2009 Annual Banking Industry Report & Performance Report

FINANCIAL INSTITUTIONS COMMISSION
of the
REPUBLIC OF PALAU

This report is provided pursuant to Section 12 of the Financial Institutions Act (RPPL 6-3, as Amended).

G. Semdiu Decherong
Executive Commissioner

June 17, 2010
Date

OVERVIEW OF BANKING INSTITUTIONS OPERATING IN PALAU

As of June 2010

Palau Local Banks (Palau Chartered Financial Institutions):

{The following three banks only provide savings accounts, time deposit accounts, and loan products at this time.}

Asia Pacific Commercial Bank

Asia Pacific Commercial Bank has majority ownership by Malaysian Investors. The bank maintains its operations on the second floor of the building across the street from Palasia Hotel in Koror.

First Fidelity Bank (formerly Palau Central Bank/Bank of Palau)

First Fidelity Bank, Inc. was formerly known as Palau Central Bank. It is the only bank operating in Palau that is wholly owned by Palauan citizens. It was granted a conditional license for 18 Months on July 21, 2004 and was subsequently re-issued a license operating as First Fidelity Bank in June 2006. The bank maintains operations on the first floor of the PDC building in downtown Koror.

Palau Construction Bank

Palau Construction Bank has majority ownership by Chinese citizens. The bank maintains operations in the commercial building across the Belau National Hospital in Meyuns, Koror.

Foreign Branch Institutions:

{Foreign bank branches are the only banks with the capability of transacting wire transfers inbound and outbound.}

Bank of Guam

Bank of Guam was chartered in 1972 and opened its Palau branch on March 13, 1984. It is a full service branch, with majority ownership by U.S. citizens. Its home office is located in Guam. The branch maintains an ATM outside its branch location and the Palau International Airport. The local branch is located on the first floor of the PDC building in downtown Koror.

[Primary Home Country Regulator: US FDIC]

Bank of Hawaii, Koror Branch

Bank of Hawaii is the oldest bank operating in Palau. Chartered on September 18, 1961, its home office is located in Hawaii. It is a full service bank branch, with the bank itself having majority ownership by U.S. citizens. The branch is located in downtown Koror. There are two Bank of Hawaii Automated Teller Machines (ATMs) maintained by the branch-one is located in the WCTC Shopping Center and the other is right outside its branch location.

[Primary Home Country Regulator: Federal Reserve; The US FDIC and the State of Hawaii's Department of Commerce and Consumer Affairs, Division of Financial Institutions also regulate and supervise Bank of Hawaii, in conjunction with the Federal Reserve]

Bank Pacific, Ltd., Koror Branch

Bank Pacific is a full service bank branch also based out of Guam. It was chartered on July 28, 1995 and is mainly owned by U.S. citizens. The branch maintains an ATM outside its branch location. The local branch is located in Dngeronger, Koror on the first floor of the Joel Toribiong commercial building.

[Primary Home Country Regulator: US FDIC; the Office of Thrift Supervision (OTS) also regulates and supervises this bank, in conjunction with the FDIC]

First Commercial Bank, Koror Branch

First Commercial Bank is a full service bank with majority ownership by Chinese citizens from Taiwan (Republic of China). The bank maintains operations on the first floor of the PDC building in downtown Koror next to First Fidelity Bank.

[Primary Home Country Regulator: Taiwan Financial Supervisory Commission ('FSC')]

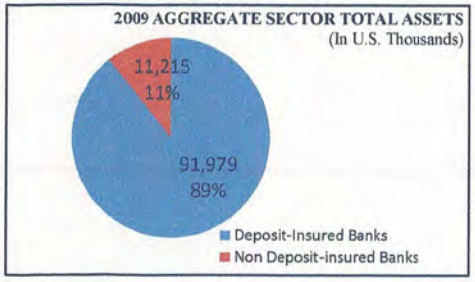
*A **full service bank/branch** offers a full range of financial products and services that may include but are not limited to the following: Deposit Accounts (Checking Accounts, Savings Accounts, Time Deposit Accounts); Loans (Personal Loans, Business/Commercial Loans, Personal and Commercial Credit Lines, Mortgage Loans); Funds Wiring Services; Credit/Debit Card Services; Cash Management Services; Check cashing; etc.)*

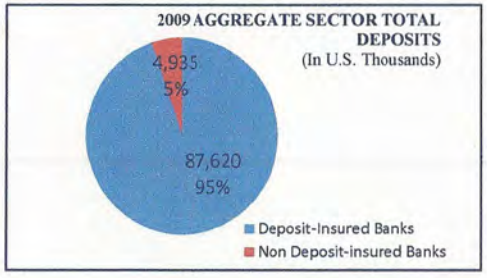
	As of Calendar Year-End 2009[1] (In U.S. Thousands)							As of Calendar Year-End 2009 (In U.S. Thousands)		
Statements of Condition figures reported by all banks	Bank of Hawaii	Bank of Guam	BankPacific[2]	First Commercial Bank	Palau Construction Bank	Asia Pacific Commercial Bank	First Fidelity Bank	**Deposit-Insured Banks**	**Non Deposit-insured Banks**	**Aggregate All Banks**
Cash & Due From Banks	1,369	16,457	9,823	4,202	300	203	230	27,649	4,935	32,584
Net Loans	17,328	6,186	3,567	2,515	1,714	721	322	27,081	5,272	32,353
Other Assets	37,146	69	34	91	784	78	55	37,249	1,008	38,257
TOTAL ASSETS	**55,843**	**22,712**	**13,424**	**6,808**	**2,798**	**1,002**	**607**	**91,979**	**11,215**	**103,194**
Deposits	51,714	22,577	13,329	3,709	933	171	122	87,620	4,935	92,555
Other Liabilities	3,531	141	72	5	10	6	8	3,744	29	3,773
TOTAL LIABILITIES	55,245	22,718	13,401	3,714	943	177	130	91,364	4,964	96,328
CAPITAL	598	(6)	23	3,094	1,855	825	477	615	6,251	6,866
TOTAL LIABILITIES & CAPITAL	**55,843**	**22,712**	**13,424**	**6,808**	**2,798**	**1,002**	**607**	**91,979**	**11,215**	**103,194**
Statements of Income (Loss) figures reported by all banks										
Interest Income	4,901	679	331	473	974	116	48	5,911	1,611	7,522
Interest Expense	1,332	213	103	18	14	5	1	1,648	38	1,686
NET INTEREST INCOME	**3,569**	**466**	**228**	**455**	**960**	**111**	**47**	**4,263**	**1,573**	**5,836**
Non Interest Income	1,052	166	107	89	22	16	7	1,325	134	1,459
Non Interest Expense	1,831	636	312	478	292	184	115	2,779	1,069	3,848
Net Income (Loss) before Tax	2,790	(4)	23	66	690	(57)	(61)	2,809	638	3,447
Less: Applicable Net Income Tax		2		8	23			2	31	33
NET INCOME (LOSS) after Tax	**2,790**	**(6)**	**23**	**58**	**667**	**(57)**	**(61)**	**2,807**	**607**	**3,414**

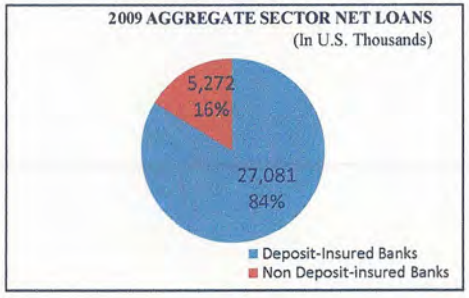
1/ All banks published Statements of Condition and Statements of Income (Loss) on March 1st 2010 with postings in bank lobbies
2/ BankPacific's figures are as of June 30, 2009, since the bank's fiscal year ends on June 30th.

Key Ratios

Return on Assets	5%	-0.03%	0.17%	1%	24%	-6%	-10%	3%	5%	3%
Return on Equity	467%	100%	100%	2%	36%	-7%	-13%	456%	10%	50%
Net Interest Margin	21%	8%	6%	18%	56%	15%	15%	16%	30%	18%
Liquid Assets to Total Deposits	3%	73%	74%	113%	32%	119%	189%	32%	100%	35%







from Annual Statements of Condition for all banks in Palau published and posted on March 1st by all banking institutions pursuant to FIC regulatory requirements (PR-11)

BANKING INSTITUTIONS OPERATING IN PALAU

As of June 2010

Bank Name	Home Country Charter	Date of Charter	License Status	Primary Regulator	Local Management	Address	Contact Information
Asia Pacific Commercial Bank	Palau	1/21/2000	Active	FIC	Mr. Mun Chee Woo, General Manager Ms. Georgina Misajon, Bank Manager	Ikelau, Koror P.O. Box 10025 #2B-105 Republic of Palau 96940	Tel. 488-8388 / 488-8981 Email: asiapac@palaunet.com
Bank of Guam	Guam	Guam: 1972 Opened Palau branch: 3/13/1984	Active	U.S. FDIC	Mr. Mathew Cruz, VP/Branch Manager	Medalaii, Koror P.O. Box 338 Republic of Palau 96940 http://www.bankofguam.com	Tel. 488-2696 / 488-2697 Email: bog@palaunet.com
Bank of Hawaii	Hawaii	9/18/1961	Active	U.S. Federal Reserve	Mr. Brian Glass, VP/Branch Manager	Medalaii, Koror P.O. Box 340 Republic of Palau 96940 http://www.boh.com	Tel. 488-2602 / 488-3285 Email: brian.glass@boh.com
BankPacific, Ltd.	Guam	7/28/1995	Active	U.S. FDIC	Mr. Joseph Koshiba, Bank Manager	Dngeronger, Koror P.O. Box 1000 Republic of Palau 96940 http://www.bankpacific.com	Tel. 488-5635 / 488-5226 Email: joek@bankpacific.com
First Commercial Bank	Taiwan	Taiwan: 1976 Palau: 6/23/1998	Active	Taiwan Financial Supervisory Commission	Mr. Jing Fang Hwang, General Manager	Medalaii, Koror P.O. Box 1605 Republic of Palau 96940 http://www.firstbank.com.tw	Tel. 488-6297 / 488-6298 Email: fcbpalau@palaunet.com
First Fidelity Bank, Inc.	Palau	7/24/1991	Active	FIC	Ms. Maria Louisa Gomez, Bank Manager	Medalaii, Koror P.O. Box 786 Republic of Palau 96940	Tel. 488-1891 / 488-2638
Palau Construction Bank	Palau	7/28/1995	Active	FIC	Ms. Lucia Tellei, General Manager	Meyuns, Koror P.O. Box 7077 Republic of Palalu 96940	Tel. 488-1946 / 488-5888 Email: pc.bank@palaunet.com

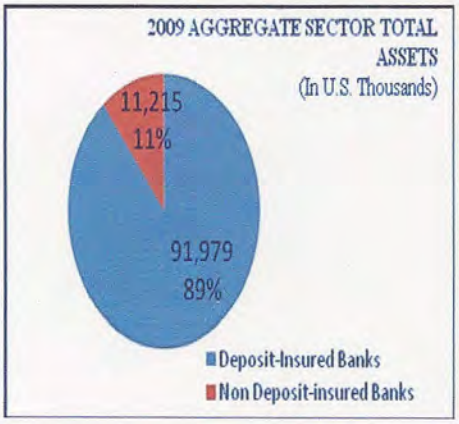
Republic of Palau
Financial Institutions Commission

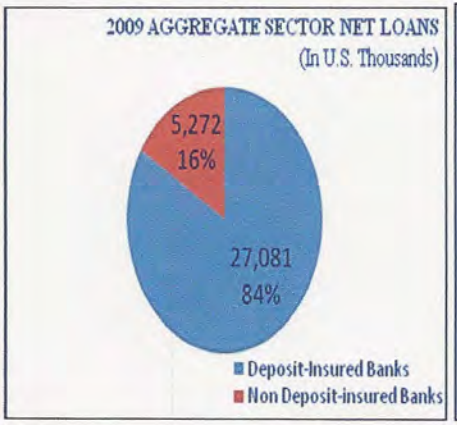
2009 Annual Palau Banking Sector Report

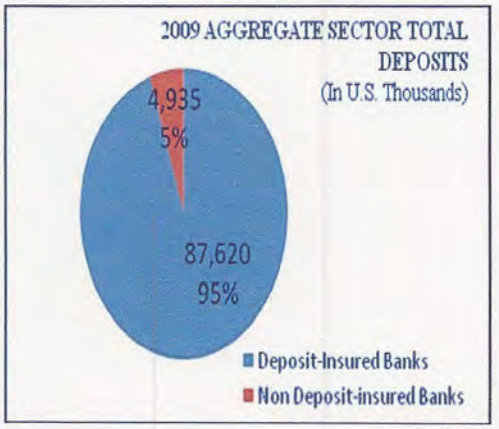
Commission Objective and Sector Overview

The Commission's primary objective is to ensure the liquidity and solvency of banks in the Republic of Palau pursuant to the requirements of the Financial Institutions Act and regulations promulgated therein. The Commission currently monitors and regulates seven banks—four foreign bank branches and three locally chartered banks. Three of the four foreign bank branches are U.S. chartered and insured by the U.S. Federal Deposit Insurance Corporation (FDIC) whereas the remaining banks do not have depositor insurance. The Palau National Development Bank is exempt from regulation, pursuant to the statute.

The U.S. bank branches hold approximately 84% of the banking sector's aggregate Net Loans and 95% of the sector's aggregate total deposits. [1]







Bank Examinations and Off-Site Monitoring

The Commission schedules onsite bank examinations based on a quarterly assessment of individual bank financial information reported on the FIC Prudential Returns as well as a bank's assigned rating in accordance to a Regulatory Response Policy. These quarterly returns consist of three forms and several related schedules and present information provided on an institution's balance sheet and income and expense statements.[2] Quarterly prudential returns are the main component of the off-site monitoring program and the Commission utilizes quarterly assessment reports as an integral part of on-site bank exam planning and scheduling.

---

[1] Based on figures reported for 2009 published by all banks. Historical data indicates that U.S. branch institutions lead the sector in assets and deposits and are reporting fairly consistent growth and stable market share. As a cautionary note, published figures and those reported to the FIC may differ due to variations in reporting requirements from bank accounting procedures. Aggregate figures used are derived from those reported to the FIC.

[2] Previous regulatory financial forms consisted only of two forms: Form A (Balance Sheet data) and Form B (Income & Expense statement). These quarterly returns were submitted on a voluntary basis by banking institutions until September 1, 2008 when FIC Prudential Regulations were made effective and required regular quarterly reporting from all banks. The FIC prudential forms were revised in January 2009 to include more detailed breakdowns of financial statement items. The new forms were effectively implemented beginning December 2009 and all banks in the sector are required to submit all relevant forms, certified by bank officials, in electronic form within 30 days following each quarter-end.

Bank Examination and Off-Site Monitoring (Continued)
The Commission has established amiable and productive working relationships with designated reporting officials for the three U.S. branch institutions and the Boards and Management of all other banking institutions in Palau. The Commission continues its efforts to improve the quality of information reported by fostering better communication between the agency, bank/branch managers, and related officials that play a pivotal role in ensuring adequacy and accuracy in financial reporting and compliance with regulatory requirements. The FIC has conducted multiple onsite examinations of the four non deposit insured banking institutions in Palau since 2007.

Agency Interaction and Cooperation with Regulated Banks
All licensed banks have cooperated with the FIC in the implementation of FIC Prudential Regulations and have lent their cooperation and support to this agency's efforts in statistical data collections, prudential reporting, onsite bank examinations, and other compliance issues. The FIC intends to continue to foster the existing good working relationship with all licensed banks to ensure cooperation, assistance, and input on Regulations, the banking law, compliance issues, and other matters pertinent to the industry.

The FIC maintains an open and transparent communications with the regulated banks and ensures that these industry partners are informed on matters affecting their operations, i.e. bank examinations, off-site reviews, revisions of laws and or regulations, policy initiatives, and fee assessments.

Lending Institutions Not Regulated by the FIC
As per the Financial Institutions Act, the National Development Bank of Palau, the Pacific Islands Development Bank, finance companies and credit unions (with assets less than $500,000) are exempt from regulatory oversight and supervision by this agency. However, the FIC seeks to garner baseline reports on the totality of the lending industry to capture all lending activities in the Republic of Palau. To that effect, the NDBP has pledged to provide aggregate financial information, in accordance to the FIC Regulations, in order to further our analysis of the overall levels and trends of lending in the Republic.

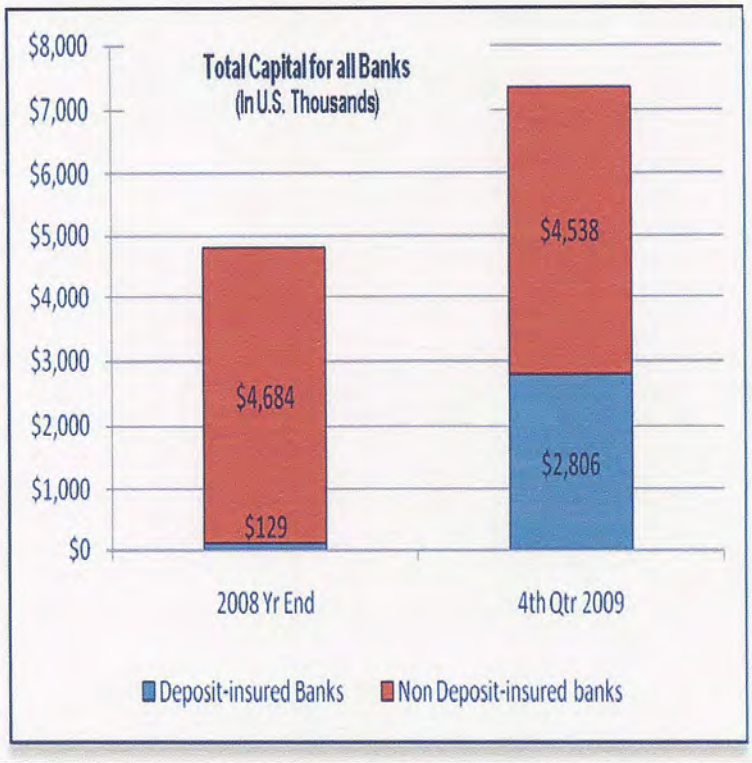
Anti-Money Laundering

In addition to regular bank supervision, the Commission is given authority in the Act to examine all financial institutions' Anti-Money Laundering and Counter Financing of Terrorism (AMLCFT) procedures and reporting standards. Such examinations may, at the sole discretion of the FIC, be conducted as an on-site or off-site examination, or both. The Financial Intelligence Unit (FIU), established by RPPL 6-4, formerly located within the FIC is now operating out of the Attorney General's Office, headed by the FIU Director. The FIU is overseen by a committee of the FIC Governing Board, and funding for the FIU has been established within the total operating budget for the FIC. Furthermore, under Chapter I Section 3 (f) of the Act, banks as a class that are organized as credit unions under Chapter 7 of the Corporation Regulations of the Republic of Palau and whose total assets exceed five hundred thousand dollars ($500,000) are subject to the FIC's licensing and regulatory requirements.

On September 1st, 2008, Prudential Regulation PR-03 became effective and established requirements for all banks and branches of foreign banks (banks) to prepare and submit quarterly reports to the FIC within 30 (thirty) days following each quarter ending on March 31st, June 30th, September 30th, and December 31st of every year. Figures are required to be reported on a calendar year-to-date basis in accordance with written instructions prepared and issued by the FIC. Aggregate figures used in this report are derived from these quarterly prudential forms submitted to the Commission. Supplemental information is included as attachments to this report.

Key Financial Sector Indicators – Capital, Assets, Earnings & Liquidity

CAPITAL



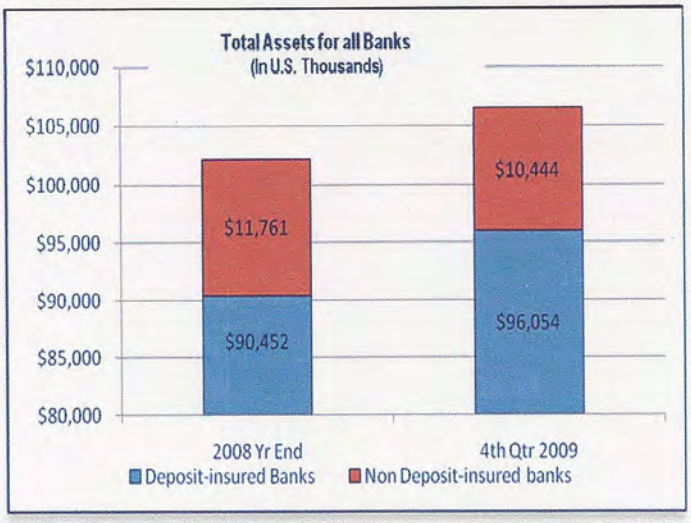
Aggregate Total Capital increased 53% in 2009

- The ratio of *Average Capital to Average Assets* was 6% at 2009 CYE, up from 5% at the prior year end.
- Only one of the sector's foreign bank branches does not have depositor insurance and is required to maintain assigned capital and needs to keep US$5 million in an escrow account pursuant to the amended Financial Institutions Act of 2001 and FIC prudential regulation PR-03.
- The three U.S bank branches in Palau maintain depositor insurance of up to $250,000 per depositor, by the U.S. Federal Deposit Insurance Corporation (FDIC); whereas the remaining four banks in the sector are non deposit-insured. Two of these non deposit insured Palau banks reported net operating losses for 2009, together totaling ($118,000), resulting in further declines in Retained Earnings, thus contributing to reductions in aggregate capital levels for this group of banks in the 2009 calendar year.

Prudential Regulation PR-01, made effective on September 1, 2008, sets minimum capital ratios required of all banks as follows: (1) Minimum Leverage Capital Ratio [Tier 1 Capital/Total Assets] of 5%; (2) Minimum Tier 1 Risk Based Capital Ratio [Tier 1 Capital/Total Risk Weighted Assets] of 6%; and (3) Minimum Total Risk Based Capital Ratio [Total Capital/Total Risk Weighted Assets] of 12%.

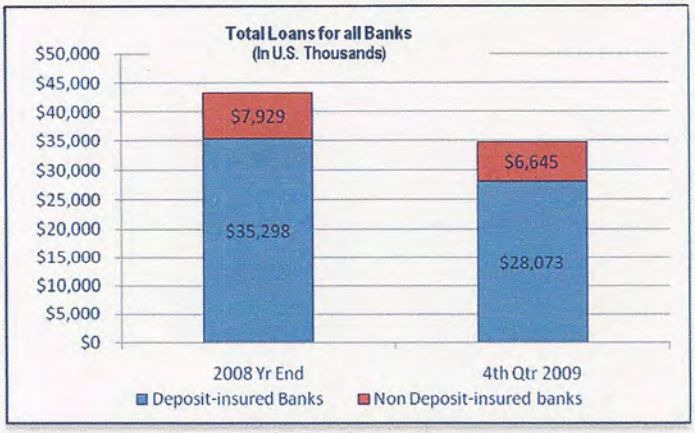
At 2009 CYE, all banks demonstrate **capital ratios** that are above the minimum requirements prescribed in PR-01 (note that the "Total Capital for All Bank's" number is skewed due to aggregation of large and small banks; however, two Palau chartered banks reported **capital levels** below the minimum statutory levels.. The FIC has, through off-site monitoring and on-site examinations of the banks, issued Regulatory Enforcement measures to bring these banks up to the statutorily mandated minimums and maintain adequate levels of capital within a stated time frame. Such measures are examples of on-site verification through bank examinations of off-site analysis of regulatory mandated quarterly reports.

ASSETS



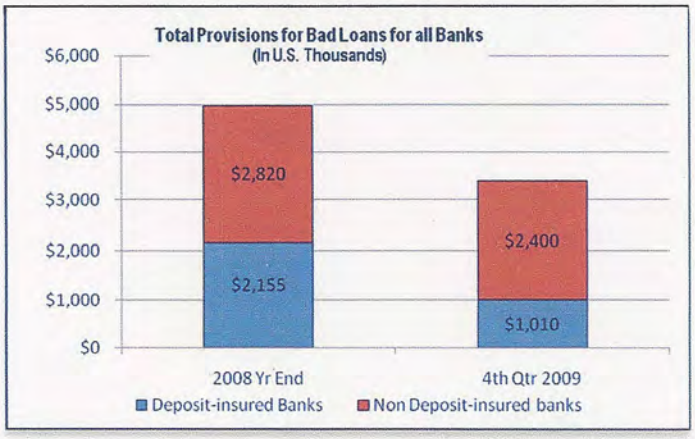
Total Assets increased 4% in 2009

- Aggregate Total Assets of deposit insured bank branches grew 6% in 2009.
- Aggregate Total Assets of non deposit insured banks fell by 11% in 2009.
- Aggregate total Liquid assets went up 257% from 2008 CYE. (*See Liquidity section for further details*).
- U.S. bank branches hold 90% of the banking sector's assets as of 2009 CYE, and maintain 81% of the sector's total loans. These banks, together, hold 92%, $2.8MM, of the sector's cash balances.
- Net loans comprise the sector's earning assets, and figures aggregated for all banks show a decline in net loans of 18% in 2009.



Total loans declined by 25% and provisions for bad loans were reduced by 31% in 2009

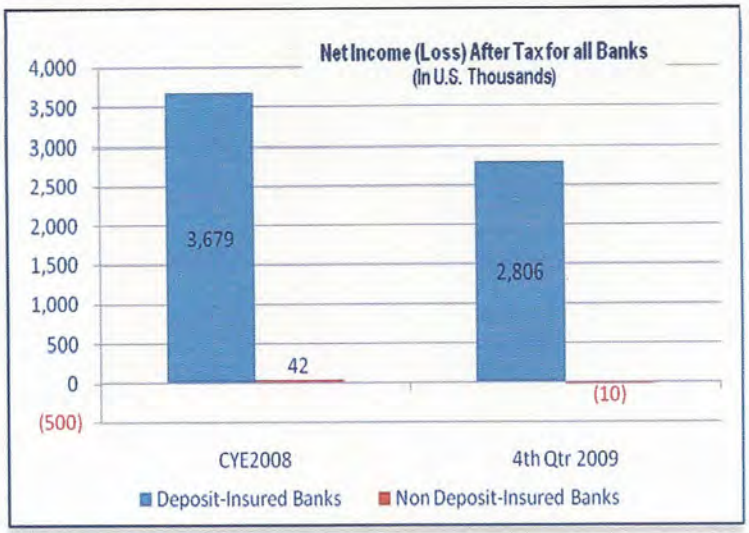
- Total loans for deposit insured bank branches fell 20% in 2009; whereas total loans held by non deposit insured banks in the sector, in aggregate, fell 16% from prior year end.
- FIC offsite monitoring data from submitted prudential returns prepared as of 31 December 2009 demonstrate that **8% of aggregate total loans for the entire sector are non-performing loans** (over 90 days past due and not accruing interest).



- Reported figures demonstrate that Provisioning levels aggregated for all banks fell 31% in 2009. Levels appear adequate to cover potential loan losses, and for two Palau banks, the FIC determined during onsite exams that levels maintained exceeded the minimum required for those banks.
  - **Deposit insured bank branches maintain 30% of the industry's Provisions for Bad Loans, totaling approximately $1MM; these branches hold 81% of the industry's total loans as of 2009 CYE.**
  - **Non deposit insured banks, in aggregate, maintain approximately $2.4MM in Provisions for Bad Loans at 2009 CYE.**

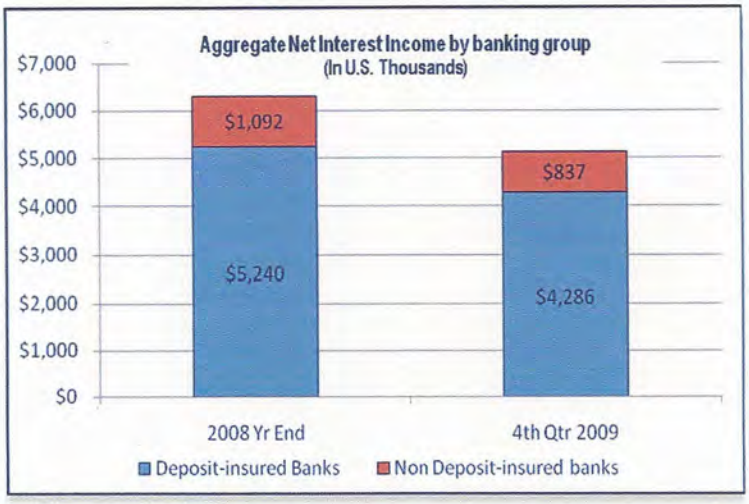
Ratio of Provisions for Bad Loans to Total Loans:	2008 CYE	2009 CYE
All Banks	12%	10%
Deposit-insured banks	6%	4%
Non Deposit-insured banks	36%	36%

EARNINGS



Earnings are down 25% compared to 2008 CYE

- There remains an inconsistency with the reporting by one bank on the applicable income tax on the prudential returns.
- Before Tax Net Income for deposit insured bank branches dropped 24% compared to 2008 CYE due to decline in Net Interest Income.
- Non-Interest expenses have remained stable for all banks in the sector.
- Aggregate figures for Non deposit insured banks demonstrate a Net Loss at 2009CYE.
- Non-Interest Income for deposit insured bank branches more than tripled in 2009—from $298M at prior year end to over $1.3MM at 2009 CYE.



- Data for deposit insured bank branches show that net interest income has fallen 19% compared to 2008CYE.
  - Net Loans for deposit insured banks fell 18% in 2009 and Deposits declined by 1%, reducing the spread between Interest Income and Interest Expense for this group of banks, resulting in lower Net Interest Income compared to 2008 CYE.
- Net interest income for non deposit insured banks declined by 23%.
  - Earning assets, or total net loans, for this group of banks, fell 17% resulting in decline in interest income. Together with minimal contributions to net change from interest expenses, the result is decline in net interest income aggregated for these banks.

Efficiency Ratio:

The Efficiency Ratio is calculated as annualized Non-Interest Expenses divided by the annualized sum of Net Interest Income and Non-Interest Income. Generally, a decrease in the ratio is good, in the sense that banks are more efficient at managing their expenses and maximizing profits. Additionally, the lower this ratio is, the more revenues a bank can generate.

	2008 CYE	2009 CYE
Efficiency Ratio – All banks	55%	54%
Efficiency Ratio – Deposit-insured banks	52%	48%
Efficiency Ratio – Non Deposit-insured banks	68%	89%

Net Interest Margin:

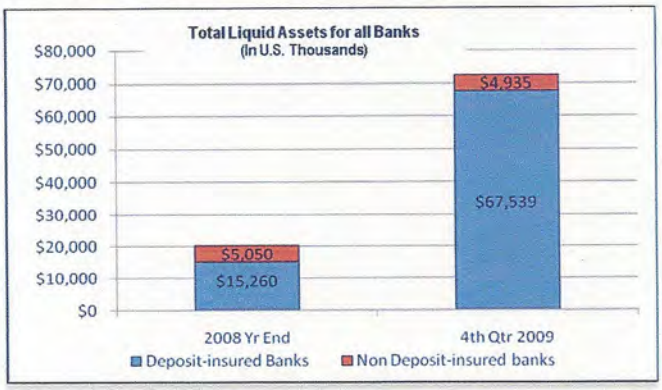
The Net Interest Margin is calculated as annualized Net Interest Income divided by Average Earning Assets. A drop in this margin is indicative of reductions in net loans and/or growth in interest bearing deposits. This ratio may be used in conjunction with the calculation of return on assets (ROA) to gauge the health and quality of earnings. The higher this ratio, the better. *See next page for ROA.*

	2008 CYE	2009 CYE
Net Interest Margin – All banks	17%	15%
Net Interest Margin – Deposit-insured Banks	16%	14%
Net Interest Margin – Non-deposit-insured Banks	21%	17%

LIQUIDITY

Prudential Regulation PR-10 sets minimum liquidity ratio requirements for all banks to maintain. The Liquidity Ratio is calculated as the ratio of Total Liquid Assets to the sum of Total Deposits and Short-term Liabilities. Liquid Assets include (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.

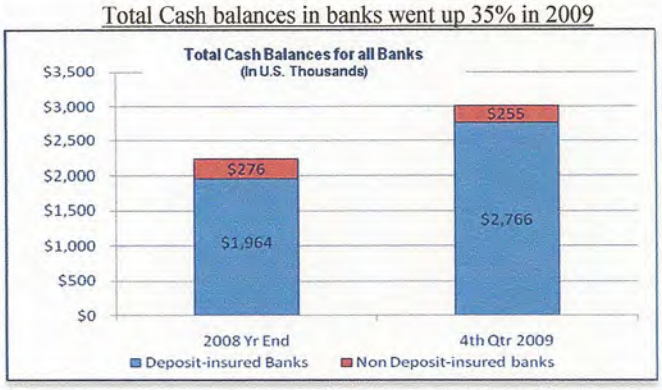
'Due from Banks' balances means those balances that a banking institution maintains with correspondent banks, either domestic or abroad, and including balances maintained at the branch's Head Office.



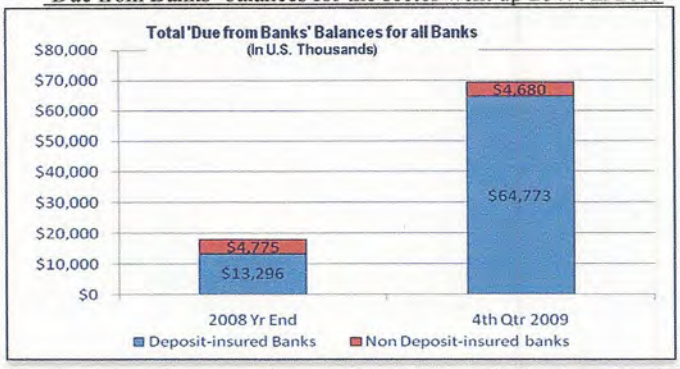
Aggregate Total Liquid Assets went up 257% in 2009

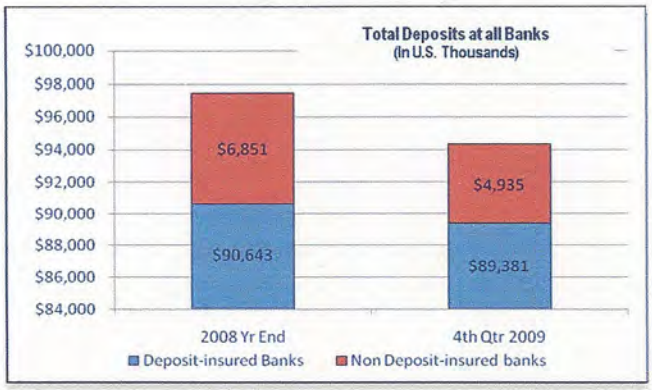
- Liquidity Ratios for all banks satisfy regulatory requirements as pursuant to FIC prudential regulation PR-10. Liquidity is adequate and banks demonstrate the ability to satisfy depositors' demands on deposits and banks are able to cover liabilities as they come due.
- The level of liquid assets has fallen 2% for non deposit insured banks. Both cash balances and 'Due from Banks' levels fell for this group.
- The substantial increase in liquid asset levels for deposit insured banks are a result of appropriate reporting of Due from Head Office balances on branch level prudential returns.

Total Cash balances in banks went up 35% in 2009



'Due from Banks' balances for the sector went up 284% in 2009





Aggregate Total Deposits declined by 3% in 2009

- Time deposits, in aggregate, fell 28% in 2009.
- Aggregate Demand and Savings Deposits on the other hand are 14% and 3% higher, respectively, compared to 2008 CYE.

- Deposit insured bank branches hold 95%, more than $89MM, of the banking sector's total deposits. Deposits aggregated for this group fell slightly in 2009.
- Total Deposits for non deposit insured banks fell 28% in 2009.

OTHER INDICATORS FOR THE BANKING SECTOR	2008 CYE	2009 CYE
Net Income to Average Capital (ROE)	77%	45%
Net Income to Average Assets (ROA)	4%	3%

Ratios from Figures Aggregated for All Banks in the Sector	2008 CYE	2009 CYE
Liquid Assets to Total Assets	20%	68%
Net Loans to Total Assets	37%	29%
Total Deposits to Total Loans	226%	272%

Quarterly Value Figures Reported by Banks
(in U.S. Thousands)

	Group A[1]		Group B[2]		All Banks	
Indicator ($Value)	**2008 Yr End**	**2009 Yr End**	**2008 Yr End**	**2009 Yr End**	**2008 Yr End**	**2009 Yr End**
Total Assets	**90,452**	**96,054**	**11,761**	**10,444**	**102,213**	**106,498**
Cash Balances	1,964	2,766	276	255	2,240	3,021
'Due From Banks'	13,296	7,939	4775	4,680	18,071	69,453
Liquid Assets	15,260	67,539	5,050	4,935	20,310	72,474
Other Assets	42,049	1,452	1,601	1,264	43,650	2,716
Net Loans	33,143	27,063	5,109	4,245	38,253	31,308
Gross Loans	35,298	28,073	7,929	6,645	43,227	34,718
Total Provisions for Bad Loans	2,155	1,010	2,820	2,232	4,975	1,222
Total Deposits	90,643	89,381	6,851	4,935	97,493	94,316
Total Liabilities	**90,921**	**3,867**	**7,077**	**971**	**97,998**	**4,838**
Total Capital	**(470)**	**2,806**	**4,684**	**4,538**	**4,214**	**7,344**
Total Net Interest Income	5,240	4,286	1,092	837	6,331	5,123
Total Interest Income	7,764	5,909	1,168	875	8,931	6,784
Total Interest Expense	2,524	1,623	76	38	2,600	1,661
Total Non-Interest Income	1,400	1,314	116	94	1,516	1,408
Total Non-Interest Expense	2,865	2,679	816	832	3,681	3,511
Total Provisions for Bad Loans Expense	60	113	343	102	403	215
Total Net Income (Loss) before Tax	3,715	2,808	49	(3)	3,764	2,805
Net Income Tax reported to FIC	-	2	7	7	7	9
Total Net Income (Loss) After Tax	**3,715**	**2,806**	**42**	**(10)**	**3,757**	**2,796**

Notes: 1/ Group A comprises of all deposit-insured bank branches in Palau; 2/ Group B comprises of non deposit-insured banks.

Summary Notes to the Annual Report:

1. Note that all figures reported are for FIC Licensed Banks only. The National Development Bank of Palau is exempt from FIC licensing, supervision, and regulation.

2. Capital positions for banks remain stable, albeit banks below statutory minimum capital requirements have been issued appropriate regulatory responses and the FIC has applied proper enforcement actions to order banks to capitalize to adequate levels in the immediate future.

3. Assets are generally increasing; however, net loans are in decline, consistent with the anticipated tightening of credit in the sector due to the economic slowdown both globally and locally. Some banks' provisioning positions have improved due to enhanced asset classification, loan restructuring and overall improvements in portfolio management – this is a result of enhanced off-site monitoring and on-site examinations of banks. Overall decline in net loans are due to reductions in total loans.

4. Earnings for foreign bank branches showed steady growth during 2009; however, year to date levels are lower than the prior year. One Palau bank showed strong growth in earnings, although the rest in this banking group are still reporting net losses.

5. Liquidity position of the overall banking sector is above satisfactory and banks remain able to satisfy demands on deposit accounts; increases in liquidity are commensurate with restrictions in lending. Improved liquidity reporting by the U.S. bank branches has elevated reported liquidity levels for the 2009 calendar year.

Background & General Overview

The Financial Institutions Commission (the Commission or FIC) is responsible for the licensing, supervision, and regulation of all banks and financial institutions in the Republic of Palau. The Commission was established as an independent and autonomous agency by Republic of Palau Public Law No. 6-3, commonly known as the Financial Institutions Act of 2001 (FIA or the Act); the Act was further amended and improved in the 7th Olbiil Era Kelulau under Republic of Palau Public Law 7-41.

Structure of the Commission

The Commission is governed by a **Board of Commissioners (Governing Board)**. The Governing Board functions as a policymaking body to promulgate the rules and regulations by which the Commission operates. The Governing Board also oversees the enforcement of policies, rules, and regulations as they apply to all licensed banks. The Governing Board is composed of five voting members and an Ex-Officio member. The five voting members are appointed by the President of the Republic of Palau, subject to the confirmation of the Senate and serve staggered two and three year terms; the sixth Ex-Officio member is the President of the National Development Bank of Palau (NDBP), as mandated by the Act.

The **Executive Commissioner** manages and oversees administrative tasks and operational matters of the Commission. The Executive Commissioner is responsible for the implementation of Governing Board policies and ensures bank compliance with FIC Regulations and executes Governing Board approved enforcement actions. Policy initiatives, in particular those that pertain to the monitoring and regulation of the Republic of Palau banking sector, are recommended by the Executive Commissioner to the Governing Board. The Executive Commissioner is appointed by and answers directly to the Governing Board and serves as the "Examiner in Charge", which involves the tasks of conducting and managing on-site examinations and is responsible for determining the scope and type of exams for banks in noncompliance with laws and regulations. All bank examinations conducted by the Commission are subject to final approval by the Examiner in Charge.

The **Bank Examiner** answers directly to the Executive Commissioner and is primarily responsible for conducting off-site analysis and on-site bank examinations. These include but are not limited to quarterly and annual analyses of individual bank and sector-wide financial returns, as required by FIC Regulations, and any available financial sector statistics. Off-site examinations involve the review, analysis, and detection of trends and/or singular events that may impact banks' financial condition. These off-site monitoring of financial institutions are provided quarterly or as need to the Executive Commissioner for determination of proper supervisory actions.

On-site examinations involve visits to bank/branch offices by the Executive Commissioner and Bank Examiner for an in-depth and detailed review of bank documents, records, as well as general observations of bank operations, for the purpose of assessing six bank rating components (i.e. Capital adequacy, Assets quality, Management, Earnings, Liquidity, and Sensitivity to market risks). Such exams are mandated in the Act, and are conducted in order to regularly monitor the performance of banks to ensure the soundness and stability of the overall sector. Off-site bank examinations allow for the Commission to assign an overall rating for individual banks, which allows for the appropriate levels of supervisory actions and regulatory oversight to ensure the safety and soundness of individual banks.

The **Office Manager (Administrative Officer II)** manages the administrative operations of the FIC office with oversight by the Executive Commissioner and is responsible for the maintenance of records, documentation processing, and fulfills all clerical and related operational and administrative functions. The Office Manager is responsible for preparation of annual budgets and assists in the monthly reporting to the Governing Board of fiscal performance of the agency. The Office Manager ensures proper procedures are followed in the procurement of goods and services and monitors operational expenses to ensure adherence to the Governing Board approved budget and works directly with the Executive Commissioner to ensure that internal fiscal policies or guidelines are adhered to and agency expenses are kept at a minimum.

Internal and External Cooperation

In the interest of maintaining the reputation of the Republic of Palau in the international financial community, the Commission is authorized by the Act to cooperate and exchange information with agencies of foreign governments and international organizations. To this extent, Section 8 of the Act stipulates that a grant of a banking license by the Commission constitutes consent of the financial institution to release to and exchange information with any law enforcement, regulatory, or supervisory authorities of any foreign government in which the financial institution operates or conducts business. As such, the Commission has worked with the U.S. Federal Deposit Insurance Corporation (FDIC), Australian Prudential Regulatory Authority (APRA), Bank Negara (Malaysia), Banco Central (Philippines), ROC Taiwan Financial Services Commission, Hawaii State Division of Financial Institutions, FSM Banking Commission, RMI Bank Commission, and other foreign regulatory authorities on a myriad of issues concerning both foreign regulators and the Commission. The Commission cooperates with competent authorities outside Palau and with international organizations in terms of its collection of statistics and related financial sector information for the purposes of comparative analysis and compliance with international regulatory and reporting standards. It is further mandated in the Act that the Commission cooperate with local public authorities in pursuing its objectives.

Training and Technical Assistance

The Commission receives extensive technical training and support from international organizations and supervisory agencies such as the International Monetary Fund (IMF), the Pacific Financial Technical Assistance Centre (PFTAC), and recently, the U.S. FDIC. The Executive Commissioner and Bank Examiner have successfully completed the first part of a U.S. FDIC training on bank examination, and has received training on liquidity frameworks and analysis from PFTAC in conjunction with APRA and the Bank of International Settlements' Financial Stability Institute. Other training received includes areas such as designing effective legal frameworks for problem bank supervision, Anti-Money Laundering and Counter-Terrorist Financing, FDIC Receivership methods and others.

FINANCIAL INSTITUTIONS COMMISSION
of the
REPUBLIC OF PALAU

2009 ANNUAL PERFORMANCE REPORT

Republic of Palau
Financial Institutions Commission

PRA Professional Building S#203., P.O. Box 10243 Koror, Republic of Palau 96940 / Tel: (680) 488-3560 / Fax: (680) 488-3564 / fic@palaunet.com

FY 2010 Budget to Expenditure Report (as of June 17, 2010)		
BUDGET ITEM	**BUDGETED**	**ACTUAL EXPENDITURE**
Personnel Services	$95,999.00	$60,611.63
Building & Other Rentals	$14,416.00	$10,800.00
Travel/Transportation/Trainings	$15,520.00	$13,536.32
General Supplies, Furniture & Equipment	$2,400.00	$4,832.28
Communication & Printing	$3,665.00	$2,182.81
Professional Services (IT)/Equipment Repair	$1,000.00	$880.00
Fuel & Other POL	$1,000.00	$729.69
Compensation & Meeting Expense (Board)	$6,000.00	$3,715.80
TOTAL:	**$140,000.00**	**$97,288.53** (69.49%)

COMMISSION EMPLOYEES	**ANNUAL SALARY**
G. Semdiu Decherong, Executive Commissioner	$42,066.00
Lindsay M.T. Pangalinan, Bank Examiner	$31,340.00
V. Tikei Sbal, Office Manager	$15,779.00
TOTAL:	**$89,185.00**

ADMINISTERING ORGANIZATION: Financial Institutions Commission

VISION

For the Republic of Palau to have the most stable and viable financial sector amongst all independent Pacific Island nations in the region through the implementation of and enforcement of policies, procedures and regulations that are consistent with or surpass regional and international standards, which will facilitate economic growth and development.

MISSION

To establish and maintain a robust financial regulatory and supervisory regime for the Republic of Palau that operates efficiently and effectively, utilizing continuously updated standards, procedures, policies and regulations tailored to be consistent with international standards while recognizing the limitations of our banking industry; and to conduct regular onsite and offsite examinations of banks to ensure safety and soundness to minimize the risk of loss to depositors and consumers of financial services.

HIGHLIGHTS

PRIORITY AND CRITICAL ACHIEVEMENT AREAS

1. Compile accurate and timely bank statistics and produce quarterly reports used to monitor bank performance and indicate weaknesses in the banking sector
2. Conduct scheduled onsite bank examinations and assign bank ratings commensurate with banks' risk profile
3. Issue timely and appropriate regulatory enforcement measures to correct identified deficiencies in banks
4. Ensure, through offsite and onsite monitoring and examinations, that all banks are compliant with the provisions of the Financial Institutions Act
5. Monitor and Supervise the ongoing Receivership for Pacific Savings Bank to ensure compliance with the FIA and ensure maximum liquidation values are attained to satisfy depositor payouts
6. Monitor, supervise and assist the Financial Intelligence Unit in the areas of ensuring licensed bank's compliance with the Anti-Money Laundering and Proceeds of Crime Act.

MISSION

To establish and maintain a robust financial regulatory and supervisory regime for the Republic of Palau that operates efficiently and effectively, utilizing continuously updated standards, procedures, policies and regulations tailored to be consistent with international standards while recognizing the limitations of our banking industry; and to conduct regular onsite and offsite examinations of banks to ensure safety and soundness to minimize the risk of loss to depositors and consumers of financial services.

MEDIUM-TERM GOALS

NO.	Description	Baseline	Status	Verifiable Indicator
1	Establish Off-Site Monitoring Procedure to Review, Analyze and Assess Soundness, Liquidity, and Conditions of Banks Utilizing Regulatory Reports ("Call Reports").	100% Complete	100%	Accurate and timely submission of bank financial information and statistics pursuant to FIC Regulations. - All Banks submitting reports pursuant to FIC Regulations. - Reports are being utilized on an ongoing basis to monitor the performance of the industry and to alert the FIC of any impending matters that may affect the safe operations of banks.
2	Establish means of Self-Funding	100%	75%	FIC operations budget currently funded by the banking industry; the FIC currently receives 75% of its operating budget from all licensed banks.
3	Develop a Bank Rating System (Internal Assessment Tool for the FIC)	100%	100%	The FIC has established an internal bank rating system that is continuously updated and verified through offsite monitoring and onsite bank examinations. - bank rating systems determine the level of safety and soundness of banks
4	Develop On-Site Examination Procedures and Processes for Banking Institutions	100%	100% Complete	The FIC has adopted policies and procedures utilized in all onsite bank examinations. These policies and procedures have been employed in all bank examinations conducted from 2007 to the present.

CORE BUSINESS PROCESS (CBP)

CORE BUSINESS PROCESS (CBP)								
No.	Description	Performance Measure	Benchmark/ Target	2007	2008	2009	2010	Projected
1	Promulgate Regulations on Core Areas of Concern for Financial Institutions	Number of regulations drafted covering liquidity and solvency concerns for financial institutions.	100%	50%	90%	---	10%	100%
2	Compile and Analyze Statistical Data for Annual Reporting	Annual performance and sector report to be submitted no later than June of each year.	100%	50%	50%	50%	100%	100%
5	Review and evaluate applications for banking licenses	Banks licensed meet all specified requirements as set forth in the FIA and regulations.	No targets are set for bank license applications.	100%	---	---		---
6	Maintain and Update Files for Licensed Banks	Establish Bank Central Registry and update twice a year.	100%	100%	100%	100%	100%	100%
7	Perform Off-Site or On-Site Examinations of Banks to Ensure Compliance with Regulations, as needed.	Number of banks examined annually	100%	40%	40%	57%	71%	71%
8	Receive Continuous Training from External Organizations on Bank Supervision and Regulation	Number of Subject Areas Covered and critical risk areas targeted.	60%	10%	10%	10%	20%	---

IDENTIFICATION OF SERVICE POPULATION:

The Financial Institutions Commission serves both public depositors and the licensed financial institutions in the Republic of Palau. Service population: 20,000 individuals (approx) and 7 licensed banks.

PROPOSALS FOR COLLECTING NEW PERFORMANCE INFORMATION:

None to propose at this time. Additional performance information are provided in a Annual Banking Sector report.

DOCUMENTATION AND ANALYSIS OF PAST AND PROJECTED PERFORMANCE:

Past Performance

- Since the passage of RPPL No. 6-3, The Financial Institutions Act of 2001 (FIA) in June of 2001, the Commission has had numerous successes in its initial efforts to fulfill its mandate to "ensure the liquidity and solvency of financial institutions in the Republic of Palau", in accordance with Chapter II, Section 6(b) of the FIA.
- We have identified performance benchmarks that we have reached since the Governing Board of the Commission was fully constituted in October of 2002.
- Amendments to the FIA to improve the FIC's ability to promulgate regulations, conduct sufficient onsite examinations, and to provide for the powers to issue adequate and proper enforcement actions were successfully adopted and made law under RPPL 7-41.
- Continued internal operational improvements, both in staffing as well as adoption of policies and regulations have allowed for quicker responses to avert potential problem issues with banks and have allowed for a more integrated process for managing examinations and issuing corrective orders for banks.

Projected Performance

- The FIC is currently reviewing draft regulations for the licensing of money remittance companies, as required under Section 50 of the FIA; the regulations will specify requirements for money remittance companies to meet in order to be licensed and will allow for improved tracking of funds movement in and out of the Republic of Palau.

PERFORMANCE OBJECTIVES AS AN INCENTIVE FOR IMPROVING PROGRAMS AND SERVICES:

The Commission relies heavily on the anticipated approval of adopted regulations and the amendments to the FIA in order to accomplish its objectives stated in the mission statement:

- Approval by the OEK on regulations adopted by the Governing Board covering the initial core requirements for prudential banking supervision and regulation
- Amendment to the FIA that would enable the Commission to become a self-sustaining institution with minimal budgetary support from the Government

JUSTIFICATION: PERFORMANCE MEASURES

i. Collection of Statistical Data from Financial Institutions

- Currently implemented process of collection of statistical data on a quarterly basis (balance sheets and income statements as designated per FIC Regulations approved format) allows for a more in-depth and continuous monitoring of financial institutions to insure compliance with minimum capital requirements as well as regulations)
- Statistical reporting to the FIC currently allows the Commission to review and analyze data to detect potential areas of concern that need corrective measures in order to safeguard institutions' depositors and creditors
- Statistical reporting has enabled the FIC to target specific banks that require onsite examinations to verify areas of weakness that require moderate to substantive regulatory action to improve bank operations and/or to prevent bank failures
- Current bank reporting system also allows for the FIC to compile quarterly and annually financial sector reports to aide the Commissioner and the Governing Board in its enforcement and policy making objectives

ii. Regulatory Level Objectives

- Prioritized collection of data from Banks as well as continuation of general data collection on banks to determine core business functions and identify weak areas for supervisory focus
- Data collection and analysis allows for early detection of non-compliance with the FIA or FIC Regulations
- Safety and Soundness and compliance examinations have been performed regularly from 2007 to date, and has resulted in dramatic improvements in individual banks' compliance with laws and regulations and has resulted in improvements in operations for banks
- RECEIVERSHIP: The FIC continues to adequately regulate and supervise the ongoing PSB Receivership to ensure compliance with the FIA

iii. Administrative Level Objectives

- Sourced additional training for EC and new Examiner with the US FDIC – the Executive Commissioner and the Bank Examiner have both successfully completed phase one of a five phase program for bank examinations based on US FDIC standards and regulations
- US FDIC training has enhanced skill sets for Executive Commissioner and Bank Examiner and will enable more comprehensive and detailed examinations of US Bank Branches in the Republic of Palau
- Expense levels kept at minimum and to match operational requirements
- Collected fees as per FIA, in the amount of $105,000 as of April 1st, 2010

iv. Projected Performance

- FIC Executive Commissioner and Bank Examiner have been accepted and slotted for phase two training with the FDIC
- Expected completion of FIC Regulation cover licensing and operations of remittance companies expected to be complete by end of 2010
- FIC to continue public education campaign on banking, beginning with expected completion of general information booklet
- FIC expects to be able to publish a complete annual report by the end of the year, depending on the banks' ability to provide sufficient financial statements and statistics.

- ***PERFORMANCE OBJECTIVES AS AN INCENTIVE FOR IMPROVING PROGRAMS AND SERVICES:***
  The FIC continues to seek further training with the IMF/PFTAC and the US FDIC to update and enhance professional skill sets to enable continued improvements in the conduct of bank examinations and promulgation of adequate and effective regulatory enforcement measures to ensure better bank performance and reduce risk of loss for licensed banks.

PERSONNEL

No.	Position Title	Status	Pay Level	Base Salary
1	Executive Commissioner	Exempt	EXEMPT	$42,066
1	Bank Examiner	Classified CS	GL 17/2	$ 31,340
1	Office Manager	Classified CS	GL 12/4	$15,779

POSITION SPECIFICATION

1. **Executive Commissioner -** Performs the technical and administrative functions of the FIC as delegated by the Governing Board. Implements the decisions and policies of the Governing Board of the FIC; Manages the day-to-day operations and staff of the FIC; Organizes the functioning of the FIC; Enacts rules for the functioning and development of the FIC; Acts as examiner-in-charge in the examination of financial institutions and prepares relevant reports; Reviews and finalizes evaluation reports on applications for a banking license; Reviews and analyzes regulatory returns and other documents submitted by assigned banks and prepares relevant write-ups / reports; Analyzes financial institutions' performance and prepares relevant industry reports; Prepares/finalizes technical studies/reports; Prepares/finalizes replies or acts on requests/queries and other correspondence received by the FIC; and Supervises and reviews output of Examiner and Office Assistant.

2. **Bank Examiner –** Answers directly to the Executive Commissioner and is primarily responsible for conducting off-site analysis and on-site bank examinations. These include but are not limited to quarterly and annual analyses of individual bank and sector-wide financial returns, as required by FIC Regulations, and any available financial sector statistics. Off-site examinations conducted by the Bank Examiner involve the review, analysis, and detection of trends and/or singular events that may impact banks' financial condition. These off-site monitoring of financial institutions are prepared by the Bank Examiner and provided quarterly or as need to the Executive Commissioner for determination of proper supervisory actions. The Bank Examiner is responsible for assigned sections of the Report of Examination and assists in the Executive Commissioner in the drafting of the Reports of Examination for all banks.

3. **Office Manager –** Performs administrative and support tasks. Reconciles expenditures and prepares monthly budget reports for review and approval by the Executive Commissioner and presentation to the Governing Board. Assists in the preparation of the annual budget. Receives and screens calls and visitors and provides assistance; prepares and processes letters, reports and other documents and communications; prepares travel documents and makes travel arrangements; arranges meetings and conferences for the FIC; maintains and updates office records; prepares procurement documents and maintains and inventories office supplies and equipment; maintains orderly workplace for the FIC. Ensures office and staff are equipped and supplied; office is clean and conference room is staffed and supplied for meetings; assists in hosting of functions and activities; keeps the appointment book for the Governing Board, the Executive Commissioner and supervisory staff; coordinates, collects and compiles data and statistics for use in reports and documents; and drafts replies or acts on general requests/queries and correspondence received by the FIC; Performs other duties as may be assigned from time to time by the Executive Commissioner.