Republic of Palau
Financial Institutions Commission

Prudential Regulations & Administrative Regulations

Approved July 29, 2008
Effective September 1, 2008
Republic of Palau
Financial Institutions Commission

Prudential Regulations
&
Administrative Regulations

Approved July 29, 2008
Effective September 1, 2008
FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION
FIC-PR-01

CAPITAL ADEQUACY

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PART I: PRELIMINARY

1: **Short Title** – Capital adequacy.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Sections 31, 33 and 54 of the Act establish specific requirements relating to minimum capital and ratios for banks and financial institutions operating in Palau.

3: **Application** – This regulation applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau whose deposits are not insured in accordance with a government sponsored depository insurance program (hereafter collectively referred to as “bank”).

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

1) “**encumbered asset**” – means an asset that is pledged to secure a loan, advance or other debt obligation such that the asset is no longer available to support liabilities to depositors and creditors. For purposes of capital calculations under this regulation, the amount to be deducted is the lesser of (i) the book value of the asset pledged or (ii) the outstanding balance of the loan secured by such asset.

2) “**leverage (equity) capital**” – means Tier 1 capital plus year-to-date earnings or losses (after charges for amortizations, depreciation and fully adequate loan loss provisions) and less any general loan loss provisions; the Leverage Capital Ratio is calculated by dividing Equity Capital by Total Assets.

3) “**loan or investment of capital nature**” – means any loan, advance or other debt obligation extended directly or indirectly to a counter-party, whether secured or not, for the purpose of purchasing, investing in, or financing the holding of shares or other capital instruments issued by the lending bank.

4) “**Tier 1 capital**” – includes permanent shareholders' equity (issued and fully paid-up ordinary shares, non-cumulative perpetual preference shares and assigned capital required to be maintained by the branch of a foreign bank in accordance with Chapter II, Section 33 (f) of the Act) plus disclosed reserves (additional paid-in share premium plus undistributed profits from prior years) plus minority interests in the equity of consolidated subsidiaries, but excluding goodwill and other intangible assets, loan loss provisions (both general and specific) and all other asset revaluation reserves, future income tax benefits, losses carried forward, and encumbered assets. Assets deducted from Tier 1 capital are also deducted from Total Risk-Weighted Assets. The Tier 1 Risk-Based Capital (RBC) Ratio is calculated by dividing Tier 1 capital by Total Risk-Weighted Assets.
A capital instrument does not qualify for Tier 1 capital if it is subject to any condition, covenant, term, restriction, or provision that:
(a) restricts the ability of the bank from conducting normal banking operations;
(b) requires dividends or interest payments that are unjustified relative to the financial condition of the bank, or permits early redemption at the option of the holder in the event of financial deterioration;
(c) impairs the ability of the bank to comply with regulatory requirements regarding the disposition of assets or incurrence of additional debt; or
(d) limits the ability of a regulatory authority to take actions to resolve, re-capitalize or re-habilitate a troubled or failing bank.

5) “Tier 2 capital” — includes year-to-date earnings\(^1\) (or losses), undisclosed reserves, asset revaluation reserves\(^2\) (if allowed and consistent with accepted accounting standards), general loan loss provisions (up to 1.25% of risk-weighted assets), subordinated term debt (up to 50% of Tier 1 capital), and hybrid debt-equity capital instruments. Tier 2 capital may not exceed Tier 1 capital.

To qualify for Tier 2 capital, a hybrid debt-equity instrument must:
(a) be unsecured, subordinated, and fully paid-up;
(b) not be redeemable at discretion of the holder or without prior consent of Commission;
(c) be available to participate in losses without the bank being obliged to cease trading (unlike conventional subordinated debt);
(d) allow debt repayment obligations to be deferred (similar to cumulative preference shares) as when profitability of bank does not support repayments even if the capital instrument may carry an obligation to pay interest that cannot permanently be reduced or waived (unlike dividends on ordinary shareholders' equity).

Cumulative preference shares and mandatory convertible debt instruments having the above characteristics will normally be eligible for Tier 2 capital.

Subordinated term debt includes conventional, unsecured subordinated term debt (also called debt equity or loan capital) which has an original minimum maturity of at least five years. It also includes limited life redeemable preference shares. During the five years immediately preceding maturity, a cumulative discount amortization factor of 20% per annum will be applied to reflect the diminishing value of these instruments as a source of capital strength. Since subordinated debt is normally not available to cover losses, the amount included for capital adequacy calculations is limited to 50% of Tier 1 capital.

6) “Total Assets” — means gross assets less goodwill and other intangible assets, future income tax benefits, losses carried forward, and encumbered assets; these items are also excluded from Tier 1 capital.

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\(^1\) Must be net of adequate provisions for taxes, loan and other asset losses and cash dividends declared and unpaid.
\(^2\) Asset revaluation reserves which take the form of latent gains on unrealized equity securities are subject to a discount of 55% on the difference between historic cost book values and current market values.
7) “Total Risk-Weighted Assets” – means the total of risk-adjusted assets as calculated and reported in financial returns required to be submitted to the Commission.

8) “Total Capital” – means Tier 1 capital plus Tier 2 capital less any investments in and loans to unconsolidated banking and other financial subsidiaries, investments in the capital of other banks and financial institutions licensed to do business in Palau, and loans or investments of a capital nature. All assets required to be deducted from Total Capital are also deducted from Total Risk-Weighted Assets (RWA). The Total RBC Ratio is calculated by dividing Total Capital by Total RWA.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation is intended to ensure that each bank maintains a level of capital, in absolute terms and in relation to total assets, which (i) is adequate to protect the interests of depositors and creditors, (ii) is commensurate with the risk profile and activities of the bank, and (iii) promotes public confidence in the individual bank and in the banking system overall.

2: **Scope** – This regulation applies to the initial capital and to the capital adequacy ratios of all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau whose deposits are not insured in accordance with a government sponsored depository insurance program.

3: **Responsibility** – It is the responsibility of a bank's board of directors to establish and maintain a level of capital that complies at all times with the Act and this regulation and is fully adequate for the risk profile and activities of the bank. The capital levels required by this regulation are the minimum levels acceptable for banks that are fundamentally sound, well-managed, and have no material financial or operational weaknesses; higher capital levels may be required for individual banks based on circumstances listed below under paragraph 3, Part III.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Minimum Required Capital** – the minimum capital required of an institution to qualify for a license to conduct banking activities in Palau shall be as specified in Section 31(b) of the Act and listed below for reference; the Commission may, by regulation, increase the minimum capital amounts as necessary to promote and assure safety and soundness and protection of depositors and creditors.

(a) **Domestic banks**: for domestic banks, the minimum required capital shall be –
   i. US $500,000 if the bank is 100% Palauan owned;
   ii. US $1,000,000 if the bank is less than 100% Palauan owned.

(b) **Foreign banks**: 
   i. for a foreign bank subsidiary, the minimum capital shall be US$5,000,000, and
ii. for a foreign bank branch or a subsidiary, the minimum capital of the parent bank and all subsidiaries shall be not less than US$75,000,000, unless the foreign bank is already licensed in Palau, provided that the bank is (a) in good standing with the United States Federal Deposit Insurance Corporation, or (b) where the bank is not governed by the rules of the FDIC, it remains in good standing with its the home country supervisor and maintains depositor insurance in accordance with its home country government sponsored insurance program.

iii. branches of foreign banks also must:
(a) maintain assigned capital of US$5,000,000 in an escrow deposit under terms and conditions satisfactory to the Commission, or
(b) provide the Commission with written proof that deposits in the foreign bank branch are insured with a government sponsored depository insurance program.

2: Minimum Capital Ratios – all banks shall have at all times capital ratios that are not less than the greater of (i) the minimum ratios specified below or (ii) any higher ratios that may be set by the Commission.

(a) Leverage Capital: the minimum acceptable Leverage Capital Ratio is 5.0%.

(b) Tier 1 Risk-Based Capital: the minimum acceptable Tier 1 RBC ratio is 6.0%.

(c) Total Risk-Based Capital: the minimum acceptable Total RBC ratio is 12.0%.

In determining whether higher ratios will be required, the Commission will consider whether a bank is pursuing or experiencing significant growth; has an inordinate level of risk or inadequate risk management systems, poor asset quality, management, earnings or liquidity; and also the criteria set forth below in paragraph 3.

3: Basel-II Requirements – banks will be allowed to utilize the Basel-II capital framework upon demonstrating to the Commission that the bank has the necessary internal systems and managerial expertise. Banks will be allowed to use the "internal ratings-based" (IRB) method and the "advanced measurement approach" (AMA) to establish capital requirements (Pillar I); however, in no event will a bank be allowed to have a leverage ratio less than 5.0%, and the adequacy of capital will continue to be subject to supervisory review (Pillar II) and market discipline (Pillar III). Higher capital levels may be required depending on the risk profile and activities of a bank.

4: Restriction on Cash Dividends, Redemption of Capital Shares and Distributions of Profits – a bank shall not declare or pay a cash dividend, or redeem any of its capital shares or other capital instruments, or make any other distribution of its profits if the resulting capital ratios will be less than the minimum capital ratios in paragraph 1 above. Cash dividends and distributions of profits may only be declared or paid from earnings that have been reviewed and certified by an external auditor; however, interim distributions may be made with the prior written approval of the Commission.

5: Capital Measures and Categories – for purposes of evaluating capital adequacy and regulatory responses, the following measures and capital categories shall apply:
(a) **Capital measures**: the ratios used for measuring capital adequacy are:
- Leverage capital ratio – Tier 1 Capital divided by Total Assets.
- Tier 1 RBC ratio – Tier 1 Capital divided by Total RWA.
- Total RBC ratio – Total Capital divided by Total RWA.

(b) **Capital categories**: for purposes of supervisory responses and enforcement actions, banks will be grouped into capital adequacy categories as follow:

1. **Well capitalized** –
   - provisions for loan losses account is fully adequate and funded;
   - leverage capital ratio ≥ 8%;
   - Tier 1 risk-based capital ratio ≥ 10%;
   - Total risk-based ratio ≥ 15%;
   - not subject to any written agreement, corrective or supervisory order, or capital directive issued by the Commission;
   - at least three years have elapsed since commencing banking operations; and
   - not pursuing or experiencing rapid growth in deposits, loans or assets.

2. **Adequately capitalized** –
   - provisions for loan losses account is fully adequate and funded;
   - leverage capital ratio 5% < 8%;
   - Tier 1 risk-based capital ratio 6% < 10%;
   - Total risk-based ratio 12% < 15%;
   - not subject to any written agreement, corrective or supervisory order, or capital directive issued by the Commission; and
   - not "well capitalized" as defined above.

3. **Undercapitalized** –
   - provisions for loan losses account is inadequate and/or not fully funded;
   - leverage capital ratio 4% < 5% (or between 5%-8% and pursuing or experiencing rapid growth);
   - Tier 1 risk-based capital ratio 4% < 6%;
   - Total risk-based ratio 8% < 12%; and
   - not in compliance with any capital-related provision of any written agreement, corrective order, or capital directive issued by the Commission.

4. **Significantly undercapitalized** –
   - provisions for loan losses account is materially inadequate and not fully funded;
   - leverage capital ratio 2% < 4% (or between 4%-6% and pursuing or experiencing rapid growth);
   - Tier 1 risk-based capital ratio < 4%;
   - Total risk-based ratio < 8%; and
   - not in compliance with any capital-related provision of any written agreement, corrective or supervisory order, or capital directive issued by the Commission.
(5) Critically undercapitalized —  
- provisions for loan losses account is severely inadequate and not fully funded;  
- leverage capital ratio < 2%  
- Tier 1 and Total RBC ratios no longer relevant; and  
- not in compliance with any capital-related provision of any written agreement, corrective or supervisory order, or capital directive issued by the Commission.

(c) Re-classifications: if the Commission determines that —  
(1) the existing capital of a bank will or is likely to become impaired due to the activities, growth trends, or risk profile of a bank; or  
(2) the bank is engaging in unsafe or unsound practices or is conducting its affairs in a manner that threatens the interests of depositors or the general public; or  
(3) the bank has not corrected previously identified weaknesses in asset quality, management, earnings, liquidity or sensitivity to market risk; then  
the Commission may downgrade a bank from an existing to a lower capital category (e.g. from 'well-capitalized' to 'adequately capitalized') and require the bank to comply with a corrective or supervisory order, or a capital directive.

6: Criteria for Higher Minimum Ratios — the Commission may require a bank to achieve and maintain higher minimum ratios if a bank —  
1) has been operating less than three years;  
2) has sustained, or is expected to sustain, losses resulting in a capital deficiency;  
3) has significant exposure to risk, whether credit, market, interest rate, liquidity, operational, legal, or from other non-traditional activities;  
4) has a high, or particularly severe, volume of poor quality assets;  
5) is growing rapidly, either internally or through acquisitions;  
6) may be adversely affected by the activities or condition of its parent holding company, associates or subsidiaries; or  
7) has deficiencies in ownership, management, shareholding structure or policies and systems for risk management; or  
8) displays other factors related to safety and soundness, solvency or viability which, in the judgment of the Commission, warrants a higher level of capital protection.

7: Risk Weights — for on-balance sheet assets, the applicable risk weights are:  
0%  
- cash (notes and coin) held in the bank’s vault and in transit;  
- claims, or portions thereof, on, guaranteed by, or fully secured by securities issued by the Republic of Palau (ROP)\(^3\);  
- claims on central governments and central banks denominated and funded in a national currency, unless specifically excluded by the Commission;  
- other claims on OECD central governments and central banks;  
- claims, or portions thereof, collateralized by securities of, or guaranteed by, OECD central governments; and  
- claims, or portions thereof, fully secured by cash or pledged deposits in the same bank.

\(^3\)For a guarantee to qualify for 0% weighting, it must be affirmed, irrevocable and unconditional.
20% - claims on multilateral development banks (IBRD, ADB, EIB or others as may be approved by the Commission) and claims, or portions thereof, guaranteed by, or collateralized by, securities issued by such banks;
- claims on, and loans, or portions thereof, guaranteed by, banks incorporated in the OECD countries;
- claims on, and loans, or portions thereof, guaranteed by, domestic commercial banks and other banks incorporated in countries outside the OECD with a residual maturity of up to one year;
- claims on, and loans, or portions thereof, guaranteed by, non-domestic OECD public-sector entities, excluding the central government, subject in all cases to prior approval of the Commission; and
- cash items in process of collection, both domestic and foreign.

50% - loans fully secured by mortgages on residential property that are or will be occupied by the borrowers or that are rented⁴; and
- claims on, and loans, or portions thereof, guaranteed by, local government authorities of Palau; and
- claims on public enterprises if approved by the Commission.

100% - claims on the private sector;
- claims on, or loans guaranteed by, domestic commercial banks and other banks incorporated outside the OECD with residual maturity of over one year;
- claims on central governments outside the OECD (unless denominated and funded in a national currency);
- claims on public sector entities not listed above and claims on commercial companies owned by public sector entities;
- premises, plant and equipment and other fixed assets;
- real estate owned and other investments (including non-consolidated investment participations in other companies);
- capital instruments issued by other banks (unless deducted from capital); and
- all other assets, excluding those deducted from capital.

8: Credit Conversion Factors - for off-balance-sheet items, the credit conversion factors below shall apply and must be multiplied by the weights for the corresponding on-balance sheet asset category. The Commission will, in its discretion, allocate particular instruments into categories based on the characteristics of the instrument.

(a) Factor Off-balance sheet instrument
100% Direct credit substitutes⁵ (e.g. general guarantees including standby letters of credit used to guarantee loans and securities; and bankers' acceptances and endorsements equivalent to acceptances).

⁴ Exclude loans for speculative development of residential property and loans to companies or persons to finance housing developments.
⁵ Include items where the risk of loss is equivalent to a direct claim on the counterparty. If, however, the risk depends on a future event which is independent of the creditworthiness of the counterparty, the items should be subject to a 50% conversion factor.
50% Transaction-related contingent items (e.g. performance and bid bonds, warranties, standby letters of credit tied to specific transactions.

20% Short-term self-trade-related contingencies (e.g. documentary credits collateralized by underlying shipments).

100% Sale-and-repurchase agreements and assets sales-with-recourse where credit risk remains with selling bank.

100% Forward asset purchases, forward deposits and partly-paid shares and securities which represent commitments with specific drawdowns.

50% Note issuance facilities and revolving underwriting facilities.

50% Other commitments (e.g. formal stand-by facilities, credit lines) with an original maturity of more than one year

0% Similar commitments with an original maturity of less than one year, or which can be unconditionally cancelled at any time

(b) Credit Risk – Forwards, swaps, purchased options and similar contracts: the treatment of forwards, swaps, purchase options and similar derivative contracts require special attention because banks are not exposed to credit risk for the full face value of their contracts but only to the potential cost of replacing the cash flow (on contracts showing positive value) if the counterparty defaults. The credit equivalent amounts will depend, inter alia, on the contract maturity, and the volatility of rates and prices for the type of instrument. Instruments traded on exchanges may be excluded where they are subject to daily receipt and payment cash variation margin.

Interest rate contracts – includes single-currency interest rate and basis swaps, forward rate agreements, interest rate futures and options, and similar instruments.

Foreign exchange rate contracts – defined to include cross-country interest rate swaps, forward foreign exchange contracts, currency futures, currency options purchased and similar instruments. Exchange rate contracts with an original maturity not exceeding 14 calendar days may be excluded.

Gold contracts – Gold contracts are treated the same as exchange rate contracts for the purpose of calculating credit risk except that contracts with original maturity not exceeding 14 calendar days are included.

Precious metals (other than gold) contracts – defined to include forwards, swaps, purchased options and similar derivative contracts that are based on precious metals (e.g. silver, platinum and palladium); such contracts receive separate treatment.

Other commodities contracts – contracts are treated separately; include forwards, swaps, purchased options and similar derivative contracts based on energy, agriculture, base metals and any other non-precious metal commodity contracts.

Equity contracts – includes forwards, swaps, purchased options and similar contracts based on individual equities or equity indices.
(c) **Current exposure method:** Banks that engage in any of the instruments defined in paragraph (b) above must calculate the credit equivalent amounts by (i) adding the total replacement cost of all contracts having positive value (obtained by "marking-to-market"), thus capturing the current exposure, and then (ii) adding an amount (called the "add-on") for potential future credit exposure calculated on the basis of the total notional principal amount\(^6\) of its book, split by residual maturity as follows:

<table>
<thead>
<tr>
<th>Residual Maturity</th>
<th>Interest Rate</th>
<th>Exchange Rate</th>
<th>Equities</th>
<th>Precious Metals</th>
<th>Other Commodities</th>
</tr>
</thead>
<tbody>
<tr>
<td>One year or less</td>
<td>0.0%</td>
<td>1.0%</td>
<td>10.0%</td>
<td>8.0%</td>
<td>10.0%</td>
</tr>
<tr>
<td>Over one year, but not more than five years</td>
<td>0.5%</td>
<td>5.0%</td>
<td>12.0%</td>
<td>10.0%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Over five years</td>
<td>1.5%</td>
<td>10.0%</td>
<td>15.0%</td>
<td>12.0%</td>
<td>15.0%</td>
</tr>
</tbody>
</table>

**Notes to exposure methods:**

1. For contracts with multiple exchanges of principal, the conversion factors are to be multiplied by the number of remaining payments in the contract.
2. For contracts structured to settle outstanding exposures after specified payment dates and where the terms are reset such that the market value of the contract is zero on the specified dates, the residual maturity must be set equal to the time until the next reset date. In the case of interest rate contracts with remaining maturities of more than one year and which meet the above criteria, the add-on factor is subject to a floor of 0.5%.
3. Forwards, swaps, purchased options, and similar derivative contracts not covered by any of the columns in this matrix are to be treated as "other commodities".
4. No potential future credit exposure shall be calculated for single currency floating/fixed interest rate swaps; the credit exposure on such contracts shall be evaluated solely on the basis of its mark-to-market value.

Once credit equivalent amounts have been calculated using either method above, the amounts shall be multiplied (i.e. weighted) by the weight applicable to the corresponding on-balance-sheet asset category.

(d) **Bilateral netting:** (1) Subject to discretion of the Commission, banks may net transactions if subject to valid and binding bilateral netting agreements, i.e. novation (an agreement under which an obligation of a bank to deliver a specified amount of currency on a given value date to a counterparty is combined with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations) and (2) banks may also net transactions subject to any legally valid form of bilateral netting not covered in (1) above, including other forms of novation. In both cases (1) and (2), a bank must satisfy the Commission that it has:

(i) a netting contract or agreement with the counterparty which creates a single legal obligation, covering all included transactions, such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions in the event a counterparty

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\(^6\) In the event that the stated notional amount is leveraged or enhanced by the structure of the transaction, banks must use the effective notional amount when determining potential future exposures to ensure that the add-ons are based on effective rather than apparent notional amounts.
fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

(ii) written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the bank’s exposure to be such a net amount under:
- the laws where the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the laws where the branch is located;
- the law that governs the individual transactions; and
- the law that governs any contract or agreement necessary to effect the netting.

(iii) procedures in place to ensure that legal characteristics of netting arrangements are kept under review in light of possible changes in relevant law.

Contracts containing walk-away clauses are not eligible for netting when calculating capital requirements. A walk-away clause permits a non-defaulting counterparty to make limited payments or no payment even if the defaulter is a net creditor.

Credit exposure on bilaterally netted forward transactions must be calculated as the sum of the net mark-to-market replacement costs, if positive, plus an add-on based on the notional underlying principal. The add-on for netted transactions ($A_{Net}$) is equal to the weighted average of the gross add-on ($A_{Gross}$) and the gross add-on adjusted by the ratio of net current replacement cost to gross current replacement cost (NGR). This is expressed through the following formula:

$$A_{Net} = 0.4 \times A_{Gross} + 0.6 \times NGR \times A_{Gross}$$

where NGR = (level of net replacement cost) divided by (level of gross replacement cost for transactions subject to legally enforceable netting agreements)$^8$

(e) Risk weighting: Credit equivalent amounts must be weighted based on the category of counterparty the same as on-balance sheet items, including weighting for exposures backed by eligible guarantees and collateral (e.g. 0% for cash, guarantees or government securities; 20% for securities issued by multilateral development banks; and 50% for local government guarantees). Cash collateral must be held by the bank and subject to legal right of setoff at all times, and guarantees must be explicit, irrevocable, unconditional and legally enforceable in order to attract the lower weighting factors. In addition, since most counterparties in these markets, particularly for long-term contracts,
tend to be first-class names, a 50% weighting may be applied in respect of counterparties which would otherwise attract a 100% weight.

(f) Market risk – derivative contracts: market risk for un-hedged positions of derivative contracts is included in the risk-weighted capital ratio by allocating a 100% weight. For foreign exchange rate contracts, banks must apply the weighting factor to the higher of (i) the sum of all long FX positions or (ii) the sum of all short positions.

9: **Capital Restoration Plan** – Any bank which fails to comply with the minimum ratios stated in paragraph 2 above, or with any higher minimum ratios that may be required by the Commission under paragraph 3, shall submit to the Commission a detailed plan to restore capital to adequate and conforming levels. To be acceptable, the plan (i) must state how and when the bank will comply with the required capital ratios, and (ii) must be submitted within 30 days after the end of the calendar quarter in which the breach occurred or within such shorter time as the Commission may require due to the severity of the capital deficiency.

10: **Reporting Requirements** – Each bank shall submit returns in respect of capital adequacy in the form and frequency as the Commission may prescribe.

**PART IV: CORRECTIVE MEASURES**

1: **Remedial measures and sanctions** – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.
PART V: EFFECTIVE DATE

1: Effective date – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted July 23, 2008

[Signature]
Governing Board
Financial Institutions Commission
Republic of Palau

Approved July 29, 2008

[Signature]
Honorable President
Tommy E. Remengesau, Jr.
FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION
FIC-PR-02

ASSET CLASSIFICATION, PROVISIONING AND SUSPENSION
OF INTEREST

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PART V
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PARAGRAPH
1. Effective Date
PART I: PRELIMINARY

1: Short Title – Asset classification and provisioning.

2: Authorization – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 54 of the Act provides that the Commission may establish specific requirements concerning classification and evaluation of assets, provisions to be made on the basis of such classification, and non-performing criteria.

3: Application – This regulation applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau (hereafter collectively referred to as a “bank”).

4: Definitions – Terms used within this regulation are as defined in the Act, as defined below, or as reasonably implied by contextual usage:

1) “capitalized interest” – means any accrued and uncollected interest which has been added to the principal balance at a payment date or maturity; it also includes unpaid interest which is refinanced or rolled-over into a new loan; for purposes of this regulation, capitalization of interest will not be permitted unless:
   a) the borrower has the ability to repay the entire debt (including both principal and interest) in the normal course of business;
   b) the capitalization of interest was anticipated when the loan was originally made based on the borrower’s planned temporary lack of cash flow;
   c) the debt is well-secured by the net realizable value of collateral security;
   d) repayment, including all capitalized interest, is based on a reasonably ascertainable future event; and
   e) the borrower can obtain funds from other sources at similar rates and terms.

For overdrafts and other loans or advances not having pre-established repayment programs or where interest is capitalized to the account as a normal practice, deposits to the account during a period of temporarily diminished cash flow should be at least sufficient to cover accrued interest for the period.

2) "current" – when referring to financial statements, asset appraisals or valuations, or in similar contexts, means the information or documentation is not more than one year old or such shorter period if specified herein.

3) “in the process of collection” – means that collection of a debt is proceeding in due course in a timely manner either through:
   a) legal action, including the enforcement of a judgment against the borrower; or
   b) by collection efforts not involving legal action but which are reasonably expected to result in full repayment of the debt (including principal and all accrued interest) within 180 days, or in restoration of the debt to a current status through payment of all principal and interest which is due.
4) “loans and advances” – means any direct or indirect advance of funds (including obligations as maker or endorser arising from discounting of commercial/business paper) which are made to a person on the basis of an obligation to repay the funds, or which is repayable from specific property pledged by or on behalf of a person.

5) “net realizable value” – means that amount which a bank can reasonably expect to realize after discounting the value of security collateral to current market conditions and also after deducting the reasonable and estimable costs of recovery and sale. Costs of recovery and sale typically include but are not limited to: legal fees, costs of valuation, selling, insurance cover, maintenance, security, and any other expenses that may be necessary to put the collateral in a saleable condition.

6) “non-accrual” – means that accrual of interest has been suspended and an asset has been placed on a cash basis for financial reporting purposes. Interest is no longer accrued on the books of the bank nor is it taken into income unless paid by the borrower in cash or otherwise provided in this regulation. Non-accrual assets include all assets which are non-performing unless an asset is both (i) well-secured and (ii) in the process of collection.

7) “non-performing” – means that an asset is no longer generating income. For purposes of this prudential regulation, the entire outstanding balance of an asset is considered non-performing when:
   a) any portion of principal or interest is due and unpaid for 90 days or more; or
   b) interest payments for 90 days or more have been capitalized, re-financed, or rolled-over into a new loan.

Overdrafts and other loans not having pre-established repayment programs are considered non-performing when any of the following conditions exist:
   a) the debt exceeds the approved limit for 90 consecutive days or more;
   b) the borrowing line has expired for 90 days or more;
   c) interest is due and unpaid for 90 days or more; or
   d) the account has been inactive for 90 days, or deposits have been insufficient to cover the interest that was capitalized during the period.

The entire principal balance owing (not just the sum of delinquent payments) must be shown as non-performing when preparing and submitting financial returns to the Commission.

8) “past due” or “overdue” – means any asset for which:
   a) any portion of principal or interest is due and unpaid for 30 days or more; or
   b) interest payments equal to 30 days interest or more have been capitalized, refinanced, or rolled-over.

Overdrafts and other loans and advances not having pre-established repayment programs are considered past due when any of the following conditions exist:
   a) the debt exceeds the approved limit for 30 consecutive days or more;
   b) the borrowing line has expired for 30 days or more;
c) interest is due and unpaid for 30 days or more; or

d) the account has been inactive for 30 days, or deposits have been insufficient to cover the interest capitalized during the period.

The entire principal balance owing (not just the sum of delinquent payments) is to be shown as past due when preparing and submitting financial returns to the FIC.

9) "provisions for loan losses" – also referred to as "allowance for loan and lease losses"; means a balance sheet valuation account established through charges to provisions expense in the profit-and-loss statement and against which bad loans, or portions thereof, are written-off.

10) "well-secured" – means that a loan is secured by:

a) collateral that can repay the full debt (principal plus accrued interest) through timely sale under an involuntary liquidation program; also, (i) proper legal documentation must be held, (ii) the collateral must have a "net realizable value" which covers principal, accrued interest, and costs of collection, and (iii) there can be no prior liens which prevent the bank from obtaining clear title; or

b) a guarantee from a financially responsible party where the beneficiary bank has performed proper financial analysis and determined that the guarantor is financially sound, well-capitalized, and able to honor the guaranty on demand; such guarantees must be (i) irrevocable and unconditional, (ii) payable on default of the borrower, and (iii) independently confirmed by the guarantor.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation establishes uniform regulations to be followed by banks to ensure that: (i) loans are regularly evaluated using an objective grading system that is consistent with regulatory requirements; (ii) the accounting treatment for non-performing assets is consistent with recognized accounting regulations and regulatory reporting requirements; and (iii) timely and adequate provisions are made and write-offs taken to reflect accurately the capital and earnings performance of the bank. It is also intended to encourage the development of effective work-out plans for problem assets and effective internal controls to manage such assets.

2: **Scope** – This regulation applies to all loans and advances carried on or off the balance sheet of a bank.

A Palau foreign bank branch, with the prior written approval of the Commission, may use and follow the policies and procedures adopted by the foreign bank’s board of directors for the classification (grading) of loans and maintenance of provisions for loan losses provided (i) the deposits of the foreign bank, including the deposits of the Palau foreign bank branch are insured in accordance with a government sponsored depository insurance program, and (ii) the policies and procedures for the classification (grading) of loans and the maintenance of provisions for loan losses comply in all material respects with the
requirements of the foreign bank’s home country supervisory authority and those of its deposit insurer.

3: **Responsibility** – It is the responsibility of the board of directors of each bank to adopt a written loan policy and to establish a loan review process which accurately identifies risk, ensures the adequacy of provisions for loan losses, and properly reflects the condition and operations of the bank in required financial returns.

**PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS**

1: **Loan Review - (a) Frequency and reporting.** The board of directors shall cause a review to be made of the quality of its loans and advances on a regular basis, at least at the end of each calendar quarter. Reports of such reviews shall be made on a timely basis directly to the board of directors and shall include enough information for the board to identify problems and require bank officers to promptly correct the problems.

(b) **Objectives.** The loan review function shall ensure that: (i) the loan portfolio and lending function conform to a sound, written lending policy which has been adopted and approved by the board of directors; (ii) executive management and the board of directors are adequately informed regarding portfolio risk; (iii) problem credits are identified, classified, and placed on non-accrual in accordance with this regulation; (iv) fully adequate provisions are made to the provisions account; and v) write-offs of identified losses are taken promptly.

(c) **Review.** At a minimum, the following loans or classes of loans shall be reviewed on a schedule that is sufficiently regular to ensure timely and accurate identification and reporting: (i) credits that exceed 10% of capital; (ii) credits that are or should be shown as non-accrual or non-performing under this regulation; (iii) a sampling of all other loans as appropriate to reach valid conclusions about the condition of the loan portfolio and the adequacy of loan loss provisions; and loans previously classified Doubtful either by the bank’s internal loan review program, the Commission, or the bank’s home country supervisory authority.

2: **Suspension of Interest - (a) Transfer to non-accrual status.** A loan is to be placed on non-accrual if: (i) it is maintained on a cash basis because of deterioration in the financial condition or paying ability of the borrower; (ii) payment in full of principal or interest is not expected; or (iii) it is non-performing unless it is both well-secured and in the process of collection as defined in this regulation.

(b) **Write-back of accrued interest.** Any interest which is accrued but not collected and still carried on the books shall be written-off by the end of the calendar quarter in which the loan is, or should have been, placed on non-accrual status, but in no event later than 90 days after being transferred to non-accrual status.

Interest which has already been taken into profits and capitalized by increasing the principal balance of the loan shall be reversed from when the loan is, or should have
been, placed in non-accrual status. Interest accrued during the current year shall be charged back against the interest income account; interest accrued in prior years shall be charged against the loan loss provisions account.

(c) Treatment of cash payments, and criteria for cash basis recognition of income. If a loan is on non-accrual and ultimate collection of all principal is in doubt, then any cash payments received shall be applied only to reduce principal. However, if the principal balance remaining after a partial write-off is regarded as collectible, then cash payments may be applied to interest income.

Where recognition of interest income is appropriate for an asset held on a cash basis, the income that may be shown is limited to the amount accrued at the contractual rate. Any cash payments in excess of this amount (and not applied to the remaining book balance) shall be recorded as recoveries of prior write-offs until all such write-offs have been fully recovered. For a loan to be considered fully recoverable, it must be supported by a current credit documentation as defined in the Act.

(d) Return to accrual status. A non-accrual loan may only be returned to accrual status when (i) no principal or interest is past due and full repayment of all remaining contractual principal and interest is reasonably expected, or (ii) when the loan is both well-secured and in the process of collection. To satisfy condition (i), a bank must have received payment in cash for all delinquent principal and interest unless the loan has been formally restructured and qualifies for accrual status. Until a loan is restored to accrual status, cash payments received shall be handled as required in paragraph (c) above.

(e) Treatment of multiple loans to one borrower. If a bank has multiple loans to a single borrower or group of related borrowers, and one loan meets the criteria for non-accrual status, then the bank shall evaluate every other loan to that borrower and place any other loans on non-accrual status if circumstances so require.

3: Classification of Assets – All loans and other assets shall be classified using the classification grades below, provided, a loan may be assigned a split classification, whereby two or more portions of the same loan are given separate classifications if appropriate. For example, a bank has an unsecured loan to a borrower in bankruptcy. The bankruptcy trustee has indicated a minimum and maximum disbursement to unsecured creditors of 40% and 65%, respectively. In this example, the proper classification of the loan would be 40% Substandard, 25% Doubtful and 35% Loss.

A bank may use classification grades different from the regulatory classification grades contained in this regulation so long as they bank maintains written documentation which correlates the bank’s classification grades to the regulatory classification grades. If different classification grades may be assigned due to interpretation of subjective criteria, the more severe grade should apply.

Significant departure from the primary source of repayment may justify an adverse grade even if a loan is current or appears supported by collateral. Classification also may be appropriate if original repayment terms were too liberal or past due payments have been
cured by refinancing or additional advances. Appendix A provides helpful guidance for assigning classification grades.

**Regulatory Classification Grades:**

(a) **Pass.** Loans or assets in this category are fully protected by the current sound worth and paying capacity of the obligor or the collateral pledged, are performing in accordance with contractual terms, and are expected to continue doing so.

(b) **Special Mention.** Loans or assets in this category are secured and repayment is not yet jeopardized but deficiencies exist which may, if not corrected, weaken the asset or the bank’s position at some future date. Such loans may be current or may be delinquent for up to 90 days. Deficiencies may include: inability to properly supervise the loan due to an inadequate loan agreement; deteriorating condition or control of collateral; deteriorating economic conditions or adverse trends in obligor’s financial position which jeopardize repayment capacity. This grade should not be used if a Substandard grade is warranted. A Special Mention classification would generally be appropriate for any asset which is past due 60 days or more but less than 90 days.

(c) **Substandard.** Loans or assets in this category are not adequately protected by the current sound worth and paying capacity of the obligor. The primary source/s of repayment is not sufficient to service the debt, and the bank must rely on secondary sources such as realizing on collateral, sale of fixed assets, refinancing, or capital injections from external sources. Substandard assets have well-defined weaknesses that jeopardize the orderly repayment of the debt. These assets may, or may not, be past due but have a higher than normal risk due to absence of current credit documentation. There is distinct possibility that the bank will sustain loss if deficiencies are not corrected. A Substandard classification would generally be appropriate for any asset which is past due 90 days or more but less than 180 days.

Re-negotiated and restructured loans shall continue to be graded Substandard unless (i) all past due interest is paid in cash at the time of restructuring, and (ii) all principal and interest payments have been made according to the modified repayment schedule for at least six months from the date the loan was re-structured.

(d) **Doubtful.** Loans or assets in this category have all the weaknesses inherent in Substandard assets but the loans are not well-secured. Weaknesses make collection in full highly questionable and improbable on the basis of existing facts, conditions, and value. The possibility of loss is high, but the actual amount of loss cannot be fully determined because specific pending factors may mitigate. Pending factors may include a merger, acquisition, or liquidation; a capital injection; obtaining additional collateral; or refinancing. If pending events do not occur within 180 days and repayment must again be deferred, Loss classification is warranted.

A Doubtful classification would generally be appropriate for any asset which is past due 180 days or more up to 360 days, unless (i) the asset is well-secured, (ii) legal action has
commenced, and (iii) the time to realize on collateral or on a guarantee does not exceed 180 days.

(e) Loss. Loans or assets in this category are deemed uncollectible or of such little value that carrying on the books is no longer warranted. Loss classification does not mean there will never be a recovery, but rather that it is no longer appropriate to defer writing off the asset. Losses shall be taken when identified as uncollectible and shall not remain on the books while pursuing long-term recovery efforts.

A Loss classification would generally be appropriate for any asset which is past due 360 days or more unless (i) the asset is well-secured, (ii) legal action has commenced, and (iii) the time to realize on collateral or on a guarantee does not exceed 180 days. In some cases, a reduced carrying value or partial write-down is justified. If a partial write-down is taken, the remaining book value must be supported by tangible facts.

Loans classified Loss shall be written off by a charge against provisions for loan losses; in no event should loan write-offs be taken directly to capital accounts. When a loan or portion of a loan is written-off, all accrued but unpaid interest should also be written off or reversed. Current period interest should be reversed and prior period interest that was taken into income should be charged against the provisions account.

4: Classification downgrades – If, at an on-site examination or otherwise, a loan or asset is graded lower by the Commission than by the bank, the bank shall (i) re-classify the asset to the lower grade assigned by the Commission, and (ii) make provisions as required. Subsequent upgrades, or further downgrades, shall be made if circumstances justify.

5: Provisioning Requirements - (a) Provisions account. All banks, including branches of foreign banks licensed by the Commission to conduct financial activities in Palau, shall maintain an account on the balance sheet called "provisions for loan losses" or "allowance for loan and lease losses". The account shall be created by charges to provision expense in the profit and loss statement and shall be maintained at a level that is adequate to absorb estimated losses.

At the end of each calendar quarter, or more frequently if warranted, an evaluation shall be made of the loan portfolio and based thereon, appropriate entries shall be made to the provisions account in the profit and loss statement to ensure that (i) the provisions account is fully funded, and (ii) earnings are accurately reported.

(b) Additions/reductions to the provisions account. Additions to the provisions account shall be made by charges to provision expense in the income statement. Write-offs and recoveries shall be charged to the provisions account; loans must not be written off or recovered directly to current year earnings or to capital accounts.

(c) Provisioning for small loans. In cases where a bank has numerous smaller loans, a bank can apply the provisioning percentages in paragraph (d) below to the aggregate total of a pool of loans.
(d) Provisioning amounts. In determining the potential loss for individual loans or for pools of smaller loans, all relevant factors shall be considered including, but not limited to current economic conditions, loss experience, delinquency trends, quality of underwriting practices, accuracy of loan review, and effectiveness of loan recovery efforts.

At a minimum, the following provisioning amounts are to be maintained:

- i) for loans graded “Pass” or “Acceptable” 1%
- ii) for loans graded “Special Mention” 5%
- iii) for loans graded “Substandard” 20%
- iv) for loans graded “Doubtful” 50%
- v) for loans graded “Loss” 100%

(i) More or less: If reliable factors indicate higher loss potential, then provisions greater than the above shall be maintained. If a bank demonstrates to the satisfaction of the Commission that lower provisions are justified, then lower amounts may be used.

(ii) Gross vs. net balance: The provisioning percentages above shall be applied against the gross loan balance for loans graded Pass, Special Mention or Substandard. For loans graded Doubtful or Loss, the provisioning percentage shall be applied to the net exposure after deducting the "net realisable value" of collateral. (Refer to paragraph (e) below.) In no event shall the provision amount be less than the amount that would be required if a loan is graded in the next higher category.

(iii) Cash-secured: Any loan, or portion thereof, secured by cash, by a segregated deposit in the lending bank, by a security issued by the Republic of Palau national government (Government), or by an unconditional and irrevocable obligation or guaranty of Government, is exempt from classification and the provisioning requirements of this regulation.

(iv) Write-off vs. full provisioning: Any loan, or portion of, that is, or should be, classified “Loss” may be fully provisioned for and charge-off deferred to the end of the current calendar quarter but not later than 90 days after being classified Loss.

(e) Treatment of Collateral. Loan classification grades should be based on an assessment of the primary repayment source – being an assessment of the financial capacity and/or cash flow of the borrower. Collateral should then be considered in determining the severity of the classification grade. For example, whether a loan should be classified Substandard because it is well-secured by collateral in the process of collection, or whether it should be classified Doubtful or Loss because the value of the collateral does not provide adequate protection to the bank from loss. Because collateral is generally illiquid, costly to acquire and maintain, and difficult to value during periods of financial distress, provisioning percentages shall be applied against the gross outstanding balance of loans graded Pass, Special Mention or Substandard. For loans graded Doubtful or Loss, the net realizable value of collateral may be deducted from the loan balance before applying the provisioning percentages. In the case of real property collateral, the net realizable value may be deducted only if transferability of title is
certain and an active market for the property exists. An "active market" means that a willing buyer and willing seller exist and a sale is reasonably expected within one year.

In no event shall provisions for a loan graded Doubtful or Loss be less than the amount required if the loan were graded in the next higher grade. For example, provisions for a loan graded Doubtful must be at least 20% of the gross outstanding loan balance.

6: **Examiner review.** Each bank shall maintain adequate records to support its determination of loan loss potential and provisions and make such records available to the Commission for inspection on request. If a review by the Commission concludes that additional provisions are required for individual loans or for the loan portfolio in aggregate, the bank will be instructed to make the necessary adjusting entries.

7: **Reporting Requirements.** Each bank shall submit to the Commission returns as may be required and in the form and frequency as the Commission may prescribe.

**PART IV: CORRECTIVE MEASURES**

1: **Remedial measures and sanctions** – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.
PART V: EFFECTIVE DATE

1: Effective date – The effective date of this regulation shall be 1<sup>st</sup> September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted July 23, 2008

[Signature]

Governance Board
Financial Institutions Commission
Republic of Palau

Approved July 29, 2008

[Signature]

Honorable President
Tommy E. Remengesau, Jr.
LOAN CLASSIFICATION (GRADING) MATRIX

A combined assessment of financial condition and repayment history of a borrower should be used to arrive at an initial classification grade for a loan. Adjustments to the initial grade should then be made based on mitigating or unique circumstances. The Loan Classification Matrix below provides criteria for assigning a preliminary classification grade.

<table>
<thead>
<tr>
<th>Financial Condition</th>
<th>Repayment History</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong</td>
<td>Pass</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>Special Mention</td>
</tr>
<tr>
<td>Fair</td>
<td>Substandard</td>
</tr>
<tr>
<td>Marginal</td>
<td>Substandard</td>
</tr>
<tr>
<td>Unsatisfactory</td>
<td>Doubtful</td>
</tr>
</tbody>
</table>

Definitions: The definitions below are used in the Matrix above.

**FINANCIAL CONDITION**

**Strong**
Borrower’s financial condition is of highest quality based on detailed, current financial statements; normal indicators of financial health indicate borrower is readily able to repay both principal and interest according to original terms of loan agreement.

**Satisfactory**
Borrower is financially stable but various aspects exist regarding the financial condition of the borrower that are less than first-rate, though generally minor in nature.

**Fair**
Borrower is financially stable but various unsatisfactory aspects exist regarding the financial condition of the borrower, some of which may be significant.

**Marginal**
Borrower is not financially stable and unsatisfactory aspects which are significant exist regarding the financial condition of the borrower.

**Unsatisfactory**
Borrower’s financial condition is highly unsatisfactory; liquidation or formal insolvency proceedings have begun or likely will commence shortly.
**REPAYMENT HISTORY**

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong</td>
<td>Interest and principal are current (i.e., not past due) and there is no evidence that the current loan balance includes any capitalized amounts of either principal or interest from previous loan rollovers. A grace period of no more than 7 days may be allowed before payments are considered past due to allow for administrative errors on the part of borrower or the bank.</td>
</tr>
<tr>
<td>Fair</td>
<td>Interest or principal has historically been past due for more than 7 days but less than 30 days, or there is evidence of interest or principal capitalization.</td>
</tr>
<tr>
<td>Unsatisfactory</td>
<td>Interest or principal has been past due for more than 30 days, or there is evidence of equivalent rescheduling of payments or capitalization of interest.</td>
</tr>
</tbody>
</table>
FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION
FIC-PR-03

STATISTICAL and RELATED INFORMATION

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Preliminary

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PARAGRAPH
1. Effective Date
PART I: PRELIMINARY

1: **Short Title** – Statistical information.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. Section 26 of the Act requires the Commission to collect statistical information, and Section 58 requires all banks to produce annual audited financial statements.

3: **Application** – This regulation applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau (hereafter collectively referred to as “bank”).

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation specifies the statistical and related information that a bank must submit to the Commission, the required form and frequency for such information, persons responsible for certifying the accuracy and timely submitting of the data, duties and responsibilities of the board of directors, and the confidentiality of such information.

2: **Scope** – This regulation applies to reports of statistical and financial data and external audit reports which must be submitted to the Commission by banks operating in Palau.

3: **Responsibility** – It shall be the responsibility of the board of directors to ensure that (i) a bank has internal accounting and recordkeeping systems sufficient at all times to create and maintain properly detailed records and accounts, (ii) information required by the Commission is accurate and complete, and (iii) reports required by the Commission are prepared and submitted in a timely manner. As appropriate, the board may designate a committee or person to ensure compliance with the above; however, such delegation does not relieve the board of its duty to oversee the affairs of the bank and ensure compliance with the Act and this regulation.

It shall be the responsibility of the chief executive officer and the chief financial officer (or in the case of a Palau branch of a foreign bank the branch/country manager and the branch accounting officer) to attest, on behalf of the board of directors, to the accuracy of information submitted in reports required by the Commission.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Quarterly Reports** – all banks shall prepare and submit quarterly reports to the Commission by not later than the 30th day of the month immediately after each calendar
quarter end (Mar 31, Jun 30, Sep 30, and Dec 31). Such quarterly reports shall such contain information and be in the form as specified by the Commission. In general, the reports will require the following types of information:
1) statement of financial position (balance sheet)
2) statement of income and expenses (profit and loss)
3) supplementary schedules (detailed information on assets and liabilities)

2: **Annual Reports** – all banks shall prepare and submit to the Commission by not later than the 30th day of January of each year the following information:
1) for banks incorporated in Palau:
   (a) a list of all shareholders,
   (b) a list of all members of the board of directors and all administrators, and
   (c) a list of all subsidiaries, affiliates and related companies of the bank.
2) for foreign banks that operate branches in Palau:
   (a) a list of all shareholders who own 20% or more of the outstanding shares,
   (b) a list of all administrators at the branch level plus the person at the main office who is responsible for oversight of the foreign branch, and
   (c) a list of all subsidiaries, affiliates and related organizations of the branch that conduct operations in Palau.

3: **Audit Report** – within six months after the end of each bank’s fiscal year, each bank shall cause to be produced audited financial statements prepared on a consolidated basis and shall submit to the Commission (i) the complete audit report together with the opinion of the auditor, plus (ii) the auditor’s letter to management. For foreign banks that operate branches in Palau, the audit report, which is prepared on a consolidated basis, shall contain a separate balance sheet and a separate income statement that reflect the operations of the Palau branch on a stand-alone, provided such separate branch balance sheet and income statement may be internally prepared and certified by the chief financial officer of the foreign bank.

**PART IV: CORRECTIVE MEASURES**

1: **Remedial measures and sanctions** – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.
PART V: EFFECTIVE DATE

1: **Effective date** — The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted<br>

Financial Institutions Commission<br>Republic of Palau

Approved<br>

Honorable President<br>Tommy V. Remengesau, Jr.
FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION
FIC-PR-04

SINGLE BORROWER and LARGE EXPOSURE LIMITS

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1. Effective Date
PART I: PRELIMINARY

1: **Short Title** – Loan limits.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 54 of the Act establishes limits for credits to any single person or group of interrelated persons and for large credits.

3: **Application** – This regulation applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau whose deposits are not insured in accordance with a government sponsored depository insurance program (hereafter collectively referred to as “bank”).

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined below, or as reasonably implied by contextual usage:

1) **“associate”** – means any person over whom another person exerts or has the ability to exert significant influence and who is not a subsidiary of the first person; also referred to as an "affiliate" or "affiliated person".

2) **“capital”** – means Tier 1 capital as defined in the Commission’s Prudential Regulation FIC-PR-01, Capital Adequacy.

3) **“cash deposit”** – means a sum of money held by the lending bank in either an escrow account or a deposit account at the lending bank and the owner of the money has pledged the funds in writing as security for a loan from the bank.

4) **“common enterprise”** – a common enterprise exists when (i) the expected source of repayment is the same or substantially the same for advances made to different but related borrowers, (ii) exposures are made to persons related by common control where the persons are engaged in inter-dependent businesses, (iii) there is substantial financial inter-dependence among them, or (iv) two or more borrowers are so closely affiliated as to be reasonably considered a common enterprise.

5) **“control”** – for purposes of this regulation, control is presumed to exist when (i) one or more persons acting together directly or indirectly own, control, or have power to vote 20% or more of the voting shares of another person; or (ii) one or more persons acting together control, in any manner, the election of a majority of the directors, trustees, or others exercising similar functions over another person; or (iii) any other circumstances exist which indicate that one or more persons acting together exercise a controlling influence, directly or indirectly, over the activities, management, practices or policies of another person.

6) **“corporate group”** – means a corporation plus all its subsidiaries and associates or affiliates; an enterprise is a subsidiary or an associate of another corporation if the other
corporation exerts, or has the power to exert, control or have significant influence over 50% or more of the voting shares of the enterprise.

7) “direct benefit” – means that the proceeds of a loan, or assets purchased with loan proceeds, are transferred to or for the benefit of another person unless the transfer is part of a normal business transaction where the proceeds are used to acquire property, goods or services in a bona fide arm’s length transaction.

8) “exposure” – means a “credit” as defined in the Act and includes any loan or credit, funded or unfunded, given to a person on the basis of an obligation to repay or which is repayable from specific property pledged by or on behalf of a person; the term exposure also include indirect exposures as defined below. The term includes the placement of funds or deposits with another bank with maturities more than seven days.

8.1 funded exposures are those for which the bank has provided funds to the borrower or to a third party on behalf of the borrower;

8.2 unfunded exposures are those which have not yet been funded but the bank is legally obligated to do so at a future date or event;

8.3 direct exposures are funded and unfunded exposures where the borrower is the primary obligor or is a co-maker to the loan and is the person to whom the bank and courts must look first for repayment of the obligation;

8.4 indirect exposures are where a person agrees and becomes obligated to repay a debt in the event that the primary obligor defaults or is unable to repay; an example of indirect exposure is where a loan given to one person is guaranteed by another person; the recipient of a loan is the ‘primary’ obligor and is a direct exposure while the guarantor is the ‘secondary obligor’ and is an indirect exposure; both persons may, however, be equally liable under the law to repay the obligation.

8.5 large exposure means any direct exposure to a single borrower or to a group of related borrowers which, in aggregate, equals or exceeds 10% of capital.

9) “related persons” – two persons will be considered to be related if one person has the ability, directly or indirectly, to control the other person or to exercise significant influence over the financial and operating decisions of the other person, or if both persons are subject to common control or common significant influence.

9.1 group of interrelated persons means two or more persons, companies, corporations, partnerships or other business enterprises which are closely related through common ownership, control, management, financial inter-dependence or cross-guarantees. The definition also includes persons who are family members that are financially inter-dependent upon one or more persons within the group.

10) “significant influence” – means the ability to participate in a material way in the financial and operating policies and decisions of another person; the absence of absolute
control does not preclude the ability to exert significant influence over the policies and decisions of another person. If one person holds, directly or indirectly through subsidiaries, 10% or more of the voting power over another person, it will be presumed that the first person exerts or has the ability to exert significant influence over the second person. Conversely, if a person holds, directly or indirectly through subsidiaries, less than 10% of the voting power over another person, it will be presumed that the first person does not exert or have ability to exert significant influence unless there are compelling circumstances to the contrary. A substantial or majority ownership in one person by second person does not preclude a third person from having significant influence over the first person.

11) “subsidiary” – means a company that is controlled by another which is referred to as the ‘parent’. Control means the power to influence, directly or indirectly, the policies and decisions of a company so as to gain benefits from its activities.

PART II: STATEMENT OF POLICY

1: Purpose – This regulation restricts credit risk, relative to capital, for exposures to a single person, a group of closely-related or financially inter-dependent persons, a corporate group, and large exposures in aggregate. This regulation also promotes diversification of credit risk and wider access to credit by limiting concentrations of credit.

2: Scope – This regulation applies to all exposures, direct or indirect, held by banks licensed by the Commission to conduct financial activities in Palau.

3: Responsibility – It is the responsibility of the board of directors and managing officers of each bank to adopt policies and procedures which are adequate and which ensure that all exposures (i) comply with the limits set forth in the Act and this regulation, and (ii) are made and administered in accordance with prudent lending practices.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: Limitations – The following limits shall apply:
   (a) Single person: the total direct exposures at any time, funded or unfunded, by a single person or group of interrelated persons, shall not exceed 20% of capital.
   
   (b) Large exposures: the total of all large exposures, as defined in this regulation, shall not at any time exceed 800% of capital.
   
   (c) Compliance with policy: all credit extended by a bank shall comply with a written, board-approved lending policy that is fully adequate for the lending activities of the bank.

2: Exceptions – The following exceptions shall apply to the limits in paragraph 1 above:
(a) **Government-backed debts.** Exposures, or portions thereof, which the national government of the Republic of Palau has unconditionally guaranteed as to payment of both principal and interest, or that are fully secured by full faith and credit obligations of the national government, are exempt from the limits in paragraph 1 above. However, exposures of companies that are owned or controlled by the national government, whether directly or indirectly or wholly or in part, but which are separate legal entities shall be subject to the limits in paragraph 1 unless the national government has unconditionally guaranteed or is directly obligated for the debts of such companies.

(b) **Exposures secured by cash deposits.** Exposures, or portions thereof, that are fully secured by cash deposits in the lending bank shall be exempt from the limits in paragraph 1 above. However, for this exception to apply, the deposit must be (i) explicitly assigned to the bank in writing by the customer, (ii) segregated and under the sole control of the bank, and (iii) the bank must have legal right to set off the deposit against the exposure at any time. If a cash deposit is in a different currency than the loan, then the amount of exposure exempt from the limit shall be the amount of the deposit converted into the same currency as the loan using the current rate of exchange.

(c) **Indirect exposures.** Exposures, or portions thereof, that are indirect as defined herein shall be exempt from the limits in paragraph 1 above. However, the Commission will aggregate indirect exposures with direct exposures for purposes of applying the 20% limit if the particular facts and circumstances indicate that an unsafe credit concentration is arising by virtue of this exception.

(d) **Bank guaranteed debts.** Exposures, or portions thereof, that are fully guaranteed by another bank shall be exempt from the limits in paragraph 1 above. However, the total of all exposures backed by guarantees issued by any one bank may not exceed 200% of the lending bank’s capital at any time. For this exception to apply, the guaranteeing bank must not be (i) related to the lending bank or (ii) rated lower than the three highest grades by an internationally recognized bank rating agency, and the guarantee must be (iii) unconditional and irrevocable, and (iv) acceptable to the Commission as to form and content.

If the Commission demands performance on a bank guarantee issued for this exception, then the bank which is the beneficiary of the guarantee will be restricted from (i) declaring or paying cash dividends, (ii) repatriating or distributing profits or capital funds to any shareholder, and (iii) paying amounts to any related person or associate for management or advisory services or other fees related to supervisory, executive, managerial, or policy-making functions until the obligation under the guarantee has been paid in full. This restriction does not apply, however, to reasonable and ordinary payments for data processing, auditing, or mortgage servicing made pursuant to pre-existing, written contracts unless the Commission specifically restricts such payments.

3: **Attribution and aggregation** – Credits extended to one person shall be attributed to and aggregated with credits to another person and shall be subject to the 20% single borrower limit when (i) loan proceeds are re-loaned to another person (i.e. accommodation), (ii) loan proceeds are used for the direct benefit of another person (the ‘use’ test), or (iii) the
two persons constitute a common enterprise and the enterprise is expected to generate or provide the funds to repay the loan/s (the ‘source’ test). For purposes of this regulation, the Commission will determine, based on the particular facts and circumstances, when a credit nominally granted to one person shall be combined with credits to another person.

4: Loans to partnerships – (a) To the partnership: For purposes of this regulation, the total exposure of a partnership shall include the credits to all general partners but not the credits to limited partners unless (i) the proceeds of credits to limited partners are used for the direct benefit of the partnership, or (ii) the credits to limited partners are repayable primarily from the profits of the partnership.

(b) To partners: For purposes of this regulation, the total exposure of each general partner shall include credits to the partnership but not credits to limited partners unless (i) the proceeds of credits to limited partners are used for the direct benefit of the general partner/s or (ii) the credits limited partners are repayable primarily from funds provided by the general partner/s.

(c) For purchasing interests in partnership: For purposes of this regulation, a loan to a person for the purpose of purchasing an interest in the partnership will be combined with loans made to the partnership.

(d) Limited interests: If a partnership agreement specifies that limited partners are not liable for the debts of the partnership, the rules in paragraphs (a), (b) and (c) above shall apply to all general partners but not to limited partners. However, if the partnership agreement specifies that limited partners are liable for a portion of the partnership debt in proportion their partnership interest, then their pro rata share of the partnership debt will be combined with their personal loans to determine their total exposure to the bank.

5: Loans written off – The lending limits in paragraph 1 (a) and (b) above apply to all loans, including any loans which have been written off in whole or in part. Loans that have been discharged by a court in bankruptcy or that are no longer legally enforceable shall not be included in the total for determining compliance with the limits in paragraph 1.

6: Loan participations – Any credit or portion thereof that has been sold as a participation to another bank shall not count against the limits in paragraph 1. For this exception to apply, the participation must be covered by a written agreement which specifies that in the event of a default both banks will share in payments and recoveries on a pro rata basis according to their respective participation percentages at the time of default.

7: Loan syndications – When two or more banks extend credit to a single borrower under a single credit facility (e.g. a syndicated credit), the limits in paragraph 1 above apply only to the funds provided by each bank and representing that bank’s pro rata share of the total loan. For this exception to apply, the syndication agreement must be in writing and must specify explicitly the terms and exposures of each bank in the syndicated credit.
8: **Capitalized interest** – Accrued but uncollected interest is not subject to the limits in paragraph 1 unless it has been capitalized by adding to the principal of the loan with a corresponding entry to interest income.

9: **Nonconforming exposures** – Exposures which do not conform to the limits in paragraph 1 when this regulation comes into effect, or which subsequently become nonconforming, will be treated as follows:
   (a) If an exposure conforms to the limits when made but subsequently exceeds the limits because (i) the bank’s capital declines, (ii) the borrower merges or forms a common enterprise with another borrower, (iii) the bank merges with another bank which also holds exposures to the borrower, (iv) the lending limits or the method for calculating the capital base changes, or (v) an exception under paragraph 2 no longer applies, then the exposure will be treated as ‘nonconforming’.
   
   (b) If an exposure becomes ‘nonconforming’, the board of directors or branch manager shall be required to act promptly to bring the exposure into compliance unless doing so would adversely affect the ability of the bank to receive full repayment of the credit.

10: **Reporting Requirements** – Each bank shall submit returns in respect of exposures in the form and frequency as the Commission may prescribe.

**PART IV: CORRECTIVE MEASURES**

1: **Remedial measures and sanctions** – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.
PART V: EFFECTIVE DATE

1: Effective date – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted July 23, 2008

Governing Board
Financial Institutions Commission
Republic of Palau

Approved July 29, 2008

Honorable President
Tommy E. Remengesau, Jr.
FOREIGN CURRENCY EXPOSURE LIMITS

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PART I: PRELIMINARY

1: **Short Title** – Foreign currency exposure limits.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended.

3: **Application** – This regulation applies to all Palau banks and branches of foreign banks licensed by the Commission to conduct financial activities in Palau whose deposits are not insured in accordance with a government sponsored depository insurance program (hereafter collectively referred to as “banks”).

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined below, or as reasonably implied by contextual usage:

1) “capital” – means Tier 1 capital as defined in the Commission’s Prudential Regulation FIC-PR-01, Capital Adequacy.

2) “foreign currency exposure” – means the equivalent sum in the currency used in Palau of all net assets or liabilities denominated in foreign currencies, whether on or off-balance sheet, unless prior approval has been given by the Commission for exclusion.

3) “intra-day foreign exchange risk exposure” – means the foreign exchange risk exposure, in a single currency or in the aggregate of all currencies, which a bank incurs between the opening and close of business on the same day.

4) “overall foreign currency exchange risk exposure” – means the sum of all net on-balance sheet and off-balance sheet assets or liabilities denominated in foreign currencies, expressed as the equivalent amount of the currency used in Palau at the spot mid-rate and using the shorthand method for measurement.

5) “single currency exchange risk exposure” – means the larger of a long position (assets) or short position (liabilities) measured using the shorthand method, denominated in a single foreign currency and expressed as a domestic currency equivalent amount at the spot mid-rate.

6) “shorthand method” – means the method for measuring the overall foreign exchange risk exposure by (i) adding all short positions separately and all long positions separately, (ii) comparing the two totals, and (iii) using the larger of the two totals as the overall open position.

7) “spot mid-rate” – means that rate, expressed as a factor of the domestic currency equivalent, at which a foreign currency is converted to domestic currency equivalent.
PART II: STATEMENT OF POLICY

1. **Purpose** - This regulation is intended to: 1) ensure that the risk to capital from foreign currency exposures is within prudent limits; 2) promote maximum availability within the domestic market of foreign exchange at competitive rates; and 3) allow banks to conduct business in a profitable yet prudent manner.

2. **Scope** – This regulation applies to all foreign currency positions held by banks licensed by the Commission to conduct financial activities in Palau.

3. **Responsibility** - It shall be the responsibility of the board of directors of each bank to establish a system for monitoring and managing its foreign currency exposures prudently and in compliance with the limits in this regulation.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1. **Limits**: (a) the overall foreign exchange risk exposure (short and long currency positions) both on-balance sheet and off-balance sheet, as measured using spot mid-rates and the shorthand method shall not exceed 30% of capital; (b) the exposure for a single currency, irrespective of short or long position, shall not exceed 15% of capital; (c) intra-day risk exposures, in single currencies and overall, shall be monitored and kept within prudent limits as set by the board of directors in a written policy for foreign currency exposures. The single and overall foreign currency risk limits above apply on a “global” basis, i.e., a bank may have different internal limits for different branches and subsidiaries; however, the limits above apply on a global basis to the bank on a consolidated basis.

2. **Computation of exposures** – each bank shall calculate its single currency exposure and its overall foreign currency exposure using the short-hand method.

3. **Correction of breaches** – each bank shall take action to immediately correct any foreign exchange risk exposures which exceed the limits in this regulation. Failure to correct any over-limit exposure within a reasonable time may result in sanctions or remedial measures imposed by the Commission.

4. **Supporting documentation** – each bank shall maintain a daily record showing close-of-business foreign exchange risk positions for single currencies and overall and also a reconciliation of opening-to-closing positions.

5. **Reporting Requirements**. Each bank shall submit reports to the Commission for foreign currency exposures in the form and frequency as the Commission may prescribe.
PART IV: CORRECTIVE MEASURES

1: Remedial measures and sanctions – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.

PART V: EFFECTIVE DATE

1: Effective date – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted [July 23], 2008

[Signature]
Governing Board
Financial Institutions Commission
Republic of Palau

Approved [July 29], 2008

[Signature]
Honorable President
Tommy E. Remengesau, Jr.
FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION

FIC-PR-06

TRANSACTIONS WITH RELATED PERSONS

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PART I: PRELIMINARY

1: **Short Title** – Transactions with related persons.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 56 of the Act establishes specific limits on transactions with related persons.

3: **Application** – This regulation, unless otherwise provided herein, applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau (Palau foreign bank branch) (hereafter collectively referred to as a “bank”).

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

1) **"capital"** – means Total capital as defined in the Commission’s Prudential Regulation FIC-PR-01, Capital Adequacy.

2) **"loan"** – means the same as the term ‘credit’ defined in the Act and includes all credit exposures between a bank and a borrower and the placement of funds or deposits with another bank with maturities more than seven days.

3) **"related person"** – means any person who participates in policy-making functions of a bank or who has authority to lend or invest bank assets or incur liabilities on behalf of the bank in the normal course; includes all persons who are related as set forth in Section 56(b) of the Act, and also includes all persons who are (i) members of the board of directors, or (ii) a legal person that has a significant interest in a parent company which holds or exercises control over a bank, and (iii) any other company that is affiliated with the bank or parent company through common ownership, control or management.

For purposes of a foreign bank licensed to operate a branch in Palau (Palau foreign bank branch), a related person of a Palau foreign bank branch would include other offices of the foreign bank.

4) **"transaction"** – means any transaction with a related person, other than loans or credit exposures; for purposes of this regulation, the term 'transactions' includes the following transactions between a bank and a related person of the bank:

   (a) purchases, leases or sales of assets, whether financial or non-financial, tangible or intangible, or involving movable or immovable property;

   (b) agreements or contracts for the provision or receipt of services, with or without fees, such as accounting, advisory, appraisal, consulting, credit administration and collateral control, data processing, insurance, legal, loan guarantees or agreements of protection, loan processing, safekeeping, staff secondments, technical assistance, training, and other similar financial, operational or professional services;
Transactions with Related Persons

(c) borrowings from a related person in the form of notes, subordinated debentures, securities sold under an agreement to repurchase, assumptions or incurrence of a liability, or any similar forms of indebtedness;
(d) investments in the shares of a related person; or
(e) any other transaction which, on the basis of its structure, terms or conditions, can reasonably be construed as being, or intended to be, a transfer of value to a related person.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation is intended to ensure that all transactions and credit exposures between a bank and a related person of the bank, including transactions between a Palau foreign bank branch and the head or home office or another branch or office of the foreign bank –
   (a) are within applicable limits as set forth in the Act or regulations issued by the Commission,
   (b) are on substantially the same terms and conditions (i.e. at “arm’s length”) as the same or similar transactions between a bank and an unrelated person,
   (c) do not result in capital or income being transferred to a related person in a manner that gives unwarranted preference to a related person,
   (d) do not adversely affect the solvency, liquidity or profitability of a bank, and
   (e) are not used as a means of evading capital or other regulatory requirements.

2: **Scope** – This regulation, unless otherwise provided herein, applies to all transactions between a bank operating in Palau and persons who are related parties of the bank as defined in this regulation, and also to all loans by a bank to related persons.

3: **Responsibility** – It is the responsibility of the board of directors of each bank to: (a) establish an appropriate policy in respect of transactions with and loans to related parties, (b) ensure that the necessary procedures are adopted to implement the policy, and (c) monitor and ensure compliance to the policy, this regulation and the Act.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Minimum Requirements** – The following minimum requirements shall apply to all transactions with and credit exposures to related persons:
   (a) **Conformance to policy:** All transactions between a bank and a related person and all loans to a related person shall conform to a written policy that has been approved and adopted by a majority of the entire board of directors and such policy must be adequate to ensure compliance with this regulation, the Act and prudent banking practices;
   (b) **Non-preferential terms:** All transactions between (i) a bank and a related person, including contracts for the payment of goods and services, and (ii) all loans by a bank to a related person, including the placement of funds or deposits by a Palau foreign bank branch with the head office or another branch or office of the foreign bank, shall be at
"arm’s length", i.e. must be on substantially the same terms and conditions in respect of charges, fees, interest rate, liability, maturity, price, repayments, risk, security, etc. as the same or similar transactions between a bank and an unrelated person,

(c) Prior Board approval: Any single transaction (including any group of closely-related or similar transactions that are in substance a single transaction) between a bank, and a related person that exceeds the lesser of $10,000 or 5% of a bank's capital shall be approved in advance by a majority of the entire board of directors; for purposes of this regulation, the amount of a transaction, or group of closely-related transactions, is the aggregate amount to be paid (or received) for services received (or given), or the book value at the time of the transaction of an asset to be sold or purchased or a liability to be assumed or incurred. A Palau foreign bank branch whose deposits are insured in accordance with a government sponsored depository insurance program is exempt from this requirement, however, the Palau foreign bank branch shall comply with any and all requirements as may be required by the foreign bank’s home jurisdiction.

2: Limits – The following limits shall apply to loans made by a bank to related persons:
(a) Single person: the total amount outstanding at any time for all loans to any one related person shall not exceed 20% of a bank’s capital; and
(b) Aggregate: the total amount outstanding at any time for all loans to all related persons shall not exceed 100% of a bank’s capital.

A Palau foreign bank branch whose deposits are insured in accordance with a government sponsored depository insurance program is exempt from this requirement, provided the Palau foreign bank branch shall comply with any and all requirements as may be required by the foreign bank’s home jurisdiction.

3: Prohibited Transactions – No bank shall:
(a) purchase a low quality asset from a related person or become obligated to a related person in respect of a low quality asset; for purposes of this regulation, a low quality asset is any asset that is, or should be, classified as Special Mention or a lower grade according to Commission regulation FICR-PR-02 “Asset Classification...”; or
(b) sell or otherwise transfer an asset to a related person at a price or value that is below the current fair market value of that asset; or
(c) purchase an asset from a related person at a price or value that is above the current fair market value of that asset.

4: Reporting Requirements – Each bank shall submit returns in respect of transactions with related persons and loans to related persons as the Commission may prescribe.
PART IV: CORRECTIVE MEASURES

1: **Remedial measures and sanctions** – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.

PART V: EFFECTIVE DATE

1: **Effective date** – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted _July 23_, 2008

_Governing Board_
Financial Institutions Commission
Republic of Palau

Approved _July 29_, 2008

_Honorable President_
Tommy E. Remengesau, Jr.
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1. Effective Date

Attachments:
(1) Sample Format for Business Plan
(2) Format for Personal Financial Statement
PART I: PRELIMINARY

1: **Short Title** – Application/s for banking license.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 32 of the Act requires the Commission to prescribe by regulation information that must accompany an application for a license, and Sections 34 and 80 give to the Commission authority to charge fees in connection with license applications and the direct and indirect costs of supervision and regulation.

3: **Application** – This regulation applies to all applicants for a license to conduct banking activities in Palau whether as a bank or a branch or subsidiary of a foreign bank.

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage:

PART II: STATEMENT OF POLICY

1: **Purpose** – The purpose of this regulation is to (i) establish the minimum information that must be submitted, (ii) specify the fees that must be paid, and (iii) ensure that appropriate public disclosure is made in respect of an application for a license to conduct banking activities in Palau.

2: **Scope** – This regulation applies to applications for a license to conduct banking activities in Palau, whether as a domestic bank or as a branch or subsidiary of a foreign bank.

3: **Responsibility** – It is the responsibility of the applicant/s for a banking license to submit all required information, pay all required fees, and comply with any other requirements of the Commission in connection with an application for a banking license.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Prohibited activities** – No person shall engage in activities and no bank shall conduct its affairs if doing so is or will result in a violation of Section 3 of the Act.

2: **Required information** – Each application for a license to conduct banking activities in Palau, whether as a domestic bank or as a branch or subsidiary of a foreign bank, must be accompanied by an application in the form prescribed by the Commission and containing such information as required by the Commission. At a minimum, all applications must provide the following basic information:

   (1) People: the qualifications and experience of all persons are or are proposed to be –
      (i) administrators of the bank or the branch,
      (ii) non-executive directors of a bank or foreign bank subsidiary, and
(iii) members of the board of directors and senior management of any company that will own or control 50% or more of the voting shares of the bank or the foreign bank subsidiary operating in Palau;

(2) Capital: the amount of proposed capital for the bank or foreign bank subsidiary or, in the case of a foreign bank branch, the amount of capital of the foreign bank;

(3) Business plan: a business plan indicating organizational structure, proposed financial activities, and financial projections for the bank or foreign bank branch or subsidiary; and

(4) Principal shareholders: the name, qualifications and experience of each person proposed to own 10% or more, directly or indirectly, of the voting shares of the bank or foreign bank subsidiary.

The Commission, at its sole discretion, may request that an applicant submit additional or supplemental information as is reasonably necessary for the Commission to evaluate the merits of an application.

3: Required fees – Each application for a license to conduct banking activities in Palau, whether as a domestic bank or as a branch or subsidiary of a foreign bank, must be accompanied by a $2,500 initial processing fee and a $7,500 issuance fee. Such fees must be paid to the Commission by certified check drawn on a Palau bank or on a foreign bank branch or subsidiary in Palau, and such fees are non-refundable and no application will be reviewed or considered until such fees are received by the Commission.

4: Additional costs – The Commission, at its sole discretion, may engage the services of any person or professional firm to assist in investigating and evaluating the merits of an application. The costs of such services will be assessed against the applicant/s and no license will be approved or granted until such costs are repaid in full to the Commission.

5: Processing – The Commission will be guided by the following process when receiving, evaluating and making a decision in respect of an application for a banking license:

(1) First submission: when an application is first submitted, the Commission will note the date of receipt; however, no action will be taken to review or consider the application until the fees required in paragraph 3 above are received by the Commission.

(2) Complete application: applicants will have six months from the date of first receipt to submit an application that is materially complete as determined by the Commission. If a complete application is not submitted within six months from the date of first submission, the application and all supporting materials will be returned to the applicant and all fees will be forfeited to the Commission.

(3) Evaluation: once a complete application is received, the Commission will have 60 days to evaluate the application and approve or deny the application; the 60-day time period may, however, be extended by the Commission for up to an additional 60 days if the Commission deems it necessary to obtain and evaluate additional information.

(4) Decision: the Commission will approve or deny an application before the end of the 60-day period, or the extended period as the case may be, and notify the applicant of its decision as provided in Section 33(a) of the Act.
(5) Conditions: in approving an application for a license, the Commission may impose conditions, as provided in Section 33(b) of the Act; such conditions must be satisfied by the licensee prior to commencement of business.

(6) Failure to comply with conditions: if the proposed bank fails to comply with the conditions and commence operations within six months from the date a conditional approval is granted, the Commission will revoke the license as provided in Section 33(c, d) of the Act, and the application and all materials will be returned and all fees will be forfeited to the Commission.

(7) Final approval: if the Commission determines that the conditions specified in a conditional approval have been satisfied, which determination shall include an on-site inspection of the adequacy of the policies and systems for managing the risks and activities of the proposed bank, the Commission will issue forthwith a final approval.

In respect of a foreign bank applying to establish a subsidiary or a branch in Palau, final approval for a license will be granted only if the Commission is satisfied that the requirements in Section 33(e, f) of the Act have been met.

(8) Follow-up inspection: the Commission will conduct a 'post-opening' exam within 90-180 days after a bank commences operations to assess whether the bank is operating in a safe and prudent manner, in compliance with its license and all applicable laws and regulations, and in accordance with the business plan on which the license was approved.

PART IV: CORRECTIVE MEASURES

1: Remedial measures and sanctions – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.
PART V: EFFECTIVE DATE

1: **Effective date** – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

 adopted July 23, 2008  
Governing Board  
Financial Institutions Commission  
Republic of Palau

Approved July 29, 2008  
Honorable President  
Tommy E. Remengesau, Jr.

Attachments:  
(1) Sample Format for Business Plan  
(2) Business Plan Checklist  
(3) Format for Personal Financial Statement
Attachment 1

BUSINESS PLAN
[Suggested Format and Information Requirements]

A. Identifying Information

1. Name and Location. State the name and location of the bank, including the locations of any branches or other office facilities.

2. Organizational Structure. Describe and provide a diagram of the bank’s organizational structure including any parent company and all subsidiaries and affiliated entities of the bank. Describe and provide a diagram of any subsidiaries and affiliated entities of principal shareholders, directors or executive officers of the bank.

3. Summary. Briefly describe how and why the proposed changes will benefit the bank and comply with the business plan. For a new banking license, the business plan should discuss how the organizing group came together, and indicate the reasons for submission of the application for a banking license.

B. Market Analysis

1. Market. Identify the markets currently served and those proposed to be served by the bank, including any new or proposed branch or other office facilities.

2. Characteristics. Describe the target market demographics and economic characteristics. Include any anticipated changes in the market, factors influencing such changes, and possible effects on the bank.

3. Competition. Identify and describe the competition (include all other financial services providers, i.e., banks, credit co-operative societies, micro-lenders, brokerage companies, insurance companies, etc.) located within the target markets of the proposed bank including any branches or other office facilities contemplated.

C. Business Strategy and Objectives

1. Market Area. Identify the market areas from which the bank generates or expects to generate approximately seventy-five percent (75%) of its business. Describe any changes that may occur as a result of the proposed transaction. Include information on any significant competing financial services providers.

2. Services. List and briefly describe the services to be offered. Distinguish among depository services, credit services, and other services. Specify any proposed new services.
3. **Assumptions.** Describe the objectives and strategies for serving the identified target markets. List assumptions, including at a minimum: market growth rates, anticipated competition, interest rates, cost of funds, overhead, asset mix, return on assets, dividends, and capital ratios (leverage capital and risk-based).

4. **Asset/Liability Management.** Discuss the reasons for the proposed asset/liability mix and actions that will be taken to reduce funding and interest rate risks.

5. **Annual Audit.** Discuss what provisions have been made for independent, annual, external audit services.

D. **Leadership and Management**

1. **Structure.** Describe the management organization structure of the bank, and indicate any anticipated changes.

2. **Ownership and Management.** List the names, home addresses, and nationality of all current/proposed organizers, principal shareholders, directors or executive officers of the bank. Indicate the number and percentage of shares each individual or group is expected to own or control.

3. **Executive Officers.** Describe the responsibilities of each executive officer, including those officers responsible for major functional areas of the bank, including, but not limited to lending and credit administration, operations and internal controls, investments and asset-liability management, treasury and foreign exchange (currency) and each branch/other office facility manager.

4. **Qualifications.** Discuss the qualifications of the current/proposed directors and executive officers showing the nature and extent of experience each possesses.

5. **Compensation.** Provide a list of the proposed fees, salaries or other forms of compensation (including benefits) for each director and executive officer.

6. **Agreements.** Describe any agreement (e.g., data processing, loan processing, etc.) the bank has or intends to make to obtain services from others. Provide the names of proposed service providers and relationship(s), if any, to organizers, principal shareholders, directors or executive officers of the bank.

7. **Lease Agreements.** Describe any lease agreements the bank has or intends to enter into with any organizer, principal shareholder, director or executive officer of the bank or with any company controlled by an organizer, principal shareholder, director or executive officer of the bank. Provide: (i) a copy of the proposed lease agreement; (ii) information showing market rate comparisons of terms and rates; (iii) and the names of any organizer(s), director(s) or director(s) who are involved.

E. **Capitalization/Net Worth**
1. **Capital.** Describe the bank’s current/proposed capital structure. For a new banking license, state the initial proposed capitalization of the bank and justify the amount proposed given minimum capitalization requirements as may be promulgated by the Financial Institutions Commission, and market factors, strategies, and expenses. Additional capital may be required by the Financial Institutions Commission on a case-by-case basis.

2. **Capital Plan.** Describe any plans for raising capital and for financing growth over the first/next three (3) years. Applications for a new banking license should indicate the type and number of shares to be authorized and to be issued, par value per share, and sales price per share. Detail any expenses to be paid from the initial capital offering or which will be capitalized and amortized over a future period.

3. **Debt.** Describe any debt (current or proposed, for capitalization or acquisition) of any individual or entity that will own or control, directly or indirectly ten percent (10%) or more of the equity or of any class of shares with voting rights of the bank. Describe any anticipated dividends, fees or salaries that will be paid by the bank, directly or indirectly, to service the debt.

**F. Pro Forma Statements**

Detailed pro forma balance sheet and income and expense statements must be submitted. Statements must show asset, liability and capital projections for three years. Sample pro forma statements are provided in Appendix 2, “Business Plan Checklist”.

BUSINESS PLAN CHECK LIST

I. Identify Information:
   A. 1. Name of proposed bank.
       2. Location of main office of proposed bank.
       3. Locations of branches or other office facilities proposed.
   B. 1. Name and address of parent company, if applicable.
       2. Name and addresses of subsidiaries, if applicable.
       3. Name and addresses of affiliates, if applicable.
   C. 1. Name and address of subsidiaries of organizers, principal shareholders, directors and executive officers, if applicable.
       2. Name and address of affiliates of organizers, principal shareholders, administrators and executive officers, if applicable.
   D. 1. Explanation of genesis of the proposed transaction.
       2. Reasons for the proposed transaction (new banking license, change of significant ownership interest, issuance of capital debt instruments, etc.)

II. Market Analysis:
   A. Definition of target market areas.
   B. 1. Supporting market research, such as area demographics and economics.
       2. Identification of major factors affecting the selected market areas.
       3. Analysis of selected market areas’ needs.
   C. 1. Identification and analysis of competition within selected market areas.

III. Business Strategy and Objectives:
    A. Targeted market areas can reasonable produce seventy-five percent (75%) of the business in light of the bank’s resources and targeted customer base.
    B. Services to be provided are listed and adequately described.
    C. 1. Strategies are consistent with stated objectives.
       2. Profitability expectations and assumptions are reasonable.
    D. 1. Pro Forma statements are accurately prepared with major assumptions adequately disclosed, and are consistent with strategies to capture and support market share.
       2. Strategic objectives, pro forma statements, and market plans are consistent.
       3. Estimates of operating results are reasonable and supported.
       4. Planning assumptions are realistic given the local.
    E. The asset/liability mix is adequately discussed. The bank has procedures to address funding and interest rate risks.
    F. External independent audit program will be provided for the first three (3) years of operations.

IV. Leadership and Management:
    A. Organizational structure of the proposed bank is adequately described.
    B. Duties and responsibilities of all executive officers/functional areas of the bank are adequately detailed.
C. Names, addresses and nationality of all organizers, principal shareholders, directors and executive officers are disclosed as applicable.

D. Proposed directors and executive officers are qualified given the services to be provided and targeted market areas.

E. Fees, salaries, and other forms of compensation for directors and executive officers are disclosed.

F. Leasing transactions or service agreements involving organizers, principal shareholders, directors and executive officers or related interests thereof, are fully disclosed.

V. Capitalization/Net Worth:

1. Initial capitalization complies with minimum statutory requirement and is adequately supported given targeted market areas, strategies, and projected organizational expenses.

2. For applications for new banking licenses, proposed capitalization is adequate for at least the first three (3) years of operation. For other applications, plans to maintain capital in accordance with regulatory requirements are adequately detailed and reasonable.

B. Plans to raise capital, both for start-up and subsequent growth, are formulated and are reasonable.

C. Current and proposed debt is disclosed. The debt service does not adversely affect the bank. Individuals involved in the application possess sufficient resources to service the debt without support (dividend payments or other fees) from the bank or demonstrate that reliance placed on earnings of the bank does not endanger the safety and soundness or the capital adequacy of the bank.

VI. Pro Forma Statements

A. Detailed pro forma balance sheets and income and expense statement show asset, liability and capital projections for a minimum of three (3) years.

B. At a minimum, the information shown in the schedules on the following pages must be provided for a business plan to be acceptable. Additional data should be included, as necessary, to explain important elements of the planned asset and liability mix (for example, the loan and deposit schedules might be expanded). Average annual balances, rather than year-end estimates, should be used in preparing pro forma balance sheet projections. In addition, the assumptions used in the preparation of the pro forma statements (such as interest rate assumptions, loan yields, and cost of funds, etc.) are be provided.
Attachment 3

Business Plan Check List
Sample Pro Forma Statements
Balance Sheet Projections
(in 000’s)

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes and Coins</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Due From Financial Institutions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities &amp; Overdrafts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans &amp; Overdrafts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Provisions for Bad Loans</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets (Net of Depreciation)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreclosed Real Estate</td>
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<tr>
<td>Other Assets</td>
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<tr>
<td>Total Assets</td>
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<table>
<thead>
<tr>
<th>Liabilities:</th>
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</thead>
<tbody>
<tr>
<td>Deposits</td>
<td></td>
</tr>
<tr>
<td>Due to Financial Institutions</td>
<td></td>
</tr>
<tr>
<td>Other Borrowings</td>
<td></td>
</tr>
<tr>
<td>Other Liabilities</td>
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<tr>
<td>Total Liabilities</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital:</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Issued and Fully Paid Common Stock</td>
<td></td>
</tr>
<tr>
<td>Paid-in Premium</td>
<td></td>
</tr>
<tr>
<td>Retained Earnings (Prior Years)</td>
<td></td>
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<tr>
<td>Income (Loss) Year-to-date</td>
<td></td>
</tr>
<tr>
<td>Other2 (Specify Type and Amount)</td>
<td></td>
</tr>
<tr>
<td>Total Capital</td>
<td></td>
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<tr>
<td>Total Liabilities &amp; Capital</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Capital Ratios:</th>
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</thead>
<tbody>
<tr>
<td>Leverage Capital / Total Assets</td>
<td></td>
</tr>
<tr>
<td>Tier-1 Capital / Total RWA</td>
<td></td>
</tr>
<tr>
<td>Total Capital / Total RWA</td>
<td></td>
</tr>
</tbody>
</table>

1 Itemize/describe all accounts/amounts that total five percent (5%) or more of total other assets or total other liabilities accounts, respectively.

2 “Other” capital accounts/instruments require the approval of the Financial Institutions Commission prior to issuance.
## Loan Details:
- Real Estate Loans
- Commercial Loans
- Installment Loans
- Other Loans (describe)
- Less: Provisions for Bad Loans
- Net Loans

## Deposit Detail:
- Demand & Checking
  - Palau Government
  - Palau Government-owned Corporations
  - Individuals / Consumers
  - Corporations/Business/Partnerships
  - Other (describe)
- Total Savings Deposits
- Total Time/Certificates of Deposit
  - Sub-total Short Term (up to 90 days)
    - Under $100,000
    - $100,000 & Over
  - Sub-total Medium Term (91 to 365 days)
    - Under $100,000
    - $100,000 & Over
  - Sub-total Long Term (Over 365 days)
    - Under $100,000
    - $100,000 & Over
- Total Deposits

<table>
<thead>
<tr>
<th>Loan Details/Deposit</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
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</tbody>
</table>
### Interest Income:
- Interest & Fees on Loans
- Interest on Deposits in Banks
- Interest & Dividends on Securities
- Other Interest Income 1
  - Total

### Interest Expense:
- Interest Paid on Deposits
- Interest Paid to Banks
- Other Interest Expense 1
  - Total

### Net Interest Income
- Provisions for Loan Losses

### Net Income from Lending & Investing

### Non-Interest Income:
- Fees & Commissions – Loans
- Fees & Charges – Deposits
- Fees – Other
  - Other Non-Interest Income 1
  - Total

### Non-Interest Expense:
- Salaries & Benefits – Dir & Offers
- Salaries & Benefits – Employees
- Fixed Asset Expense
  - Other Non-Interest Expense 1
  - Total

### Net Operating Income – Before Taxes
- Less: Applicable Income Taxes

### Net Operating Income – After Taxes

---

1 Itemize / describe all accounts/amounts that total five percent (5%) or more of total amount reported on this line.
### Business Plan List – Sample Pro Forma Statements

**Income and Expense Projections (Detail)**

(in thousand of U.S. Dollars)

<table>
<thead>
<tr>
<th>Capital Funds:</th>
<th>Year 1</th>
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<th>Year 3</th>
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</thead>
<tbody>
<tr>
<td>Beginning Capital Funds</td>
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<td></td>
</tr>
<tr>
<td>Organizational Expenses (if capitalized)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Operating Income (Loss)</td>
<td></td>
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<tr>
<td>Other Increases (Decreases)</td>
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<td></td>
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<tr>
<td>Less: Dividends</td>
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<td></td>
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<tr>
<td>Ending Capital Funds</td>
<td></td>
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<table>
<thead>
<tr>
<th>Allowance for Loan Losses:</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning Balance</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Gross Loan Losses (Write-offs)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Recoveries</td>
<td></td>
<td></td>
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<tr>
<td>Net Losses (Recoveries)</td>
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<tr>
<td>Other Increases (Decreases)</td>
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<tr>
<td>Ending Balance</td>
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<table>
<thead>
<tr>
<th>Miscellaneous:</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
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<tr>
<td>Number of Executive Officers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of Employees</td>
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<tr>
<td>Yield on Total Loans</td>
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<td></td>
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<tr>
<td>Yield on Total Investments</td>
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<tr>
<td>Interest Income to Avg Earning Assets</td>
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<tr>
<td>Interest Expense to Avg Earning Assets</td>
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<td></td>
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</tr>
<tr>
<td>Average Earning Assets</td>
<td></td>
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</tr>
</tbody>
</table>

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1 Describe all increase and decreases, and the corresponding amount for each item reported in this line.

Business Plan
A confidential personal financial statement report must be completed and filed by each person proposing to acquire a "significant interest" in a Palau financial institution. A "significant interest" means owning or controlling, directly or indirectly, twenty percent (20%) or more of the outstanding equity or any class of shares with voting rights of a financial institution. "Person" includes an individual, two (2) or more individuals acting in concert, any type of partnership, corporation, syndication, trust, or any other organization, or any combination of the forgoing, and the information required in this application is required for each member of the group. A confidential personal financial statement report must also be completed and filed by each "principal shareholder," "director," and "executive officer" proposed in connection with an application for a license to establish a new Palau financial institution.

Supporting schedules to the financial statement should be attached when necessary to itemize or clarify summarized data. Care should be taken to assure that the dates and total amounts shown on the supporting schedules correspond to those on the financial statement. Supporting schedules are included for real estate and related loans and for proprietary interest. The methods by which real estate market values are determined must be described. If investment securities are shown as an asset and if those securities represent twenty-five percent (25%) or more of an individual’s net worth, financial and cash flow statement of the company for the last two years must be provided, unless the company is publicly traded on a national exchange.

The cash flow statement (Schedule 7 to the Confidential Personal Financial Statement) should disclose in a separate line item the payments that will be required to service any loans to finance the purchase of stock.

Complete Section One (1) of the enclosed Confirmation Inquiry Form which authorizes any financial institution, brokerage firm, or any other entity in which you may have an account to confirm to the balance or market value of securities held in said account as of a certain date. If you have accounts at more than one institution, please complete the appropriate number of forms. After completing Section One (1) of the Confirmation Inquiry form, it should be submitted to the Executive Commissioner of the Financial Institutions Commission along with the completed Confidential Personal Financial Statement. Do not send the Confirmation Inquiry form directly to the confirming institution(s). All persons who have ownership interest in the account, for example, husband and wife, must sign the Confirmation Inquiry form. Otherwise, the confirming institution may return the form in blank to the Financial Institutions Commissioner, which may result in a delay in processing. Please provide account and loan numbers on forms.

The Executive Commissioner may require the submission of any other information, including appraisals, that it considers necessary to determine financial capability.

Business Plan
## CONFIDENTIAL PERSONAL FINANCIAL STATEMENT

of

(Name)

(Date of Financial Information)

(Report all Amounts in 000's)

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
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</thead>
<tbody>
<tr>
<td>Cash on Hand &amp; in Banks (Schedule 1)</td>
<td>Notes &amp; Accounts Payable to Banks (Schedule 6)</td>
</tr>
<tr>
<td>Government Securities</td>
<td>Rents &amp; Interest Due</td>
</tr>
<tr>
<td>Accounts, Loans &amp; Notes Receivable (Schedule 2)</td>
<td>Real Estate Taxes Due (Schedule 4)</td>
</tr>
<tr>
<td>Marketable Stocks &amp; Bonds (Schedule 3)</td>
<td>Liens on Real Estate (Schedule 4)</td>
</tr>
<tr>
<td>Real Estate (Schedule 4)</td>
<td>Other Taxes Due</td>
</tr>
<tr>
<td>Automobiles - Number ( )</td>
<td>Other Liabilities</td>
</tr>
<tr>
<td>Proprietary Interests (Schedule 3)</td>
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</tr>
<tr>
<td>Other Assets</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TOTAL LIABILITIES</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>NET WORTH</td>
<td></td>
</tr>
</tbody>
</table>

| TOTAL ASSETS $                               | TOTAL LIABILITIES & NET WORTH $     |

### ANNUAL INCOME

<table>
<thead>
<tr>
<th>Salary</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonus &amp; Commissions</td>
<td>On Leases or Contracts</td>
</tr>
<tr>
<td>Dividends &amp; Interest</td>
<td>Legal Claims</td>
</tr>
</tbody>
</table>

Business Plan
License Applications

Real Estate Income
Other Income (Itemize)

TOTAL INCOME $

Provision for Income Taxes
Other Special Debts (Itemize)

TOTAL CONTINGENT LIABILITIES $

Itemize all amounts in excess of ten percent (10%) of the total amount reported in "other assets" and "other liabilities," respectively.

Assets valued at $________ have been pledged to secure notes or obligations aggregating $________.

I have endorsed, guaranteed or am contingently liable for debts of others totaling $________.

Schedule 1: Banking Relationships (List all bank accounts)

<table>
<thead>
<tr>
<th>Name of Financial Institution</th>
<th>Address</th>
<th>Type of Account</th>
<th>Account Number</th>
<th>Account Balance</th>
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<tbody>
<tr>
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<tr>
<td>Total</td>
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</tbody>
</table>

Schedule 2: Accounts, Loans & Notes Receivable

<table>
<thead>
<tr>
<th>Name and Address of Debtor</th>
<th>Date Originated</th>
<th>Description/Nature of Debt</th>
<th>Security Held</th>
<th>Maturity Date</th>
<th>Balance Due</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

Schedule 3: Marketable Stocks and Bonds. Marketable stocks and bonds include only those listed on recognized national exchanges.

Business Plan
Schedule 4: Real Estate. Legal and equitable title to all real estate listed below is solely in the applicant's name except as follows:

<table>
<thead>
<tr>
<th>Description or Street Number</th>
<th>Dimensions or Acres</th>
<th>Improvements Consist Of</th>
<th>Outstanding Mtgs or Liens</th>
<th>Due Dates &amp; Payment Amount</th>
<th>Unpaid Taxes Amount</th>
<th>Original Cost</th>
<th>Present Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Schedule 5: Proprietary Interests

Provide the following information regarding all business enterprises in which you hold a beneficial interest. The term "business enterprise" includes any corporation, association, partnership, business trust, sole proprietorship or other business which shares are not listed on a securities exchange or otherwise regularly traded. Under the heading "Form of Business," state the legal form of the business. Under "Nature of Business and Percentage of Ownership," explain what the business enterprise does and percentage of your ownership interest. Submit year-end financial statements, including income and expense (profit and loss) and cash flow statements, for the last two years for each business interest in which you have an interest equal to twenty-five percent (25%) or more of your net worth.

<table>
<thead>
<tr>
<th>Name and Address Of Business</th>
<th>Legal Form Of Business</th>
<th>Nature of Business and Percentage of Ownership</th>
<th>Date Acquired</th>
<th>Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Schedule 6: Notes & Accounts Payable.

<table>
<thead>
<tr>
<th>Name of Lender</th>
<th>Lender's Address</th>
<th>Due Dates &amp; Payments</th>
<th>Security/Collateral</th>
<th>Outstanding Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
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<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total
Schedule 7: Cash Flow Statement

<table>
<thead>
<tr>
<th>Source of Cash</th>
<th>Prior Year</th>
<th>Prior Year</th>
<th>Current Year</th>
<th>Next Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Salaries, Wages, Commissions, Bonuses, or Other Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Royalties</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distributions from Estates and Trusts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash Received from Individual Business, Partnerships, or Joint Ventures</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real Estate</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other (Itemize if 10% or more of total)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Cash Received</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Uses of Cash</th>
<th>Prior Year</th>
<th>Prior Year</th>
<th>Current Year</th>
<th>Next Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Expenses (Management, Rent and Household, etc.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Loan – Principal and Interest Payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Loans – Principal and Interest Payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance Payments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income Taxes Not Covered by Withholding</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other (Itemize any items amounting to 10% or more of total income)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total Cash Outlays</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Surplus (Deficit) Cash Flow

I certify that the above Confidential Personal Financial Statement is true and correct to the best of my knowledge.

Dated and signed this ____ day of ____________, 20__

(Signature)

(print or Type Full Name)

(Seal)

(Notary Public Signature)

Business Plan
CONFIRMATION INQUIRY

CONFIDENTIAL INFORMATION

Financial Institutions Commission

To the CEO of the Bank/Financial Institution Addressed:

1. Please furnish directly to the Financial Institutions Commission at the address indicated above, the following information with respect to all accounts, including any loan accounts, maintained by me at your institution. If the answer to any item is "none," please so state.

2. At the close of business on ________________, 20__, our records showed the following balance(s) to the credit of the above named customer (include certificate(s) of deposit, money market certificate(s), stocks, bonds, etc.). In the event that we could readily ascertain whether there were any balances to the credit of the customer not designated in this request, the appropriate information is given below.

<table>
<thead>
<tr>
<th>Account Name</th>
<th>Account Number</th>
<th>Account Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. The customer was directly liable to us in respect of loans, acceptances, etc. at the close of business on that date in the total amount $__________________________ as follows:

<table>
<thead>
<tr>
<th>Date of Loan</th>
<th>Due Date</th>
<th>Interest Rate</th>
<th>Interest Paid In</th>
<th>Amount</th>
<th>Description of Liability, Collateral, Security, Loans, Endorsers, Etc.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. The customer was contingently liable as endorser of notes discounted and/or guarantor at the close of business that date in the total amount of $__________________________ as follows:

<table>
<thead>
<tr>
<th>Name of Maker</th>
<th>Date of Note</th>
<th>Due Date</th>
<th>Amount</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

5. Other direct or contingent liabilities, open Letters of Credit, and relative collateral, were:

(Date) (Confirming Institution) (Authorized Signature)
FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION

FIC-PR-08

FIT & PROPER REQUIREMENTS

Arrangement of Paragraphs

PART I
Preliminary

PARAGRAPH
1. Short Title
2. Authorization
3. Application
4. Definitions

PART II
Statement of Policy

PARAGRAPH
1. Purpose
2. Scope
3. Responsibility

PART III
Implementation and Specific Requirements

PARAGRAPH
1. Requirements
2. Criteria
3. Reporting Requirements

PART IV
Corrective Measures

PARAGRAPH
1. Remedial Measures and Sanctions

PART V
Effective Date

PARAGRAPH
1. Effective Date
PART I: PRELIMINARY

1: **Short Title** – Fit and proper requirements.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 44 provides that administrators must meet criteria established by regulation, and Section 33 allows the Commission to grant a license only if it is satisfied that the qualifications, experience and integrity of a proposed bank’s administrators and significant shareholders are appropriate.

3: **Application** – This regulation applies to all administrators of Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau (Palau foreign bank branch) (hereafter collectively referred to as “bank”).

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

1) “Administrator” – means (i) for a Palau bank any person who is an officer of the Palau bank, including any member of the board of directors or the Audit Committee, or the head of a department of the Palau bank, and (ii) for a Palau foreign bank branch any person who is an officer or any member of the Audit Committee of the Palau foreign bank branch.

2) “Significant shareholder” means a person or number of related persons acting in concert, directly or indirectly, holding 20% or more of the equity or of any class of shares with voting rights in a Palau bank, or any person or number of related persons which otherwise exercise a significant influence over the management or policies of the Palau bank.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation is intended to ensure that all persons who are, or who will be, administrators or significant shareholders of a bank are “fit and proper” persons based on prudent and objective criteria.

2: **Scope** – This regulation applies to all persons who are or are to become (i) administrators of a Palau bank or a Palau foreign bank branch or (ii) significant shareholders of a Palau bank.

3: **Responsibility** – It is the responsibility of the board of directors of each bank to ensure that every person who is, or is to become, an administrator of the bank is fit and proper at all times according to the Act and this regulation.
PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Requirements** – The following requirements shall apply:
   (a) a bank shall ensure that the criteria specified in this regulation are satisfied when electing, appointing, re-electing, re-appointing or continuing the appointment of persons as administrators of a bank

   (b) a bank shall not permit any person who is not fit and proper to be, or continue to be, an administrator of the bank;

   (c) a bank shall maintain written documentation supporting a determination that a person is fit and proper and shall provide such documentation to the Commission on request; and

   (d) a bank shall not record on its books, or otherwise recognize or permit without the prior written approval of the Commission any sale, transfer, disposal or change of ownership of its shares of stock which would result in any person or number of related persons owning or controlling, directly or indirectly, 20% or more of the bank’s shares.

2: **Criteria** – When evaluating an application for a licence to conduct financial activities in Palau, or when a person is to be appointed or elected or to continue as an administrator or when a person proposes to become a significant shareholder of a bank operating in Palau, the Commission will assess whether a person is fit and proper by applying the criteria below.

   *The Commission will conclude that a person is NOT fit and proper if –*

   (a) **Competency** – a person does not have sufficient competency, in terms of relevant experience and academic qualifications, to reasonably conclude that he/she will be able to discharge satisfactorily the duties and responsibilities of his/her proposed position.

   (b) **Mental Capacity** – a person does not have sufficient mental capacities to reasonably conclude he/she is of sound mind and able to carry out satisfactorily the duties and responsibilities of his/her proposed position.

   (c) **Removal or Suspension** – a person has been, or is being, removed or suspended, by order of a bank regulatory authority in Palau or in a foreign country, as an administrator or director of any bank licensed to operate in Palau or in a foreign country unless such removal or suspension is solely the result of his/her political affiliation and in no way relates to his/her performance, conduct or competency as a director, officer or significant shareholder of a licensed bank.

   (d) **Offences and Breaches** – a person has ever contravened any provision of the Act or any regulation issued under the Act, or has been guilty of gross negligence or willful or intentional misconduct as those terms contextually apply in the Act.
(c) **Winding Up or Liquidation** – a person has been, or is, an administrator or director of a bank licensed to carry on banking activities in Palau and which bank has been, or is being, wound up or liquidated involuntarily.

(f) **Positions in Competing Financial Institutions** – a person is an administrator or director of a bank or financial institution operating in Palau which is competing with but not a subsidiary or associate of the bank in which the person is or will be an administrator.

(g) **Censures** – a person has been censured, disciplined, prosecuted, warned as to financial crimes or irregularities conduct or made subject to a court order by any governmental department or agency, by any professional association, or by any regulatory body in Palau or elsewhere, within the last 10 years.

(h) **Convictions or Administrative Orders** – a person has been convicted of or imprisoned for any offense for fraud or dishonesty, or has had an administrative order issued by a financial regulator or supervisory authority served on him/her in Palau or elsewhere, within the last 10 years.

(i) **Investigations** – a person has been or is subject to an investigation in Palau or abroad by or at the instigation of a governmental department or agency, professional association, or other regulatory body for fraud or dishonesty.

(j) **Litigation** – a person has engaged or is expecting to be engaged in litigation in Palau or elsewhere which may have a material adverse effect on the resources of the proposed bank or its promoters.

(k) **Judgments** – a person has failed, within the last 10 years, to satisfy within one year a judgment of debt under a court order in Palau or elsewhere.

(l) **Fraud** – a person has been judged by a court in Palau or elsewhere to be civilly liable for fraud, malfeasance, or any other misconduct.

(m) **Bankruptcy or Debt Compromise** – a person has been judged bankrupt by a court in Palau or elsewhere, or has made any compromise or otherwise failed to satisfy his/her/her creditors in full within the last 10 years.

(n) **Taxes** – a person has not satisfied all undisputed obligations for taxes that are due and payable to the taxation authority in Palau or in any other jurisdiction.

(o) **Political Office** – a person holds an appointed or elected position in the national congress in Palau or in a foreign country, or is an officer of a political party as referenced in the Constitution of Palau or similarly in a foreign country.

(p) **Resources** – in the case of a corporate entity, the entity does not have or have access to sufficient financial, managerial, technological, and intellectual resources to reasonably
conclude that the entity will be able to fulfill satisfactorily the duties and responsibilities of the proposed position.

**The Commission will consider mitigating circumstances** –

If there are mitigating circumstances, but only in respect of criteria (a), (b), (f), (g) and (p), the Commission will review the circumstances and may, or may not, at its sole discretion allow a person to be an administrator or a director of a bank. The Commission will not consider mitigating circumstances for any other criteria than those listed above.

3: **Reporting Requirements.** On written request from the Commission, a person who is, or will be, an administrator of a bank shall submit such information as the Commission requires to determine whether the person is fit and proper. At a minimum, a bank or person shall provide to the Commission the following information:

(a) A written declaration of the bank’s compliance with this regulation in respect of the continuation and new appointment of an administrator of the bank and authorization for the Commission to request and receive any information necessary to conduct a background investigation to determine whether a person are fit and proper.

(b) In respect of each natural person who will be an administrator, a bank shall submit, at a minimum, the information required in Appendix A.

**PART IV: CORRECTIVE MEASURES**

1: **Remedial measures and sanctions** – If a bank, or any administrator or significant shareholder of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any administrator or significant shareholder of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.
PART V: EFFECTIVE DATE

1: **Effective date** – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted **July 23**, 2008

Governing Board

Financial Institutions Commission

Republic of Palau

Approved **July 29**, 2008

Honorable President

Tommy E. Remengesau, Jr.
ADMINISTRATORS,
MEMBERS OF THE BOARD OF DIRECTORS,
and
SIGNIFICANT SHAREHOLDERS

This application for fit and proper requests biographical and financial information on natural persons who are, or will be, administrators, members of the board of directors, or significant shareholders of a bank. An entire application must be completed and submitted for each such natural person.

Respond fully to Questions 1-25. A detailed personal financial statement, using the form provided, and a CV must be provided for each person who is or will be an administrator, a member of the board of directors, or a significant shareholder. Supporting schedules must be included for aggregated data and for all real estate, notes and accounts receivable, and proprietary interests in unlisted shares or closely held companies. Methods and assumptions used in establishing values for real estate, unlisted shares, or closely held companies must be fully disclosed. Dates and amounts shown in the supporting schedules must correspond to those shown in the financial statement. If unlisted shares are included in assets and represent 10% or more of net worth, then financial statements for the underlying company/ies must be provided for the most recent two full years.

The Commission may require submission of additional information, including real estate or business valuations, in order to accurately assess financial strength and capacity.

1. Name, Address. Provide the full name and physical address (current and permanent or immediate past) of the person who will be an administrator, member of the board of directors, or a significant shareholder of the bank.

2. Position. Provide the position and/or title the above person will hold in the bank.

3. Nationality. Provide the citizenship and national identity or passport number of the person.

4. Birth date. Provide the date and place of birth of the above person.

5. Role, Responsibilities, and Reporting. Discuss the role the above person will have in organizing and managing the affairs of the bank. Indicate to whom the person will report and/or from whom he will receive directions or instructions. If the person will be an administrator, describe the specific duties and responsibilities for the position(s) to be held.

6. Qualifications. Provide a current CV (less than one year old) listing the professional and academic qualifications of the above person.

7. Employment History. Provide the following information regarding the employment history and professional experience of the above person for the past 10 years.
Fit & Proper Requirements

(a) Name and address of employer
(b) Nature or type of business
(c) Title and duties/responsibilities
(d) Date employed, and date and reason for leaving

Provide complete details regarding positions held in financial institutions, the number of employees and/or assets supervised, lending authority, etc. and the performance of the bank or department for which responsible. If the person has ever been dismissed or otherwise terminated from any office or employment, been subject to disciplinary proceedings, or barred from entry to any profession or occupation, provide details.

8. Affiliations. Provide the name of any other financial institution which the person is now or will be affiliated with as an administrator, member of the board of directors, or a significant shareholder. Indicate his/her/her title or official capacity, duties/responsibilities in the other institution, and describe any relationship which now exists or will exist between the other institution and the proposed bank.

9. Controlling Shareholder of Any Other Financial Institution. If the above person is now or ever has been a significant shareholder (owning 20% or more of voting shares) of any other financial institution, provide details thereof including any relationship which now exists or will exist between the other financial institution and the proposed bank.

10. Membership in Professional or Trade Associations. If the above person is now or will be a member of any professional or trade association concerned with financial activities in Palau or elsewhere, provide details including whether such membership has ever been refused or terminated.

11. Censures. Has the above person ever been censured, prosecuted, warned as to conduct, disciplined, or publicly criticized by, or made subject to a court order by any governmental department or agency, professional association, or regulatory body in Palau or elsewhere?

12. Convictions or Administrative Orders. Has the above person ever been convicted of any felony offense, or has a petition for an administrative order been served on him/her/her, in Palau or elsewhere, within the last 10 years? If so, provide details.

13. Investigations. Has the above person ever been or is s/he now subject to an investigation, in Palau or elsewhere, by or at the instigation of any governmental department or agency, professional association, or other regulatory body? If so, provide details.

14. Litigation. Is the above person engaged or expecting to be engaged in litigation, in Palau or elsewhere, which may have a material effect on his/her resources or his/her/her ability to financially support the proposed bank? If so, provide details.

15. Judgments. Has the above person, within the last 10 years, failed to satisfy within one year a judgment of debt under a court order in Palau or elsewhere? If so, provide details.

16. Fraud. Has the above person ever been judged by a court, in Palau or elsewhere, to be civilly liable for fraud, malfeasance, or any other misconduct? If so, provide details.
17. Bankruptcy or Debt Compromise. Has the above person been judged bankrupt by a court, in Palau or elsewhere, or has a bankruptcy petition ever been served on him/her within the last 10 years, or has he made any compromise arrangement or otherwise failed to satisfy his/her creditors in full within the last 10 years? If so, provide details.

18. Receiver. Has a receiver of any property of the above person been appointed within the last 10 years in Palau or in any other jurisdiction? If so, provide details including whether the receiver is still acting under the appointment.

19. Liquidation: (a) Voluntary. Has a notice of resolution for the voluntary liquidation of the above person been issued within the last 10 years in Palau or in any other jurisdiction? If so, provide details including whether the liquidation has been fully resolved.

(b) Compulsory. Has a petition for the compulsory liquidation of the above person been served within the last 10 years in Palau or in any other jurisdiction? If so, provide details including whether the petition has been fully resolved.

20. Income Taxes. Is the above person in good standing with the taxation authority in Palau or in any other jurisdiction, or does he/she have any tax liabilities which are unpaid or in dispute?

21. Share Registrations. How many shares in the proposed bank are or will be registered in the name of the above person or in the name of a related party? Provide the name(s) in which the shares will be registered and the class of shares if not ordinary shares.

22. Beneficial Interest. How many shares in the proposed bank, which are not registered in the name of the above person or in the name of a related party, will the above person have a beneficial interest in? Provide the name(s) in which the shares will be registered and the nature of the beneficial interest.

23. Trustee or Nominee. Does or will the above person or any party related to him/her hold shares in the proposed bank as a trustee or nominee? If so, provide details.

24. Assignments or Pledges. Are or will any of the shares in response to Questions 21-23 be equitably or legally assigned or pledged to any other party? If so, provide details.

25. Voting Authority. (a) Direct. What proportion of the voting shares at any general meeting of the proposed bank, or of any other organization of which the proposed bank is a subsidiary, is or will the above person be entitled to vote or exercise control over? Provide details of such voting authority or control.

(b) Indirect. If the exercise of voting power at any general meeting of the proposed bank, or of any other organization of which the proposed bank is a subsidiary, is or may be controlled or influenced by someone other than the above person, provide the identity of such other person and the proportion of voting power so controlled or influenced.

Provide any other information regarding the proposed administrator or director that may assist Commission in evaluating this application.
# PERSONAL FINANCIAL STATEMENT

To be completed by each natural person proposed an administrator, a member of the board of directors, or a significant shareholder of the bank for which this application is being submitted. Report all amounts in 000's of US Dollars, and attach supporting schedules where appropriate to provide explanatory information.

| Name and Address of Proposed Bank: |  |
| Name and Proposed Position of Person: |  |
| Date of Financial Statement: |  |

## ASSETS

| Cash & Bank Balances /1 |  |
| Marketable Shares /2 |  |
| CV Life Insurance /3 |  |
| Loans Receivable – good |  |
| Loans Receivable – doubtful |  |
| Other Shares & Investments /4 |  |
| Vehicles & Equipment /5 |  |
| Personal Property /6 |  |
| Real Estate /7 |  |
| Business Interests /8 |  |
| Other assets /9 |  |

### Total Assets

<table>
<thead>
<tr>
<th>LIABILITIES &amp; NET WORTH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable</td>
</tr>
<tr>
<td>Loans Payable /10</td>
</tr>
<tr>
<td>Mortgages Payable /11</td>
</tr>
<tr>
<td>Interest Due and Unpaid /12</td>
</tr>
<tr>
<td>Taxes Due and Unpaid /13</td>
</tr>
<tr>
<td>Judgments /14</td>
</tr>
<tr>
<td>Other Liabilities /15</td>
</tr>
</tbody>
</table>

### Total Liabilities

| Net Worth |  |
|-----------|

**Total Liabilities & Net Worth**

Notes:

1. Provide name/s of banks, account numbers, and contact officers at banks.
2. Provide number of shares of listed companies, where held, date acquired, cost, current market value, and evidence of ownership if amount exceeds 10% of net worth.
3. Provide number, face amount and type of policy, name and address of company, names of insured and beneficiary, evidence of current cash value and certified copy of policy if amount exceeds 10% of net worth.
4-9: Indicate kinds of shares or investments, vehicles and equipment, property, real estate, business interests or other assets; indicate date acquired, cost, and current value if amount exceeds 10% of net worth.
10-11: Indicate to whom debts are owed, original and current balances, repayment terms, and security.
12-13: Indicate the amount/s of any accrued interest or taxes that are due and unpaid, and to whom owed.
14: Provide details of any judgments currently outstanding.
15: Provide details of other liabilities if amount exceeds 10% of net worth.

I certify that the information provided herein is true and correct to the best of my knowledge, and that there are no material omissions or misrepresentations of facts. I authorize the Commission to request and receive any information necessary to verify the accuracy of information herein.

Signature: ___________________________ Date: ___________________________
FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION
FIC-PR-09

CORPORATE GOVERNANCE

Arrangement of Paragraphs

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Corrective Measures

PARAGRAPH
1. Remedial Measures and Sanctions

PART V
Effective Date

PARAGRAPH
1. Effective Date
PART I: PRELIMINARY

1: **Short Title** – Corporate governance.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Sections 39 and 55 requirements relating to management, books of account, and corporate records.

3: **Application** – This regulation applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau (hereafter collectively referred to as “bank”).

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

(a) “Manager” – means a natural person who serves in the capacity of chief executive officer, with or without title, and who exercises overall authority and responsibility for the affairs of a bank subject only to approval of the board of directors. For a branch of a foreign bank operating in Palau, the person who serves as branch manager or country manager or in a similar capacity shall be considered the manager.

(b) “Non-executive director” – means a member of the board of directors of a Palau bank who is not a full-time employee of the Palau bank regardless if having an official title or position.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation is intended to ensure that bank administrators and boards of directors adopt and practice sound standards of corporate governance.

2: **Scope** – This regulation applies to all banks, all members of the board of directors and all administrators of banks licensed to conduct banking activities in Palau.

3: **Responsibility** – It is the responsibility of the board of directors of a bank operating in Palau to adopt sound standards of corporate governance and ensure that such standards are fully implemented and followed. The board may designate a committee or person to ensure compliance with such standards; however, delegation does not relieve the board of its duty to oversee the affairs of the bank and ensure compliance with this regulation.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Requirements** – The following requirements shall apply to all banks licensed to conduct banking activities in Palau unless specified otherwise:
(a) **Policies and Committees:** each bank operating in Palau shall adopt and implement formal written policies and establish committees as necessary to properly manage the affairs of the bank; at a minimum, each bank shall have policies and committees for audit and compliance, for lending/credit review, and for asset-liability/risk management.

(b) **Competent management:** the board of directors of each bank operating in Palau shall ensure that the bank has competent management and staff at all times to operate the bank in a safe and prudent manner.

(c) **Conflicts of interest:** the board of directors of each bank operating in Palau shall adopt and ensure compliance with a policy addressing conflicts of interest between a bank and its administrators, significant shareholders, and customers.

(d) **Records:** for each bank organized in Palau, including foreign bank subsidiaries, all records and books of account, including the daily ledger (balance sheet), income statement, accounting records, credit documentation, minutes of committees, board of directors’ and annual shareholders meetings, charter, by-laws and amendments thereto, and the register of shareholders, shall (i) be prepared and maintained at the head office in Palau, and (ii) be in English and any official language required in Palau.

Branches of foreign banks shall (i) maintain in Palau such records and books of account as are necessary to reflect the activities of the branch, including the daily ledger (balance sheet), income statement, accounting records, credit documentation, and minutes of committee meetings, and (ii) be in either of the official languages required in Palau, i.e., Palauan or English.

(e) **Board meetings:** each bank organized in Palau, including foreign bank subsidiaries, shall hold meetings of the board of directors in Palau at intervals not exceeding two months and shall review at each meeting all material aspects of condition and performance for the bank including, at a minimum, the following:

1. Balance sheet (month-end and previous month-end or year-end)
2. Income statement (year-to-date and compared to budget)
3. Key performance ratios
4. Minutes of the previous board meeting
5. New loans and investments approved, regardless if funded
6. Large deposits, accepted or withdrawn
7. Past due and non-performing loans and other assets
8. Correspondence to or from regulatory agencies
9. Committee reports (audit, compliance, risk management, asset-liability, etc.)
10. Actions taken to comply with remedial orders or enforcement actions
11. Any other items which are, or should be considered, significant to the bank

(f) **Board of directors:** at least one-third of the members of the board of directors of each bank organized in Palau, including subsidiaries of foreign banks, shall (i) be residents of Palau and (ii) be non-executive directors as defined in this regulation.
(g) Resident manager: each bank operating in Palau, including foreign bank branches and subsidiaries, shall have a manager, as defined in this regulation, who resides in Palau and works in the bank on a full-time basis.

(h) Branch visits: the chief executive officer of a foreign bank that operates a branch in Palau, or the executive officer at head office who is responsible for foreign branches of the foreign bank, shall make a visit to Palau at least annually to (i) review the operations of the branch and (ii) meet with the Commission to explain the overall condition, performance and strategic plans of the branch in Palau and the bank on a consolidated basis, and (iii) respond to questions from the Commission.

PART IV: CORRECTIVE MEASURES

1: Remedial measures and sanctions – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.

PART V: EFFECTIVE DATE

1: Effective date – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted July 23, 2008

Governing Board
Financial Institutions Commission
Republic of Palau

Approved August 8, 2008

Honorable President
Tommy E. Remengesau, Jr.
Arrangement of Paragraphs

PART I
Preliminary

PARAGRAPH
1. Short Title
2. Authorization
3. Application
4. Definitions

PART II
Statement of Policy

PARAGRAPH
1. Purpose
2. Scope
3. Responsibility

PART III
Implementation and Specific Requirements

PARAGRAPH
1. Minimum Required Liquidity
2. Calculation of Liquidity Ratio
3. Back-Up Arrangements
4. Reporting Requirements

PART IV
Corrective Measures

PARAGRAPH
1. Remedial Measures and Sanctions

PART V
Effective Date

PARAGRAPH
1. Effective Date
PART I: PRELIMINARY

1: **Short Title** – Liquidity.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 54 of the Act provides that the Commission may establish specific requirements concerning the minimum aggregate amount of liquid assets.

3: **Application** – This regulation applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau (Palau foreign bank branches) (hereafter collectively referred to as “bank”).

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined below, or as reasonably implied by contextual usage:

   1) "**asset quality rating**" – means the rating assigned by the Commission to Asset Quality at the most recent on-site examination or on the basis of off-site analysis, whichever is more current.

   2) "**capital adequacy category**" – means the capital adequacy categories as defined in Regulation FIC-PR-01 Capital Adequacy issued by the Commission.

   3) "**liquid assets**” – includes (i) currency and coin, domestic and foreign, to the extent that any foreign currency is readily convertible to U.S. dollars; (ii) net balances with banks, domestic or abroad, to the extent that such balances are not encumbered or subject to withdrawal restrictions and have a remaining term to maturity of one year or less; and (iii) unrestricted, readily marketable securities which have a value that can be determined from a listing on a recognized international securities exchange.

   4) "**liquidity ratio**” – means the ratio of liquid assets to the sum of total deposits plus short-term liabilities.

   5) "**total deposits plus short-term liabilities**” – means the sum of all deposit liabilities plus all other liabilities that are (i) due on demand, either explicitly or implicitly, and (ii) have a maturity of less than one year or are likely to become due within one year.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation is intended to ensure that each bank maintains a level of liquidity that is adequate for the prudent conduct of operations in relation to the adequacy of the bank’s capital, the quality of assets, and the risk profile of the bank’s activities.

2: **Scope** – This regulation applies to all banks.
3: **Responsibility** – It is the responsibility of the board of directors of each bank to (a) establish a liquidity policy that is adequate in scope and appropriate for the risk profile of the bank; (b) require management to adopt procedures that implement the policy, and (c) monitor and ensure compliance to the policy.

**PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS**

1: **Minimum Liquidity** – Each bank shall maintain an adequate level of liquidity. The minimum acceptable liquidity ratio shall be no less than the amount shown below; the Commission may require a higher level of liquidity for an individual bank on the basis of activities or risk profile other than capital and asset quality.

<table>
<thead>
<tr>
<th>Capital Category</th>
<th>Asset Quality Rating</th>
<th>Minimum Liquidity Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 or 2</td>
<td>3, 4 or 5</td>
</tr>
<tr>
<td>1 or 2</td>
<td>15%</td>
<td>20%</td>
</tr>
<tr>
<td>3</td>
<td>25%</td>
<td>30%</td>
</tr>
<tr>
<td>4 or 5</td>
<td>35%</td>
<td>40%</td>
</tr>
</tbody>
</table>

Palau foreign bank branches not required to maintain assigned capital as provided in Section 33 of the Act, the minimum acceptable liquidity position shall be no less than the amount shown below; the Commission may require a higher level of liquidity for an individual bank on the basis of activities or risk profile other than asset quality.

<table>
<thead>
<tr>
<th>Asset Quality Rating</th>
<th>Minimum Liquidity Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>15%</td>
</tr>
<tr>
<td>2</td>
<td>20%</td>
</tr>
<tr>
<td>3</td>
<td>30%</td>
</tr>
<tr>
<td>4</td>
<td>35%</td>
</tr>
<tr>
<td>5</td>
<td>40%</td>
</tr>
</tbody>
</table>

2: **Calculation of Liquidity Ratio** – For purposes of determining compliance, the liquidity ratio will be calculated using a rolling 30-day period, i.e. the liquidity ratio for any one day will be the average of the daily liquidity ratios for the preceding 30 days. Thus, the liquidity ratio on any one day may fall below the minimum ratio but still comply if the average of the daily ratios for the preceding 30-days complies with the minimum.

3: **Back-up Arrangements** – If a bank is rated 3, 4 or 5 for capital or asset quality, or if a bank fails to comply with the required minimum liquidity ratio for 30 consecutive days or fails to comply for more than 60 non-consecutive days in a 12-month period, then the bank shall promptly establish a back-up line of liquidity acceptable to the Commission.
To be acceptable, a back-up line of liquidity must (i) provide access to sufficient liquid funds to enable the bank to comply with the minimum liquidity ratio, (ii) be irrevocable, and (iii) be provided by an unrelated bank or by persons whose financial capacity can be verified and is acceptable to the Commission.

4: **Reporting Requirements** – Each bank shall submit returns in respect of liquidity in the form and frequency as the Commission may prescribe.

**PART IV: CORRECTIVE MEASURES**

1: **Remedial measures and sanctions** – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.

**PART V: EFFECTIVE DATE**

1: **Effective date** – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

**Adopted** July 23, 2008

**Governing Board**
Financial Institutions Commission
Republic of Palau

**Approved** August 8, 2008

**Honorable President**
Tommy E. Remengesau, Jr.
CONSOLIDATED STATEMENT OF CONDITION  
(as of December 31st, 200x; in 000's US Dollars)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and due from banks</td>
<td>Deposits:</td>
</tr>
<tr>
<td>Interest-bearing deposits in other banks</td>
<td>Non-interest bearing:</td>
</tr>
<tr>
<td>Federal funds sold, net</td>
<td>Interest bearing:</td>
</tr>
<tr>
<td>Investment securities</td>
<td>Total deposits:</td>
</tr>
<tr>
<td>Net Loans</td>
<td>Accrued interest payable:</td>
</tr>
<tr>
<td>Accrued interest receivable</td>
<td>Borrowed money:</td>
</tr>
<tr>
<td>Premises and equipment, net</td>
<td>Other liabilities:</td>
</tr>
<tr>
<td>Other Assets</td>
<td>Total Liabilities:</td>
</tr>
<tr>
<td></td>
<td>Shareholders' Equity:</td>
</tr>
<tr>
<td></td>
<td>Paid-in capital</td>
</tr>
<tr>
<td></td>
<td>Retained earnings:</td>
</tr>
<tr>
<td></td>
<td>Total Shareholders' Equity</td>
</tr>
<tr>
<td>Total Assets</td>
<td>Total Liabilities and Equity</td>
</tr>
</tbody>
</table>

CONSOLIDATED STATEMENT OF INCOME  
(for the year-ended December 31st, 200x; in 000's US Dollars)

| Interest and Fee Income:             |
| Interest Expense:                   |
| Net Interest Income                 |
| Other Operating Income:             |
| Other Operating Expenses:           |
| Net Income before taxation:         |
| Less: Income taxes                  |
| Net Income                          |
BRANCH STATEMENT OF CONDITION  
(as of December 31st, 200x; in 000's US Dollars)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and Equity</th>
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</thead>
<tbody>
<tr>
<td>Cash and due from banks</td>
<td>Deposits:</td>
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<tr>
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</tr>
<tr>
<td>Investment securities</td>
<td>Interest bearing</td>
</tr>
<tr>
<td>Net Loans</td>
<td>Total deposits</td>
</tr>
<tr>
<td>Accrued interest receivable</td>
<td></td>
</tr>
<tr>
<td>Premises and equipment, net</td>
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</tr>
<tr>
<td>Other assets</td>
<td>Borrowed money</td>
</tr>
<tr>
<td></td>
<td>Other liabilities</td>
</tr>
<tr>
<td>Due from Head Office, Related Branches</td>
<td>Total Liabilities</td>
</tr>
<tr>
<td></td>
<td>Assigned capital</td>
</tr>
<tr>
<td></td>
<td>Due to Head Office</td>
</tr>
<tr>
<td></td>
<td>Total Home Office Equity</td>
</tr>
<tr>
<td>Total Assets</td>
<td>Total Liabilities and Equity</td>
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</tbody>
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BRANCH STATEMENT OF INCOME  
(for the year-ended December 31st, 200x; in 000's US Dollars)

<table>
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<tr>
<th>Interest and Fee Income:</th>
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<tbody>
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<td></td>
</tr>
<tr>
<td>Other Operating Expenses:</td>
<td></td>
</tr>
<tr>
<td>Net Income before taxation</td>
<td></td>
</tr>
<tr>
<td>Less: Income taxes</td>
<td></td>
</tr>
<tr>
<td>Net Income</td>
<td></td>
</tr>
</tbody>
</table>
# CONSOLIDATED STATEMENT OF CONDITION

(As of December 31\textsuperscript{st}, 200\textsuperscript{th}; in 000's US Dollars)

<table>
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<td>Total Assets</td>
<td>Total Liabilities and Equity</td>
</tr>
</tbody>
</table>

# CONSOLIDATED STATEMENT OF INCOME

(For the year-ended December 31\textsuperscript{st}, 200\textsuperscript{th}; in 000's US Dollars)

| Interest and Fee Income:       |                                        |
| Interest Expense:              |                                        |
| Net Interest Income            |                                        |
| Other Operating Income:        |                                        |
| Other Operating Expenses:      |                                        |
| Net Income before taxation     |                                        |
| Less: Income taxes             |                                        |
| **Net Income**                 |                                        |
### BRANCH STATEMENT OF CONDITION
(as of December 31\textsuperscript{st}, 200x; in 000's US Dollars)

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and Equity</th>
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<tr>
<td>Investment securities</td>
<td>Interest bearing</td>
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<tr>
<td>Net Loans</td>
<td>Total deposits</td>
</tr>
<tr>
<td>Accrued interest receivable</td>
<td></td>
</tr>
<tr>
<td>Premises and equipment, net</td>
<td>Accrued interest payable</td>
</tr>
<tr>
<td>Other assets</td>
<td>Borrowed money</td>
</tr>
<tr>
<td>Due from Head Office, Related Branches</td>
<td>Other liabilities</td>
</tr>
<tr>
<td></td>
<td>Total Liabilities</td>
</tr>
<tr>
<td></td>
<td>Assigned capital</td>
</tr>
<tr>
<td></td>
<td>Due to Head Office</td>
</tr>
<tr>
<td></td>
<td>Total Home Office Equity</td>
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<tr>
<td>Total Assets</td>
<td>Total Liabilities and Equity</td>
</tr>
</tbody>
</table>

### BRANCH STATEMENT OF INCOME
(for the year-ended December 31\textsuperscript{st}, 200x; in 000's US Dollars)

<table>
<thead>
<tr>
<th>Interest and Fee Income:</th>
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</tr>
<tr>
<td>Net Income</td>
</tr>
</tbody>
</table>
FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION
FIC-PR-11

PUBLICATION and DISCLOSURE

Arrangement of Paragraphs

PART I
Preliminary

PARAGRAPH
1. Short Title
2. Authorization
3. Application
4. Definitions

PART II
Statement of Policy

PARAGRAPH
1. Purpose
2. Scope
3. Responsibility

PART III
Implementation and Specific Requirements

PARAGRAPH
1. Annual Statements
2. Submission
3. Publishing
4. Posting

PART IV
Corrective Measures

PARAGRAPH
1. Remedial Measures and Sanctions

PART V
Effective Date

PARAGRAPH
1. Effective Date

APPENDIX
PART I: PRELIMINARY

1: **Short Title** – Publication requirements.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 60 of the Act requires the Commission to call upon each bank annually to make and publish a statement of its financial condition.

3: **Application** – This regulation applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau (hereafter collectively referred to as “banks”). For purposes of this regulation, a branch of a foreign bank licensed to operate in Palau will be treated as a separate bank, and all assets and liabilities of the branch will be treated as assets and liabilities of a separate bank.

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation specifies the timing and the form and content for information that banks must publish so that the public is able to better understand and make more informed decisions about the banks operating within Palau.

2: **Scope** – This regulation applies to statements of financial condition, i.e. the balance sheet and the income statement, that must be published by each bank licensed and operating in Palau either as a domestic bank or as a branch or subsidiary of a foreign bank.

3: **Responsibility** – It is the responsibility of the board of directors of each bank, and the branch manager and the branch accounting manager of foreign banks, operating in Palau to prepare and publicly disclose basic financial information about the condition and operations of their bank so that the public can compare banks and make more informed decisions about the choices for financial services.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Annual statements** – Each bank shall prepare annually a statement of financial condition in the form and content shown in the Appendix to this regulation.

   (a) For domestic banks: the statement of financial condition shall include a balance sheet and a statement of income.

   (b) For branches or subsidiaries of foreign banks: the statement of financial condition shall include a balance sheet and statement of income prepared on a consolidated basis
for the entire foreign bank, and shall also include a balance sheet and statement of income for the branch or subsidiary on a stand-alone basis.

(c) FDIC-insured banks: foreign banks operating in Palau as branches or subsidiaries and which are insured by the FDIC may prepare consolidated statements for the balance sheet and statement of income using the form required for submission to the FDIC; however, the balance sheet and income statement for the Palau branch or subsidiary on a stand-alone basis must be prepared in the form and content shown in Appendix A.

(d) As of date: the statements required in (a) and (b) above shall be prepared as of the close of business December 31\textsuperscript{st} of each year and be submitted to the Commission not later than March 1\textsuperscript{st} immediately following.

2: Submission – Each bank, and each branch or subsidiary of a foreign bank, shall submit certified copies of the statement/s required in paragraph 1 to the Commission by not later than March 1\textsuperscript{st} immediately following the December 31\textsuperscript{st} statement date.

3: Publishing – Each bank, and each branch or subsidiary of a foreign bank, shall publish the statement/s required in paragraph 1 in a newspaper of general circulation in Palau, and shall ensure that the required statements are published not later than March 1\textsuperscript{st} immediately following the December 31\textsuperscript{st} statement date.

4: Posting – Each bank, and each branch or subsidiary of a foreign bank, shall post the statement/s required in paragraph 1 in the lobby of the bank’s head office in Palau and also in the lobby of any branch location in Palau. The statement/s shall be posted by not later than March 1\textsuperscript{st} immediately following the December 31\textsuperscript{st} statement date and shall be prominently displayed in a manner and place that is readily accessible to the public.

PART IV: CORRECTIVE MEASURES

1: Remedial measures and sanctions – If a bank, or any director or administrator of a bank, violates any provision of this regulation in a willful, negligent or flagrant manner which results, or is likely to result, in an unsafe or unsound condition for the bank or that threatens the interests of depositors, creditors or the general public, or if a bank, or any director or administrator of a bank, fails to comply with the instructions and reporting requirements in this regulation, the Commission may impose any one or more of the remedial measures or penalties provided in the Act.
PART V: EFFECTIVE DATE

1: Effective date – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted July 23, 2008

Governing Board
Financial Institutions Commission
Republic of Palau

Approved July 29, 2008

Honorable President
Tommy E. Remengesau, Jr.
CONFLICTS OF INTEREST

Arrangement of Paragraphs

PART I
Preliminary

1. Short Title
2. Authorization
3. Application
4. Definitions

PART II
Statement of Policy

1. Purpose
2. Scope
3. Responsibility

PART III
Implementation and Specific Requirements

1. Disclosure
2. Abstention
3. Recusal

PART IV
Effective Date

1. Effective Date
PART I: PRELIMINARY

1: **Short Title** – Conflicts of interest.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Sections 21 of the Act specifically requires the Commission to promulgate regulations governing recusal of its members in case of conflicts of interest.

3: **Application** – This regulation applies to all members of the Governing Board of the Commission.

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

1) “conflict of interest” – means a situation where a person has, or may be seen to have, personal interests which result, or could result, in a breach of his fiduciary duty by placing his own pecuniary interest ahead of the interests of the Commission and the institutions regulated by the Commission.

2) “improper influence” – means that a person attempts to exert, or is subject to, inappropriate pressure or influence on or by another person in an attempt to gain more favorable treatment or financial advantage.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation is intended to ensure that the Governing Board of the Commission and each of its members, collectively and individually, discharge their duties and responsibilities in a manner that avoids the appearance or actual existence of conflicts of interest and in so doing, promotes public confidence and trust in the Commission as the bank licensing, regulatory and supervisory authority in Palau.

2: **Scope** – This regulation applies to all members of the Governing Board of the Commission.

3: **Responsibility** – It is the responsibility of the Governing Board of the Commission and of each of its members to ensure that they conduct their work free from actual or the appearance of conflicts of interest and improper influence.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Disclosure** – each member of the Governing Board of the Commission shall promptly notify the Commission of any matter, issue or decision that is or may pose a conflict of interest for the member in discharge of his duties in an official capacity.

2: **Abstention** – (i) each member of the Governing Board of the Commission shall abstain from participating in discussions and voting on any matter, issue or decision that is a conflict of interest; (ii) the Governing Board may request a member to abstain from
participating in discussions and voting on any matter, issue or decision that may be perceived as a conflict of interest for that member; and (iii) any member of the Governing Board may elect to abstain from participating in discussions and voting on any matter, issue or decision without specifying a reason for abstaining.

3: **Recusal** – no member of the Governing Board of the Commission shall participate in or take any official action in any portion of a meeting of the Governing Board during which a matter, issue or decision is being considered if that matter, issue or decision relates directly to an entity for which (i) the member is an officer, director, manager, or holds a significant interest, (ii) a relative of the member to the second degree of consanguinity is an officer, director, manager, or holds a significant interest, or (iii) the member or a relative as above holds a material financial or pecuniary interest.

**PART IV: EFFECTIVE DATE**

1: **Effective date** – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted **July 23**, 2008

[Signature]

Governing Board
Financial Institutions Commission
Republic of Palau

Approved **July 29**, 2008

[Signature]

Honorable President
Tommy E. Remengesau, Jr.
FINANCIAL INSTITUTIONS COMMISSION

ADMINISTRATIVE REGULATION

FIC-AR-02

FEES & ASSESSMENTS

Arrangement of Paragraphs

PART I
Preliminary

PARAGRAPH
1. Short Title
2. Authorization
3. Application
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PARAGRAPH
1. Purpose
2. Scope
3. Responsibility

PART III
Implementation and Specific Requirements

PARAGRAPH
1. Annual Fee
2. Computation of Annual Fee
3. Assessment and Payment Schedule
4. Penalty

PART IV
Effective Date

PARAGRAPH
1. Effective Date
PART I: PRELIMINARY

1: **Short Title** – Fees and assessments.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Sections 12 and 80 specifically address fees that shall be charged by the Commission for licensing and the costs of supervision.

3: **Application** – This regulation applies to all banks licensed by the Commission to conduct financial activities in Palau.

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation is issued pursuant to provisions in the Act that require the Commission to charge fees to defray the costs of supervising and regulating financial institutions. This regulation establishes the methodology that the Commission will use to assess and collect the required fees.

2: **Scope** – This regulation applies to the fees that will be assessed by the Commission against banks operating in Palau for the costs for supervision and regulatory services. Fees relating to licensing, changes-of-control, mergers, branch offices, and non-resident workers are not covered by this regulation.

3: **Responsibility** – It is the responsibility of each bank operating in Palau to pay to the Commission the full amount of the annual fee in the manner and timetable prescribed in this regulation.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Annual fee** – each bank operating in Palau, including branches and subsidiaries of foreign banks, shall pay to the Commission an annual fee as prescribed from time to time by the Commission. The annual fee shall consist of:
   (a) a base fee which shall be set by the Commission from time to time in an official meeting, plus;
   (b) an additional amount which shall take into account (i) the relative size of a Palau bank or branch of a foreign bank licensed to conduct financial activities in Palau (hereafter collectively referred to as a “bank”) to the total assets of all banks operating in Palau and (ii) the level of regulatory and supervisory resources that the Commission must devote to the bank based on the risk profile of the bank.
2: **Computation of annual fee** – the annual fee required to be paid by each bank to the Commission shall be computed by multiplying the amount for adjusted total assets by a fee factor where the fee factor is based on the annual budget of the Commission, plus the (ii) base fee as determined by the Commission. The components and the annual fee computation are as provided below:

1) Adjusted Total Assets = \((\text{Total assets at prior year end}) \times (\text{weighting factor}^1) \times \text{(surcharge}^2)\)

2) Fee Factor = \(\frac{\text{Net annual budget of FIC}^3}{\text{Sum of Adjusted Total Assets for all banks}}\)

3) Annual fee = \([\text{(Adjusted total assets)} \times (\text{Fee factor})] + \text{Base Fee}\)

^1 Weighting factor: based on asset size range applicable to a bank, i.e. $0-10 million total assets; $10-50 million total assets; greater than $50 million total assets. The weighting factor reflects the lower incremental cost of supervision as asset size of a bank increases. The Commission, as it deems appropriate, may amend from time to time the asset size ranges and the applicable weighting factors.

^2 Surcharge: based on the composite CAMELS rating assigned at the most recent on-site examination by the FIC; the rating may be raised or lowered subsequent to an examination based on credible evidence presented to or available to the FIC. The surcharge reflects the relative level of regulatory and supervisory resources that must be devoted to a bank depending on its risk profile. The surcharge factor is multiplied by the weighted total assets to compute adjusted total assets, and then adjusted total assets is multiplied by the fee factor to compute the annual fee for each bank. Banks rated "1" and "2" will not be assessed a surcharge; banks rated "3" will be assessed a surcharge that is a percentage of the weighted total assets, and banks rated "4" or "5" will be assessed a higher surcharge that similarly is a percentage of the weighted total assets. The Commission, as it deems appropriate, may amend from time to time the surcharge factor applicable to the different CAMELS ratings.

^3 Net annual budget of the FIC: based on the annual budget of the Commission as submitted to the Olbiil Era Kelulau less the total of all Base Fees to be collected from banks licensed to conduct financial activities in Palau.

3: **Assessment and payment schedule** – the Commission will compute, as provided above, the annual fee for a bank each year using the amount for total assets as reflected in the external auditors’ report for the most recent year end. The Commission will notify a bank in writing by 30th June of the amount of the annual fee, and the bank then shall be required to pay the fee to the Commission in two equal installments. The first installment shall be due and payable on 1st October of the same year, and the second installment shall be due and payable on 1st April of the year immediately following.

4: **Penalty** – if a bank fails to pay in full to the Commission any installment of the annual fee by the due date, the Commission shall charge interest on the amount of unpaid fee for
each day that the fee remains unpaid. The interest rate charged shall be equal to one and one-half times the highest rate of interest that the bank charges its customers on loans as at the due date of the unpaid installment. The Commission will consider any unpaid fee plus the penalty interest arising therefrom as a charge against the capital of the bank, and will use the reduced capital amount to evaluate the adequacy of a bank’s capital and its compliance to capital requirements in the Act and regulations issued by the Commission.

PART IV: EFFECTIVE DATE

1: Effective date – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted July 23, 2008

[Signature]

Governor Board
Financial Institutions Commission
Republic of Palau

Adopted August 8, 2008

[Signature]

Honorable President
Tommy V. Remengesau, Jr.
FINANCIAL INSTITUTIONS COMMISSION

ADMINISTRATIVE REGULATION

FIC-AR-03

QUALIFICATIONS FOR RECEIVERS

Arrangement of Paragraphs

PART I
Preliminary

1. Short Title
2. Authorization
3. Application
4. Definitions

PART II
Statement of Policy

1. Purpose
2. Scope
3. Responsibility

PART III
Implementation and Specific Requirements

1. Qualifications
2. Legal Persons
3. Notification

PART IV
Effective Date

1. Effective Date
PART I: PRELIMINARY

1: **Short Title** – Receiver qualifications.

2: **Authorization** – The Financial Institutions Commission (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 65 of the Act provides that the Commission establish by regulation the qualifications of persons appointed as a receiver of a bank in Palau.

3: **Application** – This regulation applies to all persons, natural or legal, who are or may be appointed as a receiver for a bank operating in Palau.

4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined within this regulation, or as reasonably implied by contextual usage.

PART II: STATEMENT OF POLICY

1: **Purpose** – This regulation is intended to assure that a person who is or may be appointed as a receiver of a bank is properly qualified to perform the duties and functions thereof as provided in the Act and in accordance with applicable laws in Palau.

2: **Scope** – This regulation applies to all persons who are, or who may be, appointed by the Commission as a receiver of a bank in Palau.

3: **Responsibility** – It is the responsibility of the Governing Board of the Commission to ensure that each person who is, or is proposed as, a receiver of a bank operating in Palau is properly qualified in respect of the criteria set forth in this regulation. In addition, it is the responsibility of each person who is, or who intends to be, appointed as a receiver of a bank in Palau complies with this regulation.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Qualifications** – a person who is, or is to be appointed as, a receiver of a bank operating in Palau shall satisfy, as determined by the Commission, the following qualifications:

   (a) **Fit and proper**: a natural person must be a fit and proper person as defined by regulation issued by the Commission.

   (b) **Experience**: a natural person must have appropriate professional qualifications and experience in respect of the assets, liabilities and operations of a bank which, in the opinion of the Commission, are sufficient for the person to fulfill the duties and functions of the proposed receivership. In making its determination, the Commission will consider academic and professional qualifications, experience as a manager or liquidator of a bank or financial institution, and any other relevant information which is available.
(c) Conflicts of interest: no person may be appointed as or continue to be a receiver of a bank if such person has, or may be seen to have, personal interests which impair or could impair his ability to exercise independent and impartial judgment, or which are or could result in a breach of his fiduciary duty by placing personal pecuniary interests ahead of the interests of the receivership.

2: Legal persons – a company, partnership, association or any group of persons acting in concert may be appointed as receiver of a bank in Palau provided that all natural persons who comprise the legal entity and who will be participating directly or indirectly in the activities of the receivership must satisfy the qualifications in paragraph 1 above.

3: Notification – a person, whether natural or legal, who is or intends to become a receiver of a bank in Palau shall immediately notify the Commission in writing if he fails to meet the qualifications set forth in this regulation and the Commission shall immediately upon receiving such notification suspend that person as receiver and decide on an appropriate course of action for the circumstances. If a person is unsure whether the qualifications for a receiver have been satisfied, such person shall promptly notify the Commission in writing of the circumstances and the Commission shall determine if the person complies with the qualification and notify the person accordingly. In either case, the decisions of the Commission shall be final and binding on the person.

PART IV: EFFECTIVE DATE

1: Effective date – The effective date of this regulation shall be 1st September 2008.

Questions relating to this regulation may be addressed to the Financial Institutions Commission of the Republic of Palau.

Adopted July 23, 2008

Governing Board
Financial Institutions Commission
Republic of Palau

Adopted July 23, 2008

Honorable President
Tommy E. Remengesau, Jr.