

# **FINANCIAL INSTITUTIONS ACT 2001**

## **Financial Institutions Commission Guidance Letter No. 01-2002**

### **BUSINESS PLAN REQUIREMENTS**

#### **1. Issuing Authority and Applicability**

This Guidance Letter is issued by the Governing Board of the Financial Institutions Commission (the Commission) pursuant to the authority vested in it by Section 78, Regulatory and supervisory powers of the Commission of the Financial Institutions Act of 2001 and any amendments thereof, and is applicable to all banks licensed by the Financial Institutions Commission to operate in the Republic of Palau.

#### **2. Purpose of Guidance**

The purpose of this Guidance Letter is to emphasize the importance of business planning to the success of banking institutions, to encourage banks to conduct formal business planning on at least an annual basis, to define when a written business plan is required by the Commission and the minimum requirements for an acceptable business plan.

A clear and well-defined business plan will serve several purposes, including:

- X helping the organizers of new banks and directors and executive officers of existing banks to focus on their overall mission and goal;
- X providing a means for the boards of directors to communicate their objectives and strategies to management, officers and staff of the bank;
- X providing guidance to the management of the bank in setting specific targets and business objectives; and
- X serving as a reference point for measuring the performance of boards of directors and executive officers.

#### **3. Business Plan Submission Requirements**

Because a well-defined business plan will enable the Financial Institutions Commission to more effectively gauge and monitor the likelihood of a bank's success, a written business plan will be required on all applicants for:

- (a) The licensing of new banks;
- (b) The acquisition of significant interest in a Palau bank when:
  - (i) the transfer involves fifty percent (50%) or more of the equity interest of any class of shares with voting rights in a Palau bank; or
  - (ii) the purchaser includes another bank or any other type of company providing financial services to the public.

Additionally, if a bank encounters operating and/or financial difficulties, a written business plan provides a means for the Financial Institutions Commission and the board of directors of the bank to coordinate an effective improvement program. As such, a written business plan may be required as part of an enforcement or corrective action program initiated by the Financial Institutions Commission against a troubled bank.

#### **4. Business Plan Information Requirements**

A business Plan should be approved by the board of directors of the bank in an official meeting of the board with such approval being recorded in the minutes of the meeting, provide at least three years' operating projections (pro forma statements), and contain sufficient information to demonstrate a reasonable likelihood of success. The plan should identify the proposed markets to be served, products and services to be offered, projected profitability and capital adequacy, and managerial resources and capabilities. A detailed breakdown of the assumptions utilized in the preparation of the pro forma statements should be included in the business plan.

Appendix 1, "Suggested Business Plan Format and Information Requirements," details a suggested format for preparing a business plan; however, any alternative format may be used provided all pertinent information, as detailed in Appendix 2, "Business Plan Checklist," is included. The Executive Commissioner of the Financial Institutions Commission may request additional information depending on the adequacy and accuracy of the information provided in the business plan.

Terms used in this Guidance Letter have the meanings as specified in the Financial Institutions Act of 2001 or Regulations issued by the Financial Institutions Commission unless otherwise clearly indicated by the context.

**APPENDIX 1**  
**SUGGESTED BUSINESS PLAN FORMAT AND INFORMATION**  
**REQUIREMENTS**

**A. Identifying Information**

1. **Name and Location.** State the name and location of the bank, including the locations of any branches or other office facilities.
2. **Organizational Structure.** Describe and provide a diagram of the bank's organizational structure including any parent company and all subsidiaries and affiliated entities of the bank. Describe and provide a diagram of any subsidiaries and affiliated entities of principal shareholders, directors or executive officers of the bank.
3. **Summary.** Briefly describe how and why the proposed changes will benefit the bank and comply with the business plan. For a new banking license, the business plan should discuss how the organizing group came together, and indicate the reasons for submission of the application for a banking license.

**B. Market Analysis**

1. **Market.** Identify the markets currently served and those proposed to be served by the bank, including any new or proposed branch or other office facilities.
2. **Characteristics.** Describe the target market demographics and economic characteristics. Include any anticipated changes in the market, factors influencing such changes, and possible effects on the bank.
3. **Competition.** Identify and describe the competition (include all other financial services providers, i.e., banks, credit co-operative societies, micro-lenders, brokerage companies, insurance companies, etc.) located within the target markets of the proposed bank including any branches or other office facilities contemplated.

**C. Business Strategy and Objectives**

1. **Market Area.** Identify the market areas from which the bank generates or expects to generate approximately seventy-five percent (75%) of its business. Describe any changes that may occur as a result of the proposed transaction. Include information on any significant competing financial services providers.
2. **Services.** List and briefly describe the services to be offered. Distinguish among depository services, credit services, and other services. Specify any proposed new services.

3. **Assumptions.** Describe the objectives and strategies for serving the identified target markets. List assumptions, including at a minimum: market growth rates, anticipated competition, interest rates, cost of funds, overhead, asset mix, return on assets, dividends, and capital ratios (leverage capital and risk-based).
4. **Asset/Liability Management.** Discuss the reasons for the proposed asset/liability mix and actions that will be taken to reduce funding and interest rate risks.
5. **Annual Audit.** Discuss what provisions have been made for independent, annual, external audit services.

**D. Leadership and Management**

1. **Structure.** Describe the management organization structure of the bank, and indicate any anticipated changes.
2. **Ownership and Management.** List the names, home addresses, and nationality of all current/proposed organizers, principal shareholders, directors or executive officers of the bank. Indicate the number and percentage of shares each individual or group is expected to own or control.
3. **Executive Officers.** Describe the responsibilities of each executive officer, including those officers responsible for major functional areas of the bank, including, but not limited to lending and credit administration, operations and internal controls, investments and asset-liability management, treasury and foreign exchange (currency) and each branch/other office facility manager.
4. **Qualifications.** Discuss the qualifications of the current/proposed directors and executive officers showing the nature and extent of experience each possesses.
5. **Compensation.** Provide a list of the proposed fees, salaries or other forms of compensation (including benefits) for each director and executive officer.
6. **Agreements.** Describe any agreement (e.g., data processing, loan processing, etc.) the bank has or intends to make to obtain services from others. Provide the names of proposed service providers and relationship(s), if any, to organizers, principal shareholders, directors or executive officers of the bank.
7. **Lease Agreements.** Describe any lease agreements the bank has or intends to enter into with any organizer, principal shareholder, director or executive officer of the bank or with any company controlled by an organizer, principal shareholder, director or executive officer of the bank. Provide: (i) a copy of the proposed lease agreement; (ii) information showing market rate comparisons of terms and rates; (iii) and the names of any organizer(s), director(s) or director(s) who are involved.

## **E. Capitalization/Net Worth**

- 1. Capital.** Describe the bank's current/proposed capital structure. For a new banking license, state the initial proposed capitalization of the bank and justify the amount proposed given minimum capitalization requirements as may be promulgated by the Financial Institutions Commission, and market factors, strategies, and expenses. Additional capital may be required by the Financial Institutions Commission on a case-by-case basis.
- 2. Capital Plan.** Describe any plans for raising capital and for financing growth over the first/next three (3) years. Applications for a new banking license should indicate the type and number of shares to be authorized and to be issued, par value per share, and sales price per share. Detail any expenses to be paid from the initial capital offering or which will be capitalized and amortized over a future period.
- 3. Debt.** Describe any debt (current or proposed, for capitalization or acquisition) of any individual or entity that will own or control, directly or indirectly ten percent (10%) or more of the equity or of any class of shares with voting rights of the bank. Describe any anticipated dividends, fees or salaries that will be paid by the bank, directly or indirectly, to service the debt.

## **F. Pro Forma Statements**

Detailed pro forma balance sheet and income and expense statements must be submitted. Statements must show asset, liability and capital projections for a minimum of three (3) years. At a minimum, the information shown in the sample pro forma statements included in Appendix 2, "Business Plan Checklist," must be provided.

## **APPENDIX 2**

### **BUSINESS PLAN CHECK LIST**

#### **I. Identify Information:**

- \_\_\_\_\_ A. 1. Name of proposed bank.
- \_\_\_\_\_ 2. Location of main office of proposed bank.
- \_\_\_\_\_ 3. Locations of branches or other office facilities proposed.
- \_\_\_\_\_ B. 1. Name and address of parent company, if applicable.
- \_\_\_\_\_ 2. Name and addressed of subsidiaries, if applicable.
- \_\_\_\_\_ 3. Name and addresses of affiliates, if applicable.
- \_\_\_\_\_ C. 1. Name and address of subsidiaries of organizers, principal shareholders, directors and executive officers, if applicable.
- \_\_\_\_\_ 2. Name and address of affiliates of organizers, principal shareholders, administrators and executive officers, if applicable.
- \_\_\_\_\_ D. 1. Explanation of genesis of the proposed transaction.
- \_\_\_\_\_ 2. Reasons for the proposed transaction (new banking license, change of significant ownership interest, issuance of capital debt instruments, etc.)

#### **II. Market Analysis:**

- \_\_\_\_\_ A. Definition of target market areas.
- \_\_\_\_\_ B. 1. Supporting market research, such as area demographics and economics.
- \_\_\_\_\_ 2. Identification of major factors affecting the selected market areas.
- \_\_\_\_\_ 3. Analysis of selected market areas' needs.
- \_\_\_\_\_ C. 1. Identification and analysis of competition within selected market areas.

#### **III. Business Strategy and Objectives:**

- \_\_\_\_\_ A. Targeted market areas can reasonable produce seventy-five percent (75%) of the business in light of the bank's resources and targeted customer base.
- \_\_\_\_\_ B. Services to be provided are listed and adequately described.
- \_\_\_\_\_ C. 1. Strategies are consistent with stated objectives.
- \_\_\_\_\_ 2. Profitability expectations and assumptions are reasonable.
- \_\_\_\_\_ D. 1. Pro Forma statements are accurately prepared with major assumptions adequately disclosed, and are consistent with strategies to capture and support market share.
- \_\_\_\_\_ 2. Strategic objectives, pro forma statements, and market plans are consistent.
- \_\_\_\_\_ 3. Estimates of operating results are reasonable and supported.
- \_\_\_\_\_ 4. Planning assumptions are realistic given the local.
- \_\_\_\_\_ E. The asset/liability mix is adequately discussed. The bank has procedures to address funding and interest rate risks.
- \_\_\_\_\_ F. External independent audit program will be provided for the first three (3) years of operations.

**IV. Leadership and Management:**

- \_\_\_\_\_A. Organizational structure of the proposed bank is adequately described.
- \_\_\_\_\_B. Duties and responsibilities of all executive officers/functional areas of the bank are adequately detailed.
- \_\_\_\_\_C. Names, addresses and nationality of all organizers, principal shareholders, directors and executive officers are disclosed as applicable.
- \_\_\_\_\_D. Proposed directors and executive officers are qualified given the services to be provided and targeted market areas.
- \_\_\_\_\_E. Fees, salaries, and other forms of compensation for directors and executive officers are disclosed.
- \_\_\_\_\_F. Leasing transactions or service agreements involving organizers, principal shareholders, directors and executive officers or related interests thereof, are fully disclosed.

**V. Capitalization/Net Worth:**

- \_\_\_\_\_A. 1. Initial capitalization complies with minimum statutory requirement and is adequately supported given targeted market areas, strategies, and projected organizational expenses.
- \_\_\_\_\_ 2. For applications for new banking licenses, proposed capitalization is adequate for at least the first three (3) years of operation. For other applications, plans to maintain capital in accordance with regulatory requirements are adequately detailed and reasonable.
- \_\_\_\_\_B. Plans to raise capital, both for start-up and subsequent growth, are formulated and are reasonable.
- \_\_\_\_\_C. Current and proposed debt is disclosed. The debt service does not adversely affect the bank. Individuals involved in the application possess sufficient resources to service the debt without support (dividend payments or other fees) from the bank or demonstrate that reliance placed on earnings of the bank does not endanger the safety and soundness or the capital adequacy of the bank.

**VI. Pro Forma Statements**

- \_\_\_\_\_A. Detailed pro forma balance sheets and income and expense statement show asset, liability and capital projections for a minimum of three (3) years.
- \_\_\_\_\_B. At a minimum, the information shown in the schedules on the following pages must be provided for a business plan to be acceptable. Additional data should be included, as necessary, to explain important elements of the planned asset and liability mix (for example, the loan and deposit schedules might be expanded). **Average annual balances, rather than year-end estimates, should be used in preparing pro forma balance sheet projections.** In addition, the assumptions used in the preparation of the pro forma statements (such as interest rate assumptions, loan yields, and cost of funds, etc.) are be provided.

**Business Plan Check List – Sample Pro Forma Statements**  
**Balance Sheet Projections**  
**(in thousand of U.S. Dollars)**

	<b>Year</b>			
	<b>Current</b>	<b>1</b>	<b>2</b>	<b>3</b>
<b>ASSETS:</b>				
Notes and Coin.....	_____	_____	_____	_____
Due From Financial Institutions.....	_____	_____	_____	_____
Securities & Overdrafts.....	_____	_____	_____	_____
Loans & Overdrafts.....	_____	_____	_____	_____
Less: Provisions for Bad Loans.....	_____	_____	_____	_____
Fixed Assets (Net of Depreciation).....	_____	_____	_____	_____
Foreclosed Real Estate.....	_____	_____	_____	_____
Other Assets <sup>1</sup> .....	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
Total Assets	_____	_____	_____	_____
<b>LIABILITIES:</b>				
Deposits.....	_____	_____	_____	_____
Due to Financial Institutions.....	_____	_____	_____	_____
Mortgages, Capitalized Leases & Other Borrowings	_____	_____	_____	_____
Other Liabilities <sup>1</sup> .....	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
Total Liabilities	_____	_____	_____	_____
<b>CAPITAL ACCOUNTS:</b>				
Issued and Fully Paid Common Stock.....	_____	_____	_____	_____
Paid-in Premium.....	_____	_____	_____	_____
Retained Earnings (Prior Years).....	_____	_____	_____	_____
Income (Loss) Year-to-date.....	_____	_____	_____	_____
Other <sup>2</sup> (Specify Type and Amount).....	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
Total Capital	_____	_____	_____	_____
Total Liabilities & Capital	_____	_____	_____	_____

	<b>Year</b>			
	<b>Current</b>	<b>1</b>	<b>2</b>	<b>3</b>
Leverage Capital / Total Assets Ratio	<u>      %      </u>	<u>      %      </u>	<u>      %      </u>	<u>      %      </u>
Tier-1 Capital / Total Risk-Weighted Assets Ration	<u>      %      </u>	<u>      %      </u>	<u>      %      </u>	<u>      %      </u>
Total Capital / Total Risk-Weighted Assets Ratio	<u>      %      </u>	<u>      %      </u>	<u>      %      </u>	<u>      %      </u>

<sup>1</sup> Itemize/describe all accounts/amounts that total five percent (5%) or more of total other assets or total other liabilities accounts, respectively.

<sup>2</sup> "Other" capital accounts/instruments require the approval of the Financial Institutions Commission prior to issuance.



**Business Plan Check List – Sample Pro Forma Statements**  
**Balance Sheet Projections (Detail)**  
**(in thousand of U.S. Dollars)**

	<b>Year</b>			
	<b>Current</b>	<b>1</b>	<b>2</b>	<b>3</b>
<b>LOAN DETAIL:</b>				
Real Estate Loans.....	_____	_____	_____	_____
Commercial Loans.....	_____	_____	_____	_____
Installment Loans.....	_____	_____	_____	_____
Other Loans (describe).....	_____	_____	_____	_____
Less: Provisions for Bad Loans.....	_____	_____	_____	_____
Net Loans	_____	_____	_____	_____
<b>DEPOSIT DETAIL:</b>				
Demand & Checking.....	_____	_____	_____	_____
- Palau Government.....	_____	_____	_____	_____
- Palau Government-owned Corporations.....	_____	_____	_____	_____
- Individuals / Consumers.....	_____	_____	_____	_____
- Corporations/Business/Partnerships.....	_____	_____	_____	_____
- Other (describe).....	_____	_____	_____	_____
Total Savings Deposits.....	_____	_____	_____	_____
Total Time/Certificates of Deposit.....	_____	_____	_____	_____
- Sub-total Short Term (up to 90 days).....	_____	_____	_____	_____
- Under \$100,000.....	_____	_____	_____	_____
- \$100,000 & Over.....	_____	_____	_____	_____
- Sub-total Medium Term (91 to 365 days)....	_____	_____	_____	_____
- Under \$100,000.....	_____	_____	_____	_____
- \$100,000 & Over.....	_____	_____	_____	_____
- Sub-total Long Term (Over 365 days).....	_____	_____	_____	_____
- Under \$100,000.....	_____	_____	_____	_____
- \$100,000 & Over.....	_____	_____	_____	_____
Total Deposits	_____	_____	_____	_____

**Business Plan Check List – Sample Pro Forma Statements**  
**Income and Expense Projections**  
**(in thousand of U.S. Dollars)**

	<b>Year</b>			
	<b>Current</b>	<b>1</b>	<b>2</b>	<b>3</b>
<b>INTEREST INCOME:</b>				
Interest / Fees on Loans & Overdrafts.....	_____	_____	_____	_____
Interest / Fees on Deposits Due from Fin. Inst....	_____	_____	_____	_____
Interest / Dividends on Securities & Investments	_____	_____	_____	_____
Other Interest Income <sup>1</sup> .....	_____	_____	_____	_____
<b>Total Interest Income</b>	_____	_____	_____	_____
<b>INTEREST EXPENSE:</b>				
Interest Paid on Deposits.....	_____	_____	_____	_____
Interest Paid on Deposits Due to Fin. Inst....	_____	_____	_____	_____
Other Interest Expense <sup>1</sup> .....	_____	_____	_____	_____
<b>Total Interest Expense</b>	_____	_____	_____	_____
<b>Net Interest Income</b>	_____	_____	_____	_____
Provisions for Bad Loans.....	_____	_____	_____	_____
<b>NON-INTEREST INCOME:</b>				
Lending Related Fees & Commissions.....	_____	_____	_____	_____
Charges & Fees on Deposit Accounts.....	_____	_____	_____	_____
Exchange & Commissions.....	_____	_____	_____	_____
Other Non-Interest Income <sup>1</sup> .....	_____	_____	_____	_____
<b>Total Non-Interest Income</b>	_____	_____	_____	_____
<b>NON-INTEREST EXPENSE:</b>				
Salaries & Benefits – Directors & Officers...	_____	_____	_____	_____
Salaries & Benefits – Employees.....	_____	_____	_____	_____
Fixed Asset Expense.....	_____	_____	_____	_____
Other Non-Interest Expense <sup>1</sup> .....	_____	_____	_____	_____
<b>Total Non-Interest Expense</b>	_____	_____	_____	_____
Less: Applicable Income Taxes.....	_____	_____	_____	_____
<b>Net Operating Income (Loss)</b>	_____	_____	_____	_____

<sup>1</sup> Itemize / describe all accounts/amounts that total five percent (5%) or more of total amount reported on this line.

**Business Plan List – Sample Pro Forma Statements**  
**Income and Expense Projections (Detail)**  
(in thousand of U.S. Dollars)

	<b>Year</b>			
	<b>Current</b>	<b>1</b>	<b>2</b>	<b>3</b>
<b>CAPITAL FUNDS:</b>				
Beginning Capital Funds.....	_____	_____	_____	_____
Organizational Expenses (if capitalized).....	_____	_____	_____	_____
Net Operating Income (Loss).....	_____	_____	_____	_____
Other Increases (Decreases).....	_____	_____	_____	_____
Less: Dividends.....	_____	_____	_____	_____
Ending Capital Funds	_____	_____	_____	_____

	<b>Current</b>	<b>1</b>	<b>2</b>	<b>3</b>
<b>PROVISIONS FOR BAD LOANS:</b>				
Beginning Balance.....	_____	_____	_____	_____
Gross Loan Losses (Write-offs).....	_____	_____	_____	_____
Recoveries.....	_____	_____	_____	_____
Net Losses (Recoveries).....	_____	_____	_____	_____
Other Increases (Decreases) <sup>1</sup> .....	_____	_____	_____	_____
Ending Provisions for Bad Loans	_____	_____	_____	_____

	<b>Year</b>			
	<b>Current</b>	<b>1</b>	<b>2</b>	<b>3</b>
<b>MISCELLANEOUS:</b>				
Number of Executive Officers.....	_____	_____	_____	_____
Number of Employees.....	_____	_____	_____	_____
Yield on Total Loans.....	_____	_____	_____	_____
Yield on Total Securities & Investments.....	_____	_____	_____	_____
Interest Income to Average Earning Assets.....	_____	_____	_____	_____
Interest Expense to Average Earning Assets.....	_____	_____	_____	_____
Average Earning Assets.....	_____	_____	_____	_____

<sup>1</sup> Describe all increase and decreases, and the corresponding amount for each item reported in this line.  
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