

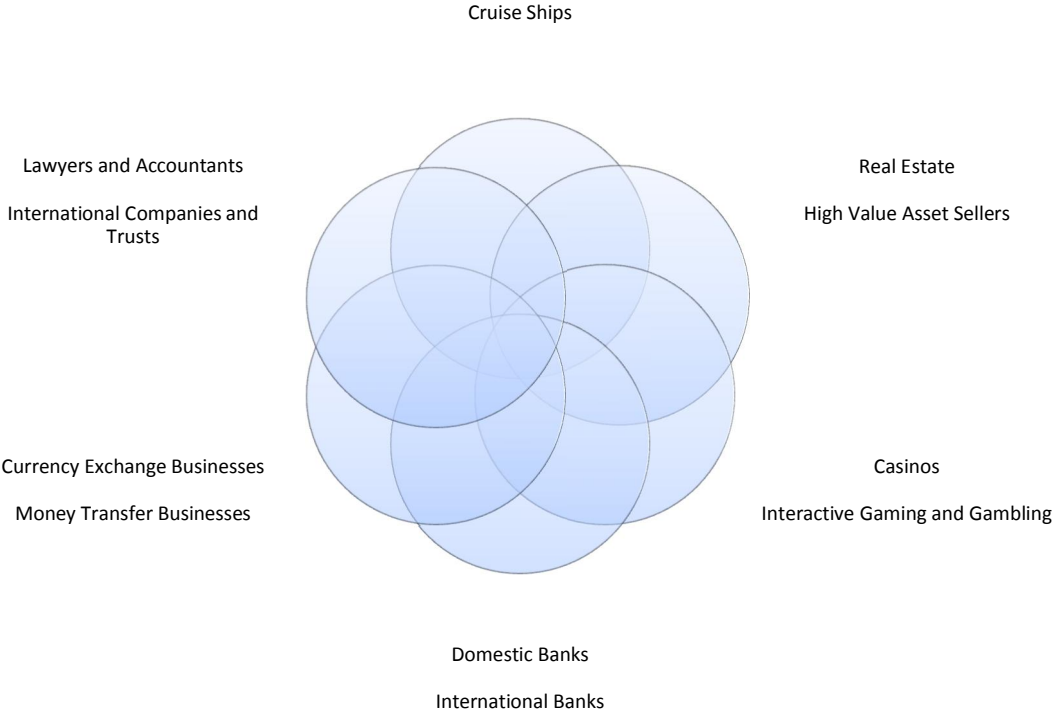
Vanuatu

Money Laundering and Financing of Terrorism National Risk Assessment

Vanuatu Financial Intelligence Unit

23 February 2015

Money Laundering and Terrorism Financing in and through Vanuatu:



Vanuatu’s risk to money laundering and terrorist financing revolves around illicit funds movements in cash and electronic transactions within and through Vanuatu enabled by vulnerabilities in a number of inter-linked factors and entities.

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Foreword

The Vanuatu National Money Laundering and Terrorism Financing Risk Assessment (ML/FT NRA) has been prepared by the Vanuatu government authorities and is a significant outcome in Vanuatu's anti-money laundering and countering the financing of terrorism (AML/CFT) program.

In addition to identifying the most significant ML/FT risks for Vanuatu, it also assists Vanuatu in meeting the global AML/CFT standards established by the Financial Action Task Force on money laundering (FATF).

Money laundering and terrorist financing are global issues and Vanuatu has a responsibility to ensure that it establishes and maintains an environment hostile to these offences, and part of this responsibility is this NRA.

This NRA provides a preliminary overview of the ML/FT issues affecting Vanuatu now, and importantly what the ML/FT risks may be in the coming years, and aims to generate knowledge and understanding to inform priority setting and aid decision makers.

This assessment of ML/FT risk requires the ongoing monitoring and reviewing of all potential ML/FT risks, and the updating of the NRA at regular intervals of between 2 to 5 years. Consequently, this requires that effective communication and consultation between all stakeholders are in place that promote collaboration and intelligence sharing across agencies.

Coupled with the sharing of information among the stakeholders, Vanuatu must ensure that its risk management plans remain up to date, relevant to objectives and that they are regularly reviewed and evaluated. This in turn enables decision makers to exchange ideas, clarify any uncertainty and ultimately make better and more confident choices.

As the key stakeholder, the Vanuatu Financial Intelligence Unit will play an important part in maturing and refining the NRA process and will need to provide a forum to gather and then to disseminate information to all other stakeholders.

This risk assessment recognises that while risk can be mitigated and managed, zero risk is unobtainable. Consequently, strategies must be implemented to continually monitor the levels of the ML/FT risks and where and when appropriate, to implement procedures to manage and to reduce the severity of those risks.

The NRA represents an opportunity for government agencies and the private sector to better understand the ML/FT issues that they may encounter, and to be able to adapt their part of the Vanuatu AML/CFT program to those risks.

This NRA is both timely and necessary in the development of Vanuatu's AML/CFT program.

Peter Tari

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Executive Summary

This Vanuatu Money Laundering and Financing of Terrorism National Risk Assessment (“ML/FT NRA”) was conducted between May 2014 and December 2014 on behalf of the Vanuatu Financial Sector Assessment Group, the body responsible for oversight of Vanuatu’s Anti-Money Laundering and Counter-Terrorism Financing (“AML/CFT”) Program. The primary Vanuatu agency responsible for the preparation of the NRA is the Vanuatu Financial Intelligence Unit (“VFIU”), with support from a range of Vanuatu government agencies including the Reserve Bank of Vanuatu, the Vanuatu Financial Services Commission, Vanuatu Police Force, Department of Customs and Inland Revenue, State Law Office and the Public Prosecutor’s office.

This NRA has drawn on the best available data and information obtained through interviews, workshops, from government agencies and financial sector data, other public sources and media reports. This information was used to assess the ML/FT risk in and through Vanuatu using the standard risk management approach of identifying and evaluating the threats, systemic weaknesses and the possible consequences to Vanuatu should those ML/FT risks eventuate.

This NRA has also referenced the *Guidance on National Money Laundering and Terrorism Financing Risk Assessments* published by the Financial Action Task Force on money laundering (“FATF”) in February 2013, the Asia Pacific Group on money laundering (“APG”) Strategic Implementation Planning (“SIP”) framework for NRAs, and the NRAs of Australia, New Zealand, Singapore and Aruba.

The major money laundering threats to Vanuatu, now and in the short term future, most likely to provide significant amounts of funds to be laundered in and through Vanuatu relate to **funds derived from offshore crime, illicit cross border currency, bribery and corruption, fraud (particularly VAT evasion) and drugs.**

The movement of funds, both cash and electronic wire transfers that originate from offshore has been identified as a significant concern enabling ML/FT to flourish in and through Vanuatu. Although there is limited information available in Vanuatu on the source of illicit transnational flows of funds into and through Vanuatu, overseas investigations have established that overseas tax evaders have used Vanuatu’s international and domestic financial sector and corporate sectors to move and attempt to hide illicit funds. It is also likely that these sectors are being used for disguising other

transnational illicit capital resulting from overseas corruption, drug trafficking and other crimes, and also potentially terrorism financing.

Illicit funds relating to bribery and corruption are high on the list of ML/FT threats. Corruption in the political and government sectors has been acknowledged over many years. Procedures are now being implemented to attempt to curtail corruption, such as through the Ombudsman’s office. It is likely however that a relatively large value of proceeds of corruption are available for laundering domestically.

Experts identified that fraud is also an issue in Vanuatu, especially fraud against the revenue in the form of VAT evasion, which appears to be widespread.

Drug related offences have traditionally been at a very low level in Vanuatu. Domestic use is now seen to be increasing, primarily due to the production and growing of illicit drugs, and recently, some small domestic seizures of imported hard drugs have emerged in the domestic market. In recent years, a small number of investigations have identified Vanuatu as a transshipment point for illicit drugs bound for other countries. It is likely that transshipments of drugs would be associated with illicit capital flows through Vanuatu, at least in small values, such as shore party facilitation payments.

Vanuatu’s relatively diverse and open financial sector creates a number of vulnerabilities which can lead to the escalation of ML/FT. The sectors that are found to be very highly vulnerable to ML/FT are the **domestic banks, international (Offshore) banks, company and trust formation providers and the related companies and trusts, money transfer businesses, currency exchange businesses, casinos and interactive gaming and online gambling sites.** The sectors that were found to be less, but still highly vulnerable were lawyers and accountants, real estate, and high value asset dealers (particularly boats). Several other sectors were also found to be of moderate or low vulnerability.

Although there has been a high level of cross party political will to ensure that significant legislative reform has recently been carried out in Vanuatu, some of the new legislation has only been amended or enacted in 2014 and it is too early to determine the effectiveness of that legislation. Further amendment and enactments are required to strengthen the AML/CFT program and must be made urgently. The new legislation provides agencies with largely adequate powers to detect and deter ML/FT, however **full implementation of those powers is essential and with limited technical and human resources there is a major vulnerability to the**

effectiveness of the legislation and consequently to minimising the ML/FT risks.

The ML/FT risks posed by the presence of threats made possible by weaknesses in the Vanuatu AML/CFT program is significantly compounded by **Vanuatu's generally low level of capacity, specifically the lack of supervision of the AML/CFT program and the inability to provide financial intelligence, investigation and prosecution of ML/FT offenders.**

Vanuatu's main capacity issues stem from insufficient staff to conduct key AML/CFT roles. A major limiting factor is the size of Vanuatu's population and consequently the resources available to all of the various agencies in Vanuatu's AML/CFT program. Ultimately, while there are talented people with good legislative powers and systems, there are not enough people to effectively make use of these advantages. In agencies with other primary core functions, or non-AML/CFT core functions, those non-AML/CFT functions necessarily take priority over the AML/CFT functions to the detriment of Vanuatu's overall AML/CFT program.

Vanuatu agencies have limited technical resources such as computers and software to assist them in their AML/CFT program. Although the transactional reporting component of the program is very good, limited technologies and expertise do not allow the VFUI an adequate degree of analysis to support the intelligence value of the reports, and consequently ML/FT is less likely to be identified, even though adequate data may be available in the financial transaction reports. Similarly, other agencies also have limited technology availability and skills in the use of technologies.

Border controls are deficient and ineffective in detecting the movement of cash into and out of Vanuatu due to capacity and infrastructure deficiencies, particularly at the seaport. With a large number of cruise ships and other shipping visitations, the limited ability of authorities to ensure that illicit cash and monetary instruments are not being brought into and taken out of the country by "transit" tourists is a major concern.

Limited human resource capacity also results in limited AML/CFT coordination. The formal frameworks, such as MOUs, are largely in place. However, lack of resources, lack of established working groups and siloed roles makes effective coordination difficult. Given the small number of staff available, there is a risk that formal arrangements for coordination are proving onerous to agencies.

A significant portion of the ML/FT risks are borne by the Vanuatu banking sectors with regard to illicit cash and electronic funds. Compounding this risk is the presence of the international banks, although the number of institutions has reduced significantly in recent years. The Reserve Bank of Vanuatu is the highest capacity supervisor which goes some way to mitigate the risk in the banking sectors. Nonetheless, the overall risk to the sector, particularly the risk of transnational laundering through the offshore banking sector remains high.

The presence of the international banks is one aspect of the high level of international exposure in Vanuatu and consequently the risk of ML/FT. Offshore services are also offered by the trusts and company service providers (TCSPs), other professional services, the insurance industry and online gambling. All of these services are facilitated by modern communications and an open economy. While the openness to international funds is a key aspect to Vanuatu's strategy for economic growth, this openness also creates a higher likelihood of the services being used to facilitate ML/FT through illicit funds flows. Vanuatu's low level of capacity means that managing these risks is very restricted.

Vulnerabilities within money transfer operators, currency exchange businesses, casinos and high value asset dealers, all create channels for placement and movement of cash proceeds. There is a high level of risk that cash proceeds will be carried into Vanuatu to be layered through these channels. Similarly the risk that proceeds of crime from domestic and overseas offenders will be layered through real estate deals is also particularly high.

Professional services and access to trust and company services compound the high level of risks in the banking and real estate sectors. Both professional services and TCSPs are rated as high risk in their own right. However, the nexus between these high risk sectors creates an overall higher national risk for Vanuatu as both the means of obfuscating illicit transactions and the channels for those transactions are readily available, particularly to the very real transnational threat.

This NRA, the first for Vanuatu, is very broad, outlines the high level of ML/FT risks and is consequently a foundation for the development of a more adequate assessment of ML/FT risk over the next few years. This NRA lacks many of the essential criteria, such as statistical and case materials, for a thorough assessment of ML/FT risk. To develop a more thorough NRA, statistical and other data will need to be collected and analysed, much of it is not currently identified and collected.

Although initial progress has been made by improving technical compliance, ML/FT is not being adequately deterred in Vanuatu. Domestically, the low level of deterrence is likely to lead to the expanding facilitation of ML/FT. Continued non-deterrence of transnational laundering is likely to lead to a loss of international reputation, which in turn threatens international business, impacting economic growth and revenue. A range of mitigating strategies have been identified to address the ML/FT risks. These strategies must be urgently implemented.

Background

Vanuatu comprises 83 islands spread over approximately 12,189 square kilometers of the South Pacific. Close neighbours comprise small Pacific Islands and its closeness to Australia and New Zealand have facilitated trade and tourism between Vanuatu and its larger neighbours. Vanuatu has a population of around 270,000 comprising ni-Vanuatu citizens, other citizens and other residents. The population is approximately 25% urban and 75% rural. The major cities are Port Vila with a population of approximately 47,000 and Luganville with about 15,000. The labour force is approximately 121,000 and the unemployment rate is around 2%.

Approximately 98% of the population are ni-Vanuatu. The remainder are foreign residents or foreigners who have obtained Vanuatu citizenship. The Vanuatu Permanent Residence Program (PR) was launched in Hong Kong in 2011. More than 600 applicants, mainly of Asian origin, paid around VT300,000 for a residency permit. Recent changes in 2013 to the immigration laws have resulted in changes to the citizenship rules, particularly for foreign investors under the Capital Investment Immigration Plan (CIIP). This has changed the requirement from a 10 year residency period for citizenship to a two year requirement providing investment and fee/permit provisions are met, with investment of VT 30 million (USD \$300,000) and fees amounting to about VT 4 million (USD \$40,000). This can be reduced to 9 months in specific circumstances and in addition, the first 500 applicants were to be given citizenship after only 3 months residency. This provides qualified investors to be granted citizenship, to travel visa-free and gain other preferential treatment. More than 50 Chinese applicants arrived in Vanuatu as new citizens under the CIIP program.

Vanuatu lies on the volatile seismic strip referred to as the Pacific Ocean's "ring of fire" with volcanic eruptions,

earthquakes and the potential for tsunamis. Tropical cyclones bearing high winds and torrential rains bring flooding, landslides and road closures as a regular occurrence.

The main three islands are Efate, Espiritu Santo, and Tanna. The main port is in Port Vila, Efate, with some shipping into Luganville on Espiritu Santo. The major international airport is in Port Vila. Although landing from sea vessels in many islands is restricted to very small vessels, it is possible to move cash and assets between the islands, consequently the borders are generally considered to be porous.

Vanuatu's GDP was approximately VT 85 billion (USD 850 million) in 2012, with real growth of about 2.6%. GDP per capita was approximately VT 300,000 (USD \$3,000).

The industry sector composition of the GDP is agriculture approximately 21%, industrial 11% and services 68%. The economy is dominated by the services sector, with a large component derived from the wholesale and retail trade and hotels and restaurants driven by tourism. It receives the bulk of bank lending. The public sector comprises approximately 13% of GDP and is an important source of employment. Finance and insurance play important roles, given the offshore centre in Vanuatu and the growth in real estate and business services. The agriculture, fishing and forestry sector is important for the livelihood of a large sector of the population and is a traditional form of safety net for the economy. Vanuatu's annual inflation rate is less than 2%, but increasing.

The Vanuatu economy has a high ratio of foreign-currency deposits to total deposits in the banking system. The foreign-currency components reflect the deposits of institutions in the offshore centre in Vanuatu and the assets of Vanuatu residents, particularly the expatriate segment, and tourism.

The extent of ML/FT in and through Vanuatu

In developing this NRA it has been useful to consider the possible extent of ML/FT in and through Vanuatu. It is important to consider both ML/FT in Vanuatu and ML/FT processes that merely use Vanuatu as a vehicle in moving funds regionally and globally. The following approaches have been considered in an attempt to quantify that value.

1. IMF – A useful estimate of ML/FT in Vanuatu may be determined through use of the IMF formula of 2% to 5% of Vanuatu GDP. The GDP of Vanuatu was estimated to be VT 82.64 billion (USD\$834.8 million) in 2013 (population 252,800). Using this formula it is possible that ML/FT in and through Vanuatu could be as much as VT 1.65 billion (USD\$16.696 million) to VT 4.13 billion (USD\$41.74 million).
2. John Walker – Extent of Global ML – In the most recent Model¹ for global ML/FT developed by John Walker, a global expert in assessing the extent of ML/FT globally, Walker has estimated that ML/FT in and through Vanuatu would be approximately 1.7% of GDP, thus approximately VT 1.404 billion (USD\$14.192 million).

As there is insufficient statistical and case materials identifying ML/FT in Vanuatu, it has been extremely difficult to estimate a figure to any reasonable extent, so the above figures have been used as a guideline as to the possible level of ML/FT in and through Vanuatu.

Understanding Money Laundering and Terrorism Financing

A contemporary view of money laundering and terrorism financing indicates that it is now very difficult to distinguish between ML and FT in terms of identifying whether the illicit funds are being used for ML or in the process of FT. It is possible that funds could be related to both ML and FT. Consequently this NRA does not distinguish between ML and FT in its consideration of the most significant ML/FT risks to Vanuatu, or in the mitigating strategies to be implemented. However, it should be noted that there is no current evidence of terrorists or terrorist related activities in, or involving, Vanuatu or its people.

Money Laundering

Money laundering is the process of obscuring the true origin of illicit funds and giving them the appearance of legitimacy. Money laundering is a dynamic process that may be broken down into three distinct stages, the Placement stage, the Layering stage and the Integration stage. It is important to note however that it is generally a single process and may not start at the Placement stage.

¹ Walker, J., (2014). Unpublished data from the Walker Gravity Model of Money Laundering, John Walker Crime Trends Analysis, Canberra, Australia.

The **placement stage** represents the initial entry of the "dirty" cash or proceeds of crime into the financial system. Generally, this stage serves two purposes: (a) it relieves the criminal of holding and guarding large amounts of bulky cash; and (b) it places the money into the legitimate financial system. It is during the placement stage that money launderers are the most vulnerable to being caught. This is due to the fact that placing large amounts of cash into the legitimate financial system may raise suspicions of officials.

The **layering stage** is the most complex stage and often entails the international movement of the funds. The primary purpose of this stage is to separate the illicit money from its source. This is done by the sophisticated *layering* of financial transactions that obscure the audit trail and sever the link with the original crime, such as by moving funds electronically from one country to another, then distributing the funds into investments placed in advanced financial options or overseas markets. By constantly moving the funds to elude detection, they exploit loopholes or discrepancies in legislation and take advantage of delays in judicial or police cooperation.

The final stage of the money laundering process, the **integration stage**, is where the money is returned to the criminal from what seem to be legitimate sources. Having been placed initially as cash and layered through a number of financial transactions, the criminal proceeds are now fully integrated into the financial system and can be used for any purpose.

Terrorism Financing

Terrorism financing is the solicitation, collection or provision of funds to support terrorist activities or organisations. The financing of terrorism has generally involved low values of funds in many cases sourced from legitimate sources, however the funding is also sourced from the profits of criminal activities. As a consequence, most of the issues identified in this NRA in terms of ML can equally be applied to FT.

Legitimately sourced funds - Terrorist organisations are able to finance their activities through the use of a variety of ostensibly legal methods, including the collection of subscriptions or membership payments, the collection of fees in connection with events organised by the group (such as meetings or entry to cultural and social events), the sale of literature and publications of the organisation and solicitation of donations within ethnic communities—particularly from wealthy members and supporting business groups. A number of terrorist groups operate as functioning

businesses in which legitimate and illegitimate funds and business activities are blended.

Illicit funds - Terrorist groups continue to be heavily involved in the drug trade and frequently engage in extortion and kidnapping for ransom. Cross-border smuggling, particularly in drugs, arms and people, has become very profitable for many terrorist groups and often involves a coordinated, organised structure with a distribution network that transports and sells contraband. Credit card fraud and other forms of financial fraud are used to fund terrorist activities, together with money laundering and counterfeiting currency. Property-related crime is also a source of illicit funds.

Understanding ML/FT Risk

Risk is a function of likelihood and consequences, where likelihood is a function of threats and vulnerabilities.

Threats are generally identified by reviewing major predicate crimes, assessing the financial value or profit generated by or through the predicate crimes, and the potential for those funds/profits to be used in the process of ML/FT.

Vulnerabilities are weaknesses that can be exploited and can make Vanuatu more attractive for the purposes of ML/FT.

Likelihood is a function of threats and vulnerabilities, where likelihood of ML/FT occurring is influenced by Vanuatu's capability to address the threats and vulnerabilities and takes into account the successful implementation of control strategies.

Consequences take into consideration the effect of an event occurring including the impact or harm that ML/FT may cause on financial systems, institutions, and the economy and society more generally.

Assessing Vanuatu's risk to ML/FT

The Vanuatu ML/FT National Risk Assessment (NRA) is a structured and comprehensive evaluation and on-going record of the current and future ML/TF risks to Vanuatu, including threats and vulnerabilities that will allow illicit funds to be laundered in and through Vanuatu. The NRA also provides an evaluation of the likelihood and consequences of those risks, leading to a prioritisation of the risks. It provides mitigating strategies to minimise the effect of those risks. This NRA will be monitored, reviewed and updated regularly.

This NRA was conducted between May 2014 and December 2014 on behalf of the Vanuatu Financial Sector Assessment Group, the body responsible for oversight of Vanuatu's AML/CFT program. The primary Vanuatu authority responsible for the preparation of the NRA is the Vanuatu Financial Intelligence Unit (VFIU), with support from a range of Vanuatu government agencies including the Reserve Bank of Vanuatu (RBV), the Vanuatu Financial Services Commission (VFSC), Vanuatu Police (VPF), Department of Customs and Inland Revenue (DCIR), State Law Office (SLO) and the Office of the Public Prosecutor (OPP).

This NRA will assist the Government of Vanuatu in assessing appropriate AML/CFT policy issues, the various government agencies in addressing ML/FT, and the private sector in identifying and reacting to the risks of ML/FT that they may encounter, and to enable them to meet their responsibilities under the AML/CFT legislation in Vanuatu. It will identify the highest ML/FT risks and support the development of collaborative thinking about strategies to minimise and manage ML/FT risks in the future. This NRA will promote the ability of all government agencies to share common understanding and awareness of national ML/FT risks so that they are ready to act independently and collaboratively to address those risks.

This NRA has referenced the *Guidance on National Money Laundering and Terrorism Financing Risk Assessments* published by the FATF in February 2013 and the APG SIP approach to NRAs. Reference has also been made to the NRAs of Singapore, New Zealand and Australia and Aruba.

The result of this NRA is a consolidated view of Vanuatu's possible ML/FT in and through Vanuatu. It does contain data limitations and assumptions that will require additional research and revision. Future iterations of this NRA are expected to reflect an enhanced methodology and approved data collection. This is the start of Vanuatu's ongoing strategy to identify and react to ML/FT risks.

The purpose of this NRA is to:

- Identify the highest ML/FT risks likely to impact Vanuatu.
- To document the risks and to identify controls and mitigating strategies
- To report on the NRA and its process which can be used to prioritise action
- To reduce the level and financial impact of ML/FT risks.

Approach taken for this NRA

The approach taken in this NRA is to assess the likely risk of ML/FT using a number of basic approaches, both qualitative and quantitative. As this is the initial NRA for Vanuatu and with the limited availability of appropriate statistics and information, it has been necessary to keep the approach relatively simple, such as determining what we know about crimes in Vanuatu, the funds associated with those crimes, the vulnerabilities that would allow those funds to be used in the process of ML/FT, what is likely or possible to eventuate in Vanuatu as a ML/FT risk in the future, what the consequences of those risks may be, and what factors can be applied to mitigate those risks.

This NRA has drawn on the best available data and information obtained through interviews, workshops, government agencies and financial sector data, other public sources and media reports. This information was used to assess the ML/FT risk in and through Vanuatu through consideration of threats, systemic weaknesses and the possible consequences should the risks eventuate. Resourcing and operational constraints together with limited statistical and other data has resulted in the need to rely heavily on interviews and discussions with relevant persons and other information sourced from public sources, particularly electronic media commentary. For future Vanuatu NRA's the Vanuatu authorities will need to ensure that adequate and appropriate statistical and other data is collected, retained and reviewed as part of the NRA process.

This NRA provides a preliminary overview of the ML/FT issues affecting Vanuatu now, and importantly what the ML/FT risks may be in the coming years, and aims to generate knowledge and understanding to inform priority setting and aid decision makers. The NRA will provide commentary on the following issues:

- Threats identified from a range of predicate crimes both in Vanuatu and offshore that may generate illicit funds that may be used in the ML/FT process
- Systemic vulnerabilities or weaknesses that may contribute to or assist in ML/FT in and through Vanuatu
- The likelihood that the funds so generated will result in ML/FT
- The extent of the consequences or harms that will result from the ML/FT
- The likely level of the ML/FT risk
- Prioritising those ML/FT risks for immediate and other action

- Outlining that action in the form of mitigation strategies

Threats and Vulnerabilities

The first requirement of this NRA is to understand and determine the threats that will generate funds for ML/FT and the vulnerabilities that will allow for those funds to be laundered or used in the process of terrorism financing.

Threats are generally identified by reviewing major predicate crimes, assessing the financial value or profit generated by or through the predicate crime, and the potential for those funds/profit to be laundered or used for terrorism financing. Vulnerabilities which may allow, assist or contribute to those funds from the predicate crimes to be laundered, then need to be considered. Vulnerabilities are weaknesses that can be exploited and can make Vanuatu more attractive for the purposes of ML/FT.

Threats leading to ML/FT in and through Vanuatu

The assessment of ML/FT threats to Vanuatu comprises the identification and analysis of the predicate crimes in and linked to Vanuatu that will generate funds that may be laundered in and through Vanuatu. It is important to identify both the predicate crimes and their origins as money may be laundered in and through Vanuatu as a result of predicate crimes in other countries.

This assessment of Vanuatu's ML/FT threats is based upon a detailed analysis of the factors that the government agencies have identified as relevant to Vanuatu's context. These include the following as major threat factors:

- Nature and extent of relevant domestic criminal activity, that is, predicate offences
- Amount of proceeds of crime generated domestically
- Physical cross border inflows and outflows of proceeds of crime
- Amounts of proceeds of crime generated abroad and laundered domestically
- Sources, location, and concentration of criminal activity, including within illegal underground areas in the economy

- Nature and extent of terrorist activities and groups in neighbouring countries, regions or sub-regions.

Each of these factors have been considered in developing the threat component of this NRA.

A number of sources have been used to identify the predicate offences that may generate funds which may be laundered in and through Vanuatu. These sources have included government and private sector representatives, published and non-published reports, and media reports on crimes. Much of this information was sourced from meetings, workshops and from research on the Internet.

In general the domestic crime rate is relatively low in Vanuatu largely due to the size of the population and its culture. This assists in keeping the ML/FT threats from domestic crime generally low.

However, the predicate crimes most likely to provide significant amounts of funds to be laundered in and through Vanuatu are:

- Illicit transnational flows of funds
- Bribery and corruption
- Illicit cross border currency movements
- Fraud (particularly VAT evasion)
- Drug related activities
- Real Estate offences
- Trade based offences
- Environmental crime.

Most of these crime types are likely to have both domestic and offshore funding components. In addition, with many of these predicate offences, it is possible that they are facilitated through the involvement of corrupt practices. It is considered that each of these offence types may generate illicit funds of more than VT 50 million to in excess of VT 1 billion per annum.

Illicit transnational flows of funds

The movement of funds that originate from offshore, including both currency and electronic funds, has been identified as a significant contributor to the laundering of funds in and through Vanuatu. Although there is limited information available in Vanuatu on the source of illicit transnational flows of funds into and through Vanuatu, overseas investigations have established that overseas tax evaders have used Vanuatu's international and domestic financial sector and corporate sectors to move and attempt to hide illicit funds. In recent years, a small number of investigations have identified Vanuatu

as a transshipment point for illicit drugs bound for other countries. It is possible that transshipments of drugs may be associated with illicit capital flows through Vanuatu, at least in small values, such as shore party facilitation payments. It is also likely that these sectors are being used for disguising and laundering other transnational illicit funds resulting from overseas corruption and other crimes including terrorist financing. The funds derived from illicit transnational funds flows which are laundered in and through Vanuatu may be greater than VT 1 billion annually.

Mitigating Strategies

- Supervisors at the RBV and VFSC must undertake more frequent and detailed inspections of customers and accounts at domestic and international banks, including the beneficial owners of funds.
- The VFSC must require greater detail of office bearers and other persons involved in international companies, and these must be regularly and effectively inspected.
- Ensure timely investigation and prosecution of the offences and seek appropriate penalties, including confiscation of illicit funds.
- Expedient and thorough cooperation with the appropriate authorities in foreign countries where the predicate offence involves persons or entities in a foreign country.

Bribery and corruption

Bribery and corruption has been evident in Vanuatu over a long period of time, involving politicians, government employees and private companies and individuals. Corruption occurs at the lower levels of government as possibly a goodwill gesture for some minor benefit and is sometimes seen as an entitlement to persons in positions of stature, such as community leaders and politicians. Abuse of position at the political and public service levels has frequently been alleged. This may occur to gain support and to influence decisions from minor decisions through to major decisions on infrastructure developments. The funds used in bribery and corruption may initiate in Vanuatu or offshore. Of most concern is the possibility of high value bribery and corruption in respect of political favours and misuse of government assets and positions.

Vanuatu is concerned at the level of bribery and corruption and procedures are being implemented to attempt to curtail corruption, such as through establishing the office of the Ombudsman and the Leadership Code Act. There have been many reports of

corrupt practices that may generate funds that can be laundered, which include:

- Nepotism
- Cronyism
- Embezzlement of public funds or assets
- Political funding
- Appointment of government Ministers and Officials
- Misuse of government assets and funds
- Misuse of political position
- Misuse of public service position
- Bribery in procurement
- Facilitating immigration, visa and citizenship improprieties
- Facilitating real estate improprieties – sales and leases.

The funds from corruption which are available for laundering in and through Vanuatu in respect of each corrupt activity are likely to be in the range from very small to large, that is, from less than VT 1 million to possibly up to VT 1 billion, with the likely annual value at that higher level.

Mitigating Strategies

- All allegations of bribery and corruption must be thoroughly and expeditiously investigated and prosecuted without fear or favour and all illicit funds confiscated.
- Cooperation with the appropriate authorities in foreign countries where the corruption involves persons or entities in a foreign country.

Illicit cross border currency movements

At the placement stage of money laundering, cash has been of significant concern for many years, and the illicit movement of cash across borders has been a major contributor to that concern. The use of couriers to facilitate illegal entry and departure is a distinct possibility at Vanuatu's porous borders.

Vanuatu legislation requires declaration reports in respect of cross border flows of currency and negotiable instruments to be provided to customs staff at the airport and seaport. It is however highly probable that persons are bringing in and taking out of Vanuatu large values of currency, and in so doing bypassing the requirement to report as required by the law and thus committing an offence under the AML & CFT Act. This is compounded by the high number of cruise ships, up to 200 visiting Vanuatu annually. Passengers and crew disembarking and later returning to the vessel are treated as "transit" passengers and currency reporting is

not pursued. Each cruise ship voyage brings in excess of VT 21.5 million, or VT 2.15 billion annually to Vanuatu. It is likely that a significant proportion of this will be cash, some of which will be illicit funds, and most will not be reported as required. The inadequacy of the customs and immigration infrastructure at the seaport in particular, adds to the likelihood of ML/FT funds filtering into Vanuatu utilising these methods.

With the volume of flights into Vanuatu, and more significantly the volume of cruise and other vessels visiting Vanuatu each year, it is likely that unreported and illicit currency may be in the range of VT 100 million to VT 1 billion per annum.

Mitigating Strategies

- The infrastructure, particularly at the seaport, but also at the airport, must be urgently reviewed and resourced to allow for appropriate checking of all persons and cargo entering Vanuatu to ensure that currency is not entering or leaving the country by this means.
- Major offences must be investigated and all illicit funds confiscated.

Fraud

The range of frauds committed in Vanuatu have been identified as fraud on the government, such as VAT evasion, other small scale fraud on the government such as avoidance of stamp duties on real estate and also corporate type frauds.

VAT is an indirect consumption tax imposed on most goods and services supplied in Vanuatu and on most goods imported into Vanuatu. Sole traders, companies, partnerships cooperatives, non-profit bodies and others must register for VAT. VAT is initially self-assessed and lodged with the Department of Customs and Inland Revenue. Failure to register and failure to lodge VAT statements after collecting the VAT from customers are considered to be at a significant level. Consequently, it is considered that VAT evasion is widespread and the funds would possibly be laundered in Vanuatu and offshore.

The level of domestic corporate fraud that may generate funds that may be laundered in and through Vanuatu is considered to be relatively low.

The funds from fraudulent VAT related activities which may be available for laundering in and through Vanuatu may possibly be from about VT 50 million and possibly up to VT 1 billion, with the annual figure possibly near the upper level.

Mitigating Strategies

Inland Revenue inspectors must be resourced to ensure that all entities with VAT obligations are registered and are declaring the appropriate levels of VAT.

Drug related activities

Drug related offences have traditionally been at a very low level in Vanuatu. Domestic use is now seen to be increasing, primarily due to the production and growing of illicit drugs, and recently, some small domestic seizures of imported hard drugs have emerged in the domestic market. Marijuana is alleged to have been grown on farms in Vanuatu over many years. Funds received from the sale of marijuana by growers generally find their way back to villagers and to purchase assets and farming materials.

In recent years, a small number of investigations have identified Vanuatu as a transshipment point for illicit drugs bound for other countries. It is possible that some of the drugs from these transshipments, and other sources, may be sold in the domestic market and consequently be associated with illicit capital flows in and through Vanuatu. Although there is no evidence of the movement of funds within Vanuatu, it is likely that at least a small value of illicit funds would have been moved into Vanuatu for in-country/shore party expenses.

The funds related to illicit drug activities which may be available for laundering in and through Vanuatu are likely to be in the range from very small to very large, that is from less than VT 1 million to possibly more than VT 100 million, with an annual figure possibly at that large level.

Mitigating Strategies

Ensure that drug related offenders are investigated and penalised appropriately, including the seizure of illicit funds.

Real Estate offences

There is no land in Vanuatu that is freehold. However, the land can be leased for up to 50 years from the government or customary owners. Since the 1980's speculative land dealings involved leases being sold over customary land often without the consent of custom owner groups. Coastal land was much sought after and since 2010 leasing has significantly increased. Many of these leases were signed at Ministerial level possibly

contrary to the legislative powers. Domestic and commercial buildings have been constructed on the leased sites and are sold at significant values.

It is possible that illicit funds are generated through the leasing process and the sale and purchase of domestic and commercial properties and then laundered in and through Vanuatu. Recent new land legislation may assist to reduce the criminal aspects of land leasing and real estate. With the volume of leases and property sales in Vanuatu it is likely that the resultant illicit funds may be in the range of VT 50 million to VT 100 million per annum.

Mitigating Strategies

Ensure that any illicit funds involved in real estate transactions are confiscated.

Trade Based crime

Vanuatu has imports amounting to around VT 24 billion (USD \$242 million) per annum in 2012 and exports of around VT 4.5 billion (USD \$41 million) in the same year.

With the relatively significant volume of imports, and to a lesser degree the exports, it is possible that ML/FT is occurring through a range of trade based activities. Such activities may include ghost shipments, mislabelling goods, inaccurate descriptions of container loads, variable volumes and other false documentation including under invoicing and over invoicing.

Vanuatu has a large tourism base and consequently goods specifically directed towards tourists are highly visible. Undervalued imported merchandise is likely to occur. Shops may be funnelling funds out of the country at higher levels than the actual value of the goods. Other structured financial transactions on behalf of third parties may be occurring in the guise of trade.

The lack of adequate and appropriate infrastructure at the shipping dock will likely assist this type of crime. The limited dock facilities mean that only one ship may dock at a time, consequently when a cruise ship arrives when another vessel is offloading its cargo, the cruise ship takes precedence and the cargo may be moved to public land, raising significant security concerns and the possibility of criminal activity being facilitated that may lead to ML/FT.

It is possible that trade based crime may contribute up to VT 100 million per annum to be laundered in and through Vanuatu.

Mitigating Strategies

Ensure that all appropriate documentation is completed accurately and where offences occur, investigate and prosecute the offenders and seize any relevant goods and illicit funds.

Environmental crime

The extent and types of environmental crimes occurring in Vanuatu are not well documented, however it is possible that illegal activities involving commercial logging particularly of sandalwood, fisheries and fishing, and illegal land clearing and consequent degradation may occur. Funds resulting from such activities may be laundered in and through Vanuatu. It is likely that environmental crime is occurring on a small scale, however the consequent illicit proceeds are likely to be high in value. It is possible that up to VT 100 million per annum may be laundered as a result of these activities.

Mitigating Strategies

Investigate any potential offences and prosecute offenders, and confiscate any illicit funds.

Vulnerabilities that may assist or facilitate ML/FT

Vulnerabilities comprise those things that can be exploited by the ML/FT threat or that may support or facilitate its activities. This means focussing on certain factors that may represent weaknesses in Vanuatu and its AML/CFT systems or controls.

In this NRA, a range of factors relevant to Vanuatu are considered in terms of the potential vulnerabilities which may arise and which may contribute to large scale ML/FT. Those factors are generally those provided in the FATF guidance and relate to:

- Capacity and institutional factors
- Cash economy
- Offshore Financial Centre
- Reporting entities – Financial institutions and DNFBPs
- Legislation
- Imports and Exports
- Foreign investment
- Legal and judicial
- Technology

The inherent weaknesses and vulnerabilities in these areas contribute to the likelihood of ML/FT occurring in and through Vanuatu and the potential for the escalation of ML/FT activity in the future if not readily addressed.

Capacity and Institutional Vulnerabilities

It is only through the full and effective enforcement of laws and regulations that ML/FT can be prevented and prosecuted and the illicit proceeds of ML/FT can be seized or forfeited. The effective enforcement of ML/FT requires:

- The accurate and timely identification of persons, accounts and financial transactions linked to criminal activity
- The collection and analysis of such information in a timely manner
- Effective timely investigations of ML/FT in support of criminal prosecutions
- The tracing and forfeiture of criminal assets
- Highly skilled operators with access to timely and on-going training and skills development.

The ML/FT risks posed by the presence of threats within vulnerable sectors is compounded by Vanuatu's generally low level of capacity in each of these areas. Limited technical and human resources is a major vulnerability to the effectiveness of the legislation and consequently to minimising the ML/FT risks. The major agencies involved in Vanuatu's AML/CFT program are:

- Vanuatu Financial Intelligence Unit (VFIU)
- Reserve Bank of Vanuatu (RBV)
- Vanuatu Financial Services Commission (VFSC)
- Department of Customs and Inland Revenue (DCIR)
- Inspector of Casinos
- Vanuatu Police Force (Transnational Crime Unit) (VPF-TCU)
- Office of the Public Prosecutor (OPP).

In the Vanuatu AML/CFT program, Vanuatu has two regulatory bodies having responsibility for regulating the domestic and international banking sectors, the RBV and the VFSC. They are supported by the VFIU, which is housed within the State Law Office. The VFSC and the VFIU have responsibilities for AML/CFT supervision of the Designated Non-Financial Businesses and Professions (DNFBPs). The VFIU is charged with monitoring and controlling Vanuatu's AML/CFT regime. The VFIU analyses suspicious transaction reports and provides information to the VPF for investigation of ML/FT offences. The VPF then refers matters to the OPP for prosecution. The VPF-TCU is a small unit which is

responsible for conducting investigations involving money laundering and terrorism financing offences, the identification and seizure of criminal proceeds, and conducting investigations in cooperation with foreign jurisdictions.

Vanuatu generally has a broad expertise in most of its agencies with regard to their primary functions. Many staff in the key agencies are long serving with a high level of education. However, despite having a broad range of prudential and investigative experience within the agencies AML/CFT expertise is generally limited to the staff in the VFIU and the RBV, and a small number of staff from the other agencies. The VFSC expertise is limited to registration and collection of fees, but is extremely limited in supervisory activities, and especially those related to AML/CFT. In addition there is limited intelligence support and forensic accounting in most agencies. Limited availability of appropriate technologies and the skills to operate the technologies is also a significant vulnerability.

Vanuatu's main capacity issues stem from insufficient staff to conduct key AML/CFT roles. Many AML/CFT functions are assigned to agencies with other functions. However, because of the low level of capacity, some agencies can only focus on their core roles as they do not have the staff resources to conduct both their original function and AML/CFT supervision.

A major limiting factor is inadequate resources available to all of the various agencies in Vanuatu's AML/CFT program. Ultimately, while there are talented people with good legislative powers and systems, there are not enough people to effectively make use of these advantages.

The low number of staff makes it difficult for agencies to fill specialist functions, such as AML/CFT supervision particularly at the VFSC and VFIU, and analysis, intelligence and investigative support for Police and Customs and Inland Revenue staff to conduct proceeds of crime investigations. This creates a systemic weakness in Vanuatu's AML/CFT program leading to an inability to suppress ML/FT and crime generally.

The transactional reporting component of the Vanuatu AML/CFT program is the starting point for the identification of ML/FT. The financial transaction reporting levels require that the VFIU have a number of staff capable of analysing the data and preparing intelligence reports for the VPF-TCU to investigate. The VFIU currently does not have sufficient analytical staff to carry out this work other than to review the suspicious transaction reports that it receives. Without the analysts

inter-linking those reports with the other financial transaction reports that the VFIU receives, the likelihood of identifying significant ML/FT is severely restricted. Intelligence flows to the VPF-TCU and Customs and Inland Revenue from the VFIU, despite the VFIU having extensive transactional report information, is very limited due to inadequate analytical staffing levels at the VFIU. The VFIU does not have sufficient staff or financial and technical resources to effectively perform its duties, particularly in light of Vanuatu's enhanced AML/CFT legislation, where that legislation provides the VFIU with a financial intelligence role and a supervisory and guidance role.

There is also a severe lack of funding and resources for the OPP which hinders their ability to work effectively. In addition, trained prosecutors quickly move on to other areas of government. The outcome of this is little prosecutorial activity, and none on ML/FT matters.

There is a need for adequate customs staff to perform functions at the borders. It is likely that with insufficient customs staff at the borders, persons will be moving large values of cash across Vanuatu's borders without reporting that cash to customs as required by the legislation.

In supervising the AML/CFT reporting entities, limited staff within the supervisory authorities such as supervisory and analytical staff, can hinder the levels of suspicious transaction reporting and the adequacy of intelligence in referrals for investigation of ML/FT. Consequently, this can result in the increased risk of ML/FT not being detected.

The Vanuatu government must ensure that the VFIU, the AML/CFT supervisors (including VFIU), enforcement agencies and prosecutors are sufficiently resourced to adequately supervise reporting entities for AML/CFT and to be able to undertake financial transaction analysis, gather evidence, mount investigations, bring charges and prosecute ML/FT offences. Lack of adequate staff in all agencies will result in ML/FT not being detected or inadequately investigated.

Vanuatu agencies have limited technical resources such as computers and software to assist them in the Vanuatu AML/CFT program. Although the transactional reporting component of the program is very good, limited technologies and expertise do not allow the VFIU an adequate degree of analysis to support the intelligence value of the reports, and consequently ML/FT is less likely to be identified, even though adequate data may be available in the financial transaction reports. Similarly, other agencies also have

limited technology availability and skills in the use of technologies.

A major concern arises with regard to the supervision of the financial sector and DNFBPs. The RBV has a strong supervisory role and is adequately resourced. The VFSC however, despite having legislative powers is not equipped and does not function in a full supervisory role. It only has the capability to licence and register entities and does not generally perform any supervisory functions other than ensuring entities are licenced or registered.

A strong border control system is essential in preventing ML/FT. In addition to the staffing capacity issues outlined above, limited infrastructure and ineffective border controls, particularly at the seaport, creates a significant ML/FT vulnerability in Vanuatu. The necessary checks on travellers, luggage and cargo are less than adequate, and consequently there is a relatively low number of reports relating to movement of currency into and out of Vanuatu reported to Customs authorities. Visibility of customs officers and other visible deterrence such as screening and inspection of travellers, luggage and cargo are essential. Security is also a major concern at the seaport. With a large number of cruise ships and other shipping visitations, the limited ability of authorities to ensure that illicit cash and monetary instruments are not being brought into and taken out of Vanuatu by this means is a major concern.

The structural framework for implementing the AML/CFT program in Vanuatu is compromised by a lack of coordination and communication among responsible government agencies. Relevant government agencies need to meet regularly at the working and management levels to keep abreast of the latest developments and crime trends in ML/FT, and to ensure that there are opportunities for sharing information such as financial intelligence, and coordinating policy decisions and implementation issues among the agencies. Limited human resource capacity in Vanuatu agencies results in limited domestic AML/CFT coordination. The formal framework, such as MOUs, are largely in place, however, lack of resources, lack of established working groups and siloed roles makes effective coordination difficult. Given the small number of staff available, there is a risk that formal arrangements for coordination are proving onerous to agencies. International cooperation is evident in a number of joint investigations, but similarly needs to be enhanced to have a more effective approach to ML/FT.

Despite some political instability Vanuatu does have the necessary political will to have an effective AML/CFT program. In addition, the legislative program is good, but it is incomplete. However inadequate financing and resourcing creates significant vulnerabilities. Vanuatu's government agencies are relatively under-resourced in terms of personnel, have inadequate AML/CFT skills and training, and the necessary technology tools are lacking. Contributing factors include the relatively small population and limited financial and other resources, and consequently the necessary infrastructure and technological resources are not able to be adequately provided by the Vanuatu government. Vanuatu's institutional framework is therefore not adequately functional to enable the effective detection and deterrence of ML/FT. These vulnerabilities may allow the AML/CFT program to be frequently exploited and therefore the overall capacity vulnerability rating would be very high in respect of each of the more significant threats.

Mitigating Strategies

- Urgent resourcing of government agencies involved in the AML/CFT program is essential.
- The ability for Vanuatu to do this is extremely limited due to the size of the population and its current skill levels. Consequently, the government of Vanuatu must source funding specifically to obtain new and adequate technologies and qualified human resources to supplement its AML/CFT program.
- Both funding and qualified human resources may need to be sourced urgently from offshore.

Cash Economy

Vanuatu is predominantly a cash economy. Globally, the use of cash is considered to be a significant vulnerability to ML/FT. The Vanuatu domestic financial sector comprises banks, insurance companies, currency exchange businesses, money transfer businesses, Savings and Loans Cooperatives, securities dealers, funds managers of mutual funds, a credit union, and a pension fund. Cash transactions are a major part of daily business for most of these entities. The customers of the banks, credit unions and insurance providers are predominantly ni-Vanuatu, other citizens and other foreign residents. It is likely that the customers of the currency exchange businesses and money services businesses are largely tourists.

Another significant addition to the vulnerability of the cash economy is the operation of three casinos in Vanuatu. Casinos rely heavily on cash based customers, and in Vanuatu that would predominantly be tourists

and expatriates working in Vanuatu, but will also include some ni-Vanuatu customers. Cash passing through the Casinos is globally recognised as a significant vulnerability to ML/FT. In addition, many of the DNFBPs may deal in cash.

The vulnerability of the porous borders is also significant in terms of the potential for cash to enter Vanuatu and be used in ML/FT.

Foreign currency repatriation from Vanuatu is an indicator of the value of cash entering Vanuatu. Similarly the repatriation of Vatu back into Vanuatu identifies the cash flow out of Vanuatu.

The cash economy in Vanuatu in terms of its economic and social indicators is significantly high. The high frequency of cash in the economy can facilitate the movement and concealment of illicit funds. Consequently, the potential vulnerability to ML/FT involving the cash economy is rated as very high.

Mitigating Strategies

- The Government of Vanuatu must look at means of reducing the use of cash in Vanuatu. This is a long term strategy.
- In the shorter term, supervisors at the RBV and VFSC must undertake more frequent and detailed inspections of reporting institutions that may be involved in the cash economy, including the identification of the beneficial owners of cash funds.
- The Inspector of Casinos must undertake more frequent and detailed inspections of casinos to identify the value and source of funds in the casinos.
- The VFIU must adequately analyse financial transaction reports relating to cash, particularly cash transaction reports, suspicious transaction reports involving cash and cross border currency reports, and make recommendations to the Government of Vanuatu in terms of the sources of cash in Vanuatu and reducing the use of cash in and through Vanuatu.

Offshore Financial Centre (OFC)

OFCs attract business by offering a wide range of financial services combined with an attractive tax regime and are conducted primarily on behalf of non-residents. Funds can flow quickly into the entities in these centres but can also flow out just as quickly, with the limited ability to identify the beneficial owners and source of funds. All of these financial services are designed to assist legitimate businesses but they are attractive to ML/FT, in particular in hiding illicit funds and assets.

Globally, the OFCs are considered to be a significant vulnerability to ML/FT. Vanuatu has an OFC with eight international (offshore) banks and about 4,300 registered international (offshore) entities which offer a wide range of offshore banking, investment, legal, accounting, and insurance and trust company services. Consequently this part of the financial sector relies heavily on electronic or wire transfers of funds. The use of electronic wire transfers promotes a non-face-to-face interaction with customers. It is therefore difficult to link specific funds to customers, in terms of who actually made the transaction, the beneficial owners, and the recipients of the funds. In the past few years, more extensive regulation of the offshore banks by the RBV, particularly in enforcing local physical presence, lead to a dramatic drop in the number of off-shore banks operating in Vanuatu. It is likely that the customers of these entities are resident professionals and offshore customers. It is noted that many shipping companies register as international organisations in Vanuatu and Vanuatu maintains an International Shipping Register in New York. Despite the benefits of maintaining Vanuatu as an OFC, the vulnerabilities to ML/FT that arise as a result of having the centre are considered to be very significant.

Mitigating Strategies

- Supervisors at the RBV and VFSC must undertake more frequent and detailed inspections of customers and accounts at domestic and international banks, including the beneficial owners of funds.
- The VFSC must require greater detail of office bearers and other persons involved in international companies and these must be regularly and effectively inspected.

Vulnerabilities – Reporting Entities

The vulnerability of the different types of financial institutions arises from, inter alia, the products and services they offer and types of clients they serve. In addition, control factors are assessed in order to understand the level of vulnerability that exists in the sector such as:

- Level of commitment of financial sector to the AML/CFT program, including levels of reporting and/or lack of quality of STRs
- Financial sector not sufficiently concerned or incentivised regarding vulnerability to ML/FT related reputational risk
- Requirements of AML/CFT regime not well understood or implemented by financial institutions and DNFBPs

- Existence of measures to facilitate financial transactions by non-residents
- Types and range of customers
- Nature of business relationships.

It is considered that institutions with a high proportion of cash deposits or withdrawals, cross border wire transfers and non-face-to-face business are normally highly vulnerable to ML/FT.

Vanuatu's relatively diverse and open financial sector creates a number of vulnerabilities to money laundering and terrorist financing, especially, transnational money laundering. The Sectors that were found to be very highly vulnerable to ML/FT are:

- Domestic Banks
- International (Offshore) Banks
- Company/ trust formation
- Money Transfer Businesses
- Currency Exchange Businesses
- Interactive gaming and online gambling
- Casinos.

The sectors that were found to be highly vulnerable to ML/FT were:

- Lawyers and accountants
- Real estate
- Vehicle dealers
- Non-profit organisations
- High value asset dealers (boats).

With the range of reporting entities rated as very high and their relative size, role and importance to the Vanuatu economy, it is considered that reporting institutions collectively should be rated as having a very high vulnerability to ML/FT.

Financial Institutions

Vanuatu has a predominantly cash economy with deposits of local currency and foreign currency, both at about 50% of all deposits. The financial market is dominated by commercial banks, international bank, money transfer businesses, currency exchange businesses, savings and loans cooperatives and insurance providers. The bulk of the financial transaction reports made to the VFIU under the AML & CFT Act come from the domestic and international banks. Financial institutions are defined in the AML & CFT Act.

Domestic Banks

The five Domestic Banks (ANZ, Westpac, Bred, Vanuatu National Bank and European Bank) are licenced under and governed by the Reserve Bank of Vanuatu under the Financial Institutions Act. These banks, with the exception of European Bank, have a range of banking businesses including taking deposits, providing cheque services, lending and other services. These banks service a range of clients from individual customers to corporate customers. They offer a wide range of services with a major focus on cash deposits and withdrawals. These banks have a global presence and their activities include trade finance, cash management services and correspondent banking. The majority of domestic banks are foreign-owned. Only the National Bank of Vanuatu (NBV) has a broad branch network, with 28 branches on about 15 islands.

The European Bank is an enigma in the Vanuatu financial sector. It is regarded as a domestic bank but only has offshore clients. Supervision of this bank appears to be very limited. European Bank was incorporated in Vanuatu on the 17th of May 1972, and holds a full Vanuatu Banking License with group representation in Vanuatu, New York, London, Hong Kong and Singapore. Unlike the commercial banks represented in Vanuatu (ANZ, Westpac, Bred and National Bank of Vanuatu). European Bank does not offer general retail bank services. European Bank operates as the only Private Bank in Vanuatu and provides services to high net worth individuals and companies primarily in the spheres of deposit taking, international money transfers, foreign exchange, money market operations and check clearing as well as fund and portfolio management. It effectively operates as an International bank with a domestic banking licence. The European bank has been implicated in a major ML activity involving more than VT 700 million. Proceedings in respect of the "Benford case" are still proceeding in the Vanuatu Supreme Court.

The Domestic Banks are well supervised by the RBV for AML/CFT and by the VFIU for the reporting of financial transactions. The banks are subject to biennial AML/CFT inspections by the RBV and are provided with a good level of AML/CFT guidance materials.

Under Vanuatu legislation, only the domestic banks can take deposits and extend credit in the domestic market. The domestic banks dominate the financial system with assets accounting for about 75% of total financial system assets. Their dominance reflects the relatively small and weak non-bank financial institutions sector. Several prudential indicators support the conclusion that Vanuatu has a generally sound financial sector.

However, the domestic banks are a significant vulnerability to ML/FT. The reporting of STR's provides some limited evidence of the types of conduct being used in ML/FT in Vanuatu.

Despite being adequately regulated by the Reserve Bank of Vanuatu and the VFIU with regard to prudential and AML/CFT requirements, the domestic banks are considered to be of very high ML/FT concern due to the size of the banks, the number and type of customers, including potentially high risk customers, the cash intensive nature of their business and their offshore links.

Mitigating Strategies

Although there is a reasonable level of supervision of domestic banks, greater scrutiny and more regular inspections of their AML/CFT programs is necessary.

International Banks

Vanuatu is an offshore financial centre comprising 8 international (offshore) banks. Consequently this part of the financial sector relies heavily on electronic or wire transfers of funds. International Banks are licenced under and governed by the Reserve Bank of Vanuatu under the International Banking Act. All International banks must be registered in Vanuatu and must have a physical presence in Vanuatu, with management, directors, and employees being residents. Greater regulation of the International banks, conducted by the RBV enforcing local physical presence, led to a dramatic drop in the number of International banks operating in Vanuatu. It is likely that the customers of these entities are resident professionals and offshore customers. The international banks are well supervised by the RBV for AML/CFT and by the VFIU for the reporting of financial transactions. The banks are subject to annual AML/CFT inspections by the RBV and are provided with a good level of guidance materials. These banks typically deal with offshore persons and entities and high net worth individuals and corporates, generally regarded as high risk customers. The International banks have a more limited customer base than the domestic banks. Transactional activity is generally low, but of high value. These services are facilitated by modern communications and an open economy. While the openness to international capital is a key aspect to Vanuatu's strategy for economic growth through fostering financial services, this openness also creates a high level of potential abuse to facilitate illicit capital flows. The Vanuatu legislation prohibits the

international banks from carrying out banking and deposit-taking in Vanuatu. However, those banks are able to use the domestic banks in channelling funds to offshore investment. The international banks are considered to be particularly vulnerable to foreign illicit funds movements, which has been highlighted in a number of investigations by domestic and foreign law enforcement and revenue agencies. The activities of these banks are considered to be of a very high vulnerability in terms of ML/FT.

Mitigating Strategies

- Although there is a reasonable level of supervision of international banks, greater scrutiny and more regular inspections of their AML/CFT programs is necessary.
- RBV supervisors must undertake more frequent inspections reviewing accounts to ensure that the international banks are obtaining information on customers and beneficial owners

Money Transfer Businesses

Money Transfer Businesses in Vanuatu are supervised by the Customs and Inland Revenue Department. Money transfer businesses in Vanuatu are limited to two Western Union franchises operated by the Vanuatu Post Office and Money Transfer (Vanuatu) Ltd, and a bank-account transfer operator, Goodies. The money transfer sector in Vanuatu is relatively small, servicing mainly the tourist industry. AML/CFT supervision of money transfer businesses is very limited in Vanuatu. Inspections of these entities as to their AML/CFT compliance and particularly the transactional activity of their customer base does not occur to an acceptable degree. This is a consequence of capacity issues of the AML/CFT supervisors. There are very few transactional reports from these entities.

It is likely that the following will occur through the money services businesses in Vanuatu:

- Cash converted to electronic funds and sent offshore
- Electronic funds from offshore converted to cash
- High volume of transactions over a relatively short period of time.

Global evidence shows that criminals involved in the most significant crimes that generate large values of funds use money transfer businesses to launder their funds or to move funds for the purposes of terrorism

financing. As Vanuatu is a cash based economy and money transfer businesses have been highlighted globally as a high risk to ML/FT, they are rated as a very high vulnerability for ML/FT in Vanuatu. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFSC and VFIU must undertake a much higher level of supervision of these businesses for which they have responsibility under the AML/CFT program, including regular and frequent on-site inspections of those entities and the application of penalties where there are failings.

Currency Exchange Businesses

Foreign currency exchange in Vanuatu is conducted with the five domestic banks, Western Unions, Goodies and 7 Eleven, with a number of small shop-front dealers. Currency exchange businesses are regulated by the Ministry of Finance through the Customs and Revenue Department. AML/CFT supervision of currency exchange businesses, other than the domestic banks, is inadequate. Inspections of these entities as to their AML/CFT compliance and particularly the transactional activity of their customer base does not occur to a acceptable degree. This is a consequence of capacity issues of the ML/CFT supervisors. There are very few transactional reports from these entities. Global evidence shows that criminals involved in the most significant crimes that generate large values of funds use currency exchange businesses to launder their funds or to move funds for the purposes of terrorism financing. It is likely that the following is likely to occur through the currency exchange businesses in Vanuatu:

- Foreign currency is converted to Vatu
- Vatu is converted to foreign currency
- Large volumes of low denomination notes
- Large volumes of high denomination foreign notes
- High frequency of exchanges

The cash based economy in Vanuatu and the global concerns as to ML/FT facilitation through currency exchange businesses would indicate that these businesses should be rated as very highly vulnerable in terms of ML/FT. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFSC and VFIU must undertake a much higher

level of supervision of these businesses for which they have responsibility under the AML/CFT program, including regular and frequent on-site inspections of those entities and the application of penalties where there are failings.

Savings and Loans Cooperatives

There are about 300 Savings and Loans Cooperatives registered in Vanuatu. The Cooperatives hold accounts with the National Bank of Vanuatu, one of the five domestic banks. Members are able to draw down funds against savings. Despite being generally low value deposits and withdrawals, the Savings and Loans Cooperatives are likely to earn over VT 1 billion in 2014. Profits increased by 6.2% in 2013 to VT 926 million and the numbers of cooperatives increased substantially. As transactional activity is comprised largely of cash and the value of funds held in the cooperatives is significant and increasing rapidly, the level of vulnerability to ML/FT is considered to be potentially high. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFSC and VFIU must undertake a much higher level of supervision of these businesses for which they have responsibility under the AML/CFT program, including regular and frequent on-site inspections of those entities and the application of penalties where there are failings.

Other Financial institutions

Vanuatu Agricultural Development Bank - The Vanuatu Agricultural Development Bank (VADB) was set up under legislation in 2006, principally to develop the natural resources of Vanuatu giving special regard to agriculture, forestry, fisheries, tourism and manufacturing. The VADB targets development loans that contribute to the development of national resources through existing well-managed intermediaries such as Non-Government Organisations (NGOs), Faith Based Organisations and Self Help Groups. The government provided the VADB with VT 200 million in 2008 and VT 100 million in 2009. Some of the funding in the VADB is obtained from foreign governments. Although the entities and the loans provided are

relatively small, potential does exist for illicit funds being used to pay back loans. The VADB is supervised by the RBV. The level of vulnerability to ML/FT is considered to be medium.

Insurance Companies - Local and international insurance companies including Captives, Intermediaries, Managers and Reinsurers may be established under the Insurance Act 2005, Insurance Regulations and Protected Cell Company Act 2005. Insurance companies are supervised by the Reserve Bank of Vanuatu. There are approximately 34 insurance providers in Vanuatu. Evidence of beneficial ownership, financial standing, experience of the managers and a business plan must be submitted to the RBV. In 2011 approximately VT 1 billion was paid in premiums, with 71 % collected through brokers. The main classes of business are fire, household, general accident, personal accident and health, motor vehicle, workers compensation, engineering and marine and product liability. Offshore business includes, aviation hull and liability life insurance, workforce protection, marine hull, professional indemnity, and travel, death and income protection. The domestic market is dominated by one insurer who writes 70% and one broker who controls over 90% of customers, with four other brokers, mainly dealing with high income businesses and individuals. ML may be evident through life insurance products with single premium payments and high cash surrender values or through the assignment of policies to third parties. Cash payments for premiums may also result from illicit funds. This would most likely only lead to a low level vulnerability. There is a possibility that foreign illicit funds may flow into the insurance sector through international insurance companies and Captives. This, however, would be relatively low in value and would constitute no more than a medium level vulnerability.

Credit Unions - There is only one small credit union in Vanuatu which is supervised by the RBV. Funds into the credit union are very low and generally deposit directly from the payroll. There is very low concern as to the Credit Union's vulnerability to ML/FT.

Securities Dealers - Vanuatu does not have a domestic stock market. Consequently Securities Dealers operate on offshore stock markets. The Securities Dealers in Vanuatu are licenced under the Prevention of Frauds Act to inter alia, buy, sell, trade securities such as shares, and bonds options and to manage a portfolio of investments on behalf of customers. It is also possible to register as a Securities Dealer exclusively for offshore operations. The ability to be licenced to conduct offshore operations raises this from a generally low level

of vulnerability to ML/FT to a level of medium. The lack of adequate supervision is also a significant factor in this vulnerability level.

Funds Managers of Mutual Funds - Mutual Funds and Funds Managers are licenced under the Mutual Funds Act and are supervised by the VFSC. Mutual funds are investment schemes that allow investors to pool their funds and receive profits from investments in acquiring, managing and selling property and other investments. The mutual fund may be a company, a unit trust or a partnership. Foreign mutual funds may operate in Vanuatu but be established outside of Vanuatu, however there is only one Fund Manager of a Mutual Fund operating in Vanuatu. AML/CFT vulnerabilities are therefore rated as low.

Pension Fund - There is only one Pension Fund in Vanuatu, the National Provident Fund which is a government run superannuation fund. Contributions are made by employers. The main purpose of the fund is to provide future security when a member retires or suffers a permanent disability. This is important as Vanuatu does not have a government-funded social services scheme. In 2012 seven executives of the pension fund were suspended as a result of alleged mismanagement and corruption. Although the fund has been subject to these allegations of fraud and corruption, in terms of the funds vulnerability to ML/FT, it is generally considered to be very low as the money going into the fund is from employers and payouts are only made on death, retirement or permanent disability.

Mitigating Strategies

The VFU, together with the RBV and VFSC must ensure that they provide appropriate AML/CFT supervision to these entities and where there are failings, take appropriate action.

Reporting Entities – Designated Non-Financial Businesses and Professions (DNFBPs)

Money launderers frequently use DNFBPs to assist them to hide and move their funds. Entities that are defined as DNFBPs under the AML & CFT Act and therefore fall within the AML/CFT regime in Vanuatu include trust companies and service providers (TCSPs), lawyers, accountants, gambling and gaming entities, real estate agents, car dealers and dealers in other high value assets, micro finance institutions, small non-bank lenders and a lottery. There are also approximately 503 registered charitable organisations, most of which are

micro entities. The reporting of financial transactions under the AML & CFT Act by DNFBPs is extremely low. The vulnerability of the different types of DNFBPs arises from, inter alia, the products and services they offer and type of clients they serve. Control measures are also assessed in order to understand the level of vulnerability that exists in the sector such as:

- Lack of commitment by DNFBPs to the AML/CFT program
- Low levels of reporting and/or lack of quality of STRs
- Lack of concern regarding vulnerability to related reputational risk.

Requirements of AML/CFT regime are not well understood or implemented by DNFBPs.

TCSP – Company formation

Company service providers must be licenced through the VFSC. Company Services Providers provide the following:

- General administrative services
- Providing a registered office
- Providing an accommodation address facility
- Providing a registered agent for an international company
- Acting as a director, secretary, nominee shareholder or nominee member of a company
- Any other related services incidental to the above.

There are about 4,300 registered international companies which offer a wide range of services related to offshore banking, investment, legal, accounting, and insurance and trust company services. In some cases, residents may act as nominee directors to conceal the identity of the true company owners. The lack of a public registry of shareholders also increases the level of concern. The cost of setting up these companies is relatively low and consequently they can be readily used as vehicles for facilitating ML/FT. The anonymity of persons involved in the international companies, together with the global concerns of ML/FT through these type of companies raises the level of vulnerability to ML/FT to a very high level. The role of TCSPs in creating and facilitating the international companies is a significant component of this vulnerability. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

- The VFSC must undertake a much higher level of supervision of the TCSPs and the companies they

create, including regular and frequent on-site inspections of those entities and the application of penalties where there are failings.

- The VFSC must require greater detail of office bearers, beneficial owners and other persons involved in international companies and these must be regularly and effectively inspected and supervised.

TCSP – Trusts

Vanuatu has 11 Trust Service Providers operating in Port Vila. These are licenced companies through the Register of Companies in the VFSC. Trust services include the following:

- Services in relation to the creation or modification of an express trust, other than as a legal practitioner
- Services of a professional trustee, protector or administrator of a trust or settlement
- Managing and administering a trust or settlement
- Any other related services incidental to the above services
- Providing any of the above services for a private trust company, or a company that acts as trustee of a single trust.

It is possible to use trust structures to create layers that obscure the link between illicit funds and their origins. It is also possible to set up complex trust structures across multiple jurisdictions making tracing of illicit funds extremely difficult. It is also likely that trust structures are created as part of wealth management services for high risk customers. Trust Managers in Vanuatu need to be incorporated as local companies in Vanuatu as international companies are not permitted to engage in trust management activity. The anonymity of persons and funds involved in these trusts, together with the global concerns of ML/FT through trusts raises the level of vulnerability to ML/FT to a very high level. The role of TCSPs in creating and facilitating these trusts is a significant component of this vulnerability. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

- The VFSC and VFIU must undertake a much higher level of supervision of the TCSPs and the trusts that they create, including regular and frequent on-site inspections of those entities and the application of penalties where there are failings.

- The VFSC must require greater detail of persons involved in trusts and these must be regularly and effectively inspected and supervised.

Casinos

Three casinos currently operate in Vanuatu, although there are a number of applications for licenses currently under consideration. Licenses for casinos are issued by the Department of Customs and Inland Revenue. Foreign applicants for a casino license must first receive a clearance from the Vanuatu Investment Promotion Authority (VIPA) which will determine if the applicant is of a good character and that there is a viable business plan. Casinos are subject to the AML & CFT Act and therefore subject to supervision by the VFIU. Otherwise there is very limited supervision of casinos in Vanuatu.

Examples of possible ML/FT activity:

- Converting small denomination currency notes to larger denominations
- Foreign currency exchange
- Cash in/Cash out without playing
- Wire transfers from offshore
- Wire transfers of “winnings” to offshore
- Funds transferred to bank accounts from casino bank accounts
- Funds deposited into casinos offshore bank accounts
- Structuring transactions to avoid financial transaction reporting.

Casinos have been identified globally in the process of ML/FT using cash and electronic payments. With a significant cash economy in Vanuatu, coupled with a high tourist focus and virtually no supervision, the casinos in Vanuatu are seen as having a very high vulnerability to ML/FT.

Mitigating Strategies

The VFIU, together with the Inspector of Casinos must undertake a much higher level of supervision of the Casinos in respect of their AML/CFT obligations, including regular and frequent on-site inspections of those firms and the application of penalties where there are failings.

Interactive Gaming, Gambling and Betting Sites

Interactive gaming, gambling and betting is one of the fastest growing sectors globally, and is expected to grow

by as much as 30% over the next few years. Unlicensed sites are growing at a much more rapid pace than licensed sites. ML/FT through these sites is also assisted by the offshore nature of many of the services. Money launderers have many opportunities to obfuscate money flows through these on-line sites, making the task for law enforcement more difficult.

Interactive gaming, gambling and betting sites must be licensed in Vanuatu under the Interactive Gaming Act. There are three active licensed internet casinos in Vanuatu. Sites generally provide activities such as sports betting, poker, casino, bingo and interactive games, many of which involve two or more players in different locations. Customs and Inland Revenue are responsible for the licensing and supervision of the sites. Licensees are required to provide monthly reports showing players funds.

Globally, these sites are vulnerable to a wide variety of criminal activities including ML/FT. For example, criminals may participate in games with other criminals, specifically to exchange and launder illicit funds. This can be done by intentionally losing games. Bribery and corruption can also be facilitated by these means. There is evidence that virtual currencies are also being used in interactive gaming to launder funds.

Relative anonymity and ease of access, together with limited supervisory ability make these sites very highly vulnerable to ML/FT. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFIU, together with the Inspector of Casinos must undertake a much higher level of supervision of the Casinos in respect of their AM/CFT obligations, including regular and frequent on-site inspections of those firms and the application of penalties where there are failings.

Lawyers

There are approximately 20 law firms operating in Vanuatu. There is no government supervision of lawyers in Vanuatu, however the Vanuatu Law Society, largely an informal association of private lawyers, registers and monitors the firms and has disciplinary processes. Lawyers in Vanuatu comprise mostly expatriates from Australia and New Zealand, although there is a growing number of ni-Vanuatu lawyers. Lawyers mainly service the commercial and financial interests of residents and offshore clients. In addition to the provision of advocacy and litigation services, lawyers in Vanuatu also provide

company services for both domestic and international companies, including the incorporation of local and international companies, creation and provision of partnerships and trusts, provision of company secretarial services, the provision of directors, trustees etc. In Vanuatu, there is some concern that lawyers may provide advice on ML/FT to their clients on the assumption that they will be protected by the rules of privilege that protects the confidentiality of the lawyer/client relationship.

The strong links to TCSP services and the global concern with the facilitation of ML/FT through lawyers raises the level of potential vulnerability of lawyers to high. The lack of adequate government supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFIU must undertake a much higher level of supervision of the Lawyers in respect of their AML/CFT obligations, including regular and frequent on-site inspections of those firms and the application of penalties where there are failings.

Accountants

There are approximately 15 accountancy firms operating in Vanuatu. There is no registration or licencing of accountants in Vanuatu, however the VFIU has a supervisory role with regard to AML/CFT, and they are required to be registered when undertaking TCSP businesses. In addition to the provision of general financial and accounting services, funds management, asset management and real estate services, accountants in Vanuatu also provide company services for both domestic and international companies, including the incorporation of local and international companies, creation and provision of partnerships and trusts, provision of company secretarial services, the provision of directors, trustees etc. The strong links to TCSP services and the global concern with the facilitation of ML/FT through accountants raises the level of potential vulnerability of accountants to high. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFIU must undertake a much higher level of supervision of the accountants in respect of their AML/CFT obligations, including regular and frequent on-site inspections of those firms and the application of penalties where there are failings.

Real Estate

The majority of land in Vanuatu is unregistered or indigenous land. Land for lease must be registered. The primary role of real estate agents in Vanuatu is to facilitate lease or freehold property transactions for clients. There have been allegations of criminal activity in regard to real estate in Vanuatu over many years, although this may now be on the decline as a result of legislative changes. Small cash payments to customary owners to lease highly undervalued land is an issue of concern in Vanuatu. There is no restriction on lease, purchase or sale by non-resident foreigners, and payment can be made in Vatu or any foreign currency. Consequently illicit funds can be used in this process. Similarly, land and property can be used as a means of laundering funds. The structure of the real estate market in Vanuatu makes it vulnerable to exploitation by people moving funds through Vanuatu. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFIU, in company with the Lands Department, must ensure that Real Estate agents and others are aware and comply with their obligations with regard to Vanuatu's AML/CFT program, and ensure that they are adequately supervised.

High Value Asset Sellers

There are few high value assets sold in Vanuatu. An area that raises some concern is in the sale and purchase of boats and yachts, and vessel management. Although there is no evidence of ML/FT in this industry, the high value of the vessels, the use of cash generally in Vanuatu, the ability to import large cash values, and links to international funding through the international banks, raises the level of vulnerability to high. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFIU must ensure that all sellers of high value assets are aware and comply with their obligations with regard to Vanuatu's AML/CFT program, and ensure that they are adequately supervised.

Other DNFBPs

Micro-Finance Institutions - There are a very small number of micro-finance entities generally set up along community lines. These entities generally have a savings scheme for members, with savings generally unable to be withdrawn until the client forgoes their membership, or with a very low rate of interest if funds are withdrawable. They also provide small loans over short periods of time. The vulnerability to ML/FT is considered to be low.

Non-Bank Lenders - As with Micro-Finance generally, there are very few non-bank lenders in Vanuatu. These entities generally provide very low value loans over short periods of time. The vulnerability to ML/FT is considered to be low.

Not for Profit Organisations (NPOs) - NPOs in Vanuatu are governed by the Charitable Organisations Act. There are approximately 300 registered NPOs. There is no real supervision of NPOs in Vanuatu by the VFSC. There is no evidence of ML/FT involving NPOs in Vanuatu, however, global concerns together with the lack of supervision would raise the level of vulnerability to ML/FT to Medium.

Lottery - There is only one lottery operating in Vanuatu. This is governed by the Vanuatu Lotteries Act and is regarded to have a very low vulnerability to ML/FT.

Car Dealers - There are approximately 15 car dealers in Vanuatu, many of which are second hand dealers and provide motor mechanical services. The use of cash is prevalent in the industry. Car Dealers are supervised by the VFIU for AML/CFT purposes. Because of the wide use of cash in the industry and the value of motor vehicles, the vulnerability to ML/FT is considered to be at the medium level. The lack of adequate supervision is also a significant factor in this vulnerability level.

Mitigating Strategies

The VFIU, together with other supervisors of these entities must ensure that they provide appropriate AML/CFT supervision to these entities and where there are failings, take appropriate action.

Legislation

To deter and counter ML/FT, Vanuatu needs, inter alia, strong political will accompanied by strong laws, an independent judiciary, a responsive public service and effective enforcement.

In recent times the Executive government in Vanuatu has been subject to a level of instability with relatively frequent changes as a result of political challenges to members. Allegations of political corruption have also contributed to this political instability. Vanuatu's inability to adequately and quickly investigate and prosecute corruption, creates a further vulnerability that allegations will continue to be made. Despite this relative instability, cross party political will and commitment in terms of Vanuatu's AML/CFT program has been enhanced over the past few years.

Significant legislative reform has recently been carried out in Vanuatu, with much of the legislation only being amended or enacted during 2014. The principal laws relevant to AML/CFT are:

- Anti-Money Laundering & Counter-Terrorism Financing Act No. 13 of 2014 – establishes the competent authority (VFIU), VFIU powers and the AML/CTF supervisory framework
- Proceeds of Crime Act [CAP 284] – sets a legal framework for confiscation of the proceeds of crime and establishes a criminal offence of money laundering
- Counter Terrorism and Transnational Organised Crime Act [CAP 313] – establishes a criminal offence of terrorist financing
- Reserve Bank of Vanuatu Act [CAP 125] – provides the legal basis for financial sector (banking, offshore banking, credit union and insurance) regulation and supervision
- Mutual Assistance in Criminal Matters Act [CAP 285] – provides the legal framework for receipt and dissemination of legal assistance
- Company and Trust Service Providers Act No. 8 of 2010 – provides for the licensing and regulation of service providers
- Currency Declaration Act No. 7 of 2009 – provides the legal declaration framework at the border
- International Banking Act [CAP 280] – provides for licencing, supervision and enforcement of international banks.

The AML & CFT Act is the centrepiece of Vanuatu's AML/CFT program. It is comprehensive and is generally adequate in its coverage of all of the essential AML/CFT

global standards including preventive controls such as financial sector and DNFBP requirements for customer due diligence, internal controls, record keeping and transactional reporting requirements. It provides for supervision by the RBV, VFSC and VFIU which should be adequate, however capacity issues, particularly at the VFSC and VFIU, limit the effectiveness of these controls particularly in respect of the DNFBPs.

The new legislation seems to provide supervisory and investigative agencies with largely adequate powers to detect and deter ML/FT. Full implementation of those powers is essential, but is generally not occurring due to capacity issues in each of those the agencies.

Another concern is that the money laundering offence, which although sufficiently broad, may be overly onerous to prove, and consequently further consideration of any risks posed by the offence will need to be considered. As there have been no money laundering related prosecutions in Vanuatu, it is difficult to assess the effectiveness of this legislation. The AML/CFT related legislation is still incomplete and a number of necessary amendments and enactments are required urgently, consequently the vulnerabilities in respect of legislation are considered to be medium.

Mitigating Strategies

- The new legislation seems to provide supervisory and investigative agencies with largely adequate powers to detect and deter ML/FT. Full implementation of those powers is essential.
- Some AML/CFT related legislation is still incomplete. All necessary legislative enactments and amendments must be identified, drafted and enacted as soon as possible to ensure that the AML/CFT program has the appropriate legal and legislative basis.

Imports and Exports

ML/FT can be associated with significant distortions in a country's imports and exports. On the import side, criminal elements often use illicit funds to purchase imported luxury goods in the process of laundering the funds. Those imports do not generate domestic economic activity. Exports from Vanuatu are mainly copra followed by timber, beef, cocoa and kava which accounts for around 20% of GDP. Fishing is also a factor, but much of the fishing is now by foreign fleets. In 2012 exports were approximately VT 4.1 billion (USD \$41 million), and the main trading partners for exports were Thailand (57%) and Japan (22%). Imports amount to about VT 24 billion (USD \$242 million) and are mainly machinery and equipment, foodstuffs and fuel.

Vanuatu's main import partners are China (approximately 27%), Singapore (21%), Australia (14%), New Zealand (7%), Fiji (7%) and Japan (5%). Falsifying import and export documentation and consequent failure to pay appropriate fees is a concern with regard to ML/FT. Consequently, these vulnerabilities may allow the AML/CFT program to be frequently exploited and therefore the vulnerability rating would be high.

Mitigating Strategies

The Vanuatu government authorities must ensure that all imports and exports are correctly identified in documentation, and that all fees are appropriately paid, and the application of penalties where there are discrepancies.

Revenue

In 2012 Vanuatu's budget revenues were approximately VT 18.6 billion (USD \$188.2 million), with expenditure of about VT 21 billion (USD \$207 million). Tax revenues come mainly from import duties, VAT and licence fees. Failure to pay appropriate import duties and a significant failing in payment of VAT and licence fees is a significant vulnerability with the potential for those unpaid fees and taxes to be used in the process of ML/FT. A major concern in VAT evasion is the collection of the VAT but not paying it to Inland Revenue. This is made even more vulnerable as the VAT system is based on self-assessment registered persons who calculate their own VAT liability and are expected to advise the Revenue Office. These vulnerabilities may allow the AML/CFT program to be frequently exploited and therefore the vulnerability rating would be high.

Mitigating Strategies

The Vanuatu government authorities must ensure that all revenue is appropriately collected, and that the VAT system is adequately enforced, including registrations and on-site inspections and prosecutions where offences occur.

Foreign Investment

Foreign investment in Vanuatu is an essential and ongoing component of the Vanuatu economy. Foreign direct investment into Vanuatu has increased significantly in recent years, amounting to VT 5.8 billion

(USD \$58 million) in 2011. This is the net inflow of investment to acquire a lasting management interest in an enterprise in Vanuatu. It is the sum of equity capital, reinvestment of earnings, other long term capital, and short-term capital. This has increased from about VT 4.1 billion (USD \$41 million) in 2010 and about VT 1.2 billion (USD \$12 million) in 2005. The CIIP is a means to facilitate more foreign investment into Vanuatu. The objective of the CIIP is to attract wealthy investors and it is reported that foreign investment in respect of the first 500 applicants under the program may have yielded investment of up to VT 9.85 billion (USD \$98.5 million). It is a requirement of the program that investment be through a Vanuatu international company. In most cases, it is likely that the CIIP applicant will have one or more international company/ies created specifically for this purpose. There have been a number of concerns raised with regard to investment into Vanuatu, particularly as to the ability of new citizens to readily be able to invest in other countries as a result of their involvement in Vanuatu's CIIP program. Vanuatu's program of foreign investment is therefore considered to be highly vulnerable to potential ML/FT.

Mitigating Strategies

- The Vanuatu Government must review their CIIP program to ensure that any resultant investment does not involve illicit funds and that the CIIP program is not being abused.
- The Vanuatu Government must ensure that full due diligence is undertaken in respect of potential investors into Vanuatu and is periodically reviewed, particularly in respect of those foreign persons who are seeking, or who have obtained citizenship under the CIIP.
- The Vanuatu government must ensure that new citizens are fully aware of Vanuatu's AML/CFT program and fully abide by all of its requirements.

Legal and Judicial

Vanuatu has a relatively effective legal system based on British common law, and the judiciary is largely independent, has relatively high levels of integrity but a lack of resources hinders the hiring and retention of qualified judges and prosecutors and may result in backlogs of cases. Tribal chiefs often adjudicate local disputes. Land disputes are a constant source of tension. Customary law is recognised in the Vanuatu constitution and exists alongside and is integrated into the common law in Vanuatu. A system of island courts deal with customary disputes and customary land matters. The law prohibits lawyers representing in

customary courts. To be effective, the judiciary must have cases brought before it, but there have been no ML/FT cases brought before the Vanuatu courts. This is generally a consequence of the capacity concerns of a range of agencies outlined in this NRA. The concern is that, if and when ML/FT cases come before the courts, will the prosecutors and judges be adequately resourced and trained to present and hear these very complex cases, which have the potential to tie up the courts for lengthy periods of time. The potential vulnerability to ML/FT is rated as high.

Mitigating Strategies

The Vanuatu government authorities must ensure that the judiciary is well trained in terms of ML/FT conduct, investigations and legal proceedings.

Technology factors

More than 85% Of Vanuatu residents have access to the mobile telephone network, and more than 11% have Internet access. A submarine cable system came into effect in January 2014, at a cost of USD \$30 million, and links directly into the high capacity Southern Cross Cable enabling Vanuatu to connect to the global telecommunications super highway to the USA, Australia, Asia and Europe. Vanuatu is heavily reliant on electronic payment systems, particularly for international banks. Also for domestic transactions the major banks provide internet, telephone banking and mobile banking facilities with a particular focus on the outlying islands. The National Bank of Vanuatu has 28 branches on 15 islands and offers mobile banking and micro finance as well as the usual banking services. In 2013 it was estimated that less than 15% of the population had direct access to banking services. However, with the technology developments in Mobile and Mobile Phone banking generally, banking services outreach to rural areas will increase considerably. There is no evidence of alternative payment systems, such as Bitcoin, in Vanuatu at this time. With the development of funds based technology comes the need for adequate supervision because of the ability to abuse these systems for the purpose of ML/FT. Consequently the vulnerability to ML/FT is rated high for technology solutions.

Mitigating Strategies

The RBV, VFSC and VFIU must carefully scrutinise the use of new technologies in payment systems in Vanuatu for ML/FT vulnerabilities, prior to their implementation by private

sector entities.

Likelihood and Consequence

Consideration of likelihood and consequence are important in the process of assigning some relative value to ML/FT risks. The following outlines Vanuatu's assessment of the likelihood of ML/FT occurring in and through Vanuatu and the possible consequences for Vanuatu resulting from the ML/FT and consequence is the potential impact or outcome of the risk event.

Likelihood is generally considered to be the chance of a risk occurring and is a function of threats and vulnerabilities. The likelihood of an event occurring is influenced by a number of factors, including Vanuatu's capability to address the ML/FT threats and vulnerabilities and takes into account the successful implementation of control strategies and legislative provisions. Likelihood also considers factors such as trends, available intelligence, offender characteristics and opportunity. Risk is determined by cross referencing the assessed likelihood of an event with its assessed consequence.

Consequence is the potential impact or outcome of the risk event and takes into consideration the effect of an event occurring, including the impact or harm that ML/FT and the effect of the underlying criminal activity on financial systems and institutions as well as on the economy and society more generally. The consequences of ML/FT may be short or long term in nature and may also relate to national populations, specific communities, the business environment, other national and international interests, as well as the reputation and attractiveness of the Vanuatu's financial sector. Other possible factors taken into account include financial loss, media response, available resources, impact on the community and risk to reputation. The recognition that there are specific consequences of ML/FT threats and vulnerabilities assists in assigning a relative value or importance to ML/FT risks.

It is estimated that the total harm to the Vanuatu economy could be as much as 1.7% of GDP or VT 1.4 billion per annum.

Those threats and vulnerabilities likely to have the most severe consequences to Vanuatu are offshore activities including tax evasion, illicit drug related activities and funds derived from other types of crime in other

countries and the movement of cash in and through Vanuatu, together with illicit funds associated with bribery and corruption, and VAT fraud.

In terms of vulnerabilities that will assist those funds from the predicate crimes create severe consequences in Vanuatu, are those vulnerabilities associated with low levels of capacity within the AML/CFT program, the institutional framework and the reporting entities.

The most severe consequences will arise from funds resulting from offshore criminal activities, corruption, cross border cash and VAT evasion, associated with vulnerabilities in terms of lack of capacity in the regulatory, supervision and law enforcement agencies and vulnerabilities within the reporting institutions.

Consequently the highest level risk to possible ML/FT in and through Vanuatu, align with those high level threats and vulnerabilities outlined above. The highest priority need for mitigating action will result from a combination of the highest level risks and the highest level vulnerabilities, combined with the greatest consequences.

The highest priority for action is ML/FT through offshore criminal activity. It is most difficult for Vanuatu to implement controls to stop criminal activity in other countries, other than international cooperation, however action must be taken to fix the weaknesses in Vanuatu's AML/CFT program that allow for illicit funds to be moved into or through Vanuatu.

Vulnerabilities that allow for bribery and corruption, fraud, particularly VAT evasion, the cross border movement of cash, domestic illicit drug activity and real estate abuses also need priority action. The priority for action on ML/FT risks is particularly related to lack of capacity of the VFIU, VFSC and other supervisors, law enforcement agencies and the Public Prosecutors Office, and weaknesses that allow for reporting entities to be the vehicles for ML/FT.

Summary and Conclusions

Vanuatu has the basis of a very good AML/CFT program. Despite that, there are a range of threats and vulnerabilities that make the program very susceptible to ML/FT now and in the future.

This Vanuatu ML/FT NRA has been conducted by the Vanuatu authorities to identify the threats, vulnerabilities and consequences of ML/FT, to determine the level of ML/FT risk and to prioritise those risks for mitigating action. It is now essential that mitigating strategies outlined in this NRA are implemented, with those that require urgent action being implemented without delay.

The highest priority need for action results from a combination of the highest level risks and the highest level vulnerabilities, combined with the greatest likely consequences of those ML/FT risks.

The funds with the highest level risk to possible ML/FT in and through Vanuatu result from offshore criminal activities including tax evasion, illicit drug related activities and other crimes committed in other countries, and the movement of cash into and through Vanuatu without being declared at the border. In addition, illicit funds associated with bribery and corruption and fraud (particularly VAT evasion) are also rated as a high risk to ML/FT. Funds associated with illicit drug activities in Vanuatu, trade based activities and environmental crime are also of concern and are rated as a medium risk to ML/FT.

In terms of vulnerabilities that may assist the funds from the predicate crimes to be involved in ML/FT are those vulnerabilities associated with limited capacity within the AML/CFT program, the institutional framework and the reporting entities, and all are rated as very high in terms of ML/FT risk. Other factors identified as contributing to vulnerabilities in the AML/CFT program are related to economic and geographic factors, legal and judicial factors and technology factors with identified vulnerabilities which are rated as high.

Consequently the most significant ML/FT risks arise from cash and electronic funds resulting from offshore criminal activities, corruption, cross border cash and VAT evasion, associated with vulnerabilities in terms of lack of capacity in the regulatory, supervision and law enforcement agencies and vulnerabilities within the reporting institutions.

There are a number of methods for addressing this ML/FT risk, including prevention or avoidance, mitigation or reduction, contingency planning or acceptance. Higher level risks may require more immediate action, while lower levels of risk might require lesser action or action to be taken when resourcing becomes available. Some ML/FT risks will require action over a period of time. While risk can be mitigated and managed zero risk is unobtainable. It is

considered that measures to achieve zero risk would be disproportionate, intrusive, unwieldy and expensive.

It is important to identify strategies that will address how to prevent ML/FT, and how to better detect, disrupt and prosecute the offenders.

The NRA requires ongoing monitoring and reviewing of risk, communication and consultation. This ensures management plans remain relevant to objectives, progress can be reviewed, analysts and decision makers can exchange ideas and any uncertainty or bias can be accepted and recorded in a transparent manner. These strategies may require policy development, which may take some time. It is therefore essential to identify the range of mitigating strategies that should be applied to the threats and vulnerabilities to manage the risk, so that implementation processes can be planned and managed.

There are three areas of urgent concern to the Vanuatu AML/CFT program. Immediate attention to these issues will assist to minimise the most significant ML/FT risks identified in this NRA. Those areas of concern are:

- Capacity of government agencies
- Cash economy
- International banks and companies

The most significant concern in Vanuatu's AML/CFT program is the very low capacity in all areas of the program with most, if not all, of the identified vulnerabilities occurring as a direct result of this limited capacity. Unless the capacity issues are resolved, the level of ML/FT risk will remain extremely high. Urgent resourcing of government agencies involved in the AML/CFT program is essential. The ability for Vanuatu to do this is extremely limited due to the size of the population and its current skill levels. The Government of Vanuatu must provide funding, from government revenues or from external donor providers, specifically to provide new and adequate technologies and qualified human resources to supplement its AML/CFT program. Both funding and human resources will need to be sourced urgently, and most likely as the skills required may not presently be available in Vanuatu, consideration should be given to sourcing those skilled resources from offshore.

To enhance capacity, the government of Vanuatu will take immediate steps to initiate the following:

- Allocate sufficient financial, human and technological resources to government agencies for

AML/CFT supervision and to identify, investigate and prosecute major crime threats.

- Most urgently, this will be funding and resources to the VFIU to enable it to increase its analytical staff and to source appropriate technology solutions to enable the VFIU to adequately analyse the extensive financial transaction information it already has and will continue to receive on a daily basis. It will also be provided with appropriate systems and human resources to be able to adequately supervise those reporting entities not otherwise receiving formal AML/CFT supervision from other government agencies.
- Funding and resources to the VFSC to enable it to adequately supervise and enforce the AML/CFT requirements in respect of all entities for which it has regulatory responsibility.
- Funding and resources to Customs to enable it to adequately perform its border control functions, particularly with regard to cash movements into and out of Vanuatu at the seaport.
- Within the next 12 months, to provide adequate funding and resources to the VPF (TCU) to conduct ML/FT investigations, to the Office of the Public Prosecutor to ensure prosecution of ML/FT, and to the judiciary to preside over ML/FT prosecutions.
- Investigate major crimes rigorously
 - Formalise and update internal standard operating procedures to enhance the early detection, tracking and referral of possible ML/FT offences.
 - Provide more guidance and training to government agencies on AML/CFT supervision and investigations.
 - Focus AML/CFT investigative activities primarily on offshore crimes where funds enter the Vanuatu financial and offshore centres, corruption, cross border movements of currency and VAT evasion.
- Strengthen cooperation between government agencies
 - Conduct meetings between policy makers and government agencies to explore new AML/CFT strategies.
 - Leverage on the financial intelligence provided by the VFIU to detect ML/FT.
- Engage industry and community

- Disseminate crime indicators to reporting entities to assist in detection of ML/FT and to report STRs.
- Collaborate with industry associations to raise awareness of ML/FT.
- Educate the public on AML/CFT.
- Conduct community engagement programs via various media.

In terms of the cash economy the Government of Vanuatu will initiate consideration of the following:

- Reduce the use of cash in Vanuatu.
- Gradually restrict large cash payments/receipts to banks.
- Pay special attention to bulk currency and couriers.
- Remove incentives to use money transfer businesses and currency exchange businesses.
- Improve regulation for authorisation and registration/licencing, supervision and inspection and sanctions for all cash based reporting entities.

In terms of the international banks and companies, the Government of Vanuatu will work to:

- Improve the efficiency of domestic banking system making it more attractive.
- Provide enhanced and appropriate supervision of all international banks and international companies including greater scrutiny and frequent inspections of those entities, and the application of penalties where there are failings.
- Apply strict supervision and penalties to the TCSPs where the international banks and international companies infringe Vanuatu and other countries laws.
- Increase public awareness with regard to ML/FT concerns with international banks and international companies.

This NRA, the first for Vanuatu, is very broad, outlines the high level of ML/FT risks and is consequently a foundation for the development of a more adequate assessment of ML/FT risk over the next few years. This NRA lacks many of the essential criteria for a thorough assessment of ML/FT risk. To develop a more thorough NRA, statistical and other data will need to be collected and analysed, much of which is not currently collected. The information and statistics that will be required, need to be identified and collection must be commenced urgently.

Although initial progress has been made by improving technical compliance ML/FT is not being adequately deterred in Vanuatu. Domestically, the low level of

deterrence is likely to lead to increased facilitation of ML/FT. Continued non-deterrence of transnational laundering is likely to lead to a loss of international reputation, which in turn threatens international business, impacting economic growth and revenue.

This ML/FT NRA will be reviewed over the coming 12 months and a further ML/FT NRA will be conducted within the next 2 to 5 years.