Walking a Tightrope:

Vanuatu financial services and the dichotomy of legitimacy and growth

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As an international finance centre in the South Pacific since 1971, Vanuatu seems to evoke images of *laissez faire* regulation, dogmatic bank secrecy and tax avoidance. Indeed, the many appealing features of Vanuatu's regulatory and commercial environment have historically been relied upon to drive a myopic perception of illegitimacy. Combating that erroneous perception has demanded that Vanuatu tread a paradoxical fine line. Make conditions too favourable for investors, and the jurisdiction becomes vulnerable to criticism for encouraging "undesirable" commercial practices. Yet, too much regulatory interference, and investors will migrate to more welcoming financial climes. A combination of thoughtful legislation and proactive administration has enabled Vanuatu to strike an intelligent balance between legitimacy and growth. International clients can rest totally assured that when they invest in Vanuatu, they are gaining the benefit of a regulatory system that has been forged and approved under the closest international scrutiny. More significantly, that experience has equipped the financial services industry with the creativity and foresight necessary to create favourable outcomes for commercial clients.

Unjustified attention

In recent times, the word "zero" has been treated as a dirty word by many of the world's developed economies when accompanied by the term "taxation". The emigration of enterprises from their traditional homes in search of a cheaper fiscal existence overseas wounds the home nation in two critical areas. First, considerable expenditure flees the local economy. Second, the tax base is eroded. Hence, where foreign jurisdictions offered favourable tax treatment to mobile enterprises, "home nation" self-interest dictated that something be done to prevent the situation from continuing. The result was the OECD project on harmful tax competition.

An in-depth discussion of the project is beyond the scope of this article. Indeed, the philosophical merits and effectiveness of the project have been commented on extensively in academic journals. See, for example, Littlewood "Tax Competition: Harmful to Whom?" (2004) 26 *Michigan Journal of International Law* 411. For present purposes, it is sufficient to record that harmful tax practices were the focus of the OECD project, and Vanuatu was firmly within its sights.

One only needs to recite the basic features of the Vanuatu taxation system to understand why it aroused the interest of the OECD:

- No income tax, corporate tax, capital gains tax, estate duty and inheritance tax;
- International companies statutorily exempt from taxation for 20 years provided they remain solvent;
- No double taxation agreements; and
- "Offshore transactions" exempt from 12.5% value added tax.

The OECD response was to place Vanuatu on the list of unco-operative tax havens. Over time, however, the OECD project strained under both the magnitude of the task it initially set and the obstinate reactions of developing nations at what they saw as extraterritorial hypocrisy. As a result Vanuatu secured a compromise which

enabled it to maintain all of the attractive features of its tax system in exchange for limited disclosure of company information. Vanuatu was removed from the list. This had the ancillary advantage of lending an international seal of approval to the Vanuatu regulatory framework.

A survey of Vanuatu's statute book demonstrates that the legitimacy label is entirely justified, and efforts to brand Vanuatu as a rogue jurisdiction are misconceived:

- **Secrecy:** Members of the public are unable to obtain detailed information about international companies. Court proceedings involving such companies can be held in private with no public record. The obligation of confidentiality is backed by criminal sanctions. Yet confidentiality does not apply when information is required either in regard to serious criminal offences or by certain authorised bodies.
- **Money laundering prevention:** Vanuatu has extensive legislative mechanisms dealing with money laundering. They operate on two levels:
  1. **Prevention:** The Financial Transactions Reporting Act 2000 sets out mandatory suspicious transaction reporting requirements which are enforced by Vanuatu's Financial Intelligence Unit. At a transactional level, all local banks have extensive "know your customer" protocols. It is on the strength of this framework that Vanuatu has remained off the Financial Action Task Force blacklist; and
  2. **Criminalisation:** Money laundering is a criminal offence under the Proceeds of Crime Act 2002. The terms "property" and "proceeds of crime" are defined broadly to encompass property of any time that directly or indirectly represents the proceeds of crime. Powers of confiscation, freezing and forfeiture are all available under the Act. Vanuatu has established a Transnational Crime Unit dedicated entirely to the investigation of money laundering and terrorist financing.
- **Anti-terrorism:** Vanuatu is a signatory to the International Convention for the Suppression of the Financing of Terrorism. That convention has been incorporated into domestic law via a multitude of statutory instruments dealing with mutual assistance in criminal matters through to substantive counter terrorism initiatives.

Capitalising on a stable platform

Having recently passed the test of international opinion, Vanuatu has now undergone further development. As the largest captive domicile in the South Pacific, Vanuatu has reinvented itself as a jurisdiction specialising in captives. The advantages and commercial benefits of captive insurance are well documented. Yet the ideal vehicle for forming a captive and accessing those benefits is often overlooked. The incorporation of a separate company for that purpose can be costly and time consuming, while rent-a-captive facilities can give the perception of a relinquishment of control. The recent enactment of protected cell legislation in Vanuatu has provided one solution to this dilemma by affording the traditional advantages of a separate legal entity without the associated compliance costs. When added to the range of captive options already on offer, the protected cell legislation has enabled Vanuatu to offer a full smorgasbord of captive insurance options for the international client.

The legislation in brief

The Insurance Act and Regulations provide the regulatory background against which the Protected Cell legislation operates. The Protected Cell Company Act 2005 represents a subtle conceptual shift away from traditional corporate regulation. A protected cell company (PCC) presents all the benefits of a limited liability company without the associated set-up and compliance costs. The fundamental principle underscoring the legislation is that assets and liabilities of one cell can be segregated entirely from those of other cells under the ambit of a single corporate structure. This does not mean that all the individual cells within a PCC are legal entities in their own right. Rather, a series of mechanisms within the legislation has the practical effect of treating individual cells as separate legal entities:

(a) The directors of a PCC are under an obligation to keep the assets and liabilities of one cell identifiable and entirely separate from those of another cell;

(b) Every third party that contracts or deals with a particular cell is deemed to accept that in recovering its debts from a particular cell, it will not have recourse against other cells within the PCC. The corollary of this is that every PCC is legally obligated to put third parties on notice that they are contracting with a PCC. This is done by:

  (i) including the expression "Protected Cell Company" or "PCC" at the end of the company name; and

  (ii) every director of a PCC informing third parties that they are contracting or dealing with a PCC; under threat of the director being personally liable for any losses resulting from a failure to do so.

(c) A PCC can create and issue shares in any of its cells. This enables ownership of a cell to be divided among a number of legal persons, thereby facilitating the equitable distribution of cellular profits.

The opportunities

This fresh legal framework presents an exciting opportunity for captive and insurance PCCs to be established. Consistent with Vanuatu's focus on financial services, incorporation of PCCs is reserved solely for captive insurers, mutual funds or unit trusts. Once that statutory prerequisite is satisfied the PCC is permitted to operate entirely in Vanuatu, entirely outside of Vanuatu or within and outside Vanuatu at the same time.

Vanuatu has experienced insurance managers on hand who are ideally placed to demonstrate the advantages and explore the diverse range of possibilities of PCCs. Insurance managers also provide the necessary medium between the captive applicant and Vanuatu's regulatory body, the Vanuatu Financial Services Commission. This ensures that the Commission is fully apprised of investor concerns and needs on an ongoing basis and that the applicant seamlessly complies with all regulatory requirements. All captive insurance managers belong to the Vanuatu Captive Insurance Association, a professional body dedicated to the maintenance of high service standards.

The process in motion

Commencing a captive programme and taking advantage of the opportunities that Vanuatu can offer takes two steps:

1. Submit a draft application and insurance plan to an insurance manager; and
2. Submit a full application with a detailed business plan.

Once a full application has been submitted, a decision will be made and an insurance licence issued within one month. Insurance managers work closely with applicants so that they remain fully informed throughout the process and ensure their compliance with all regulatory requirements. Upon the licence being issued, the company can immediately commence business.

For a list of authorised resident insurance managers and for any further information refer to www.insurance.vu.