

GUIDELINES ON EXTERNAL SERVICE ARRANGEMENTS FOR LABUAN FINANCIAL INSTITUTIONS

1.0 Introduction

- 1.1 The engagement of external services, particularly for activities that fall within the ambit of the group centralised function, is increasingly used by financial institutions as a means of improving operational efficiency, reducing costs and achieving group-consistent strategic objectives. The growing trend of external service arrangement is now beginning to recognise the importance of how the service providers are responding to this by offering a broader end-to-end services in areas which are not traditionally externalised. The ability to leverage on expertise within financial groups and harness potential group synergies has also led to financial institutions deploying a broader range of internal processes and business functions to their affiliate service providers.
- 1.2 Notwithstanding its potential benefits, the external service arrangements (ESAs), if not effectively managed, can pose a significant risk to the financial institution and threaten its safety and soundness. In this regard, there is a need for Labuan financial institutions (LFIs) to mitigate and manage the risks posed by over-reliance on service providers for activities that are critical to their ongoing operations.
- 1.3 The requirements put forth by the Guidelines are consistent with expectations on ESAs which are embedded within the international standards set by the:
- (i) Basel Committee on Banking Supervision for banking business;
 - (ii) International Association of Insurance Supervisors for (re)insurance business; and
 - (iii) International Organisation of Securities Commissions for securities market.

2.0 Regulatory Expectation

- 2.1 Labuan FSA expects that any ESAs would not result in any delegation or dilution of management oversight and responsibilities, obligations of the LFI towards its clients be compromised, impairs the effectiveness and robustness of the LFI's internal controls or undue risks being imposed on the LFI's safety and soundness.
- 2.2 The board and senior management of the LFI shall remain fully responsible and accountable for overseeing the ESAs.
- 2.3 The *Guidelines on External Service Arrangements for Labuan Financial Institutions* (the Guidelines) sets out the scope of arrangements relevant to the ESAs policy, and the requirements and expectations on LFIs to maintain appropriate internal governance and risk frameworks, including those relevant to the protection of data confidentiality. The requirements also serve to ensure Labuan FSA's continued ability to carry out effective supervisory oversight over LFIs in relation to the activities undertaken via ESAs.
- 2.4 LFIs operating as a branch may leverage on their group/parent internal governance and ESAs risk framework, or aspects thereof, to the extent appropriate for the LFIs. The extent and degree to which an LFI implements the Guidelines should commensurate with the nature of the risks in, and materiality of, the relevant ESAs, as well as the nature, scale and complexity of the business of the LFI. LFIs are also expected to ensure that any ESAs would not compromise the effectiveness of Labuan FSA's supervisory oversight over the Labuan branch.
- 2.5 The Guidelines shall not be construed as a means to substitute or dilute the substantial activity requirements under the Labuan Business Activity Tax (Requirements for Labuan Business Activity) Regulations 2018.

3.0 Applicability

3.1 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;
- (iv) Labuan takaful and retakaful operators licensed under Part VII of the LIFSSA; and
- (v) Labuan fund managers licensed under Part III of the LFSSA and Part IV of the LIFSSA.

3.2 In relation to Labuan captive (re)insurers and Labuan captive (re)takaful operators, the Guidelines will serve as best practices in managing the risks arising from their ESAs.

3.3 With the implementation of the Guidelines, the *Circular on Application for Outsourcing of Business Activities by Labuan Licensed Entities* dated 12 August 2016 shall no longer be applicable.

4.0 Legal Provision

4.1 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.

4.2 Any LFIs which fail to comply with the Guidelines may be guilty of an offence punishable under Sections 36B and 36G of the LFSAA.

5.0 Effective Date

- 5.1 The Guidelines shall come into effect on 1 January 2021, and would remain effective and applicable unless amended or revoked.
- 5.2 Any proposed ESAs that are to be effected on 1 January 2021 onwards are expected to be in full compliance with the requirements of the Guidelines.
- 5.3 As a transitioning measure, all existing ESAs are required to comply with the Guidelines upon expiry of the existing contracts or by 1 January 2023, whichever is earlier. Notwithstanding this, LFIs which intend to early adopt the requirements of the Guidelines are permitted to do so prior to the effective date.

6.0 Definitions

Board	This refers to the board of directors of the LFI, including a committee of the board if such committee is established where responsibilities of the board set out in the Guidelines have been delegated to oversee the ESAs and manage the risk arising from such activities. In relation to LFIs of a branch status, the 'board' shall refer to the LFIs' regional/head office or any equivalent person or body with the authority to oversee the branch, whichever is relevant.
Client information	This refers to any information ¹ relating to the affairs of any particular client ² of the LFI in whatever form including in the form of a record book, register, correspondence, or other documents.

¹ Any information that is related to or have reference to the exact client.

² This includes person representing the client e.g. parent, authorised representative, who enters into an agreement with the LFI for the benefit of the client.

<p>Group shared services</p>	<p>This refers to the group’s centralised service arrangements which may be undertaken by:</p> <ul style="list-style-type: none"> (i) related companies in the form of subsidiary, holding company and related companies as defined under Sections 3 and 4 of Labuan Companies Act 1990; (ii) regional or head office of the LFI; (iii) other branch of the entities mentioned in (i) and (ii); or (iv) any service provider engaged for the group’s ESAs.
<p>Material External Service Arrangement</p>	<p>This refers to an ESA which:</p> <ul style="list-style-type: none"> (i) in the event of a service failure or security breach, has the potential to significantly impact the LFI’s provision of financial services to clients, business operations, financial position, reputation, or compliance with applicable laws and regulatory requirements; (ii) involves client information and in the event of unauthorised access, disclosure or modification, or loss or theft of the information, has a material impact on the client or LFI; or (iii) relates to internal control functions of the LFI relating to risk management, internal audit, actuarial and compliance functions. <p>In assessing whether an ESA is material, the LFI shall have regard to the factors set out in Appendix II.</p>
<p>External Service Arrangement</p>	<p>This refers to an arrangement in which a service provider performs an activity on behalf of the LFI on a continuing basis³, where the activity would otherwise be undertaken by the LFI and does not include activities set out in Appendix I⁴.</p>

³ For the avoidance of doubt, an agreement which is time-bound does not preclude the activity from being considered as being performed on a continuing basis.

⁴ Appendix I provides a non-exhaustive list of arrangements that are outside the scope of the Guidelines.

Senior management	<p>This refers to the principal officer, any officer(s) or committee performing a senior management function who reports to the Board of LFI and is principally accountable for:</p> <ul style="list-style-type: none"> (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 which include a compliance officer, designated compliance officer, shariah adviser, member of Internal Shariah Advisory Board, chief internal auditor, appointed actuary and head of risk management.
Service provider	<p>This refers to the service provider engaged by the LFIs including the group shared services, for the ESAs.</p>
Sub-contracting	<p>This refers to assigning part of the obligations and tasks under a contract to another party i.e. a subcontractor.</p>

PART I: POLICY REQUIREMENTS

7.0 Responsibilities of the board and senior management

7.1 LFIs shall have strong oversight and control over ESAs, as would have been the case if they were performed in-house.

7.2 The board and senior management shall be accountable for ensuring effective oversight and governance of ESAs, supported by a robust risk management framework⁵ to manage risks arising from the ESAs and ensure compliance with relevant laws, regulations and prudential requirements that relate to activities undertaken under the ESAs. In particular, the board and senior management must have regard to the LFI's ability to fulfil its obligations to clients, including the ability of clients to obtain redress, and ensure consistency with its recovery and resolution planning.

Responsibilities of the Board

7.3 In fulfilling its responsibilities, the board must:

- (i) have a clear risk appetite governing the ESA;
- (ii) approve the ESA's risk management framework which, among others, addresses the LFI's basis and approach for identifying material ESAs;
- (iii) establish a sound internal governance structure that provides effective oversight and control over ESAs, consistent with the LFI's overall business strategy and risk appetite, and does not result in the delegation of the board and management oversight and decision-making responsibilities;
- (iv) retain sufficient management capacity and skilled resources within the LFI to oversee the ESA; and
- (v) ensure effective management of ESA risks, having regard to the assessments made by senior management on the state of compliance to the ESA's risk management framework.

⁵ Where the LFI is responsible for oversight over its subsidiaries, the board and senior management must ensure that the group-wide external service risk management framework adequately addresses external service arrangement risk across entities within the group.

7.4 In respect of paragraph 7.3(iv), the board must have in place adequate processes to ensure that:

- (i) the ESA does not create situations of conflict between the LFI and the service provider;
- (ii) the LFI retains the continuous ability to comply with regulatory and supervisory requirements, in particular where the LFI is dependent on the service provider to meet this objective; and
- (iii) where the ESA is undertaken by the group shared services, the LFI retains effective control⁶ of the arrangement.

Responsibilities of the Senior Management

7.5 Senior management shall bear primary responsibility over the day-to-day management of ESA risks. In fulfilling its responsibilities, the senior management must:

- (i) have an ESA risk management framework which amongst others, clearly articulates the accountability of the board and senior management and the process involved in approving and managing the arrangements. The framework, including the basis and approach for identifying material ESAs, must be reviewed periodically and kept up to date to ensure that it is appropriate in light of material changes to the scope, nature and complexity of the LFI's operations, and in line with the LFI's ESA strategy and risk appetite;
- (ii) manage ESAs risks on an institution-wide basis;
- (iii) continuously monitor all ESAs. This includes:
 - a) ensuring timely escalation to the board of material developments on ESAs, risk issues and incidents of non-compliance by the service provider;

⁶ LFIs are expected to effect the control of the ESA through contractual agreement with the service provider. In the case of leveraging group systems, the LFI may retain control over decisions with respect to system parameters and inputs, where practicable.

- b) ensuring ESAs continue to remain within the ESAs strategy and risk appetite;
 - c) conducting a periodic review to ensure compliance with the ESAs requirements of the Guidelines and taking prompt remedial actions to address any gaps identified. The review may include having an independent review (as LFI deems necessary) which can be undertaken by the auditors or relevant agents, who have the requisite skills and experience to perform such reviews;
 - d) ensuring internal audit covers ESA risks as part of the risk-based audit plan; and
 - e) where relevant, ensuring ESAs do not compromise the LFI's ability to comply with Shariah requirements;
- (iv) conduct assessments on the effectiveness of management of ESA risks on a periodic basis, including, as relevant:
- a) a review of the performance of the service provider⁷ and whether the service provider complies with the terms of the agreement;
 - b) the adequacy of internal control processes, including data security practices of the service provider;
 - c) whether prompt corrective actions taken by the service provider in the event of a breach of the agreement are effective;
 - d) whether the terms of the agreement remain appropriate and are in line with the LFI's ESAs risk appetite; and
 - e) the LFI's ability to preserve continuity of the ESAs under periods of stress⁸;
- (v) ensure prompt notification to Labuan FSA of developments concerning ESAs that result in a material impact on the LFI; and

⁷ This includes an assessment of the continued ability of the service provider to perform the activity to the level expected in accordance with the external service arrangement agreement.

⁸ For the avoidance of doubt, this refers to stress incidents that could occur at the LFI or the service provider.

- (vi) maintain a complete register of ESAs in line with the criteria specified under the Guidelines. The register must, at a minimum, include the information set out in Appendix III and be made readily available to Labuan FSA upon request.

7.6 In respect of paragraph 7.5(i), senior management must determine whether an ESA is material and whether the arrangement is appropriate to be externalised, based on the LFI's ESA risk framework and having regard to the factors as set out in Appendix II.

8.0 Group Shared Services

8.1 It is common for a financial institution to leverage on their group's expertise as means of effecting cost-rationalisation measures and intra-Group governance especially for common functions. In this regard, LFIs that wish to leverage on their group's centralised internal control functions (i.e. internal audit, compliance, actuarial and risk management function) are permitted to do so by observing the requirements as specified under paragraph 12.0.

8.2 Notwithstanding the above, where the functions are undertaken by the group shared services, LFIs must undertake the appropriate due-diligence on the service provider as follows:

- (i) Evaluation of qualitative aspects of the service provider's ability to address risks specific to the LFI, particularly those relating to business continuity management, monitoring and control, audit and inspection. For this purpose, LFI may rely on the due-diligence undertaken by its Group on the service provider and ensure that the evidence of the due-diligence process shall be maintained and made available to Labuan FSA;
- (ii) Confirmation on the right of access to be provided to Labuan FSA, to retain effective supervision over the LFI, and compliance with local regulatory requirements (if any); and

- (iii) The respective roles and responsibilities of each party in the ESA should be documented in writing in a service legal agreement or an equivalent document.

9.0 Process and management of risks arising from External Service

- 9.1 Effective management of ESA risk requires LFIs to have an in-depth and holistic understanding of risks arising from such arrangement. This entails an understanding of the relationship between the LFI and the service provider, and impact of the ESA to the operations of the LFI.
- 9.2 The LFI should have in place appropriate controls and safeguards to manage the risks that may arise from cross-border arrangements, having regard to social and political conditions, government policies, and legal and regulatory developments. In addition, LFI must ensure that the due diligence assessment addresses the added dimensions of risks associated with cross-border arrangements, and the ability of the LFI or service provider to implement appropriate responses to emerging risk events in a timely manner.
- 9.3 The LFI must ensure that all ESAs are conducted in a manner which does not impair Labuan FSA's ability to exercise its regulatory or supervisory powers, in particular Labuan FSA's timely and unrestricted access to systems, information or documents relating to the ESA.

Assessment of third party service provider

- 9.4 Conducting a comprehensive and robust due diligence process is necessary for the LFI to make an informed selection of service providers in relation to the risks associated with the ESAs.

9.5 The LFI must conduct appropriate due diligence of a third party service provider⁹ at the point of considering all new arrangements, and renewing or renegotiating existing arrangements. The scope and depth of the due diligence process must be commensurate with the materiality and nature of the ESA. The due diligence process for material ESA should consider, as appropriate:

- (i) capacity, capability, financial strength and business reputation¹⁰;
- (ii) risk management and internal control capabilities, including physical and IT security controls, and business continuity management¹¹;
- (iii) the location of the ESA to be undertaken (e.g. city and country), including primary and back-up sites;
- (iv) access rights of the LFI and Labuan FSA to the service provider¹²;
- (v) measures and processes to ensure data protection and confidentiality;
- (vi) reliance on sub-contractors, if any, in particular where the sub-contracting adds further complexity to the operational chains of the ESA;
- (vii) undue risks¹³ resulting from similar business arrangements, if any, between the service provider and the LFI;
- (viii) the extent of concentration risk to which the LFI is exposed with respect to a single service provider and the mitigation measures to address this concentration; and
- (ix) ability of the service provider to comply with relevant laws, regulations and guidelines relating to the ESA with LFI¹².

9.6 The LFI must ensure that the outcomes of the due diligence process are well-documented and escalated to the board, where relevant, in line with the ESA risk management framework of the LFI.

⁹ Third party service providers are the ESAs service providers that are external to the LFI and not part of the group shared services.

¹⁰ This includes an assessment of the continued ability of the service provider to perform the activity to the level expected in accordance with the ESA agreement.

¹¹ Including the ability of the service provider to respond to service disruptions or problems resulting from natural disasters, or physical or cyber-attacks, within an appropriate timeframe.

¹² This is not applicable for ESA that will be undertaken by a service provider regulated by Labuan FSA.

¹³ For instance, concentration risk to a systemic service provider in the industry or where the service provider's fee structure or relationship with the LFI may create potential conflict of interest issues.

Agreement of the external service arrangement

9.7 An ESA must be governed by a written agreement that is legally enforceable. The agreement must, at a minimum, provide for the following:

- (i) duration of the agreement;
- (ii) duties and responsibilities of the contracting parties including sub-contractor;
- (iii) controls and risk mitigation for information security including the use of information shared with the service provider;
- (iv) audits and inspections on the service provider including its sub-contractors and activities undertaken;
- (v) notification on adverse developments affecting the ESA and measures to preserve business continuity;
- (vi) regular testing of service provider's including its sub-contractor's business contingency plan;
- (vii) dispute resolution process for any default of obligations which may include monetary compensation;
- (viii) termination provisions of the ESA;
- (ix) obligations to comply with conduct requirements and standard imposed by Labuan FSA; and
- (x) provisions for supervisory access to documents, independent review and intervention.

9.8 The detailed information required for an ESA agreement is prescribed under Appendix IV.

Protection of data confidentiality

- 9.9 Misuse, unauthorised or inadvertent disclosure of confidential information is a serious risk event for LFIs. It is therefore imperative that the LFI satisfies itself that the level of security controls, governance, policies, and procedures at the service provider are robust to protect the security and confidentiality of information shared under the ESA.
- 9.10 The LFI must ensure that appropriate controls are in place and are effective in safeguarding the security, confidentiality and integrity of any information shared with the service provider. In meeting this requirement, the LFI should consider, as appropriate, that:
- (i) information disclosed to the service provider is limited to the extent necessary to provide the contracted service, and only on a need-to-know basis;
 - (ii) information shared with the service provider is used only to the extent necessary to perform the obligations under the ESA agreement;
 - (iii) all locations (e.g. city and country) where information is processed or stored, including back-up locations, are made known to the LFI;
 - (iv) where the service provider is located, or performs the activity, outside Malaysia, the service provider is subject to data protection standards that are comparable to Malaysia;
 - (v) where the service provider provides services to multiple clients, the LFI's information must be segregated (either logically or physically) from the information of other clients of the service provider;
 - (vi) the service provider is bound by confidentiality provisions stipulated under the ESA agreement even after the arrangement has ceased; and
 - (vii) information shared with the service provider is destroyed, rendered unusable, or returned to the LFI in a timely and secure manner once the ESA ceases or is terminated.

Business continuity planning

- 9.11 The LFI is responsible for ensuring that its Business Continuity Plan (BCP) considers any operational disruptions at, or failure of, the service provider.
- 9.12 The LFI must ensure that its BCP provide for all ESAs. The depth and comprehensiveness of the BCP must be commensurate with the materiality of the ESA. At a minimum, the LFI must ensure that the BCP include probable, adverse scenarios¹⁴ with specific action plans. The practicality of such plans must, among others, take into consideration:
- (i) the estimated cost involved to resume the activity which fall under the ESA;
 - (ii) the possible need for an alternative service provider, including considerations of the limited number of service providers in the market; and
 - (iii) the degree of difficulty, cost and time required to reintegrate the activity in-house.
- 9.13 In the event of a disruption, material ESAs must be resumed without undue delay and with minimal impact and disruptions to both business operations and the LFI's clients.
- 9.14 The LFI must, at all times, ensure that it has access to all its records and information at the service provider with respect to the ESA which would be necessary for it to operate and meet its legal and regulatory obligations. This includes scenarios where network connectivity is not available, the service provider becomes insolvent or a dispute resolution process is ongoing.

¹⁴ For instance, failure, liquidation or operational disruption of the service provider, non-performance by the service provider, unexpected termination of the external service arrangement, or material deterioration in the performance of the service provider.

9.15 The LFI must periodically test its own BCP and proactively seek assurance on the state of BCP preparedness of the service provider and where relevant, alternative service providers. The intensity and regularity of the BCP testing and assessments of BCP preparedness must be commensurate with the materiality of the ESA. In assessing this preparedness, the LFI should take into consideration, as appropriate:

- (i) ensure that the back-up arrangements are available and ready to be operated when necessary;
- (ii) ensure that the service provider periodically tests its BCP and provides any test reports, including any identified deficiencies, that may affect the provision of the ESA and measures to address such deficiencies as soon as practicable; and
- (iii) participate in joint testing with the service provider to enable an end-to-end BCP test for these arrangements by the LFI, where it is reasonably practicable to do so.

9.16 The LFI must ensure that ESAs undertaken outside Malaysia are conducted in a manner which does not affect:

- (i) the LFI's ability to effectively monitor the service provider and execute the institution's BCP; and
- (ii) the LFI's prompt recovery of data in the event of the service provider's failure, having regard to the laws of the particular jurisdiction.

10.0 External service arrangement involving cloud services

10.1 Where the ESA involves a cloud service provider, the LFI should take effective measures to address risks associated with data accessibility, confidentiality, integrity, sovereignty, recoverability and regulatory compliance. This is particularly important as cloud service providers often operate a geographically dispersed computing infrastructure with regional or global distribution of data processing and storage.

- 10.2 In using cloud services, the inherent risks involved are similar to that of other forms of ESAs. LFI that subscribes to cloud services must comply with the requirements of the Guidelines.
- 10.3 In relation to the LFI's ability to conduct audits and inspections on the cloud service provider and sub-contractors pursuant to paragraph 1(iv)(a) of Appendix IV, the LFI may rely on third party certification and reports made available by the cloud service provider for the audit¹⁵, provided that such reliance is supported by an adequate understanding and review of the scope of the audit and methods employed by the third party, and access to the third party and service provider to clarify matters relating to the audit.
- 10.4 In relation to the testing of a cloud service provider's BCP pursuant to paragraph 1(vi)(a) of Appendix IV, the LFI must be able to access information on the state of robustness of the controls instituted by such cloud service providers arising from the BCP testing.

11.0 Record keeping

- 11.1 Notwithstanding that ESAs are permitted by Labuan FSA, LFIs shall always comply with the requirements under the *Directive on Accounts and Record-Keeping Requirement for Labuan Entities* as well as other relevant laws and regulations issued by Labuan FSA from time to time.

¹⁵ For the avoidance of doubt, such certifications or reports should not substitute the LFI's right to conduct on-site inspections where necessary.

PART II: REGULATORY PROCESS

12.0 Notification for internal control functions under Group Shared Services

12.1 LFIs are required to give prior notification to Labuan FSA in writing within 30 days before the contract or arrangements take effect. Within this 30-day window, Labuan FSA may liaise with the LFI concerned to deny or modify the proposed arrangements. Should there be no response from Labuan FSA within the timeframe, this would tantamount to Labuan FSA's concurrence and LFIs may proceed with the group arrangement accordingly.

13.0 Approval for material external service arrangement

13.1 The LFI must obtain Labuan FSA's written approval before:

- (i) entering into a new material ESA¹⁶; or
- (ii) making a significant modification to an existing material ESA. A significant modification to an ESA is one that materially changes the level or type of risk the LFI is exposed to with respect to the arrangement (e.g. geographical risk). This includes, amongst others, change in service provider or change of country location where the external service is provided¹⁶.

13.2 In assessing an application under paragraph 13.1, Labuan FSA will have regard, among others, to the following factors:

- (i) the state of controls, risk management and governance of the LFI;
- (ii) the materiality of the ESA; and
- (iii) other relevant matters, including a confirmation¹⁷ from the regulatory authority that the service provider or group shared services is under its regulatory oversight.

¹⁶ Excluding the internal control functions i.e. internal audit, compliance, actuarial and risk management undertaken under the group shared services where only prior written notification within 30 days to Labuan FSA is required.

¹⁷ This is only applicable to financial institutions or regulated service providers excluding those regulated by Labuan FSA.

13.3 An application for approval pursuant to paragraph 13.1 must comprise, at a minimum, of the following information:

- (i) name and registered address of the service provider, including the sub-contractors, where applicable;
- (ii) date of commencement of the arrangement and expiry or renewal date;
- (iii) a brief description of the activity to be externalised;
- (iv) the locations (e.g. city and country) where the material ESA is undertaken by the service provider and sub-contractors, including where information is processed or stored, and the primary and back-up locations;
- (v) where the arrangement involves the use of cloud service providers, the cloud services, deployment model, nature of data to be held and locations (e.g. city and country) where such data is stored, including back-up locations;
- (vi) outcomes of the LFI's due diligence process;
- (vii) total costs of the ESA, including upfront and ongoing expenses;
- (viii) overall impact of the arrangement on employment and talent capacity within the LFI; and
- (ix) a copy of board resolution, board confirmation or evidence of similar approval granted by the relevant approval authority as determined under the LFI's internal governance framework on the appointment of the service provider for the ESA.

13.4 Labuan FSA to provide a written reply on the ESA application to the LFI within 30 days from the submission of complete information and documents.

14.0 Submission of external service arrangement

- 14.1 For the purpose of notification and application for approval to Labuan FSA as required under paragraphs 12.1 and 13.1, the submission shall be made to Labuan FSA at the following address:

Head of Supervision and Monitoring
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: *sed@labuanfsa.gov.my*

15.0 Statistical reporting

- 15.1 For the purpose of statistical reporting under the Statistical Management System (SMS), the LFI is required to submit information on any of its ESA pursuant to the Reporting Guideline on Statistical Data Submission for Labuan Entities. The information include both material and non-material ESA.
- 15.2 In the event where Labuan FSA is of the view that the ESA is considered material, the LFI shall comply with paragraph 13.1.

16.0 Enforcement

- 16.1 Notwithstanding paragraphs 12 and 13, where Labuan FSA has reason to believe that the ESA is not appropriate having due regard to the business circumstances and risk profile of the LFI, Labuan FSA may impose new or additional terms, conditions, restrictions or limitations upon the implementation of the ESA or revoke the approval of ESA which has been granted to the affected LFI.

APPENDIX I EXAMPLES OF ARRANGEMENTS EXCLUDED FROM SCOPE OF ESAs

1. For the purpose of the Guidelines, arrangements which entail procurement of services¹⁸, leveraging common industry-wide infrastructure driven by regulatory requirements, and involvement of third parties due to legal requirements, are generally not considered as ESAs. These include:
 - (i) Services for the transfer, clearing and settlement of funds or securities provided by an operator of a designated payment system or an operator of an approved payment system under the Financial Services Act 2013, Islamic Financial Services Act 2013 or any other jurisdictional laws
 - (ii) Global financial messaging network services provided by an operator that is owned by its member financial institutions and is subject to the oversight of relevant regulators
 - (iii) Independent consultancy service (e.g. legal opinions, tax planning and valuation)
 - (iv) Independent audit assessment
 - (v) Clearing and settlement arrangement between clearing houses and settlement institutions and their members
 - (vi) Co-insurance, reinsurance and retrocessions
 - (vii) Selling of insurance or takaful products by the appointed managing general agent or broker
 - (viii) Correspondent banking service
 - (ix) Adjusting business
 - (x) Trustee arrangement including company incorporation and secretarial services secured by LFIs from the Labuan Trust Company as their resident secretary
 - (xi) Credit or market information services
 - (xii) Repair, support and maintenance of tangible asset

¹⁸ Where the LFI acquires services, goods or utilities which are not expected to be performed by the LFI.

- (xiii) Purchase or subscription of commercially available software
- (xiv) Maintenance and support of licensed software
- (xv) Marketing and advertising
- (xvi) Telecommunication, postal and courier service
- (xvii) Physical security, premise access and guarding services
- (xviii) Cleaning and event services

Factors for determining material ESAs

1. In assessing whether an ESA is material, the LFI shall have regard to the following factors:
 - (i) significance of the arrangement e.g. in terms of contribution to income, cost as a percentage of total operating expenditure, or ability to achieve its strategic and business objectives;
 - (ii) financial, reputational and operational impact on the LFI or significant business line;
 - (iii) impact on the LFI's continuing ability to meet its obligations to its clients and counterparties in the event the service provider fails to provide the service or encounters a breach of confidentiality or security;
 - (iv) impact of the arrangement on the LFI's ability to maintain strong internal controls and meet its legal and regulatory requirements;
 - (v) risk to security, confidentiality and integrity of its client information;
 - (vi) interdependence of the activity to be externalised with other activities of the LFI;
 - (vii) aggregate exposure to a particular service provider in cases where the LFI, including any group shared services, outsources multiple activities to the same service provider;
 - (viii) impact to the LFI's business continuity and recovery and resolution plans, including the degree of difficulty, cost and time required to select an alternative service provider or to bring the ESA in-house; and
 - (ix) complexity of the ESA and number of parties involved, in particular where the service is sub-contracted or where more than one service provider collaborates to deliver an end-to-end solution.
2. For the avoidance of doubt, an assessment of the factors in paragraph 1 of this Appendix shall be made independent of mitigating controls by the LFI to reduce the impact of a potential failure by a service provider in meeting the obligations under an ESA.

APPENDIX III REGISTER OF ESAs

1. The register must, at a minimum, include the following information for all ESAs including group shared services:
 - (i) date of last update of the register;
 - (ii) name, registered address, country of registration and corporate registration number of the service provider and sub-contractors;
 - (iii) clear identification of any service provider or sub-contractor that is a group shared services of the LFI;
 - (iv) whether the service provider and sub-contractors are licensed, registered or supervised by a regulatory authority;
 - (v) a brief description of the services/activities undertaken;
 - (vi) date of first commencement of arrangement, current date of appointment and expiry/renewal date;
 - (vii) the locations (e.g. city and country) where the activity is undertaken by the service provider and sub-contractors, including where information is processed or stored, and back-up locations;
 - (viii) where an arrangement involves the use of cloud service provider, the nature of data held and locations where such data is stored; and
 - (ix) where there are incidents involving data security breaches, a brief description of the incidents including the date of incidents and corrective actions taken by the service provider.

APPENDIX IV EXTERNAL SERVICE ARRANGEMENT AGREEMENT

1. The ESA agreement must, at a minimum, provide for the following:

(i) Duration of the agreement

- a) duration of the arrangement with date of commencement and expiry or renewal date.

(ii) Duties and responsibilities of the contracting parties including sub-contractor

- a) responsibilities of the service provider, with well-defined and measurable risk and performance standards in relation to the activities undertaken under the ESA. Commercial terms tied to the performance of the service provider must not create incentives for the service provider to take on excessive risks that would affect the LFI; and
- b) where relevant, terms governing the ability of the primary service provider to sub-contract to other parties. Sub-contracting should not dilute the ultimate accountability of the primary service provider to the LFI over the ESA, and the LFI must have clear visibility over all sub-contractors¹⁹. Therefore, the agreement between the LFI and primary service provider must stipulate the following:
- the accountability of the primary service provider over the performance and conduct of the sub-contractor in relation to the ESA arrangement;
 - the rights of the LFI to terminate the agreement in the event of excessive reliance on sub-contracting (e.g. where the sub-contracting materially increases the risks to the LFI); and
 - the requirement for the sub-contractor and its staff to be bound by confidentiality provisions even after the arrangement has ceased²⁰.

¹⁹ In this respect, the primary service provider must provide sufficient notice to the LFI before entering into an agreement with the sub-contractors.

²⁰ See Paragraph 9.10(vi).

(iii) Controls and risk mitigation for information security including the use of information shared with the service provider

- a) controls to ensure the security of any information shared with the service provider at all times, covering at a minimum:
- responsibilities of the service provider with respect to information security;
 - scope of information subject to security requirements;
 - provisions to compensate the LFI for any losses and corresponding liability obligations arising from a security breach attributable to the service provider;
 - notification requirements in the event of a security breach; and
 - applicable jurisdictional laws;
- b) use of information shared with the service provider is limited to the extent necessary to perform the obligations under the ESA agreement; and
- c) continuous and complete access by the LFI to its data held by the service provider in the event of a dispute with the service provider, or termination of the arrangement.

(iv) Audits and inspections on the service provider and ESA

- a) ability of the LFI and its external auditor²¹ to conduct audits and on-site inspections on the service provider and its sub-contractors, and to obtain any report or finding made in relation to the ESA.

(v) Notification on adverse developments affecting the ESA and measures to preserve business continuity

- a) notification to the LFI of adverse developments that could materially affect the service provider's ability to meet its contractual obligations.

²¹ Including an agent appointed by the LFI.

- b) measures that the service provider would take to ensure continuity of the arrangement in the event of an operational disruption or failure on the part of the service provider.
- (vi) Regular testing of service provider's business continuity plan
- a) regular testing of the service provider's business continuity plans (BCP), including specific testing that may be required to support the LFI's own BCP testing, and a summary of the test results to be provided to the LFI with respect to the ESA.
- (vii) Dispute resolution process for any default of obligations
- a) the dispute resolution process in the event of default or non-performance of obligations, including remedies and indemnities where relevant.
- (viii) Termination provisions of the arrangement
- a) circumstances that may lead to termination of the arrangement, the contractual parties' termination rights and a minimum period to execute the termination provisions, including providing sufficient time for an orderly transfer of the ESA to the LFI or another party.
- (ix) Obligations to comply with conduct requirements and standard imposed by Labuan FSA
- a) corresponding obligations for staff of the service provider, who are involved in the delivery of services to the LFI's customers, to comply with similar conduct standards imposed by Labuan FSA on the LFI.
- (x) Provisions for supervisory access to documents, independent review and intervention
- a) enable Labuan FSA to have direct, timely and unrestricted access to the systems and any information or documents relating to the ESA;
 - b) enable Labuan FSA to conduct on-site supervision of the service provider where Labuan FSA deems necessary;

- c) enable Labuan FSA to appoint an independent party to perform a review of the relevant systems, information or documents of the service provider relating to the arrangement, where Labuan FSA deems necessary; and
- d) allow LFI the right to modify or terminate the arrangement when Labuan FSA issues a direction to the LFI to that effect under the LFSSA, LIFSSA and Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001 and any other relevant laws, as the case may be.