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Malaysia's potential as the fintech hub for the ASEAN region

The Malaysian Digital Economy Corporation Sdn Bhd ("MDEC") recently announced that Malaysia has the potential to become a digital hub for ASEAN as Malaysia is in a position to spread the growth of the digital economy throughout the region. Likewise, Ernst & Young's ASEAN FinTech Census 2018 dubbed Malaysia as an "emerging fintech hub in Asia". The country's increasingly digitalised economy, which is tailored to boost start-up presence and draw in investors, together with support from Malaysian government and regulators, will also create a mature fintech ecosystem which will contribute to Malaysia's potential to be the hub for digital economy of the ASEAN region.

Whilst Singapore stands out in terms of being a mature fintech market in the region this also means that there is an emerging opportunity for less-developed markets that are growing rapidly in terms of income per head, population growth, online access and smartphone usage. According to the Network Readiness Index ("NRI"), Malaysia is ranked at number 31 out of 139 countries in terms of their readiness to transition to a digitised economy and society. Whilst Singapore is ranked at number 1, the rest of the ASEAN countries were ranked quite low in the NRI (with ranking between 60 and 80). This measure is important for businesses looking to enter new countries as it can easily determine if the country can support a business that relies on the Internet.

This, coupled with the support from the government, regulators and industry players, provide Malaysia with the opportunities and potential as an emerging market to catch up to Singapore and to be the preferred fintech home in ASEAN.

Malaysia's unique value proposition to fintech players

1. Low cost

The cost of living and business in Malaysia is a third of Singapore, which might see more companies putting non-client facing jobs like operations, marketing and technology support in Malaysia.

2. Leader in Islamic finance

Islamic finance has placed Malaysia on the world map. With the industry total assets reaching USD204.4 billion, Thomson Reuters has recognised Malaysia as the most developed Islamic financial market for five consecutive years. Furthermore, the growing Muslim population in ASEAN region has led to an increasing demand for development of fintech in terms of Shariah-compliant investment-related products, especially in Malaysia and Indonesia. Against that backdrop, Malaysia has emerged as the world's top hub for Islamic fintech startups, with 18 companies operating in the sector as of end 2018.

Thus with experts who are well-versed in Islamic finance, coupled with Malaysia's developed Shariah-compliant finance infrastructure and ecosystem, Malaysia is well-placed to host and develop Islamic fintech startups and initiatives, and also to become a well-rounded regional hub that can offer both conventional and Islamic fintech support.

3. Labuan International Business and Financial Centre ("Labuan IBFC")

Malaysia is the only country in South East Asia that can offer two different regulatory framework in order to conduct businesses – i.e. via Malaysia as a whole, or specifically through Labuan IBFC. As a midshore jurisdiction, Labuan IBFC has a comprehensive, modern and globally-recognised regulatory framework, that adhere to international standards and compliance while still maintaining an attractive and favourable tax rate.

Labuan IBFC provides a unique and special proposition for companies, including fintech (which is coined as 'Innovative Financial Services' ("IFS")), to grow their businesses whether into, or out of, Asia and ASEAN.

Conducting fintech business in Labuan

Setting up and operating a business in Labuan is fairly easy, flexible and incur lower costs, as compared to other jurisdictions such as Hong Kong and Singapore. A business established in Labuan can enjoy minimum tax of 3% on its net profits per year and able to enjoy certain tax exemptions, such as no withholding tax on lease rentals, dividends, interests, royalties, technical and management fees and stamp duty exemption on instruments executed by a Labuan entity made in connection with a Labuan business activity.

With respect to fintech and digital services, Labuan IBFC has adopted a unique approach to IFS and announced that no special licence is required to operate an IFS-related business in Labuan. Interested business owners with IFS-related businesses need merely apply to operate as a Labuan-licenced entity under the Labuan Financial Services & Securities Act 2010 or the Labuan Islamic Financial Services & Securities Act 2010. For existing Labuan-licensed entities that wish to incorporate any IFS activities into their current business operations, they are simply required to apply to Labuan Financial Services Authority ("Labuan FSA") to notify the change of business plan.

In 2018, Labuan FSA has approved four IFS-related Labuan entities including Algebra, Asia's first robo-adviser to offer Shariah-compliant investments, and HWG Cash, Asia's first stable and secure licensed cash token which offers cryptocurrency services out of Labuan. In addition, Labuan FSA has also recently approved China Construction Bank Corporation Labuan Branch, a licensed Labuan bank to conduct digital banking activities in the Labuan IBFC.

Thus, the above examples represent the beginning of an exciting journey that will further solidify Labuan IBFC's positioning as the preferred jurisdiction for businesses seeking to connect with Asia's economies and beyond.

Using Labuan as a vehicle for foreign funding

Recent amendments under the Finance Act 2018 has removed the restriction on transaction conducted by Labuan entities with Malaysian residents as well as the prohibition on transaction in Ringgit Malaysia ("RM"). The ability to manage both RM and non-RM for the benefit of businesses, especially for start-ups, is unique because no other countries in ASEAN are able to do that.

Thus the uniqueness of Labuan's regulatory framework would allow fintech startups, SMEs, growth and scaleable companies to tap on foreign investments and funds.

A fund set up in Labuan would not be subject to onshore Malaysia's exchange control regulations when dealing with non-residents and would not have any issue to invest into domestic companies in Malaysia. Furthermore, foreign investors are free to remit divestment proceeds, profits, dividends or any income arising from investments in Malaysia and no income tax and withholding tax will be imposed on any dividend or distribution from the Labuan fund to the investors.

Setting up an investment holding entity in Labuan

The favourable investment and tax regime, coupled with its unique regulatory framework makes Labuan IBFC an attractive location to establish a holding company. A Labuan holding company that derives its investment income from a non-trading activity (i.e. holding of investment in securities, stock, shares, loans, deposits or any other properties situated in Labuan by a Labuan entity on its own behalf) is not subject to tax under Labuan laws. Moreover, a Labuan holding company is able to enjoy certain tax exemptions such as stamp duty exemption on any instrument executed by the Labuan holding company in relation to its non-trading activity, and exemption from withholding tax on any payments of dividends, interest, service fees and royalties made by such Labuan holding company to non-resident/foreign company.

As mentioned above, a Labuan holding company will not be subject to Malaysia's exchange control regulations when dealing with non-residents and are free to invest in any form of RM and non-RM investments in Malaysia. Similarly, it is allowed to remit out divestment proceeds, profits, dividends or any income arising from investments in Malaysia.

In addition to the above, the Malaysian government and regulatory authorities are generally in support and encourage the development of the fintech ecosystem in Malaysia. Below is a summary of fintech and digital-friendly regulations and incentives that have been undertaken to promote the growth of fintech in Malaysia.

Creating a fintech-friendly industry

The various regulatory authorities in Malaysia have set up various initiatives to promote the fintech industry, including:

- The "Alliance of FinTech Community" or "aFINity@SC", was launched by the Securities Commission of Malaysia ("SC") in September 2015. It is a focal point for development initiatives under Fintech and serves as a hub for raising awareness, nurturing the fintech ecosystem and providing policy and regulatory clarity to promote responsible financial innovation. In 2019, aFINity saw 109 engagements involving 91 participants with a total of 210 registered members.
- The Financial Technology Enabler Group ("FTEG"), was set up by Bank Negara Malaysia or the Central Bank of Malaysia ("BNM") in June 2016. It comprises a cross functionality group within BNM, which is responsible for the formulation and enhancement of regulatory policies to facilitate the adoption of technological innovations in the Malaysian financial services industry.
- The Fintech Association of Malaysia ("FAOM"), was established by the fintech community in Malaysia in November 2016. It seeks to be the key enabler and a national platform to support Malaysia to be the leading hub for fintech innovation and investment in the region. FAOM aims, among others, to be voice of Malaysia's fintech community and to engage with industry players including regulators in policy making in order to foster a healthy fintech ecosystem.
- In November 2017, the Malaysian government launched its Digital Free Trade Zone ("DFTZ") to facilitate seamless cross-border trade and enable local businesses to export their goods with a priority for e-commerce. This is easily done through collaboration with Alibaba as the e-fulfilment logistics hub and e-services platform and establishment of Kuala Lumpur Internet City which will be the primary digital hub for the DFTZ.
- MDEC introduced the "Malaysia Digital Hub" which supports local tech startups by providing, among other things, facilities to help them to expand globally. This includes:
    - establishing "Orbit" as a co-working space for fintech startups to encourage innovative fintech ideas and to create an access to regulators through, among others, quarterly regulatory bootcamps with participation from both BNM and the SC;

- launching “Titan”, a platform where startups with proven potential can expand their business and reach in South East Asian and European markets via MDEC’s market access programmes;
- creating various initiatives, such as the Malaysian Tech Entrepreneur Programme, Global Acceleration and Innovation Network and the Digital Finance Innovation Hub to, among other things, encourage fintech founders to set up their business in Malaysia, provide opportunities for local and foreign investments, expand their market reach and accelerate innovation in digital financial services; and
- setting up a dedicated Islamic Digital Economy unit and making available a board of Shariah advisors to help fintech startups make their financial products Shariah compliant. Doing so could potentially help them tap into the global Islamic economy that is expected to grow to the tune of USD3 trillion by 2021.

- BNM’s Interoperable Credit Transfer Framework policy was issued in March 2018. This policy aims to create a cashless payment landscape in Malaysia, foster efficient, competitive and innovative payment solutions, and promote collaborative competition between banks and non-bank electronic money (e-money) issuers through fair and open access to shared payment infrastructure.
- Various institutions and regulatory bodies in Malaysia made available, among others, the following funding/facilities/incentives for new and growing fintech startups:
    - SC introduced regulatory framework for peer-to-peer (P2P) lending under the its Guidelines on Recognised Markets;
    - Malaysia Debt Ventures Berhad started an Intellectual Property Financing Scheme to enable companies to use their intellectual property rights as loan collateral;
    - Ministry of Finance established Cradle Fund Sdn. Bhd. to provide, among others, funding and investment assistance as well as commercialisation support, coaching and various other value-added services to potential and high-calibre tech startups; and
    - ICT companies with “Multimedia Super Corridor (MSC) Malaysia” status granted by MDEC will be able to enjoy up to 100% income tax exemption for five years, which may be extended for another five years.
- FAOM is in discussions with Labuan IBFC and Labuan FSA on facilitating businesses in Malaysia and abroad to utilise the uniqueness of Labuan’s financial regulatory framework focusing on fintech startups, SMEs, growth and scalable companies that seek to tap on foreign investments and funds.

Digital law development in Malaysia

The Malaysian government and various regulatory authorities in Malaysia have set up a number of initiatives to promote and support a healthy development in the Malaysian fintech and digital asset regulatory landscape, including the following:

- In October 2016, BNM issued the Financial Technology Regulatory Sandbox Framework (the “Sandbox Framework”) which provides regulatory flexibilities to financial institutions and fintech companies in Malaysia to conduct experimentation of fintech solutions in a live controlled environment for a limited time. The Sandbox Framework aims to provide an environment that is conducive for the deployment of financial technology and to foster innovations and development of Malaysia’s financial sector.
- In May 2017, the SC introduced the Digital Investment Management framework that sets out the licensing and operational requirements for the offering of digital investment management and robo-advisory portfolio services to investors. Under the aFINity engagement labs, Digital Investment Management engagements form 41% of the total engagements in 2018.

- BNM released Anti-Money Laundering and Counter Financing of Terrorism guidelines in respect of:
- money services businesses which requires approved remittance business which offer online and/or mobile remittance services to implement electronic know-your-customer (e-KYC) system for their on-boarding process; and
- any person who offer services to exchange digital currencies either from or to fiat money, or from or to another digital currency shall be subjected to obligations as a "reporting institution" under the First Schedule of the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act 2001.
- In January 2019, BNM has issued a policy document on Publishing Open Data using Open Application Programming Interface (Open API). The policy document sets out BNM's guidance on the development of Open API for open data, i.e. publicly available and usable data, including financial product information (i.e. key information on a financial product, such as those provided in product disclosure sheets, which facilitates customers in making informed decisions) that financial institutions may make available to third parties via the Open API. The policy is aimed, among other things, to break banks' monopoly on customer data, equalise the playing field for fintech companies and allow the use of technology as a leverage for the distribution and consumption of financial products.
- Also in January 2019, the Ministry of Finance and the SC issued the Capital Markets and Services (Prescription of Securities) (Digital Currency and Digital Token) Order 2019 which came into force on 15 January 2019 (the "CMS Order"). Digital currencies and digital tokens are defined in the CMS Order as prescribed as securities for the purpose of securities laws and would be regulated by the SC.
- The SC has also:
- amended its Guidelines on Recognised Markets to (1) introduce new requirements for electronic platforms that facilitate the trading of digital assets which requires any person who is interested in operating a digital asset platform is required to apply to the SC to be registered as a recognised market operator ("RMO") and (2) to provide additional requirements to RMOs which operate property crowdfunding platforms; and
- issued a Public Consultation Paper on Proposed Regulatory Framework for the Issuance of Digital Assets through Initial Coin Offerings (ICO) where digital asset as described in the CMS Order will require (1) prior authorisation from the SC for the offering or issuance of the ICO and (2) the registration of a disclosure document (Whitepaper). The invitation for feedback has closed and the framework is currently being processed by the SC.
- Malaysia's Parliament has passed the Trademarks Bill 2019 and Trade Descriptions (Amendment) Bill 2019 (the "Bills"). These Bills provide expansion of the trademark protection scope to non-traditional marks and enable Malaysia to accede to the Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks ("Madrid Protocol"). The Madrid Protocol, an international treaty administered by the International Bureau of World Intellectual Property Organisation, allows a trademark owner to seek protection of the trademark in several countries simultaneously by filing one application with a single office, in one language and by paying one fee. Once the Bills have obtained Royal Assent, it will come into operation on a date to be notified in the Gazette.
- Labuan FSA has issued a Frequently Asked Questions on IFS in Labuan which sets out the regulatory expectations that Labuan FSA has on IFS activities that can be carried out in Labuan and procedures to apply or register the proposed IFS business.

- In June 2019, BNM has issued an Exposure Draft on Framework for Electronic Trading Platforms which sets out BNM's requirements and expectations on market participants who offer services of electronic trading platforms within the Malaysian wholesale financial markets, specifically money and foreign exchange markets. Eligible platform operators are required to obtain the Bank's approval prior to offering their services in Malaysia. The invitation for feedback has closed and the framework is currently being processed by BNM.

The support received from governmental agencies and regulators in Malaysia would not only increase Malaysia's potential to be the digital and fintech hub for the ASEAN region. It would also transform Malaysia's financial landscape where policymakers, regulators, fintech firms, financial institutions, consumers and educators are able to collaborate closely to create a future of financial service industry that is not only safe, but also sophisticated and sustainable.

If you have any questions or require any additional information, please contact Chua Wei Min or the Zaid Ibrahim & Co. partner you usually deal with.

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