chapter eight

labuan international offshore financial centre

Background

Labuan was declared as an International Offshore Financial Centre (IOFC) in October 1990 to complement the activities of the domestic financial market in Kuala Lumpur, strengthen the contribution of financial services to Gross National Products of Malaysia as well as develop the island and areas within its vicinity.

Specifically designed legislation and regulations, primarily based on experiences of other IOFCs around the world, provide the framework for business in the IOFC.

Combined with a flexible and favourable tax treatment and low cost of setting up and operating in the IOFC, this framework has succeeded in attracting substantial numbers of international businesses to domicile in Labuan, including 60 world leading banks, 78 insurance and insurance-related companies, and 20 trust companies. These institutions conduct the core businesses of the IOFC.

Of significance is that the players in the IOFC come from a highly diversified country of origin, reflecting growing global awareness as well as recognition and acceptance of the IOFC as an attractive, viable and cost-efficient financial centre.

The IOFC operates in a rapidly changing and increasingly competitive marketplace. Its business environment and business rules of the game have continuously evolved to become more business friendly. With the rapid advancements in information technologies, business strategies are now changing and geographical location is no longer a major deciding factor.

The ability of the IOFC to remain competitive depends heavily on its innovative capability, efficiency and market orientation. The IOFC and its players must stay forward-looking and agile in the new financial climate as well as constantly promoting new business solutions and technologies such as efficient delivery channels. Of importance, to enhance the IOFC growth prospects, is the collaboration and smart partnership between the government and the private sector to drive this process.

While the IOFC's regulatory framework is favourable and market driven, it is balanced with prudential requirements in line with accepted international regulatory practices and standards. The regulatory regime places strong emphasis on the preservation of its reputation as a credible centre, free of undesirable activities.

In the early years of the IOFC, the strategic focus was on attracting the critical mass of core and top players that can provide services and products to investors investing in this region. The quality and reputation of the players have been instrumental in the shaping of an active and clean offshore industry in the IOFC. Having succeeded in this, the thrust is now to build on the strength and expertise of the existing players, and encourage proactive expansion of the scope and breadth of services and products in the IOFC.

The efforts to attract more players to the IOFC will continue. The increase in the number of players in addition to the banks, insurance companies, trust companies, Islamic institutions, are other support service providers such as legal and accounting firms. This is also important to generate further expansion in economic activity for the island. In attracting new players to the IOFC, target groups should be identified. The overall development of Labuan, however, cannot rely on just the offshore financial services industry. Labuan needs to develop other complementary industries such as tourism, manufacturing industries and education.

Vision and Objectives

The IOFC in the future is not only a centre that thrives on the offshore financial services, but also one, which is developed holistically to support the development of the island, and plays an effective complementary role to the domestic financial market. Several areas can be further developed in the IOFC. These include enhancing the Islamic banking business with the establishment of an international Islamic financial market as well as developing the banking and insurance sectors to become a significant regional hub while taking the lead in retakaful business. The recommendation to set up a financial exchange and electronic commerce facilities has now been implemented. Labuan is also now being promoted as a meeting and conference centre in addition to tourism to enhance the development of Labuan as an IOFC.

Recommendations

The ensuing recommendations are made in three main areas as follows:

i. Promote and diversify further the financial players and activities in the IOFC;

ii. Promote the development of Islamic banking and retakaful business; and

iii. Develop and strengthen the capital market, e-commerce and the ancillary activities.

I. Promote and Diversify Further the Financial Players and Activities in the IOFC

Recommendation 8.1:

Develop an active International Offshore Financial Centre for Malaysia

Malaysia needs an active offshore financial centre that is able to support the increasing demands of the domestic economy. Expansion of the local businesses abroad for instance requires a complete chain of financial services ranging from advice on the investee company, place of business to financing the project in foreign currency. Demands for assistance in arranging financial swaps and issuance of PDS are becoming more prevalent in the growing Malaysian economy. Offshore financial institutions also provide competition to the onshore banks. In this regard, the offshore financial institutions play an important complementary role in the Malaysian financial system. Measures to strengthen the position of the IOFC will continue to be taken as follows:

- Offshore banks and offshore insurance companies would continue to have the rights of first refusal to offshore business services required by Malaysian corporates, financial institutions and the Government. These entities on the other hand are expected to make their presence felt in the local industry by providing competitive and efficient services and products; and

- In managing the transition to greater international competition envisaged in the liberalisation of the Malaysian financial markets, priority will be accorded to international competitors who are based in Labuan and have the necessary skills, manpower and systems located in Malaysia. This will be done gradually, as has already taken place through the ringgit loan and investment windows that have been made available to Labuan offshore banks.

Recommendation 8.2:

Review existing rules and regulations to facilitate expansion in the scope of core businesses

New business should be explored and developed to widen the scope of offshore business in the IOFC. In this regard, a review will be made on the existing rules and regulations, which is deemed to impede the progress and further development of the offshore business. The legislation needs to be

reviewed to facilitate new businesses, and at the same time allow the offshore service providers to maximise their capabilities and expertise to expand their businesses. The areas that can be considered are:

- Incorporation or registration of various other types of offshore companies, which can be used for administrative and operational efficiency purposes, by both non-residents and residents. These include external companies– a company that is incorporated in one jurisdiction but carries on business in another jurisdiction, and managed foreign domiciled companies– the administration of companies that are registered outside the IOFC;
- The trust companies in the IOFC are domestic companies incorporated under the Companies Act 1965, and are subject to domestic rules and tax. The domicile status of Labuan trust companies needs to be changed to that of offshore companies to facilitate their dealings and to encourage foreign trust companies to be based in Labuan. An immediate impact from the increase in the number of trust companies to the local economy would be on employment given that trust companies are more labour-intensive than the other industries. In the interim, trust companies in Labuan are allowed to manage trust companies of other jurisdictions in order to expand the horizon of their business, as well as to maximise the available administrative skills and experience in Labuan;
- In the area of insurance, the IOFC can be developed as a centre for innovation of new and sophisticated insurance products and services. The policy direction for the future development of the offshore insurance industry includes developing the IOFC as an active reinsurance and captive centre, including rent-a-captive business. In this regard, the number of insurance companies, knowledge, skills and expertise needs to be enhanced;
- There is a need to rationalise the roles of offshore banks to fully complement their activities with that of the domestic financial market. The critical mass that has been attained in the offshore banking industry can be further enhanced through the entry of more banks, both conventional and Islamic. Financial institutions with sound track record, accorded with a good credit rating by acceptable rating agencies, supervised by a relevant regulatory body and that conform to the accepted standards of international practices will be encouraged to set up their operations in the IOFC. There will not be any compromise on quality and prudence, as the entry to the IOFC will continue to be restricted to sound and well managed institutions; and
- Facilitate the setting up of its treasury centres for multinational corporations, and financial institutions, particularly for the offshore banks.

Recommendation 8.3:

Adopt a consultative and market driven approach to create a conducive tax and business environment

The IOFC is not designed to be a tax haven. The conducive tax environment in the IOFC reflects its efficiency in lowering the cost of operations for offshore companies. Continual review and assessment of tax structure will be done to ensure Labuan remains competitive and

attractive. Towards this end, the Labuan Tax Advisory Council, a consultative body comprising tax experts, practitioners and regulators, has been formed. It is a smart partnership that will maximise the tapping of expertise and knowledge for the positive development of the IOFC.

This smart partnership concept will also be extended to cover the development of businesses and products for the IOFC. A Business Consultative Council, similar in nature to the Consultative Council of Labuan that has already been established will also be set up. Industry leaders and individuals with wide experience will be invited to be members of the business council.

Recommendation 8.4:

Benchmark against the best to maintain the low-cost operating environment

In order to be competitive, the IOFC has to maintain its low-cost operating environment which it enjoys today. In this regard, benchmarking against the leading IOFCs around the world in various areas of business will be established to ensure that the IOFC will always be competitive, especially in terms of pricing and cost of doing business. A study showed that the cost of operation in Labuan is one-third of the other financial centres in this region. Labuan should strive to further improve its competitiveness to attract more players and investors.

Recommendation 8.5:

Establish a well-balanced regulatory policy and supervisory framework

Offshore centres are under intense international scrutiny to comply with best standards of prudential supervision and regulation. The supervisory practice and legal framework in the IOFC is currently in accordance with internationally accepted standards. These however need to be continually assessed and upgraded to ensure that they remain in line with the latest international supervisory requirements. At the same time, there is a need to balance between conducive and stringent regulatory environment. The necessary supervisory structures have been set up within LOFSA to conduct on-site inspection so as to preserve the IOFC as a reputable offshore centre conducive to quality players and genuine investors. Furthermore, the legislation on money laundering is now being finalised to safeguard the IOFC from being used for such activities.

II. Promote the Development of Islamic Banking and Takaful Business

Recommendation 8.6:

Strengthen Islamic banking and finance as well as Islamic insurance (takaful)

The strong Islamic banking, finance and takaful foundation already established in Malaysia provides a platform from which Labuan can be developed with a strategic focus on Islamic products and services. There is also a growing interest in Syariah-based financial services and products in the global financial market. These opportunities for the development of a niche market in Islamic banking, finance and retakaful can be pursued in the following initiatives:

- **Development of the International Islamic Financial Market (IIFM)**

  Given the rapid growth in Islamic funds and growing interest in Islamic financing and investment globally, there is a strong basis to build a broader, deeper and more liquid Islamic financial market. This would allow issuers, investors and

intermediaries access to the same benefits of liquidity and price discovery that are available to conventional players in conventional markets. It would be a key contributor to the expansion of Islamic financing globally and, an essential precondition to the Islamic system to compete with the conventional system. Additionally, this is clearly an important driver to the efficiency, effectiveness and stability of Malaysia's own increasingly important Islamic banking sector. Once the IIFM is fully developed (which would encompass a money and capital market), it would have a synergistic role in enhancing the flexibility and risk management requirements of domestic Islamic financing.

- **Establishment of a consultative financial markets Syariah Advisory Council (SAC)**
  This is to provide input for the development of Islamic banking, finance and takaful in the IOFC. As the champion for the development of the market, the IOFC has a crucial role to play in defining the standards and rules required to make the market function smoothly. It will provide the first mover advantage in building a critical mass of market participants and position Malaysia as a centre for Islamic finance with spin-off benefits for the economy. To ensure that the SAC has the credibility and acceptance in the global financial community, it will have international representatives, scholars and practitioners with strong credentials and wide experience.

- **Increase the number of Islamic players in the IOFC**
  To develop the Islamic niche in the IOFC by building a critical mass of players and providing a range of Islamic financial instruments, interested financial institutions and takaful operators would be invited to set up Islamic operations in Labuan IOFC as participants in the IIFM. In particular, Islamic institutions from the Middle East will be encouraged to set up operations in Labuan. As for Islamic instruments, the Government and large Malaysian conglomerates will be encouraged to capitalise on the readily available large investor market generated by the IIFM to issue Islamic financial instruments.

- **The IOFC to develop retakaful business with global reach and capacity**
  The growth of takaful and Malaysia's expertise in developing Islamic insurance products has gathered momentum. Globally, there are less than 40 takaful/retakaful operators, mostly based in Saudi Arabia and Sudan. Estimates indicate that the takaful sector would grow by 25%-40% annually. There is currently also no strictly Islamic reinsurance available globally. The retakaful business remains an important potential area of business. There is therefore an opportunity for Malaysia, with Labuan as the natural domicile for the industry, to develop the global retakaful business in the longer term.

III. Develop and Strengthen the Capital Market, E-Commerce and the Ancillary Activities

Recommendation 8.7:

Enhance the Labuan International Financial Exchange (LFX)

The LFX was officially launched on 23 November 2000. It is a global exchange that provides listing and trading facilities for a wide range of financial and non-financial products (as well as Islamic products), including mutual funds, bonds, derivatives, insurance-linked products and, possibly, intellectual

properties. There are abundant opportunities for offshore players in the LFX including to provide custodial, depository, clearing and trustee services, other than being licensee as listing sponsors and trading agents. The LFX can be a major exchange capitalising on its many advantages including it being a one stop financial exchange, its extensive use of multimedia and internet, simplicity in its operations, customer orientation, and competitive listing fees.

At its early stage of operations, the support and participation of resident companies is important not only to promote market activity and add liquidity, but also to build international confidence and interest in the LFX. In this regard, domestic securities firms should be allowed to participate in the LFX, either as a listing sponsor or trading agents. Malaysian companies should give priority to the LFX when they plan to list their foreign bonds or other securities in international bourses.

Given its international accessibility, the LFX can also play a regional role by offering its platform to be a bourse for regional countries which do not have exchanges of their own. At the same time, the LFX can be used as a window for Malaysians wishing to invest abroad. The LFX can be a window for domestic institutions to expand their international business activity. The availability of a wide range of products and services will contribute to the overall efficiency of the Malaysian economy.

Recommendation 8.8:

Enhance the e-commerce gateway (ECG)

The IOFC needs to leverage the internet to effectively and efficiently reach out to the global market place. The ECG, that was launched on 23 November 2000, is a financial portal allowing access to information on products and services, including real time pricing, available in the IOFC. With this electronic infrastructure and the conducive business environment in Labuan, global e-commerce operators are encouraged to set up domicile in Labuan. In time, this portal will be developed into a full-fledged e-commerce site with a focus on Islamic products, bringing together a variety of third party providers of Islamic services. Other businesses and other financial services activities such as a clearing-house for financial payments, a marketplace for financial products and backroom operation activities will be encouraged.

The ECG can also be the means for submission of statutory documents and statistical information to LOFSA, reducing the flow and handling of physical documents as well as improving the speed of processing.

Due to its wide reach and multimedia capabilities, the ECG can also be used as a marketing tool. Information on products and services can be widely disseminated, and easily accessed by market players. However, like traditional forms of business, e-commerce needs to be appropriately regulated. In the case of Labuan, the legislation for such activity should neither be too restrictive nor be too liberal. There has to be a balance between too much control which will discourage businesses and the lack of control which may allow unfavourable activities to be conducted.

It is therefore opportune to revive the concept of twinning Labuan with the Multimedia Super Corridor (MSC). Under this concept, MSC companies may enjoy MSC benefits in Labuan, while Labuan offshore companies can also capitalise on the MSC facilities. By this, Labuan could enhance the usage of its presently underutilised state-of-the-art technology infrastructure. Given that the LFX has

offered itself as a listing and trading platform for MSC companies, this link can be extended to other Labuan institutions under the twinning concept.

Recommendation 8.9:

Maximise potentials of Labuan IOFC by developing other complementing economic measures

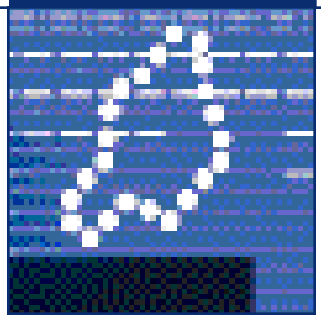
The development of the IOFC to drive the island has to be complemented by similar developments in other sectors. This will maximise the potentials and synergies that the IOFC has with other economic sectors. In this context, the following should be implemented:

- **Labuan as a centre of educational excellence**
  The quiet and conducive atmosphere of

Positioning Labuan IOFC with the key linked iniatives



Domestic market Advantages Expertise Experience Institutions	**IIFM** Completing the landscape for Malaysia in Islamic banking and finance	**Synergies**	**LFX** Listing and trading **ECG** Global market gateway



Labuan's pleasant surroundings, coupled with the availability of excellent high-tech communications facilities, low operating costs and skilled workforce, gives the island the potential to be a choice education center. Local and foreign learning institutions should be encouraged to set up branches on the island. Labuan is already home for Universiti Malaysia Sabah-Kampus Antarabangsa Labuan that specialises in offshore finance and multimedia with the capacity of accommodating 6,000 students. To fully develop into a world-class centre of educational excellence, strong study alliances with the private sector would be needed. Training institutions such as the BIMB Institute of Research and Training (BIRT) could provide valuable input in designing the syllabus for Islamic banking studies.

- **Labuan as a tourist centre and as health plus convalescence resort**
  Promoting tourism industry in Labuan would have positive spillover effects on the local economy and the offshore industries. Most other offshore centres evolved from a successful tourism industry. In the case of Labuan, the island was made an IOFC first, and now the move to successfully develop the tourism industry. Labuan as a retiree paradise is in line with the planned building of an 18-hole golf course and retirement homes. Retirees, from the region and other parts of the world, will be attracted to set up homes in Labuan. A Retirement Package Incentive, covering PR status, can be offered to high net worth retirees.

- **Labuan as a free-trade zone**
  Another measure to attract more high value added industries that require intensive manpower but do not cause pollution to the environment, is to introduce the free tax status to identified industries, and free trade zone status to be accorded during a promotional period of two years, on a first come first serve basis.

- **Labuan as a Meeting, Conference, Exhibition Centre (MICE)**
  Labuan has all that it takes to be a MICE, with its state-of-the-art telecommunication facilities, excellent conference centre, world class hotels, institutions of higher learning and major key players. Training institutes such as Malaysian Insurance Institute, Institut Bank-Bank Malaysia, BIRT should be encouraged to hold their seminars and courses in Labuan to increase awareness of the IOFC.

- **Accessibility**
  Most essential is that the accessibility to the island should be enhanced. Labuan should have more flights from Kuala Lumpur, Kota Kinabalu and Kuching and from other regional capitals such as Singapore, Hong Kong, Tokyo, Taipei, Shanghai, Seoul, Manila and Jakarta. In tandem with its role as the centre for offshore business, Labuan should have an 'open sky' policy to allow for increased access.

Approach to Implementation

The development of the IOFC is the long-term agenda of the Malaysian government. The implementation of the above recommendations would be pursued according to the broad long-term plan. The government will work with the industry to provide the necessary support needed for this process. The government will continue to be responsive and adopt market driven, consultative and pro-active approach in developing the IOFC.