

COSTS AND BENEFITS OF ADOPTING AND IMPLEMENTING NEW INTERNATIONAL STANDARDS FOR THE OPERATION AND REGULATION OF THE INTERNATIONAL FINANCIAL SERVICES SECTOR IN VANUATU*

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INTRODUCTION

Vanuatu's International Finance Centre (IFC) started in 1969 on the advice of the British government when it was still a Condominium. By 1970 and early 1971 a full offshore regime was legislated.

This paper is in three parts. Part 1 of this paper discusses the International Financial Services (IFS) Sector, its origins and development in Vanuatu and its importance to the economy. Part 2 deals with the regulation and supervision of the IFS Sector, in particular the structure of IFS, the regulation and supervision bodies in Vanuatu and the emergence/evolution of the Post-2000 regulatory regime for the IFS. Part 3 discusses the incremental costs of adopting new international regulatory standards, the incremental benefits of enhanced IFS regulation and supervision, and the overall assessment of net benefits accruing from adoption of new international regulatory standards and strengthened regulatory regime. The paper then draws conclusions and addresses future implications of the current international regulatory initiatives imposed on the IFS sector.

THE INTERNATIONAL FINANCIAL SERVICES (IFS) SECTOR

Origins and Developments of the IFS Sector in Vanuatu

An IFC is a jurisdiction that levies no, or very low, direct corporate and personal income taxes. Such a jurisdiction may also be known as an Offshore Finance Centre 'that hosts financial activities that are separated from major regulating units (states) by geography and/or by legislation'.¹ Most IFCs follow the English common law system. Countries and territories that host IFC facilities offer a legal system that provides for the formation of international companies and trusts that can be used in the management of tax neutral portfolios and world-wide assets. Services provided by the IFCs are also known as International Financial Services.

* The original version of this report was prepared for the Commonwealth Secretariat, in London. However, the opinions expressed in this article do not necessarily represent the views of the Commonwealth Secretariat nor are they endorsed by it. The information contained in this article is from mid 2006 and some figures, such as staffing levels in particular offices, may now have changed slightly.

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¹ M Hampton, *The Offshore Interface: Tax Havens in the Global Economy* (1996) 4.

The IFC has had an important effect on the history of Vanuatu. From 1970, it greatly boosted the revenues of the pro-independence British administration and reduced the relative importance of the French. The IFC brought lawyers, trustees and bankers to Port Vila, particularly from Australia and New Zealand.²

The initial legislation upon which the offshore sector was founded includes the following:

- *Banking Act* [Cap 63] (Vanuatu) (repealed and replaced by the *Banking Act 2002* (Vanuatu)).
- *Trust Companies Act* [Cap 69] (Vanuatu).
- *Prevention of Fraud (Investment) Act* [Cap 70] (Vanuatu).
- *Insurance Act* [CAP 82] (Vanuatu).

Later after independence the Vanuatu government introduced further legislation to compliment the existing IFS framework. The additional governing laws of the IFC are:

- *Companies Act* [CAP 191] (Vanuatu).
- *Serious Offences (Confiscation of Proceeds) Act No. 50 1989* (Vanuatu).
- *Casino Control Act No. 6.1993* (Vanuatu).
- *Financial Institution Act No. 2.1999* (Vanuatu).
- *International Companies Act No. 32 1992* (Vanuatu).
- *Financial Transactions Reporting Act No. 33 2000* (Vanuatu).
- *International Banking Act No. 4 2002* (Vanuatu).
- *Proceeds of Crime Act No. 13 2002* (Vanuatu).
- *Mutual Assistance in Criminal Matters Act No. 14 2002* (Vanuatu).
- *Betting (Control) Act No.37 2003* (Vanuatu).
- *Insurance Act 2005* (Vanuatu).

The IFC of Vanuatu provides the four most important general products: international business companies or international companies as they are known locally, offshore banks, exempted insurers and offshore trusts. These are governed by the *International Companies Act No. 32 of 1992* (Vanuatu) (last amended in 2000), *International Banking Act No. 4 of 2002* (Vanuatu), *Insurance Act of 2005* (Vanuatu) and the *Trust Companies Act 1971* (Vanuatu) (last amended in 1988), respectively. Offshore financial products are usually used for the purposes of minimising tax and/or to protect assets.³

In 1970 the banks and banking regulation legislation and the companies regulation legislation were introduced, and in the same year ANZ opened its first branch in Port Vila. The *Trust Companies Act* was introduced in 1971, and by 1973 other banks including the Bank of New South Wales, National Australia Bank, Barclays, the Commonwealth Bank and HSBC were all licensed in New Hebrides. Ten trust companies were in operation and the *Insurance Act* [Cap

² A. Van, Fossen , ‘Offshore Financial Centres and Internal Development in the Pacific Islands’ (2002) 17(1) *Pacific Economic Bulletin* 38.

³ Interview with Mr George Andrews, Commissioner, VFSC (Port Vila, 20 February 2006).

82] (Vanuatu) was also introduced.⁴ Both population and land prices in Port Vila experienced very rapid growth as Vanuatu attracted business fleeing perceived political instability in IFCs like the Bahamas and Bermuda.

By 1976, the IFC was truly established. At independence in 1980 the first Prime Minister Father Walter Lini and all prominent Vanuatu politicians expressed support for the IFC. The Reserve Bank of Vanuatu (RBV) was created and the IFC was to stay.⁵

In 1989 the first anti-money laundering law, the *Mutual Assistance in Criminal Matters and Serious Offences (Confiscation of Proceeds) Act* (Vanuatu) were introduced.

In 1993 Vanuatu introduced its first dedicated international company legislation (*International Companies Act 1992* (Vanuatu)) to restore competitiveness with other IFCs in this area. The legislation was based on the international business companies law of the British Virgin Islands as well as New Zealand company law. Previously, foreign investors had made use of the provision for Exempt status in the normal company legislation. The international company legislation restricts the ability of such companies to conduct business in Vanuatu under a ring-fencing provision.

International companies are commonly used to provide secrecy for their owners in a number of ways. To guarantee privacy of the owners, the company registries are not open for public inspection.⁶ If this secrecy provision is breached the perpetrator(s) face criminal prosecution and jail. International companies do not have to pay any local taxes and duties and are subject to low reporting requirements.

Vanuatu does not have offshore trust legislation, but trusts are commonly used in the IFS sector.

The Vanuatu Financial Services Commission (VFSC) was established in 1993, and in 1994 a promotions committee was set up with the Vanuatu Finance Centre Association (VFCA) to advertise the IFC in Australia, New Caledonia, Hong Kong and Eastern Europe. In 1995 the *Banking Act* [Cap 63] (Vanuatu) was amended and supervision of offshore banks was transferred from the Minister of Finance to the VFSC, which set up a Bank Supervision Unit. At this time the fee for an offshore bank licence was increased to US\$5000.⁷

In December 1999 a group of United States banks decided to suspend electronic banking links with Vanuatu, Nauru and Palau after Congressional testimony alleging links between these centres and money laundering. In January 2000 a joint government/private sector mission from Vanuatu went to Washington and New York to meet with officials. The ban was lifted for the domestic licensed banks.⁸

⁴ Greg Rawlings 'Laws, Liquidity and Eurobonds: The Making of the Vanuatu Tax Haven' (2004) 39(3) *Journal of Pacific History* 325.

⁵ Ibid.

⁶ See *International Companies Act 1992* (Vanuatu) s 65. This Act provides that only members of the company or authorised persons can inspect the company records.

⁷ Above n 3.

⁸ Interview with Mr Tom Bayer, PITCO (Port Vila, 19 December 2005).

In 2000 there was a joint assessment visit by the Asia-Pacific Group on Money Laundering and the Offshore Group of Banking Supervisors. In addition, in the same year Vanuatu was reviewed by the Financial Action Task Force (FATF) as part of a non-cooperative countries and territories exercise. The *Financial Transactions Report Act 2000* (Vanuatu) was introduced in September to avoid Vanuatu being placed on the non-cooperative countries and territories list. In May and June 2000 Vanuatu was placed on the lowest tier of the Financial Stability Forum's three-tier categorisation of the perceived quality of IFC supervision, and included in the Organisation for Economic Co-operation and Development's (OECD's) "Tax Havens" list with 34 other jurisdictions as part of the 'Harmful Tax Competition' initiative.⁹

The International Monetary Fund (IMF) performed a module 2 assessment of Vanuatu's offshore and domestic financial sectors in 2002. The resulting report (published in 2003) made major recommendations including the following: to transfer regulatory responsibilities from the VFSC to the RBV; to dilute secrecy provisions, to overhaul the offshore legal structure, and to conduct a cost-benefit analysis of the IFS industry. This report also estimated the gross contribution of the offshore sector to government revenues at US\$1 million. At this time the VFSC had 13 staff (2 in banking supervision) and the RBV had 53 staff, 4 in (domestic) banking supervision. The OECD's 'Unco-operative Tax Havens' list, published in April of 2002, included Vanuatu along with 6 other jurisdictions.¹⁰

In response to the IMF report, in 2003 the *International Banking Act 2002* (Vanuatu) was introduced, the major innovation being that offshore banks were required to have a permanent office with the bank's records and at least one full-time employee in Port Vila. As a direct result, the number of exempted (offshore) banks dropped from 35 to 9 in the subsequent 12 months. Offshore bank supervision was moved from the VFSC to the RBV, and the licence fee increased to US\$8000.

Before 2002 offshore banks were accorded more privacy and greater flexibility in operation as they were not required to have any physical presence (office/staff) in Vanuatu. Also, they were not required to disclose company records to the public, were free from all forms of inspection, and did not have to comply with strict capital adequacy requirements. Since 2002, however, offshore banks must maintain an office in Vanuatu, have a resident manager/full time employee based in Vanuatu, and are subject to compliance inspections by the Reserve Bank of Vanuatu.¹¹ Offshore banks are still forbidden to accept deposits from the public in Vanuatu, or to solicit business locally, and in this regard these banks can still be distinguished from local banks.

In May 2003 Vanuatu reversed its earlier decision and agreed to commit to the principles of tax information exchange and transparency required by the OECD, and as a result Vanuatu was removed from the 'Unco-operative Tax Haven' list.¹²

⁹ Above n 4.

¹⁰ Above n 8.

¹¹ *International Banking Act No.4 of 2002 (Vanuatu)* s 14 and s 20.

¹² Above n 8.

In 2005 a new insurance act was passed, and the Australian government made a formal request to enter into negotiations concerning a bilateral Tax Information Exchange Agreement with Vanuatu.

It is planned that this year the VFSC will move to immobilise bearer shares according to the British Virgin Island model of custodianship, and register corporate and trust service providers in line with the Isle of Man model. The supervision of insurance companies and trust providers may also be transferred from the VFSC to the RBV. Despite this transfer of responsibility, however, there are no plans to reduce staffing at the VFSC. There are plans to legislate for the provision of new products, such as protected cell companies, based on the Guernsey model, unit trusts and mutual funds. For this the State Law Office will need expert advice from draftpersons and funding to be able to secure such services. Also, if these laws are passed then regulators would need to recruit at least 2 more staff per office to carry out the additional supervisory work.¹³

The private sector industry, i.e. the banks, insurance companies, accountants, trust companies, lawyers and other service providers, has an organisation called the Vanuatu Financial Centre Association (VFCA). The VFCA is governed by a constitution and has membership requirements, sanctions and a code of conduct for members. Members of the VFCA meet once a month and liaise between the private sector and government.

The Importance of IFS to the Vanuatu Economy

Vanuatu has a domestic financial sector and an international financial sector. The domestic sector consists of banks, insurance, accountants, lawyers and other financial institutions. ANZ, Westpac and the National Bank of Vanuatu (which is government owned) operate within Vanuatu as local banks and operate in the international sector as well.¹⁴ The European Bank is registered as a domestic bank but mainly operates in the international sector. There are currently 7 offshore banks registered (with 4 applications pending for registration) and 5 local insurance companies operating in Vanuatu. There are 8 accounting firms of which 5 correspond with international firms.¹⁵

The Vanuatu National Provident Fund is a statutory fund established by the government in 1987 to function as a compulsory superannuation scheme. It controls the retirement savings (currently 8% of wages and salary) of all employees. Vanuatu also has modern telecommunication and internet services provided by Telecom Vanuatu Limited which is important for the IFS sector for trading reasons.

The international sector comprises offshore banks, offshore insurance companies, shipping, trust and company service providers. The most important part of the sector is international companies, the number of which is stable at around 4,500. These have had the advantage of enhanced privacy and confidentiality guaranteed under the *International Companies Act 1992* (Vanuatu),

¹³ Interview with Mr George Andrews, Commissioner, VFSC (Port Vila, 20 February 2006).

¹⁴ Editor's note: Since this article was accepted for publication the BRED Bank has also commenced operation in Vanuatu.

¹⁵ Above n 3.

however, since 2000 this privilege has been diluted to some extent by the new anti-money laundering/countering the finance of terrorism transactions regulatory requirements.¹⁶

Contribution to the Economy/Gross Domestic Product (GDP)

It is difficult to assess accurately the financial contribution of the offshore centre to the economy of Vanuatu. This is mainly because of the integration between the domestic and offshore sector. However, through government statistics and information from the private and public sector some degree of assessment is possible.

The main difficulty relating to the private sector is in identifying the proportion of revenue generated by the various accounting and law firms undertaking offshore activities (such as acting as company officers and administering international companies) but which also maintain their own professional practices. The public sector regulatory bodies also have dual responsibilities in regulating both the offshore and domestic sectors.¹⁷

According to the earlier cost-benefit analysis done in 2004, the best way to define the two sectors is through determining the residential status of the clients or customers to separate residents from non-residents. If this classification is used then shipping and internet gambling would be part of the offshore industry. However, even this approach is problematic, as some “offshore” clients invest directly in the country, and/or over time become residents of the country.¹⁸

The income tax-free regime in Vanuatu that applies to both resident and non-resident owned operations also creates a problem as it often makes it difficult to distinguish between what is offshore and what is domestic activity. Shipping, the e-commerce industry and internet gambling are administered by the government separately to other offshore operations. Even though they are not formally part of the private offshore sector, they involve many of the same operators, and in the case of shipping, directly involve the use of international companies registered through the IFC.¹⁹

Identifying the gross revenue of the offshore sector assists in determining the contribution of the IFS industry to the general economy. One of the main sources of government revenue derived from the offshore sector is the annual fees charged by the VFSC. There is a set annual fee for each type of company registration, which varies by the authorised capital for local companies. According to the Commissioner of the VFSC, the fees charged by the Vanuatu registry are highly competitive compared to other IFCs.²⁰

In general, the Government of Vanuatu derives its revenues from various registration and license fees, stamp and customs duties and consumer taxes such as the value added tax (12.5%). This is mainly collected from the domestic sector rather than IFS.²¹

¹⁶ Above n 3.

¹⁷ Weenink, ‘Cost Benefit Analysis of the Offshore Financial Sector in Vanuatu’ (Port Vila, December 2004) 9.

¹⁸ *Ibid.*

¹⁹ *Ibid.*

²⁰ Above n 3.

²¹ Above n 3.

Local industry representatives claim the offshore sector contributes upwards of 12 per cent of GDP.²² Most recent IMF figures put the direct contribution of the IFC (excluding the shipping registry) at 3 percent of GDP and 1.5-2 percent of government revenue.²³ However, the recent cost-benefit assessment funded by the Pacific Islands Forum Secretariat at the request of the government of Vanuatu estimated that in mid-2004 the entire “offshore industry” represented 9.7 percent of GDP and 5.1 percent of government revenues. The RBV estimates that the figures are currently 9 per cent and 5.5 percent respectively.²⁴

Much of the discrepancy between the IMF and other figures results from disagreement about how to measure the indirect “spin-off” benefits of the IFS industry for the general economy. The Ministry of Finance has previously estimated the multiplier effect as 2.5, which (when including the shipping registry) would largely resolve the conflicting figures on the contribution of the IFS sector as a proportion of GDP.²⁵

Offshore (Exempt) Banks

The offshore banks operate in a closed environment, and generally do not form part of the local industry. As the name suggests, these banks are allowed to operate overseas as exempt companies through the IFC. The offshore banking sector had a healthy growth rate until 1993 at which time it peaked at 120 licensed banks. After 1993 offshore banks experienced a decline to 92 in 1995. This pattern of decline started even before the recent regulatory changes. By 2000 the number of banks had been steeply reduced to 59, with only 7 remaining in 2005.²⁶ The offshore banking sector was previously dominated by shell operations. With the enactment of the *International Banking Act 2002* (Vanuatu), requiring physical presence through an office and staff to be in Vanuatu, a majority of the remaining licensees withdrew from the IFC.²⁷

Currently only 7 offshore banking licenses and one general banking license are issued to offshore banking operations in Vanuatu.²⁸ Only 3 of the offshore banks have significant physical presence in Vanuatu, employing between 5-7 staff each. However, the remaining banks are in the process of establishing business operations as required by the new *International Banking Act 2002* (Vanuatu). Overall, approximately 20 people are employed locally by the offshore banks.²⁹

The operating offshore banks are not associated with any international banking or financial service institutions. They are held by private interests and generally operate in niche markets and products. Offshore bank assets amounted to US\$202.3 million at the end of 2005, a significant drop since March 2003 when these were recorded at US\$1442 million. The offshore

²²Interview with Mr Lindsay Barrett, BDO Accountants (Port Vila, 20 December 2005).

²³International Monetary Fund, *Vanuatu: Selected Issues and Statistical Appendix*, (2005) 24.

²⁴ Interview with Mr Mark Mera, Research and Statistics Officer, RBV (Port Vila 20 February 2006).

²⁵ Above n 17.

²⁶ Data provided by the VFSC and the RBV on 20 February 2006.

²⁷ Above n 3.

²⁸ Data provided by the RBV on 20 February 2006.

²⁹ Interview with Mr Peter Tari, Deputy Governor, RBV (Port Vila, 6 December 2005).

banking sector generates around VT14 million per year, which is about 0.4% of the overall GDP.³⁰

The RBV believes that after the passing of the *International Banking Act 2002* (Vanuatu), there are now greater prospects for the development for the offshore banking industry. An indication of the potential growth in this area is that there are currently 4 pending applications for new offshore bank licenses.³¹

Trusts

There are 11 trust company licenses issued, of which three operate independently in the offshore sector and the rest operate in conjunction with legal and accounting firms.³² Vanuatu has no trust legislation, such as that in the Cook Islands and other IFCs.

International Companies

Offshore company registration is the main offshore activity in Vanuatu. The bulk of clients are from Australia, New Zealand and Asia.

These international companies are awarded enhanced privacy rights and confidentiality. They are not required to file annual accounts or reports as they are in to Australia, New Zealand and the USA. Their records are not open to public unless special permission is acquired from the company director.³³ The number of offshore companies peaked in the 1990s but has remained stable or slightly declined since 2000. The 2004 cost-benefit analysis attributes this to 'increased competition through developed technology and aggressive pricing from other jurisdictions such as British Virgin Islands and Samoa'.³⁴

Vanuatu has a tiny share of the IBC market by international standards with 4664 international companies currently registered through its IFC.³⁵ This is compared to other IFCs such as Samoa, which has over 20,000 such companies, and the British Virgin Islands with over 400,000.³⁶

Offshore Insurance

The number of offshore insurance firms has significantly increased in recent years, with the number of offshore insurers increasing from 15 at the end of 2002 to 26 at the end of 2005.³⁷ This is in comparison to 5 domestic insurance companies operating within Vanuatu.

³⁰ Interview with Mr Mark Mera, Research and Statistics Officer, RBV (Port Vila, 20 February 2006).

³¹ Information provided by Mr Nelson Shem, Banking Supervision Officer, RBV (Port Vila, 10 February 2006).

³² Data provided by the VFSC on 10 February 2006.

³³ See *International Companies Act 1992* (Vanuatu) s 65.

³⁴ Above n 17, 9.

³⁵ Statistics provided by the VFSC as at 30 September 2005.

³⁶ Offshore Investment, 'Company Formation Survey 2006' <http://www.offshoreinvestment.com/index.html> (Accessed March 2006).

³⁷ Statistics at 31 December 2005 as provided by the VFSC.

Offshore insurers have only a minimal presence in Vanuatu compared with the offshore banks and are almost exclusively managed by the local trust companies. It is 'mainly captive insurance business primarily sourced out of North America with some finance based insurance products marketed into Australia'.³⁸ The offshore insurance sector is still small by most standards and is in a development stage. A new insurance act was passed in late 2005 but its impact on offshore insurance is yet to be seen. The private sector is, however, concerned that the stricter requirements imposed by the new act will mean that offshore and captive insurance companies will exit Vanuatu.³⁹

Shipping

In the late 1980s Vanuatu became popular as an international shipping registry, and since that time has shown a steady growth with about 600 international ships now registered.⁴⁰

Even though the shipping industry is not directly dependent on the rest of the offshore sector it relies largely on the general tax-free operating environment in Vanuatu. It contributes significantly to the offshore revenues by making up 10% of the total revenue generated by the offshore sector and about 28% of the overall offshore contribution to government revenues.⁴¹

The administration of the shipping registry has been under private contract since 1981 when the international shipping registry commenced, producing gross returns of approximately VT100 million per annum for that period. It is operationally administered in New York and there is a central registry (kept at Vanuatu Maritime Authority) in Port Vila, Vanuatu.⁴²

Securities/Managed Funds/E-Commerce

The e-commerce sector offers services such as internet gaming, internet pharmaceutical operations and credit card processing. It is relatively small and still developing as an industry. The e-commerce sector works through the offshore industry yet it relies just as much on the domestic environment. The services provided and infrastructure of Vanuatu, no or low domestic tax, and general operating costs are important to the future growth of these offshore industries.⁴³

Moreover, the local banks also earn some revenue for the government through the funds invested by offshore entities. One of the domestic banks at the end of the financial year in 2005 held VT32,522 million out of which approximately 80 per cent was held in offshore accounts in foreign deposits. The offshore sector overall had VT 415.7 million in net foreign exchange earnings at the end of the first quarter in March 2005.⁴⁴

³⁸Above n 17, 11.

³⁹ Source: interviews of the author with various private sector members.

⁴⁰ Statistics at end of December 2005 as provided by the Vanuatu Maritime Authority.

⁴¹ Above n 17.

⁴² Interview with Mr Tom Bayer, PITCO (Port Vila, 7 March 2006). Editor's note: since this article was accepted for publication the Vanuatu Maritime Authority Act has been repealed (*Vanuatu Maritime Authority (Repeal) Act 2007*).

⁴³ Above, n 17.

⁴⁴ Reserve Bank of Vanuatu, *Quarterly Review* (March 2005).

Employment

The integrated working environment of the domestic and offshore sector makes it difficult to calculate the number of employees working exclusively in the offshore sector. Although the RBV provides employment figures for the financial sector as a whole (600 in March 2005, 531 Ni-Vanuatu and 69 expatriates), these do not distinguish between those involved in IFS and those employed in the domestic financial sector. It is probable that over half of this 600 employee figure represents the domestic sector, particularly domestic banking.⁴⁵

The commercial banks employ about 300 staff and offshore banks employ 27. There are a total of 115 employees working in accounting firms out of which 26 could be said to be doing IFC work. Insurance and trust companies employ 153 staff out of which 53 work in the area of the IFC. Out of the legal firms, 5 persons work within the IFC.⁴⁶

The above showed the origins and development of the IFS sector of Vanuatu. The paper will now turn to look at the structure, regulation and supervision of the IFS sector.

REGULATION & SUPERVISION OF THE IFS SECTOR

Structure of IFS Regulation & Supervision in Vanuatu

Two separate regulatory bodies have responsibility for regulating the offshore sector. These are the RBV and the VFSC which are supported by the Financial Intelligence Unit (FIU), established within the State Law Office. The State law Office, though not a regulator, provides important drafting and technical legal assistance. Also, though the Vanuatu Investment Promotion Authority (VIPA) is not an IFS regulator as such, it does have the authority to approve investments, assist investors, set down requirements to regulate investment.

Reserve Bank of Vanuatu (RBV)

The RBV is the central bank of Vanuatu. It was enacted and operates through the *Reserve Bank of Vanuatu Act 1980* (Vanuatu), the *Financial Institutions Act 1999* (Vanuatu) and the *International Banking Act 2002* (Vanuatu).

As the bankers' bank it is generally responsible for the banking and financial system of the country. By statute it is responsible for granting licenses to and supervising/regulating both the domestic and offshore banks. It currently has 60 staff out of which 52 are professionals and 8 support staff. Currently 7 staff are involved in the supervision and regulation of offshore activities.⁴⁷

Since 2003 the RBV has taken over responsibility from the VFSC of issuing licenses and regulating offshore banks. It has become quite efficient at revoking the licenses of offshore

⁴⁵ Above n 39.

⁴⁶ Interview with Mr Mark Mera, Research and Statistics Officer, RBV (Port Vila 20 February 2006).

⁴⁷ Interview with Mr Mark Mera, Research and Statistics Officer, RBV (Port Vila 20 February 2006).

banks that do not follow the new regulatory requirements. The RBV may in the future acquire responsibility for regulating the insurance industry from the VFSC.⁴⁸

Vanuatu Financial Services Commission (VFSC)

The VFSC is a statutory body set up under the *Vanuatu Financial Services Commission Act 1993* (Vanuatu). It comprises a Commissioner (who also serves as Registrar of Companies), and a government-appointed Board, consisting of the Governor of the RBV or his nominee, a person with legal background and experience, and four people appointed by the minister at least two of whom must have financial background and experience.⁴⁹ The VFSC currently has 20 staff out of which 17 are professionals.⁵⁰ The VFSC is a regulator in both the domestic and offshore financial sectors. Domestically, it is responsible for the registration of local companies, licensing of local insurers, collection of stamp duties, charities, and recording trademarks and patents. It charges penalties for breaches of licensing requirements and the late payment of annual fees. In relation to the offshore sector, it is responsible for the licensing of offshore insurers, trust companies and the registration of international and exempt companies. It collects the registration and annual fees. It is also the official receiver of the country. The VFSC is responsible for the promotion and development of the offshore sector. There is a move to make the VFSC responsible for licensing corporate service providers, a prerogative which in the past rested directly with the Minister of Finance.⁵¹

To meet the international standards of regulation required under the OECD and FATF initiatives, the VFSC had to establish a new supervision unit with four officers. This cost the VFSC an increase of VT6,750,000 in salaries per year. The operating costs also increased by VT2 million and VT4,250,000 was spent on training new or existing staff. It faced an overall increase of VT13 million to set up the new supervision unit.⁵²

In addition, several draftpersons were required to perform a legislative overhaul in 2005. This was funded by the IMF. The estimated costs were as follows: VT3 million for drafting, VT10 million technical advice (IMF advisor), VT3 million for consultation and VT3 million for translation.⁵³

Financial Intelligence Unit (FIU)

The FIU was established by the *Financial Transactions Reporting Act 2000* (Vanuatu). Situated at and administered by the State Law Office, its main function is to monitor and control Vanuatu's anti-money laundering regime. It is responsible for monitoring accounting and law firms, company service providers, and fund managers. Any transaction of VT1 million or more

⁴⁸ Interview with Mr George Andrews, Commissioner, VFSC (Port Vila 20 February 2006).

⁴⁹ See s 3 of the *VFSC Act of 1993* (Vanuatu). Note that the *VFSC (Amendment) Act of 2002* (Vanuatu) has amended the VFSC Act and taken away the requirement of one member of the Commission had to be a member of the Finance Centre Association.

⁵⁰ Statistic given by senior staff of the VFSC on 20 January 2006, there is a plan to recruit further 2 senior persons for supervisory roles.

⁵¹ Information provided by Mr George Andrews, Commissioner, VFSC (Port Vila, November 2005).

⁵² Interview with Mr George Andrews, Commissioner, VFSC (Port Vila, 20 February 2006).

⁵³ *Ibid.*

suspected of being connected with money laundering must be reported to the FIU. The FIU provides training and guidelines to financial institutions to assist them in identifying such transactions, and performs an information gathering and compliance role under the financial institutional structure.⁵⁴

Currently there is one full-time staff member and one part-time staff member at the FIU. There are plans to employ two more full-time staff. The FIU works closely with the RBV and to some extent with the VFSC. At the moment the FIU is co-funded by the VFSC and RBV, but there is some uncertainty as to whether this arrangement will continue.⁵⁵

If a suspicious transaction is reported by the financial institutions then the FIU disseminates such reports and conducts investigations to ensure compliance with the *Financial Transactions Reporting Act 2000* (Vanuatu). The FIU is not mandated to analyse Suspicious Transaction Reports, and the determination of any possible money-laundering activities are carried out by the police and Public Prosecutor's Office.⁵⁶

Vanuatu Investment Promotion Authority (VIPA)

The main role of VIPA is to promote foreign investment in Vanuatu. Once VIPA approves applications for investments in Vanuatu, it has the added responsibility of assisting investors facilitate implementation of their approved projects in the country. The office of the VIPA has not had to employ any extra staff to accommodate the new regulatory requirements, as by the time investment applications are filed with them the private sector is responsible for complying with these requirements. As such, the VIPA did not experience any extra costs as a result of the new regulatory requirements, though it hopes that the reputational benefits of compliance will lead to increased foreign investment in the country.⁵⁷

Emergence/Evolution of the Post-2000 Regulatory Regime for IFS

Multilateral organisations such as the OECD and FATF have since 2000 put considerable pressure on IFCs to introduce new and stricter regulatory requirements. In June 2000 the FATF produced a blacklist of non-cooperative countries and territories. In the same month the OECD published a blacklist of International Financial Centres accused of practicing 'harmful tax competition'.⁵⁸ Vanuatu was included on this OECD blacklist, and the subsequent 'Unco-operative Tax Havens' list of April 2002.⁵⁹

⁵⁴ Interview with Mr Samson Endehipa, Attorney General and Mr Mackenzie Obed, FIU officer, State Law Office, (Port Vila, 20 December 2005).

⁵⁵ Ibid.

⁵⁶ International Monetary Fund, *Vanuatu Assessment of the Supervision and Regulation of the Financial Sector*: (June 2003).

⁵⁷ Interview with Mr Joe Ligo, CEO of VIPA (Port Vila, 21 December 2005).

⁵⁸ OECD, *Harmful Tax Competition: An Emerging Global Issue* (1998), OECD, *Towards Global Tax Co-operation* (2000).

⁵⁹ J. C Sharman, 'The Offshore Sector in the South Pacific: Development Potential and Multilateral Pressures' in Ivan Molloy and Ron Reavell (eds) *The Eye of the Cyclone: Governance and Stability in the* (2006) 113.

Since then Vanuatu has committed itself to the conditions of the OECD initiative in return for being struck off the blacklist. However, it will need to continue to introduce laws that will promote transparency. According to the Ministry of Finance, even though Vanuatu has not yet signed any tax information exchange deal with any country, legislation relating to this can still be passed in the absence of such an agreement.⁶⁰

Vanuatu has not been blacklisted on the non-cooperative countries and territories list, which would have a significant adverse effect on Vanuatu's reputation as an IFC. In order to stay off this list, more stringent laws have been introduced. *The Financial Transactions Reporting Act* (Vanuatu) was introduced in 2000, and according to the public sector there may be additional laws passed to further strengthen the regulatory requirements.⁶¹

Vanuatu has gone through many assessments in recent years. In 2000 the Financial Stability Forum surveyed its members concerning the perceived quality and standard of supervision and cooperation offered by the IFCs and produced a three-part categorisation. Vanuatu was placed in Group III with IFCs that were considered to have inferior standards when compared with Group I and II.⁶²

Also in 2000 a joint mutual assessment of Vanuatu was performed by the Asia Pacific Group on Money Laundering and the Offshore Group of Banking Supervisors. That assessment provided a number of recommendations to strengthen the anti-money laundering system. Vanuatu acted on the recommendations and the *Financial Transactions Reporting Act 2000* (Vanuatu) was introduced in September 2000.⁶³ Another joint Asia Pacific Group on Money Laundering and Offshore Group of Banking Supervisors visit took place February-March 2006.⁶⁴

In 2002 the IMF conducted a Module 2 Assessment of the Supervision and Regulation of the Financial Sector of Vanuatu as part of their Offshore Audit program. As a response to one IMF recommendation, in 2004 a cost-benefit analysis of the IFS sector in Vanuatu was conducted on behalf of the government and the Pacific Islands Forum Secretariat.⁶⁵

It is planned that the VFSC will be introducing licensing trust and company service providers modelled on the Isle of Man legislation. The powers awarded to the VFSC will be along the same lines as the *Insurance Act 2005* (Vanuatu). Insurance and trust regulation may be moved from the VFSC to the RBV, however the private sector is totally against such a transfer of responsibility. The private sector claims that the RBV has no expertise in these areas.

The main difference between the old *Insurance Act* and the new one is that the licensing powers given to the VFSC previously rested with the Minister of Finance; that previously VFSC had no powers to supervise, inspect and regulate insurers but it can under the new Act; the VFSC can

⁶⁰ Comments from the Finance Department, 27 February 2006.

⁶¹ Ibid.

⁶² Financial Stability Forum survey 2000.

⁶³ Weenink, above n 17.

⁶⁴ Interview with Mr Nick Soni, Financial Advisor, Ministry of Finance of Vanuatu, (Port Vila, 27 February 2006).

⁶⁵ Ibid.

also approve or remove principals of insurers and obtain and exchange information. Under the new Act there is a set minimum capital requirement and the fees have increased.⁶⁶

It is this regime that regulates/supervises the current IFS in Vanuatu. The next part shows the costs and benefits of enhancing this regime.

INCREMENTAL COSTS VS. BENEFITS OF ENHANCING IFS REGULATORY/ SUPERVISORY REGIME

Incremental Costs of Adopting New International Regulatory Standards

As discussed in the previous section during the past 5 years the public sector has recruited new staff and retrained existing staff to meet the new international regulatory standards. The private sector has also had to recruit new staff and retrain existing staff to fulfill the new due diligence and suspicious transactions reporting requirements. Where new staff were recruited, new office space had to be allocated, and other hardware and software systems had to be bought or licensed. Some offices also bought new IT systems such as “World Check” to be able to satisfy the new international regulatory standards. Overall administrative overhead has increased for both the private and public sector.⁶⁷

The regulatory bodies have borne increased compliance costs in accommodating the external demands for enhanced regulation. The VFSC has had to take on new responsibilities. It has had to create a new section conducting supervision and compliance with 4 new staff. To accommodate the growing number of staff and resources needed to house them, the VFSC had to move into a bigger building which cost VT5 million in 2004 and VT7 million in 2005. The overall renovation and extension to the building cost VT47 million which was funded from the Commission’s reserves. In 2003 it cost the VFSC VT4 million to hire more officers to regulate the area of money laundering, which increased to VT5 million in 2004 and VT7 million in 2005. It has had to spend VT1 million each in 2004 and 2005 on training new staff in the area of news systems installed for anti-money laundering and countering the finance of terrorism transactions. Moreover, staff were sent to special conferences on anti-money laundering and countering the finance of terrorism transactions which cost VT1.5 million in 2003, VT2 million in 2004 and VT3 million in 2005. The VFSC has had to rely on aid from other countries both in the way of financial and technical assistance. For example in 2003 VT6 million was provided by the Asian Development Bank (ADB) and IMF for technical assistance and advisors, this increased to VT12 million in 2004 and VT18 million in 2005. A further VT3 million was provided in 2003 for foreign legal advisors, VT6 million in 2004 and VT8 million in 2005. Moreover, in 2005 the VFSC installed an additional hardware system to meet suspicious transaction reporting and know your customer requirements which cost VT3million. It spent an additional VT750,000 in 2003, VT1.5 million in 2004 and VT3 million in 2005 to recruit draftpersons to draft legislation to comply with the anti-money laundering/countering the finance of terrorism transactions requirements. The cost of additional internal audit requirements for the new suspicious transaction reporting and know your customer requirements was VT1 million in 2003 and

⁶⁶ Ibid.

⁶⁷ Above n 39.

increased to VT3 million in 2004 and VT5 million in 2005. The cost of additional external audit requirements for the new suspicious transaction reporting and know your customer requirements was VT500,000 in 2004 and increased to VT1million in 2005.⁶⁸ The VFSC contributed VT1 million each in 2004 and 2005 towards the budget of the FIU however the government has now taken over the funding of the FIU.

The RBV also has had to take on demanding new duties as a result of the multilateral initiatives. The Government has had to increase the RBV's budget to cope with the increased costs of regulation. The RBV has spent VT400,000 per year since 2000 to train 4 staff working in the area of suspicious transaction reporting and know your customer requirements in relation to banks. It also sent staff overseas for training in these areas, the costs being covered by AusAID. For other external training it has spent about VT1 million per year since 2003. It received technical assistance for the purposes of anti-money laundering/countering the finance of terrorism transactions which was funded by the IMF. The RBV recruited 7 persons in 2002 to act as domestic regulators which cost approximately VT7 million. It plans to recruit a further 5 persons for this purpose this year. New equipment for these staff cost VT600,000 in 2002, VT300,000 in 2004 and 2005. The Reserve bank also contributes towards the operations of the FIU and has provided VT2 million each in 2004 and 2005 to the FIU.⁶⁹ To house the bigger banking supervision department office space had to be renovated which cost VT500,000 and was borne by the RBV.⁷⁰

The FIU has received assistance from the VFSC and RBV budget but has also had to rely on international aid to help meet the new regulatory demands. From 2000 to 2003 there were 2 staff from the State Law Office working part time for the FIU which cost about VT1 million. AusAID initially provided the equipment to set up the FIU department. In 2004 a dedicated FIU office was set up and a full-time employee recruited costing about VT1 million per annum. At this stage, more equipment was needed by the FIU to be able to provide training for private financial institutions in the area of anti-money laundering/countering the finance of terrorism transactions. The French government and the United Nations Office for Drugs and Crime (UNODC) provided for and funded seven computers for this purpose. In 2005 the British High Commission donated a laptop, scanner, desktop and printer to the FIU. In early 2006 AusAID provided another computer for the FIU database. In 2005 another full-time employee was recruited, increasing the cost to VT 2million. To accommodate the 2 staff members of the FIU new office space had to be created, costing VT 1.5 million for the extension to the building and an increase in the rent to VT540,000 per year. Between 2000 to 2003 the staff of the FIU attended special conferences on anti-money laundering/countering the finance of terrorism transactions which cost about VT400,000 and from 2004 to 2005 VT1million each year. In 2005 AusAID funded for one officer of the FIU to receive specialist training in Singapore and to become the Specialist Enforcement Officer for anti-money laundering/countering the finance of terrorism transactions for Vanuatu. About VT800,000 was spent between 2000 to 2003 to train the staff on new systems of hardware and software for the anti-money laundering/countering the finance of terrorism transactions and a further VT500,000 between 2004 and 2005. External technical advisors were also needed to help with setting up the office and assist in anti-money

⁶⁸ Interview with Mr George Andrews, Commissioner, VFSC of Vanuatu (Port Vila, 13 December 2005).

⁶⁹ Interview with Mr Peter Tari, Deputy Governor, RBV (Port Vila, 6 December 2005).

⁷⁰ Ibid.

laundering/countering the finance of terrorism transactions matters, these positions being funded by the IMF. The IMF also funded the cost of additional external audit requirements for the new suspicious transaction reporting and know your customer requirements regime, which have been approximately VT4 million since 2004.⁷¹ In 2006 further offers of assistance have been made by the ADB, The Financial Sector Reform and Strengthening (FIRST) Initiative and the European Union (EU). FIRST has proposed to finish off the Trust and Company Service Providers and Trust bills while the EU has proposed to look at the governance issue in finance, tax and judicial areas.⁷²

The IFS providers too have had to shoulder added costs due to the new regulatory requirements. Banks, accounting and law firms, and the providing corporate and trust services have faced an increase in operating costs. This is due to the added requirements of the know your customer regime and suspicious transaction reporting checks.⁷³

The commercial banks reported that they did not experience any significant new incremental costs as a direct result of the new regulatory requirements. This is because two of the banks are associated with a bigger foreign bank (ANZ and Westpac, both based in Australia) and had to implement such international know your customer requirements even before Vanuatu was required to do so. For example, these banks had already introduced new IT system hardware or software to better regulate client information by 2000. The third bank, National Bank of Vanuatu, maintains a very small number of clients in the offshore sector and the costs associated with the changes in recent years have not been significant enough to cause concern to this particular bank.⁷⁴

The offshore banks surveyed reported that they faced an increase in costs due to the new regulatory requirements but no specific figures were provided. However, they also pointed out that these are costs that it is necessary to bear if they wish to continue operating in competition with other IFCs.⁷⁵ If Vanuatu had not introduced recent reforms, expensive as they are, it might be the case that the IFC could have had its foreign customers onshore progressively restricted from access to Vanuatu IFS.

The accounting firms that operate within the IFC experienced a significant increase in operating costs. One particular firm had to re-train (in house) its existing staff in the areas of suspicious transactions reporting which cost about \$A10,000, as well as spending \$A150,000 on enhanced know your customer procedures between 2003 and 2005. While there was no direct additional monetary costs for this it cost in terms of time spent away from other responsibilities of the staff. Another firm had to appoint a person to carry out suspicious transaction reporting and know your customer requirements on a half day basis, costing VT1 million in 2004. In relation to extra space needed to house new staff, only one firm faced this problem, spending an extra VT240,000 in increased rental costs.⁷⁶

⁷¹ Interview with Mr Mackenzie Obed, FIU Officer, State Law Office of Vanuatu, (Port Vila, 15 December 2006).

⁷² Information provided by the Financial Advisor of the Ministry of Finance, Mr Nick Soni.

⁷³ Above n 39.

⁷⁴ Ibid.

⁷⁵ Ibid.

⁷⁶ Ibid.

Most of the firms surveyed reported that they sent staff to specialised conferences on anti-money laundering/countering the finance of terrorism transactions which cost VT9 million from 2000 to 2005. Some of the firms invested in new systems of hardware and software for anti-money laundering/countering the finance of terrorism transactions which cost about VT400,000. All firms surveyed reported that they experienced additional costs of compliance relating to anti-money laundering/countering the finance of terrorism transactions. While this figure was as low as VT2 million for some, it was more than VT6million per year since 2000 for some others. One firm in particular experienced a significant increase in this area in 2004 (VT13 million) and 2005 (VT18 million). While most firms did not face any extra costs due to additional internal/external audit requirements, one firm experienced an increase of VT1million and VT500,000 respectively for 2004 and 2005.⁷⁷

The law firms that operate within the IFC experienced a significant increase in operating costs too. These firms reported that from 2000 to 2005 they spent between 20 to 50 additional hours per year to fulfill the new suspicious transaction reporting and know your customer requirements, which cost about an extra VT1 million each year to its operating costs. However, the law firms did not recruit any new staff to perform this work, either re-training existing staff or, in the majority of cases, the senior partners performing these duties personally. About VT120,000 was spent by some firms to attend special conferences on anti-money laundering/countering the finance of terrorism transactions.⁷⁸

In some instances the incremental costs were passed on from the regulators to the IFS providers and from the IFS providers to the clients. This was mainly by way of higher fees and other charges. For example, the fee for registering an offshore bank in Vanuatu was increased from \$US5000 to \$US8000.⁷⁹ Other non-pecuniary costs clients had to cope with were the loss of privacy and confidentiality, and delays in remittance transaction periods due to the new more detailed due diligence/know your customer requirements. Overall this increased the time that is usually taken to clear documentation and do business, which frustrated some clients and drove them to other destinations. This led to lost business opportunities for the offshore sector.⁸⁰

Because most forms of regulatory requirement lead to an employment opportunity for a local in the country, however, some of these costs may also provide employment benefits.

Incremental Benefits of Enhanced IFS Regulation & Supervision

It is difficult to identify incremental benefits to the offshore centre due to the enhanced IFS regulation and supervision, and impossible to quantify any such benefits. One qualitative benefit identified by public sector regulators and some (though by no means all) private sector respondents is that the enhanced regulation and supervision requirements are said to have improved Vanuatu's reputation as an IFC. It has also possibly enhanced Vanuatu's competitiveness with other IFC jurisdictions, though this assessment is supported by only some

⁷⁷ Ibid.

⁷⁸ Ibid.

⁷⁹ Information provided by the RBV 20 February 2006.

⁸⁰ Above n 39.

of the public sector and a minority in the private sector, who believe that such benefits may only be seen over a period of time. Other skeptics think that Vanuatu, due to its remoteness, is not in competition with other geographically better placed IFCs like the British Virgin Islands and Cayman Islands.⁸¹

By complying with the FATF initiatives Vanuatu avoided being placed on the non-cooperative countries and territories list and the associated negative publicity which would tend to discourage offshore clients and international aid. Since committing to the OECD Harmful Tax Practices initiative in May 2003 Vanuatu has been removed from the 'Unco-operative Tax Haven' list.⁸² Given the serious reputational and material damage inflicted by blacklisting on other Pacific IFCs since 2000, these are significant achievements. Public sector regulators and those surviving offshore bankers identify the major benefit of adopting reforms as the continued ability to enjoy access to the global market for IFS.⁸³

According to the RBV and the VFSC, the number of registrations of international companies and offshore banks have declined due to the new regulatory requirements since 2000, but both regulators were positive that with time the numbers would increase and the offshore centre will attract more business. It is anticipated that the new international regulations will increase growth and in turn bring a more diverse IFS client base. However, there has not been any significant positive growth since 2000.⁸⁴ In general a large majority of the participants in the workshop for the OFC of Vanuatu at Le Meridien on 10th March 2006 agreed that it is difficult to identify any direct "reputational dividend" accruing to Vanuatu as a result of its compliance with new regulations. The general feeling among workshop participants was that both the public and private sector had spent a great deal of effort meeting new regulatory standards with very little to show for it in terms of increased revenue, and little thanks from the outsiders that have driven these regulatory changes, particularly by the threat of blacklisting.⁸⁵

A significant negative change has been noted in the collection of the offshore sector's revenues due to the new international regulations. A private sector source claimed that the loss of offshore banks has cost the public and private sector a total of US1 million.⁸⁶

Overall Assessment of Net Benefits Accruing from Adoption of New International Regulatory Standards and Strengthened Regulatory Regime

The overall net impact on the Vanuatu economy in adopting the new international regulatory standards has been generally negative so far. Complicating this assessment, however, is the improved reputation Vanuatu may have gained in the international business arena. The new regulatory standards may result in reputational gains which would result in foreign authorities

⁸¹ Ibid.

⁸² Note that being removed from the OECD blacklist was not the only reason why Vanuatu committed to the OECD Harmful Tax Initiative. There were 8 other conditions listed in Vanuatu's commitment letter to the OECD in addition to the removal from the 'OCED list of Uncooperative Tax Havens' – information provided by the Finance Department on 27 February 2006.

⁸³ Above n 39.

⁸⁴ Ibid.

⁸⁵ Ibid.

⁸⁶ Ibid.

removing barriers to the marketing of financial services from the IFC, and/or private investors may be more likely to invest in a jurisdiction that has met international standards and is not on any blacklist. However, there is as yet little or no firm evidence to support this optimistic scenario.⁸⁷

The government and the public sector regulators, under international pressure, have had to adopt new international regulatory requirements. It has cost the public sector far more to implement the new standards than any quantitative benefits received to date. In most instances new staff had to be employed or existing staff retrained to take on the new responsibilities. In some instances new office space had to be rented to accommodate the new staff. Where new staff were recruited new equipment had to be bought, which increased the cost of operations of the public sector regulators.⁸⁸

Private sector IFS providers also have had to implement the new international standards, particularly in the form of stricter due diligence/know your customer requirements. As a result, a substantial volume of business was lost, as the IFC's international clientele found the new regulatory requirements excessively intrusive.⁸⁹ In particular, some private sector respondents emphasised in interviews and at the workshop for the OFC of Vanuatu at Le Meridien on 10th March 2006 the amount of business they had lost to less strictly regulated onshore jurisdictions, like Delaware or London, or IFCs like Hong Kong and Singapore that have so far not been targeted by the OECD or FATF. In order to be able to comply with the new regulatory requirements, the private sector has often had to retrain existing staff. For some operators senior partners have had to do the compliance work themselves due to the lack of experience of existing staff in this area. A few operators bought new IT software to comply with new regulatory requirements, while others indicated that they were already using such software before 2000. Once more, for the private sector the overall net quantitative benefits in adopting the new international regulatory standards have been negative to date. However, some private sector operators believe that there has been a net qualitative benefit from Vanuatu's compliance with the new international regulatory standards, again through an enhanced reputation internationally.⁹⁰

The costs borne overall by the IFC (i.e. both the public and private sector) are far greater than any apparent benefits to date. The public sector is generally hopeful that the benefits from adopting the new standards will become more obvious in the near future with an increase in business.

For Vanuatu's offshore industry to grow and become more profitable, however, the implementation of the new regulatory standards is not sufficient. Even though its name has been cleared from the OECD's blacklist, there is significant concern in the public sector that Vanuatu is still labelled by many banks as a "blacklisted country". Vanuatu is now explicitly marked out

⁸⁷ Ibid.

⁸⁸ Ibid.

⁸⁹ Statement made by a private sector operator who believes that the international clientele jealously guard their privacy when dealing with offshore centres and any additional requirements of providing personal information is treated as being intrusive.

⁹⁰ Above n 39.

for unfavourable treatment in national tax blacklists maintained by Argentina, Brazil, Colombia, France, Italy, Latvia, Mexico, Peru, Portugal, Spain, Venezuela. There have also been difficulties processing transactions from foreign banks, particularly in the United States. Some of these problems date from 1999, but the FSF and OECD's blacklists have been an important contributing factor. The private sector believes that because banks in OECD states still treat Vanuatu as a non-compliant country, it is very difficult for the private sector to establish new banking contacts or maintain existing ones. Major international banks such as HSBC, Deutsche Bank, and Bank of New York, to name but a few, still refuse to carry out any transactions involving Vanuatu.⁹¹

Some in the private sector believe that due to the small size of the Vanuatu IFC's operations, the success of meeting the new international regulatory standards may not make any difference to the amount of business that comes its way, certainly not enough to compensate for the costs of implementing these standards. All of the above lead to the following conclusions.

Conclusions and Future Implications of Current International Regulatory Initiatives

According to some industry members, the imposition of new standards by a number of diverse sources is not an appropriate response to the underlying problems that are being addressed. The substantial volume of regulatory requirements imposed on Vanuatu in the recent years is said to be excessive considering the small scale of operations and the country's remoteness with reference to transactions relating to money laundering and the financing of terrorism. Private sector sources believe that this is particularly true because in order to get to Vanuatu's offshore providers such transactions would have to go through other larger countries which should be already addressing any illegal activity. The new regulatory requirements are said to be going in the wrong direction by requiring over-regulation of the IFS sector for anti-money laundering/countering the finance of terrorism transactions concerns when the possibility of such incidents occurring in Vanuatu is remote.⁹²

The FATF has been very active in ensuring that Vanuatu adheres to new anti-money laundering/countering the finance of terrorism transactions international regulatory standards. Some skeptics have characterised its behaviour towards Vanuatu as oppressive, and believe that other larger financial centres have not had to implement such requirements, a suspicion confirmed in relation to Delaware, Nevada and Wyoming by recent US government reports.⁹³ The industry generally believes that new and more rigorous standards are being developed at a frenetic pace not because there is an actual need for them in accomplishing desired objectives, but because an industry with vested interests has now emerged within the OECD and the international financial institutions (World Bank and IMF) for generating standards to give the impression of "something" being done.⁹⁴

Vanuatu has made some conditional commitment to international tax information exchange with the OECD. In May 2003 the Minister of Finance wrote a letter to the OECD Secretary General

⁹¹ Above n 39.

⁹² Ibid.

⁹³ Reserve Bank of Vanuatu, *Government Accounting Office* (2006).

⁹⁴ Above n 39.

agreeing to implement the reforms requested.⁹⁵ The commitment letter noted, however, that the reforms desired by the OECD would have ‘significant adverse cost and revenue implications’ for Vanuatu, and asked for donor countries to keep this sacrifice in mind when allocating development aid.⁹⁶

In the commitment letter, the government of Vanuatu agreed to:

- Exchange tax information with other countries relating to criminal matters from 31 December 2003 and on civil tax matters from 31 December 2005. The fact that particular acts may not constitute crimes in Vanuatu or that Vanuatu has no fiscal interest in the case are not sufficient grounds to refuse information exchange.
- Establish beneficial ownership of companies, banks, partnerships and other corporate vehicles and the settlors, trustees and beneficiaries of trusts, make this information available to regulators, and exchange this information with foreign tax authorities. Authorities will have access to and exchange bank information on a similar basis.
- Ensure that companies and other corporate vehicles will submit regular accounts in line with standards to be drawn up by the Joint Ad Hoc Group on Accounts.

Vanuatu’s commitment letter was made conditional on the “level playing field” being achieved and all countries failing to meet OECD standards on information exchange being subject to ‘co-ordinated defensive measures’. Although the OECD has refused in principle to accept “conditional commitments”, the status of the commitment and the specific measures is now unclear. Four OECD members have so far refused to abide by new rules on international tax information exchange (Austria, Belgium, Luxembourg and Switzerland), while the remaining five jurisdictions on the ‘Unco-operative Tax Havens’ list (Nauru having committed in December 2003) have not been subject to any co-ordinated defensive measures.⁹⁷

Representatives from Vanuatu attended the November 2005 OECD Global Tax Forum at which it was agreed that information exchange should take place on a bilateral, voluntary basis according to the principle of mutual benefit. Australia is particularly keen to conclude a Tax Information Exchange Agreement with Vanuatu.⁹⁸

Vanuatu does not have any tax treaties with any country to date, though it may negotiate a bilateral tax information exchange agreement with Australia. Skeptics from the private and public sector are of the opinion that Vanuatu will have nothing to gain from such an agreement since it is a tax haven, and any other country’s tax information will be of no use to it. There were suggestions that if Vanuatu were made to release such information relating to its investors then the body or country interested in this information should pay the price for it by way of some compensatory benefit to the country. Concerns were raised about the domestic privacy laws of

⁹⁵ Organisation for Economic Co-operation and Development <http://www.oecd.org/dataoecd/61/28/2634587> (Accessed 5 February 2006).

⁹⁶ Interview with Mr Nick Soni, Financial Advisor, Ministry of Finance of Vanuatu, (Port Vila, 27 February 2006).

⁹⁷ Interview with Mr J Sharman, senior lecturer, Sydney University, Australia (10 March 2006).

⁹⁸ Interview with Mr Nick Soni, Financial Advisor, Ministry of Finance of Vanuatu, (Port Vila, 27 February 2006).

countries like Australia and New Zealand which may result in a one way traffic flow from Vanuatu with nothing in return because under domestic law these countries would not be able to give their tax/confidential information.⁹⁹

The other “participating partner” governments in the OECD process are now in the situation of deciding whether the direct and indirect costs of concluding Tax Information Exchange Agreements is worth the benefits OECD countries are offering. Thus far, the Exchange Agreement between the Isle of Man and the Netherlands, concluded in late 2005, is regarded as being the most successful model of an arrangement conferring substantial mutual benefits.¹⁰⁰

Potential future costs from the OECD’s initiative arise in several forms. There are the direct costs of implementing the specified reforms, particularly establishing beneficial ownership. Because the measures required by the OECD are largely the same as those in the FATF’s 40 Recommendations (and those called for in the 2003 IMF report), it is artificial to attribute these costs to the OECD initiative alone.¹⁰¹

Additionally, there is the impact in terms of reducing Vanuatu’s attractiveness as an IFC in the eyes of foreign investors. These costs can be expected to be significant. Both in promotional material and in interviews local client service providers tend to emphasise the importance of secrecy and confidentiality for clients forming international companies and trusts, either separately or in combination. To the extent that the identities of beneficial owners and directors of companies and the identity of trust beneficiaries must be disclosed to the authorities and thence passed on to foreign governments, the attractiveness of these vehicles can be expected to decline. Even for discretionary trusts it is expected that beneficiaries must be identified as soon as they receive income or assets from the trust. Similarly, increased reporting requirements for international and insurance companies may be expected to reduce their appeal to prospective clients.¹⁰²

Finally, a priority for the future identified by both the public and private sectors is to improve the marketing of the IFC. For example, the VFSC is seeking to introduce on-line services and a marketing plan with the assistance of the ADB, which may cost approximately \$US500,000. Despite the consensus on the need for enhanced marketing, there is no consensus as to who should take the lead and bear the costs: the private sector regards the government as having primary responsibility, while the regulatory bodies see marketing as incompatible with their role. There is a need for the government to continue to support and strengthen this area for the offshore sector to grow and be effective as an income earner.

⁹⁹ Above n 39.

¹⁰⁰ Interview with Mr J Sharman, senior lecturer, Sydney University, Australia (10 March 2006).

¹⁰¹ Above n 39.

¹⁰² Ibid.