NCA
National Crime Agency

Chinese Underground Banking and 'Daigou'

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Purpose

This document has been compiled by the National Crime Agency's National Assessment Centre from the latest information available to the NCA regarding the abuse of Chinese Underground Banking and 'Daigou' for money laundering purposes. It has been produced to provide supporting information for the application by financial investigators from any force or agency for Account Freezing Orders and other orders and warrants under the Proceeds of Crime Act 2002. It can also be used for any other related purpose. This document is not protectively marked.

Executive Summary

- The transfer of funds for personal purposes out of China by Chinese citizens is tightly regulated by the Chinese government, and in all but exceptional circumstances is limited to the equivalent of USD 50,000 per year. All such transactions, without exception, are required to be carried out through a foreign exchange account opened with a Chinese bank for the purpose. The regulations nevertheless provide an accessible, legitimate and auditable mechanism for Chinese citizens to transfer funds overseas.

- Chinese citizens who, for their own reasons, choose not to use the legitimate route stipulated by the Chinese government for such transactions, frequently use a form of Informal Value Transfer System (IVTS) known as 'Underground Banking' to carry them out instead. Evidence suggests that this practice is widespread amongst the Chinese diaspora in the UK.

- Evidence from successful money laundering prosecutions in the UK has shown that Chinese Underground Banking is abused for the purposes of laundering money derived from criminal offences, by utilising cash generated from crime in the UK to settle separate and unconnected inward Underground Banking remittances to Chinese citizens in the UK. The cash is frequently deposited into 'mule accounts' held by Chinese students as the first step in the process.

- Cash derived from criminal activity is also paid into the accounts of persons carrying out a form of retail commerce known as 'Daigou', where goods in demand in China are purchased in the UK by Chinese citizens and exported to China for sale there, often in contravention of Chinese customs controls.

Chinese Underground Banking

1. Chinese Underground Banking is a form of informal value transfer system (IVTS), commonplace within the Chinese community in the UK and in many other countries. It is likely that its prevalence is driven at least in part by the Chinese government's policy and regulations regarding personal foreign exchange transactions and the removal of capital from China.

2. In China, foreign exchange matters are controlled by the State Administration of Foreign Exchange (SAFE), which has, since 1998, been a government agency under the control of the People's Bank of China. SAFE has a number of responsibilities including drafting regulations and policy related to foreign exchange and supervising and inspecting foreign exchange transactions.

3. The main law of the People's Republic of China governing foreign exchange is titled 'Regulation of the People's Republic of China on Foreign Exchange Administration'. This law was originally drafted in 1996, and was last updated in 2008 (中华人民共和国外汇管理条例(2008修订)[现行有效])

4. As a means of implementing the law, SAFE issued the 'Measures for the Administration of Individual Foreign Exchange (个人外汇管理办法)' in 2006. More specific details about the implementation of this legislation were set out in an additional publication – The 'Detailed Rules for the Implementation of the Measures for the Administration of Individual Foreign Exchange' (个人外汇管理办法实施细则， the

'Detailed Rules') – in February 2007. These rules contain the specific regulations and requirements for currency transfers. This legislation applies to both Chinese nationals or organisations and foreigners or foreign organisations living or operating in China.[1]

5. Under these regulations, in particular the 'Detailed Rules', in nearly all circumstances the maximum value of foreign exchange transactions permissible by a Chinese citizen in a calendar year is the equivalent of USD 50,000. In addition, since 2017, the maximum permissible value of overseas withdrawals by a private individual using a Chinese bank card has been set at RMB 100,000 – approximately USD 13,988.

6. The rules also stipulate that Chinese citizens wishing to transfer money out of China, up to the USD 50,000 cap, must do so via a foreign exchange settlement account opened for the purpose with a SAFE–approved bank on production of a valid identity card and any other documents justifying the transaction requested by the relevant bank, depending on its purpose[2].

7. An additional regulation issued in November 2009, titled 'Notice of the State Administration of Foreign Exchange on Further Improving the Management of Personal Settlement and Sale of Foreign Exchange' (国家外汇管理局关于进一步完善个人结售汇业务管理的通知) states that Chinese citizens are not permitted to attempt to circumvent these controls, particularly the USD 50,000 limit, by dividing a larger sum into smaller amounts and asking friends, family or associates to use their 'allowance' to transfer these amounts overseas (a practice described by SAFE as 'splitting').

8. Further clarification, contained within the 'Measures for the Administration of Individual Foreign Exchange' states that, if there are exceptional circumstances where a Chinese citizen needs to transfer funds in excess of the annual USD 50,000 limit out of China, for example because they are permanently emigrating to another country and wish to buy a house there with the proceeds of the sale of a property in China, they are required to do so through a bank authorised by SAFE and to supply various additional documentation justifying the transaction, which will be verified and checked for authenticity by the bank.

9. Financial institutions on the Chinese mainland are currently required to report all cash deposits or withdrawals valued over RMB 50,000 (or an amount equivalent to USD 10,000 in foreign currencies) to the People's Bank of China. For cross-border transactions settled in Renminbi[3], the reporting level is RMB 200,000.

10. Passengers leaving China with in excess of RMB 20,000 cash or any foreign currencies in cash equivalent to USD 5,000 require a permit issued by the bank that provided the currency. For amounts over USD 10,000, the passenger must complete a declaration form and pass through the "Goods to Declare Channel" (Red Channel) at international airports, seaports, train or bus stations; they must also provide a formal written application, a valid passport, a foreign currency certificate and a document outlining the reason for the need to carry the cash out of the country[4].

11. Breaches of the legislation by individuals in China, including carrying out foreign exchange transactions other than through a bank, are punishable by a fine of up to 30% of the foreign exchange involved (although more serious cases can be subject to criminal sanctions). Businesses facilitating this type of activity – referred to as 'Underground Money Shops' – are regularly

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[1] Article 4 of the Regulation of the PRC on Foreign Exchange Administration

[2] See www.boc.cn/en/pbservice/pb4/200806/t200806_1323972.html

[3] 'Renminbi' translates as 'the people's currency'; the basic unit of the Renminbi is the Chinese Yuan.

[4] http://english.customs.gov.cn/Statics/88707c1e-aa4e-40ca-a968-bdbdbb565e4f.html

prosecuted under criminal law by the Chinese authorities[5], who recognise 'Underground Banking' as a significant money laundering and terrorism finance threat[6].

12. Permissible purposes for purchase of foreign exchange in China are dictated by banks in accordance with guidance issued by SAFE. These can include 'studying abroad at one's own expense, living costs, traveling abroad, business visit, visiting relatives and friends, seeing doctors abroad, pilgrimage, overseas training, being employed to work abroad, international exchanges, leaving the country and settling abroad, dispatched labour, overseas mail order costs, payment of membership fees to international organisations, relieving overseas direct relatives, overseas consulting and other relevant charges'[7]

13. There is currently no legal means for Chinese citizens to transfer currency overseas for the purpose of buying property as an investment. Buying property abroad as a permanent residence after emigrating must be effected from a capital account, and any person doing so must provide the bank effecting the transfer with proof of the cancellation of their residence in China. Buying property for any other purpose is regarded as an individual direct investment which is currently not permitted by the Chinese authorities.

14. The proper channel to be used by a Chinese citizen who wishes to invest money abroad is to register with, and use, a business approved by the Chinese Government 'Qualified Domestic Institutional Investor' (QDII) programme. Conditions for businesses registering as a QDII include having personnel with experience of investment abroad (including 1 member with over 5 years and a further 3 members with over 3 years). Rules apply to the value of assets and number of years in operation, which vary according to the business type (e.g. RMB 200 million in net assets plus 2 years in business for asset management companies; RMB 800 million in net assets plus 1 year in business for securities firms).

15. Chinese citizens who wish to transfer funds overseas for the purposes of investing in property or who do not wish to comply with their country's laws and regulations concerning foreign exchange for some other reason, will therefore need to find an alternative method for executing a transaction. As a result, a thriving market has developed, between China and many western countries, which requires the transfer of large amounts of funds out of the country, in contravention of the laws of China.

16. This alternative mechanism is underground banking. This mechanism involves paying the amount required to be remitted overseas to a bank account controlled by a Chinese IVTS provider, who then arranges for a reciprocal payment to be made into a bank account of the remitter's choice in the UK (or wherever the chosen destination is).

17. This form of IVTS is frequently encountered in many countries where there is a significant expatriate Chinese community. As one of the main drivers for this activity is the restrictions on moving money out of China, it is likely that any Chinese national wishing to move funds anywhere out of China without the knowledge of the Chinese government will be drawn towards this methodology.

18. Chinese IVTS providers will gain more customers, and therefore make more money, if they are able to offer their clients the ability to move funds to a wide range of destinations, rather than just one. It is highly likely that they endeavour to build their networks in numerous countries, and so develop the ability not only to move value between China and elsewhere, but also between any countries where they have a presence.

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[5] In 2017, SAFE investigated and resolved 3,160 cases of foreign exchange irregularities, levying fines and confiscations of RMB 760 million (approximately £90 million) – SAFE annual report 2017

[6] www.FATF-GAFI.org/publications/mutualevaluations/documents/mer-china-2019.html

[7] See www.boc.cn/en/pbservice/pb4/200806/t200806_1323972.html

19. It is highly likely that it is this ability to move funds between jurisdictions other than China that makes this form of IVTS attractive to criminal groups outside China. They can dispose of the cash that they have made from their illegal activities by handing it to a Chinese IVTS provider in their country who needs it to settle an inwards remittance on behalf of a Chinese citizen, and receive the value in a location where the IVTS provider has a presence and the ability to make a reciprocal payment.

20. It is highly likely that this is achieved by having access to pools of funds in each location; funds are received into one and a corresponding payment is made from another. These pools of funds are commonly referred to as 'cash pools' but the funds are not always held in the form of cash; they can also be in other forms, including assets in company and personal bank accounts. This system also has the benefit of being an efficient method of foreign exchange, as the cash received at the pay-out location will be in the currency of the host country.

21. The payment by the Chinese IVTS provider into the recipient's UK account is frequently made in cash, 'smurfed[8]' or broken down into a large number of smaller amounts, often paid in at branches in numerous widely spaced locations. In some cases, the recipients have opened numerous accounts with multiple banks into which the cash is paid.

22. Alternatively, payments are received from one or more bank accounts of other Chinese nationals, into which cash has been 'smurfed' previously on the instruction of the Chinese IVTS provider. In order for this to happen, the Chinese IVTS provider has three requirements; access to bank accounts, ready access to a supply of cash and access to network co-ordinators.

<u>Access to bank accounts</u>

23. Access is needed to a large number of bank accounts in the destination country into which large amounts of cash can be deposited; accounts over which the IVTS provider can exercise an element of control. This could be either through the genuine account holder, or through some other method, such as acquiring online banking credentials from them (widely referred to as 'mule accounts').

24. Chinese IVTS providers are readily able to source mule accounts in the UK. The majority of these bank accounts appear to have been initially set up by Chinese students studying in the UK,[9] who have been recruited by members of Chinese money laundering groups through social media, including 'WeChat'. It is likely that some students set up multiple bank accounts with different banks, and allow the use of, or hand control of these accounts to the money laundering group, for a financial reward; alternatively, they may hand control of their accounts to the money laundering group when they return to China on the completion of their studies.

25. Chinese students are recruited into this activity by being told that they are providing money transmission services for other students, and unbanked Chinese citizens working in the UK. It is likely that, at least initially, once cash is received into their accounts, the student makes a payment from an account they control in China to an account controlled by the person who recruited them.

26. Students who regularly allow their accounts to be used for a fee may become more active within the money laundering group, and may be tasked with collecting cash from the group's criminal customers, consolidating it and paying it into mule accounts. It is likely that at this stage students undertaking this activity are aware, or at least suspicious of, the criminal origin of the cash that they are handling; it is almost certain that they will be aware that they are contravening the laws of China.

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[8] The practice of breaking down a cash deposit into small sums in an effort to evade perceived reporting restrictions

[9] UK Government immigration statistics identify that in the 12 months to June 2019, 107,622 Tier 4 sponsored study visas were issued to students from China – 42.5% of all those issued in that time period. This is nearly five times more than were issued to the next largest non UK student population (21,881 - India).

27. This process gives the money laundering group additional opportunities for the ready dispersal of criminally derived cash, with the added advantage of not having to settle a transaction on behalf of the student in return. In one case, the money laundering group was able to gain control of approximately 600 accounts held with just one bank, with the group known to control accounts with multiple financial institutions.

28. It is likely that funds from bank accounts controlled by Chinese money laundering groups may be transferred into other accounts held by businesses involved in the export of high end luxury goods to China; in effect a form of trade based money laundering. It is likely such goods are mis-described or undervalued on import into China in order to evade customs controls and import duties and taxes (see section on 'Daigou' below).

Ready access to a supply of cash

29. Because the use of this form of IVTS is widespread, the amount of cash needed to service this demand in the UK is very large. Since the legitimate use of cash in significant volumes in the UK (and most Western countries) is relatively unusual, due to the continual refinement of anti-money laundering regulations, Chinese IVTS providers regularly source the cash they need from criminal groups all over the UK involved in a wide range of commodity based activity, such as drug trafficking, cigarette smuggling, organised immigration crime and human trafficking.

30. In some cases, cash seized from Chinese cash collectors in England has been found to contain a significant proportion of Scottish and Northern Ireland banknotes, which has long been accepted in the UK as an indicator that the cash is likely to be derived from some form of criminal activity.

31. In many cases the amounts of cash being exchanged has been between GBP 300,000 – 500,000. This figure is significantly in excess of the GBP 50,000 – 100,000 normally encountered in similar situations where the money laundering group is known to be controlled by Indian or Pakistani nationals. This suggests that Chinese IVTS suppliers may have a greater risk appetite than their South Asian counterparts.

32. The operating practices and methods employed by Chinese cash collectors at these handovers are largely similar to their South Asian counterparts. These include the use of postcodes, sent between parties on mobile phones (often using the 'WeChat' messaging and social media platform), to identify handover locations, the use of 'tokens' to authenticate the identity of the parties to the handover, and the maintaining of handwritten 'ledgers' by the collector recording amounts of cash collected and disbursed and the exchange rates applied to each transaction.

Access to network co-ordinators

33. As their networks grow, Chinese IVTS providers need to employ people in the UK who are willing to manage part of their network on their behalf. In turn, these people will need to recruit others to perform a range of functions. These will include collecting cash from criminal groups, dispersing it according to their instructions (usually by paying it into mule accounts), and identifying and acquiring access to bank accounts.

34. In the UK, the activities of individual cash collectors are co-ordinated by other persons, leading to the formation of loose and informal networks which facilitate the receipt, management and dispersal of larger amounts of cash across wider geographical areas. The extent and nature of the management of UK based networks from overseas is currently an intelligence gap, as is the extent to which networks in the UK collaborate with each other. However, given the similarities between the methods of operation of south Asian and Chinese networks within the UK, it is almost certain that Chinese 'international controllers' exist and conduct operations within the UK.

35. In some cases, there are irregularities in the immigration status of individuals whose bank accounts are exploited or taken over by money laundering groups, and by those collecting and disbursing cash. These irregularities include not returning to China on the expiry of student or work visas, and

the use of false documentation demonstrating fictitious large scale investments in UK companies in order to obtain 'investor visas'.

Daigou

36. Daigou (pronounced 'dye-go', or sometimes 'dye-goo') is a Chinese term which roughly translates to 'buying on behalf of'. It relates to another practice commonplace in Western countries with a sizeable expatriate Chinese community, that of purchasing goods on behalf of third parties back in China. The term applies both to the activity and the persons carrying it out.

37. In China, luxury goods are often subject to significant import tariffs, and so can be very expensive to buy. Counterfeiting of designer brands is also rife. Also, following a number of widely reported scandals between 2004 and 2008, involving babies in China dying after being fed counterfeit or tainted locally produced infant formula milk, there is a significant demand in China for genuine products sourced from Western countries. A flourishing market has therefore developed whereby Chinese nationals in the UK (and many other Western countries) purchase large amounts of high end branded goods and infant formula milk, and ship them back to China to sell them there.

38. This practice can be highly lucrative and for some has extended beyond servicing the needs of immediate friends and family, with some Daigou making substantial sums by selling goods on online marketplace sites such as TaoBao (a Chinese company similar to eBay). This activity is not illegal in China as long as all local laws are complied with. However in practice many Daigou flout the law by importing the goods into China without paying the required import duties and taxes, in order to enable them to sell the goods cheaper than official outlets, and some bribe customs officials to evade controls.

39. In addition, many Daigou do not pay the required income tax on their income in China. The Chinese Government introduced a new e-commerce law in January 2019 which is designed to crack down on illegal practices in this industry. This legislation introduces a number of requirements on Daigou including the obligation to register with the Government before operating an online business, which is likely to lead to the practice being driven further underground.

40. Daigou operating in the UK experience significant difficulty in funding their activities, as the restrictions on moving money imposed by SAFE prevents them removing the proceeds of their sales from China. It is therefore common for them to rely on the same form of IVTS, with many receiving criminally derived cash directly into their UK bank accounts, or wire transfers from mule accounts set up in the name of other Chinese nationals, into which criminally derived cash has previously been 'smurfed'. It is almost certain that the Daigou then pay out the equivalent value to the cash they receive, less any service fee charged, to the IVTS provider in China using the funds derived from the sale of the clothes or other luxury items, with the Daigou retaining any profit from their activities.

41. In the UK, an additional effect of the growing prominence of Daigou is the increase in the exploitation of the HM Revenue & Customs (HMRC) VAT 407 retail export scheme, which allows VAT to be reclaimed on goods purchased in retail stores in the UK that are intended to be exported. In addition, some high end stores provide a service to customers whereby they assist in the reclaim of the VAT under this scheme, and also ship the goods on behalf of their customers.

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