

PALAU FINANCIAL SERVICES AUTHORITY

PRUDENTIAL REGULATION
PFSA-PR-10

LIQUIDITY

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1. Effective Date

PART I: PRELIMINARY

- 1: **Short Title** – Liquidity.
- 2: **Authorization** – The Financial Services Authority (the Commission) of the Republic of Palau (Palau) is authorized to promulgate regulations under Sections 12 and 80 of the Financial Institutions Act of 2001 (the Act) as amended. In addition, Section 54 of the Act provides that the Commission may establish specific requirements concerning the minimum aggregate amount of liquid assets.
- 3: **Application** – This regulation applies to all Palau banks and the branches of foreign banks licensed by the Commission to conduct financial activities in Palau (Palau foreign bank branches) (hereafter collectively referred to as “bank”).
- 4: **Definitions** – Terms used within this regulation are as defined in the Act, as defined below, or as reasonably implied by contextual usage:
 - 1) **“asset quality rating”** – means the rating assigned by the Commission to Asset Quality at the most recent on-site examination or on the basis of off-site analysis, whichever is more current.
 - 2) **“capital adequacy category”** – means the capital adequacy categories as defined in Regulation PFSA-PR-01 Capital Adequacy issued by the Commission.
 - 3) **“liquid assets”** – 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.
 - 4) **“liquidity ratio”** – means the ratio of liquid assets to the sum of total deposits plus short-term liabilities.
 - 5) **“total deposits plus short-term liabilities”** – means the sum of all deposit liabilities plus all other liabilities that are (i) due on demand, either explicitly or implicitly, and (ii) have a maturity of less than one year or are likely to become due within one year.

PART II: STATEMENT OF POLICY

- 1: **Purpose** – This regulation is intended to ensure that each bank maintains a level of liquidity that is adequate for the prudent conduct of operations in relation to the adequacy of the bank’s capital, the quality of assets, and the risk profile of the bank’s activities.
- 2: **Scope** – This regulation applies to all banks.

- 3: **Responsibility** – It is the responsibility of the board of directors of each bank to (a) establish a liquidity policy that is adequate in scope and appropriate for the risk profile of the bank; (b) require management to adopt procedures that implement the policy, and (c) monitor and ensure compliance to the policy.

PART III: IMPLEMENTATION AND SPECIFIC REQUIREMENTS

- 1: **Minimum Liquidity** – Each bank shall maintain an adequate level of liquidity. The minimum acceptable liquidity ratio shall be no less than the amount shown below; the Commission may require a higher level of liquidity for an individual bank on the basis of activities or risk profile other than capital and asset quality.

<u>Minimum Liquidity Ratio</u>		
<u>Capital Category</u>	<u>Asset Quality Rating</u>	
	1 or 2	3, 4 or 5
1 or 2	15%	20%
3	25%	30%
4 or 5	35%	40%

Palau foreign bank branches not required to maintain assigned capital as provided in Section 33 of the Act, the minimum acceptable liquidity position shall be no less than the amount shown below; the Commission may require a higher level of liquidity for an individual bank on the basis of activities or risk profile other than asset quality.

<u>Asset Quality Rating</u>	<u>Minimum Liquidity Ratio</u>
1	15%
2	20%
3	30%
4	35%
5	40%

- 2: **Calculation of Liquidity Ratio** – For purposes of determining compliance, the liquidity ratio will be calculated using a rolling 30-day period, i.e. the liquidity ratio for any one day will be the average of the daily liquidity ratios for the preceding 30 days. Thus, the liquidity ratio on any one day may fall below the minimum ratio but still comply if the average of the daily ratios for the preceding 30-days complies with the minimum.
- 3: **Back-up Arrangements** – If a bank is rated 3, 4 or 5 for capital or asset quality, or if a bank fails to comply with the required minimum liquidity ratio for 30 consecutive days or fails to comply for more than 60 non-consecutive days in a 12-month period, then the bank shall promptly establish a back-up line of liquidity acceptable to the Commission.

To be acceptable, a back-up line of liquidity must (i) provide access to sufficient liquid funds to enable the bank to comply with the minimum liquidity ratio, (ii) be irrevocable, and (iii) be provided by an unrelated bank or by persons whose financial capacity can be verified and is acceptable to the Commission.

- 4: Reporting Requirements** – Each bank shall submit returns in respect of liquidity in the form and frequency as the Commission may prescribe.

PART IV: CORRECTIVE MEASURES

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

PART V: EFFECTIVE DATE

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

Questions relating to this regulation may be addressed to the Financial Services Authority of the Republic of Palau.

Adopted _____, 2008

**Governing Board
Financial Services Authority
Republic of Palau**

Approved _____, 2008

**Honorable President
Tommy E. Remengesau, Jr.**