2015 Annual Banking Industry Report

FINANCIAL INSTITUTIONS COMMISSION
of the
REPUBLIC OF PALAU

This report is provided pursuant to § 1016 of 26 PNC Chapter 10, the Financial Institutions Act.

G. Semdiu Decherong
Executive Commissioner

March 11, 2016
Date

2015 Annual Palau Banking Sector Report

Summary Industry Assessment

The overall condition of the Palau banking sector remains satisfactory and there continues to be growth and stability. Assets grew 28% during the year as a result of continued expansion in customer deposits. Aggregate capital for the two remaining locally chartered banks grew 8% in 2015 due to net profits and direct capital injection. Capital exhibits an increasing trend and uninsured locally chartered banks demonstrate the desire to maintain capital growth.

Asset quality indicators remain satisfactory. Overall, the ratio of Non Performing Loans (NPLs) to Total Loans fell from 3.19% to 2.10% during the year. Loan volume declined by 2.5% or approximately $815M and Provisions for Bad Loans remain adequate to mitigate against potential losses, covering 267% of the sector's Non Performing Loans.

Return on Assets, at 1.38%, remains relatively stable although slightly down from 1.44% at the prior year-end. Relative stability is maintained as a result of asset growth. Also contributing to stable profits for the banking sector, the decline in Non-Interest Expense to Average Assets suggests that local banks have managed to keep costs down notwithstanding significant growth in total assets.

Liquidity remains adequate and all banks demonstrate the ability to continue to meet depositors demand. Funds management practices are adequate for the scope of local banking operations, as supported by onsite exam findings, and continue to demonstrate satisfactory results. U.S. branches continue to generate strong earnings from excess funds invested abroad, and maintain reliable access to adequate sources of funds to meet anticipated local liquidity needs.

*[Note: for the purposes of this report, numbers accompanied by the Roman numeral "**M**" represent figures in thousands, and "**MM**" represents figures in millions]*

New Developments

Governing Board of Commissioners

The FIC Board bid farewell to Chairman Okada Techitong in May 2015. The Board terms of Ms. Uroi Salii and Mrs. Jennifer Koskelin-Gibbons were renewed in November 2015 by Senate confirmation. Following reorganization of the Board pursuant to its by-laws, a new Chairman and Vice Chairman were selected by unanimous vote and currently, Mr. Tutii Chilton and Ms. Uroi Salii, respectively, hold these positions on the Governing Board.

There remains one vacant seat on the FIC Governing Board of Commissioners that has yet to be filled.

National Development Bank of Palau

The FIC worked diligently with the National Development Bank of Palau (NDBP), its Board and Executives, to familiarize the bank with the banking law and other related legislation, and particularly bank regulations. The

Bank Examiner facilitated several sessions at the NDBP covering prudential and administrative regulations. At the same time, the FIC assisted in the drafting of Terms Of Reference (TOR) for the Republic's request of the Asian Development Bank (ADB) to provide technical assistance in preparing the NDBP to accept deposits.

The FIC, with the assistance of an International Monetary Fund (IMF) Pacific Financial Technical Assistance Center (PFTAC) PFTAC Consultant, conducted a preliminary full scope onsite examination of the NDBP in November 2015. Examination findings were discussed with the bank's Board and representatives of the Olbiil Era Kelulau and the Executive Branch, as is appropriate given that the National Government is effectively the principle shareholder/owner of the bank.

Cooperation & Collaboration with International Organizations and Agencies

Credit Unions

The FIC, in collaboration with PFTAC, conducted workshops with nearly all credit unions registered with the National Corporate Registry. A Technical Advisor (TA) from PFTAC was sent to facilitate the workshops that trained credit union officials and members on how to utilize an electronic form to build accurate financial statements. The TA also held training sessions with the Bank Examiner on reporting and compiling credit union financial data. Following these training workshops, on April 17, 2015, the Senate held a hearing to discuss the Credit Union bill and related banking sector matters with the Executive Commissioner and PFTAC Technical Advisor Mr. Pierre Seguin. The Credit Union Act subsequently failed to pass first reading on the Senate floor.

Counterfeit Currency

The U.S. Secret Service held counterfeit training sessions in June 2015. U.S. agents trained local law enforcement officials, including from the Koror State Government, Customs agents, policeman, National Treasury personnel, merchants, and other businesses and institutions dealing with high volumes of cash.

IMF PFTAC and the AFSPC

In August 2015, the FIC's Executive Commissioner and Bank Examiner attended the annual meeting of the Association of Financial Supervisors of Pacific Countries (AFSPC) held in the Solomon Islands. At the meeting, Palau and the other member jurisdictions made presentations and held candid discussions pertaining to supervisory issues, shared concerns regarding the direction and trend in banking and financial regulation, regionally and globally. The workshops facilitated by IMF PFTAC Advisors during the week-long program covered areas of Corporate Governance and the Basel Core Principles of banking and financial regulation.

The FIC has been a member of the AFSPC since 2003. In all these years, the annual meeting of the AFSPC has never been held in any of the North Pacific countries. During this most recently held meeting of financial supervisors in the Solomon Islands, Palau was selected to host the 2016 Annual Meeting of the AFSPC. Plans and preparations are currently underway and the meeting has been scheduled for the week of June 13th through June 17th, 2016, at the Palau International Coral Reef Center (PICRC).

New Banking License

During the 2015 calendar year, there were a few individuals/entities that expressed interest in establishing banking institutions in Palau, however, the Commission did not receive any complete application packets for new banking licenses, and thus, none have been reviewed. The Governing Board of the FIC had lifted the moratorium on issuance of new banking licenses by that resolution unanimously adopted on and dated July 29, 2010. The moratorium on the establishment of new banks in Palau became effective on February 19, 2003 by FIC Resolution No. 02-2003-03 dated the same in order to allow the Commission time to adopt and fully implement its prudential and administrative regulations as promulgated under the Financial Institutions Act.

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 during the 7th Olbiil Era Kelulau under Republic of Palau Public Law 7-41. The FIA was codified into the Penal Code under 26 PNCA Chapter 10.

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 law.

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. This off-site monitoring of financial institutions is conducted quarterly or as needed 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. On-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 III)** 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. In addition to administrative tasks, the Office Manager is also the Registrar of the Secured Transactions Registry.

Anti-Money Laundering

In addition to regular bank supervision, the Commission is given authority in the Financial Institutions 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 FIC includes onsite AML/CFT examinations during regularly scheduled onsite bank examinations.

Financial Intelligence Unit

The Financial Intelligence Unit (FIU), established by 17 PNCA Chapter 38, is located within the FIC and operates as an independent agency under the direction of the FIC Governing Board with an operating budget; however, the budget for the current fiscal year is insufficient to ensure their operational goals are met. A request for additional funding has been provided to the Office of the President by the FIC Governing Board. The FIC Governing Board, as mandated by law, has appointed an FIU Director, who manages the operations of the agency and performs the tasks set forth in 17 PNCA Chapter 38. The current FIU Director is Mr. Nelson Werner, an American attorney formerly with the Office of Independent Counsel and the Palau Attorney General's Office. Director Werner currently has one staff, Mr. Hussein "Boboi" Derbai, who was hired last year to fill the position of FIU Analyst. Over the past two years, the FIU has been developing its operations and administrative functions as an independent agency, and assisting the Bureau of Public Safety on several cases where money laundering offenses may be charged.

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 three phases of the FDIC's series of examination schools and completion of the final part of FDIC examination training will be made possible through a grant awarded to the FIC by the U.S. Department of Interior for the purpose of technical capacity building. Other training received by the Executive Commissioner includes areas such as designing effective legal frameworks for problem bank supervision, Anti-Money Laundering and Counter-Terrorist Financing, FDIC Receivership methods, and others. In addition, the Bank Examiner has received training on liquidity frameworks and analysis as well as loan and financial statement analysis from PFTAC in conjunction with APRA and the Bank of International Settlements' Financial Stability Institute.

Sector Overview

The Financial Institutions Commission monitored and regulated five banks during the 2015 calendar year—three U.S. bank branches and two locally chartered banks. The three foreign bank branches are U.S. chartered and insured by the U.S. Federal Deposit Insurance Corporation (FDIC) whereas the locally chartered banks do not maintain depositor insurance. The National Development Bank of Palau, formerly exempt from regulation and oversight, automatically fell under the supervisory authority of the FIC when RPPL 9-41 was signed into law on December 5, 2014.

For the purposes of this report, the banking sector has been divided into two banking groups, namely the insured banks and uninsured banks, due to the broad differences in size and business scope that are unique to the banks that have been categorized within these groupings. Statistics for the National Development Bank of Palau are not yet incorporated into the FIC's Annual Report to the OEK and will be excluded from aggregate

industry data for the banking sector until the NDBP is issued a banking license.

In this report, "insured banks" means those banks/branches whose deposits are insured by the U.S. FDIC; and "uninsured banks" are those banks that do not maintain depositor insurance under a government sponsored insurance program. As of the calendar year ended December 31, 2015, the U.S. bank branches hold approximately 93% of the banking sector's aggregate Net Loans and 99.7% of the sector's aggregate Total Deposits. [1]

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 agency fulfills its objective by conducting offsite monitoring of all licensed banks and through onsite examinations.

Off-Site Monitoring and Bank Examinations

The Commission schedules onsite bank examinations based on each bank's assigned rating determined at the most recent onsite examination in accordance to a Regulatory Response Policy. The Executive Commissioner reviews quarterly an individual bank's financial information reported on the FIC Prudential Returns as well as analysis reports produced by the Bank Examiner. Quarterly returns consist of three forms and several related schedules providing current information on an institution's balance sheet and income and expense statements.[2] Quarterly prudential returns and analysis reports are the main component of the FIC's off-site monitoring program and the Commission utilizes quarterly assessment reports as an integral part of on-site bank examination planning and scheduling.

Data submitted by all licensed banks on quarterly prudential returns are entered into a computer database and used in the calculation of pertinent ratios and indicators which help to monitor the performance of each bank. These ratios and indicators are compiled into a report aptly named the Uniform Bank Performance Reports which are disseminated as appropriate to all licensed banks. The UBPRs contribute to the FIC's off-site monitoring program and provide comparative analysis and performance tracking for each bank, banking group, and industry wide. Valuable data is provided to management of each licensed institution through dissemination of UBPRs and the publication of quarterly and annual reports on the FIC's official website.

The FIC continues to regularly and consistently produce timely analysis reports for each licensed bank and branches, as well as an overall banking industry report every quarter. These reports are produced by the Bank Examiner and submitted to the Executive Commissioner for review and final draft. The industry report is generated as a general overview of the condition of the banking sector and is submitted to the Governing Board of the FIC. An annual report is also produced for submission to the Olbiil Era Kelulau (OEK) as required under the banking law using figures from those statements of condition published annually by each licensed bank in Palau as well as aggregate figures derived from the FIC's quarterly prudential returns. This report is the seventh annual report published by the FIC. The sixth Annual Banking Sector Report was submitted to the OEK (Palau National Congress) on May 4th, 2015; and the fifth Annual Banking Sector Report to the OEK was submitted on April 15th, 2014, for the calendar year ending December 31st, 2013. Prior year reports submitted to the OEK are available through the FIC official website.

The FIC conducted a total of five onsite examinations during the 2015 calendar year, including an initial full scope onsite examination of the National Development Bank of Palau completed in November 2015. The Report of Examination in relation to the aforementioned was submitted to the Board of the NDBP in January 2016 and discussions are ongoing between the development bank and the FIC to address regulatory concerns identified during the onsite examination. Also examined were the Palau Construction Bank, BankPacific, Ltd., and Bank of Guam. Moreover, at the behest of the Attorney General, the FIC conducted an Anti-Money

[1] Historical data indicates that U.S. branch institutions continue to lead the sector in assets and deposits and are reporting fairly consistent growth and stable to growing 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.

[2] Previous regulatory financial forms 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 licensed banks. The FIC prudential forms were revised in January 2009 and again in July 2012 to include more detailed breakdowns of financial statement items. The required forms were initially implemented beginning December 2009 and all banks in the sector are required to submit all relevant forms and schedules, certified by bank officials, in electronic form within 30 days following each quarter-end.

Laundering focused onsite examination of the Belau Community Credit Union (BCCU).

Onsite examinations are scheduled based on composite ratings issued using the CAMELS rating system adopted from the bank examination procedures employed by U.S. regulators. Both the Executive Commissioner and the Bank Examiner have completed several bank examination trainings by the U.S. FDIC and PFTAC.

The FIC 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.

Agency Interaction and Cooperation with Regulated Banks

All licensed banks have cooperated with the FIC in compliance with 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 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 open and transparent communications with all 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.

Financial Institutions Not Regulated by the FIC

Insurance providers/agencies, micro-lending facilities (a.k.a. finance companies), pension funds, and credit unions with assets less than $500,000 are exempt from regulatory oversight and supervision. However, the FIC has received expert advice and opinions from the Asian Development Bank, the IMF, and PFTAC regarding bringing these non-banks under its supervisory authority.

Below is an analysis of the current condition of the banking industry. 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.

BANKING SECTOR INDICATORS: Capital, Assets, Earnings, & Liquidity

[Note: for the purposes of this report, numbers accompanied by the Roman numeral "**M**" represent figures in thousands, and "**MM**" represents figures in millions]

CAPITAL ADEQUACY (Uninsured banks):

- **Aggregate capital for uninsured banking institutions continues its upward trend and increased by 8%, or $239M, during the year.** The strong earnings performance of one of the two locally chartered banks has resulted in aggregate capital accretion for the uninsured banks, which individually are required to maintain at least one million U.S. dollars in capital.
- The FIC monitors Uninsured banks to ensure capital levels are maintained above statutory minimum requirements and has verified each bank's capital position during onsite examinations conducted during the 2014 and 2015 calendar years. As of the calendar year ended December 31, 2015, the two uninsured banks in the sector remain in compliance with regulatory minimum capital ratios pursuant to statute and FIC prudential regulation PR-01 as well as the required minimum level of capital.

ASSET QUALITY:

- Quality of assets remains satisfactory for the banking sector.

  The quality of the sector's loan portfolio continues to be satisfactory. The ratio of Non Performing Loans to Total Loans declined from 3.19% at the prior year down to 2.10%. The total volume of Non Performing Loans (NPLs) fell 36%, or by $366M during 2015.
- Total loans declined by $815M or 2.5% during 2015. Unsecured consumer loans, which comprise 88% of the sector's portfolio, grew 5.9%, or by approximately $1.6MM. On the other hand, Business loans (i.e. loans to Non-financial corporations) declined by $460M or 15%.
  - *Insured banks* hold 98%, or approximately $243MM, of the banking sector's total assets of $248MM; 91% or approximately $28MM of the sector's total loans, and 76%, or approximately $501M of the sector's Non Performing Loans as of year-end.[3]
- The ratio of Loans past due 360 days or more to Total Loans is minimal at 0.13%, down from 1.23% at prior year-end. Loans past due 360 days or more[4] fell 90%, or by approximately $356M, from last year bringing down the total to $40M for all commercial banks.
- **Provisions for Bad Loans remain adequate for all commercial banks**. Aggregate Provisions for Bad Loans covers 267% of the sector's Non Performing Loans indicating that there is sufficient cushioning that well exceeds the potential for loan losses and the FIC regulations.
- Due From Home Office balances of U.S. Branches comprise 85% of the banking sector's Total Assets. Approximately $210MM of the industry's $213MM in Liquid assets are demand deposits due from the Home Offices of U.S. FDIC-insured banks. Onsite exam findings show that all of the **Insured bank branches generated yields higher than the average effective Federal Funds Rate**.

[3] The FIC has confirmed during onsite examinations of these branch institutions that internal policies and procedures, particularly those that dictate asset management, comply with prudential regulations, ensuring that asset quality remains satisfactory and resulting in minimal losses as demonstrated by historical figures reported for this group of banks.

[4] *Insured banks* do not maintain on their books any loans past due 180 or more days as pursuant to their respective internal loan policies, thus the balance of these loans that are more than a year past due is attributable to Uninsured banks. As a result of recommendations made following onsite examinations conducted by the FIC, commercial banks have written off a significant majority of severely delinquent loans.

EARNINGS PERFORMANCE:

- **Earnings performance for the sector continues to be satisfactory.** Most banks generated profits during the calendar year. Stable and growing profitability is expected overall as lending can expand, spurred on by continued deposit growh.
  - Return on Assets (ROA) for the overall sector remains relatively stable at 1.38%, although slightly down from 1.44% last year. According to the most recent interest rate surveys conducted, deposit rates range from 0.02% to 1.5% with local demand and savings rates gradually falling. Lending rates remain stable and capped at 18% due to standing legislation. Unsecured consumer loan rates range from 11% at the lowest whereas business loans may yield as low as 7.25% depending on subjective criteria specific to each bank's credit policy.
    - ROA for *Insured banks* is slightly up from 1.36% to 1.38%. However, for *Uninsured banks* ROA shows significant decline from 3.82% down to 1.25% primarily due to required additional Provisions for Bad Assets Expense.
  - Both Net Interest Margin (NIM)[5] and average Yield on Loans are slightly lower compared to last year, suggesting that, on average, lending rates are on a gradual downward trend. NIM fell from 2.99% to 2.56% and Yield on Loans is slightly down from 11.17% to 10.91%, both compared to prior year-end.
  - The estimated average yield on aggregate balances Due from Home Office & Other branches of the *Insured group of banks* remains relatively stable at 0.87% though slightly up compared to prior year-end. The average yields of U.S. bank branches operating in Palau have historically been above the Effective Federal Funds Rate. The average Effective Federal Funds Rate for 2015 was 0.13%. The yield on local branch balances maintained at U.S. bank Home Offices indicate strong earnings from the investment of excess funds outside Palau.

Condensed Income & Expense Statement

Annualized (in U.S. '000s)	CYE2014			CYE2015		
	Insured	Uninsured	All Banks	Insured	Uninsured	All Banks
Interest And Fee Income	4,581	557	5,138	5,189	515	5,704
Interest Expense	182	2	184	160	1	161
NET INTEREST INCOME	**4,399**	**555**	**4,954**	**5,029**	**514**	**5,543**
Provisions For Bad Loans Expense	**766**	**14**	**780**	**624**	**70**	**694**
NON-INTEREST INCOME	**792**	**5**	**797**	**870**	**6**	**876**
NON-INTEREST EXPENSE	**2,063**	**325**	**2,388**	**2,167**	**369**	**2,536**
NET INCOME (LOSS) BEFORE TAXES	2,362	221	2,583	3,108	81	3,189
Less: Applicable Income Taxes	94	13	107	113	10	123
Year-to-date Income (Loss)	**2,268**	**208**	**2,476**	**2,995**	**71**	**3,066**

LIQUIDITY ADEQUACY:

- **Liquidity continues to be strong for all banks in the sector.**
- The Liquidity Ratio calculated for the banking sector, at 90%, continues to be stable and growing. This means that for every dollar in short term liabilities, the banking sector maintained 90 cents in liquid assets. Liquid assets[6] grew by approximately $55MM, or 35% during 2015, which is commensurate with the increase in short term deposits.

[5] Net Interest Margin is equal to Net Interest Income, which is the difference between Interest Income and Interest Expense, divided by Average Earning Assets. Earning Assets comprises net loans and deposits placed with the headquarters of local branches which earn a return from investments abroad. NIM will generally be lower than the difference between average yield on loans and cost of deposits because it is a calculation of the estimated return for every dollar of earning assets.

[6] Liquid Assets (PR-10) 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.

- Even though local liquid assets (i.e. cash balances) aggregated for *Insured branch institutions* cover just 0.79% of total short term liabilities, including deposits with maturities of one year or less for this group of banks, onsite examinations of all U.S. branch institutions show that insured branches maintain sufficient funds to meet depositor demands and operational needs. All U.S. branches demonstrate a net cash export position as well as maintain adequate reporting and monitoring systems to manage risk of cash shortfall.
- Notwithstanding concerns with the security of their respective liquid assets, *Uninsured banks* demonstrate ability to cover all customer deposits and short term liabilities and rely more on capital to generate earnings.
- **All banks in the sector demonstrate continued ability to meet depositor demands**.
- Total short-term Customer Deposits for the banking sector grew 31%, or by approximately $55MM, during the calendar year. The deposits of non-financial corporations in particular grew by a significant $19.5MM or 23% during the year. The deposits of State Governments and Individuals follow suit expanding by $9.5MM (or 64%) and $13MM (or 24%), respectively, during 2014. Similarly, National government deposits grew 59%, or by $10MM, increasing from approximately $17.4MM up to $27.5MM.

The ratio of Total Deposits to Total Loans rose significantly from 573% to 761%, commensurate with deposit growth outpacing loan growth. This ratio means that on average, for every dollar in loans, the sector maintains approximately $7.61 in deposits. This ratio has several implications, including that deposits continue to be taken in faster than new loans are being issued by banks in the sector. Although bank officials have expressed during onsite exams the willingness and capacity to expand their respective loan portfolios, there are factors inhibiting any significant growth in loans. Namely, lack of legislative support for real estate secured lending and market size (i.e. limited pool of qualified borrowers). Rather than investing locally in terms of expansion in lending activities, U.S. banks continue to invest excess liquidity abroad.

OTHER BANKING SECTOR STATISTICS

Remittances (*U.S. bank branches are the only local financial institutions with wire transfer capabilities*)

Palau maintains a net outbound position in remitted funds, meaning more funds are sent outside Palau than are received by local institutions.

- **A total of approximately $138MM came into Palau and approximately $152MM were sent abroad during the 2015 calendar year** through the banking sector. Remittances to and from the U.S., Taiwan, and Japan – our main trading partners – top the list.
- Remittances received in Palau from those three above listed countries together comprise 75%, or approximately $103MM, of total funds received during 2014. Of the total Outgoing wire transfers during 2014, approximately $102MM in funds, or 67%, were sent to those same three countries listed above.
- Government received approximately $11MM, or 46%, more in funds compared to the prior year. The domestic Private Sector (non-financial corporations, individuals, and non-profit institutions), received $102MM and sent out $141MM during the calendar year.

Financial Access

The number of Depositors and number of Borrowers are aggregated from figures reported by all five banks, and as such, there will be overlap as there are customers that will have accounts at multiple banks.

- The sum of the number of Depositors reported by all licensed banks and the total number of Deposit Accounts declined compared to the prior year, despite further expansion in the sector's volume of funds held in deposit accounts. The aggregate total number of Depositors was reduced from 22,231 down to 19,919. The average number of depositors for the banking sector, if every depositor held at least one deposit account at three of the five licensed financial institutions, is 6,640—down from 7,410 last year. Similarly, the total number of Deposit Accounts declined from 23,902 down to 22,155—that is a 1,747 reduction in the number of deposit accounts.
- Despite decline in the volume of loans outstanding, the total number of Borrowers and the number of Loan Accounts are just slightly higher compared to last year by 52 and 33, respectively. Total number of Borrowers is 6,272 whereas Loan Accounts total 6,265 as of the end of 2015. This implies a gradual expansion in local access to credit. Consumer loans in particular show 2% growth during the calendar year. Notwithstanding the establishment of a Secured Transactions Registry, the volume of secured loans continues to decline. Secured loans fell 30%, or by $1.1MM during the 2015 calendar year.

Ratios & Summary Balance Sheet

KEY RATIOS (%)	CYE2014			CYE2015		
	Insured	Uninsured	All Banks	Insured	Uninsured	All Banks
Total Capital to Total Assets	n.a.	53.26	n.a.	n.a.	55.60	n.a.
Tier 1 Leverage Capital Ratio	n.a.	49.50	n.a.	n.a.	54.37	n.a.
Tier 1 Risk Based Capital Ratio	n.a.	94.19	n.a.	n.a.	87.11	n.a.
Total Risk Based Capital Ratio	n.a.	103.14	n.a.	n.a.	90.59	n.a.
Non Performing Loans to Total Loans	1.97	14.12	3.19	1.76	5.42	2.10
Provisions for Bad Loans to NPLs	194.73	298.02	240.57	192.61	505.13	266.82
Net Income to Average Assets (ROA)	1.36	3.82	1.44	1.38	1.25	1.38
Net Interest Income to Average Earning Assets (NIM)	2.72	14.24	2.99	2.37	13.29	2.56
Interest Margin to Gross Income	81.87	98.75	86.14	83.00	98.66	84.24
Non Interest Expense to Average Assets	1.24	5.97	1.39	1.00	6.50	1.14
Average Yield on Loans	10.66	15.72	11.17	10.46	15.30	10.91
Average Cost of Deposits	0.11	0.35	0.11	0.08	0.15	0.08
Liquidity Ratio (PR-10)	87.08	164.83	87.01	90.06	164.97	90.26
Net Loans to Total Assets	14.77	33.62	15.31	11.30	36.43	11.88
Customer Deposits to Total Loans	634.88	17.04	572.95	835.70	20.95	760.72
Cash Balances to Short Term Liabilities	0.96	21.61	1.05	0.79	21.50	0.85

Summary Balance Sheet Calendar Year to Date Amounts (in U.S. '000s)	CYE2014			CYE2015		
	Insured	Uninsured	All Banks	Insured	Uninsured	All Banks
Cash and Due from Other Banks	156,926	928	157,854	212,057	1,036	213,093
Net Loans	27,761	1,863	29,624	27,427	2,090	29,517
Gross Loans	*28,869*	*3,216*	*32,085*	*28,392*	*2,878*	*31,270*
Provisions for Bad Loans	*(1,108)*	*(1,353)*	*(2,461)*	*(965)*	*(788)*	*(1,753)*
Performing Loans	*28,300*	*2,762*	*31,062*	*27,891*	*2,722*	*30,613*
Non Performing Loans	*569*	*454*	*1,023*	*501*	*156*	*657*
******Loans over 360 days past due******	*NA*	*396*	*396*	*NA*	*40*	*40*
******Past Due Loans (includes NPLs)******	*1,646*	*699*	*2,345*	*1,406*	*377*	*1,783*
Other Assets	3,284	2,750	6,034	3,146	2,611	5,757
TOTAL ASSETS	**187,971**	**5,541**	**193,512**	**242,630**	**5,737**	**248,367**
Total Deposits	183,284	548	183,832	237,273	603	237,876
Demand/Checking	*83,029*	*0*	*83,029*	*99,738*	*0*	*99,738*
Savings	*87,934*	*513*	*88,447*	*125,283*	*581*	*125,864*
Time Deposits	*12,321*	*35*	*12,356*	*12,252*	*22*	*12,274*
Other Liabilities	2,419	2,042	4,461	2,362	1,944	4,306
TOTAL LIABILITIES	**185,703**	**2,590**	**188,293**	**239,635**	**2,547**	**242,182**
Issued and Fully Paid Up Common Stock	NA	4,005	4,005	NA	4,105	4,105
Paid-in Premium	NA	0	0	NA	0	0
Retained Profits (Losses)	2,268	(1,054)	1,214	2,995	(915)	2,080
Other Changes to Capital	0	0	0	0	0	0
TOTAL CAPITAL	**2,268**	**2,951**	**5,219**	**2,995**	**3,190**	**6,185**
TOTAL LIABILITIES & CAPITAL	**187,971**	**5,541**	**193,512**	**242,630**	**5,737**	**248,367**

APPENDIX

	As of Calendar Year-End 2015[1] (In U.S. Thousands)					As of Calendar Year-End 2015 (In U.S. Thousands)		
Statements of Condition figures published by all banks	Bank of Hawaii	Bank of Guam	BankPacific[2]	Palau Construction Bank	Asia Pacific Commercial Bank	**Insured Banks**	**Uninsured Banks**	**Aggregate All Banks**
Cash & Due From Banks	666	91,657	15,985	709	335	108,308	1,044	109,352
Net Loans	17,982	7,271	2,043	1,176	913	27,296	2,089	29,385
Other Assets[3]	105,604	77	18	669	29	105,699	698	106,397
TOTAL ASSETS	**124,252**	**99,005**	**18,046**	**2,554**	**1,277**	**241,303**	**3,831**	**245,134**
Deposits	118,958	98,992	18,112	401	201	236,062	602	236,664
Other Liabilities	33	13	35	36	4	81	40	121
TOTAL LIABILITIES	118,991	99,005	18,147	437	205	236,143	642	236,785
CAPITAL	5,261		(101)	2,117	1,072	5,160	3,189	8,349
TOTAL LIABILITIES & CAPITAL	**124,252**	**99,005**	**18,046**	**2,554**	**1,277**	**241,303**	**3,831**	**245,134**
Statements of Income (Loss) figures published by all banks	Bank of Hawaii	Bank of Guam	BankPacific[2]	Palau Construction Bank	Asia Pacific Commercial Bank	**Insured Banks**	**Uninsured Banks**	**Aggregate All Banks**
Interest Income	3,654	1,148	171	361	146	4,973	507	5,480
Interest Expense	176	108	14	1	1	298	2	300
NET INTEREST INCOME	**3,478**	**1,040**	**157**	**360**	**145**	**4,675**	**505**	**5,180**
Non Interest Income	881	201	98	9	5	1,180	14	1,194
Non Interest Expense	794	937	356	179	259	2,087	438	2,525
Net Income (Loss) before Tax	3,565	304	(101)	190	(109)	3,768	81	3,849
Less: Applicable Net Income Tax	104	17	0	9	1	121	10	131
NET INCOME (LOSS) after Tax	**3,461**	**287**	**(101)**	**181**	**(110)**	**3,647**	**71**	**3,718**

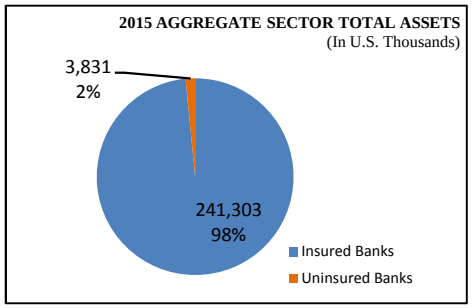
1/ All banks published Statements of Condition and Statements of Income (Loss) by March 1st 2016 with postings in bank lobbies

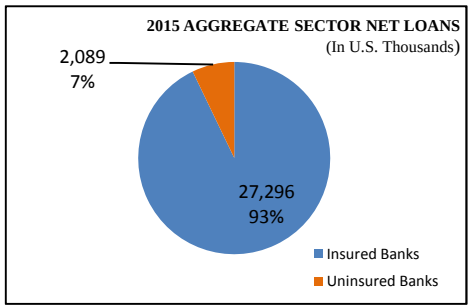
2/ BankPacific's figures are as of June 30, 2015, since the bank's fiscal year ends on June 30th.

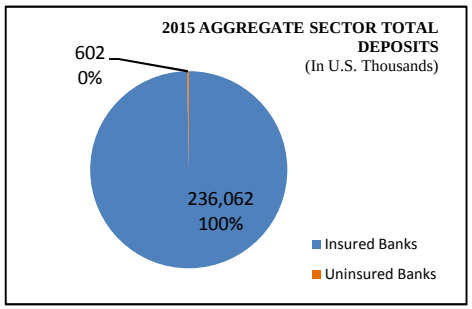
3/ includes fixed assets and accrued receivables other than loans; for Bank of Hawaii, Other Assets includes balances Due From Home Office

Key Ratios

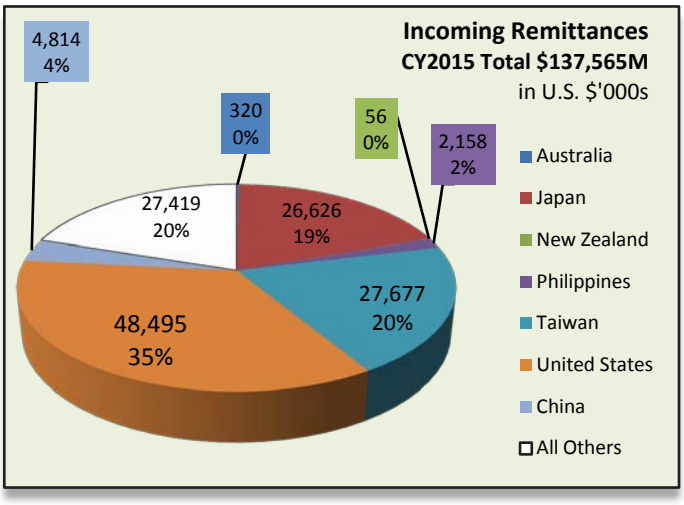
Return on Total Assets	2.79%	0.29%	-0.56%	7.09%	-8.61%	1.51%	1.85%	1.52%
Return on Total Equity				8.55%	-10.26%		2.23%	
Capital to Average Assets				83.54%	97.50%		32.41%	
Liquid Assets to Total Deposits	1%	93%	88%	177%	167%	46%	173%	46%

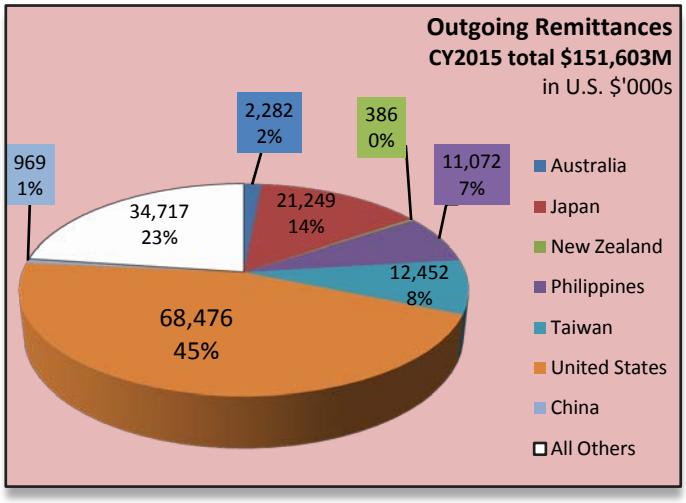






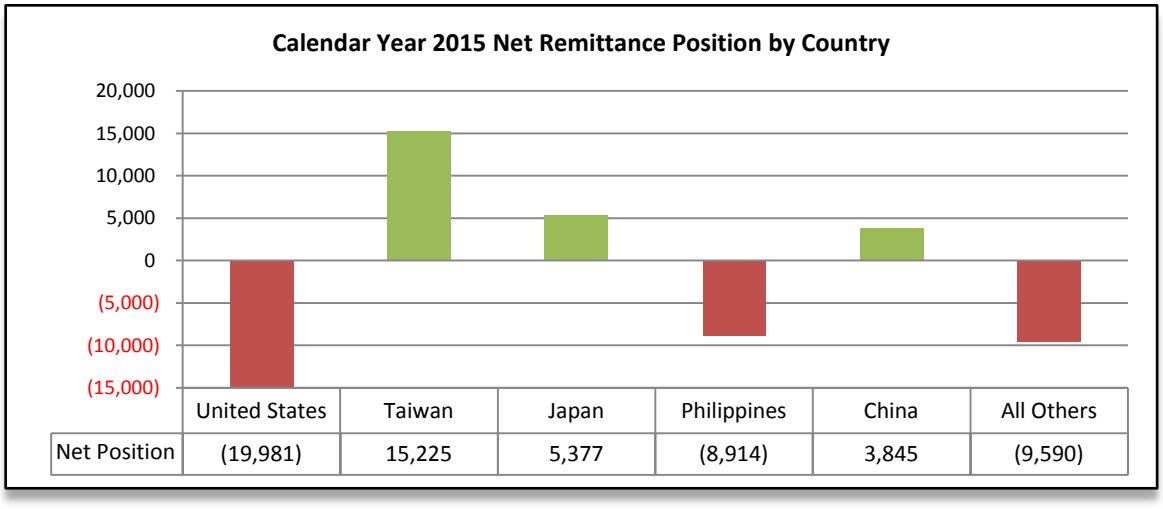
from Annual Statements of Condition for all banks in Palau published and posted on March 1st by all banking institutions pursuant to FIC regulatory requirements (PR-11)



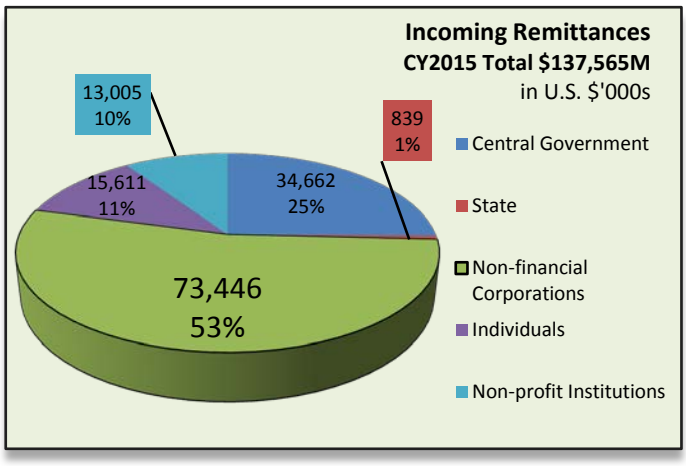


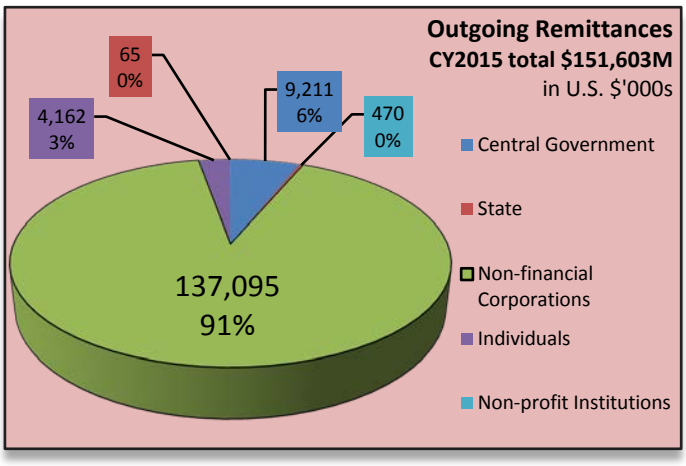
In U.S. Thousands of Dollars	CY2014	CY2015	% Change	4th Qtr 2014	4th Qtr 2015	% Change
Incoming Remittances	**108,470**	**137,565**	**27%**	**30,862**	**34,469**	**12%**
United States	30,524	48,495	59%	10,544	9,840	-7%
Taiwan	22,681	27,677	22%	6,644	9,951	50%
Japan	22,557	26,626	18%	5,038	8,631	71%
All Others*	32,708	34,767	6%	8,636	6,047	-30%
Outgoing Remittances	**130,214**	**151,603**	**16%**	**39,226**	**32,361**	**-18%**
United States	58,175	68,476	18%	17,224	15,542	-10%
Taiwan	11,401	12,452	9%	5,869	2,211	-62%
Japan	20,183	21,249	18%	4,575	5,292	16%
Philippines	13,158	11,072	-16%	3,594	1,692	-53%
All Others**	27,297	38,354	41%	7,964	7,624	-4%

*Includes wires from: Australia, NZ, Philippines, China, and unspecified countries grouped in "All Others" category
** Includes wires to: Australia, NZ, China, and unspecified countries grouped in "All Others" category

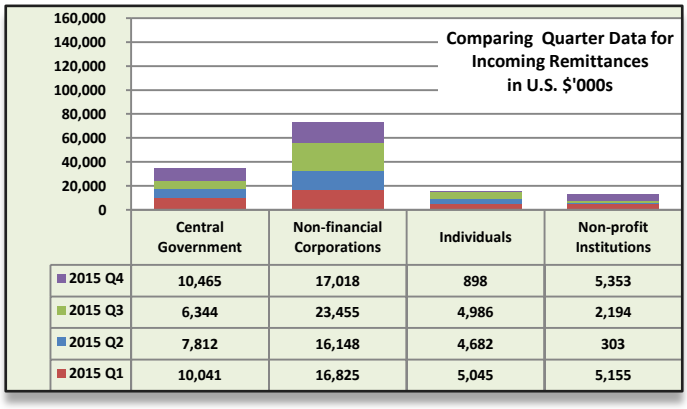


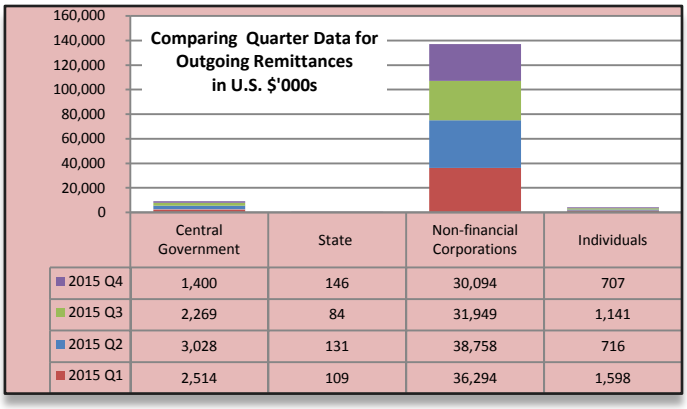
Reported figures show **Net Outbound Position** for calendar year 2015 with total Outgoing wires surpassing total Incoming wires by approximately $14MM.





In U.S. Thousands of Dollars	CY2014	CY2015	% Change	4th Qtr 2014	4th Qtr 2015	% Change
Incoming Remittances	**108,470**	**137,565**	**27%**	**30,862**	**34,469**	**12%**
Non-financial Corporations	64,651	73,446	14%	17,439	17,018	-2%
Central Government	24,196	34,662	43%	9,474	10,465	10%
Individuals	10,781	15,611	45%	3,010	898	-70%
Non-profit Institutions Serving Households	8,653	13,005	50%	906	5,353	491%
All Other Sectors	189	841	345%	33	735	2,127%
Outgoing Remittances	**130,214**	**151,603**	**16%**	**39,226**	**32,361**	**-18%**
Non-financial Corporations	98,319	137,095	39%	34,646	30,094	-13%
Central Government	10,293	9,211	-11%	2,442	1,400	-43%
Individuals	20,653	4,162	-80%	1,709	707	-59%
All Other Sectors	949	1,135	20%	429	160	-63%

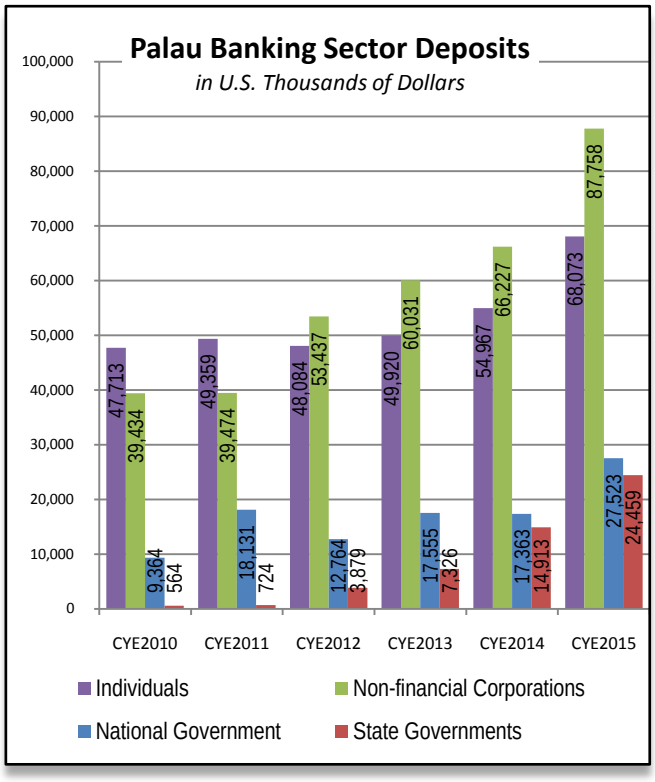




HIGHLIGHTS

- Local companies received $8.8MM, or 14%, more funds from abroad compared to last year, and wired out 39%, or approximately $39MM, more funds during 2015 to recipients outside of Palau.
- Incoming remittances received by Individuals exceed the total received in 2014 by 45%. The total of funds received by Individuals in Palau during the 2015 calendar year are approximately $4.8MM more than the amount recorded for the previous year. On the other hand, funds wired outside Palau by Individuals declined 80%, or $16.5MM less, compared to calendar year 2014. To illustrate, Individuals sent $7.2MM to the U.S. in 2014, compared to approximately $1MM in 2015.
- Non-profit Institutions received $4.4MM, or 50%, more funds in 2015 compared to the prior year.

CYE2015 Summary Report on Year-on-Year Deposit Level Changes
Republic of Palau Banking Sector



Total Deposits for the industry grew from approximately $184MM to $238MM during the 2015 calendar year, an increase of approximately $54MM, or 29%. Compared to the 25% or $37MM increase in overall deposits during the previous year, this further expansion is significant and once again the issue of where these funds are coming from arises.

The deposits of Non-financial Corporations show 23% growth, or approximately $20MM increase, in 2015. This is comparable to the 33% or approximately $21.5MM growth in total volume of deposits seen during 2014. Business sector deposits have shown exponential growth in recent years, driven by expansion in tourism. The Palau Visitors Authority reported that tourist numbers exceeded 160,000 during the 2015 calendar year and are projected to reach similar levels by the end of this year, indicating that further growth in bank deposits is likely to be observed.

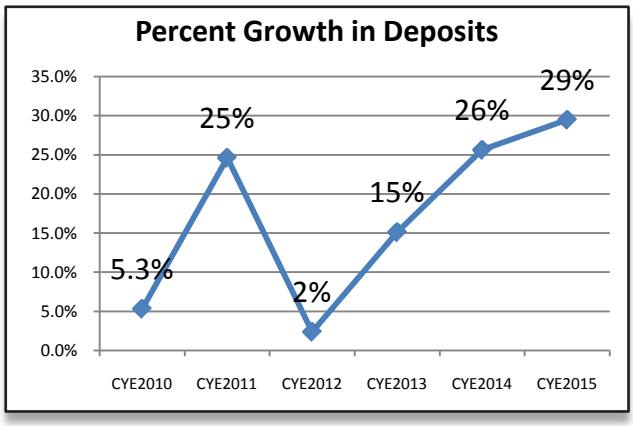
The deposits of Individuals also show considerable growth of 24% or approximately $13MM during 2015 compared to an approximate $5MM or 10% increase during the prior year. It is noted that these deposits also include the accounts of Individual entrepreneurs used for business purposes and those of individuals acting as "fronts" for foreign businesses which have noticeably increased throughout Koror and are observed to be expanding to Babeldaob.

Government deposits show corresponding increase with those of private sector businesses. During 2015, the combined deposits of national and state governments grew 61% or by approximately $20MM, a significant increase compared to the $7MM or 30% growth during the prior year.

Insured Banks

Deposits of Insured bank branches are backed by the U.S. FDIC and the insured group of banks in aggregate hold virtually all deposit liabilities for the banking sector.

Note: Uninsured locally chartered banks hold less than 1% of the local banking sector's deposits.



The tables on the following pages show the values of deposits in U.S. thousands of dollars and are segregated by type of depositor into five major categories. Three of these major categories are further divided into sub-categories in a way that makes it easier to identify the source of increase (or decrease) in deposit levels. Also shown are year-on-year growth in dollar amount and percent.

AGGREGATE OF DEPOSITS AT PALAU LICENSED BANKS[1]

(in U.S. thousands of dollars)	CYE2013	CYE2014	CYE2015
Deposits - Other Financial Corporations	**4,284**	**7,569**	**8,950**
Development Financing Corporations	199	285	191
Others	4,085	7,284	8,759
Deposits - Government	**24,881**	**32,276**	**51,982**
National Government	17,555	17,363	27,523
State Governments	7,326	14,913	24,459
Deposits - Public Non-financial Corporations	**591**	**705**	**125**
Deposits - Private Sector	**116,147**	**142,725**	**176,149**
Non-financial Corporations	66,227	87,758	108,076
Individuals	49,920	54,967	68,073
Deposits - Non-residents	**4**	**4**	**68**

Growth year-on-year, volume change (in U.S. thousands of dollars)	CYE2013	CYE2014	CYE2015
Deposits - Other Financial Corporations	**3,937**	**3,285**	**1,381**
Development Financing Corporations	7	86	(94)
Others	3,930	3,199	1,475
Deposits - Government	**8,238**	**7,395**	**19,706**
National Government	4,791	(192)	10,160
State Governments	3,447	7,587	9,546
Deposits - Public Non-financial Corporations	**(1,052)**	**114**	**(580)**
Deposits - Private Sector	**8,032**	**26,578**	**33,424**
Non-financial Corporations	6,196	21,531	20,318
Individuals	1,836	5,047	13,106
Deposits - Non-residents	**0**	**0**	**64**

Growth year-on-year, percent change	CYE2013	CYE2014	CYE2015
Deposits - Other Financial Corporations	**1135%**	**77%**	**18%**
Development Financing Corporations	4%	43%	-33%
Others	2535%	78%	20%
Deposits - Government	**50%**	**30%**	**61%**
National Government	38%	-1%	59%
State Governments	89%	104%	64%
Deposits - Public Non-financial Corporations	**-64%**	**19%**	**-82%**
Deposits - Private Sector	**7%**	**23%**	**23%**
Non-financial Corporations	10%	33%	23%
Individuals	4%	10%	24%
Deposits - Non-residents	**0%**	**0%**	**1600%**

[1] Aggregate total is net of total reported deposits of depository institutions

BANKING INSTITUTIONS OPERATING IN PALAU

As of January 2016

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, *VP* Ms. Florencia Rirou, *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*	Dngeronger, Koror P.O. Box 338 Republic of Palau 96940 http://www.bankofguam.com	Tel. 488-2696 / 488-2697 Email: bog@palaunet.com Email: matthew.c.cruz@bankofguam.com
Bank of Hawaii	Hawaii	9/18/1961	Active	U.S. Federal Reserve	Mr. Richard Ziegler, *VP/Palau Island Manager*	Medalaii, Koror P.O. Box 340 Republic of Palau 96940 http://www.boh.com	Tel. 488-2602 / 488-3285 Email: Richard.Ziegler@boh.com
BankPacific, Ltd.	Guam	7/28/1995	Active	U.S. FDIC	Mr. Joseph Koshiba, *Branch Manager*	Dngeronger, Koror P.O. Box 1000 Republic of Palau 96940 http://www.bankpacific.com	Tel. 488-5635 / 488-5226 Email: joek@bankpacific.com
Palau Construction Bank	Palau	7/28/1995	Active	FIC	Ms. Lucia Tellei, *General Manager*	Meyuns, Koror P.O. Box 7077 Republic of Palau 96940	Tel. 488-1946 / 488-5888 Email: pc.bank@palaunet.com
National Development Bank of Palau	Palau	2/24/1982	*conditional*	FIC	Mr. Harley Fletcher, *Acting President* Ms. Karla West, *Operations Manager*	Ngetkib, Airai P.O. Box Republic of Palau 96940	Tel. 587-2578 Email: hfletcher@ndbp.com, or kwest@ndbp.com