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The blockchain tipping point is here. Can we afford to miss out?

> *"As blockchain decentralizes financial activities, governments will continue striving to understand and regulate the technology. And those that do so effectively will have an opportunity to attract global investment and become frontrunners in a blockchain economy."*
>
> – "Blockchain and the future of finance", KPMG, 2019

Just a few years ago, the word blockchain was more likely to conjure up associations with fringe tech than serious business. It was first deployed by cryptocurrencies like Bitcoin, whose abstract nature and volatility inspired widely divergent opinion in the financial community, from evangelic worship to blanket rejection. Cryptocurrencies, however, are just one digital asset that can be exchanged using blockchain. And the technology itself is gaining increased traction in mainstream business communities around the world — but not in Vanuatu. Perhaps it's best to start with a bit of background.

Blockchain is here to stay

Deloitte's 2020 Global Blockchain Survey reveals that the technology has passed a tipping point and is now "solidly entrenched in the strategic thinking of organizations across industries, sectors, and applications. (…) Leaders no longer consider the technology ground-breaking and merely promising—they now see it as integral to organizational innovation. This year, the C-suite is putting money and resources behind blockchain as a strategic solution in more meaningful and tangible ways".

Sharing the truth

Blockchain, also known as Decentralized Ledger Technology (DLT), is a digital ledger system where entries are related chronologically and collectively managed by a network of computers. Any participant in the network with the proper authorization can view the entire ledger without relying on an intermediary or any one authority; and data cannot be changed without the approval of other participants. As a result, each and every authorized party in the network has access to a single, shared truth, which fosters confidence in transacting across multiple sites or geographies.

Where there's truth, there's trust

The key element behind blockchain's broad appeal is its ability to inspire confidence in the security of any trade of digital assets — and not just for cryptocurrencies but for anything represented in digital form that has intrinsic or acquired value. These can be digital representations of land, commodities or fiat currency; tokenized debt or equity; or financial instruments or derivatives, with dozens more possibilities on the horizon. The potential is huge in such areas as title documents, patient data, intellectual property and product traceability.

Where there's trust, trade inevitably follows

In the financial world, we're already seeing a significant adoption of blockchain. For instance, a group of large banks including Citi, Standard Chartered, HSBC, BNP Paribas and ING are using Contour's DLT platform to shrink processing time for trade letters of credit from 5 to 10 days to less than 24 hours.

Global financial messenger SWIFT is talking about deploying DLT-based services for its 11,000+ members. SWIFT cites five benefits: trust in a disseminated system, efficiency in sharing information, complete traceability of transactions, simplified reconciliation, and high resiliency. However, it also notes opportunities for improvement in data controls, standardization, identity management and cybersecurity, among others.

Other large organizations currently share the same mix of enthusiasm and reservations. But there's no reason concerns can't be addressed by technological improvements and regulatory solutions. And that's already happening.

Building an international regulatory framework

In a Guidance document issued in 2019, the Financial Action Task Force (FATF) clarified how its rules regarding Money Laundering and Terrorism Financing (ML/TF) should apply to "virtual asset service providers". They included recommendations for monitoring, licensing, customer due diligence, recordkeeping and suspicious transaction reporting. "While virtual asset activities may serve as another mechanism for the illegal transfer of value or funds, countries should not necessarily categorize [them] as inherently high ML/TF risks", the Guidance document read.

As the main standard-setting body in the fight against financial crime, not only has the FATF never advocated for prohibition of any DLT technology, but it has issued clear guidance on what national jurisdictions could do to address potential risk.

In Vanuatu, plenty of prudence but little progress

As all this suggests, we're at a tipping point and it's clearly a matter of time before blockchain gets broad traction around the world. Indeed, jurisdictions that resist the trend may risk their future viability as financial centres.

Vanuatu has not evolved on this issue for some time now. In the fall of 2017, the Reserve Bank of Vanuatu (RBV) "strongly advised" against using cryptocurrencies and deemed them "illegal" in Vanuatu under the RBV act. The Vanuatu Financial Intelligence Unit (VFIU) echoed that statement, adding that a regulatory framework needed to be put in place before the nation embraced digital currency transactions. Under the advice of the Council of Ministers, the Minister of Finance instructed the Vanuatu Financial Services Commission (VFSC) to suspend the granting of Financial Dealer Licenses for blockchain and cryptocurrency dealing and appointed a task force with representatives from the RBC, VFSC and other specialists in the field to work on a "proper legal framework".

Almost two years in, we've seen negligible progress on this front.

Others are taking the lead

In the meantime, other jurisdictions have charted new territory in innovative regulatory frameworks that seek to ensure proper oversight and control of the trade in digital assets. Over the past three years alone:

2017

- **Gibraltar** introduces the Distributed Ledger Technology Regulatory Framework, placing cryptocurrencies under the supervision of the Gibraltar Financial Services Commission. Gibraltar now bills itself as the first regulator to do so.

- **Australia** recognizes cryptocurrencies as a type of property and places digital asset exchanges under supervision of the Australian Transaction Reports and Analysis Centre (AUSTRAC), a government body charged with monitoring their compliance with the country's Anti-ML/TF regulations.

2018

- **The European Commission** includes virtual asset providers in its Fifth Anti Money Laundering and Terrorist Financing Directive, making them "obliged entities" under Anti-ML/TF regulations. All countries in the European Economic Area fall under this directive, which allows for these types of businesses to operate while properly managing risk.

- **Thailand** passes the Digital Asset Decree of 2018, establishing the necessary requirements for a business to offer or provide operations for digital assets. The Decree covers cryptocurrencies as well as digital tokens and is overseen by the Securities and Exchange Commission. Three types of licenses are available for Digital Asset Exchange, Digital Asset Brokers, and Digital Asset Dealers.

- **Malta** declares itself “Blockchain Island” as it opens international applications for Virtual Financial Asset Service provider licenses. Strict government oversight of the location and traceability of involved parties helps reduce the risk of fraud. Malta modeled this approach on its experience with online gambling, where the government had to tighten regulation following early missteps.

2019

- **Singapore** passes the Payment Services Act, expanding the regulatory scope of the Monetary Authority to include the offer or issue of digital tokens falling within the definition of “securities”.

- **Hong Kong**’s Securities and Futures Commission advises operators that digital tokens are considered securities, and any person who markets and distributes them to Hong Kong investors is required to be licensed or registered for Type 1 regulated activity (Dealing in securities) under the Securities & Futures Ordinance (SFO).

2020

- **Vanuatu** has yet to report any progress.

The time to act is now

As shown above, momentum is building and Vanuatu cannot afford to sit on the sidelines. What's more, online trading is one of the few sectors where Vanuatu can still grow its services economy, foreign currency inflows, and overall GDP, especially as Covid-19 has gutted our tourism sector for the foreseeable future.

We all know that for every new business that sets up in Vanuatu, countless jobs are created and sustained through demand for professional services such as accountants, lawyers, IT and real estate. All of which further stimulates the circulation of money.

But why look overseas for examples of DLT’s potential benefits? Last year, Oxfam's pilot program used cryptocurrency for disaster relief in two Efate villages. So once again, DLT or blockchain is much more than cryptocurrencies. It can make processes more efficient and secure in many areas of society, from healthcare to environment, transport to education.

How to address Anti-ML/TF regulation concerns

There's certainly a lot of media hype surrounding blockchain, and much of it should definitely be taken with a grain of salt. But as Deloitte's 2020 Blockchain Survey suggests (see above), the growing interest in DLT from businesses around the world is real. What's more, it could translate into market share for Vanuatu. The trend in jurisdictions around the world are clear indicators that regulating blockchain, including cryptocurrencies dealing, is in our national economic interest.

Some, like Malta, have issued convoluted state-of-the-art regulations that have notably failed to attract much investment. But most simply adjusted their current legal systems, especially their Anti-ML/TF regulations, to clarify the status of blockchain services, with an emphasis on the registration and monitoring of digital asset service providers.

Vanuatu's legislation can be amended to ensure such businesses conduct activities in accordance with our Anti-ML/TF objectives and subject to the same oversight as all other "reporting entities" under the legislation. And it could even be done with advice from FATF and the EU to ensure stronger alignment.

Getting our feet wet

There are low-risk and cost-effective ways for Vanuatu to make inroads in DLT, such as restricting the trade of digital assets to FDL platforms. This would mitigate risk while providing a sandbox for the Vanuatu fintech industry to develop and innovate, giving our authorities time to adapt current regulations for the coming "token economy".

Whatever avenue we choose, it's fair to say that maintaining a moratorium on cryptocurrencies and similar assets is not sustainable — not when these technologies are going mainstream worldwide. It's time for Vanuatu to look at blockchain from a fresh perspective. Perhaps it's even time not just to get our feet wet but to actually take the plunge. Our future financial health may hang in the balance.