

This exposure draft presented by Labuan FSA to provide an overview of the proposed requirements and best practice recommendations on client money for Labuan Trust Companies (LTCs). The exposure draft intends to ensure that LTCs manage client money in a proficient and professional manner in fulfilling their fiduciary duties or custodian for their clients.

Labuan FSA welcomes and values feedback on the requirements of the exposure draft. The comments or inputs may encompass suggestions, recommendations and alternatives, which should be supported with clear rationale, practicality and relevance for Labuan FSA's consideration.

Feedback shall be submitted electronically to Labuan FSA using the response template by 8 September 2023 to the following officers:

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GUIDELINES ON CLIENT MONEY FOR LABUAN TRUST COMPANIES

1.0 Introduction

- 1.1. A Labuan trust company (LTC) plays a pivotal role in delivering corporate and trust services in Labuan International Business and Financial Centre (IBFC). This includes ensuring the administration and holding of client money is carried out in effective and professional manner.
- 1.2. The *Guidelines on Client Money for Labuan Trust Companies* (the Guidelines) is intended to provide the minimum regulatory standards for handling of client money to be observed by the LTC. This includes the money that an LTC receives, keeps and controls on behalf of its clients while acting in the capacity of a fiduciary or custodian for them in the course of carrying out the trust company business in Labuan IBFC.
- 1.3. The requirements put forth by the Guidelines are consistent with expectations on client money regulation which are embedded within the international standards set by the Group of International Finance Centre Supervisors (GIFCS)¹.

2.0 Applicability

- 2.1 The Guidelines is applicable to the LTC licensed under Part V of the Labuan Financial Services and Securities Act 2010 (LFSSA) excluding Labuan Private Trust Companies.

¹ The GIFCS is a long-established group of financial services supervisors since 1980 with a core interest of promoting the adoption of international regulatory standards especially in the banking, fiduciary and AML/CFT arena.

2.2 The Guidelines would need to be read together with the following guidelines:

No.	Guidelines	Reference Paragraph	Issuance Date
1.	Governance and Market Conduct Framework for Labuan Trust Companies	<ul style="list-style-type: none">• Para. 8.1 (ii) & (vii)• Para. 8.12• Para. 8.16	21 August 2015
2.	Guidelines for the Establishment of Labuan Managed Trust Companies	<ul style="list-style-type: none">• Para. 6.3• Para. 6.4	18 December 2015
3.	Directive on Internal Audit Requirement for Labuan Managed Trust Companies	<ul style="list-style-type: none">• Para. 2.1• Para. 2.8	28 September 2016

3.0 Legal Provision

- 3.1. The Guidelines is issued pursuant to Section 4A of the Labuan Financial Services Authority Act 1996 (LFSSA) to specify the minimum prudential standards to be implemented by Labuan trust companies licensed under Part V of LFSSA.
- 3.2. The Guidelines is intended to specify the client money management by the LTCs pursuant to Section 83 of the LFSSA. The clause requires that the money paid or given to or held by an LTC in a fiduciary position would need to be kept separate from its own money at all times.
- 3.3. Any person who fails to comply with the Guidelines may be subject to an administrative penalty and/or other enforcement actions under Section 36B and Section 36G of the LFSSA.

4.0 Effective Date

- 4.1 The Guidelines shall come into effect on DD/MM/2025 and would remain effective and applicable unless amended or revoked. Notwithstanding this, LTCs that intend to early adopt the requirements of the Guidelines are permitted to do so prior to the effective date.

Question 1:

Do you foresee any challenges with the effective date of the Guidelines with regards to the adherence to its requirements? If yes, please provide your recommendation with justification.

5.0 Definitions

Board	Refers to the board of directors of the LTC; or any equivalent person or body with the authority to oversee the LTC.
Client	In respect of LTC to carry on trust company business, means - (a) A person who has made arrangement with LTC for the provision of services rendered; or (b) A person who has benefitted or may receive the benefit from the services provided or arranged by the LTC.
Client Money	Refers to money paid to, hold or received by LTC on behalf of client for the purpose of conducting corporate services and trust business in which LTC has control of and responsible for it to safeguard.
Money	Refers to medium of exchange in the form of cash, cheques and other payable orders and money deposited in accounts, in each case, in any currency.

Definitions

Senior Management	<p>Refers to the Principal Officer (PO), any officer(s) or committee performing a senior management function who are primarily accountable for:</p> <ul style="list-style-type: none">(a) Making decisions that affect the whole, or a substantial part of the LTC's business;(b) Implementing and enforcing policies and strategies approved by the Board including Head of Department or any equivalent designated person; or(c) Internal controls or other key functionalities of the LTC which include compliance, AML/CFT compliance and risk management.
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Question 2:

Is the definition and the scope of client money adequately worded and sufficient to cater for the intended objectives of this Guidelines? If not, please suggest alternative definition and scope.

6.0 Board Oversight

Principle 1: The Board of Directors (Board) is ultimately accountable and responsible to oversee the effective handling and control over client money by LTCs through sound internal policies and procedures.

Minimum Requirements

6.1 The Board is expected to be responsible for ensuring appropriate governances within the LTC which include to:

- (i) approve client money policies and procedures in setting out the basic principles and sound internal controls to protect over client money;
- (ii) ensure adherence with the legal and regulatory requirements pertaining to client money transacted in Labuan IBFC;
- (iii) establish internal governance structure that provides effective oversight and management of client money; and
- (iv) ensure sufficient risk management framework is implemented in order to minimise potential weakness and risk associated with managing client money including Money Laundering/Terrorism Financing (ML/TF) risk that may arise from client money transaction.

7.0 Senior Management Responsibilities

Principle 2: The Senior Management ensures that the approved policies and procedures for managing client money are implemented and observed by the relevant functions within the LTC.

Minimum Requirements

7.1 Key roles of the senior management in managing client money include to:

- (i) develop and implement policies, procedures and controls in managing the client money;
- (ii) exercise diligence, professionalism and high integrity in handling client money pursuant to the objectives of the trust company;
- (iii) ensure organisational adherence to the client money policies and procedures as mandated by the Board;
- (iv) safeguard and maintain the confidentiality of client money record pursuant to Section 178 of LFSSA;

- (v) adopt absolute strict discretion on the sensitive data of client money, in which it is stored securely and pose no operational risk in a way that preserve the secrecy; and
- (vi) provide timely updates to the Board on matters that materially affect the client money management to facilitate strategic decision making.

Question 3:

- 3.1 Are there any challenges for your Board / senior management in discharging the responsibilities with regards to the above requirement? If yes, please provide details and recommendations.
- 3.2 Is there any other relevant matter pertaining to the Board / senior management oversight? If so, please provide your insights.
- 3.3 How do you assess your personnel competencies in managing the client money?

Best Practices

- 1. The Board may conduct self-assessment to maintain the personnel professionalism and confidentiality standard on sensitive information.
- 2. The senior management may consider to set performance metric on dedicated personnel to uphold the highest standards with utmost care when dealing with client money in accordance with client interest and direction.

8.0 Client Money Management

Principle 3: The LTC would need to have in place effective controls for the administration and holding of client money which are subject to periodic review. This is to ensure the client money is appropriately safeguarded and utilised only for the intended contractual purposes.

Minimum Requirements

8.1 The LTC is required to establish internal controls aimed at facilitating prudent and effective business operations and processes which includes holding or receiving the money on behalf of the client. In this regard, the LTC is required to maintain and implement the following requirements:

I. Segregation of Account

- 8.2 The LTC must ensure clear segregation of the client money that it has received in its capacity as the trust service provider from those of its own.
- 8.3 The LTC must maintain the client money in a separate trust account from any of the LTC accounts with an authorised financial institution at all times.
- 8.4 In an event that the personnel become aware of the client money has been inadvertently mingled with the LTC's, it must be separated and kept at client money account as soon as practicable.
- 8.5 Client money can be held either centrally pooled into single account with its title indicates clearly for client money or multiple accounts for diverse clients.

Best Practices

1. In order to ensure a clear separation between the client money and LTC's, the inadvertently mingled client money should be deposited back into client account within five (5) working days from the date of discovery.
2. The LTC may implement internal measures or checklist for its personnel to check, verify and monitor the transactions under the clients account on daily basis to minimise the risk of co-mingling of funds.

II. Disclosure to Clients

- 8.6 The LTC would need to demonstrate proper disclosure and transparent communication with its clients of the terms upon which client money is held.
- 8.7 The LTC must ensure the clients are well informed on the risk associated with handling client money and how the unidentified and unclaimed funds are dealt with on transparent basis.
- 8.8 All records relating to the disclosure to clients shall be kept physically in client file or stored electronically by the LTC.

Best Practices

1. The LTC may consider to insert a clause under the contractual document with its clients on the manner of which the disclosure on the client money terms will be made as well as the risks associated with the handling of the client money by the LTC.
2. The LTC may encrypt the electronic documents with a password to secure and protect the clients' data from any unauthorised modification or destruction.

III. Reconciliation

- 8.9 The LTC is required to perform a reconciliation of any receipt or transaction of client money account promptly, including client suspense account, if any.
- 8.10 The LTC must also ensure that the client money account is part of the annual financial audit and the scope shall include compliance with the:
- (i) Requirements of this Guidelines; and
 - (ii) Contractual agreements between the LTC and its clients pertaining to the handling of client money.
- 8.11 The LTC is required to maintain the reconciliation record for a period of at least six (6) years, following the termination or cessation of the client's business relationship.

IV. Controls

- 8.12 At the minimum, the LTC is required to enforce dual authorisation for withdrawal of client money from the trust account.
- 8.13 There need to be adequate internal controls to be established with regard to proper handling of client money, which prevent improper use of them for other purposes such as settlement and disbursement of LTC's dues.
- 8.14 The LTC is accountable to ensure the client money is not utilised for other unrelated customer or for its own interest.
- 8.15 The senior management must be immediately notified for any concern relating to lost or misplaced client money. Such events could be attributable to:
- (i) misconducts by the LTC's personnel; and
 - (ii) perpetration by third party.

Best Practices

1. The LTC may implement a systematic communication method and procedure by actively monitor and respond to potential misinformation and misinterpretation of handling of client money in all communication and media platforms that may adversely affect its transparency to the clients.
2. The LTC may establish efficient training programs to ensure its personnel consistency in demonstrating professional behaviour in terms of handling client money on an ongoing basis.
3. The LTC may consider to purchase Fidelity Guarantee Insurance as precautionary measure to protect against dishonesty or faulty practices of their personnel in handling client money.

V. Audit Review

- 8.16 The LTC must implement a scheduled review of the control over client money, on a risk-based approach to address any key control deficiencies that could compromise the effectiveness of the LTC in managing its clients' money.
- 8.17 The comprehensive review shall be conducted to validate the efficiency of LTC in controlling and safeguarding of client money, particularly in addressing precautionary measure to avoid possible loss, misappropriation and mishandling of client money.
- 8.18 The independent review of the controls over client money can be undertaken for at least on an annual basis either through an internal or external assessment.
- 8.19 The auditors shall be given full access to relevant information with regards on the management of client money for audit and review purpose and responsible to observe the secrecy of the data.
- 8.20 The audit report must be recorded and tabled to the Board within three (3) months of the completion of the audit.

Best Practices

1. The LTC may establish an audit committee to represent the Board in carrying out and assessing the audit and independent review matters including deliberating on its findings and recommendation.
2. The LTC is encouraged to maintain a proper documentation of the past audit trail and records for future reference.

VI. Client Suspense Account

- 8.21 The LTC is required to have in place a suspense ledger or separate bank account to hold the old and unidentified client money.
- 8.22 The LTC must ensure the breakdown of the balance reflecting the duration of each amount has been held in the account are documented and made available for future inspection.
- 8.23 The LTC must ensure the suspense account is up-to-date and cleared out once the issue is addressed, at which time the money is moved to the designated accounts.

Question 4:

- 4.1 Do you foresee any difficulties in implementing the above client money requirement for LTC? If yes, please provide details and recommendation.
- 4.2 Is it practical for the LTC to separate client money from its own money within 5 working days as drafted under best practices? Or would it be shortened as other international jurisdictions impose more stringent requirement i.e. within two days. Please share with us your recommendation and rationale.
- 4.3 Do you have difficulties in handling client money that is mingled with the LTC's money. If no, how would you normally segregate the fund?

Best Practices

1. The LTC is encouraged to conduct a clearing-out process of the client suspense ledger at least on monthly basis.
2. It is recommended for the LTC to periodically trace and analyse the old unidentified money in the suspense account and not to keep it for longer than seven (7) years.
3. The LTC may refer to the Registrar of Unclaimed Moneys for any submission of unclaimed money pursuant to Section 14 of the Unclaimed Moneys Act 1965.

Question 5:

Are there any other relevant areas or current market practices that should be covered by this proposed Guidelines? If yes, please describe your suggestions in details.