2012 Annual Banking Industry 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, Amended by 7-41).

G. Semdiu Decherong
Executive Commissioner

____________April 1, 2013
Date

Republic of Palau

Financial Institutions Commission

2012 Annual Palau Banking Sector Report

Summary Industry Assessment

The overall condition of the Palau banking industry remains satisfactory and there continues to be improvements in the performance of the five remaining licensed banks. As of the most recent year ending December 31st, 2012, all licensed banks have now been examined by the FIC with the conclusion of Bank of Hawaii – Palau branch's onsite examination on September 5th, 2012. Aggregate capital for those remaining banking institutions required to maintain capital or assigned capital has fallen significantly within the past year due to the exit of the FCB branch, however, the aggregate level of capital for the two remaining locally chartered banks grew by 1.6% during 3rd quarter, and another 1.9% during 4th quarter of 2012, primarily because of strong and consistent earnings generated by one of those banks in particular.

Asset quality indicators continue to demonstrate improvements. Overall, the ratio of Non Performing Loans (NPLs) to Total Loans has remained relatively stable having only slightly increased from 3.26% to 3.57% within the past year. The ratio of Loans past due 360 days or more to Total Loans also fell from 2.15% to 1.89% because of the 12% reduction in the volume of loans past due 360 or more days. Provisions for Bad Loans remain adequate to mitigate against potential losses and cover 206% of the sector's Non Performing Loans.

Reduction in lending rates has resulted in reduced Interest Income, however, earnings are higher overall compared to last year due to declines in Interest Expense, Provisions for Bad Loans Expense, and Non Interest (Operational) Expenses.

Liquidity continues to be adequate and all banks demonstrate the ability to continue to meet depositors demand. Funds management practices continue to demonstrate satisfactory results and U.S. branches have reliable access to adequate sources of funds abroad to meet anticipated liquidity needs.

New Developments

The Olbiil Era Kelulau (OEK) passed RPPL 8-42 The Secured Transactions Act. The act was signed into law by President Johnson Toribiong on May 10th, 2012. The act created the Secured Transactions Registry, a system whereby any lender can record a security interest in certain movable consumer goods, offering priority and protection based on the filing of the notice online. This structural improvement in the financial system is expected to result in increased lending activity in the medium to long term, as it will enable financial institutions as well as other businesses to accept moveable property as collateral for credit extended to consumers. The FIC's Administrative Officer has been assigned the role of Registrar.

The Palau branch of First Commercial Bank, a Taiwan bank branch, formally closed its operations on August 31st, 2012, leaving only two locally chartered banking institutions in the sector. First Commercial Bank's unwillingness to comply with the minimum capital requirements set forth in the FIA resulted in the voluntary closure. The voluntary closure successfully concluded in November of 2012, with all depositors and creditors who filed claims to be fully paid. The process was done in compliance with guidelines on voluntary liquidation put forth by the FIC.

With the assistance of PFTAC, the FIC developed a new set of Prudential Returns, revised to capture macro-economic and other data that may be used in the production of monetary statistics. This initiative was undertaken for the purpose of harmonizing off-site monitoring and reporting among the North Pacific jurisdictions. As of the date of this report, Palau has been the only jurisdiction in the North Pacific to complete the process of implementation and is now utilizing the new Prudential Returns.

The FIC has been regularly and consistently producing analysis reports for each licensed bank and branch, as well as an overall banking industry report every quarter since CYE2009. 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. The third Annual Banking Sector Report to the OEK was submitted on May 25th, 2012, for the calendar year ending December 31st, 2011.

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 series of reports entitled Uniform Bank Performance Reports prepared for the Executive Commissioner and all licensed banks.

During the 2012 calendar year, there were individuals/entities that expressed interest in establishing banking institutions in Palau, however, the Commission has not yet received 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.

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 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. 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 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 has also been appointed Registrar of the Secured Transactions Registry.

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 successfully completed the first three phases of the FDIC's series of examination schools. Other prior 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. The Bank Examiner completed the FDIC's Loan Analysis School in May 2012 and is scheduled to complete the final part of U.S. FDIC training in 2013 depending on the availability of funding. 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 six banks during the 2012 calendar year—four foreign bank branches and two locally chartered banks—until one foreign branch formally closed operations during 3rd quarter. The Palau branch of First Commercial Bank voluntarily closed effective August 31, 2012. The three remaining 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 is exempt from regulation and oversight pursuant to the statute.

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 differences in size and business scope that are unique to the banks that have been categorized within these groupings. 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. The U.S. bank branches hold approximately 93% of the banking sector's aggregate Net Loans and over 99% 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 also 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 and current information provided on an institution's balance sheet and income and expense statements.[2] Quarterly prudential returns and analysis reports 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 2012 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 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. Aggregate figures used are derived from those published by all licensed banks.

[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 licensed 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 and schedules, certified by bank officials, in electronic form within 30 days following each quarter-end.

The FIC conducted one onsite examination of a U.S. bank branch during the 2012 calendar year. The launch of two significant projects partly contributed to the postponement and delay of the onsite exam schedule. The development and implementation of the Secured Transactions Registry and the introduction of the FIC's new and notably expanded prudential returns.

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.

Lending Institutions Not Regulated by the FIC

As per the Financial Institutions Act, the National Development Bank of Palau (NDBP), finance companies and credit unions (with assets less than $500,000) are exempt from regulatory oversight and supervision by this agency. 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.

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 prudential bank examinations. The Financial Intelligence Unit (FIU), established by RPPL 6-4, formerly located within the FIC is now operating as an independent body with an operating budget. *The Deputy Director was formally appointed in August of 2011 and the FIU is overseen by both the Governing Board of the FIC and the Attorney General. The FIC provides administrative support as well. Funding for the FIU has been established within the total operating budget for the FIC for FY2012~13.*

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

CAPITAL ADEQUACY (Uninsured banks):

- **Aggregate capital for uninsured banking institutions has declined within the past year due the voluntary closure of the FCB branch in August 2012.** Capital has been reduced by $2.3MM, or by 48%, from last year-end due to the exit of FCB. The aggregate level of capital as of the end of the calendar year is at $2,540M. The level of capital went up by 1.9% or $48M during 4th quarter.
- **Capital is generally adequate for the two remaining uninsured banks in the sector.** The FIC monitors Uninsured banks to ensure capital levels are maintained above statutory minimum requirements. The two remaining uninsured banks in the sector remain in compliance with regulatory minimum capital ratios pursuant to statute and FIC prudential regulation PR-01. At the aggregate, the ratios for Uninsured banks are: Tier 1 Leverage Capital Ratio 55.42%; Tier 1 Risk Based Capital Ratio 98.33%; and Total Risk Based Capital Ratio 100.09%.

ASSET QUALITY:

- Quality of assets remains satisfactory for the banking sector. Total assets grew 4.9%, or by $6.6MM within the past year.
- **The quality of the sector's loan portfolio continues to be satisfactory** with a Non Performing Loans to Total Loans ratio of 3.57%, slightly up from 3.26% at this time last year, although slightly higher than last year, it has remained relatively stable compared to ratios shown for prior years. The sector's loan portfolio only slightly declined by $125M, or 0.4%, within the past year. This is indicative of relative stability in the volume of total loans outstanding in the sector which has fluctuated between $25MM and $30MM since 2nd quarter of 2011. There were $909M in aggregate loan write-offs during the 2012 calendar year and $502M in total recoveries on prior loan write-offs. Total recoveries are 87% of write-offs for the prior year. Altogether, these factors indicate that the sector is lending, but only enough to make up for slightly more than the volume of write-offs, thus keeping the aggregate outstanding credit level stable.
    - *Insured banks* hold approximately 89% of total loans for the banking sector. Aggregate gross loans for this group of banks slightly grew by $474M, or 1.95%, during 4th quarter. Compared to the same time last year, gross loans for *Insured banks* had minimal growth of 0.34%, or $83M. Secured loans in particular have declined by 50% or $4.2MM in the past year, but growth of approximately $4.3MM, or 26%, in Unsecured loans have nearly made up for the decline in secured loans for this group of banks.
    - *Uninsured banks* on the other hand have shown a consistent downward trend in the past year. Aggregate gross loans for this group of banks have declined by approximately $208M, or 6.4% in the past year, due to loan write-offs, loan paydowns and payoffs, and due to the closure of the branch of First Commercial Bank.
  - *Insured banks* maintain a ratio of less than one percent in NPLs to Total Loans; whereas the ratio for *Uninsured banks* has slightly increased from 23.5% at this time last year to 26.4%.
    - The NPLs to Total Loans ratio for *Uninsured banks* went up slightly primarily because of the 5.4%, or $41M, increase in nonperforming loans for this group of banks. *Uninsured banks* reported $433M in write-offs year-to-date, indicating that the decline in aggregate loans for this group of banks is mitigated by some new lending activity.
  - The ratio of Loans past due 360 days or more to Total Loans is 1.89%, down from 2.15% this time last year. Loans past due 360 days or more fell 12.6%, or by $76M, contributing to the slight decrease in the ratio. *Insured banks* do not maintain on their books any loans past due 180 or more days as pursuant to their respective internal loan policies.
  - *Insured Banks* hold 89% of the sector's loans and 19% of the sector's non performing loans.
- **Provisions for Bad Loans remain adequate**. The current aggregate level of Provisions for Bad Loans covers 206% of the sector's Non Performing Loans indicating that there is sufficient cushioning that well exceeds the potential for loan losses.
- Due From Home Office balances comprise 77.5% of the banking sector's Total Assets and 97% of Liquid Assets. $108MM of the industry's $111MM in total liquid assets are demand deposits due from the Home Offices & Other branches of U.S. FDIC-insured banks. Two insured banks report yields on these Due from Home Office balances that are higher than the effective overnight bank lending rate, the Federal Funds Rate.

EARNINGS PERFORMANCE:

- **Earnings performance remains fair.** All but one institution generated profits for the 2012 calendar year. Earnings have stabilized for the overall sector as demonstrated by the slight growth in year-to-date Net Interest Income compared to last year.

- Return on Assets for the banking sector has gone down from 2.13% last year-end to 1.63% this year. Revised figures submitted by Bank of Hawaii-Koror following an onsite exam of the branch institution going back to calendar year end 2009 show that earnings were being understated for the branch and thus, for the entire sector going back to at least CYE2009. ROA for *Insured banks* has gone down from 2.31% last year to 1.55%; whereas ROA for *Uninsured banks* has significantly increased from 0.45% last year to 3.65% for the year ended December 31, 2012. The exit of FCB and improvement in earnings for APCB, together with PCB's ongoing strong earnings trend, have resulted in a much higher ROA for *Uninsured banks* compared to the same period last year.

  - The ratio of Net Interest Income to Average Assets has fallen from 3.25% down to 2.91% during the year as a result of reduction in lending rates. Even though the ratio of interest expenses to average assets has fallen for the sector overall due to decline in interest bearing deposits, particularly Time Deposits. The ratio of Non Interest Income to Average Assets has gone down from 1.22% last year to 0.87% generally due to decline in the levels of lending fees and commissions as well as other interest income.

  - Net Interest Margin has gone up from 11.92% last year to 13.76% this year due to decline in loans and lending rates. Decline in lending rates have resulted in the slight decline in average yield on total loans for the sector from 11.82% down to 11.64% in the past year. At the same time, despite growth in deposits, there appears to be a shift from Time Deposits to low- or non-interest bearing deposits, which has contributed to driving down the average cost of deposits for the industry, which has slightly fallen from 0.26% to 0.21% in the past year.

  - The estimated average yield on aggregate balances Due from Home Office & Other branches of the *Insured group of banks*, at 1.02%, is notably above the Effective Federal Funds Rate average of 0.14% for the 2012 calendar year.

Condensed Income & Expense Statement

Calendar Year to Date Amounts (in U.S. '000s)	CYE2011			CYE2012		
	Insured	Uninsured	All Banks	Insured	Uninsured	All Banks
Interest And Fee Income	3,480	522	4,002	3,652	456	4,108
Interest Expense	267	9	276	256	5	261
NET INTEREST INCOME	**3,213**	**513**	**3,726**	**3,396**	**451**	**3,847**
Provisions For Bad Loans Expense	**(385)**	**22**	**(363)**	**303**	**0**	**303**
NON-INTEREST INCOME	**1,078**	**321**	**1,399**	**1,096**	**49**	**1,145**
NON-INTEREST EXPENSE	**2,203**	**753**	**2,956**	**2,101**	**307**	**2,408**
NET INCOME (LOSS) BEFORE TAXES	2,473	59	2,532	2,088	193	2,281
Less: Applicable Income Taxes	88	8	96	115	9	124
Year-to-date Income (Loss)	**2,385**	**51**	**2,436**	**1,973**	**184**	**2,157**

LIQUIDITY ADEQUACY:

- **Liquidity in the sector remains satisfactory.**
- The Liquidity Ratio calculated for the banking sector has remained stable at 83% since last year-end. This means that for every dollar in short term liabilities, the banking sector maintained around 83 cents in liquid assets. Liquid assets[3] have grown by approximately $7MM, or 6.7% during 2012, which is commensurate with growth in deposits.
- Even though local liquid assets (i.e. cash balances) aggregated for *Insured branch institutions* cover just 2.23% of total short term liabilities, including deposits with maturities of one year or less, for this group of banks, year onsite examinations of all U.S. branch institutions show that insured branch institutions maintain sufficient funds to meet depositor demands and operational needs. All U.S. branches maintain adequate reporting and monitoring systems to manage liquidity risk.
- Figures reported for *Uninsured banks* show that the Liquidity Ratio for this group of banks is maintained at 82% from last quarter, but down from 140% last year-end due to the closure of the FCB branch which significantly reduced the volume and proportion of aggregate liquid assets to short term liabilities.
- **Banks in the sector demonstrate continued ability to meet depositor demands**.
- Total Customer Deposits for the banking sector have grown 2.4%, or by approximately $3MM, during the 2012 calendar year. This increase is attributable primarily to the 12%, or $6.6MM growth in the deposits of private sector non-financial corporations, despite declines in deposit levels for other sectors. Altogether, Demand deposits have gone up 17% or by $8MM whereas Savings and Time deposits declined 5% and 11%, or by approximately $3.3MM and $1.8MM, respectively, during the year.
  - *Insured banks* show a 4.6%, or $5.5MM, growth in aggregate customer compared to last year, contributing to the 12%, or approximately $11.8MM increase in Liquid Assets[1] for this group of banks. The Liquidity Ratio for insured banks is slightly up from 81% last year to 83%.
  - *Uninsured banks* show a remarkable 88%, or approximately $4.8MM, decline in aggregate customer deposits due primarily to the exit of FCB from the banking sector. Excluding FCB deposits, aggregate customer deposit levels for this banking group fell by $2.6MM, or 80%. Only the branch of FCB offered Demand deposit accounts. *Uninsured banks* hold just 0.52% of the banking sector's deposits as of this reporting period.
- The ratio of Total Deposits to Total Loans increased from 442% to 455% during the year. This ratio means that on average, for every dollar in loans, the sector maintains approximately $4.55 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, most banks have demonstrated the intent and ability to expand their respective loan portfolios. With the continued upward trend in deposit activity, there remains potential for expansion in lending because the sector's liquidity growth demonstrates ability to support further loan growth.

[3] 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.

Ratios & Summary Balance Sheet

KEY RATIOS (%)	CYE2011			CYE2012		
	Insured	Uninsured	All Banks	Insured	Uninsured	All Banks
Total Capital to Total Assets	n.a.	54.06	n.a.	n.a.	76.23	n.a.
Tier 1 Leverage Capital Ratio	n.a	45.86	n.a	n.a.	55.42	n.a.
Tier 1 Risk Based Capital Ratio	n.a	101.35	n.a	n.a.	98.33	n.a.
Total Risk Based Capital Ratio	n.a	32.83	n.a	n.a.	100.09	n.a.
Non Performing Loans to Total Loans	0.60	23.49	3.26	0.77	26.44	3.57
Provisions for Bad Loans to NPLs	440.94	198.04	237.68	419.90	155.40	206.12
Net Income to Average Assets (ROA)	2.31	0.45	2.13	1.55	3.65	1.63
Net Interest Income to Average Earning Assets	14.18	4.53	11.92	13.78	13.55	13.76
Interest Margin to Gross Income	74.88	61.51	72.70	75.60	90.20	77.06
Non Interest Expense to Average Assets	2.13	6.65	2.58	1.65	6.09	1.82
Average Yield on Loans	11.35	14.73	11.82	11.10	15.97	11.64
Average Cost of Deposits	0.27	0.10	0.26	0.21	0.38	0.21
Liquidity Ratio (PR-10)	81.24	139.66	83.05	82.67	82.43	82.67
Cash Balances to Short Term Liabilities	2.35	4.81	2.44	2.23	19.37	2.34
Average Earning Assets to Average Assets	21.94	75.95	27.27	19.39	65.98	21.17
Net Loans to Total Assets	19.37	20.56	19.45	17.66	53.84	18.52
Customer Deposits to Total Loans	487.42	98.62	442.24	507.97	21.81	454.85

Summary Balance Sheet **Calendar Year to Date Amounts (in U.S. '000s)**	CYE2011			CYE2012		
	Insured	Uninsured	All Banks	Insured	Uninsured	All Banks
Cash and Due from Other Banks	99,070	5,430	104,500	110,820	652	111,472
Other Assets	1,175	1,293	2,468	1,187	886	2,073
Net Loans	24,082	1,740	25,822	24,020	1,794	25,814
Gross Loans	*24,739*	*3,253*	*27,992*	*24,822*	*3,045*	*27,867*
Provisions for Bad Loans	*(657)*	*(1,513)*	*(2,170)*	*(802)*	*(1,251)*	*(2,053)*
Performing Loans	*24,590*	*2,489*	*27,079*	*24,631*	*2,240*	*26,871*
Non Performing Loans	*149*	*764*	*913*	*191*	*805*	*996*
******Loans over 360 days past due******	*0*	*603*	*603*	*0*	*527*	*527*
******Past Due Loans (includes NPLs)******	*720*	*1,072*	*1,792*	*873*	*1,036*	*1,909*
TOTAL ASSETS	**124,327**	**8,463**	**132,790**	**136,027**	**3,332**	**139,359**
Total Deposits	120,584	3,208	123,792	126,088	664	126,752
Demand/Checking	*45,392*	*596*	*45,988*	*53,991*	*0*	*53,991*
Savings	*59,877*	*2,607*	*62,484*	*58,553*	*647*	*59,200*
Time Deposits	*15,315*	*5*	*15,320*	*13,544*	*17*	*13,561*
Other Liabilities	1,358	680	2,038	7,966	128	8,094
TOTAL LIABILITIES	**121,942**	**3,888**	**125,830**	**134,054**	**792**	**134,846**
Issued and Fully Paid Up Common Stock	0	4,265	4,265	0	3,965	3,965
Paid-in Premium	0	700	700	0	0	0
Retained Profits (Losses) (Prior Years)	0	(441)	(441)	0	(1,609)	(1,609)
Income (Loss) Year-to-date	2,385	51	2,436	1,973	184	2,157
TOTAL CAPITAL	**2,385**	**4,575**	**6,960**	**1,973**	**2,540**	**4,513**
TOTAL LIABILITIES & CAPITAL	**124,327**	**8,463**	**132,790**	**136,027**	**3,332**	**139,359**

APPENDIX

Statements of Condition figures published by all banks	As of Calendar Year-End 2012[1] (In U.S. Thousands)						As of Calendar Year-End 2012 (In U.S. Thousands)		
	Bank of Hawaii	Bank of Guam	BankPacific[2]	First Commercial Bank	Palau Construction Bank	Asia Pacific Commercial Bank	**Insured Banks**	**Uninsured Banks**	**Aggregate All Banks**
Cash & Due From Banks	1,300	44,110	11,604	Closed as of August 31, 2012	512	249	57,014	761	57,775
Net Loans	14,635	7,074	2,423		974	820	24,132	1,794	25,926
Other Assets[3]	52,504	152	41		671	107	52,697	778	53,475
TOTAL ASSETS	**68,439**	**51,337**	**14,068**		**2,157**	**1,176**	**133,844**	**3,333**	**137,177**
Deposits	67,930	51,299	14,007		564	100	133,235	664	133,899
Other Liabilities	32	38	83		125	4	153	129	282
TOTAL LIABILITIES	67,962	51,337	14,090		689	104	133,389	793	134,182
CAPITAL	477		(22)		1,468	1,072	455	2,540	2,995
TOTAL LIABILITIES & CAPITAL	**68,439**	**51,337**	**14,068**		**2,157**	**1,176**	**133,844**	**3,333**	**137,177**
Statements of Income (Loss) figures published by all banks	Bank of Hawaii	Bank of Guam	BankPacific[2]	First Commercial Bank	Palau Construction Bank	Asia Pacific Commercial Bank	**Insured Banks**	**Uninsured Banks**	**Aggregate All Banks**
Interest Income	2,452	1,159	238	Closed as of August 31, 2012	313	142	3,850	455	4,305
Interest Expense	236	183	19		4	1	438	5	443
NET INTEREST INCOME	**2,216**	**977**	**219**		**309**	**141**	**3,412**	**450**	**3,862**
Non Interest Income	850	133	111		31	19	1,093	50	1,143
Non Interest Expense	1,103	806	352		162	153	2,261	315	2,576
Net Income (Loss) before Tax	1,963	303	(22)		178	7	2,244	185	2,429
Less: Applicable Net Income Tax	100	15				1	115	1	116
NET INCOME (LOSS) after Tax	**1,863**	**288**	**(22)**		**178**	**6**	**2,129**	**184**	**2,313**

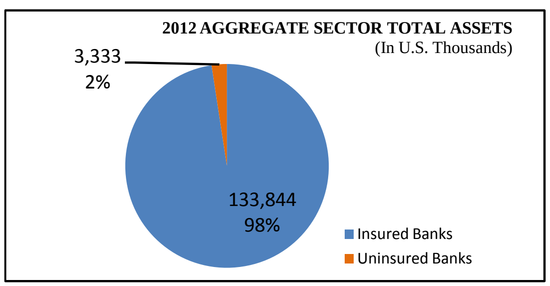
1/ All banks published Statements of Condition and Statements of Income (Loss) by March 1st 2013 with postings in bank lobbies

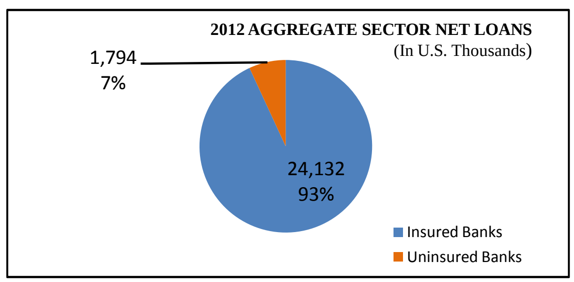
2/ BankPacific's figures are as of June 30, 2012, since the bank's fiscal year ends on June 30th.

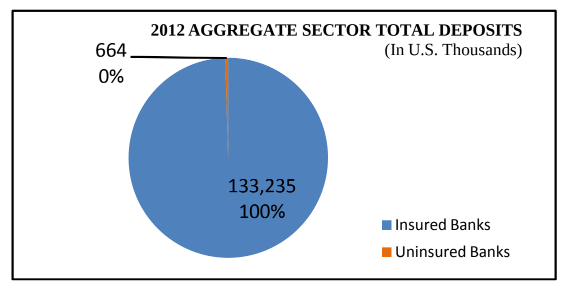
3/ includes fixed assets and accrued receivables other than loans; for Bank of Hawaii, Other Assets includes balances Due From Home Office

Key Ratios

Return on Total Assets	2.72%	0.56%	-0.16%		8.25%	0.51%	1.59%	5.52%	1.69%
Return on Total Equity					12.13%	0.56%		7.24%	
Capital to Average Assets					57.93%	97.50%		25.82%	
Liquid Assets to Total Deposits	2%	86%	83%		91%	249%	43%	115%	43%







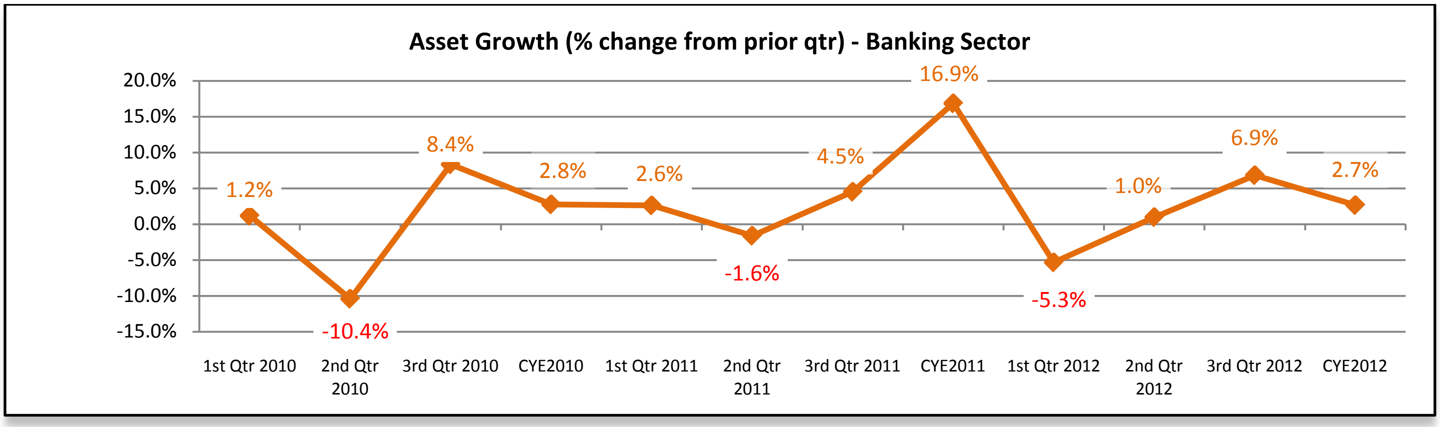
from Annual Statements of Condition for all banks in Palau published and posted on March 1st by all banking institutions pursuant to FIC regulatory requirements (PR-11)

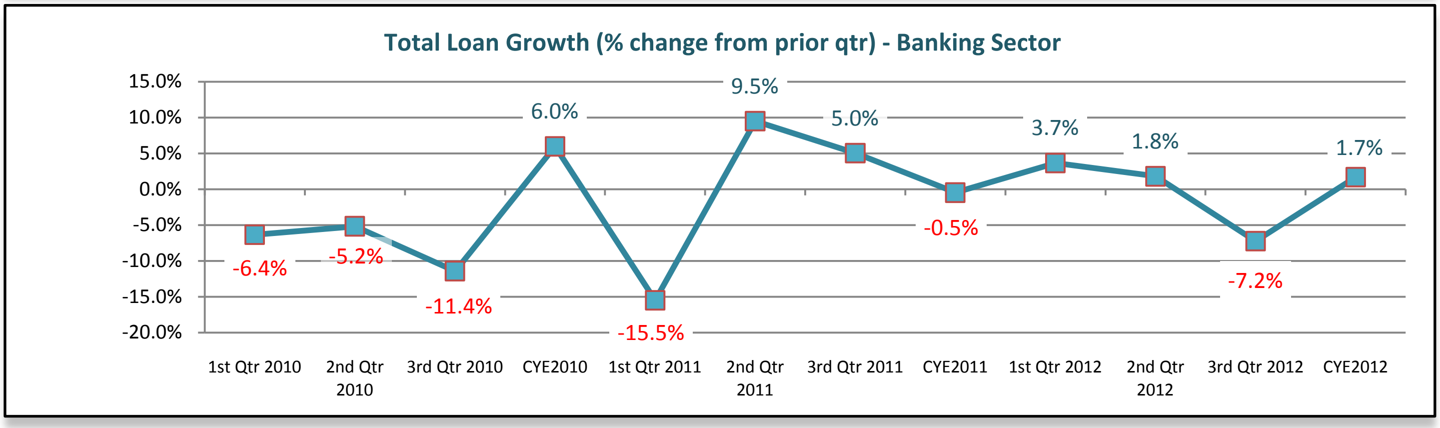
BANKING INSTITUTIONS OPERATING IN PALAU

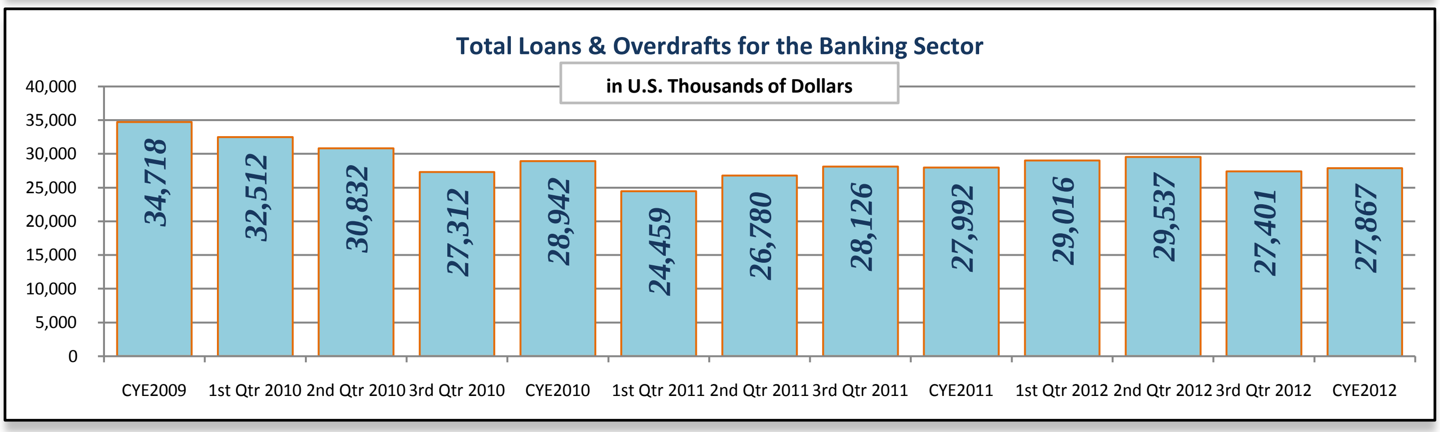
As of January 2013

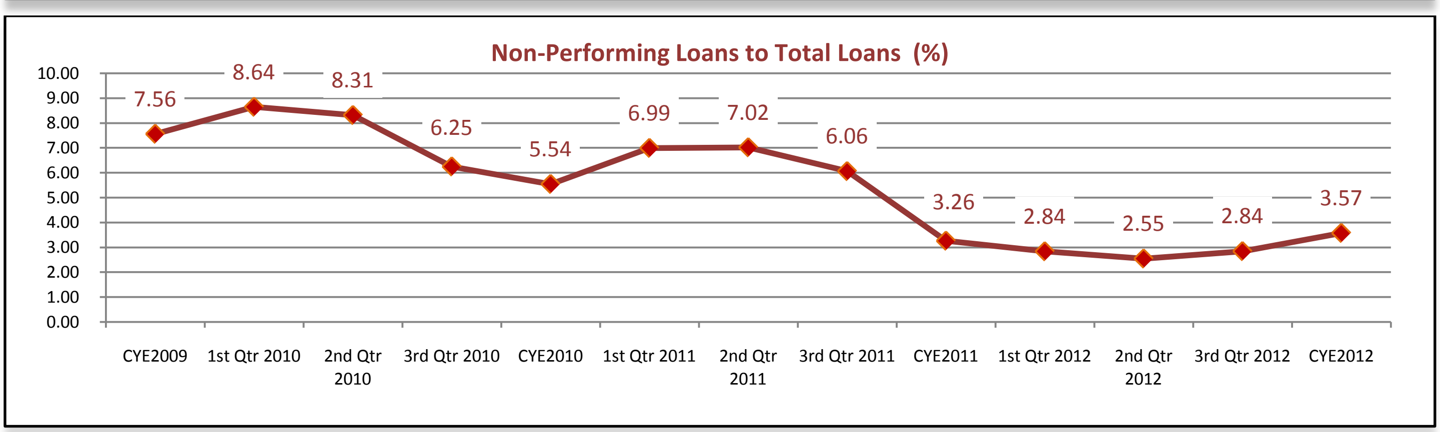
Bank Name	Home Country Charter	Date of Charter	License Status	Primary Regulator	Local Management	Address	Contact Information
Asia Pacific Commercial Bank	Palau	1/21/2000	Active	FIC	Mr. Mun Chee Woo, General Manager Ms. Georgina Misajon, Bank Manager	Ikelau, Koror P.O. Box 10025 #2B-105 Republic of Palau 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	Dngeronger, 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. Richard Ziegler, Branch 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, 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	Voluntary Closure effective August 31, 2012	Taiwan Financial Supervisory Commission	Mr. Jing Fang Hwang, General Manager	Dngeronger, Koror P.O. Box 1605 Republic of Palau 96940 http://www.firstbank.com.tw	Tel. 488-6297 / 488-6298 Email: fcbpalau@palaunet.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

Assets

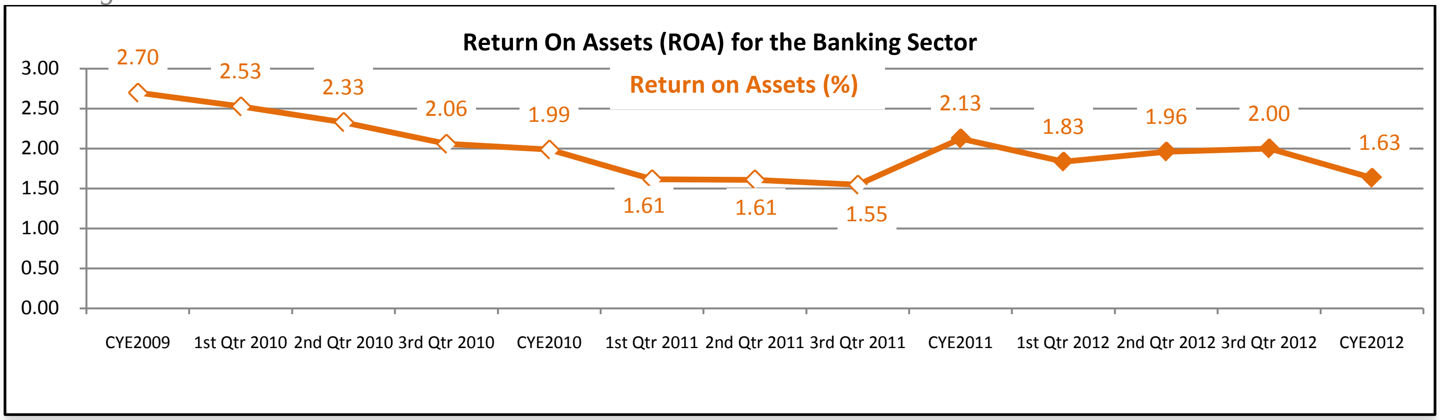

Asset Growth (% change from prior qtr) - Banking Sector
20.0%
15.0%
10.0%
5.0%
0.0%
-5.0%
-10.0%
-15.0%
1.2%
-10.4%
8.4%
2.8%
2.6%
-1.6%
4.5%
16.9%
-5.3%
1.0%
6.9%
2.7%
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012

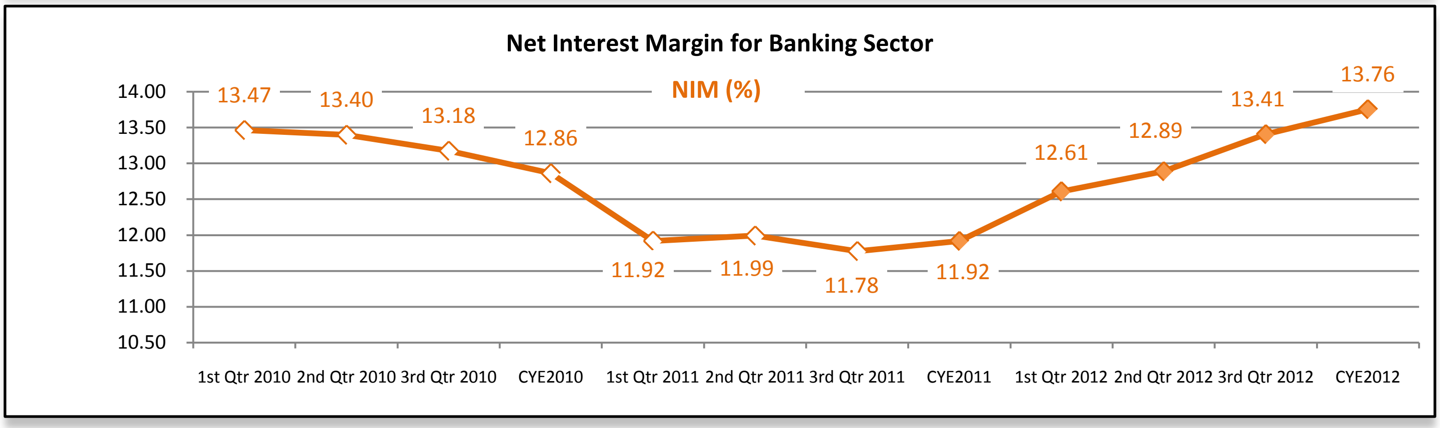

Total Loan Growth (% change from prior qtr) - Banking Sector
15.0%
10.0%
5.0%
0.0%
-5.0%
-10.0%
-15.0%
-20.0%
-6.4%
-5.2%
-11.4%
6.0%
-15.5%
9.5%
5.0%
-0.5%
3.7%
1.8%
-7.2%
1.7%
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012

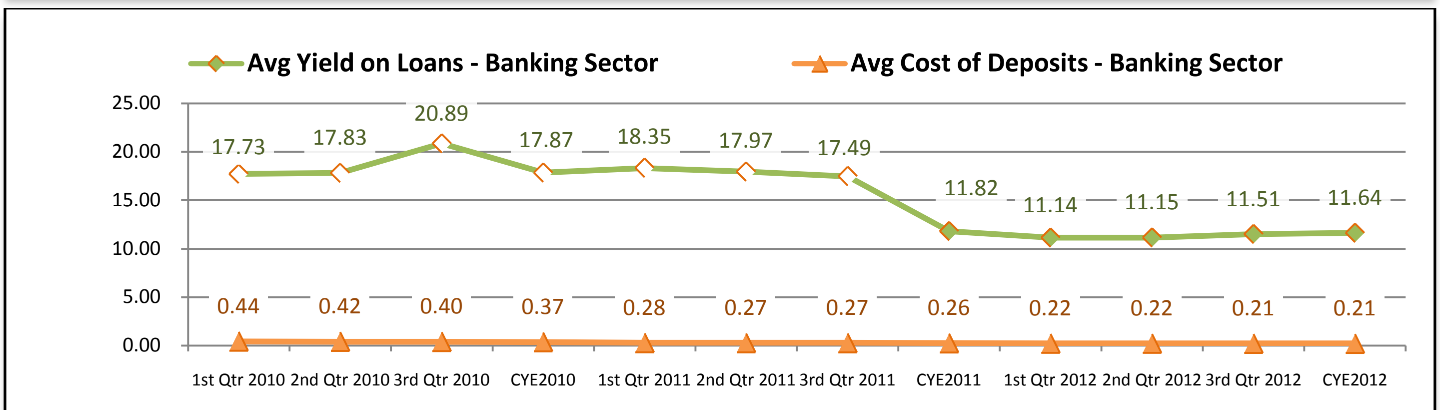

Total Loans & Overdrafts for the Banking Sector
in U.S. Thousands of Dollars
40,000
35,000
30,000
25,000
20,000
15,000
10,000
5,000
0
34,718
32,512
30,832
27,312
28,942
24,459
26,780
28,126
27,992
29,016
29,537
27,401
27,867
CYE2009
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012

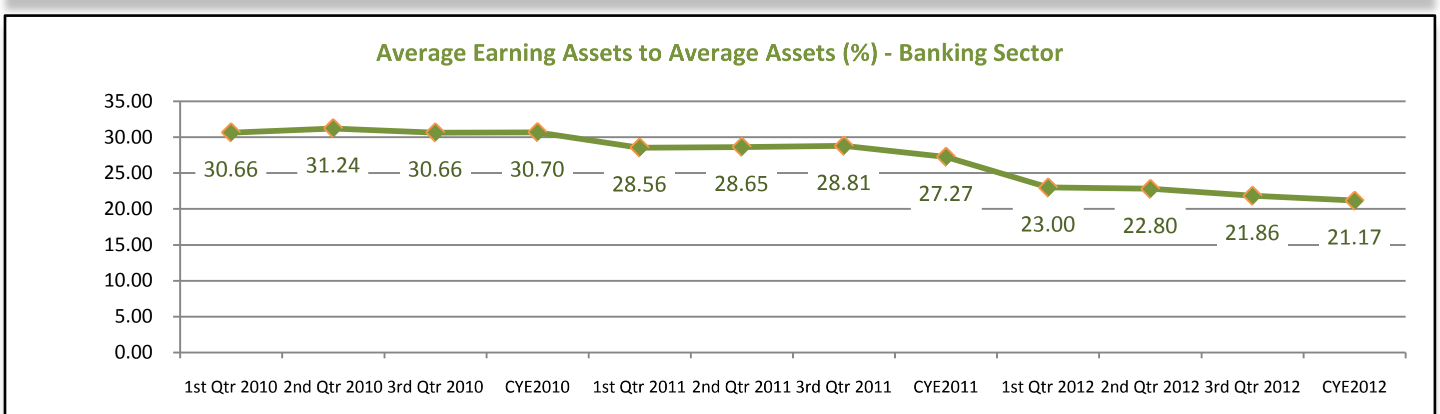

Non-Performing Loans to Total Loans (%)
10.00
9.00
8.00
7.00
6.00
5.00
4.00
3.00
2.00
1.00
0.00
7.56
8.64
8.31
6.25
5.54
6.99
7.02
6.06
3.26
2.84
2.55
2.84
3.57
CYE2009
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012

Earnings

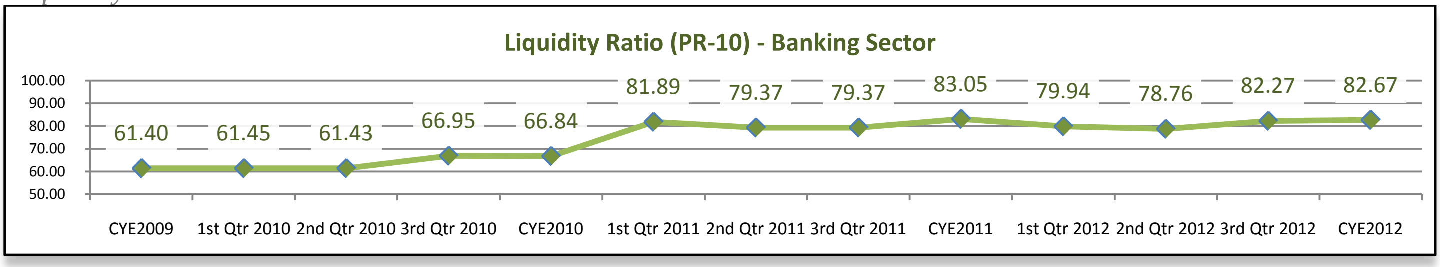

Return On Assets (ROA) for the Banking Sector
Return on Assets (%)
3.00
2.50
2.00
1.50
1.00
0.50
0.00
2.70
2.53
2.33
2.06
1.99
1.61
1.61
1.55
2.13
1.83
1.96
2.00
1.63
CYE2009
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012

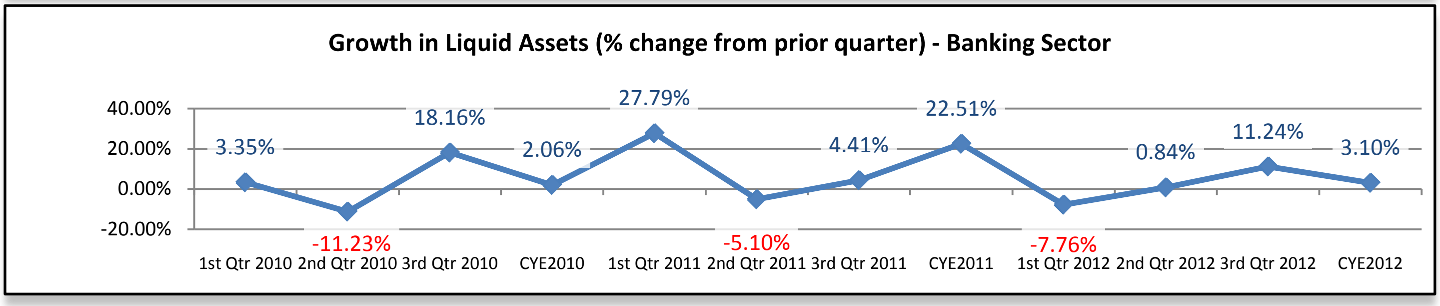

Net Interest Margin for Banking Sector
NIM (%)
14.00
13.50
13.00
12.50
12.00
11.50
11.00
10.50
13.47
13.40
13.18
12.86
11.92
11.99
11.78
11.92
12.61
12.89
13.41
13.76
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012

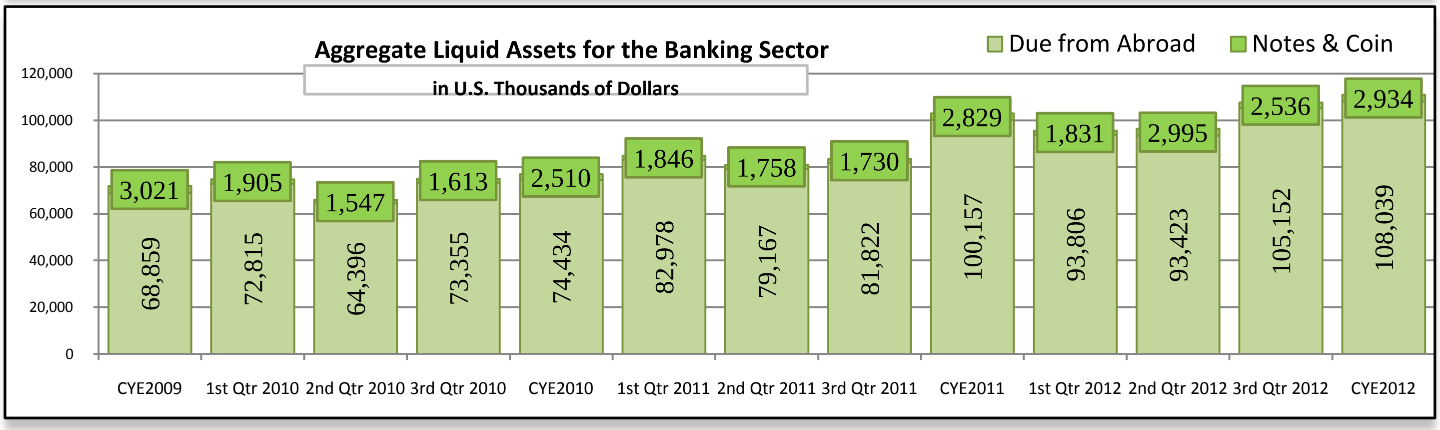

Avg Yield on Loans - Banking Sector
Avg Cost of Deposits - Banking Sector
25.00
20.00
15.00
10.00
5.00
0.00
17.73
17.83
20.89
17.87
18.35
17.97
17.49
11.82
11.14
11.15
11.51
11.64
0.44
0.42
0.40
0.37
0.28
0.27
0.27
0.26
0.22
0.22
0.21
0.21
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012

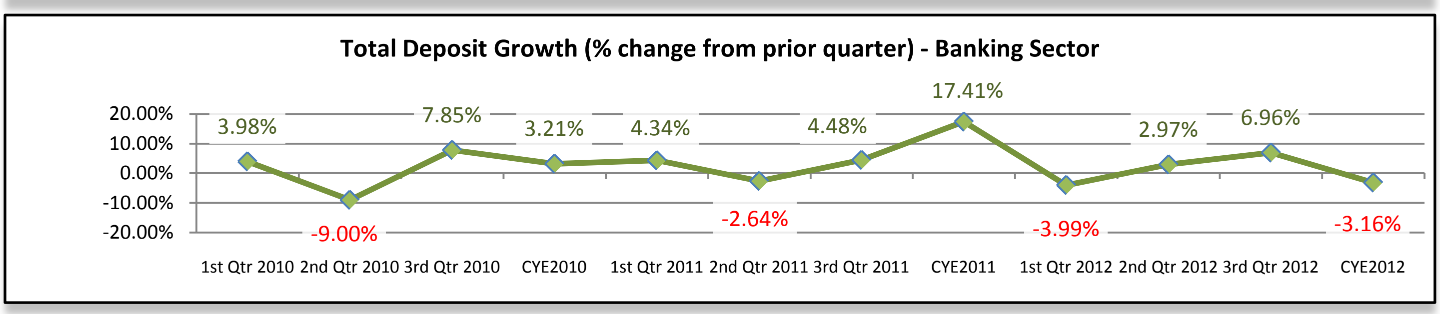

Average Earning Assets to Average Assets (%) - Banking Sector
35.00
30.00
25.00
20.00
15.00
10.00
5.00
0.00
30.66
31.24
30.66
30.70
28.56
28.65
28.81
27.27
23.00
22.80
21.86
21.17
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012

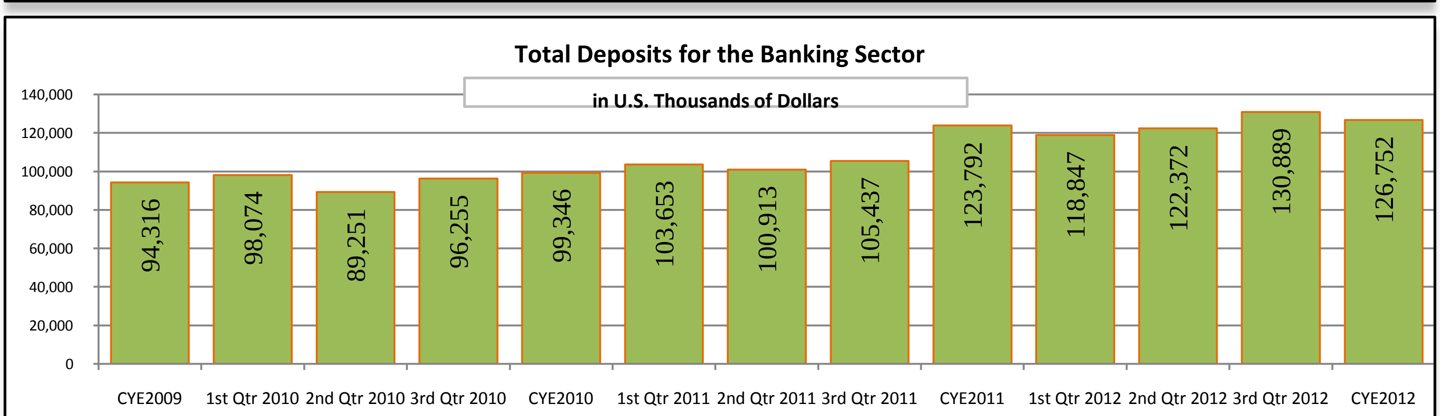
Liquidity


Liquidity Ratio (PR-10) - Banking Sector
100.00
90.00
80.00
70.00
60.00
50.00
61.40
61.45
61.43
66.95
66.84
81.89
79.37
79.37
83.05
79.94
78.76
82.27
82.67
CYE2009
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012


Growth in Liquid Assets (% change from prior quarter) - Banking Sector
40.00%
20.00%
0.00%
-20.00%
3.35%
-11.23%
18.16%
2.06%
27.79%
-5.10%
4.41%
22.51%
-7.76%
0.84%
11.24%
3.10%
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012


Aggregate Liquid Assets for the Banking Sector
in U.S. Thousands of Dollars
Due from Abroad
Notes & Coin
120,000
100,000
80,000
60,000
40,000
20,000
0
3,021
68,859
1,905
72,815
1,547
64,396
1,613
73,355
2,510
74,434
1,846
82,978
1,758
79,167
1,730
81,822
2,829
100,157
1,831
93,806
2,995
93,423
2,536
105,152
2,934
108,039
CYE2009
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012


Total Deposit Growth (% change from prior quarter) - Banking Sector
20.00%
10.00%
0.00%
-10.00%
-20.00%
3.98%
-9.00%
7.85%
3.21%
4.34%
-2.64%
4.48%
17.41%
-3.99%
2.97%
6.96%
-3.16%
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012


Total Deposits for the Banking Sector
in U.S. Thousands of Dollars
140,000
120,000
100,000
80,000
60,000
40,000
20,000
0
94,316
98,074
89,251
96,255
99,346
103,653
100,913
105,437
123,792
118,847
122,372
130,889
126,752
CYE2009
1st Qtr 2010
2nd Qtr 2010
3rd Qtr 2010
CYE2010
1st Qtr 2011
2nd Qtr 2011
3rd Qtr 2011
CYE2011
1st Qtr 2012
2nd Qtr 2012
3rd Qtr 2012
CYE2012