FINANCIAL INSTITUTIONS COMMISSION

PRUDENTIAL REGULATION
FIC-PR-06

TRANSACTIONS WITH RELATED PERSONS

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PART I: PRELIMINARY

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

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

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

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

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

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

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

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

4) **"transaction"** – means any transaction with a related person, other than loans or credit exposures; for purposes of this regulation, the term 'transactions' includes the following transactions between a bank and a related person of the bank:
(a) purchases, leases or sales of assets, whether financial or non-financial, tangible or intangible, or involving movable or immovable property;
(b) agreements or contracts for the provision or receipt of services, with or without fees, such as accounting, advisory, appraisal, consulting, credit administration and collateral control, data processing, insurance, legal, loan guarantees or agreements of protection, loan processing, safekeeping, staff secondments, technical assistance, training, and other similar financial, operational or professional services;

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

PART II: STATEMENT OF POLICY

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

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

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

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

1: **Minimum Requirements** – The following minimum requirements shall apply to all transactions with and credit exposures to related persons:
(a) Conformance to policy: All transactions between a bank and a related person and all loans to a related person shall conform to a written policy that has been approved and adopted by a majority of the entire board of directors and such policy must be adequate to ensure compliance with this regulation, the Act and prudent banking practices;

(b) Non-preferential terms: All transactions between (i) a bank and a related person, including contracts for the payment of goods and services, and (ii) all loans by a bank to a related person, including the placement of funds or deposits by a Palau foreign bank branch with the head office or another branch or office of the foreign bank, shall be at

"arm's length", i.e. must be on substantially the same terms and conditions in respect of charges, fees, interest rate, liability, maturity, price, repayments, risk, security, etc. as the same or similar transactions between a bank and an unrelated person;

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

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

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

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

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

PART IV: CORRECTIVE MEASURES

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

PART V: EFFECTIVE DATE

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

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

Adopted July 23, **2008**

[redacted]

Governing Board
Financial Institutions Commission
Republic of Palau

Approved July 29th, **2008**

[redacted]

Honorable President
Tommy E. Remengesau, Jr.