

FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION

FIC-PR-05

FOREIGN CURRENCY EXPOSURE LIMITS

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1. Effective Date

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 the 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 _____, 2008

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

Approved _____, 2008

**Honorable President
Tommy E. Remengesau, Jr.**