

**REPORT TO TRANSITION TEAM
PRESIDENT-ELECT SURANGEL WHIPPS, JR.**

The Republic of Palau
FINANCIAL INSTITUTIONS COMMISSION



This report has been prepared for the purpose of providing a briefing and assist with the preparation of a new Administration for the Republic of Palau. Information contained in this report is not confidential as defined under the Financial Institutions Act, 26 PNC Chapter 10, and is publicly available.

G. Semdiu Decherong
Executive Commissioner

November 19, 2020

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Republic of Palau

Financial Institutions Commission

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November 19, 2020

Kione J. Isechal
Co-Chairman Transition Team
President Elect SWJ

Minister Charles I. Obichang
Co-Chairman Transition Team
President Elect SWJ

Dear Co-Chairman's,

On behalf of myself, the Financial Institutions Commission Staff and Governing Board, we would like congratulate the President-Elect on a successful campaign and a decisive victory in a very important campaign for our Republic. We appreciate the opportunity to present to the SWJ Transitioning Team the attached report.

This report was prepared in accordance to the outline your team provided and we hope that we are able to paint an accurate portrait of our Agency and the current work we are doing, as well as the challenges we face. In this report we made an effort to emphasize the FIC's work that would be of benefit or use to the President Elect's vision and policy development as he takes the helm and leads our nation.

As the Transitioning Team moves forward with its operations and prepares for a successful handover of the Administration, we hope the attached report will aid in this effort. Again, we appreciate your consideration of our small Agency and we stand ready to answer any questions you may have, or meet with your Team and the President-Elect. Please contact us should there be anything we can assist you with.

Godspeed,

Semdiu Decherong
Executive Commissioner

Ms. Jennifer
Koskelin-Gibbons
Chair

Ms. Landisang
Kotaro
Vice Chair

Mr. Kevin
Mesebeluu
Voting Member

Mr. Vance
Polycarp
Voting Member

Mr. Okada
Techitong
Voting Member

Ms. Claire Harvey
NDBP
President, Ex-
Officio

EXECUTIVE SUMMARY

The Financial Institutions Commission (“FIC”) was established by the Financial Institutions Act of 2001 (“FIA”), and began operations in October of 2002. This establishment of this agency is in accordance to Article IX, Section 5(5) of the Constitution of the Republic of Palau. As such, the Agency is established to be an independent and autonomous institution with a mandate to ensure the safety, soundness, and integrity of Palau’s financial sector.

The FIC is minimally staffed with three full-time personnel and a Governing Board comprised of five (5) voting members and one (1) ex-officio member, whom is the President of the NDBP. The Governing Board oversees policy level matters and also serves as the governing body for the Financial Intelligence Unit, as designated under the Anti-Money Laundering Act.

The agency does not and cannot own real estate and its office is located on leased premises. The FIC also maintains minimal assets, commensurate with the size and scope of its operations. Similarly, the FIC’s budget is conservative and has been maintained at reasonable levels since its inception. While the budget for this Agency is conservative, the FIC has been supplementing coverage of its operational costs by assessing annual bank fees on all licensed banks; these fees account for 75% of the total operating budget each year.

Per the legislative mandate, the FIC conducts onsite examinations and off-site monitoring of licensed financial institutions. The Agency is also the primary licensee of all banks and other financial institutions designated under the FIA. In addition, the FIC manages the implementation of the Secured Transactions Registry and performs other tasks such as assisting with the formulation of legislation that impacts and/or improves Palau’s financial sector.

The current COVID-19 Pandemic has been at the forefront of the FIC’s list of priorities, and the FIC continues to work to ensure the liquidity and solvency of banks, and monitor the effect of this event on the financial sector. While doing so, work proceeds on key priorities such as human resource development, learning new technologies affecting banks, and assisting with the development of key legislation related to the financial industry.

The FIC has several partner organizations (IMF, ADB, World Bank) that provide technical assistance bank supervision and regulation, legal matters, and information technology.

The Agency has projects and priorities that are designated in a developed strategic plan which it is implementing. Some of the key initiatives the FIC faces in now and onto next calendar year is to secure the annual operating budget, have Board Members are selected and appointed in January 2021, and maintain progress with staff development and ensuring that the Agency augments its knowledge base on key developments in the financial sector.

The agency will be looking to expand operations and move into new facilities in the coming years. Furthermore, it is working on updating and upgrading the FIA, which will include language to secure its operational autonomy and fiscal independence.

The FIC intends to continue with assisting with the development and improvement of the financial sector in key areas of expanded financial services access, more efficient operations, and further enhancement of expertise in financial sector issues.

I. ENACTING LEGISLATION

26 PNC CHAPTER 10, THE FINANCIAL INSTITUTIONS ACT

(Note: Regulations required for the fulfillment of our mandate are in place and are available on our website at www.ropfic.org, along with all other relevant documents, reports, and associated legislation)

II. VISION AND MISSION STATEMENT

“PROTECTING AND ENSURING THE INTEGRITY OF, AND CONFIDENCE IN THE FINANCIAL SECTOR OF THE REPUBLIC OF PALAU.”

CORE VALUES

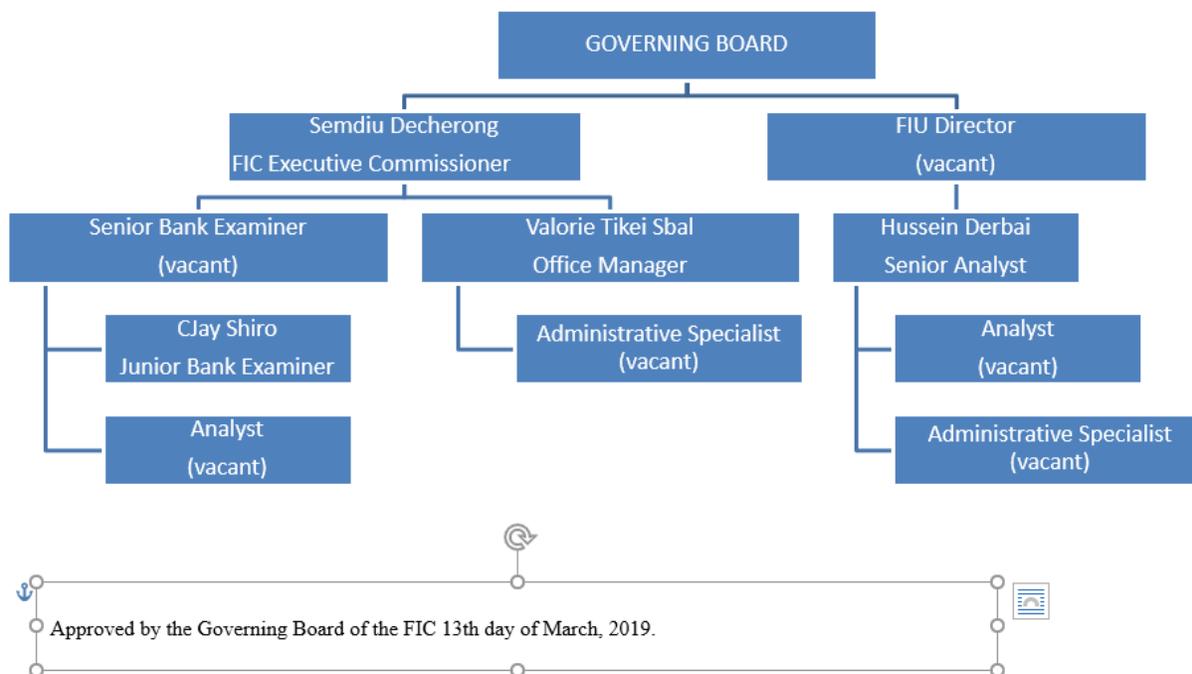
- ❖ WE CONDUCT OURSELVES WITH INTEGRITY AND MAINTAIN OUR INDEPENDENCE TO ENSURE OUR CREDIBILITY IS NOT AT RISK.
- ❖ WE ARE ETHICAL, FAIR, AND RESPECTFUL IN ALL THAT WE DO.
- ❖ WE COMMUNICATE OPENLY, HONESTLY, AND WITH GOOD INTENT AMONG OURSELVES AND WITH THOSE WHOM WE SERVE.
- ❖ WE CONTINUE TO ESTABLISH AND MAINTAIN EFFECTIVE RELATIONSHIPS WITH ALL RELEVANT STAKEHOLDERS/PARTNERS AND AGENCIES.
- ❖ WE PROVIDE AN ENVIRONMENT FOR LEARNING AND GROWTH SO THAT WE ARE REGARDED AS SUBJECT MATTER EXPERTS IN FINANCIAL SECTOR ISSUES AND MATTERS.
- ❖ WE ARE PROACTIVE IN OUR APPROACH TO DEVELOPMENT WITHIN THE FINANCIAL SECTOR AND THE IMPACT ON PALAU’S ECONOMY.

III. AREA OF RESPONSIBILITY

- ❖ The FIC’s core area of responsibility, in accordance to our enabling legislation, is to ensure the liquidity and solvency of the licensed financial institutions in the Republic of Palau. In doing so, the FIC’s task is in essence, to reduce the risk of loss to depositors and enable banks and other licensed institutions the ability under our laws and regulations to conduct their role as the intermediary for the movement of money within as well as into and out of the Republic of Palau. The FIC’s responsibility extends to the improved and well-maintained reputation of our financial industry in order to give confidence to depositors and investors alike.
- ❖ Credit Unions and Money Remitters also fall under the purview of the FIC to a limited extent; at this time, these other types of financial institutions have not been licensed as we are awaiting action on a Credit Union Act to formalize and further enhance the viability, operational integrity, and growth opportunity of this subset of the industry. As for Money Remitters, regulation has been drafted and pending release for the licensing of such.

IV. ORG CHART/PERSONNEL

Financial Institutions Commission Governing Board



Current Board Members

Jennifer K. Gibbons, Chair
Landisang Kotaro, Vice-Chair
Vance Polycarp, Member

Kevin Mesebeluu, Member
Okada Techitong, Member
Claire Harvey, Ex-Officio Member

V. BUDGET

Financial Institutions Commission	
<i>FY 2021 OPERATING BUDGET</i>	
Personnel Services	\$135,584
Purchase Professional and Tech Services	\$0
Purchased Property Maintenance	\$6,000
Rentals	\$11,020
Other Purchased Services	\$9,350
Travel & Transportation	\$12,000
Communication	\$3,268
Supplies	\$10,000
Fuel & Other POL Products	\$4,000
Utilities	\$4,000
Purchased Property	\$40,000
Other Expenses	\$4,778
Total	\$240,000

- ❖ According to our enabling legislation, the FIC Governing Board adopts its budget and submits it to the OEK for consideration.
- ❖ NOTE: The FIC levies an annual fee, in accordance to regulation, to all licensed banks. Fees collected are placed in a separate non-lapsing account that is utilized for the ongoing operations of the FIC in carrying out our legislative mandate. The fee collected on an annual basis accounts for 75% of our annual operating budget.
- ❖ Budget for the FIC has been kept at conservative levels. The FIC’s budget levels have been in line with operational requirements and projected needed expenditures since its inception in 2002. However, the FIC will in the next few months request for additional budget appropriation. This is to allow us to cover costs associated with an anticipated move to new facilities, a potential new hire, as well as cover training costs with the FDIC for our new Bank Examiner.

VI. SERVICES, PROGRAMS, TASKS AND ACTIVITIES

- ❖ Offsite Monitoring – the FIC conducts reviews of Prudential Returns (detailed statements of financial condition) to determine the ongoing condition of each bank. This activity is prescribed through regulation and occurs every quarter. Offsite Monitoring may trigger prompt corrective actions and/or an Onsite Examination should reports show any sudden change in a bank’s financial condition that requires additional inspection and verification to ensure that a licensed bank continues to operate in a safe, sound, and prudent manner.
- ❖ Onsite Bank Examinations – the FIC conducts onsite bank examinations on a rotating scheduled each year. Such examinations are set forth in our annual workplan. The purpose of the onsite bank examinations is to verify and confirm that Prudential Returns submitted to the FIC are accurate and present a fair representation of the performance and condition of each licensed bank. During these bank examinations, the FIC also verifies compliance with our enabling legislation and prudential and administrative regulations promulgated thereunder. These onsite bank examinations further allow for joint inspection of banks by the FIC and the FIU, to determine their ability and capacity to continually comply with the Anti-Money Laundering and Proceeds of Crime Act (“AMLPCA”) and accompanying regulations. Findings during Onsite Bank Examinations result in recommendations, corrective actions, and from time to time, bank closure and license revocation. During bank examinations, the FIC can and will report its findings to proper authorities should it find possible infractions of any other laws applicable to these types of businesses.
- ❖ Monitoring of Bank Branch Home Office – the FIC monitors the performance of the home offices of branch institutions to ensure that each bank’s overall condition is sound and that branch operations in Palau are not adversely affected by conditions at home office jurisdictions, i.e. the US Territory of Guam and the State of Hawaii.
- ❖ Engagement with “Home Country Supervisors” – we are looking to re-establish ties with the FDIC to engage them on a more frequent basis regarding operations of US branch institutions (the FIC will be looking to the Executive Branch for assistance on this matter).

- ❖ Bank Licensing – the FIC receives, analyzes and evaluates license applications for interested applicants who want to establish a bank in Palau. This process is a key part of our efforts in maintaining the stability and integrity of our banking industry and extreme diligence is employed for all license applications. The last bank license application approved was for the ‘whole bank purchase’ of the bank formerly known as Palau Construction Bank; this matter was decided by the Governing Board 2 years ago.

- ❖ Development of and Lobbying for Key Legislation Affecting Financial Sector – We have and continue to engage with external experts on key legislative developments and policy initiatives:
 - Amending and updating the Financial Institutions Act: work is currently underway. The FIC is working with the Pacific Financial Technical Assistance Center (“PFTAC”) and the IMF on a final legal review of the draft update and improvements to the banking act.
 - Engaged with ADB Technical Assistant on developing a legal framework for the formation of trusts which will enable Palau to attract investments through these types of investment entities.
 - Credit Union Act – the IMF/PFTAC worked with the FIC more than five years ago to develop and finalize legislation that will improve on and allow for the expansion of Credit Unions in Palau. This law is complete and has been with the Senate, 10th OEK; the FIC will lobby and seek substantive action on this legislation with the 11th OEK and will request support from the Whipps Administration.
 - Corporate Registry Act (domestic) – the FIC worked with the ADB under their Private Sector Development Initiative (“PSDI”) to develop and introduce a modern and comprehensive corporate registry legislation. The registry will be supported and run through an online corporate registry database system. This legislation has been with the HOD of the 10th OEK; we intend on further lobbying for reintroduction and request support from the Whipps Administration on this matter.

- ❖ Regulations/Advisory Plan – the FIC promulgates regulations to effectuate our enabling legislation. We are currently working on finalizing a Regulatory Response Regulation as well as developing advisory methods both for the public and to individual banks and the industry as a whole. This is an administrative/operational process which we expect to complete in the near term, and will be brought to the attention of this new Administration in the next 3 months.

- ❖ Training and Technical Assistance/Capacity Development – the FIC Executive Commissioner, Bank Examiner, and Office Manager continually seek out and are provided technical and academic training on bank supervision, bank examination, financial technologies, securitization, anti-money laundering, and other relevant subjects.

- ❖ IT/MIS Improvements – we continue to seek out and implement IT and management information systems improvements for our office in order to improve efficiencies and maximize outputs within budget and maintain costs in line with our Board approved budget.

- ❖ Secured Transactions Registry – the FIC manages the electronic Secured Transactions Registry which was established under 11 PNCA Chapter 19. The STR allows lenders to register moveable assets as collateral in support of loans. The Office Manager for the FIC is also the

“Filing Officer” who manages the registry system and is the liaison between the system service providers and all clients (businesses, banks and other lenders).

- ❖ **Strategic Planning Development and Implementation** – The FIC Governing Board and staff have in the last 24 months, been developing a roadmap which has helped us chart out the course of this agency in the near term, medium and long term. Our strategic plan is upgraded at least once a year and serves as a self-monitoring tool that guides the FIC in achieving its mandate.
- ❖ **COVID-19 Related Services/Activities** – The FIC has been engaged with all banks since the end of February 2020 to coordinate and assist with matters relating to cash shipments, maintenance of access to banking services and other issues. We are also currently monitoring bank portfolios and financial performance to ensure that banks remain viable, safe and sound during this pandemic. Current issues such as non-functioning ATM’s are also at the forefront of discussions and the FIC has been constantly advising the banks on their need to get all ATM’s operating at full capacity during this Pandemic. Other actions we are taking is engaging with banks and encouraging those that provide debit/credit card services to allow for these merchants to be able to provide “cash-back” to card users, in lieu of ATM withdrawals. This matter is still under discussion.

VII. Project Checklist (incl. Critical Dates/Budget/Costs) – *Not Applicable to the FIC.*

VIII. List and Description of Major Assets/Inventory – The FIC maintains a current inventory listing of all purchased assets. Per the Ministry of Finance, Division of Property & Supply, the FIC only provides them a listing of assets that are valued at \$5,000 and above. However, a complete and updated listing of our assets is available upon request. Below are assets that were valued above \$5,000 at time of purchase:

1. Honda CRV, 4 Door, Gold Color, Model Year 2003
2. Honda CRV, 4 Door, Dark Blue Color, Model Year 2008

IX. Key Agency Priorities:

- a. Continued monitoring of all banks’ performance and condition during COVID-19 Pandemic.
- b. Appointment of 2 Board Members by incoming Whipps Administration.
- c. Gain financial and administrative independence through initiatives that will augment budget position and allow for increased operational autonomy and realize efficiencies.
- d. Realize action on Legislative Initiatives – Corporate Registry Act, Credit Union Act, Completion of Amendments to the FIA, Completion of Trust Services legislation
- e. Continued training to build internal capacity and human resources expertise in the field of banking and financial sector supervision.
- f. Continue with shift to digitization of operations.
- g. Introduce updated and new regulations enhancing our ability to supervise banks.
- h. Finalize contracts and move into long-term facility to house planned FIC expanded operations.

X. List of Politically Appointed Positions Needed to Be Filled

- | | |
|-------------------------------------|----------------------------|
| 1. Jennifer K. Gibbons, Chairperson | Term Expiration 01/22/2021 |
| 2. Vance Polycarp | Term Expiration 01/22/2021 |

XI. Existing Major Agreements, Arrangements with External Institutions and Organizations

The FIC engages with the following on a regular basis:

- The International Monetary Fund (IMF)
- The Pacific Financial Technical Assistance Center (PFTAC)
 - The FIC is a member of the Association of Supervisors for Pacific Countries (AFSPC)
- Asia Development Bank (ADB)
 - ADB Private Sector Initiative (PSDI)
- World Bank
- Asia Pacific Group on Money Laundering (APG)
- Carnegie Mellon University

We currently have ongoing work and partnerships with these entities that is provided through Technical Assistance, which is requested through the Minister of Finance and through other direct arrangements. These partnerships and collaborative efforts allow for the FIC to access up-to-date training on bank supervision, money laundering, and new developments affecting the financial sector.

One specific arrangement to note is our partnership with Carnegie Mellon University. We have been working closely with this University to garner help in the development and upgrading of our IT systems capacity, especially in relation to data collection and management. This program is provided at minimal cost and has so far been successful and yielded results that helped us make great gains in output efficiencies.

XII. Near Term, Medium, and Long-Term Challenges, Solutions, and Recommendations

Near Term -

- a. Board Membership – the FIC has been long stifled by the gaps in filling vacancies on the Board. Board requirements are stringent and there is a recognized small pool of qualified individuals to serve on this Board. The vacancies on the Governing Board will need to be filled immediately after the Administration is in place. We request prioritization of this need for our Board.
- b. Staff development and training and succession planning – Staff continues to be trained locally with supplemental training provided by the external partners listed. Within the next year, we will seek support from the Whipps Administration for additional training, previously provided, through the US FDIC. This will involve funding through grants, as had previously been the case before. We recommend that the new Administration, through its Ministry of State or others, assist the FIC in reaching out to the relevant US authorities, beginning with the US Ambassador to Palau and others.

- c. New Technologies in the Banking Industry – we have been continually learning about new information technology shifts and improvements that have an impact on the global banking system. The staff of the FIC has received training on crypto-assets, cybersecurity, and threats to financial systems from enhancements in information technology. While these efforts are ongoing, we continue to seek out additional training and guidance from all partners.
- d. Budget – the Budget for the Commission will need to be appropriated for the remainder of the fiscal year. Furthermore, we will be amending our legislation to enhance our fiscal and administrative autonomy to allow for greater operational efficiency. We also anticipate a slight increase in our budget which requires a portion be allocated by the Government. For this we will request support from the new Administration as we anticipate a conservative increase in our operating budget to accommodate a planned move to our new office location, expand operations, and apply for courses with the FDIC.

Medium Term -

- a. Our banking law needs to be upgraded. The obstacles will be that, as we've seen in the past, legislative changes are made to our preferred formulated bill, and therefore we request that the new Administration maintain our amendments as is and we request guidance as to protocols and preferences for introduction of legislation.
- b. Staff retention and maintaining the caliber of personnel serving the FIC and the Republic has always been a challenge. Continued training and further enhancement of staff expertise, as well as expanding programs to allow for introduction of new and interested qualified students/graduates would be one solution. While we continue to work with the Scholarship Office on this issue, we ask for the support of the Whipps Administration to prioritize this human resource development goal as it relates to experts in this particular field.
- c. External engagement with regulators from the U.S. has been difficult to establish and maintain. As the three US bank branches are systemically important to Palau, we need to engage on a more regular basis with their home country regulators, such as the Fed Reserve and the FDIC. One recommendation would be to include the FIC in discussions with the US to include banking sector issues in the ongoing COFA negotiations.
- d. Businesses, especially small enterprises have a difficult time accessing financing. We highly recommend the adoption of the needed tax reforms, including a clear-cut reporting system so the banks may be able to utilize official tax filings in lieu of financial statements to support their credit requests from the banks.

Long Term -

- a. Without our own currency and a central bank, Palau will continue to rely on US banking institutions to be the primary intermediaries of money movement into and out of Palau. This has at times caused issues with the speed at which money can flow. Transactions are either delayed or rejected, or increased scrutiny regarding investment funds or other

money flows that are needed for continued economic development can be hampered. While we recognize that Palau has to adhere to international obligations, laws need to be upgraded. There will be a need to upgrade our laws and introduce new legislation to accommodate for the potential of Palau's financial sector. We also recommend that the Palau Government seek additional avenues for monetary transactions, and a solution would be to reach out to other allies such as Taiwan and Japan to look into options for options to expand our financial sector.

- b. A majority of our domestic deposits are invested abroad. A wide range of agencies such as the CSPP, PAN Fund, Social Security and HFC, and others that have fund to invest should be encouraged to invest locally, i.e. the Development Bank or other entities so that funds can circulate internally rather than earn profits externally and slow potential development within our own country. We recommend that the Whipps Administration look to these independent or semi-autonomous agencies and seek their support in amending their enabling laws to allow for a reasonable level of domestic investments and retaining our deposits on island.

XIII. Actionable Recommendations to Support Whipps Administrations Initiatives and Development Policies

The actionable recommendations that support the incoming President and his Administration in line with his platform and policy initiatives have been incorporated within this report in the prior sections. Items that are not specifically pointed out and/or addressed can be brought to our attention for a formal response, either through a meeting or supplemental written reports.