights of our meeting with Mr. José Pereira Coutinho

### Biography



Source: Daiwa

Mr. Pereira Coutinho is a member of the Legislative Assembly of Macau, one of the highest governing bodies in Macau and where his party, New Hope, occupies 2 of the 14 seats for elected members. Mr. Pereira Coutinho is now one of the longest-serving directly elected members of the assembly (on his 3<sup>rd</sup> term, with almost 12 years in office) and has been among the most vocal on issues relating to gaming. He also has a clear view on issues from a legal standpoint given his career in law prior to his entry into politics.

### Concessions may be ultimately accountable for junket failures

**By law, the casino operators have the responsibility and the means to monitor, supervise, and regulate junket and junket-related activities**

**Casinos' responsibilities vis-à-vis junket activities.** According to Macau's gaming laws, casino operators have substantial responsibilities relating to the reporting, supervision, and oversight of junket and junket-related activities taking place within their casinos. Thus, the DICJ has predominantly relied on the casino operators to oversee VIP/junket-related activities. According to Mr. Pereira Coutinho, the concessions/sub-concessions are directly responsible for supervising junket and junket-related activities taking place at their respective casino premises and to report instances of unlawfulness. Based on Macau gaming law (see the tables below), we see a high risk of the operators ultimately being held accountable for: 1) the failure of the existing junket system, and 2) the financial repercussions of this, including the loss of third-party deposits.

#### Concession/sub-concession gaming contracts for Macau casino games of chance

##### Concession/sub-concession gaming contracts for Macau's casino operators

###### Article 88

###### Gaming promoters

The Concessionaire/Sub-Concessionaire shall be held accountable to the Government for the activities conducted by the gaming promoters registered with the company, their directors and partners in its casinos and other gaming areas; for this purpose, the Concessionaire/Sub-Concessionaire shall supervise their activities.

##### Legal Framework for the Operations of Casino Games of Fortune

###### Law 2001/06; Article 23\*

###### Gaming Junkets

The concession/sub-concessions shall supervise the activities conducted by junkets as well as that of their respective executive/administrative employees and other partners; as well as to bear responsibility to the government for these parties' compliance to rules and regulations.

###### Law 6/2002; Article 29

###### Responsibilities of Gaming Junkets

The concession/sub-concession and the junket operator are jointly responsible for the compliance of applicable laws and regulations in relation to activities carried out by the junket executives, partners, and related employees working in the casino

###### Law 6/2002; Article 31

###### Gaming Junkets

Junket as well as related staff and partners must bear responsibilities for activities carried out in the casino, and are jointly responsible for their compliance with applicable laws and regulations

Source: DICJ, Daiwa

Note: Translated by José Pereira Coutinho

Note: point 3 of Article 23

In Mr. Pereira Coutinho's view, casino operators that feign ignorance or fail to take responsibility for junket activities may not be able to avoid legal and financial liabilities relating to these junket activities, as highlighted in the following 3 points.

- 1. Casinos are the counterparties for financial settlement between the government and the junkets.** Concessionaires and sub-concessionaires should also be well acquainted with the financial conditions of the junkets operating in their casinos as they are: 1) the direct counterparties to all financial matters relating to junket gaming activities, and 2) legally responsible for settling the taxes of junket gaming activities as well as gaming agent commissions.

#### Concession/sub-concession gaming contracts for Macau casino games of chance

##### Article 51

##### Tax withholding at the source

The Concessionaire/Sub-concessionaire shall collect and pay statutory taxes on commission and other remunerations for the gaming agents by way of determinative source-based withholding. The related taxes shall be paid to the Finance Department Treasury Office of Macao Special Administrative Region on a monthly basis no later than the tenth of the month following the respective month according to law.

Source: DICJ, Daiwa

Note: the casino operators' responsibility to settle (junket) taxes on behalf of the government also puts them at risk of being liable for tax evasion as a result of widespread side-betting activities in junket rooms (at its peak, the side-betting volume was estimated by the industry to be as high as 3-5x the reported VIP revenue). Based on this estimate, gaming taxes collectively evaded as a result of side-betting would be at least HKD240bn for 2014 alone, or more than the total reported GGR for 2015.

- 2. Privileged direct access to junket cages and gaming floor.** Also, the casino operators have direct video access to all of the junkets' cages since it is a legal requirement for all casino operators to set up extensive CCTV access, and be responsible for monitoring all of the cages on their respective casino premises. Meanwhile, the casinos also have a physical presence on the junket gaming floor (ie, dealers, pit managers, supervisors, etc), dealing directly with gaming patrons and junket staff.
- 3. Casino operators are obligated to report all suspicious and large-amount transactions.** According to Macau's Financial Intelligence Office (GIF) website, instruction No. 2/2006 "Preventive Measures against Crimes of Money Laundering and Terrorist Financing" indicates that the gaming concessions and sub-concessions are responsible for identifying and reporting all "large-amount transactions" that exceed MOP500,000 to the DICJ within 2 days of the transaction date. The information required includes the name, address, identification document, date of transaction, and amount/source of funds. A sample of the form is attached in Appendix 2. The casino operators are also required to provide the necessary training to employees concerned about the rules and procedures on preventing financial crimes.

Transactions of over MOP500,000 are legally required to be reported by casino operators to Macau's Financial Intelligence Office (GIF)

#### Transactions requiring casino operators to file a "large-amount transaction report"

- 1 Gambling or wagering in amount equal to or exceeding MOP500,000 or equivalent
- 2 Gaming credit or the repayment of a loan equal to or exceeding MOP500,000 or equivalent
- 3 Gambling, wagering, gaming credit or repayment of loan, although individually less than the above reporting amount, but in the aggregated total equal to or exceeding MOP500,000 or equivalent within 24 hours
- 4 Any games promotion business transaction equal to or exceeding MOP500,000 or equivalent, including the payment to player or expenditure incurred by bettor.

Source: GIF, Daiwa

Note: taken from instruction No. 2/2006 "Preventive Measures against Crimes of Money Laundering and Terrorist Financing"

## What does the Dore incident mean for Wynn?

**"...the Company wishes to advise that Dore owes no money to the Company and continues to operate at Wynn Macau. Dore is an independent, registered and licensed company operating a gaming promoter business at Wynn Macau. Any matters related to Dore's alleged failure to honor withdrawal of funds requests are related to Dore's direct financial relationships with the parties requesting such withdrawals and accounts maintained directly between Dore and such parties."**

Stephen A. Wynn, HKEx filings dated 14 September 2015

**The DICJ has a renewed focus on resolving the Dore incident.** While the responsibility towards junket activities applies to all operators, the Macau Government has renewed focus on specifically resolving the well-publicised Dore incident.

Following the incident, which took place in September 2015 and involved an amount now reported at upwards of MOP800m ([see our 10 September 2015 Memo](#)), DICJ Director Paulo Martins Chan indicated earlier this month that the DICJ had been actively engaged with lawyers representing Dore to seek a solution for the investors affected. According to Mr. Chan, investors in Dore can be divided into 3 groups:

1. **Investors registered in Dore's accounting documents.** This group comprises investors who have documents proving their investments in Dore's cage operations, and are recognised by Dore as its investors. Dore is currently negotiating directly with this group of investors to settle the amounts outstanding. The claims made by this group of investors represent only around 10% of the total amount missing.
2. **Investors who claim to have invested in the cage operations but are not registered in Dore's accounting documents.** The claims made by this group of investors are to be settled in court as the investments are not documented, though they claim to have been directly invested in Dore's cage operations.
3. **Investors who claim to had their deposits absconded along with the investor capital.** This group of investors is effectively claiming compensation as victims of a crime, as their capital was not directly invested in Dore's cage operations but was placed as deposits with Dore.

**90% of deposits in question relating to Dore, which operates exclusively at Wynn, are not "properly" documented; the remainder are not directly traceable**

The type of investors revealed as being affected by the Dore incident further highlights the convoluted and intricacies of the junket capital structure. As noted by Mr. Chan, just 10% of the publicised MOP800m absconded is actually deemed as 'properly' documented, with the remaining 90% of the allegedly absconded amount not being directly traceable. In our view, this signals: 1) a lack of proper financial recording, 2) a lack of internal controls, and/or 3) a lack of oversight by those responsible for understanding Dore's complex shareholding structure as well as regulating its activities. It is noteworthy that, despite the aforementioned issues, Dore was renewed as a DICJ-approved junket operator (the list was updated on 31 January 2016; 5 months after the incident took place).

**Wynn has the necessary means and obligation to monitor and report large and suspicious transactions.** As Wynn's own employees work on the gaming floor, along with the operator's direct CCTV access to the junket cage, as legally required, the operator should have a very clear understanding of the junket activities on its premises. (Indeed, failure to do so is a dereliction of its legal responsibilities).

**Almost all deposits in question made to Dore exceed the statutory definition of "large amount transactions" of MOP500,000**

Furthermore, the operator should be fully aware of the transactions in question given the size of outstanding balances, and its legal obligation to identify and report said transactions to the DICJ (even if they were determined to be not suspicious, this would have required a separate registration with the DICJ). Of the individual depositors who have filed a complaint with Mr. Pereira Coutinho's office in the past, all of the amounts in question were over MOP500,000 (and at least 40% of the deposits were for over MOP10m), far higher than the prescribed threshold defined as a "large-amount transaction".

Also keep in mind that when the Dore incident occurred, there were over 50 individuals lining up within Wynn's casino premise seeking to redeem their cash deposits from Dore. This could arguably have been considered "suspicious" in nature, which would have been grounds for reporting to DICJ.

## Wynn could ultimately be found liable for the Dore incident, in Mr. Pereira Coutinho's view

**José Pereira Coutinho: Wynn may be found liable for the Dore incident, setting a precedent.** Given the above requirements, Mr. Pereira Coutinho believes it is not a far-fetched scenario that Wynn could ultimately be found (at least partially) financially liable for the failings of Dore.

Indeed, the publicised amount of outstanding debt may not be especially large and Wynn can certainly afford it (the entire amount in question is equivalent to only quarter of Wynn's dividend payment last year or 11% of its end-2015 cash balance). That said, this incident could be damaging to sentiment on Macau's gaming sector in the long run, as it could set a precedent for the regulatory handling of similar incidents going forward.

## Macau's gaming policy environment today

### Risks have not diminished given the lack of proper legal framework

In Mr. Pereira Coutinho's view, there has been an apparent lack of will and inclination to enforce Macau's gaming law as written. Indeed, 6 months after the Dore incident, the government response has been rhetorical in nature, with no clear plan or timeline for action/resolution. To compound the issue further, Mr. Pereira Coutinho said there are glaring gaps within Macau's gaming legal framework governing the gaming industry. As evident from the Dore/Kimren incidents in recent years, these shortfalls are becoming increasingly apparent as the industry downturn takes hold.

Mr. Pereira Coutinho further stressed that the apparent lack of proper legal framework has made it difficult to hold those in various positions of power accountable. While the discussion on accountability is ultimately moot, Mr. Pereira Coutinho highlighted a number of key points that he believes pose an unaddressed negative overhang on the casino operators. In his view, despite the well-publicised weakness in the junket segment, the largest of these key risks to the casino operators still stems from this segment.

### Weaknesses in existing junket business model are well established

Fundamentals within the junket business continue to be challenged. In retrospect, many market observers have attributed the VIP segment's recent boom and bust to the direct consequence of: 1) limited regulatory oversight and risk controls, 2) reckless extension of credit by junket/agents, and 3) the ultimate inability of the junkets to collect the said outstanding gaming debts. This problem of rising bad debts continues to be a major issue in Macau, and is among the key drivers for the successive junket mergers and closures that we continue to see today. It is noteworthy that a 39% tax is imposed on Macau's gross gaming revenue by the government regardless of its ultimate collectability, and this poses a further financial burden on the junket operators which are required to settle these balances with the casino operators in full.

### Government supervision still "purposefully relaxed"

***"We believe it is inappropriate to criminalize debtors who fail to repay gaming debts.... the number of instances of bad debts resulting in judicial proceedings as described is extremely low....As we can see, criminalizing non-repayment of gaming debt is both meaningless and offers not tangible benefits."***

*MSAR's response to Mr. José Pereria's written interpellation dated 17 April 2009.*

The DICJ is the government department responsible for regulating Macau's junket activities from licensing to supervision. Despite these legal obligations, Mr. Pereira Coutinho contended that government oversight had historically been intentionally relaxed. He said he had submitted many written interpellations to the government as early as 2009 highlighting the deficiencies of the legal framework governing the junket business and the increasing risk of debt and non-collection. His remarks went largely unheeded (we have translated the written interpellation along with the government written response with the help of Mr. José Coutinho, and these are included in the appendix of this report).

## The DICJ is responsible for supervising junket and junket-related activities

### DICJ: responsibilities on junket activities

Responsibilities
1 To issue licences for the junket promoters of casino games of fortune or other gaming activities;
2 To examine, supervise and monitor the activities and promotions of the junket promoters, especially as regards their compliance with the legal, statutory and contractual obligations, and other responsibilities stipulated in the applicable legislations;
3 To examine, supervise and monitor the eligibility of the single or collective junket promoter(s), their partners and principal employees;

Source: DICJ, Daiwa

### No official acknowledgement of sub-junkets

It is the legal obligation of the junket operators to provide the DICJ with monthly financial statements (ie, balance sheets, profit/loss statements, etc.). This financial information should give DICJ a clear view of the size and structure of the junkets' share capital, as well as their outstanding receivables and bad debts. The DICJ thus has the ability to clearly understand the size and constitution of the junkets' cash balances, share capital, as well as the enormity of the cash and receivables outstanding.

However, it is particularly noteworthy that even today, Mr. Pereira Coutinho asserts that there is no explicit legal framework that even acknowledges, defines, or regulates the sub-junkets and their related activities in Macau. There is also no regulation related to regulating third party cash deposits into junket/sub-junket operators. Both of these activities constitute a very material contribution to the junkets' ultimate underlying capital base, representing a significant contribution to Macau's gaming revenue. Indeed, the Macau Government and the casino operators continue to allow these extremely convoluted junket shareholding/capital structures to exist, and for activities operating implicitly out of Macau's legal framework to persist.

### New junket regulation: in the right direction, with more action to come

On 22 October 2015, the DICJ hosted a conference with key junket industry participants to clarify the regulations and policies on accounting controls for junket operations (see [Macau gaming: DICJ increasing scrutiny on junket financial reporting](#), 23 October 2015). The conference was a follow-on from the issuance of the Junket Accounting Guidelines, which were provided by the DICJ to junket promoters in early October 2015 to further clarify the junket accounting regulations laid out by the DICJ. This stance was reaffirmed by Mr. Paulo Martins Chan, the new Director of the DICJ. Upon being sworn into office in November 2015, he pledged to review and improve Macau's gaming law.

### Review: detail of the guidelines

The guidelines are essentially a reiteration of existing regulations laid out in the Macau Administrative Regulation no.6/2002, with an emphasis on 3 key directives: 1) the junket operators are required to maintain monthly financial records, subject to the DICJ's review upon request at any time starting January 2016, 2) the junket operators are required to provide background information on their senior accounting and finance staff, and 3) the junket operators are to maintain financial records physically in Macau, subject to the DICJ's review upon request at any time. Details of the guidelines are set out below.



### Junket Accounting Guidelines in detail

1. Junket operators must possess sound accounting systems and controls
2. All accounting and financial records and documents must be made available for the DICJ's inspection, upon request at anytime
3. All junket operators must submit the following documents in hard copy before 1 December 2015:
  - Background information on their senior accounting and finance staff, including home address, contact number, job title, employment date, education history and work experience
  - Physical location of accounting records
4. Beginning 1 January 2016, the junket operators are required to maintain monthly financial records, with the "Disclosure of personal data of key employees" (including directors and shareholders with more than a 5% stake in the company), subject to the DICJ's review, upon request at any time
5. Financial records must be kept for a minimum of 5 years
6. The junket operators must make transparent their bank balances upon request by the DICJ at any time
7. Gaming concessionaires and junket operators are jointly legally responsible in ensuring that all business activities carried out in casinos are compliant with the gaming regulations set out by the DICJ; junket operators must adhere to the guidelines set out by the gaming concessionaires

Source: DICJ, <http://bo.io.gov.mo>

## What has happened since?

### Increasingly diligent and a step in the right direction

Mr. Chan's rhetoric on tightening regulation and on ensuring proper accounts recording of the Macau junket business has been clear from his first days in office. At the beginning of 2016, Mr. Chan indicated that 35 junket operators were denied licence renewal due to their failure to submit accounts and financial records in accordance with the new Junket Accounting Guidelines issued in October 2015 ([Macau Gaming: DICJ increasing scrutiny on junket financial reporting](#), 23 October 2015) within the set deadline. According to Mr. Chan, these new requirements, which came on the heels of the Dore incident, aim to increase scrutiny over the junket system and raise the threshold for entering the Macau gaming industry.

### Junkets with an operational presence are still largely unaffected

As things stand today, Mr. Pereira Coutinho remarked that the aforementioned standards were merely instructions and guidance, but not compulsory requirements. Despite all the recent overtures, there are no material changes to the underlying administrative process governing junkets and their activities today. However, we note that new administration's early stance in solving the Dore incident is much more diligent than the stance of the prior administration in resolving the Kimren incident that occurred 2 years ago. While the policies continue to be lax today in the view of Mr. Pereira Coutinho, we will continue to see tightening in execution of relevant rules and regulations in the future.

### Talks of raising capital requirements for junkets

The Macau Government has already begun talks with the junkets to raise the capital requirements for new operators, according to a recent Bloomberg report. One of the proposals being considered includes raising the capital requirements for new junket operators to MOP10m (from the current MOP100,000, representing a 100x increase) and requiring at least one Macau resident to be a shareholder. The report said that the proposed rule would not affect the existing 141 licensed junkets. The junkets were also reported to be working with the Macau Government to establish a shared blacklist of players deemed to be at high risk of defaulting on loans. Mr. Pereira Coutinho indicated that further tightening of junket regulations could be possible, as early as sometime this year. That said, we still see the possibility for less well-capitalised entities to remain operational given Macau's existing sub-junket model.

In the immediate future, the junket segment is unlikely to be affected by the capital-raising proposal, but the industry will indeed result in higher barriers of entry for new entrants. This new developments do support the assertion that policy direction points to one of further scrutiny and tightening going forward.

**Government appears to be getting tougher on the junket segment**

**Societal and political repercussions too big to ignore**

Mr. Pereira Coutinho believes there are still a number of recent junket-related incidents that have not been as well publicised as the Dore and Kimren incidents. Parties with vested interests had actively contained each situation, but this does not remove the underlying systemic risk of the junket segment. Mr. Pereira Coutinho said there are potential widespread and unpredictable societal and political repercussions related to how junket capital is funded and junket failings that may ultimately be too big to ignore.

## Daiwa's view of the implications for the sector

### What does this all mean for the casino operators?

#### Junket segment still as relevant today

##### The street's lack of attention to this segment is worrisome

The street seems to hold the view that junket business risks are well-established and represent an ever-diminishing relevance in the discussion about the prospects of Macau's gaming industry.

We find this perspective worrying. In our view, a closer examination of Macau's junket business is increasingly relevant and material today. The significant operating pressures faced by the junkets give rise to increasing unaddressed risks that may well be underestimated by the street. Indeed, the cost of potential liabilities borne by casino operators for both existing and emerging issues facing the segment today could be very high (ie, junket failings, absconding of capital).

These costs may not be reflected in the operators' adjusted-EBITDA and property EBITDAs (the yardstick used most frequently by the street to evaluate performance), but they will certainly affect the operators' underlying profitability in terms of operating profit and net profit.

##### Quality of earnings is at risk

The counter-argument to our view suggests that the VIP segment is no longer making a material contribution to profitability (being as low as 10% among some operators). We agree that such a statement about profitability does have a measure of validity (the mass segment is margin-accretive after all).

However, we believe that an examination of the operators' GGR composition rather than their EBITDA contribution (which can be subjective depending on the operators' cost accounting policies) is much more relevant when assessing and quantifying the magnitude of junket and junket-related risk faced by the casinos. As of 1Q16, the sector's VIP revenue still stood at ~MOP28bn, representing a very material ~50% of Macau's total GGR. As we discuss below, potential risks and liabilities may be a multiple of this figure.

#### Junkets absorb fixed costs; new capacity and VIP weakness threaten margins

As we have highlighted in previous reports, a significant proportion of Macau's casino hotel rooms have been, and continue to be, allocated to the junket operators in Macau. Over the past year, the weakness in the junket segment has resulted in a continued shift in hotel room resources to the mass market/cash business. However, no less than 50% of the operators' hotel rooms are still allocated to junkets today (a decline from the peak of 70-80%). The result of this is clear – despite a modest increase in hotel rooms from GM2 and Studio City (a total of around 3,000 rooms), hotel room prices have plummeted over the past year. Indeed, we find this worrying when looking into 2H16 as new capacities come on line (almost 6,000 rooms at the Wynn Palace and Parisian this year alone, which is 2x the incremental increase seen in 2015).

Furthermore, there have been cases of hotel rooms purchased by junkets actually being substantially higher than the market cash spot rates offered by travel agents and the hotels themselves. The potential reduction in the junket hotel room allocation and the increase in hotel room capacity will undoubtedly result in renewed and sustained hotel room pricing pressure in Macau for 2016 and beyond. As such, a strong case can be made for the junket operators now actually absorbing a large proportion of the casinos' fixed operating costs (after all, the hotels are already built and the casino operators cannot lay off Macanese staff). As such, weakness in VIP revenue will not only threaten its segmental EBITDA contribution, but also the EBITDA contributions (and margins) of all of the other major segments of the casino business (including the mass market).

**The potential cost of liabilities may not be reflected in the casino operators' short-term property EBITDAs, but will potentially impact their overall underlying profitability**

### Trends on the ground are not encouraging

The junket segment continues to face mounting operating pressures, and below is a quick update on key observations we see on the ground.

### Small/mid-sized junkets are still struggling, rooms still closing

The small/mid-sized junkets continue to bear higher operating pressures as they are negatively impacted by a poorer capital base (ie, lower ability to have credit extended to them), narrower client reach, and limited ancillary services.

We use lao Kun Group (IKGH US, not rated) as an example. By our definition, this junket operator would be considered mid-sized as it has an operational presence in 5 casinos in Macau (StarWorld, GM1, City of Dreams, Sands Cotai Central, and L'Arc) and around 24 tables, by our count. As the table and graph below illustrate, this mid-sized junket operator has underperformed in terms of rolling volume vs. the industry since the beginning of the downturn in 2H14. We believe other junket operators of similar sizes are facing a similar trend.

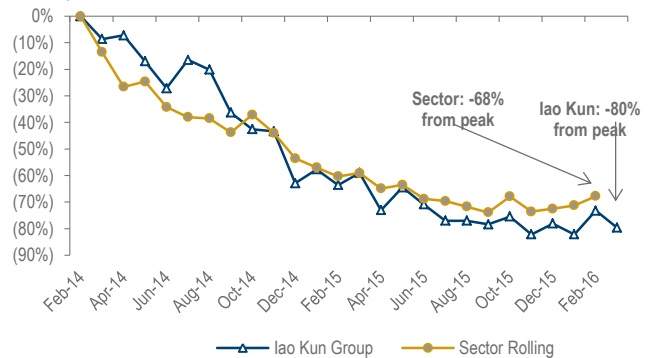
The systemic increase in both gaming debts and bad debts will ultimately result in working capital problems and solvency issues, especially among the smaller junkets as we have seen in the past. By our count, at least 4 junket rooms across the board closed in February and March 2016.

Rolling volume of lao Kun vs. industry (by quarter)

(HKDbn)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16
lao Kun	37.2	36.3	33.6	22.3	17.2	13.4	10.0	9.5	5.9
Δ %	17%	4%	5%	-35%	-54%	-63%	-70%	-57%	-44%
Sector	1,983	1,708	1,446	1,330	963	818	682	693	471
Δ %	16%	-3%	-19%	-35%	-51%	-52%	-53%	-48%	-27%

Source: Company, DICJ, compiled by Daiwa  
Note: Sector monthly rolling figures based on unofficial data sources

Rolling volume of lao Kun vs. industry since peak (ADR by month)



Source: Company, DICJ, compiled by Daiwa  
Note: Sector monthly rolling figures based on unofficial data sources

### Most junkets are struggling to break even

Based on the current economics of the junket business, we estimate that most of the junket operations are also struggling just to break even. As a matter of fact, a high proportion of junkets is loss-making today (especially true if we include the impact of the sector's estimated bad debts). Using lao Kun Group as an example, it is clear that the operator's reported profitability declined by over 95% between 1Q14 and 4Q15 with some quarters even dipping into substantial operating losses (after we adjusted for luck), as illustrated below. It is noteworthy that lao Kun Group has not booked any bad debts or allowance for doubtful accounts over the past 3 years. The economics of the junket operator would fare even worse if bad debts were indeed recognised.

A similar trend can be observed for junket operator Neptune Group (70 HK, not rated), the operating profit of which declined by 49% YoY for July-December 2015. Based on its listed documents, the operator had VIP rooms in the Venetian, Sands Macau, Galaxy Macau, and City of Dreams, as at 30 June 2015.

**Iao Kun Group (IKGH US, not rated): historical profit/loss statement**

(USD '000s)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15
Revenue from VIP Gaming	79,939	49,694	51,917	52,274	41,701	21,870	22,395	19,036
Win rate	3.6%	2.2%	2.5%	4.0%	4.2%	2.5%	4.2%	3.3%
Commission to Agents	(55,065)	(49,434)	(47,136)	(36,813)	(27,998)	(19,254)	(15,604)	(14,124)
SG&A	(6,539)	(7,322)	(5,485)	(7,160)	(5,392)	(4,645)	(4,347)	(3,971)
Special rolling tax	(477)	(467)	(432)	(287)	(220)	(174)	(127)	(122)
Operating (loss)/ income <sup>(1)</sup>	17,858	(7,528)	(1,137)	8,014	8,092	(2,202)	2,318	818
	17%	-183%	-111%	-328%	-55%	-71%	-304%	-90%
Luck adjusted operating (loss)/ income <sup>(2)</sup>	1,575	8,459	5,516	(6,788)	(5,095)	546	(4,942)	(1,999)
	-78%	66%	70%	-221%	-423%	-94%	-190%	-71%

Source: Iao Kun, Daiwa

Note: (1) excludes one-off non-cash fair value changes, (2) adjusted revenue based on normalized 2.85% statistical average win rate

**Neptune Group (70 HK): profit/loss statements**

(HKDm)	Jun-14	Dec-14	Jun-15	Dec-15
Revenue	359	284	190	133
Δ %	23%	-19%	-47%	-53%
Operating profit	156	285	(1,281)	(251)
Add-back: one-offs <sup>(1)</sup>	202	-	1,220	395
Normalised operating profit	358	285	(62)	144
Δ %	34%	-18%	-117%	-49%

Source:

Note: (1) includes impairments for goodwill/intangible assets, fair value changes in securities, other fair value changes, impairment of trade receivables, etc

**Debt-collection cycle is getting longer**
**At least HKD30bn of “healthy” gaming debts outstanding**

Collection of gaming debts continues to be a critical issue facing junket operators today, with the average collection cycle for “healthy” debts ranging between 3 and 6 months. This lengthening has a negative (and multiplying) impact on VIP revenue as the junket system’s overall capital base continues to shrink (the result of junket closures, capital withdrawals among third party depositors, and cutting of credit extension by the casino operators).

Based on current VIP gaming volume, a 3-6 month collection cycle would imply that the entire junket system’s total “healthy” outstanding gaming debt is at least HKD30bn (this excludes receivables related to side-betting, stale and bad debts).

**This figure may still be far too optimistic**

It is especially noteworthy that the above is a very conservative estimate and may still be far too low. As our calculation below suggests, the estimated total debt outstanding could easily be double at HKD60bn (or more). This assertion rests on 2 key points.

- 1) We compared our estimate against Iao Kun’s end-2015 marker receivable which was reportedly HKD1.3bn. This is equivalent to a 4.3% market share against our HKD30bn estimate above.

This suggests that Iao Kun’s market share for marker receivables is 2.7x higher than that of its VIP rolling (which stood at 1.6% in 2015). This suggests that: a) the other small/mid-sized junkets are faring much better in terms of collections (a very unlikely scenario), or b) our estimate for total outstanding gaming debts is far too low.

- 2) Again using Iao Kun as an example, the operator’s marker receivable days in 2015 was 224 days (or 7.3 months). This is significantly above the 3-6 month collection cycle assumption we used. (Note: Iao Kun has not written off its receivables for the past 3 years.)

## CNY depreciation is still a looming risk

Albeit that the short-term risks of significant CNY depreciation appear to be lower now than they were a few months ago, the overhang nevertheless remains. We have explored this in depth in our prior discussions: [CNY weakness to hit VIP even harder](#) (13 August 2015).

## Junket quality matters

### It's about risk aversion

In our view, junket quality is increasingly important in this sustained depressed environment as a key element in considering an operator's risk profile. The total outstanding leveraged capital at risk can easily be an order of magnitude as to what these junkets are doing in revenue today.

### Estimated junket stale and bad debts are multiples of "healthy debts"

The lengthening of the collection cycle, combined with the macro environment in China where capital flows are facing increasing scrutiny, have continued to increase the risk of bad debts. As things stand, industry participants have indicated to us that total outstanding stale and bad debts in the entire junket system would be multiples of "healthy" gaming debts (and distributed more heavily among the smaller junkets), implying that sector bad debt could, at a minimum, be measured in multiples of the existing "healthy" gaming debt, which we estimate at HKD30bn.

A look at the composition of the receivables of Lao Kun Group and Neptune Group indeed suggests that our estimate is conservative — more than 90% of Neptune's receivables are over 90 days (or 7x the receivables that are below 90 days), and of the receivables that are over 90 days, 64% had already been written off by end-2015.

**Junket operator Neptune Group wrote off 58% of its entire trade receivables between January and December 2015**

#### Trade receivables of Neptune Group (70 HK)

(HKD '000s)	Dec-15	% contribution
0-30 days	19,628	2%
31-60 days	18,696	2%
61-90 days	24,749	3%
Over 90 days	726,701	92%
<b>Total receivables</b>	<b>789,774</b>	<b>100%</b>
Less: write-off	(461,570)	
<b>% of receivables &gt;90 days written off</b>	<b>64%</b>	

Source: Company

#### Trade receivables of Lao Kun Group (IKGH US)

(HKD '000s)	Dec-15	% contribution
0-30 days	10,405	18%
31-60 days	8,907	16%
61-90 days	9,906	17%
Over 90 days	28,121	49%
<b>Total receivables</b>	<b>57,340</b>	<b>100%</b>

Source: Company

## What does this high level of outstanding debt mean?

When looking at the estimated total bad debts outstanding, even the conservative (and minimum) HKD30bn estimate is not immaterial, as it is equivalent to: a) 50% of the cumulative end-2015 cash balances of the 6 casino operators, or b) more than the entire capex cost of any of the Cotai 2.0 properties.

We contend that the high-quality junkets present relatively lower risk to the casino operators than the lower-quality junkets (loss-making small/mid-sized junkets that are not as well capitalised and are at greater risk of experiencing serious financial stress). Also critical is that varying degrees of balance-sheet risks do exist for the casino operators by virtue of their allowing junkets of different size and scale to operate on their premises.

That said, this is not to say that: a) the casino operators would be liable for all gaming bad debts, or b) the big and reputable junkets would not face issues (ie, we have seen notable cases of this already, including David Group and Heng Sheng over the course of 2014/15). Instead, we are highlighting that: a) junket and junket-related activities do pose risks to the casino operators, and 2) the casino operators with junket mixes largely consisting of smaller, less well-capitalised junkets have higher risk profiles.

## A read-through on casinos' premium direct business

### A significant rise in bad debts

**Gaming revenue is declining much more rapidly than the casino operators' receivables**

Macau's underlying junket business environment can also serve as a read-across to the casino operators' premium direct business (the casinos' direct-VIP business segment where the casino operators provide gaming credit directly to patrons rather than the junket operators). As we have analysed the deterioration of receivables among the two listed junket operators, a similar trend on the casino's receivables can be also observed. In the tables as illustrated below, the following key observations show the clear deterioration in casinos' receivables:

- Total trade receivables declined by only 6% YoY in 2015 despite a 34% YoY decline in GGR.
- Total receivables impaired increased from 4% of sector EBITDA in 2014 to 9% in 2015
- Trade receivables over 90 days grew by 51% YoY in 2015 and represent close to 20% of total receivables (this includes MGM, Sands, and Wynn; the remaining operators do not have the up-to-date numbers at the time of publication).
- Allowances of doubtful accounts (provisions for bad debts) increased by 28% YoY against a declining receivables and revenue base.

**Casino operators are collectively writing off an increasing amount of receivables**

#### Casino operators: trade receivables

(USDm)	2012	2013	2014	2015
Gross gaming revenue	37,954	45,018	43,867	28,928
YoY growth	14%	19%	-3%	-34%
Sector adjusted EBITDA	6,569	7,648	8,634	5,175
YoY growth	25%	16%	13%	-40%
Gross trade receivables	2,658	2,535	2,453	2,294
YoY growth	4%	-5%	-3%	-6%
<b>Receivable impaired</b>	<b>556</b>	<b>477</b>	<b>521</b>	<b>669</b>
YoY growth	-8%	-14%	9%	28%
Allowance for doubtful accounts (% of gross)	21%	19%	21%	29%
Receivables impaired as % of group adjusted EBITDA	5%	4%	4%	9%

Source: Companies

**Trade receivables over 90 days are growing rapidly, signalling further collection risks**

#### Casino operators: aging summary (as % of total)

(USDm)	2012	2013	2014	2015
Within 30 days	85%	85%	78%	62%
31-60 days	4%	5%	9%	12%
61-90 days	4%	4%	3%	7%
<b>Over 90 days</b>	<b>7%</b>	<b>6%</b>	<b>10%</b>	<b>19%</b>
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Trade receivables &gt;90 days (YoY growth)</b>	<b>13%</b>	<b>-16%</b>	<b>24%</b>	<b>51%</b>

Source: Companies

Note: The cumulative balances of MGM, Sands China, and Wynn Macau as disclosed.

(Note: based on publicly disclosed information, the operators do not provide a trade receivable breakdown by segment. However, the majority of trade receivables are casino receivables described as being related to the operator's "casino rolling business", "gaming promoter credit", "credit to approved casino customers", "advances to gaming promoters and patrons".)

## Fortune favours the bigger junkets

### Junket table movements

**Large junkets continues to capture additional market share in Macau**

We updated our junket table count analysis in March 2016. When compared with June 2015, we estimate that the overall number of junket tables has fallen by 14% to 1,287. While the magnitude of the table reduction seems modest, both the table mix and VIP market share within the segment continue to see significant swings.

All in all, we have witnessed a sustained market shift towards Macau's top junkets, which remain Suncity and Tak Chun. The operational footprints of the said junkets have expanded over the past 6 months, and are likely to see further expansion when junket capacities are introduced in Studio City later this year.

### Casino operators' risk profile: Wynn and Melco Crown face highest risk

In this report, we analyse the relative quality of the junket and revenue mix among the casino operators. We evaluate this primarily based on junket size, as well as anecdotal commentary from industry participants on the recent performance of the junket operators. We also examined the revenue contribution of the operators' premium-direct business, which possess high collection risk.

On our analysis, Wynn and Melco Crown stand out for being the most exposed of the operators to: 1) the riskier portion of the junket business, and 2) to premium-direct business. While the market largely perceives Melco Crown to be a premium mass-centric property, with little emphasis on the VIP business, our view on Wynn may run counter to common expectations. However, the proportion of small junkets within Wynn's portfolio (both in terms of gaming tables and implied gaming volumes) is indeed much higher than for its peers (3 of 12 resident junket operators are small and operate exclusively in Wynn, accounting for ~20% of Wynn's total junket tables, by our count). Against this finding, we are particularly concerned about the street's overall bullish expectations for Wynn Palace's opening for the following reasons:

1. Wynn's current GGR exposure to the VIP and premium-direct segments is still among the highest in Macau, and a mass-focused business has never been Wynn's business model in Macau over its operating history. Indeed, execution of a premium mass-centric strategy for Wynn Palace is a risk and the ramp-up of its mass business may disappoint the market in the short run by taking longer than expected.
2. Wynn's smaller junkets are unlikely to have the financial capability to open additional VIP rooms in Wynn Palace. Upon Palace's opening, they are most likely going to: a) stay at Wynn Macau, or b) close their existing rooms and move to the Palace. Neither scenario is likely to generate significant incremental revenue for Wynn.
3. It is also noteworthy that since 1H15, GM2 is the only new property that has expanded its junket rooms (Studio City did not initially open the property with VIP offerings). Despite being the clear leader in this segment, GM2 only opened with 2 new VIP rooms, and both are the top-2 junkets in Macau that also had operations at GM1. Only 1 of these 2 junkets currently operates at Wynn Macau today.

### March 2016 junket table count

Mar 2016 count	Est. Rolling Market Share	Sands China				Galaxy				MPEL			MGM	Wynn	SJM			Total	Variance (vs. Jun15)		
		Venetian	SCC	Plaza	Sands Macao	Total	GM1	GM2	SW	Total	City of Dreams	Altira	Total	MGM	Wynn	Grand Lisboa	Self-promoted	Satellite Casinos		Total	
Suncity Group	40%	18	15	16	11	60	20	16	20	56	24	11	35	40	20	37	-	41	78	289	4.7%
Guangdong Group	11%	14	10	-	12	36	13	-	11	24	9	-	9	22	14	13	-	13	26	131	-27.6%
Tak Chun Group	8%	-	-	-	-	-	-	-	-	-	-	-	-	-	-	72	20	4	96	96	7.9%
Macau Golden Group	8%	13	12	-	-	25	12	10	14	36	8	11	19	-	-	-	-	9	9	89	-7.3%
Junket tables		56	83	16	38	193	143	40	102	285	94	37	131	105	137	145	32	259	436	1,287	-14.0%
Large junket table count <sup>(1)</sup>		45	37	16	23	121	45	26	45	116	41	22	63	62	34	122	20	67	209	605	-5.8%
Mid-size junket table count <sup>(2)</sup>		-	22	-	12	34	69	14	26	109	30	10	40	26	47	23	-	132	155	411	-28.4%
Small junket table count <sup>(3)</sup>		11	24	-	3	38	33	-	31	64	23	5	28	17	56	-	12	60	72	275	-2.9%
Direct VIP tables		34	52	14	7	108	52	31	-	83	-	-	-	35	91	16	4	2	22	339	-11.4%
Total VIP tables <sup>(*)</sup>		90	135	30	45	301	199	71	102	372	94	37	131	140	228	161	36	261	458	1,630	-13.7%

Source: Daiwa estimates

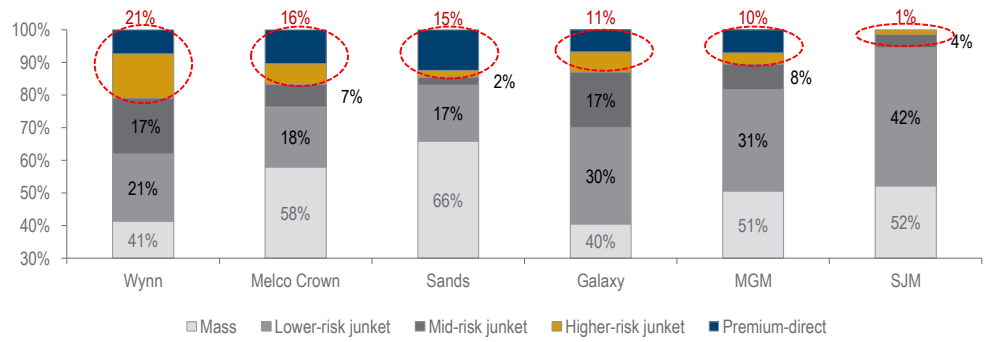
Note: 1) Large junkets: junkets with multiple property exposure that operate more than 50 tables; 2) mid-size junkets: junkets with presence in >2 casinos and operate 20-50 tables; 3) small junkets: junkets that operate fewer than 20 tables with presence in 1-2 casinos

(\*) Table count carried out between February-March 2016. Our estimates may differ from the operators' published/formal official counts



**Wynn and Melco Crown's VIP revenue feature the largest contributions from lower-quality junkets, on our estimates**

Revenue contribution breakdown by segment



Source: Daiwa estimates

Note: \*Does not include revenue contribution from satellite casinos, \* breakdown on premium-direct based on 4Q15 unofficial figures compiled by Daiwa

- (1) High risk: revenue generated by small junkets defined as junkets that operate fewer than 20 tables over 1-2 properties
- (2) Mid risk: revenue generated by mid-sized junkets defined as junkets that operate 20-50 tables with exposure in more than 2 properties
- (3) Low risk: revenue generated by large junkets that operate more than 50 tables (Suncity, Guangdong, Tak Chun, Macau Golden)

## Appendix I

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***Translation disclaimer:***

*The written interpellations and government responses contained herein (“Documents”) have been translated for your convenience. We provide these for information purposes only.*

*The English version is a translation of either the original in Chinese, or a translated document in Chinese based on the original. In case of a discrepancy, the Chinese or Portuguese original will prevail.*

*Daiwa Capital Markets Hong Kong Limited endeavours to ensure the accuracy and reliability of the translation in the Documents but does not guarantee its accuracy or reliability and accepts no liability for any loss or damage arising from any inaccuracies or omissions.*

## José Pereira Coutinho: Written Interpellation to MSAR (submitted 2 February 2009)

### WRITTEN INTERPELLATION

Based on Macau's prevailing condition and its due course of development, MSAR has made the decision to liberalize and open Macau's gaming industry since the official handover. In 2003, MSAR officially granted 3 gaming concessions, and granted an additional 3 sub-concessions thereafter. This ushered in a new period of gaming industry's development in Macau.

Against Macau's special heritage as well as its unique administrative structure, the Chief Executive of MSAR, on the basis of Macau's "Basic Law", issued Executive Ruling No. 120/2000 on 29 June 2000. This ruling created The Gaming Commission with aims of studying the development and managerial aspects of the gaming industry. The commission is also responsible for formulating and implementing policies on a timely basis as necessary in order to ensure the healthy and sustainable development of Macau's gaming industry.

Throughout the many years of the gaming industry's liberalization, the economic environment of Macau experienced many changes and this was coupled with the significant structural changes within the gaming industry. Regrettably, however, we have witnessed aggressive competition within the gaming industry as a result of the granting of additional gaming concessions. Such competition does not fall short of "over aggressiveness". After years of unhealthy conduct amongst operations, large structural issues within the gaming industry began to emerge. The government's persistent pursuit of economic benefits through gaming taxes along with an unproductive Gaming Commission largely overlooked the industry's overall health and sustainability. The lack of a holistic framework governing the operation and management of the gaming industry contributed to the dire predicaments we face today.

#### **MSAR, gaming concessionaires/sub-concessionaires, junket investors and their clients: the interlinking of these 4 parties**

Casino business is Macau's largest industry and gaming taxes is the government's most important source of income. Naturally, MSAR pays heavy attention to the casino operators, and casino operators pay special attention to the junket operations. Junket investors, in turn, pay heavy attention to quality clients, gaming operations regime, business environment and social economic conditions. Currently, there is a lack of a well-rounded regime governing the operations and development of the gaming industry. Together with adverse overaggressive competition, difficulties in recouping invested capital, there is less room for survival for junket investors. A substantial number of junket investors have been negatively affected and this problem is only exacerbating.

Another major issue is the lack of legal recognition of "markers" under the gaming industry regulatory regime. A marker is the note signed by clients when junkets (as licensed agents) extend credit to them – a lot of junket investors find it difficult to collect the credit extended to clients. From the junket investor's perspective, there exist no way of safeguarding their means of operations. Against the significant risks of debt collection, junket operations find themselves facing significant risks in order to sustain business operations.

Currently, it is fair to say that a significant proportion of junket investors already lack the necessary capital to continue operating in this business environment. If we do not institute proper safeguards and to properly regulate the industry, the results for the junket businesses will be both unimaginable and disastrous. This will undoubtedly adversely impact the sustainability of Macau's gaming and tourism industries.

#### **In the spirit of the aforementioned issues affecting the sustainability and health of Macau's gaming industry, I submit the following written interpellation to the MSAR:**

1. In the face of the rapid development of the Macau gaming industry, coupled with the lack of legal framework governing the junket industry, casino investors (and particularly junket investors) have been steered to engage in unhealthy and over-aggressive competition.

The marker junket investors (as licensed agents) rely on when extending credit is not an actually legally binding document. Therefore, many junket investors are facing difficulty in debt collection. The consequential rise in bad debts will ultimately lead to junket room closures. In this context, when will the MSAR government set up proper legislation to safeguard the licensed credit providers (i.e., junkets) and their operations? Under what mechanism and legal basis will the MSAR put in place to ensure the legal enforceability of markers?

2. Owing to the lack of a regulatory regime in the gaming industry, majority of licensed credit providers (junket investors) face difficulty in collecting gaming debts. Not only has this resulted in a massive accumulation un-recuperated invested capital, it also severely affect normal business operations. This is a risk and a call for concern for the entire gaming industry. In the spirit of protecting junket investors, the normal operations of junket business, and the sustainability of the Macau gaming industry, when will the MSAR government enact laws to criminalize debtors who fail repay gaming debts in the form of "markers"?
3. Macau's gaming industry has been facing the aforementioned risks and concerns for years and they have been simmering and aggravating, yet the legal deficiencies remain. What has the DICJ done in the past 9 years to address these concerns? How will the MSAR monitor the work of DICJ going forward?

MSAR  
Member of the Legislative Assembly  
**José Maria Pereira Coutinho**  
17 September 2009

**MSAR: written response to Written Interpellation submitted 2 February 2009 (dated 17 April 2009)**

**Governo da Região Administrativa Especial de Macau  
Comissão do Jogo de Macau**

1. Relating to the first question, attention must be paid towards the relevant legal framework:

As a matter of fact, the Legislative Assembly has already established a gaming credit law in 2004 (Law No. 5/2004, "Gaming Credit Administrative Regulation", enacted on June 14, 2004) governing the granting of gaming credit in the MSAR.

The gaming credit law sets out the legal framework that governs credit lending in the gaming industry. The law not only provides definition of gaming credit lending (article 2) and specifies authorized parties to provide such business (article 3), it also sets out regulations that governs gaming credit lending, such as the inability for such parties to conduct other business outside of this scope (article no. 5) and matters of confidentiality (article no. 10).

Furthermore, what is set forth by Law No. 5/2004 and Civil Code No. 1171 are indeed different. The laws are explicit and are to be used to classify such instruments and its treatment should be accordingly under the respective legal frameworks. In other words, debts arising from casino games and gambling does not strictly constitute as debt as defined above; as such, recourse can be sought through judicial proceedings.

On the other hand, the principle that grants the freedom of issuing debt do exist under the code of debt securities issuance, pursuant to the Commercial Code No. 1064. Within this framework, there is no special framework governing the issuances of debt securities that can be signed out. As long as the rationale behind such issuances of debt is stated, the law does not prohibit this.

In general, the debt security used between debtor and creditor is categorized as such, and is named as 'marker' in the United State of America.

Since 'marker' is a form of debt security, it enjoys the same legal protection as a debt security. Therefore, once a debt security is labelled a 'marker' (pursuant to Code of Civil Action No. 677 Article C), the creditor may directly exert his civil rights, without the need to first clarify his right, to launch a complaint and to recuperate this debt through legal channels.

As illustrated, the existing legislation as well as related legal protection have been in place and are effective and adequate. At the same time, should the debtor not fulfil his repayment obligations, the rights of a creditor - as a legal entity engaged in the business of providing credit - are protected by law and the methods through which such legal entity could exercise its right as a creditor are clearly stated.

2. In relation to the second question, as mentioned in the above, the existing legal framework already provides effective and adequate legal protection to entities that are legally eligible to conduct issuances of debt securities.

However, we believe it is inappropriate to criminalize debtors who fail to repay gaming debts.

This is because not all debt securities have the characteristic of a 'marker' since debt securities may not involve a payment order issued by the debtor's bank account to indicate that the creditor as the actual beneficiary.

Furthermore, it has never been proposed that the same criminal conviction shall apply to a blank cheque and a bad gaming debt. The reasoning behind providing special protection against blank cheques is due to the advantage of lowering currency flows and to protect the confidence of using this medium which has become a common form of payment. As the saying goes, 'the purpose of convicting against a blank cheque is not to protect property; it is to protect the cheque itself.'

Furthermore, it is important to remember that the majority of creditors do not reside in Macau. Most of their places of residence are located in jurisdictions where such related debts are not legally enforceable.

Lastly, and on a point that is particularly important – the number of instances of bad debts that resulting in judicial proceedings as described is extremely low.

Therefore, criminalizing non-repayment of gaming debt is both meaningless and offers not tangible benefits.

3. Lastly, in regards to the third question, it must be pointed out that the Macau government has always adopted a responsible attitude and has been closely monitoring the development of the gaming industry; the DICJ has been in close communication with bodies that monitor gaming operations as well as gaming operators and has also been working efficiently to lower financial risks and minimize chance of any negative impact that may arise from debt securities, in order to achieve benefits for the general public.

Macau, dated 17 April 2009

Commissioner for Legal Affairs for Macau Gaming Commission  
Jorge Oliveira

**José Pereira Coutinho: Written Interpellation to MSAR (submitted 14 September 2009)**

**WRITTEN INTERPELLATION**

This is in regard to the response received from MSAR dated 17 April related to the written interpellation I have submitted on 2 February discussing the related legal framework as well as safeguards of rights for junkets and their investors. The response from the relevant departments of the government did not directly resolve the looming distress faced by the junkets, and such response could only be described as “extremely bureaucratic”, “irresponsible”, “turning a blind eye”, and “failure to act”.

Has MSAR considered how important the gaming industry is to Macau’s economy? Gaming taxes constitutes over 80% of Macau’s total tax revenue. As of May this year, total tax revenue stands at MOP18.3b, of which 15.3b comes from gaming taxes, or 83%. MSAR frequently stresses how important the gaming industry is to Macau and its economy, but its chief concern seems to be tax revenues from the gaming concession/sub-concessions. The government has never contemplated implementation of the critical and necessary oversight and safeguards to protect investor rights of this industry.

Since 2002, the economic benefits and contribution from junket businesses are very high representing an average 70% of gross gaming revenue. Using 2Q09 as an example, Macau’s GGR was MOP24.7b, of which 64% was contributed from junket rooms (or MOP15.1b). \*

Junket operations do face extreme risks since the majority share of their business originates from those who do not reside in Macau. The operations also require significant credit provisions between junkets and their customers. The government’s lack of specific policies and safeguards to this types of activities have directly led to the ability for customers to utilize legal loopholes to i) repeatedly obtain substantial gaming loans from different junkets amounts ranging from a few million to tens of millions of HKD, and ii) leaving Macau with ease without repaying these loans. Over due course, this has resulted in the accumulation of tens of billions HKD in bad debts among junkets. This has resulted in further aggravating the already aggressive and unhealthy competitive environment. This has prompted further provisions of credit, increasing unrest and conflicts of interests, and a slew of social issues. A number of junkets can no longer bear this extreme risk that has resulted in gaming tables cuts and staff layoffs. We witnessed almost 10% cut in gaming tables from 4,375 tables at the peak in 2007 to 3,998 by 1Q09. This has threatened the very livelihoods of tens of thousands of local Macanese. This will be detrimental to the stability and health of Macau’s leading industry as well as severely damaging the peace and prosperity of Macau’s society.\*

Since the liberalization, the gaming industry has seen rapid development which ushered Macau’s into a new phase of economic prosperity. Given this unique position, MSAR should institute laws and regulation to safeguard and protect this “pillar of economy”. However, whether is it because a fear of threatening the industry or because of the existing vested interests and conflicts of interests, the government has chosen to look away from especially concerning issues faced by the junkets. The government’s response to my written interpellation only touched very lightly on and vastly understated the enormity of bad debts junkets faces, and advised to seek recourse following the “Code of Civil Procedure”. The response comment’s “...majority of creditors do not reside in Macau. Most of their places of residences are located in jurisdictions where such related debts are no legally enforceable” argues that the government’s inability to supervise the aforementioned credit activities is simply irresponsible. Taking out large amount of credit from junkets without intention of repayment through abusing the government’s negligence and legal loopholes is an offense of fraud which seriously harms the industry, the economy, as well as the livelihoods of the general public.

Once again, the response indicated the lack of need to combat and eradicate these scams and crimes, shows the government’s irresponsibility. And to state that “criminalizing non-repayment of gaming debt is both meaningless and offers not tangible benefits” is just another way of indicating the government’s tolerance in allowing “unlawful parties” to continue damaging Macau’s biggest industry. The government is essentially acting as an accomplice in destroying Macau’s very economy.

Has the government actually try to understand the condition of the ruined state of the junket business environment? Does the government understand the importance of this segment’s contribution to the gaming industry’s development? Does the government realize how much tangible benefits is derived from them? The government appears to only focus on gaming taxes and ignored the difficulty all of them face and their ultimate survivability.

Has the government ever contemplated that, other than the hard work of the local Macanese, that a large reason for the gaming industry’s success we see today is on the backs of the junkets? That junkets have contributed cash investments in the magnitude of tens of billions, and this has resulted in significant gaming taxes for the government? The government purposefully did not fulfill the responsibility in building a safe and secure investing environment, nor acknowledge their significant operating risks. This has led to significant damages to these parties – is this the attitude that a responsible government should be taking?

A number of junket investors has expressed to me the pessimism they feel towards Macau’s future gaming industry with plans to redirect investments to other jurisdictions such as Singapore. If this is true, the diversion of capital will result in a chain reaction that will cripple Macau’s gaming industry and result in significant risks to Macau’s overall economy. Is the government going to bear responsibility for this disaster?

**Given the situation as described above, I submit the following interpellation to MSAR:**

1. Will the MSAR set up civil and judicial policy specifically to penalize and prevent debtors who have failed to repay debts from continuously obtaining credit from different casinos and junket operators?
2. What policy or strategy does the MSAR have in place to increase competitiveness of Macau’s gaming industry, improve investing environment, attract and retain gaming investors to continuously invest in Macau, and prevent investments from diverting to nearby gaming jurisdictions?

MSAR  
Member of the Legislative Assembly  
**José Maria Pereira Coutinho**  
17 September 2009

Source: Assembleia Legislativa, Daiwa

Note: \* 2002 to 2009 data on junket and casino revenues are featured in the original interpellation but are omitted in this translation as they are out of date

**MSAR: written response to Written Interpellation submitted 14 September 2009 (dated 11 November 2009)**

澳門特別行政區政府  
Governo da Região Administrativa Especial de Macau  
博彩監察協調局  
Direcção de Inspeção e Coordenação de Jogos

**Response to the written interpellation of José Maria Pereira Coutinho dated 14 September 2009**

First and foremost, the MSAR government has always been extremely attentive to issues in Macau's gaming industry.

The fact of the matter is that the gaming industry is one of the most regulated industries in Macau both on the civil, criminal and commercial code levels.

Particularly, the Civil Code dedicated a chapter (Article No. 13) on gaming regulation. The legislative council also enacted laws to regulate the gaming industry, these laws include: Law No. 16/2001 (Macau Gaming Law), Law No. 5/2004 (Gaming Credit Law), as well as laws that regulate illegal and criminal gaming activities; Moreover, the gaming industry is also regulated through a series of civil regulations, including Law No. 27/2009 (Amendment to Administrative Regulation no. 6/2002 with regulations relating to gaming promoters).

The Commercial Code has also incorporated unprecedented legislative measures. Such measures take particular aim at regulating credit lending activities carried out by junket agents and gaming promoters. (For example: bearer debt securities, floating charge, independent guarantee/first demand, pledge rights and stock pledge rights, etc.)

Furthermore, the MSAR government will examine ways to assist industry participants in developing a customer database and improve transparency on debtors' credit backgrounds, credit trustworthiness and repayment ability, so as to allow creditors to efficiently evaluate credit risks.

On the other hand, the MSAR government is avidly promoting Macau as a "world tourist destination", and will continuously improve Macau's infrastructural software and hardware throughout this process. We believe that investors, including those with investments in the gaming industry, will continue to invest and be encouraged to increase their investments in Macau.

Director of Direcção de Inspeção e Coordenação de Jogos (DICJ)  
Manuel Joaquim das Neves  
19 November 2009

Source: Assembleia Legislativa, Daiwa

## José Pereira Coutinho: Written Interpellation to MSAR (submitted 8 October 2015)

### WRITTEN INTERPELLATION

Our office has recently received complaints from almost 50 Macau residents related to Wynn Macau's Dore VIP room whose investors had all the funds deposited into the said junket which is now unreasonably frozen. This has purportedly been caused by the embezzlement of one of a high ranking employee. This news has not only shocked the entire Macau, it also heightened global attention towards the development of Macau's largest industry. Concurrently, not only has this office received complaints from local Macanese, we had also received grievances from mainland China and Hong Kong residents (albeit a small number) - they had pointed out that significant capital was invested into said junket which has now resulted in substantial losses. Over the course of dealing with this case, our office has a total outstanding amount frozen at upwards of HKD350m.

This case has been exposed for well over two weeks, but not a single government department (DICJ, DICJ audit department, Macau Monetary Authority, the Financial Intelligence Office and the Office of Finance and Economy) has contacted the relevant personnel to understand the situation. At the same time, DICJ recently issued a press release indicating that unauthorized credit agencies operating inside junkets and VIP rooms cannot receive "deposits" from local residents. However, analysis conducted by this office finds that the junket operators use a number of different methodologies and loopholes to accept Macau resident's "deposits", such as contracts, verbal agreements (WeChat, Whatsapp), electronic wire transfer (in the name of an individual or an institution), and others.

On the other hand, I have submitted two different written interpellations in 2009 which has described the aforementioned business operations and the risks involved. The statement also stressed the deficiencies in the existing legal framework as well as to highlight the significant risks that means to the industry and to the general public. This can cause severe damages to our gaming industry and to our economy.

At the time, the official government responded by indicating that the industry's structure and related legislature to be stable and robust and commented that "majority of creditors do not reside in Macau", "number of instances of bad debts that result in judicial proceedings was described is extremely low". These comments deceive not only themselves but also the general public. The government also evaded responsibility by stating that "...this proposal is both meaningless and does not offer tangible benefits" to deny amendments seeking to rectify the identified legal loopholes. As we face what has happened with Dore today is proof of the government's lack of foresight and crisis management. This makes the government's frequent axiom "living in peace while vigilant against crisis" both empty words and a joke.

According to Administrative Regulation No. 34/2003 (The Structure and Operations of DICJ) Article 2(2)(7), the supervision of the gaming concession/sub-concessions and junket activities is one of DICJ's chief responsibilities. Article 2(8) further asserts that DICJ's audit department to be responsible for "monitor, supervise, and regulate junket and all of their commercial accounting books and documents so to facilitate the audit". As such, in relation to the embezzlement case of Dore's employee, constitute a dereliction of duty on the part of the relevant departments, and is an issue we look upon the leading government officials to examine.

Additionally, in relation to Article 23(3) of Law 16/2001 (Legal Framework for the Operations of Casino Games of Fortune), "the concession/sub-concessions shall supervise the activities conducted by junkets as well as that of their respective executive/administrative employees and other partners; as well as to bear responsibility to the government for these parties' compliance to rules and regulations". As such, Wynn Macau Limited (the gaming concession) has the obligation to regulate Dore's activities, as well as bear responsibility to this incident for violation of its responsibilities.

Furthermore, Article 31 of Law 6/2002 indicates that "junket and related staff and partners must bear responsibilities for activities carried out in the casino, and are jointly responsible for their compliance with applicable laws and regulations" which is to say that Dore junket bears the responsibility for this incident. At the same time, Article 29 of the same law indicates that "the concession/sub-concession and the junket operator are jointly responsible for the compliance of applicable laws and regulations in relation to activities carried out by the junket executives, partners, and related employees working in the casino." This is to say that Wynn Macau Limited has to take responsibility for the incident of embezzlement by Dore's employee.

**Given the situation as described above, I submit the following interpellation to MSAR:**

1. Various government departments (namely, the DICJ, DSEC, the Macau Monetary Authority, the Financial Intelligence Office and the Office of Finance and Economy) have obligations to monitor, audit, and regulate operations of the gaming concession/sub-concessions as well as that of the junkets. Given that gaming is Macau's core industry, money flows within the industry should be carefully monitored. The abscondment of MOP2bn could not have been done easily by a single individual and must have been the result of diligent planning and the joint efforts of various parties. Yet, why has the DICJ, the DSEC, the Macau Monetary Authority, the Financial Intelligence Office or the Financial Services Bureau not been able to detect any glitches before the incident happened? Does this not constitute a serious negligence of duties that ultimately led to serious damage to Macau People's welfare?
2. The Dore incident has revealed an enormous loophole in the junket industry, yet the industry represents the biggest source of income for the Macau government. The incident has adversely affected society, damaged the image of the gaming industry as well as its monitoring bodies, and weakened authority of the Macau government and overall confidence in Macau's future developments. Given the challenging environment that the junkets now operate in and the apparent risks in the industry, what strategies does the MSAR government have in place to recuperate Macau citizens' confidence in the Macau gaming sector and to address the "grey areas" and loopholes of the law?
3. All along, the government has indicated that the related business operations by gaming concession/sub-concession and junkets as described bears no problems, that the industry is very stable, and will lead Macau's overall economic growth and stability. However, the truth does speak louder than words. This incident clearly illustrates the prevailing risks within the gaming industry. Our first priority should be to rectify this issue expediently as a precaution against further deterioration.

In the Dore incident, a portion of the absconded capital is invested by local citizens in junket operations. According to the Basic Law, the MSAR government has the obligation and duty to recuperate debt owed to Macau citizens from respective debtors. Pursuant to Law No. 6/2002 Article 31: Gaming promoters and their employees are jointly liable for junket activities carried out in casinos and must abide by the same legal and regulatory rules and responsibilities. Pursuant to Law No. 6/2002 Article 29: The concessionaires and gaming promoters are jointly liable for junket activities carried out by the junket, its employees, directors, and partners in the casinos and must abide by the same legal and regulatory rules and responsibilities. As such, will the MSAR government assist Macau citizens in recuperating losses in the Dore incident from Wynn and Dore Group, and increase oversight and regulation of the junket industry, to ensure that such incidents will not repeat themselves and to safeguard the sustainable development of Macau's gaming industry?

MSAR  
Member of the Legislative Assembly  
**José Maria Pereira Coutinho**  
8 October 2015

Source: Assembleia Legislativa , Daiwa

**MSAR: written response to Written Interpellation submitted 8 October 2015 (NA)**

**No response from MSAR government to date.**

Source: Assembleia Legislativa , Daiwa



## Appendix II

### Large Amount Transaction Report

## Large Amount Transaction Report

Date:
Casino:
Location:

### 1. Participant

Name:	
Report Writer:	Signature:
Telephone:	

### 2. Identification

Name: (could be more than one)	Sex (M/F):
ID / Passport No.:	Nationality:
Date of Birth / Place of Birth:	
Address: (could be more than one)	
Occupation:	
Identification documents for verifications:	

### 3. Transaction

Date of Transaction:
Amount Involved:
Source of Fund:

### 4. Description (Please provide detailed information; attach additional pages if necessary)

Signature of the follow-up and coordination personnel

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Rating	Percentage of total
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Source: Daiwa

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