FINANCIAL MARKETS ASSOCIATION
VANUATU

Notes on the new guidelines for financial dealers in Vanuatu (Nov. 2021)

This document aims to clarify the intent and the implications of the latest changes in Vanuatu's legislation governing the financial industry, as well as a set of guidelines recently issued by our regulator, the Vanuatu Financial Service Commission (VFSC), regarding the Financial Dealer License (FDL) programme.

It's important to note that the VFSC and its governing department, the Ministry of Finance and Economic Management ("the Ministry"), have clearly expressed a favourable view of the FDL programme and, more broadly, of the Vanuatu International Financial Centre.

The VFSC acts both as the Registrar of Companies and as the regulator of the FDL programme and is working closely with the service providers licensed under the Company and Trust Services Providers Act (CTSP Act), the Financial Markets Association (FMA), and the Vanuatu Financial Centre Association (FCA) to support and grow Vanuatu's financial industry.

A bit of context

Vanuatu's International Financial Centre has long been instrumental in creating opportunities for Ni-Vanuatu, bringing revenue to the nation, and fostering prosperity for the entire community.

However, the world has changed a lot since the Centre was set up by the British in the 1970s, back when our small island nation was a British-French Condominium known as the New Hebrides.

Since declaring its independence in 1980, Vanuatu has grown to become a strong parliamentary democracy and an open society of rights and law. Today, the country adheres to international standards of governance and is an active participant in all major global initiatives to fight tax evasion, money laundering and the financing of terrorism. Vanuatu takes part in the OECD's Common Reporting Standard (CRS) for financial transparency and is a founding member of the APG (Asia Pacific Group on money laundering), which itself is a member organization of the Financial Action Task Force (FATF).

During the last decade, with the help of the APG, the FATF and the OECD, Vanuatu has upgraded its monitoring and regulatory systems as well as its legislation to put them on par with global standards.

In other words, Vanuatu is now at the forefront of global trends toward openness, and its authorities are in a position to strike a fair balance between transparency and privacy rights.

Traditionally, the International Financial Centre was catering to a mostly offshore clientele, i.e. businesses operating outside of Vanuatu while being licensed within our jurisdiction. However, in its renewed governance approach, the Government of Vanuatu now wants these clients to transition from “offshore activities” to ‘’onshore exports of services”. **Vanuatu wants to bring about a sea change in the way it does business, by transitioning from an <<offshore, protected international financial centre>> to an <<onshore, transparent international fintech centre>>**

Bringing the offshore industry back onshore can spur investment in Vanuatu, create jobs, stimulate further development, and support education and training. The VFSC and the FMA are both expecting that FDL holders will open up offices in Vanuatu and that these businesses will hire and train Ni-Vanuatu to fulfil positions in their newly established Vanuatu headquarters.

In short, the days where a simple PO box and some accounting entries were enough to claim a stake in the Vanuatu International Financial Centre are over.

As a general principle, anyone who wants to benefit from Vanuatu’s regulatory and fiscal regime must come to the country and bring a tangible contribution to the community. The more a business benefit from Vanuatu’s regime, the more it is expected to reinvest in the development of the nation. In particular, the authorities have an eye on employment, training and skill development opportunities brought on by foreign investors.

Vanuatu has invested far too much time and resources in putting its laws, regulations and institutions on par with global standards to let bad actors come in and ruin the market for honest and dedicated participants. The regulator along with the Financial Markets Association are deeply committed to transparency and fairness, as they know firsthand the devastating effects that weak regulation and lax enforcement can have on their reputation and their opportunities if they don’t uphold the highest standards of professionalism.

With this preamble in mind, let’s now dive into the details of the new legislation and the guidelines issued by the VFSC.

The new VFSC guidance notes in detail

1. Physical Presence

Extracts from the official VFSC guidance notes:

- *The intention of the physical presence requires that each licensee must have its own separate, stand-alone (as opposed to shared) premises, records, management staff and key equipment, and the software system that is fully controlled in Vanuatu.*

- *There must be **at least one person** who is a direct employee of the licensee and who meets the requirements of the "fit and proper" criteria, as issued under the "Fit and Proper" guideline.*

- *VFSC expects that the bigger and more complex the licensee's business the more staff would be in Vanuatu to manage the business operations and to maintain all necessary records.*

- *To satisfy the requirements of the physical presence, the licensee must be able to show that a person appointed to manage the operation in Vanuatu is vested with some executive powers to manage the day-to-day operations of the dealer*

Comments:

These guidance notes about Physical Presence and Economic Substance are pretty straightforward. They state the minimal physical presence requirement and show how the regulator expects to see licensees invest in Vanuatu **in relation to the size of the business that is booked in Vanuatu**. The bigger the business, the more employees it should have on the ground and the more it should logically invest in offices, training, equipment, etc.

2. Licensed Resident Managers

Extracts from the official VFSC guidance notes:

- *The intention of the licensed resident manager is to act and manage the business on behalf of a financial dealer in securities who **for some valid reasons could not establish or meet a physical presence required under the act.***

- *To satisfy the requirements of the physical presence, the licensed residen t manager must be able to show that he/she is vested with some executive powers to manage the day-to-day operations of the licensed financial dealer.*

Comments:

These guidance notes are relevant for startup brokers and small brokers that are not active or only have really limited activity. This show a willingness by the regulator to accommodate an investor's initial arrival to Vanuatu, as well as to maintain the licenses that are on idle mode. The hiring of a Resident Manager is most probably meant to be a temporary solution, helping licensees who are not yet in operation to lower their initial start-up costs. Vanuatu is a small developing Nation and adding the Resident Manager solution in the regulation is a way to help the little guy. It is simply allowing easier access to the first ladder of the program, by meeting the Physical Presence requirement discussed above with only little investment.

3. Requirements for Licensee Application as a Security Dealer

Extracts from the official VFSC guidance notes:

- *A license issued under the Act shall remain in force until it is revoked under the Act.*
- *The Amendment Act gives the Commission the power to impose conditions on a license.*
- *For existing licence holders, the Commissioner may revoke a licence where he is satisfied that the licence conditions are not met.*
- *The amendment requires that all licensees must operate from an office in Vanuatu.*
- *The Amendment introduces the licensing of resident manager as an alternative to having a fully fledged physical presence in Vanuatu*
- *The Commission will apply these Guidelines from 16th October 2021*

Comments:

As of October 16, 2021, there are four distinct classes of FDL. Licenses are not limited to one year anymore; duration is now infinite, as long as requirements are met, but the VFSC can revoke a license at any time for non-compliance with the Act.

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Type of licence	Class A	Class B	Class C	ClassD
Products covered by the license	**FX deliverable** and **debt** instruments	Capital of a corporation (**shares**); precious metals; **commodities;**	Future contracts and **derivative products**	**Dealing in digital assets**
Principal's License Fee	**VUV 150,000**	**VUV 150,000**	**VUV 150,000**	**VUV 150,000**
Representative's License Fee	**VUV 150,000**	**VUV 150,000**	**VUV 150,000**	**VUV 150,000**
Cumulative 1st year Fees (includes one off application fee)	**VUV 300,000**	**VUV 300,000**	**VUV 300,000**	**VUV 1,200,000**
Annual fees cumulative (excludes one off application fee)	**VUV 200,000**	**VUV 200,000**	**VUV 200,000**	**VUV 800,000**
Bond Deposit	**VUV 5,000,000**			
Minimum issued capital	**-**	**-**	**-**	**USD 500,000**

- Most of the FDL currently in operation as of the end of October need a Class C license as they are offering CFD.
- To get a Class D license, one must first obtain Class A, Class B and Class C licenses, and meet several specific added requirements: 3 people (one of whom is CTO), USD 500,000 minimum capital, physical presence, custodianship, etc.
- Class D license holders cannot act as a custodian of digital assets unless they can prove that they have all the risk management systems in place and they are licensed custodians and regulated by a regulator in another jurisdiction.
- A Bond Deposit must be paid one time per Licens**ee** (not per license), so the same legal entity that applies for Class A, Class B and Class C is lodging only **one bond deposit.**

Note on the transition period:

For new licenses that did not exist prior to 16 October 2021, everything in the guidance notes applies, including the physical presence, local director, ABCD license classes, etc. New applicants must comply with the entire new set of rules.

The VFSC will need at least 3 months from the date a license application is received to make a decision on it, whether it is approved or declined. If the application is approved and the license is granted, VFSC will grant at least a further three months for the licensee to establish its physical presence in Vanuatu, before it can start doing business. New applicants should prepare before their application is presented to VFSC – setting up an office space, hiring staff, buying equipment, etc. – so that they do not need longer than three months to start doing business in Vanuatu once their license is granted.

Here it is important to state again that the VFSC aims to select serious applicants. If applicants are genuine and dedicated in their approach and intend to properly run a business in Vanuatu, the VFSC will be flexible and patient.

For existing licenses that existed prior to October 16, 2021, and are to be renewed by October 16, 2022, a transition period will apply. They have until October 16, 2022, to comply with the requirements of physical presence; failing this, they might have their license revoked by the VFSC. They will need to apply to Class A, B, C or ABCD licenses before the expiration of their existing license, using the new prescribed forms and paying the new fees. Their new licenses will have no fixed expiration date.

The VFSC is aware that licensees might have difficulties securing physical presence because of the Covid-19 pandemic, and this will be taken into consideration if an extension is required by an applicant who cannot travel to Vanuatu.

4. Digital Assets

Extracts from the official VFSC guidance notes:

- *The Act defines digital asset as* ***"an immaterial asset in digital form stored on a distributed ledger technology (such as blockchain) and representing a set of rights or value"****.*

Comments:

- Class D licenses are only available for holders of Class ABC licenses or, in exceptional circumstances, if the applicant simultaneously applies for Class ABCD licenses.
- Class D licenses will only be granted to sophisticated or institutional investors (i.e. no start-up businesses).
- A Class D license is required for any business which buys, sells, custodizes, or trades in digital assets on behalf of third parties/clients.
- **CFD brokers** which use oil, gold, or any commodities or cryptocurrencies as underlying assets are considered derivatives brokers, thus **do not need a Class D** license.
- The Act and the VFSC Guidance notes are meant for the BROKERAGE of digital assets and not the ISSUANCE of digital assets, thus Initial Coin Offerings are not allowed.
- As digital assets present their own risk and are a newer type of financial product, the VFSC will request more transparency and more evidence of the honesty of licensees holding for Class D licenses. For these reasons, Class D license applications will be reviewed with extra scrutiny.
- Applicants must have at least USD 500,000 of unimpaired liquid capital.
- A minimum of 3 staff must be employed in Vanuatu, along with several other requirements regarding risk management, outsourcing, internal control, compliance manuals, AML-CFT procedures, marketing material, continuity plan, etc.
- The business of providing exchange between fiat and cryptocurrencies to third parties may require approval from the Reserve Bank of Vanuatu and may require a specific license.

- Generally, the VFSC is opening up the field and would like to see experienced players already operating in other jurisdictions coming to Vanuatu to kickstart the industry and to slowly train local services providers on this new technology.
- The expectation is that the vast majority of current FDL will not apply for that license and that only a really small number of such licences will be issued in the coming months or years.

5. Outsourcing

Extracts from the official VFSC guidance notes:

- *This Guideline operates on the premise that **licensed entities retain ultimate accountability for all outsourced activities**. Furthermore, VFSC's supervisory powers should not be constrained, irrespective of whether an activity is conducted in-house, outsourced, or otherwise obtained from a third party.*

- *A holder of Class D license cannot outsource the position of the **"Chief Technology officer"***

- ***Location of Records***
  In accordance with the Financial Dealers Licensing Act and other relevant legislation, certain records of entities carrying on business in Vanuatu should be maintained in Vanuatu. In addition, the Licensee is expected to ensure that VFSC can access in Vanuatu any records necessary to enable VFSC to fulfill its supervisory mandate.

Comments:

These guidance notes are pretty clear and extensive, and bring a level of formalism that we haven't seen before. All outsourced activities must be well documented and ultimate responsibility will fall on the Vanuatu licensee. Certain best practices are also imposed on licensees. For Class D licenses, the CTO must be based in Vanuatu and this role cannot be outsourced.

6. Custody of Digital Assets

Extracts from the official VFSC guidance notes:

- *For purposes of this guideline, the term "digital asset" refers to an asset that is issued and/or transferred using distributed ledger or blockchain technology ("distributed ledger technology"), including, but not limited to, "virtual currencies," "coins," and "tokens."*

- *VFSC, therefore, requires that a firm providing custodian services of digital assets, must be a licensed custodian, well-capitalized and well regulated by a reputable regulator in another jurisdiction.*

Comments:

Only entities that are already regulated in another jurisdiction will be considered for Class D licenses that allow custodianship services. This means established players like Coinbase, Bitfinex, Binance, FTX, Kraken, etc. could potentially apply for a license since they are well capitalized and have extensive experience and a good reputation. On the other hand, the VFSC is closing the door to digital asset custodian start-ups.

7. Risk Management

Extracts from the official VFSC guidance notes:

- *The purpose of this guideline is to set out the high level principles for Financial Dealers to identify and manage their inherent risks. Each licensee is required to submit a written Risk Management policy and procedure to VFSC covering all identified inherent risk and the mitigating factors put in place to manage those risks. The high level principles for risk management would be subject to regular update and amendment, as required. Amendments to risk management documents are to be approved by the Board of Directors. The risk management document must be reviewed at least annually in connection with changes in the technology, market environment and when maximum limits for risk exposure are reviewed and amended.*

Comments:

These guidance notes are quite extensive; they impose certain best practices to licensees regarding risk management.