

LABUAN DIGITAL BANKING FRAMEWORK

1.0 General

- 1.1 Technology-based innovations have rapidly increased within the financial sector which aim to deliver services more effectively and efficiently to a broader market reach. The accelerating demands towards multitude of convenient banking services have driven further innovation in banking industry to support the unserved and underserved wholesale market.
- 1.2 In support of this emerging trend to embrace innovation in Labuan International Business and Financial Centre (Labuan IBFC), Labuan Financial Services Authority (Labuan FSA) has developed a *Labuan Digital Banking Framework* (the Guidelines) for qualified applicants to offer Labuan banking businesses¹ which are conducted primarily or wholly through digital or other forms of electronic channels.
- 1.3 The Guidelines allows qualified corporation to conduct banking business via establishment of a digital bank in Labuan IBFC. The main aim is to attract qualified Fintech service providers that wish to undertake digital banking business to help spur the banking industry in Labuan IBFC in light of shifting customer's preference to online or digital channels.
- 1.4 Applicants that are eligible to conduct Labuan banking activities (including digital banking business) may submit their applications in accordance with the requirements of the existing *Guidelines on Entry Criteria for Labuan Bank*. However, for existing licensed Labuan banks that wish to undertake digital banking business are allowed to operate within the scope of their existing banking licence.
- 1.5 Meanwhile, for applicants that are eligible to apply for Labuan investment banking business, primarily or wholly through digital or other forms of electronic channels, may submit their applications in accordance with the *Guidelines on the Establishment of Labuan Investment Banking Business in Labuan IBFC*.
- 1.6 The licence application can be submitted under Section 88 of Labuan Financial Services and Securities Act 2010 (LFSSA) or Section 63 of Labuan Islamic Financial Services and Securities Act 2010 (LIFSSA).

¹ Refers to definitions of Labuan banking businesses under Section 86 of Labuan Financial Services and Securities Act 2010 including Labuan Islamic banking business under Section 60 of Labuan Islamic Financial Services and Securities Act 2010.

2.0 Legal Provision

- 2.1 The Guidelines is issued pursuant to Section 4A of the Labuan Financial Services Authority Act 1996 (LFSAA) to clarify the provisions of Part VI of LFSSA and Part VI of LIFSSA.
- 2.2 Any person who fails to comply with this Guidelines commits an offence and may be punishable under Sections 36B or 36G of LFSAA as the case may be. Labuan FSA may also undertake the appropriate enforcement action to the extent provided by the law.

3.0 Effective Date

- 3.1 The Guidelines shall come into effect immediately and would remain effective and applicable unless amended or revoked.

4.0 Eligibility

- 4.1 A corporation that:
 - (i) has strong financial resources and demonstrates ability to meet and maintain the applicable minimum paid-up capital requirement;
 - (ii) has credible and viable business plan which sets out the approach on how it intends to incorporate innovative use of technology for its operations to meet the proposed strategic business objectives; and
 - (iii) demonstrates the ability to conduct digital financial services, e-commerce and technological-driven business.

5.0 Capital

- 5.1 Maintain minimum capital that is unimpaired by losses of at least RM200 million or its equivalent in any foreign currency. Labuan FSA may exercise its discretion to require additional capital to commensurate with the business operations of the digital bank, taking into account the risk profiles as well as nature, scale, complexity and diversity of the business activities.
- 5.2 Place a non-interest bearing security deposit with Labuan FSA amounting to RM5 million or its equivalent in any foreign currency which is refundable after three years from the date of placement, subject to the assessment of the digital bank's performance over three years.

6.0 Banking System

- 6.1 Have an in-house core banking system that processes and records daily banking transactions in regard to the banking activities which may include, but not limited to, the following:
- (i) Digital corporate banking.
 - (ii) Customer onboarding.
 - (iii) Digital trade.
 - (iv) Digital loans origination.
 - (v) Watch banking / wearable tech.
 - (vi) Financial chatbot.
 - (vii) Mobile wallet.
 - (viii) Social banking.

7.0 Internal Controls and Risk Management

- 7.1 Ensure the policies and controls on technology-related areas, especially on information security, system resilience and business continuity management including IT governance, cybersecurity, online client on-boarding processes and systems are adequate.
- 7.2 Have adequate cyber risk management policy in relation to:
- (i) Occurrence and severity of cyber breaches including the maximum service downtime, recovery time objectives, contingency measures etc.;
 - (ii) Measures to manage cyber risk encompassing prevention, detection and recovery from a cyber breach;
 - (iii) Roles and responsibilities of key personnel and functions involved in cyber risk management; and
 - (iv) Processes and procedures for the Labuan digital bank's management response to cyber breach risk events (e.g. assessment, decision-making rectification, communication to stakeholders).

- 7.3 Establish procedures for regular review of its security and technology related arrangements to ensure that such arrangements remain appropriate having regard to the continuing developments in IT based on the cybersecurity risk profile.
- 7.4 Have robust Know-Your-Customer (KYC) including e-KYC framework which consist of proper customer due diligence and enhanced due diligence processes for onboarding clients and for transactional activities.

8.0 Market Conduct

8.1 Labuan digital bank is expected to adhere to the principles of good conduct as provided below:

(i) Integrity and Fair Dealing

Conduct its business with honesty, fairness, integrity and professionalism.

(ii) Skills, Care and Diligence

Act competently and diligently with regard to all dealings with its clients.

(iii) Handling of Confidential Information

Treat information relating to the deals transacted or being transacted as confidential and limit access to such information. Subject to applicable laws and regulations, confidential information may be disclosed where the disclosure is:

- (a) with the explicit permission from the parties involved; or
- (b) required by laws, a court of law or relevant supervisory authorities.

(iv) Professional Client Management

- (a) Act in the best interest of its clients and must not jeopardise or prejudice the clients' interest and ensure that client's asset is properly safeguard from any wrongful conversion or inappropriate use by any individual.
- (b) Any information provided to its clients must be fair, accurate and timely.

(v) Proper Disclosure Mechanism

Have in place adequate mechanism to properly disclose pertinent information to its clients including potential risks and chargeable fees taking into account the nature of the Labuan digital bank which predominantly has minimal face-to-face client dealings.

(vi) Dispute and Complaint Handling

Have in place adequate mechanism to handle client disputes or complaints that are appropriate to the nature, scale and complexity of the business. Details of the complaints, responses and actions taken must be recorded and maintained.

(vii) Conflict of interest

Efficiently manage conflict of interest which may rise in the course of the company carrying out its business. Such conflict must be managed in a timely manner.

9.0 Anti-Money Laundering and Countering the Financing of Terrorism

9.1 Have in place policies, controls and procedures to manage and mitigate Money Laundering/Terrorism Financing (ML/TF) risks that may arise from the digital banking activities.

9.2 Ensure that the infrastructure provided is effectively reliable to capture all digital transactions including:

- (i) Identifying and assessing the ML/TF risks that may arise in relation to the digital infrastructure. This includes, but not limited to the risks with regard to the development of new products, services, business practices, delivery mechanisms, adoption of new technologies and dealings with their counterparties (e.g. clients, liquidity provider);
- (ii) Effecting appropriate measures to manage and mitigate the risks; and
- (iii) Maintaining sufficient documentation of this risk management policy.

10.0 Exit Plan

10.1 Labuan digital bank is required to develop a credible exit plan to ensure that the bank is able to unwind its business operations voluntarily without any regulatory intervention and in an orderly manner without causing disruption to its customers and the financial system.

10.2 The exit plan should cover at least the following:

- (i) circumstances in which the plan will be triggered;
- (ii) the channels to be used to repay depositors;
- (iii) source of funding to make the payments; and
- (iv) communication strategy including the method and timeframe for communicating with relevant parties, e.g. Labuan FSA, customers and investors.

11.0 Other Requirements

11.1 Establish an operational office in Labuan to comply with LFSSA or LIFSSA.

11.2 Ensure that the persons in control, directors and officers are fit and proper.

11.3 Maintain adequate and proper records and books of accounts in Labuan and ensure that all its operations are conducted in, from or through the operational office in Labuan.

11.4 Indicate clearly the Labuan digital bank's names in all media being used for communication purposes.

11.5 Appoint an internal and external auditor to carry out an audit of its operations and accounts pursuant to Sections 173 and 174 of LFSSA and Sections 134 and 135 of LIFSSA, as the case may be.

11.6 Obtain prior approval from Labuan FSA on the following matters:

- (i) Change of name;
- (ii) Change of business plan;
- (iii) Change of ten per centum or more of the shareholding² of the bank;
- (iv) Appointment of its board of directors²;
- (v) Appointment of Principal Officer (PO). The appointment of PO is only valid for two (2) years or as may be determined by Labuan FSA. The Labuan digital bank may renew the appointment of the PO by submitting the renewal application one (1) month before the expiry date;

² For branch set-ups, only notification to Labuan FSA is required for the change of shareholding structure and appointment of its board of directors.

- (vi) Establishment of office outside Labuan including the acquisition of subsidiary and establishment of a marketing office or co-located office;
- (vii) Reduction of paid-up capital³; or
- (viii) Use of external service provider.

11.7 Notify Labuan FSA within 14 days pertaining to the following matters:

- (i) Resignation of directors and principal officer;
- (ii) Change of place of business or office in Labuan;
- (iii) Change to its constituent documents; or
- (iv) Significant event that affects its going concern or reputation.

11.8 Comply with substantial activity requirements in Labuan as prescribed under the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018 (Substance Regulation) and any amendments thereto.

11.9 Comply with the applicable laws, rules and regulations relevant to the Labuan digital banking business, including relevant guidelines issued by Labuan FSA as per the *Appendix* and other regulatory requirements of the jurisdictions where the Labuan digital bank is authorised to operate in, where applicable, at all times. In this regard, Labuan digital bank is expected to obtain the necessary approvals from the authorities in the markets it intends to operate in prior to commencing its business in those respective markets.

11.10 Comply with any other operational requirements as may be imposed by Labuan FSA from time to time.

Labuan Financial Services Authority

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³ Not tantamount to reduction of amount lower than the prescribed minimum paid-up capital requirement and/or higher capital as imposed/determined by Labuan FSA, during the licence granted.

List of Relevant Guidelines and Circulars

The following are the list of Guidelines/Directives/Circulars that are applicable to Labuan banks (including Islamic):

1. Guidelines on Fit and Proper Person Requirements;
2. Guidelines on Compliance Function for Labuan Licensed Entities;
3. Directive on Financial Reporting Standards for Labuan Financial Institutions;
4. Circular on Financial Reporting Standards for Labuan Financial Institutions;
5. Directive on Accounts and Record-Keeping Requirements for Labuan Entities;
6. Guidelines on External Auditor of Labuan Financial Institutions;
7. Guidelines on Shariah Governance for Labuan Islamic Financial Institutions;
8. Directive on Islamic Financial Business in Labuan IBFC;
9. Guidelines on Corporate Governance for Labuan Banks and Labuan (Re)Insurers;
10. Guidelines on Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) for Banking Sector;
11. Guidelines on the Establishment of Marketing Office;
12. Guideline on Co-location of Labuan Bank;
13. Banking Capital Adequacy Framework: Guidelines on Capital Components;
14. Banking Capital Adequacy Framework: Guidelines on Risk Weighted Assets;
15. Guidelines on Minimum Audit Standards for Internal Auditors of Labuan Banks;
16. Guidelines on Single Counterparty Exposure Limit for Labuan Banks;
17. Guidelines on Credit Transactions and Exposures with Connected Parties for Labuan Banks; and
18. Guidelines on Classification and Impairment Provisions for Loans/Financing for Labuan Banks.
19. Guidelines on External Service Arrangements for Labuan Financial Institutions.

Note: The above lists are not exhaustive and may be amended from time to time.