

# Sixth Casino Review—Draft report—China sections

Revisions are to the version dated 21 May 2018

8 June 2018

## Executive summary

Page 8, line 37, add in the **bolded** text—

Significant matters shown by the investigation have included—

- 4  a change in strategic direction for Crown Resorts from one of international expansion to a conservative approach focused on completing major capital projects in Melbourne and Sydney
- 8  continued integration of management of the Melbourne Casino business into Crown Resorts
- increased community expectations of the way that Crown Melbourne will conduct its casino operations
- 12  failures of risk management and governance, contributing to compliance slippages **domestically and the detention of 19 Crown staff in China in October 2016**, and
- no step-change in Crown's approach to responsible gambling.

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Page 9, line 22, add in the **bolded** text—

20 In respect of risk management and governance, the failures are evidenced by two matters where the VCGLR imposed historically significant fines by way of disciplinary action, **and in the detention of 19 Crown staff in China in October 2016**. The outcome is that the effectiveness of the governance and risk arrangements in the Review Period must be questioned.

24 The disciplinary actions involved failure to properly document international commission-based play junkets and a gaming machine trial which involved modified gaming machines being operated without the required approvals. Underlying the two matters was insufficient sensitivity to the requirements  
28 of the regulatory regime.

**The VCGLR has concluded that the detention, and subsequent prosecution and punishment of Crown staff in China was both**

4 **foreseeable and avoidable. Crown’s risk processes did not adequately manage the process by which Crown sought to represent itself in China and a failure of communication between China based staff and executives in Australia prevented effective management of the risk.**

Page 10, line 7, add in the **bolded** text—

8 This all sits in an environment of rising community expectations, acknowledged by Crown’s leaders. Crown has started to address the community’s responsible gambling expectations by engaging with key stakeholders on issues of transparency **and, following the detention of Crown staff in China, by restructuring its compliance arrangements.**  
12 However, there is more to be done to ensure that Crown Melbourne is still seen as a suitable licensee in five years’ time.

## Conclusions

### 16 Findings

#### Suitability

Page 12, line 32, add in the **bolded** text—

20 However, as explored in Part 2, there have been failings in governance and risk management. Three disciplinary actions taken in the Review Period raise questions as to the existence of a culture conducive to compliance, **while the detention of 19 Crown staff in China in October 2016 demonstrates a serious failure of governance and risk management processes.** The relative recency of the last disciplinary action means that  
24 this is a work in progress, but it is clear that Crown has taken decisive steps to address the systemic weakness.

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## Areas for improvement

### Organisational approach to regulation

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Page 16, line 26, add in the **bolded** text—

- 4 Confidence that Crown's own assessment of expectations will meet its regulators' must be seen in the light of its engagement with AUSTRAC, **the detention of staff in China during the Review Period** and disciplinary actions by the VCGLR.

### Institutional governance

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8 Page 17, line 20, add in the **bolded** text—

- 12 **Notwithstanding a complex and multi-layered risk management system, the scoping of the risk to which Crown's China operations were exposed was inadequate, as was the chain of command and communication. The outcome is that Crown was "blindsided" by the detention of its 19 staff in China when it should not have been.**

- 16 **In addition,** the disciplinary action concerning the use of unapproved gaming machine types demonstrated that changes of regulatory significance could be made without the awareness of directors and senior executives.

## Part 2—Suitability

### Corporate governance and risk

#### Internal governance institutions and functions

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20 Page 76, line 29, add in the **bolded** text—

In the Review Period:

- the average duration of Crown Melbourne board meetings was 35 minutes
- 24  when he was Chairman of Crown Melbourne, Mr James Packer participated in two of the 16 meetings held between January 2013 and May 2016 (one in person and one by telephone)

- the size of the board fell from seven to five, with one of the departures being the retirement of longstanding independent director Mr Kevan Gosper
- 4 □ most of the resolutions were related to capital initiatives already determined by the Crown Resorts board or were formal resolutions complying with Corporations law requirements (such as the approval of financial statements and the declaration of dividends), **and**
- 8 □ **matters concerning the detention of 19 Crown staff in China in October 2016 were noted simply as having been discussed by the Crown Resorts board.**

## General governance and risk observations

12 Page 92, line 27, add in the **bolded** text—

However, as described elsewhere in this report, Crown Melbourne has experienced risk failings relevant to its primary licence. In particular:

- 16 □ Crown Melbourne has been the subject of disciplinary action in two matters where adherence to internal controls was significant—being fined \$150,000 for non-compliance with junket paperwork requirements and \$300,000 for varying the operation of 17 gaming machines without the VCGLR's approval, **and**
- 20 □ **Crown Melbourne's offshore promotional activity led to the detention of 19 Crown employees in China in October 2016 with 11 being imprisoned for up to 10 months and 16 fined in aggregate \$1.67 million.**

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Page 107, line 32 to page 111, line 3, substitute—

## China

28 International commission-based business is an important component of the operations of the Melbourne Casino and a significant source of headline revenue for Crown Melbourne. During the Review Period, Crown encountered a major setback with the operation of its sales team in its largest source market, China.

32 Starting on 13 October 2016, Chinese Government authorities detained 19 Crown staff (including Crown's Group Executive General Manager—VIP International, who was visiting China at the time). They remained in detention until 26 June 2017, when they appeared in court to plead guilty to

offences related to the promotion of gambling in China. The court imposed fines aggregating \$1.67 million on 16 of them and terms of imprisonment of up to 10 months on 11 of them (time in detention being taken into account).

4 On 12 July 2017, all but the Group Executive General Manager—VIP International were released. The Group Executive General Manager—VIP International was released on 12 August 2017.

8 While the focus of this review is the implications of what happened in China for Crown’s risk management and governance, the VCGLR wishes to acknowledge the personal cost borne by the 19 staff and by their families. It also notes the genuine concern of the directors of Crown Resorts as recorded in the minutes of their meetings, as examined.

12 The commission of offences against another country’s gambling laws by a casino operator or its staff or agents does not constitute an offence under the Casino Control Act. However, it is a condition of both the Management Agreement and the Casino Agreement that Crown Melbourne will comply with applicable laws and, in any event, the circumstances surrounding these offences raises questions about the suitability of Crown Melbourne to hold a casino licence. There are related questions about the suitability of associates involved in the matters leading up to the detentions.

20 For those reasons, the VCGLR investigated and considered, separately to the conduct of this section 25 review, what the circumstances which led to the detentions and ultimate admissions of the breaches of China’s gambling laws, and their aftermath, mean for the ongoing regulation of the Melbourne Casino.

28 For the purposes of its considerations, the VCGLR has accepted the admissions of guilt at face value and, despite there being no charges naming Crown Melbourne or Crown Resorts as defendants, takes the view that those entities are responsible.

These considerations are informed by events which have preceded the detentions and the consequences for Crown which have followed them.

32 Two key prior events are relevant. The first is that, starting in February 2015, China’s Ministry of Public Security had made it known that it would be enforcing laws which restricted the attraction and retention of Chinese citizens to gamble in casinos outside China. The second is that, in June 2015, China-based employees of a South Korean casino operator were detained and charged with breaches of those gambling laws.

40 In the course of the investigation, the VCGLR has identified that, in October 2015, Chinese national television carried news reports regarding foreign casinos enticing Chinese citizens to travel overseas to gamble. A translation obtained by the VCGLR says:

*We are highly concerned about foreign casinos and their infiltration and development of gambling activities in our country. In particular, we are determined to eliminate organised gambling activities in China by foreign*

4 *casinos. It is legislated in China that an organisation of more than 10*  
*people going overseas for gambling activities, or in numerous occasions*  
*with an accumulated number of 10 people, constitutes a prosecutable*  
8 *offence. As early as 2013, the Ministry of Public Security successfully*  
*handed over the project 801 to the public security authorities in Hebei*  
*Province, destroying a casino criminal gang in Jeju Island, South Korea,*  
*and sentenced four South Korean casino managers who came to China to*  
12 *organise Chinese citizens for gambling in South Korea. The casino*  
*affected was forced to go out of business after a sudden drop in Chinese*  
*guests. After the project 801, the overseas casino was somewhat less*  
*active in China and the criminal groups became more vigilant. They will*  
*frequently rotate their employees on a regular basis.*

From this the VCGLR can conclude that China's authorities were open in their own community about their concerns and their interpretation of the laws.

16 Following the detentions of its 19 staff, Crown arranged appropriate  
representation and support. It also withdrew from the market, and refrained  
from seeking commission-based business out of China until October 2017,  
20 after the last of the staff had been released and until it had restructured its  
sales approach.

A further, relevant consequence is that a shareholder class action was filed  
in the Federal Court of Australia in early December 2017 against Crown  
Resorts. That shareholder class action is ongoing and the claims which  
24 support that shareholder class action are detailed in the information box  
adjacent to page *[cross-reference to be inserted]*.

On the basis of the information available to the VCGLR, the detention of  
the 19 employees in China in October 2016 was both foreseeable and a  
28 distinct possibility. A fully functioning chain of command and risk  
management framework would have brought the developing situation in  
China to the attention of the directors and senior managers. However,  
again on the basis of the information available to the VCGLR, that did not  
32 occur with the result that the company did not effectively control its  
operations.

The immediate and continuing consequences for Crown are significant. It  
has lost a year of commission-based play revenue; it has incurred  
36 significant costs in managing the aftermath of the detentions and in  
rebuilding its international sales team; and it is defending a shareholder  
class action which will most likely have some time to run. To this must be  
added intangible but significant reputational damage arising from the  
40 adverse publicity surrounding the detentions.

What the VCGLR has concluded about the China matter is that there was a  
high-consequence failure of governance and risk management; this  
44 combined an incompletely formulated description of the risk and related  
controls with a poor flow of information from China-based staff to executive  
management in Australia.

4 The VCGLR has examined the risk management plans applying before and after the detention of the 19 staff. The “before” plans did not contemplate operations outside Australia and the controls were limited to annual  
4 planning processes and the monitoring of financial performance. Following the detentions, the controls were broadened to include awareness of relevant laws and training for employees.

8 Crown apparently received advice that its operations in China were permitted, but declined to provide evidence of this, citing client legal  
8 privilege. While entitled to do so, the claim of privilege prevents the VCGLR from testing or assessing the advice received (or the context in which it was given) and so, for suitability purposes, little regard can be given to that  
12 matter.

This leads directly to consideration of the following aspects of suitability, whether:

- 16  Crown has sufficient business ability to maintain a successful casino, and
- each director, executive officer and secretary and any other relevant officer is a suitable person to act in that capacity.

20 Governance and risk management systems are clearly components of business ability and, of course, the operations in China were integral to the operation of the casino. What has transpired since the detention of the 19 staff is that Crown has put in place a new offshore team which has received enhanced training delivered in Australia, working in a new structure which  
24 includes a compliance officer reporting directly into the Melbourne office. Crown has also further revised its risk management plan to more comprehensively address the identified risks.

28 The VCGLR notes that all but two of the people detained have since left the company. The VCGLR also notes that Crown has altered its international strategy and undertaken an organisational restructure which has coincided with the departure of the group chairman and the group chief executive and a small number of senior staff whose responsibilities included advising on  
32 compliance matters.

36 Notwithstanding all of the changes at Crown, there is still a concern about whether there remain in the organisation cultural drivers which could give rise to similar failings. Crown will therefore need to work hard to rebuild community, government and regulator confidence in its capacity to identify and manage risks.

40 Information box to be inserted adjacent to this section  
**China class action**  
for text, refer to page 260