

## **Labuan: A Niche in the Islamic Money Market**

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The 87-square-kilometre island of Labuan (population around 60 000), off the coast of Sabah, is geographically placed at the epicentre of the Asia Pacific region. Labuan originally came under the rule of the Brunei Sultanate. The British then officially declared Labuan a colony of the British Empire in 1849 and renamed it Victoria. The British lost its hold over Labuan in 1942 when the Japanese invaded the island. Britain resumed power over Labuan three years later and subsequently ceded the island to Sabah in 1963 when Sabah joined Malaysia. The administration of Labuan was handed over to the Federal Government of Malaysia in 1984. In 1990, Labuan was declared an International Offshore Financial Centre (IOFC). It is a tax-free or low-tax alternative environment for non-resident entities — there are no withholding, capital gains, transfer wealth, gift or income taxes.<sup>175</sup>

Major banks in Labuan include Standard Chartered Bank, Hongkong and Shanghai Banking Corp Ltd, Bank of Tokyo-Mitsubishi Ltd, Fuji Bank Ltd, BNP Paribas, Dresdner Bank AG and Deutsche Bank AG. Local players include Arab-Malaysian Merchant Bank Bhd, Public Bank Ltd, Maybank International Ltd, RHB Bank Ltd, Danaharta Managers Ltd,

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<sup>175</sup>[www.labuan.net](http://www.labuan.net).

Bumiputra-Commerce Bank Ltd, Schroders Malaysia Bhd, Citibank Malaysia Ltd, AMMB International Ltd, Bank Islam Ltd and JP Morgan Malaysia Ltd.

After 1 October 1990, when Labuan was established as an IOFC, the Federal Government took steps to improve the island's infrastructure in order to help assist its development as an IOFC. It is also the Malaysian Government's intention that Labuan should expand its business activities in the area of offshore Islamic financing and fund management. The proposed establishment of the Islamic money market is expected to boost Islamic-based investments and mutual fund activities. The primary objectives here are to tap into the global pool of under-performing Islamic funds and to provide alternative investment opportunities and products. With many available Islamic products already developed in the domestic market in Peninsular Malaysia, Labuan is in the position to offer competitive Islamic offshore financial products such as Islamic financing, *takaful* and *re-takaful* (insurance and reinsurance), Islamic trusts, Islamic investment funds and Islamic capital market instruments. Other Islamic products are gradually being developed in response to market needs and requirements. These Islamic products may be participated in freely by non-Muslims, who are also welcome to tap into the capacity created.

### **10.1 Role of Labuan Financial Services Authority**

The Labuan Financial Services Authority (LOFSA) which was established in 1996, is the single regulatory authority in Labuan, with responsibility for spearheading and co-coordinating the development of the island's offshore industry. LOFSA is also responsible for setting objectives, policies, promotional and developmental aspects of Labuan.

Labuan does have its own set of offshore legislation. Beginning in 1990, the Federal Government enacted a number of statutes with the aim of promoting Labuan as an IOFC:

- Offshore Companies Act, 1990
- Labuan Offshore Business Activity Tax Act, 1990
- Offshore Banking Act, 1990
- Offshore Insurance Act, 1990
- Labuan Trust Companies Act, 1990
- Labuan Offshore Trust Act, 1996
- Labuan Offshore Limited Partnership Act, 1997
- Labuan Offshore Securities Industry Act, 1998

## **10.2 Labuan Offshore Companies**

The Labuan Offshore Companies Act, 1990 allows the incorporation of an offshore company (LOC) or registration of an existing foreign company (i.e. company incorporated outside Malaysia) with no prior government approval, except in the case of offshore banking, insurance and mutual fund companies where licenses under the applicable regulatory environment are required. An offshore company may issue shares of different classes and denomination of shares may be in any world currency other than the Malaysian Ringgit. Except for offshore banks and offshore insurance companies, there is no minimum capital requirement.

## **10.3 Currency and Exchange Control**

The offshore transactions carried out in Labuan must be in any other currency than Malaysian Ringgit except for defraying any administrative and statutory expenses and certain allowable investments in Malaysian domestic companies. There are no exchange controls on any foreign currency.

## 10.4 Tax Incentives

Labuan offshore entities are exempted from withholding tax, stamp duty and any indirect taxes such as sales tax, import duties, surtax, excise duties and export duties. The Labuan Offshore Business Activity Tax Act, 1990 provides for special tax incentives for offshore companies carrying on offshore business activity such as banking, insurance or leasing in or from Labuan. An offshore company has the option of paying 3 per cent tax on net audited profits or a lump sum of RM20 000 per year of assessment. The election to pay at 3 per cent or RM20 000 is on an annual basis. On the other hand, an offshore company involved in offshore non-trading activity, such as investment holding, is exempt from tax.

## 10.5 Labuan International Financial Exchange

The establishment of the Labuan International Financial Exchange (LFX) is expected to further promote Labuan as a significant financial centre. The primary objective of LFX is to provide listing facilities for funds and other permitted financial instruments launched in Labuan and abroad.

The proposed activities of the LFX will include:

- Banking and investment banking
- Money broking
- Trusts
- Leasing and factoring business
- Fund management
- Insurance and reinsurance and other insurance-related activities
- Management companies
- Islamic financial services and instruments

The goal of LFX is to facilitate the influx of funds through the listing and trading of financial instruments. To achieve

its stated goal, LFX will strive to be recognised as investor friendly, be market driven and transparent and to utilise international networking communication systems.

Its purpose is to cater for the changing needs of global investors and companies, the listing of a multitude of multi-currency financial instruments, companies wishing to raise capital effectively and efficiently in line with the concept of globalisation and liberalisation.

LFX aims at providing opportunities for global investors and companies by providing a funding mechanism for international companies operating in the Asia-Pacific region, the listing of conventional and Islamic instruments, the availability of multi-currency securities and instruments, flexibility of trading and free from selective controls for international investors.<sup>176</sup>

## 10.6 Moving Forward with Islamic Banking

The International Islamic Financial Market (IIFM) began operations in April 2002, arising from a cooperative agreement between the Islamic Development Bank, Bahrain Monetary Agency, the Central Bank of Indonesia, the LOFSA (representing Malaysia), the Central Bank of Sudan and the Ministry of Finance of Brunei Darussalam. The primary purpose of the IIFM is to provide a cooperative framework to ensure the continued growth of an Islamic financial market, based on Shari'ah rules and principles, as a viable alternative to the conventional banking system.

The roles of the IIFM are as follows:

- (i) To promote the harmonisation and convergence of Shari'ah interpretations in developing Islamic banking products and practices which are universally acceptable.

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<sup>176</sup><http://lfxsys.lfx.com.my/>.

- (ii) To encourage a large number of Islamic financial institutions to participate in the market by introducing a wide range of Shari'ah-compliant products and the creation of an active secondary market thus providing liquidity to the instruments traded in the market.

It is designed to be a network of Islamic money markets which will be able to meet the liquidity needs of Islamic financial institutions worldwide engaged in international finance. It is anticipated that the establishment of IIFM will encourage the expansion of business and dealings between Islamic nations and generate spin-offs for the overall development of the Islamic capital market. The successful implementation of IIFM depends entirely on the concerted efforts between the governments of Islamic countries and the private Islamic bankers.

The IIFM will abide by Islamic Shari'ah rules and principles, which forbid investment in such sectors as alcohol, tobacco and gambling, as well as companies whose earnings are all or partly derived from interest, such as financial and insurance firms.

## 10.7 Conclusion

In May 2003, LFX signed a "Memorandum of Understanding" (MOU) with the Bahrain Stock Exchange (BSE) with the objective to further jointly promote and develop the Islamic capital market leading to the dual and/or secondary listing of instruments on both exchanges. A positive outcome of the MOU is the secondary listing of the Malaysian Government USD600 million Sukuk Al-Ijarah on the BSE in September 2003, following an earlier secondary listing on the LFX in September 2002. These secondary listings on BSE were expected to be reciprocated in the near future with listings of Bahraini Sukuk on the LFX.

LFX has also signed an MOU with the Bahrain-based IIFM on 19 January 2004. The objective of the MOU is to set a framework for greater co-operation between LFX and IIFM to pave the way for both organisations to jointly develop an Islamic Capital Market with an enhanced global reach. The MOU is set to promote development of channels of communications and exchange of information and collaboration in the listing and active secondary trading of Islamic financial instruments.

By playing a pivotal role in creating an environment that will encourage cross-border trading of Shari'ah-compliant instruments, the IIFM's principal objective is to develop an active international financial market based on Shari'ah rules and principles.<sup>177</sup>

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<sup>177</sup>[www.iifm.net](http://www.iifm.net).