

GUIDELINES ON CORPORATE GOVERNANCE FOR LABUAN BANKS AND LABUAN (RE)INSURERS

1.0 Introduction

- 1.1 The adoption of sound corporate governance standards and practices by the Labuan financial institutions (LFIs) serves to protect the critical role of the LFIs in supporting economic efficiency, sustainable growth and financial stability. It ensures that the LFIs are managed in a sound and prudent manner with due regard to the interests of the stakeholders.
- 1.2 The increasingly complex business environment resulting from globalisation, innovation in financial products and technological advances has intensified risk in the financial sectors. Against this backdrop, effective corporate governance plays a critical role in ensuring the business of LFIs continues to be managed in controlled and prudent manners. The LFI's corporate governance arrangements represent a fundamental component of Labuan FSA's supervisory assessments in determining the level of supervisory intensity applied to an LFI. The board should have the competence, confidence and objectivity to challenge senior management and hold it to account. Accordingly, the Guidelines sets out strengthened expectations on directors' oversight responsibilities and the composition of the board. Labuan FSA will expect to see evidence of effective challenge by the board, particularly in relation to key strategic decisions. In turn, senior management is responsible and accountable for the sound and prudent day-to-day management of the LFI in accordance with the direction of the board.
- 1.3 Good corporate governance also needs to be rooted in a corporate culture that reinforces ethical, prudent and professional behaviour. This begins with the right "tone from the top", where the example set by the board and senior management shapes the core values for the LFI.

1.4 Labuan FSA expects the LFIs to implement the minimum standards set out in the Guidelines on Corporate Governance for Labuan Banks and Labuan (Re)Insurers (Guidelines) and demonstrate that their governance arrangements are operating effectively and remain appropriate given their size, nature of business, complexity of activities, structure and systemic importance. LFIs should also strive to continuously enhance these arrangements to reflect changing conditions and emerging sound practices, as appropriate. Notwithstanding this, LFIs are encouraged to observe higher regulatory and prudential standards and ensure that the observed standards are in line with internationally accepted standards and best practices.

2.0 Applicability

2.1 The Guidelines is applicable to the following LFIs:

- (i) Labuan banks and investment banks licensed under Part VI of the Labuan Financial Services and Securities Act 2010 (LFSSA);
- (ii) Labuan Islamic banks and Islamic investment banks licensed under Part VI of the Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA);
- (iii) Labuan insurers and reinsurers licensed under Part VII of the LFSSA, excluding Labuan captive business; and
- (iv) Labuan takaful and retakaful operators licensed under Part VII of the LIFSSA, excluding Labuan captive takaful business.

2.2 For LFI operating as a branch, the requirements in the Guidelines shall also apply in subject to the following modifications:

- (i) parts I, V and VI are not applicable for branch set-up;
- (ii) parts III and IV are allowed to be leveraged on to the practices of their group/parent;

- (iii) save for paragraph 2.2(i) above, any reference to the board mentioned in the Guidelines should refer to the LFI's regional/head office or an equivalent person, whichever is relevant; and
- (iv) any reference to senior management in the Guidelines should refer to the Principal Officer (PO) of the branch or any officer performing a senior management function in respect of the branch operations.

2.3 The Guidelines should be read together with the following guidelines:

- (i) Guidelines on Fit and Proper Person Requirements;
- (ii) Guidelines on Compliance Function for Labuan Licensed Entities;
- (iii) Guidelines on Shariah Governance for Labuan Islamic Financial Institutions;
- (iv) Guidelines on Minimum Audit Standards for Internal Auditors of Labuan Banks;
- (v) Guidelines on Minimum Audit Standards for Internal Auditors of Labuan Insurance and Insurance-Related Companies;
- (vi) Guidelines on External Auditor of Labuan Financial Institutions;
- (vii) Guidelines on Market Conduct for Labuan Insurance and Insurance-Related Companies;
- (viii) Guidelines on AMLCFT – Banking Sector; and
- (ix) Guidelines on AMLCFT - Insurance and Takaful Sector.

2.4 Effective from 1 January 2020, the following guidelines shall no longer be applicable to the LFIs as listed under paragraph 2.1(i) to 2.1(iv):

- (i) Prudential Framework of Corporate Governance for Labuan Insurance and Insurance-Related Companies dated 26 January 2007; and
- (ii) Guidelines on Corporate Governance for Labuan Banks dated 3 November 2008.

- 2.5 Notwithstanding the above, for clarity purposes, the Prudential Framework of Corporate Governance for Labuan Insurance and Insurance-Related Companies dated 26 January 2007 shall remain in force for the following LFIs:
- (i) Labuan captive insurer licensed under Part VII of the LFSSA and Part VII of the LIFSSA; and
 - (ii) Labuan insurance-related companies licensed under Part VII of the LFSSA and Part VII of the LIFSSA.

3.0 Legal Provision

- 3.1 The Guidelines is issued pursuant to Section 4A of the Labuan Financial Services Authority Act 1996 (LFSAA) to clarify the minimum prudential standards to be observed by LFIs.
- 3.2 Any person who fails to comply with the Guidelines commits an offence upon which Labuan FSA may undertake appropriate enforcement action to the extent provided by the law.

4.0 Effective Date

- 4.1 The Guidelines shall come into effect on 1 January 2020 and would remain effective and applicable unless amended or revoked.
- 4.2 The guidelines provided under paragraph 2.4 shall continue to be applicable until the effective date of the Guidelines.

PART I: THE BOARD

5.0 Board Responsibility

- 5.1 The board must have a board charter that sets out the mandate, responsibilities and procedures of the board and the board committees, including the matters reserved for the board's decision.
- 5.2 The board has the overall responsibility for promoting the sustainable growth and financial soundness of the LFI, and for ensuring reasonable standards of fair dealing without undue influence from any party. This includes a consideration of the long-term implications of the board's decisions on the LFI and its clients, officers and the general public. In fulfilling this role, the board must:
- (i) approve the risk appetite, business plans, corporate policies, outsourcing policies, audit plan and other initiatives which would, singularly or cumulatively, have a material impact on the LFI's risk profile and functions¹;
 - (ii) oversee the selection, performance, remuneration and succession plans of the PO, control function heads and other members of senior management, such that the board is satisfied with the collective competence of senior management to effectively lead the operations of the LFI;
 - (iii) oversee the implementation of the LFI's governance framework and internal control framework to ensure on-going effectiveness vis-à-vis the LFI's operations;
 - (iv) assess and approve the related-party transactions that are material in nature and to ensure that these transactions are done in accordance to arm's length approach;
 - (v) promote a sound corporate culture within the LFI which reinforces ethical, prudent and professional behaviour;

¹ These include initiatives which affect the financial soundness, reputation or key operational controls of the LFI.

- (vi) promote sustainability through appropriate environmental, social and governance considerations in the LFI's business strategies;
- (vii) oversee and approve business continuity plans for the LFI to restore its financial strength, and maintain or preserve critical operations and critical services in a distressed situation;
- (viii) promote timely and effective communication between the LFI and Labuan FSA on matters affecting or that may affect the safety and soundness of the LFI;
- (ix) establish the responsibilities and balance of power and authority of committees of the board and of the senior management, as well as accountability requirement for them so that no individual has unfettered powers of decision;
- (x) ensure a documented and well-communicated organisational structure that clearly shows lines of reporting, responsibilities and authority; and
- (xi) ensure that the senior management provides adequate and timely information relating to the activities of the LFI including immediate action(s) taken to address any material internal control deficiencies or breaches with proper monitoring and reporting on the progress made to address such deficiencies.

5.3 For the board of the LFI that carries on any Islamic financial business, the overall responsibilities outlined in paragraph 5.2 includes the responsibility to uphold Shariah compliance in accordance with expectations set out in the Guidelines on Shariah Governance for Labuan Islamic Financial Institutions issued by Labuan FSA and ensure its integration with the LFI's business and risk strategies. In this respect, the board must clearly define its relationship with the LFI's Shariah Committee. While the Shariah Committee has distinct responsibilities in relation to Shariah matters, the board remains responsible for the overall direction and control of the LFI's business and risk strategies.

6.0 Board Meetings

- 6.1 The chairman, if so elected in leading the board, is responsible for the effective overall functioning of the board. In fulfilling this role, the chairman must:
- (i) ensure that appropriate procedures are in place to govern the board's operation;
 - (ii) ensure that decisions are taken on a sound and well-informed basis, including by ensuring that all strategic and critical issues are considered by the board, and that directors receive the relevant information on a timely basis;
 - (iii) encourage healthy discussion and ensure that dissenting views can be freely expressed and discussed; and
 - (iv) lead efforts to address the board's developmental needs.
- 6.2 A director must devote sufficient time to prepare for and attend board meetings, and maintain a sound understanding of the business of the LFI including a commitment to an on-going education to keep abreast with the relevant market and regulatory developments relating to the LFI's business.
- 6.3 The board should meet regularly with appropriate notice and agenda prior to the meeting. Acknowledging the importance for the LFIs to have regular board meetings, these meetings need to be conducted physically and can be complemented by virtual means. It is expected that at least two board meetings would be held in Labuan with the majority of the board are physically present in the island. In this regard, the remaining directors may join the board meeting via tele-conferencing or video-conferencing. It is expected that appropriate safeguards are being undertaken for meetings that are fully conducted in virtual means to preserve the confidentiality of the deliberations.

- 6.4 An alternate director is allowed to attend or participate in a board meeting on behalf of the principal director. This permissibility is subject to the condition that the principal director shall be accountable for any decisions made by the alternate director, and that the duties and liabilities of the alternate director shall be identical to that of the principal director.
- 6.5 The directors (other than alternate directors) must attend at least half of the board meetings held in each financial year.
- 6.6 In respect of the quorum for board meetings, the LFI must require at least half of the board members to be present.
- 6.7 The board must ensure that clear and accurate minutes of board meetings are maintained to record the decisions of the board, including the key deliberations, rationale for each decision made and any significant concerns or dissenting views. The minutes must also indicate whether any director has abstained from voting or excused himself from deliberating on a particular matter.
- 6.8 The LFI must provide the board with access to advice from third party experts on any matter deliberated by the board as and when required.

7.0 Board Appointments and Removals

- 7.1 A director and/or alternate director shall meet the fit and proper requirements and fulfil the minimum requirement set out in paragraph 7.2 at the time of his appointment and on a continuous basis.
- 7.2 A director is expected not to have competing time commitments that impair his ability to discharge his duties effectively. The board must maintain a policy on the maximum number of external professional commitments that a director may have so as to commensurate with the responsibilities placed on the director concerned taking into account the nature, scale and complexity of the LFI's operations. In addition, a director should also avoid any potential conflict of interests that may affect his independency.

- 7.3 At least one member of the board of the LFI should be qualified or experienced in the industry. LFI should also develop a program to familiarise a new director with the industry (including relevant legal and regulatory requirements) and the company. On an on-going basis, LFI should notify and discuss with the board of all new regulatory requirements introduced via guidelines and circulars issued by Labuan FSA which are relevant to the LFI on a timely manner.
- 7.4 The board must establish and timely review succession plans for the board to promote board renewal and address any vacancies.
- 7.5 The board must establish a process for the appointment and removal of directors including an assessment of candidates against the minimum requirement as set out in paragraph 7.2 at a frequency that is practicable to the LFI or as and when the board becomes aware of any information that may materially affect the director's fitness and propriety, or any circumstance(s) that suggests that the director is ineffective, errant or otherwise unsuited to carry out his responsibilities. A director must immediately disclose to the board any circumstance(s) that may affect his ability to meet the minimum requirement.
- 7.6 It is expected that each director acknowledges the terms of his appointment, which should include:
- (i) the roles and responsibilities of the director, including those arising from his membership in any board committee;
 - (ii) the tenure of the appointment; and
 - (iii) provisions for the director's removal in the event that he no longer meets the minimum requirement set out in paragraph 7.2, or has been assessed to be ineffective, errant or otherwise unsuited to carry out his responsibilities.
- 7.7 LFI must not make an application to Labuan FSA to appoint a director unless the board is satisfied, based on its objective assessment, that the candidate meets the minimum requirement set out in paragraph 7.2, understands the expectations of the role and is able to meaningfully contribute to the board.

- 7.8 Once the approval on the appointment of director has been obtained:
- (i) the LFI may publicly announce the appointment of a director; and
 - (ii) a director whose tenure has expired and is being approved for reappointment may immediately assume office and act in such capacity.
- 7.9 In circumstances of the director's resignation and/or removal by the LFI, notification to Labuan FSA is to be made within 14 days from the date of the resignation and/or removal.
- 7.10 In situations where the director's role was left vacant, the LFI is required to identify his replacement, who is suitably qualified, and notify Labuan FSA within 30 days from the date of the vacancy.

8.0 Composition of the Board

- 8.1 The board and the board committees must be of a size that promotes effective deliberation and encourages the active participation of all directors.
- 8.2 The board must develop and document the criteria and skill sets required of its members, both individually and collectively. The criteria and skill sets must reflect the fit and proper requirements and specific market or business knowledge required on the board. It is important that the criteria and skill sets be reviewed regularly by the board to ensure alignment with the strategic direction and emerging challenges faced by the LFI. This must also take into account supervisory concerns highlighted by Labuan FSA that require specific expertise on the board.
- 8.3 The structure of the board will have the biggest influence on the way in which corporate governance will be practised by the LFIs. In this regard, the chairman of the board must be a non-executive director. In situation where the board of the LFI has two or more executive directors, the board must ensure that the additional appointment will not compromise the board's effectiveness, having regard to:
- (i) the extent of his involvement in making or implementing management

decisions that are subject to the board's oversight;

- (ii) the degree to which his incentives are influenced by the performance of the LFI;
 - (iii) the effectiveness of the non-executive directors in providing a counterbalance to the collective influence of executives on the board; and
 - (iv) the significance and uniqueness of the contribution that the candidate is expected to bring to the board.
- 8.4 Executive directors bring to the board technical expertise and useful insights about the LFI's operations. However, it is important that their representation on the board does not reduce the board's ability to objectively scrutinise the proposals and performance of senior management.
- 8.5 The composition of the board should be effective with strong independence element where decision making is not denominated by any individuals or group of individuals. For that purpose, the board must have a balance of executive directors and non-executive directors (including independent non-executive director²) at all times.
- 8.6 An individual would not be considered to be an independent director if he or any person linked to him:
- (i) has been an executive director in the last two years;
 - (ii) is a substantial shareholder of the LFI or any of its affiliates; or
 - (iii) has had a significant business or other contractual relationship with the LFI or any of its affiliates within the last two years.
- 8.7 While common directors on the board of the LFI and its affiliates can contribute to the group oversight and alignment, inordinate overlaps in board membership can raise conflicts, particularly where issues affect the LFI and its affiliates in different ways. To ensure that group interests are appropriately balanced against the

² Refers to a non-executive director who does not have any management responsibilities within the LFI and is not under any other undue influence, internal or external, political or ownership, that would impede the board member's exercise of objective judgment.

fiduciary and statutory duties that directors owe towards each legal entity they serve, directors who are board members of the LFI and its affiliates must remain in the minority of the LFI's board.

9.0 Board Committees

Audit Committee

- 9.1 In order to ensure strong and good quality governance practices, Labuan commercial banks and insurers which have public interests dealings, are required to establish an Audit Committee (AC). The AC would need to have written terms of reference that clearly sets out its roles and responsibilities. Notwithstanding this, other LFIs are also encouraged to establish an AC as a good governance platform to strengthen their internal audit function.
- 9.2 LFIs may leverage on the AC of their group/parent office by ensuring that the AC's deliberation at the group/parent office is transparent to the LFI's board at all times.
- 9.3 It is Labuan FSA's expectations that the AC established would:
- (i) not have any executive directors in its memberships;
 - (ii) be chaired by an independent director; and
 - (iii) comprise directors who have the skills, knowledge and experience relevant to the responsibilities of the board committee.
- 9.4 To promote robust and open deliberations by the board on matters referred by the AC, the chairman of the board must not chair the AC or any of the other board committees.
- 9.5 The AC must assume the specific responsibilities enumerated for it in Appendix 1.

Other Board Committees

- 9.6 Effective board committees are an integral part of the LFI's planning and overall operations. In this manner, the board may establish certain specialised board committees such as risk management committee, compensation committee, nominations committee, remuneration committee, compliance committee or other committees responsible for any specified aspects of business to ensure the effectiveness in executing its functions.
- 9.7 The board remains fully accountable for any authority delegated to the board committees. The board is required to ensure that the mandate and operating procedures for each board committee are set out in the board charter and clearly:
- (i) delineate the areas of authority delegated to the board committee; and
 - (ii) define reporting arrangements for keeping the board informed of the board committee's work, key deliberations and decisions on delegated matters.
- 9.8 The LFI is expected to provide the board committees with sufficient support and resources required to investigate any matter within their mandates.

10.0 Board Evaluations and Development

- 10.1 The board is expected to periodically evaluate the effectiveness of the overall board, its board committee(s) and individual directors. This is important to enable the board to identify areas for professional development and process improvements, having regard to the changing needs of the LFI.

11.0 Conflict of Interests

- 11.1 The board is required to establish a written policy to address directors' actual and potential conflict of interests. At a minimum, the policy must:
- (i) identify circumstances which constitute or may give rise to conflicts of interests;
 - (ii) clearly define the process for directors to keep the board informed on any change in his circumstances that may give rise to a conflict of interest;

- (iii) maintain updated records on each director's conflicts of interest; and
 - (iv) articulate how any non-compliance with the policy will be addressed.
- 11.2 A director is expected to disclose to the board the nature and extent of his interest in a material transaction or material arrangement, and if such material transaction or material arrangement is being deliberated during a board meeting, to be abstained from making decisions at such deliberations.

PART II: SENIOR MANAGEMENT³

12.0 Key Responsibilities

- 12.1 The PO⁴, in leading the senior management, bears primary responsibility over the day-to-day management of the LFI. The responsibilities of senior management include:
- (i) implementing the business and risk strategies, remuneration and other policies in accordance with the direction given by the board;
 - (ii) identifying the principle of risks to which the LFI is or will be exposed, whether on- or off-balance sheet in conducting its current and planned operations and measuring those risks on an aggregate basis;
 - (iii) developing appropriate and prudent risk management policies including policies on aggregate exposure limits and ensuring that the day-to-day business affairs of the LFI are effectively managed;

³ An "officer" as defined in LFSSA and LIFSSA, where applicable, includes a PO; or any person performing a senior management function who are principally accountable for:

- (i) Making decisions that affect the whole, or a substantial part of, the LFI's business;
- (ii) Implementing and enforcing policies and strategies approved by the board including Head of Department or any equivalent designated person; or
- (iii) Internal controls and processes of the LFI (includes a compliance officer, designated compliance officer, shariah adviser, member of Internal Shariah Advisory Board, chief internal auditor, appointed actuary and head of risk management).

⁴ The officer that is ultimately responsible for managing the overall affairs of the LFI and is equivalent to the role of a Chief Executive Officer (CEO).

- (iv) establishing a management structure that promotes accountability and transparency throughout the LFI's operations, and preserves the effectiveness and independence of control functions;
- (v) reviewing the LFI's risk management and internal control policies regularly to ensure that they remain appropriate, relevant and prudent;
- (vi) promoting together with the board, a sound corporate culture within the LFI which reinforces ethical, prudent and professional behaviour;
- (vii) addressing actual or suspected breaches of regulatory requirements or internal policies in a timely and appropriate manner; and
- (viii) updating the board with the material information the board needs to carry out its oversight responsibilities on regular basis, particularly on matters relating to:
 - a) the performance, financial condition and operating environment of the LFI;
 - b) internal control failures, including breaches of risk limits;
 - c) legal and regulatory obligations, including supervisory concerns and the remedial actions taken to address them; and
 - d) the implementation of overall corporate governance practices.

13.0 Senior Management Appointments and Removals

13.1 A member of senior management shall meet the fit and proper requirements and fulfil the minimum requirements set out in paragraphs 13.2 to 13.3 at the time of his appointment and on a continuous basis.

13.2 A member of senior management is expected not to have competing time commitments that impair his ability to discharge his duties effectively. The senior management must maintain a policy on the maximum number of external professional commitments that a senior management may have so as to commensurate with the responsibilities placed on the member concerned taking into account the nature, scale and complexity of the LFI's operations.

- 13.3 A PO is required to devote adequate and appropriate professional time to the service of the LFI unless Labuan FSA approves otherwise in writing^{5,6}. Labuan FSA may allow a PO to assume a position of responsibility outside of the LFI if the proposed position does not:
- (i) create substantial conflicts of interest⁷ or demands on the PO's professional time;
 - (ii) infringe on his ability to carry out his duties; and
 - (iii) result in the PO holding directorships in more than five entities other than the LFI.
- 13.4 The LFI must have a robust succession plan for senior management and clearly defined processes for:
- (i) the appointment and removal of the PO and senior officers; and
 - (ii) assessment of the candidates against the minimum requirements set out in paragraphs 13.2 to 13.3.
- 13.5 Each member of senior management must be assessed against the relevant minimum requirements set out in paragraphs 13.2 to 13.3 at a frequency that is practicable to the LFI or as and when the board becomes aware of information that may materially compromise the individual's fitness and propriety, or any circumstance that suggests that the individual is ineffective, errant or otherwise unsuited to carry out his responsibilities. It is the responsibility of each member of senior management to immediately disclose to the board any circumstance that may affect his ability to meet the minimum requirements.

⁵ Labuan FSA's approval is not required for a PO to hold a non-executive position in a professional body, industry association, statutory body, charitable body or other non-commercial public-interest entity, unless Labuan FSA specifies otherwise.

⁶ For avoidance of doubt, any approval(s) granted prior to 1 January 2020 are deemed valid and approved.

⁷ A PO is expected to have no direct responsibility on any written arrangement made between the LFI and other related party or a third party unless prior written approval from Labuan FSA has been obtained.

- 13.6 The LFI must not make an application to Labuan FSA to appoint or reappoint the PO unless the board is satisfied, based on its objective assessment, that the candidate meets the minimum requirements set out in paragraphs 13.2 to 13.3.
- 13.7 Once the approval on the appointment of PO has been obtained:
- (i) the LFI may publicly announce the appointment of the PO; and
 - (ii) a PO whose tenure has expired and is being approved for reappointment may immediately assume office and act in such a capacity.
- 13.8 In circumstances of the PO's resignation and/or removal by the LFI, notification to Labuan FSA is to be made within 14 days from the date of the resignation and/or removal.
- 13.9 In situations where the PO's role was left vacant, the LFI is required to identify his replacement, who is suitably qualified, and notify Labuan FSA within 30 days from the date of the vacancy.

PART III: CULTURE AND REMUNERATION

14.0 Culture

- 14.1 LFI must adopt a code of ethics⁸ which provides guidelines on appropriate conduct and addresses issues of confidentiality, conflicts of interest, integrity in reporting, and the fair treatment of clients. LFI is expected to maintain a record of breaches of the code of ethics and address such breaches in a manner that upholds high standards of integrity.

⁸ In establishing the code of ethics, the LFI should consider established professional and ethical standards recommended by standard-setting bodies such as that issued by the Financial Services Professional Board.

- 14.2 LFI must establish a whistleblowing policy that sets out avenues for legitimate concerns to be objectively investigated and addressed. Individuals must be able to raise concerns about illegal, unethical or questionable practices in confidence and without the risk of reprisal. In meeting this expectation, the LFI must:
- (i) clearly indicate the parties to whom concerns can be escalated within the LFI;
 - (ii) ensure that individuals are made aware of other avenues for whistleblowing to regulators or law enforcement agencies;
 - (iii) communicate the whistleblowing policy to third parties such as contractors, consultants and interns and allow them to report their concerns; and
 - (iv) designate a non-executive director to be responsible for the effective implementation of the policy⁹.

15.0 Remuneration

- 15.1 Remuneration systems form a key component of the governance and incentive structure through which the board and senior management drive performance, convey acceptable risk taking behaviour and reinforce the LFI's corporate and risk culture.
- 15.2 The remuneration policy of the LFI must be approved by the board, and be subject to periodic board review, including when material changes are made to the policy.
- 15.3 The remuneration for each director and member of senior management must be approved by the board annually.
- 15.4 The remuneration structure should be in line with the business and risk strategy, objectives, values and long-term interests of the LFI. It should also incorporate measures to prevent conflicts of interest. Remuneration programmes should encourage a sound risk culture in which risk-taking behaviour is appropriate and

⁹ This includes evaluating periodic reports that monitor and assess how concerns are escalated and dealt with, and overseeing periodic reviews of the effectiveness of the whistleblowing policy.

which encourages employees to act in the interest of the company as a whole rather than for themselves or only their business lines. In particular, incentives embedded within remuneration structures should not incentivise staff to take excessive risk.

- 15.5 Remuneration should reflect risk-taking and risk outcomes. Practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain should be carefully evaluated by means of both qualitative and quantitative key indicators. The remuneration framework should provide for variable remuneration to be adjusted to take into account the full range of risks, including breaches of risk appetite limits, internal procedures or legal requirements.

PART IV: RISK MANAGEMENT AND INTERNAL CONTROLS

16.0 Risk Management and Internal Controls

- 16.1 The board is responsible for the governance of risk. The board should ensure that the LFI maintains a sound system of risk management and internal controls to safeguard shareholders' interests and the LFI's assets, and should determine the nature and extent of the significant risks which the board is willing to take in achieving its strategic objectives.
- 16.2 The board should determine the LFI's levels of risk tolerance and risk policies, and oversee the LFI in the design, implementation and monitoring of the risk management and internal control systems.
- 16.3 The board should, at least annually, review the adequacy and effectiveness of the company's risk management and internal control systems, including financial, operational, compliance and information technology controls. Such review can be carried out internally or with the assistance of any competent third parties.
- 16.4 The degree of sophistication of the LFI's risk management infrastructure shall include in particular, a sufficiently robust data infrastructure, data architecture and information technology infrastructure which keep in pace with developments

such as balance sheet and revenue growth, increasing complexity of the LFI's business, risk configuration or operating structure, geographical expansion, mergers and acquisitions, or the introduction of new products or business lines.

17.0 Cyber Risk Management

17.1 Cyber risk is now a major threat to business operations of the LFI as well as the stability of the financial system. As part of the overall corporate governance framework and in furtherance of the safe and sound operation of the LFI, the board must ensure that the LFI have in place clear and comprehensive cyber security policies and procedures, which commensurate with its risk profile.

17.2 Such policies and procedures must among others include the following:

- (i) Clear description of the risk management policy in relation to cyber risk that is acceptable to the LFI such as, occurrence and severity of cyber breaches, the maximum service downtime, recovery time objectives, minimum level of system and services availability, potential negative media publicity, potential regulatory and financial impact or a combination of other measures;
- (ii) Strategy and measures to manage cyber risk encompassing prevention, detection and recovery from a cyber breach;
- (iii) Roles, responsibilities and lines of accountabilities of the board, the board committee, responsible person and key personnel involved in functions relating to the management of cyber risk (such as information technology and security, business units and operations, risk management, business continuity management and internal audit);
- (iv) Processes and procedures for the identification, detection, assessment, prioritisation, containment, response to, and escalation of cyber breaches for decision-making;
- (v) Processes and procedures for the management of information technology's outsourcing arrangement, system development and maintenance arrangements with third-party service providers, including requirements for

such third-party service providers to comply with the LFI's risk management policy; and

- (vi) Communication procedures that will be activated by the LFI in the event of a cyber security breach, which include reporting procedures, information to be reported, communication channels, list of internal and external stakeholders and communication timeline.

PART V: GROUP GOVERNANCE

18.0 Adherence to Group Governance and Policies

18.1 LFI must discharge its own legal and governance responsibilities as a separate entity, even if it is a subsidiary of another financial institution or of a foreign entity which is subject to prudential regulation. Accordingly, the board and senior management of the LFI must:

- (i) validate that the objectives, strategies, plans, governance framework and other policies set at the group level are fully consistent with the regulatory obligations and the prudential management of the LFI and ensure that entity-specific risks are adequately addressed in the implementation of group-wide policies; and
- (ii) in the case of locally-incorporated foreign financial institutions, ensure timely engagement with Labuan FSA on strategic and regulatory developments at the group level that may significantly impact the Malaysian operations of the LFI.

18.2 Requirements as prescribed under this part are not applicable to LFIs operating as branches.

PART VI: TRANSPARENCY

19.0 Corporate Governance Disclosures

- 19.1 LFI must disclose information on its corporate governance policies and practices relating to the composition, function and conduct of the LFI's board, as and when there are changes.
- 19.2 LFI will be deemed to have complied with paragraph 19.1 to the extent that it has disclosed the information required in that paragraph in accordance with other laws or legal requirements.
- 19.3 The board must ensure that the corporate governance disclosures are accurate, clear and presented in a manner that is easily understood by its shareholders, clients and other relevant stakeholders as well as easy access of the information to make a well informed decision. The public disclosure is desirable via the LFI's website, in its annual and periodic financial reports, or by other appropriate means that accessible by the public.
- 19.4 Requirements as prescribed under this part are not applicable to LFIs operating as branches.

PART VII: SUBMISSION OF APPLICATION

20.0 Submission of Application

20.1 For the purpose of approval and/or notification to Labuan FSA as required under paragraphs 7.9, 7.10, 13.8 and 13.9, the submission shall be made to Labuan FSA at the following address:

Head of Business Operations Unit
Labuan Financial Services Authority
Level 17, Main Office Tower
Financial Park Complex
87000 Federal Territory of Labuan, Malaysia

Telephone no.: 087 591 200
Facsimile no.: 087 453 442 / 413 328
Email: bou@labuanfsa.gov.my

Labuan Financial Services Authority
30 July 2018 (Revised)
26 January 2007¹⁰ & 3 November 2008¹¹ (1st Issuance)

¹⁰ Issuance of the Prudential Framework of Corporate Governance for Labuan Insurance and Insurance-Related Companies.

¹¹ Issuance of the Guidelines on Corporate Governance for Labuan Banks.

APPENDIX 1 BOARD AUDIT COMMITTEE RESPONSIBILITIES

1. Support the board in ensuring that there is a reliable and transparent financial reporting process within the LFI.
2. Oversee the effectiveness of the internal audit function of the LFI. At a minimum, this must include:
 - (i) reviewing and approving the audit scope, procedures and frequency;
 - (ii) reviewing key audit reports and ensuring that senior management is taking necessary corrective actions in a timely manner to address control weaknesses, non-compliance with laws, regulatory requirements, policies and other problems identified by the internal audit and other control functions;
 - (iii) noting significant disagreements between the chief internal auditor and the rest of the senior management team, irrespective of whether these have been resolved, in order to identify any impact the disagreements may have on the audit process or findings; and
 - (iv) establishing a mechanism to assess the performance and effectiveness of the internal audit function.
3. Foster a quality audit of the LFI by exercising oversight over the external auditor, in accordance with the expectations set out in the *Guidelines on External Auditor of Labuan Financial Institutions*. At a minimum, this must include:
 - (i) making recommendations to the board on the appointment, removal and remuneration of the external auditor;
 - (ii) monitoring and assessing the independence of the external auditor including by approving the provision of non-audit services by the external auditor;
 - (iii) monitoring and assessing the effectiveness of the external audit, including by meeting with the external auditor without the presence of senior management at least annually;

- (iv) maintaining regular, timely, open and honest communication with the external auditor, and requiring the external auditor to report to the board audit committee on significant matters; and
 - (v) ensuring that senior management is taking necessary corrective actions in a timely manner to address external audit findings and recommendations.
4. Review and update the board on all related party transactions.
 5. Review the accuracy and adequacy of the chairman's statement in the directors' report, corporate governance disclosures, interim financial reports and preliminary announcements in relation to the preparation of financial statements.
 6. Monitor compliance with the board's conflicts of interest policy described in paragraph 11.1.
 7. Review third-party opinions on the design and effectiveness of the LFI's international control framework.