



# Anti-money laundering and counter-terrorist financing measures

## Palau

Mutual Evaluation Report

September 2018





The Asia/Pacific Group on Money Laundering (APG) is an autonomous and collaborative international organisation founded in 1997 in Bangkok, Thailand consisting of 41 members and a number of international and regional observers. Some of the key international organisations who participate with, and support, the efforts of the APG in the region include the Financial Action Task Force, International Monetary Fund, World Bank, OECD, United Nations Office on Drugs and Crime, Asian Development Bank and the Egmont Group of Financial Intelligence Units.

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Cover image: The legendary Money Bird of Palau (Delerrok)

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## EXECUTIVE SUMMARY

1. This report provides a summary of the AML/CFT measures in place in The Republic of Palau (Palau) as at the date of the on-site visit 20 November – 1 December 2017. It analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of Palau's AML/CFT system, and provides recommendations on how the system could be strengthened.

### A. *Key Findings*

- § Palau completed its first formal assessment of Money Laundering/Terrorism Financing risks in 2017. Palau has demonstrated reasonable actions to identify and assess its Money Laundering (ML) and Terrorism Financing (TF) risks though the private sector's understanding of risks in Palau was very limited. Palau identifies two high-risk predicate offences – illicit trafficking in narcotic drugs and psychotropic substances and trafficking in human beings and sexual exploitation. Banks and money lenders are considered high risk financial institutions. DNFBPs with a high vulnerability include real estate agents and dealers in high value assets, with lawyers at a medium level. Corruption risks are however not given sufficient focus in Palau. Being a cash-based economy, cash represents a significant risk.
- § Palau has a low level of risk for TF and has never identified either terrorism or TF. Palau lacks a national policy and strategic mechanism to respond to TF risks, should they arise recognising the risk level. While government agencies have some understanding of TF risk, the understanding of the private sector is negligible, which reduces Palau's ability to identify TF.
- § Palau has not yet developed a written national AML/CFT policy, though has made a number of significant policy decisions based on and informed by risk including formation of the Narcotics Enforcement Agency (NEA), the Financial Crime Investigations Unit (FCIU) and the Human Trafficking Task Force.
- § There is good cooperation between the competent authorities through the Money Laundering Working Group (MLWG) at a strategic level, and the creation of the FCIU at an operational investigative level. Additional coordination is required in relation to TF and Proliferation Financing (PF) issues.
- § Some use has been made of financial intelligence by competent authorities investigating ML or predicate offences. The Financial Intelligence Unit (FIU) provides decent quality financial intelligence to law enforcement agencies and prosecutors to combat ML and predicate offences, with disseminated reports based predominantly on Suspicious Transaction Reports (STR) and

#### Cash Transaction Reports (CTR).

- § Law Enforcement Agencies (LEA) have limited understanding of the benefits and use of financial intelligence, lack resources and capacity to act on it and do not undertake a proactive approach to carrying out parallel financial investigations on the predicate and related ML offences. The number of reports disseminated by the FIU appears appropriate when considering the context of Palau.
- § The quality, quantity and scope of STRs reported to the FIU by foreign banks has improved in recent years, however STRs are not received from some significant Reporting Entities (REs) which limits the data available to the FIU for analysis.
- § The illicit funds associated with Palau's higher risk crimes - drugs and prostitution – are rarely funnelled through Palau's formal financial sector which suggests the current level of STR filing by non-financial institutions is not commensurate with the ML/TF risks identified by Palau.
- § ML investigations have not historically been pursued as a policy priority in Palau until the formation of the FCIU in late 2016.
- § Palau has had five successful ML prosecutions up until 2011. However these convictions do not align with Palau's higher risk predicate offences and have not resulted in the application of proportionate and dissuasive sanctions.
- § Whilst profit driven crime in Palau is generally low, the fact that confiscation of proceeds of crime is not seen as a priority for authorities leads to reduced outcomes when the opportunity arises in criminal cases.
- § Palau has improved the declaration system for incoming and outgoing cross-border transportation of currency and bearer negotiable instruments through translating the declaration forms into languages used by the majority of tourists which has resulted in improved reporting and declarations.
- § Palau has a basic legal framework to implement Targeted Financial Sanctions (TFS). Authorities do not consistently share updated lists of designated persons or entities. TFS implementation through automated screening is generally strong in the banking and remittance sectors though local banks and DNFBPs, which are very small, had no understanding of TFS. While Palau has a very small Not for Profit Organisations (NPO) sector, it has still not conducted a risk assessment of NPOs and no strategic and operational monitoring of activities of the NPO sector occurs.
- § The Financial Institutions Commission (FIC) is applying context appropriate risk-based supervision to the banking sector, where three United States (US) banks account for 98% of the total financial sector activity. Palau has not designated relevant AML/CFT supervisors for all the different sectors, in particular DNFBPs such as real estate agents and lawyers, who have high and medium risk for ML/TF respectively.
- § Palau issued the new AML/CFT regulations for Financial Institutions (FI) in November 2017, which contain detailed preventative measure requirements. The three U.S. banks and foreign money remittance service providers have measures in place to comply with CDD and record keeping requirements and identify beneficial owners to some extent, including applying EDD on high risk customers though the other FIs have limited implementation of CDD and negligible procedures to identify beneficial ownership.
- § The DNFBP regulations have not been issued and they have not implemented preventative

measures.

- § Palau has not undertaken a ML/TF risk assessment of all forms of legal persons and legal arrangements. Measures to prevent or deter the misuse of legal persons and legal arrangements are very limited. As there is no requirement in Palau for companies to maintain BO information beyond the legal owner of shares, authorities may not be able to secure adequate, accurate and current BO information on all types of legal persons in Palau.
- § Palau has a reasonable legal framework for international cooperation for both MLA and extradition, and while there are no policies and procedures on how MLA and extradition will be sought and responded to, the lack of policies and procedures has not detrimentally affected the success of the few requests received and made.
- § Palau does not have a legal framework or processes to implement TFS for proliferation financing (PF).

## **B. Risks and General Situation**

2. The following summary of the assessment team's understanding of Palau's ML/TF risk is based on material provided by Palau including its National Risk Assessment (NRA) and information gathered from discussions with competent authorities, the private sector as well as open source materials.

### *Money Laundering*

3. Palau's context is of importance when considering ML threats, vulnerabilities and risks. Palau has a small population and low GDP. The banking sector manages over 98% of financial transactions with nearly all financial transactions going through three international banks.

4. Palau faces a range of ML threats and vulnerabilities. Palau's NRA has identified as high risk the illicit trafficking in narcotic drugs and psychotropic substances and trafficking in human beings and sexual exploitation. Banks and money lenders are considered high risk financial institutions with further high ranked vulnerabilities including the lack of capacity of LEAs and lack of beneficial ownership transparency for non-profit corporations and foreign corporations. DNFBPs with a high vulnerability include real estate agents and dealers in high value assets, with lawyers being of medium risk. While the risk for corruption was considered as low in the NRA, further consideration is necessary. Lawyers play an intermediary role in real estate transactions and assisting foreign investors to set up companies in Palau.

5. The cash economy represent a significant risk as Palau is a cash-based economy, with cash intensive industries continuing to be an ongoing vulnerability, such as individual's purchases of high-end goods such as cars, boats, and household items, which are seldom processed through financial institutions. The movement of funds, both cash and electronic wire transfers that originate from offshore is identified as a concern and a further potential enabler for ML to occur in Palau.

6. While the DNFBP sector is very small, both real estate and lawyers have high and medium level risks for ML respectively, and are not regulated for ML. This exposure is further increased by real estate being unregulated.

## *Terrorism Financing*

7. Palau's exposure to TF is very limited and it has never had any links to terrorism or any cases of TF. The risk of TF is considered low. The small NPO sector is considered to have low vulnerability to TF and is not subject to supervision or monitoring by authorities. Palau's TF vulnerabilities include limited expertise among relevant agencies, lack of oversight of the NPO sector, negligible implementation of TFS in the non-bank sector and no implementation in DNFBPs.

### **C. Overall Level of Effectiveness and Technical Compliance**

#### *C.1. Assessment of Risks, coordination and policy setting (Chapter 2 - IO.1; R.1, R.2, R.33)*

8. Palau completed its first formal assessment of ML/TF risk in 2017 through a NRA. The major risk findings are reasonable in the circumstances, though further analysis is required. The TF assessment of low risk appears appropriate.

9. The process to prepare Palau's first NRA (included the private sector) was less than optimal from a private sector perspective, as most private sector reporting entities exhibited very limited and in some cases negligible understanding of the AML/CFT risks facing Palau.

10. While Palau does not have significant ML risks (when compared to larger jurisdictions), it does have some high and moderate risks within its own context that require consideration and analysis. Palau identifies two high-risk predicate offences – illicit trafficking in narcotic drugs and psychotropic substances and trafficking in human beings and sexual exploitation. Corruption risks are however not given sufficient focus in Palau. DNFBPs, which are very small in Palau, have a number of high risk sectors including real estate agents, lawyers and dealers in high value assets. Being a cash-based economy, cash represents a significant risk.

11. There is no documented AML/CFT strategy or policy informed by risks, to address ML/TF risks in Palau, though positive steps have been undertaken by Palau over the last few years based on risk such as the formation of the NEA and the development of the Human Trafficking Task Force.

12. Palau is yet to fully adopt a risk-based approach for exemptions from AML/CFT requirements and the application of enhanced or simplified preventative measures has occurred to a limited extent based on ML/TF risk and the FI regulations that include such measures were only enacted during the onsite visit.

13. There is a sound level of cooperation between the competent authorities through the MLWG at a strategic level, and the creation of the FCIU at an operational investigative level. Significant improvements in coordination are required in relation to TF and PF.

#### *C.2. Financial Intelligence, Money Laundering and Confiscation (Chapter 3 - IOs 6-8; R.3, R.4, R.29-32)*

14. Some use has been made of financial intelligence and information by competent authorities investigating ML or predicate offences. The FIU provides decent quality financial intelligence and other relevant information to LEAs and prosecutors to combat ML and predicate offences to some extent, though disseminated reports are based predominantly on STRs and to a lesser extent CTRs. The intelligence has supported and contributed to ML investigations over the last two years and it also does, on occasion, support proceeds-generating predicate offence investigations undertaken without a ML component. However, LEAs have limited understanding of the benefits and use of financial intelligence, and lack resources and capacity to act on it.



15. LEAs in general have not made effective use of information provided by the FIU, though steps have been undertaken over the past 12-18 months through the formation of the FCIU to improve this. LEAs do not undertake a proactive approach to carrying out parallel financial investigations on the predicate and related ML offences, including the use of financial intelligence.

16. The quality, quantity and scope of STRs reported to the FIU by foreign banks has improved in recent years, which has improved the FIU's ability to produce value-added financial intelligence, however STRs are not received from some significant REs. This limits the data available to the FIU for analysis and does not align fully with the assessed risks.

17. The FIU has not conducted or disseminated strategic analysis.

18. Since 2011, Palau has had five successful ML prosecutions. This is a reasonable outcome in light of the Palauan context, however these convictions do not align with Palau's higher risk predicate offences and have not always resulted in the application of proportionate and dissuasive sanctions. The predicate offences prosecuted include theft, smuggling, tax evasion and corruption.

19. The creation of the NEA in 2017 and the FCIU in 2016 has allowed Palau to focus its limited resources on its most significant risks and to develop a multi-agency task force focused on investigating STR-generated ML cases.

20. Most sentences for ML involve suspended sentences and fines, and in many cases do not appear proportionate and dissuasive, despite there being satisfactory maximum sanctions available for both natural and legal persons.

21. Despite having a generally comprehensive legal framework, Palau has not demonstrated that confiscation is a key priority in its criminal justice regime or pursued as a primary policy objective. Of the high-risk key proceeds-generating crimes, drug trafficking has a good level of confiscation as the NEA has effectively confiscated vehicles and cash.

22. Palau has improved the declaration system for incoming and outgoing cross-border transportation of currency and bearer negotiable instruments (BNI) through translating the declaration forms into languages used by the majority of tourists which has resulted in improved reporting and declarations.

### *C.3. Terrorist Financing and Financing Proliferation (Chapter 4 - IOs 9-11; R.5-8)*

23. Palau has a low level of risk for TF. Palau has never identified either terrorism or TF and has never conducted an investigation, which is consistent with its risk. This low risk is reinforced by Palau having no offshore sector and limited exposure to the international financial sector.

24. While recognising the low level of risk, Palau lacks a national policy and strategic mechanism to respond to TF risks, should they arise. Palau does not have a broader CT strategy.

25. While government agencies have some understanding of TF risk, the understanding of the private sector is negligible, which reduces Palau's ability to identify TF.

26. At the operational level, Palau has not demonstrated the necessary capacity and capability to identify, investigate and prosecute TF.

27. While Palau has a very small NPO sector, it has still not conducted a risk assessment of NPOs (NPOs were not considered in the NRA) and no strategic and operational monitoring of the activities of the NPO sector occurs. Due to the small size of the NPO sector, it was not of concern to authorities.

28. TFS implementation is generally strong in the banking and remittance sectors, through which approximately 99% of the financial activity in Palau is processed. Smaller financial institutions (FIs) and DNFBPs had no understanding of TFS. No terrorist assets have been frozen (whether

through criminal, civil or administrative processes), in connection with TFS, which is consistent with Palau's low TF risk. The three US banks and two money service remittance providers have strong screening systems for both account opening and ongoing transactions. The remaining financial institutions and DNFBPs have no understanding of their PF obligations.

#### *C.4. Preventive Measures (Chapter 5 - 104; R.9-23)*

29. Palau has made improvements to its legal framework for preventative measures with issuance in November 2017 of the AML/CFT regulations for FIs, which contains detailed requirements. However, there has been no implementation of the additional requirements contained in the regulations since they were only introduced during the onsite visit, though the three U.S. banks and money remittance service providers implement preventative measures to some extent and have a good understanding of these preventative measures. The smaller FIs and DNFBPs, which are very small in Palau, have not implemented preventative measures and the DNFBP regulations have not yet been issued.

30. The degree of understanding of ML/TF risks is very limited across the financial sector, with domestic banks, money remittance service providers and DNFBPs demonstrating no understanding of ML and TF risks in Palau.

31. The U.S. banks and two foreign owned money remittance service providers apply mitigating measures commensurate with their institutional risks to a large extent. While they exhibited limited understanding of Palau's ML/TF risks, it is unclear if they would be required to undertake even further measures noting the overall low risk of ML and low risk of TF in Palau when compared to the risks in their home jurisdictions (US and Philippines).

32. Illicit funds associated with Palau's higher risk crimes - drugs and sexual exploitation/prostitution (human trafficking) - are rarely funnelled through Palau's formal financial sector which suggests the current level of STR filing by non-financial institutions is not commensurate with the ML/TF risks identified by Palau.

33. The three U.S. banks and foreign money remittance service providers have measures in place to comply with Customer Due Diligence (CDD) and record keeping requirements and identify beneficial owners to some extent, including applying Enhanced Due Diligence (EDD) on high risk customers though the other FIs have limited implementation of CDD and negligible procedures to identify beneficial ownership.

34. FIC examination reports confirm U.S. banks have implemented strong internal controls and procedures to comply with AML/CFT requirements. The issuance of the FI regulations enacted during the onsite visit did not provide adequate time for FIs to update their AML/CFT policies and procedures. Other FIs (including credit unions and remittance service providers), NPOs and DNFBPs, have not been supervised for AML/CFT compliance.

#### *C.5. Supervision (Chapter 6 - 103; R.26-28, R. 34-35)*

35. The FIC is applying context appropriate risk-based supervision to the banking sector, where three US banks account for 98% of the total financial sector activity. The international banks, and to a slightly lesser extent the domestic banks, have a good understanding of their AML/CFT obligations though had very limited understanding of ML/TF risks in Palau. DNFBPs have little understanding of AML/CFT obligations and negligible understanding of ML/TF risks.

36. REs are not required to undertake risk assessments or apply simplified and enhanced CDD measures when applicable. Other than the NRA which was recently completed, supervisors do not

appear to have mechanisms to regularly identify and assess the ML/TF risks of the FIs and sectors they supervise and no sectoral assessments have been undertaken.

37. The licensing (including licence renewal) framework for REs is not comprehensive. There are variable fit and proper requirements in place to prevent criminals and their associates from operating within the financial sector, and for the DNFBP sector, which is very small, requirements are very limited, particularly in the absence of AML/CFT regulations for DNFBPs.

38. Palau has not designated relevant AML/CFT supervisors for all the different sectors, in particular DNFBPs such as real estate agents and lawyers, who have high and medium risk for ML/TF respectively. DNFBPs other than real estate agents and lawyers either have very low risks or their activities do not fall under the FATF standards (accountants, DPMS and notaries). Palau does not have TCSPs though lawyers do perform legal services related to the formation of legal entities. Due to legal privilege, Palau does not intend to apply AML/CFT obligation on lawyers even when they are only acting as TCSPs.

39. No financial or criminal sanctions have been applied to date by the FIC or FIU for breaches of AML/CFT requirements, which when noting the nature of crime and the context in Palau is understandable. The FIC have issued limited corrective orders to the five banks for areas requiring remedial action in cases of AML/CFT deficiencies, with all requests addressed.

#### *C.6. Transparency of Legal Persons and Arrangements (Chapter 7 - I05; R. 24-25)*

40. Palau has not undertaken a ML/TF risk assessment of all forms of legal persons and legal arrangements.

41. Measures to prevent or deter the misuse of legal persons and legal arrangements are generally inadequate. Palau has implemented some structural preventative measures designed to prevent the misuse of legal persons and arrangements for ML or TF including all legal persons are required to register with the OAG who is also the Registrar of Corporations; at the time of incorporation, an affidavit by the president, secretary and treasurer of the corporation shall be filed with the Registrar; foreign owners are required to obtain a Foreign Investment Act Certificate (FIAC) from the Foreign Investment Board (FIB); and financial institutions are required to take reasonable measures to understand and document the ownership and control structure of legal persons.

42. Because there is no requirement in Palau for companies to maintain BO information beyond the legal owner of shares, authorities may not be able to secure adequate, accurate and current basic and BO information on all types of legal persons in Palau.

43. Trustees are not subject to comprehensive AML/CFT obligations.

44. TCSPs, while not present in Palau, are not covered under the AMLA or supervised although some of these services appear to be offered by lawyers.

#### *C.7. International Cooperation (Chapter 8 - I02; R. 36-40)*

45. Palau has a reasonable legal framework for international cooperation for both MLA and extradition, but there are no policies and procedures on how MLA and extradition will be sought and responded to. The lack of policies and procedures has not detrimentally affected the few requests received and made.

46. Palau received one MLA request from the United States (2010-11), one request from Chinese Taipei (2014) and has made no MLA requests. Palau has made one extradition request to the U.S. (Guam), which in the context of the risks and type of criminality in Palau seems reasonable.

47. The use of formal and informal international cooperation is limited so it is difficult to comment on whether it matches Palau's risk profile, though informal international cooperation has been undertaken by the FIU, FIC, Customs, OSP, CID and the NEA.

48. Palau engages closely and effectively with the U.S. with respect to the FIU, Supervisory authorities and law enforcement.

49. Palau has never made or received a request for international cooperation to identify or exchange basic or beneficial ownership information. Palau is in principle able to cooperate with foreign competent authorities through a formal MLA request or under existing MOUs or other informal cooperation arrangements. However, there is no requirement in Palau for companies to maintain BO information beyond the legal owner of shares, so authorities may not be able to secure adequate, accurate and current basic and BO information on all types of legal persons in Palau.

50. Palau is not yet a member of the Egmont Group (though it has applied for membership).

#### **D. *Priority Actions***

51. The following are priority actions for Palau based on these findings, are:

- i. Continue to enhance risk assessments of ML including more in-depth analysis of higher risk predicate offences including corruption; sector-specific and thematic (crime type) assessments, including of the NPO sector and legal persons; continue to develop ML/TF risk understanding among competent authorities and the private sector; and based on a comprehensive understanding of ML/TF risk develop an AML/CFT National Strategy.
- ii. LEAs need to increase effective and appropriate use of financial intelligence in undertaking investigations of both ML and related predicate offences. The FIU should undertake strategic analysis to further enhance the value of disseminated reports to LEAs and prosecutors, both directly and through the FCIU.
- iii. LEAs and prosecutors should more proactively pursue the confiscation of proceeds of crime and make greater use of the full range of seizure and confiscation powers available to them to pursue proceeds of crime that are not directly linked to offences being prosecuted.
- iv. Develop and implement a CFT policy and strategy. Amend gaps in the TFS framework, particularly in relation to UNSCR 1267 and 1373.
- v. Conduct outreach and develop sector-specific guidance for all REs on ML/TF risks and AML/CFT obligations including application of enhanced and simplified measures.
- vi. FIs and DNFBPs should be required to conduct internal risk assessments and develop risk-based compliance programs
- vii. The DNFBP regulations should be enacted and applied to all DNFBPs even if, in practice, they initially only apply to real estate agents and possibly lawyers, because the other entities either do not exist (casinos, TCSPs), have very low risk or do not undertake transactions that relate to the FATF definitions (accountants, DPMS).
- viii. The FIC should commence a programme of risk-based supervision of FIs for AML/CFT particularly for simplified and enhanced CDD measures, informed by a sectoral risk assessment of the sector. Outreach to and supervision of higher risk sectors, which includes real estate and lawyers, should be undertaken.
- ix. Palau should require legal persons to maintain updated and accurate information on their beneficial ownership. This information should be maintained in a way that allows timely access by the relevant authorities without legal restriction or hindrance.

- x. Palau should develop policies and procedures to clearly articulate how MLA and extradition will be sought and responded to on an ongoing basis.
- xi. Palauan competent authorities should continue to establish and strengthen their individual cooperation mechanisms with neighbouring jurisdictions' equivalent competent authorities in order to exchange financial intelligence and supervisory, law enforcement and other information with foreign counterparts.
- xii. Bring into force and affect a legal framework to give effect to R.7, and implement institutional frameworks, procedures, and measures to give effect to TFS for PF including the development of a coordination and cooperation mechanism.

## E. Effectiveness & Technical Compliance Ratings

### Effectiveness Ratings

<b>IO.1</b> - Risk, policy and coordination	<b>IO.2</b> - International cooperation	<b>IO.3</b> - Supervision	<b>IO.4</b> - Preventive measures	<b>IO.5</b> - Legal persons and arrangements	<b>IO.6</b> - Financial intelligence
<b>Moderate</b>	<b>Substantial</b>	<b>Moderate</b>	<b>Moderate</b>	<b>Low</b>	<b>Moderate</b>
<b>IO.7</b> - ML investigation & prosecution	<b>IO.8</b> - Confiscation	<b>IO.9</b> - TF investigation & prosecution	<b>IO.10</b> - TF preventive measures & financial sanctions	<b>IO.11</b> - PF financial sanctions	
<b>Moderate</b>	<b>Moderate</b>	<b>Low</b>	<b>Moderate</b>	<b>Low</b>	

### Technical Compliance Ratings (C – compliant, LC – largely compliant, PC – partially compliant, NC – non compliant)

<b>R.1</b> - Assessing risk & applying risk-based approach	<b>R.2</b> - National cooperation and coordination	<b>R.3</b> - Money laundering offence	<b>R.4</b> - Confiscation & provisional measures	<b>R.5</b> - Terrorist financing offence	<b>R.6</b> - Targeted financial sanctions – terrorism & terrorist financing
<b>PC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>
<b>R.7</b> - Targeted financial sanctions – proliferation	<b>R.8</b> - Non-profit organisations	<b>R.9</b> - Financial institution secrecy laws	<b>R.10</b> - Customer due diligence	<b>R.11</b> - Record keeping	<b>R.12</b> - Politically exposed persons
<b>NC</b>	<b>NC</b>	<b>C</b>	<b>PC</b>	<b>C</b>	<b>PC</b>
<b>R.13</b> - Correspondent banking	<b>R.14</b> - Money or value transfer services	<b>R.15</b> - New technologies	<b>R.16</b> - Wire transfers	<b>R.17</b> - Reliance on third parties	<b>R.18</b> - Internal controls and foreign branches and subsidiaries
<b>PC</b>	<b>NC</b>	<b>PC</b>	<b>PC</b>	<b>PC</b>	<b>C</b>
<b>R.19</b> - Higher-risk countries	<b>R.20</b> - Reporting of suspicious transactions	<b>R.21</b> - Tipping-off and confidentiality	<b>R.22</b> - DNFBPs: Customer due diligence	<b>R.23</b> - DNFBPs: Other measures	<b>R.24</b> - Transparency & BO of legal persons
<b>PC</b>	<b>LC</b>	<b>C</b>	<b>NC</b>	<b>PC</b>	<b>NC</b>
<b>R.25</b> - Transparency & BO of legal arrangements	<b>R.26</b> - Regulation and supervision of financial institutions	<b>R.27</b> - Powers of supervision	<b>R.28</b> - Regulation and supervision of DNFBPs	<b>R.29</b> - Financial intelligence units	<b>R.30</b> - Responsibilities of law enforcement and investigative authorities
<b>PC</b>	<b>PC</b>	<b>C</b>	<b>NC</b>	<b>LC</b>	<b>LC</b>
<b>R.31</b> - Powers of law enforcement and investigative authorities	<b>R.32</b> - Cash couriers	<b>R.33</b> - Statistics	<b>R.34</b> - Guidance and feedback	<b>R.35</b> - Sanctions	<b>R.36</b> - International instruments
<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>PC</b>	<b>PC</b>	<b>NC</b>
<b>R.37</b> - Mutual legal assistance	<b>R.38</b> - Mutual legal assistance: freezing and confiscation	<b>R.39</b> - Extradition	<b>R.40</b> - Other forms of international cooperation		
<b>LC</b>	<b>LC</b>	<b>LC</b>	<b>LC</b>		

## MUTUAL EVALUATION REPORT OF PALAU

### *Preface*

This report summarises the AML/CFT measures in place as at the date of the on-site visit. It analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of the AML/CFT system, and recommends how the system could be strengthened.

This evaluation was based on the 2012 FATF Recommendations, and was prepared using the 2013 Methodology. The evaluation was based on information provided by the country, and information obtained by the evaluation team during its on-site visit to the country from 20 November 2017 – 30 November 2017.

The evaluation was conducted by an assessment team consisting of:

- Mr. Jimmy Sendersly, Solomon Islands FIU (FIU expert)
- Mr. Kenneth Chin Jiayang, Attorney General's Chambers, Singapore (legal expert)
- Mr. Muhammad Afzaal Khattak, Banking Inspections Department, State Bank of Pakistan (financial expert)
- Mr. Rick Hsiang-Heng Wang, Financial Supervisory Commission, Chinese Taipei (financial expert)
- Ms. Rosanna Celona, Australian Federal Police (law enforcement expert)

The assessment process was supported by Mr. David Becker and Dr. Mohammad ALRashdan of the APG secretariat.

The report was reviewed by the FATF Secretariat and Ms. Marlene Manuel-Fevrier, Department of Finance (FIN), Canada.

Palau previously underwent a FATF Mutual Evaluation in 2008, conducted according to the 2004 FATF Methodology. The 2008 evaluation and subsequent follow-up reports have been published and are available at [www.apgml.org](http://www.apgml.org).

Palau's 2008 Mutual Evaluation concluded that the country was compliant with 3 Recommendations; largely compliant with 10; partially compliant with 17; and non-compliant with 19. Palau was rated compliant or largely compliant with 3 of the 16 Core and Key Recommendations.





## CHAPTER 1. ML/TF RISKS AND CONTEXT

### *Background*

1. The Republic of Palau (Palau) is an island nation located in the western Pacific Ocean roughly 800 kilometres southeast of the Philippines and approximately 1100 kilometres southeast of Guam. Palau has more than 340 islands, of which only nine are permanently inhabited, with most business, commercial, and financial activity taking place on the island of Koror, where more than 70% of the population reside. The land area of Palau totals approximately 460 square kilometres (178 square miles). Current estimates put Palau's population at approximately 18,500. The capital relocated in 2006 from Koror to a newly constructed complex in Melekeok State on the larger but less developed island of Babeldaob, which is home to 20% of the population.

2. After almost four decades of US administration under the United Nations Trust Territory of the Pacific Islands (TTPI), Palau, opted for independent status in 1978. Palau adopted its own constitution and became the Republic of Palau in 1981. It has been in a compact of free association with the US since 1993. Palau gained full sovereignty when the Compact went into effect on 1 October 1994, concluding Palau's transition from trusteeship to independence.

3. Palau is a democratic republic with directly elected executive and legislative branches. The President is both head of state and head of government. Executive power is exercised by the government while legislative power is vested in both the government and the Palau National Congress (the Olbiil era Kelulau (OEK)). The Palau National Congress has two houses – the Senate with nine members elected nationwide and the House of Delegates made up of 16 members, one from each of Palau's 16 states. There is also a Council of Chiefs, comprising the highest traditional chiefs from each of the 16 states. The Council of Chiefs serves as an advisory board to the President on matters concerning traditional laws and customs.

4. The Palau judiciary consists of the Supreme Court (Trial Division and Appellate Division), the Land Court, the Court of Common Pleas, and associated administrative units that provide various services to the courts. Article X of the Constitution of the Republic of Palau provides for a judiciary independent of legislative and executive powers.

### *ML/TF Risks and Scoping of Higher-Risk Issues*

#### *Overview of ML/TF Risks*

5. Palau is exposed to a range of ML threats and vulnerabilities. Palau's strategic geographic position in relation to Asia, the Philippines, the US and the Pacific increases its exposure to ML/TF risks. The significant cash-based economy, limited technology and limited expertise across relevant agencies increases the vulnerabilities. The sectors most vulnerable to ML are identified as businesses generally (due to the significant role that cash plays), banking, real estate and lawyers (related to real estate transactions, creating legal persons and assisting businesses regarding foreign ownership). Palau has a low level of TF risk.

6. A NRA was finalised in November 2017. The NRA notes a number of predicate crimes with ML threats that are most apparent in Palau, including: criminal proceeds resulting from illicit trafficking in narcotics (high risk), trafficking in human beings and sexual exploitation (high), cross-border cash couriers (medium), counterfeit currency (low), tax crimes (low), corruption (low), robbery and theft (low), and environmental crime and illegal fishing (low).

The NRA also rates the vulnerability to ML/TF risks of some FIs, such as banks and alternative money remittance companies as high, and also high for a number of designated non-financial businesses and professions (DNFBPs) such as real estate agents and dealers in high value assets (cars and boats), with lawyers considered to have medium vulnerability to ML/TF risks.

7. However, many of the threats and vulnerabilities noted within the NRA do not have any clear analysis to explain how this occurs in Palau, why it poses a threat or vulnerability, how it links to ML in Palau, and more detail on each of the main risks associated with each in Palau.

### *Country's risk assessment & Scoping of Higher Risk Issues*

8. The NRA identified the following vulnerability ratings for FIs and DNFBPs (Table 1):

**Table 1: Palau's NRA rated vulnerability of sectors to ML/TF risk**

<b>Financial Institutions</b>	<b>Vulnerability rating</b>
Banks	High
Credit unions	Low
Insurance intermediaries or brokers	Low
Money remittance companies/Alternative remittance service (ARS)	Medium
Portfolio Management	Low
Credit Card/Debit Card Issuers	Low
Finance companies (money lenders)	Not rated in NRA
<b>DNFBPs</b>	<b>Vulnerability rating</b>
Real estate agents	High
Dealers in high value assets (cars and boats)	High
Lawyers/other legal profession (including licensed notaries)	Medium
Dealers in precious metals/precious stones (jewellery shops)	Low
Accountants (Auditors)	Low

9. The mutual evaluation onsite visit focussed on the following high-risk issues, based on a brief draft summary of risks in Palau (provided by Palau prior to the onsite visit), open source information, and information provided by the reviewers of Palau's ME:

- *Cash economy*: ML/TF implications of Palau's reliance on cash intensive businesses and any associated cash courier activity.
- *Drug trafficking*: increase in domestic drug use creating greater opportunities for criminals to generate criminal proceeds through a range of potential methodologies for importing narcotics into Palau including the carrying of drugs on arrival at airport, mail, through seaports and by on-duty airport personnel. Palau's understanding of the risks involved and the policies and measures in place to mitigate associated ML risks were examined.
- *Trafficking in human beings and sexual exploitation* – financial flows associated with both were considered.
- *Other predicate crimes* – risk of ML arising from other predicate crimes such as illicit narcotic trafficking, human trafficking, corruption/fraud, tax evasion, robbery and theft, illicit cross-border movement of currency, environmental crime and illegal fishing.

- *Shipping registry*: challenges that Palau may face regarding the proper implementation of TFS, particularly when there is a lack of information on the ownership of ships.
- *Lawyers*: captured by the Money Laundering Act (AMLA) but not supervised. Lawyers are rated as medium risk in the NRA guide. Palau's understanding of the risks involved and the measures in place to further identify and mitigate those risks were examined.
- *Real estate agents, dealers in high value assets (cars and boats)*: captured by the AMLA but not supervised. Both sectors are rated as high risk in the NRA guide. Palau's understanding of the risks involved and the measures in place to further identify and mitigate those risks were examined.
- *Legal persons, transparency and beneficial ownership*: the ML and TF risks posed by legal persons (including companies and limited partnerships) and the relatively low cost of establishing these entities were examined.
- *Foreign investors*: the presence of a large number of foreign investors and associated ML/TF risks, especially in Palau's real estate and business sectors were examined.
- *Cross-border currency movements*: non-declaration of currency movements by an estimated large number of persons entering and leaving Palau through air and sea were examined.
- *Terrorism financing and proliferation*: the TF offence, implementation of TFS relating to terrorism and TF, and to proliferation of weapons of mass destruction, and Palau's trade relationship with Iran and Democratic People's Republic of Korea (DPRK) were examined.

### Materiality

10. Palau's gross domestic product (GDP) in 2017 is estimated at approximately USD301 million. The gross national income (GNI) per capita in 2017 is estimated at approximately USD15,000. Palau's major merchandise exports include shellfish and tuna fish, harvested by foreign-owned and foreign-crewed fishing fleets. The main export destinations are the US (USD575K), Guam (USD253K) and Japan USD112K). The top import origins are Japan (USD27.9M), the United States (USD25.7M), China (USD19.2M), South Korea (USD10.9M) and the Philippines (USD2.67M).<sup>1</sup> Major merchandise imports include mineral fuels, sea vessels, vehicles, machinery and transport equipment, food and manufactured goods. Total imports increased from USD156.8 million in 2015 to USD179.3 million in 2016.<sup>2</sup>

11. The economy has a narrow production base as a result of limited natural resources and few skilled personnel, as well as unsteady growth of GDP over the last three years with an average growth of 11.4% in 2015, 1.9% in 2016 and 1% in 2017.<sup>3</sup>

12. Tourism is one of the main pillars of Palau's economy, along with subsistence agriculture and fishing. Business and leisure tourist arrivals reached a record 167,966 in 2015, a 14.4% increase over the previous year (2014), but fell to 138,408 in 2016. Long-term prospects

<sup>1</sup> The Observatory of Economic Complexity: Palau exports and imports in 2016 - <https://atlas.media.mit.edu/en/profile/country/plw/>

<sup>2</sup> US Central Intelligence Agency (CIA), "the World Fact Book", for Palau, at 21 February 2018.

<sup>3</sup> See above.

for tourism have been bolstered by the expansion of air travel in the Pacific, the rising prosperity of industrial East Asia, and the willingness of foreigners to finance infrastructure development. Palau's proximity to Guam, the region's major destination for tourists from East Asia, and a regionally competitive tourist infrastructure enhance Palau's advantage as a destination.<sup>4</sup>

13. At the financial business level, there is also a presence of a number of US financial institutions operating in Palau (3 US banks), that are considered the main pillars of the Palauan economy, accounting for 98% of the total financial transactions in Palau.

#### *Financial Institutions*

14. Palau has a small financial sector that focuses on providing basic financial services to the population. There are five banks licensed by the FIC of which three are branches of foreign banks (US banks) that account for over ninety-eight percent (98%) of the total financial transactions in the jurisdiction; with the remaining significant FIs including two locally-chartered banks (accounting for USD700,000 combined) and two money remittance service providers. While the three US banks are regulated by the FIC and the FIU, they are also regulated by the U.S. Federal Deposit Insurance Corporation (FDIC) and FINCEN.

15. Palau law does not allow for the establishment of offshore banks and the FIC is the primary licensing authority for institutions that engage in banking activities in the country. Currently, local banks are unable to establish branches outside Palau. Banks licensed in Palau are required to incorporate and the FIC has exclusive authority for the licensing of these institutions.

16. The non-bank financial sector consists of five insurance agents (insurance intermediaries), 12 finance companies, seven unlicensed money and value transfer services (MVTs) and six licensed credit unions. All locally-owned businesses in Palau are required to obtain a business license from the Division of Revenue and Taxation (DRT) and a business license from each state in which they operate. Partly or wholly foreign-owned businesses are required to obtain a license from the Foreign Investment Board (FIB), in addition to the DRT and state licenses. There are no securities dealers in Palau.

#### *DNFBPs*

17. Designated non-financial businesses and professions (DNFBPs) are very small in Palau and consist of accountants (though they only provide basic bookkeeping services), lawyers (will be exempt in future from AML/CFT obligations), real estate agents and dealers of precious metals and stones (low value tourist shops). As at November 2017, there were 17 accountants and 5 accountancy firms registered with the Office of Public Auditor, 18 lawyers with current practising certificates working in private practice (with 56 lawyers working in government service), two real estate agents and 32 licensed notaries<sup>5</sup>. The three precious metals and stones stores are small family retail businesses. There are three car dealerships in Palau, two boat/engine dealers and one exclusive boat engine dealer.

<sup>4</sup>Same as above.

<sup>5</sup>Palau indicated that Licensed Notaries in Palau are only licensed to authenticate signatures for legal documents, such as affidavits, land lease documents, or any document filed with the courts requiring authentication. They are not providing services as described by FATF definition.

18. Most DNFBP sectors are covered under the AML/CFT framework, except accountants (who will be included in the DNFBP regulations when enacted) and dealers in high value assets (cars and boats), however DNFBP Regulations have not been issued.

### *Structural Elements*

19. While some building blocks for an effective AML/CFT system are generally in place in Palau, resources and skills required are incomplete and pose ongoing obstacles to effectiveness.

20. There is sound political and institutional stability, with accountability mechanisms and anti-corruption measures included in the Code of Ethics Act of 1999 and the Public Service Rules and Regulations of 1996. However, there are reports of corruption challenges in Palau, especially within some governmental sectors from local to national levels as well as corruption involving overseas officials. Cases consist mainly of misuse of government funds, favouritism and cronyism, the latter two being due to the fact that Palau is a small country with many family or clan relations. Palau is aware of and is responding to these risks, and a Special Prosecutor and a Public Auditor are part of the mechanisms in place to increase government accountability. The Office of the Special Prosecutor (OSP) has in recent years commenced taking criminal proceedings against elected OEK members and state officials for misuse of public funds.

21. Palau has a competent, efficient and independent judiciary.

### *Background and other Contextual Factors*

22. While Palau's geographic location provides some measure of protection from international and cross-border crimes, a range of cases demonstrate that Palau is not immune from them.

23. Palau is a member of the Pacific Transnational Crime Network (PTCN) which has been working collaboratively with the Pacific law enforcement community since its inception in 2002. The PTCN provides a police-led proactive criminal intelligence and investigative capability to combat transnational crime in the Pacific through a multi-agency and regional approach. FIUs across the 17 member jurisdictions partner with the PTCN.

24. The Palau FIU is a member of the Association of Pacific Islands FIUs (APIFIU). The MOU for APIFIU allows for the exchange of information between member FIUs which include the FIUs of Cook Islands, Fiji, Kiribati, Nauru, Niue, Palau, Papua New Guinea, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga and Vanuatu. The Palau FIU is not a member of the Egmont Group though an application has been submitted.

25. Palau is also a member of Secretariat of Pacific Community, Pacific Islands Forum Secretariat, Pacific Islands Chiefs of Police, Pacific Immigration Directors Conference, Pacific Islands Law Officers Network, Forum Fisheries Agency, and Oceania Customs Organisation.

### *AML/CFT strategy*

26. There is no documented AML/CFT strategy or policy informed by risks, to address ML/TF risks in Palau. Palau has undertaken measures to respond to risk including the creation of the NEA due to the marked increase in drug trafficking mainly in the importation and sale of methamphetamine from Philippines and mainland US, the creation of a Human Trafficking Task Force (October 2017), and the creation of the FCIU but no comprehensive and overarching strategy has been developed for AML/CFT.

27. Law enforcement, the FIC, Office of the Attorney General (OAG) or Customs do not have any specific activity based plans and strategies to prioritise or conduct AML work. Over the past 18 months, the creation of the FCIU has provided a focal point for a range of investigative agencies (including the above) including the FIU to consider and prioritise disseminated intelligence reports based on suspicious matter reports.

28. Palau has no strategy or coordination mechanism to combat PF, which is of concern given potential vulnerabilities related to the shipping registry.

### *Legal & institutional framework*

29. The legal framework for AML/CFT preventative measures is set out in the AMLA, Counter-Terrorism Act 2007 (CTA) and the Criminal Procedure Code 18 (PNCA).

30. The key institutional elements for an effective AML/CFT system are largely present in Palau. There is an independent and active judiciary consisting of the Supreme Court (trial Division and Appellate Division), the Land Court, the Court of Common Pleas, and associated administrative units that provide various services to the courts; and a number of departments, agencies and public authorities having significant functions in Palau AML/CFT system as follows:

- **Money Laundering Working Group (MLWG):** the MLWG is the coordination body responsible for overseeing the AML/CFT system in Palau and providing input on AML/CFT policies to the President. It was established by Presidential Executive Order in 2003 and meets monthly. The membership of the MLWG consists of the Chairman of the FIC Board, the Attorney General, the Executive Director of the FIC, the Chief of the Bureau of Revenue, Customs & Tax – Customs Division, the Director of the Bureau of Immigration, the Director of the Bureau of Public Safety, and a representative from the Office of the President.
- **Financial Intelligence Unit (FIU):** The FIU is responsible for receiving, analysing, and processing suspicious transaction reports (STRs), cash transaction reports (CTRs), electronic funds transfer reports (EFTRs) and cross-border cash declarations and other data. The FIU may disseminate STR generated reports to other domestic authorities. The FIU is also the AML/CFT regulator for DNFBPs including lawyers and licensed notaries and the lead agency for AML/CFT policy formulation. The FIU is responsible to the Governing Board of the FIC in the exercise of its powers and functions.
- **Financial Institutions Commission (FIC):** was established in 2001 and is in charge of licensing, supervising, and regulating Palau's financial institutions under the Financial Institutions Act (FIA) – both prudential and AML/CFT. Under the AMLA, the FIC is in charge of AML/CFT compliance of financial institutions and the licensing of money transmission providers. Since February 2008, the FIC is also hosting the FIU.
- **Office of Attorney General (OAG):** is responsible for the prosecution of ML cases, and execution of MLA and extradition requests. In addition, the Attorney General is also the Registrar of Corporations and maintains registers of all corporations, including NPOs.
- **Office of the Special Prosecutor (OSP):** The OSP through the Special Prosecutor's Act, is an independent prosecuting body in Palau tasked with receiving complaints of, investigating, and prosecuting any and all allegations of violations of the Constitution and laws of the Republic. The OSP has led the investigation and prosecution of a number of ML cases.

- **Ministry of Finance (MOF):** is, among other responsibilities, responsible for the Bureau of Revenue, Customs & Tax, which in turn consists of the Division of Revenue and Taxation and the Division of Customs.
- **Division of Revenue and Taxation (DRT):** is responsible for issuing business licenses and collects taxes. The Division of Customs includes a unit for Revenue Collection and Law Enforcement Operation which is responsible for border entry and checks persons at points of entry into Palau among others for cross-border cash transportations.
- **Bureau of Public Safety (BPS):** Has a number of divisions including: the Police (that is responsible for investigating ML and TF, Patrol, Fish and Wildlife, Fire and Rescue, Corrections, and Marine Law Enforcement).
- **Narcotics Enforcement Agency (NEA):** was created in March 2017 as a proactive and independent measure to investigate and take proceeds of crime action for high risk drug offenses (including trafficking), tobacco, gambling and transnational crimes.
- **Ministry of Justice (MOJ):** is responsible for the OAG, the BPS, and the Bureau of Immigration. The MOJ delegates all tasks related to AML/CFT to these agencies.
- **Ministry of Foreign Affairs (MFA):** is primarily responsible for diplomatic liaison, including in relation to UN Conventions. It is also responsible for receiving MLA requests, listing and de-listing requests of names /entities/ groups related to UNSCR requirements, and forwarding them to the United Nations Secretariat.
- **Foreign Investment Board (FIB):** is responsible for approving all foreign investments as well conducting investigations into those applying to operate a business in Palau, issue citations and refer illegal businesses to the OAG and/or FIU for investigation and criminal prosecution (noting that FIB does not have a direct role in AML/CFT matters).
- **Office of Public Auditor (OPA):** is responsible for undertaking public audits across all levels of government and in all other public legal entities or non-profit organisation receiving public funds from the national government. OPA is a self-regulatory body for the accounting profession in Palau responsible for determining the qualifications of persons for admission; registration of accountants and auditors; and regulation of their practice.
- **Financial Crimes Investigation Unit (FCIU):** The FIU has established the FCIU through Executive Order as a task force between AML/CFT competent authorities, to enhance investigative capabilities and the coordination between the Bureau of Customs and Border Protection, Narcotics Enforcement Agency, Criminal Investigations Division, Palau Postal Service and Bureau of revenue and Taxation to investigate SMR initiated crimes.

### *Financial sector and DNFBBPs*

#### *The Financial Sector*

31. The financial sector in Palau is relatively small compared to international standards. The financial sector is dominated by banks, which makes up 98-99% of the financial sector and 1-2% for other FIs and DNFBBPs operating in Palau. Palau has three US owned banks, two domestic banks and two foreign remittance service companies, one which provides global services and the second remitting funds only from Palau to the Philippines.

32. Table 2 below list the types of financial institutions in Palau's financial sector, while table 3 gives the status of financial institutions' with regards to licensing, registration and assets in Palau:

**Table 2: Palau's financial sector: institution types and number**

Financial Sector Institution Type	Number of institutions
Banks	5
Credit unions	6
Insurance intermediaries or brokers	5
Money remittance companies/Alternative remittance service (ARS)	7
Finance companies (money lenders)	12
Portfolio Management	0
Credit Card/Debit Card Issuers	Debit cards (3 international banks) and credit cards (one international bank)

**Table 3: Palau's financial sector: licensing, registration and assets**

Financial Sector Institution Type	Licensed / registered institutions	Unlicensed institutions	% of financial sector assets *
Banks	5		98-99
Domestic	2		
Foreign branches	3		
Credit unions	0	6	
Insurance intermediaries or brokers	5		
Money remittance companies/Alternative remittance service (ARS)	0	7	
Finance companies (money lenders)	12		
Portfolio Management	0		
Credit Card/Debit Card Issuers	Debit cards (3 major banks) and credit cards (one international bank)		

\* The remaining sectors hold approximately 1-2% of the sector assets, split across these sectors.

33. The banks (including local and foreign banks) and money remittance companies/alternative remittance services (ARS) are licensed and regulated by the FIC. Credit unions are currently unlicensed and not regulated for AML/CFT in Palau. Insurance intermediaries/brokers and finance companies (money lenders) are locally-owned businesses in Palau and are required to obtain a business license from the DRT and a business license from each State in which they operate. ARS are not currently licensed or registered.

#### *DNFBP Sector*

34. The AML Act includes DNFBP categories of casinos, lawyers, notaries (independent legal professionals), real estate agents, trust and company service providers and dealers of precious metals and stones (small locally-owned jewellery shops). While casinos have been included in the AMLA, they are not legal in Palau. The Act also includes dealers in high value assets (cars and boats). While these DNFBPs and additional businesses are included under the Act, detailed



obligations, through further regulations, for recordkeeping/CDD and STR reporting have not yet been applied to these sectors. The size of the DNFBP sector is very small (table 4).

**Table 4: DNFBPs in Palau**

DNFBP type	No. of businesses/professionals
Real estate agents	2
Dealers in precious metals/precious stones (jewellery shops)	3
Lawyers/other legal profession	66
Accountants	17
Licensed notaries	32
TCSPs	0
Casinos <sup>6</sup>	0
Dealers in high value assets (cars and boats)	car dealerships (3), boat/engine dealers (2) and exclusive boat engine dealer (1).

35. At the time of the on-site visit, there were no trust and company service providers in Palau. There are 66 lawyers captured by the AMLA. Palau has a Bar Association that is a self-regulatory body for lawyers and legal practice is governed by the courts. There are no casinos in Palau and gambling is strictly prohibited by law (Palau National Code (Criminal Code) Chapter 5, Section 5004(a)(b)).

36. Notaries are licensed by the Ministry of Justice, and criminal record checks occur on application and on renewal (after two years). Notaries are only licensed to authenticate signatures for legal documents, such as affidavits, land lease documents, or any document filed with the courts requiring authentication.

26. Palau has only one accounting firm that only undertakes national and state government auditing services. While there are four other accounting firms and a number of individual accountants registered to operate in Palau, none are professionally active and nearly all are resident overseas. The Office of the Public Auditor has a framework in place for licensing accountants and it undertakes regular monitoring of its members (currently 17 accountants/auditors).

37. The two real estate agents in Palau have no licensing requirements and the sector is not regulated. The agents are covered in the AMLA and are included in the yet to be enacted draft FIU regulations for DNFBPs.

38. The sectors of dealers of precious metals and precious stones is very small (family owned businesses) and mainly deals with products of low value (USD2,000 or less) and Palau has no bullion dealers.

### *Preventive measures*

39. Principal legal instruments that include provisions on combating ML/TF in Palau include: AMLA, Counter Terrorism Act (CTA), Criminal Code, Criminal Procedures Code, Financial Institutions Act (FIA), and Corporation Act. The FIC and the FIU are the supervisory authorities that monitor and supervise FIs and DNFBPs for AML/CFT compliance. The following

<sup>6</sup>Prohibited – land based and online.

financial institutions and DNFBPs are not supervised for AML/CFT – insurance intermediaries, finance companies, credit unions, accountants, lawyers, gold and precious metal dealers and real estate agents.

40. Palau has also issued a number of regulations setting out broad requirements for FIs, including: Customs Regulation, Corporation Regulation as well as Financial Institutions Regulation (FIR) for AML/CFT issued by the FIU during the onsite-visit to Palau. However, there has been no implementation of the additional requirements contained in the FIR regulations since they were only introduced during the onsite visit, and equivalent regulations are yet to be issued setting out detailed preventive measures for DNFBPs.

41. The draft DNFBP regulations (as at the time of the onsite visit to Palau) cover a number of DNFBPs, as defined by the FATF. This includes accountants, who are not included as DNFBPs in the AMLA. The regulations when enacted will not apply to lawyers, due to legal professional privilege. The assessment team believes that the regulations should apply to real estate agents as the risk in this sector is not low (as indicated above) and it is vulnerable to ML. In practice, DNFBPs generally are not being targeted for AML/CFT obligations due to their very small size and low risk.

### *Legal persons and arrangements*

42. In Palau, legal persons must be established under, and are regulated by, the Corporations Act (Title 12 PNCA) and Corporations Act Regulations (“the Regulations”). Under those instruments the following eight types of legal persons may be established:

- Corporations for Profit (Regulations, Chap 1);
- Non-profit Corporations (Regulations, Chap 1);
- Foreign Corporations, including foreign government corporations, and foreign eleemosynary (or non-profit) corporations (Regulations Chap 3, Part 1);
- Corporations Sole for Ecclesiastical Purposes (Regulations, Chap 4);
- Limited Partnerships<sup>7</sup> (Regulations, Chap 5);
- Foreign Limited Partnerships (Regulations, Chap 5, paragraph 1.5)
- Credit Unions (legal persons formed by 25 or more citizens of Palau under the Corporations Act section 101 and the Regulations Chap 7, part 2, paragraph 2.1); and
- Cooperatives (legal persons formed by association of 10 or more natural persons under the Corporations Act section 101 and the Regulations, Chap 8, part 2, paragraphs 2.1 and 2.2).

43. The Registrar of Corporations (“the Registrar”) issues, receives and holds all documents upon establishment of these legal persons including the corporate articles of incorporation and by-laws, partnership documentation etc. After establishment, corporations, including limited partnerships, must file annual reports with the Registrar (variously referred also as “annual statements” and “annual exhibits” in the Regulations).

<sup>7</sup>Defined as a “person” under the Corporations Act section 201(b). Under the Corporation Regulations Chap 5, part 2.1, limited partners are not bound by the obligations of the partnership – i.e., they have limited liability based on their legal status as separate legal entities.

44. Palau does not keep information on the numbers of the various forms of legal persons established and/or operating in Palau or on legal arrangements.

45. The information relating to the mechanisms to identify and describe the different types of legal persons and the processes necessary to create them are publicly available. Some legislation is available online (to some extent). Some legislation is kept at two public law libraries.

46. Neither the Corporations Act nor the Regulations require legal persons to take reasonable measures to obtain and hold up-to-date information on their beneficial owners (where applicable) beyond the direct owners of shares.

47. There is a significant gap in the lack of measures to ensure there is adequate, accurate and updated information on beneficial ownership (as defined by the FATF) which can be obtained or accessed by competent authorities in a timely manner.

### *Supervisory arrangements*

48. There are two AML/CFT supervisors in Palau designated under the AMLA: the FIC and the FIU.

49. The FIC is the prudential supervisor of Palau's financial institutions. While the AMLA Section 3327 designates both the FIC and the FIU as being responsible for AML/CFT supervision of reporting entities, in practice the FIC has responsibility for monitoring compliance by banks and the FIU for money remittance service providers, with the regulations issued by the FIU to FIs.

50. The FIU is responsible for AML/CFT supervision of DNFBPs.

51. Both the FIC and FIU are administered by and accountable to the Financial Institutions Commission Board in the discharge of their powers and functions, including supervision of all reporting entities.

### *International Cooperation*

52. The OAG is responsible for mutual legal assistance (MLA) and extradition. Palau has experienced limited formal international cooperation relating to ML/TF, however regularly conducts informal cooperation with foreign counterparts. Besides references to MLA and extradition in the legislation, there are no guidelines, directions or prioritisation policies for handling MLA and extradition matters, though the legislation provides enough detail to cover this limited deficiency. Palau is also a member of the Pacific Islands Forum (PIF), and works with its regional colleagues to enhance political governance and security in the region.

CHAPTER 1. ML/TF RISKS AND CONTEXT

1



### *Key Findings and Recommended Actions*

#### **Key Findings**

- Palau has a reasonable understanding of its ML and TF risks.
- Palau completed its first formal assessment of ML/TF risk through undertaking a NRA which was finalised in November 2017. The major risk findings are reasonable in the circumstances, though further analysis is required. The TF assessment of low risk appears appropriate.
- The process to prepare Palau's first NRA was less than optimal from a private sector perspective, as most private sector reporting entities exhibited very limited to negligible understanding of the AML/CFT risks facing Palau and it was unclear how the private sector had informed and contributed to the identified risks in the NRA.
- While Palau does not have significant ML risks (when compared to larger jurisdictions), it does have some high and moderate risks within its own context that require consideration and analysis.
- Palau identifies two **high-risk** predicate offences – illicit trafficking in narcotic drugs and psychotropic substances and trafficking in human beings and sexual exploitation. Corruption risks are however not given sufficient focus in Palau. Banks and money lenders are considered high risk financial institutions with further high ranked vulnerabilities including lack of capacity of LEAs and lack of beneficial ownership transparency. DNFBPs with a high vulnerability include real estate agents and dealers in high value assets, with lawyers at a medium level. Corruption risks are not given sufficient focus in Palau. Being a cash-based economy, cash represents a significant risk.
- Palau has not yet developed a written national AML/CFT policy which is guided by identified risk. While not formally drafted, Palau through the MLWG has made a number of significant policy decisions based on and informed by risk including formation of the NEA, the FCIU and the Human Trafficking Task Force, which has resulted in the assessment team placing little weight on this deficiency noting the size and context within Palau.
- Palau is yet to fully adopt a risk-based approach for exemptions from AML/CFT requirements and the application of enhanced or simplified preventative measures has occurred to a limited extent based on ML/TF risk and the FI regulations were only enacted during the onsite visit.
- There is a sound level of cooperation between the competent authorities through the MLWG at a strategic level, and the creation of the FCIU at an operational investigative level has greatly improved operational collaboration which is a welcome development. Additional coordination is required in relation to TF and PF issues.

#### **Recommended Actions**

- Competent authorities should undertake both sector-specific and thematic (crime types) risk assessments as well as more in-depth analysis of higher risk predicate offences including corruption, which incorporate Palau's ML threats (as identified in the NRA) in order to establish a more comprehensive understanding of ML risk.
- An over-arching national AML/CFT strategy/policy and sector-specific policies should be developed as a priority and consistent with the identified risks. Once developed, the internal

policies, priorities and procedures of relevant key agencies should be adjusted as required to ensure that the objectives and activities of the competent authorities are focused on the areas of higher risk.

- A formal engagement strategy with REs is required to ensure they fully understand the risks, undertake risks assessments, and to assist in increased engagement in future risk assessments. Based on the understanding of risk by both government and REs, the application of additional enhanced measures for higher risk scenarios, or simplified measures for lower risk scenarios, needs to be considered and adopted where possible.
- A CFT coordination mechanism and policy should be developed in line with Palau's context and low risk.
- Ensure that competent authorities cooperate and coordinate in the development and implementation of policies and activities to combat PF, by incorporating this into a National Strategy.

54. The relevant Immediate Outcome considered and assessed in this chapter is IO1. The recommendations relevant for the assessment of effectiveness under this section are R1-2.

### *Immediate Outcome 1 (Risk, Policy and Coordination)*

#### *Background and Context*

55. Understanding Palau's context is of importance when considering ML/TF threats, vulnerabilities and risks. Palau has a small population and small GDP. The three US financial institutions that manage 98% of financial transactions through branches in Palau are FDIC and FINCEN-regulated. The wire transfers (USD255million per annum) into and out of Palau are very small by world standards (the vast majority of the funds wired in and out of Palau are due to government expenditures principally with the US), though are not insignificant amounts for a small jurisdiction when considering the size of its GDP (USD298mill in 2016). The assessment team carefully considered this context in considering Palau's overall effectiveness in understanding its ML/TF risks.

56. Prior to commencing the NRA process, Palau's FIU and LEAs had some understanding of the emerging threats in criminal activities which advertently had an impact on ML risks. These emerging risks (in particularly illicit drugs, prostitution and cross-border cash couriers) were reflected in the NRA

57. The FIU led Palau's first NRA process which was coordinated by the MLWG. A NRA Guide was developed which provided an overview of what ML and TF is, what an NRA is, why it was important to be undertaken, a general questionnaire for all stakeholders and customised targeted questionnaires for key government agencies and FIs. The government agencies which received customised questionnaires were: Ministry of Justice, Bureau of Immigration and Labour, Foreign Investment Board, Procurement Office, Customs Office, Ministry of State, and Chamber of Commerce. The members of the MLWG were consulted and interviews were held with LEAs (NEA in particular) and the OAG.

58. A range of additional sources of information was considered in developing the NRA, including from US LEAs, though it is unclear what was provided by each. By including a diverse range of public and private sector stakeholders in the development of the NRA, Palau has taken

important initial steps to enhance the understanding of ML/TF risks within relevant entities, though further work is required.

59. The NRA was finally completed during the onsite visit and only MLWG members had received copies of the finalised assessment at that time. Other agencies and the private sector who had contributed to the NRA had not received a copy of the final NRA report by the end of the onsite visit.

60. The NRA used a number of assumptions in determining the levels of ML/TF risks including:

- Palau assumed that areas with a strong vulnerability will have a higher ML/TF risk. In most cases this was not clearly and logically articulated.
- The variables considered were not given an equal weighting. This was not clearly articulated which made it difficult to fully appreciate how the weighting was determined and the impact this had on identified vulnerabilities, threats and risks.
- Palau noted that the NRA utilised a number of domestic and international sources of information, but it is not clear how these sources (except regarding TF), and in particular some of the international sources, contributed to and informed the findings of the NRA.

### *Risk, Policy and Coordination*

#### *Country's understanding of its ML/TF risks*

61. Palau authorities demonstrated a reasonable understanding of its ML/TF risks, but this understanding needs to be developed further. Palau's first NRA was finalised in November 2017. Palau had previously identified some of the more significant ML risks – illicit drugs and sexual exploitation - which were confirmed by the NRA. Palau has indicated that the NRA is a preliminary assessment and its goal is for the FIU to update the risk assessment on an annual basis, which is supported by the assessment team.

62. While noting Palau's small population and ML/TF context, limited analysis has so far been undertaken on how the different proceeds-generating crime types occur in Palau and the related ML risk. In updates to its risk assessment, further consideration also needs to be given to a range of potential risks (vulnerabilities) including real estate, use of legal persons, beneficial ownership, financial technology and the use of the remittance sector for money transfers.

63. The major ML risks assessed by Palau are:

- Illicit trafficking in narcotic drugs and psychotropic substances (high risk);
- Trafficking in human beings and sexual exploitation (high risk); and
- Cross border cash couriers (medium risk).

64. In relation to its domestic ML risks, Palau authorities continue to see their own ML risks as being high in relation to illegal proceeds from local drug trafficking, human trafficking, counterfeit currency and tax crimes.

65. The risk assessment findings regarding risks posed by drugs and human trafficking have some similarities with a UNODC published threat assessment of transnational organised crime in the Pacific (September 2016).

66. While the NRA indicates what some of Palau's risks are, significant vulnerabilities and impacts of risks and crime types, it is not clear how these findings were reached. For example, in Palau trafficking in human beings and sexual exploitation is ranked as a high risk for ML and as posing a significant threat, though no clear analysis is provided on how human trafficking occurs in Palau, what makes it such a threat for ML in the local context and how the proceeds of trafficking are being laundered. Authorities appeared to focus on prostitution as the real issue which did not fully explain the high risk for human trafficking.

67. Palau's understanding of ML risk for drug trafficking is well developed. Palau's Belau Drug Enforcement Taskforce conducted a drug trend report for the years 2015 to 2016 and provided a follow-up assessment to the Vice President in June 2017. The taskforce report identified methamphetamine as being the main drug trafficking threat in Palau.

68. The NEA has considered the risks and threats associated with drug trafficking and have implemented measures to mitigate these risks. For example, the seaport only had border security officials on duty between 8am and 5pm even though ships can arrive at any time, which has been addressed by the NEA.

69. Palau notes that it is primarily a cash-based economy, and cash intensive industries continue to represent an ongoing vulnerability. They recognise that the proceeds from criminal activity are laundered primarily through an individual's purchases of high-end goods such as cars, boats, and household items, which are seldom processed through financial institutions. This indicates an area of risk that warrants further consideration.

70. Palauan authorities understanding of ML risks is variable. Further clarity or analysis is required for:

- Human trafficking and sexual exploitation, which is principally cash based, provided no clear analysis;
- Corruption/bribery/fraud is rated a low risk for ML even though the likelihood is medium and the consequence is high. Palau has subsequently suggested that corruption/bribery deals primarily with family, clan or community sponsored corruption and is not a risk for ML. It may be that Palau considers that the mitigation measures it has taken reduces the risk from these offences to low, but it is not clear what specific measures have been undertaken. Based on discussions at the onsite visit, corruption was viewed as a higher risk by a number of government agencies and some representatives from the private sector, suggesting that further consideration is required. ;
- The reference in the NRA to an influx of high-end investors into Palau entering into long term land-lease agreements, provides an indicator for potential risks associated with real estate and potentially corruption which are not fully considered by authorities in the NRA. The risks related to real estate were highlighted at the onsite visit by both government and private sector stakeholders, which suggests this area warrants further analysis and consideration;



71. Palau authorities have not fully considered a range of potential risks and vulnerabilities including real estate (agents recognised as a high vulnerability), lawyers and dealers in high value assets (cars and boats). The risks associated with real estate including the role of lawyers in this area were raised during the onsite visit, by both government agencies and the private sector but have not been clearly assessed. It should be noted that the NRA acknowledged the lack of transparency in the real estate sector and large purchases, but provided no further insight as to why they see both as a high vulnerability and yet the risk for each does not appear to have been clearly analysed or assessed. .

72. Possible risks associated with the misuse of legal persons have not been assessed by Palauan authorities or the private sector, and limited understanding was confirmed at the onsite visit.

73. When considering the main channels and techniques of ML in Palau, many typologies used in Palau are noted but without any clear analysis to explain how this typology occurs within Palau, the extent of them, why it poses a threat, how it links to ML in Palau, and more detail of the risks associated with each in Palau. Examples of these typologies include electronic transfers, co-mingling, trade-based money laundering (TBML) and smurfing. When considering TBML, the NRA notes that this could be used to either launder proceeds of crime or to fund overseas terrorism though Palau has never identified an instance of TBML and considers it of low concern.

74. Authorities consider Palau as a low risk jurisdiction for ML/TF from crimes committed outside of Palau based on the size of its economy and financial sector and the fact it is not an offshore financial centre within the Region. This conclusion appears reasonable.

75. While outreach to larger FIs was undertaken by the FIU, it was not apparent to the assessment team what input the three international banks, two domestic banks and two larger remittance companies had into the NRA. Palau indicated that the NRA consultation process included DNFBPs (real estate agents and money remittance service providers) through consultation with the Chamber of Commerce, however, it is still unclear how the private sector's views informed the NRA.

76. Palau's assessment of TF risk as low appears appropriate when considering regional assessments undertaken and the nature and context within Palau. Palau has had no reported incidences of terrorism or TF. In 2015, Palau's risk for TF was assessed by the U.S. State Department as low, recognising that Palau is not a regional or offshore financial centre and was a low-risk jurisdiction for organized crime and TF (US Department of State Jurisdiction of Concern Assessment, 2015). Notwithstanding this low risk, it was not always clear that all authorities fully understood what TF is and how it may occur in Palau.

#### *National policies to address identified ML/TF risks*

77. There is no documented AML/CFT strategy or policy informed by risks, to address ML/TF risks in Palau. While not formally drafted, Palau through the MLWG has an undocumented national strategy based on and informed by risk which is based on an ongoing consultative process amongst this leadership group.

78. The NRA sets out five areas of urgent concern in Palau's AML/CFT environment which need to be addressed, which the assessment team supports. These include – (1) cash-based economy; (2) improved insight into beneficial ownership of foreign owned legal persons; (3)

investigative capacity of LEAs; (4) improving capacity and capability of financial technologies; and (5) lack of transparency in the real estate sector and purchases of large business interests.

79. In practice, to date Palau has primarily focused on the investigation and prosecution of major predicate offences (particularly drug related crimes, which is the highest risk predicate offence in Palau) whilst limited expertise and resourcing in investigating and prosecuting financial crime and ML is impacting on ML investigations.

80. While there is no documented AML/CFT strategy informed by risk, the creation of the NEA and the FCIU was an implicit policy response to high risk crimes namely drug trafficking and the improved coordination of predicate and ML investigations for the latter.

81. Palau has no anti-corruption policy or strategy. However, it does have a focus on achieving integrity and transparency in government through the Office of the Public Auditor and Code of Ethics Act. Any suspected cases of fraud, violations of laws, or other irregularities uncovered during an audit are reported to OAG or OSP for further investigation.

### *Exemptions, enhanced and simplified measures*

82. Palau is yet to fully adopt a risk-based approach for exemption from AML/CFT requirements and the application of enhanced or simplified preventative measures has occurred to a limited extent based on ML/TF risk and the FI regulations that include such measures were only enacted during the onsite visit.

83. Accountants are considered very low risk by Palau and provide low level book-keeping services, and are employees of a range of businesses in Palau, as opposed to preparing for and carrying out transactions for clients as per the FATF standards, which is in line with the assessments teams findings. Accountants have been exempted from AML/CFT obligations in Palau based on very low risk and materiality. Palau only has one accounting firm which only undertakes national and state government auditing services. While there are four other accounting firms and a number of individual accountants who are registered to operate in Palau, none are professionally active and nearly all are resident overseas. Palau's exemption of them, based on the current context, from AML/CFT obligations appears reasonable in the circumstances.

84. Palau does not have any dealers in precious metals and jewels. A few shops catering to tourists have limited low value jewellery and trinkets. Palau is not a recognised destination for the purchase of such products. Palau has assessed the risk of ML/TF for these shops as very low. While dealers in precious metals are included in the definition of DNFBP in the law, Palau has not extended detailed CDD obligations to them. Due to low risk and context, Palau does not intend to apply AML/CFT obligations to them which appear reasonable in the circumstances.

85. The two real estate agents active on the island are involved in both small value transactions and in the purchase and sale of long-term real estate leases. The absence of regulation and comprehensive AML/CFT obligations for this sector is not in keeping with any risk-based exemption.

86. Palau does not have a CT or CFT strategy, although the team notes that Palau assesses itself as low risk for both which, as noted above, the assessment team agrees is reasonable. Nonetheless, an appropriate strategy should be developed given the potentially severe consequences of any terrorism or TF-related activity for any country.

*Objectives and activities of competent authorities*

87. Palau has initiated a Risk Based Approach (RBA) to allocate resources and implement some measures to prevent or mitigate ML/TF on the basis of assessed risk, with measures undertaken prior to undertaking the NRA and further measures yet to be considered based on finalisation of the risk assessment. Palau lacks a formal national AML/CFT policy and consistent agency level objectives. The measures undertaken by competent authorities to address some of Palau's ML/TF risks include:

- *NEA* – The creation of the NEA in March 2017 and the efforts in investigating drug related crime and confiscations associated with this crime is a significant measure to address Palau's highest ranked risk for ML.
- *FCIU* – The FIU has established the FCIU as a coordination mechanism (task force) between AML/CFT competent authorities, to enhance investigative capabilities and the coordination between different agencies to investigate SMR initiated crimes. As the FCIU has only been created within the last 12–18 months, the efficacy of this body is yet to be fully realised, though it is an excellent initiative within the risk and context in Palau. The types of predicate offenses appear to be understood by FCIU members, and the risks inherent in dealing with the targeted individuals or corporations, are under FCIU's review. The FCIU deals with ML risk on a case-by-case approach in consideration of the appropriate allocation of resources required. This targeting approach is appropriate for a small jurisdiction like Palau.
- *Human Trafficking Task Force* – In October 2017 a Ministry of Justice led Special Presidential Human Trafficking Task Force was established to address this high risk predicate offence and to assist Palau in reaching Tier 1 status as determined by the US Department of State Trafficking in Persons report. The task force was tasked to prepare an action plan to determine how Palau can reach Tier 1 status which will require mechanisms to address alleged failure to secure convictions, issuance of light penalties and the development of a national action plan to combat human trafficking in general.

*National coordination and cooperation*

88. There is, in practice, a sound level of cooperation between the FIU, the NEA, the FIC and Bureau of Customs Protection and Taxation, through both the MLWG and over the last 12-18 months, through the FCIU. The MLWG is tasked with coordinating Palau's efforts to counter ML and TF. One of its key tasks is to take the lead in undertaking an annual NRA. The MLWG meets monthly (though prior to the last 12 months it was quarterly or less regularly) and is represented by key agencies including the FIU, AOG, law enforcement, FIC among others.

89. While the anti-terrorism coordinator is a member of the MLWG, and the MLWG is tasked to take the lead in coordinating anti-terrorism and CFT activities, it was less clear if the MLWG had a complete understanding of TF to coordinate any measures to address TF. Furthermore, Palau has no established policies, procedures or mechanisms for handling and identifying TF offences and the implementation of targeted financial sanctions relating to terrorism and terrorism financing is very limited.

90. Coordination on PF is absent. Palau has not established procedures or mechanisms for handling and identifying TF offences and the implementation of targeted financial sanctions relating to terrorism and TF.

*Private sector's awareness of risks*

2

91. Palau did not demonstrate that either the FIU, FIC or other authorities had taken steps to ensure that respective FIs and DNFBPS are aware of relevant results of the NRA or other assessments. It is not clear that the private sector was closely involved in the work to prepare the NRA. The results of the NRA were not shared with the private sector and no information was provided about awareness raising activities related to the risks being shared with the private sector. Despite this, international banks have a generally reasonable understanding of risks, which results from a broader view of ML/TF risks in the Pacific.

*Overall conclusions on Immediate Outcome 1*

92. Palau has taken positive steps towards implementing strategies to identify emerging ML/TF risks through the MLWG, the creation of the FCIU in recent months, completing its first NRA, and improved collaboration amongst the LEAs. Further assessments of risk are required related to real estate, corruption, legal persons and NPOs. While major improvements are needed with private sector engagement around risk and understanding of Palau specific risks, recognising the major role that international banks and money service providers play in Palau and recognising that these REs have a reasonable understanding of regional ML/TF risks,

93. **Palau has a moderate level of effectiveness for Immediate Outcome 1.**

## CHAPTER 3. LEGAL SYSTEM AND OPERATIONAL ISSUES

### *Key Findings and Recommended Actions*

#### **Key Findings**

##### *Immediate Outcome 6*

- Despite some recent improvements through the creation of the FCIU regarding the use of financial intelligence to investigate ML or predicate offences, major improvements are still required.
- To some extent, the FIU provides decent quality financial intelligence and other relevant information to law enforcement agencies and prosecutors to combat ML and predicate offences.
- LEAs in general have limited understanding of the benefits and use of financial intelligence, and lack resources and capacity to act on it.
- While the number of reports disseminated by the FIU appears appropriate when considering the context of Palau, disseminations do not align with identified high and moderate risks.
- LEAs in general have not made effective use of information provided by the FIU, though steps have been undertaken over the past 12-18 months through the formation of the FCIU to improve this.
- LEAs do not undertake a proactive approach to carrying out parallel financial investigations on the predicate and related ML offences, including the use of financial intelligence. LEAs also do not develop their own financial intelligence and rely predominantly on FIU generated intelligence.
- The quality, quantity and scope of STRs reported to the FIU by foreign banks has improved in recent years, however STRs are not received from some significant REs which limits the data available to the FIU for analysis.
- The illicit funds associated with Palau's higher risk crimes - drugs and prostitution – are rarely funnelled through Palau's formal financial sector which suggests the current level of STR filing by non-financial institutions is not commensurate with the ML/TF risks identified by Palau.
- The FIU undertakes operational intelligence but, as yet, has not undertaken strategic analysis.
- No typologies, trend analyses or other reports have been developed and shared with the private sector, and none was shared to support the risk assessment process.

##### *Immediate Outcome 7*

- ML investigations have not historically been pursued as a policy priority in Palau until the formation of the FCIU in late 2016.
- Palau has had five successful ML prosecutions since 2011, however these convictions do not align with Palau's higher risk predicate offences and have not resulted in the application of proportionate and dissuasive sanctions.
- ML investigations undertaken are not consistent with Palau's threats and risk profile as few ML investigations have related to the two highest risk predicate offences (drug trafficking,

and human trafficking and sexual exploitation), recognising the level of criminality in Palau is not very high.

- The predicate offences prosecuted include theft, smuggling, tax evasion and corruption.
- LEAs and prosecution authorities are applying their limited resources to undertake ML investigations and prosecutions, pre-dominantly in self-laundering matters (which is the vast majority of ML cases in Palau).
- Financial/ML aspects in investigating predicate offences is still at its early stages in Palau, though formation of the NEA and FCIU will greatly enhance this.
- Most sentences for ML involve suspended sentences and fines, and in many cases do not appear proportionate and dissuasive, despite there being satisfactory maximum sanctions available for both natural and legal persons.
- Joint investigations with foreign jurisdictions, aside from the US, has been limited and challenging.

#### *Immediate Outcome 8*

- Whilst profit driven crime in Palau is generally low, the fact that confiscation of proceeds of crime is not seen as a priority for authorities leads to reduced outcomes when the opportunity arises in criminal cases.
- Other than drug trafficking, there are very limited confiscations from other higher-risk predicate offences including human trafficking and sexual exploitation. The NEA has effectively confiscated vehicles and money only.
- Palau has not received any requests from foreign jurisdictions for the seizure and confiscation of proceeds of crime besides the US.
- Palau has not undertaken analysis to determine the extent of proceeds of crime entering Palau.
- Palau does not appear to have pursued funds that have moved offshore from domestic predicate offences through informal or formal channels.
- Palau has improved the declaration system for incoming and outgoing cross-border transportation of currency and bearer negotiable instruments through translating the declaration forms into languages used by the majority of tourists which has resulted in improved reporting and declarations.
- Twenty-three cases between 2013 and 2017 involving either undeclared tobacco/cigarettes or undeclared currency reporting at the airport has occurred, with duty and fines imposed for the tobacco/cigarettes and fines imposed for the undeclared currency.

#### **Recommended Actions**

##### *Immediate Outcome 6*

- The FIU should use the NRA as a basis to enhance increased outreach and education and to improve the quality and quantity of STR reporting.
- The FIU should engage more formally with all REs through regular feedback, update briefings and increased risk-based on-site supervision (by both FIU and FIC) to further improve the level and quality of STRs and reporting in general.
- The FIU should further increase spontaneous information sharing with: (i) domestic counterparts e.g., police and customs, to facilitate the spontaneous dissemination of

financial intelligence to LEAs, and (ii) with foreign counterparts, with priority to higher risk jurisdictions in the Palauan context to facilitate international intelligence exchange.

- LEAs need to increase effective and appropriate use of financial intelligence in undertaking investigations of both ML and related predicate offences.
- The LEAs should provide the FIU with feedback on reports disseminated by the FIU, to improve the performance of both the FIU, LEAs and other key government agencies.
- The FIU should undertake strategic analysis to further enhance the value of disseminated reports to LEAs and prosecutors, both directly and through the FCIU.

#### *Immediate Outcome 7*

- Palau should prioritise ML investigations, particularly for major proceeds-generating offences, and strengthen the institutional frameworks required to support effective systems that address Palau's ML risk profile.
- Palau should develop internal policies, procedures and mechanisms for all LEAs and the prosecutorial agencies (OAG and OSP) for more effective resource allocation to support financial investigations and prosecutions.
- LEAs should commence ML/parallel financial investigations prior to the laying of criminal charges, for the predicate offences with the prosecutor being more involved in providing direction in ML investigations.
- The FCIU should coordinate all ML investigations not only investigations generated by STRs as per the FCIU terms of reference. This would also include prioritising matters to be investigated against Palau's risks and allocating resources across the LEAs.
- Penalties and sentences meted out by the courts need to be more dissuasive and proportionate and to act as a true deterrent.
- Palau should provide ongoing training to LEA staff, prosecutors and judiciary to enhance understanding of ML investigations, prosecution issues and operational functions.
- Recruit a forensic accountant, possibly as a shared resource between different agencies (including the NEA and the FIU), to provide expertise to undertake and support financial investigations.

#### *Immediate Outcome 8*

- Adopt a clear policy and operational commitment to prioritise confiscation, and strengthen institutional frameworks required to support effective systems that support increased confiscation in accordance with Palau's ML/TF risk profile.
- LEAs should more proactively pursue confiscation and make greater use of the full range of seizure and confiscation powers available to them to pursue proceeds of crime that are not directly linked to offences being prosecuted.
- Provide targeted proceeds of crime confiscation training to LEA staff and prosecutors to enhance understanding of AML/CFT issues and awareness of Palau's system generally.
- Palau should increase LEAs technical skills to effectively confiscate direct and indirect proceeds of crime.
- Palau should increase the penalties imposed on persons carrying cash or bearer negotiable instruments into and out of Palau in order to become dissuasive.

- Palauan authorities should pursue proceeds of crime (and ML) investigations arising from cross-border declarations, where appropriate.

3

94. The relevant Immediate Outcomes considered and assessed in this chapter are IO6-8. The recommendations relevant for the assessment of effectiveness under this section are R.3, R4 & R29-32.

### *Immediate Outcome 6 (Financial intelligence ML/TF)*

95. Palau's FIU was created in 2003 and, as noted in the 2008 MER, previously had limited functionality. In July 2014, Palau adopted a new Criminal Code, which included a completely revised AMLA and, which created an autonomous stand-alone FIU and clearly articulated its role and powers to operate as an administrative FIU, AML/CFT regulator and AML/CFT supervisor of DNFBP sectors.

96. The FIU serves as the national central agency for receiving and collecting financial transaction information filed by reporting entities, conducting analysis, and disseminating information to the relevant LEAs. The FIU is staffed by a full time Director and a Senior Analyst. The FIU reports to the Board of the Financial Institutions Commission (FIC).

### *Use of financial intelligence and other information*

97. In 2016, Palau created the FCIU, a taskforce, which is mandated to meet on a monthly basis and includes a number of select investigators from various agencies in the government including the FIU, Bureau of Public Safety, the OAG, the Customs Office, Special Prosecutor's Office, NEA, Revenue and Taxation, and the Postal Inspector. The FCIU meets to review and assign STRs received from the FIU to one or more members of the investigative core and then formulates an investigative plan and reviews the progress of the assigned investigator(s). Establishment of the FCIU has created a practical mechanism for cooperation and coordination of activities to combat ML.

98. The use of financial intelligence in investigations related to predicate crimes is higher but still very limited. LEAs focus on proceeds-generating predicate offence investigations. Until the recent formation of the FCIU, Palauan investigative authorities had very limited access to, and made little use of financial intelligence, received from the FIU or obtained directly by LEAs in the course of their investigations. LEAs have generally not requested financial intelligence to support either predicate crime or ML investigations. While the FCIU makes use of financial intelligence disseminated by the FIU, FIU intelligence is still being used by LEAs on a limited basis (though it is increasing) due to variable understanding of its use, limited skills or knowledge in how to use financial intelligence and the benefits of financial intelligence to LEAs. LEAs do not appear able to develop their own financial intelligence at this stage to further support investigations. Considering the limited activity in investigating ML in particular (5 ML investigations in total), financial intelligence is only being used on occasion in ML investigations or to develop evidence and trace proceeds related to ML.

99. The FIU has disseminated a number of reports to the FCIU for consideration. These reports, which appeared to include relevant detail and operational analysis, had links to ongoing investigations. While it is too early to fully assess how financial intelligence from the FIU has assisted in these ongoing investigations and prosecutions, members of the FCIU confirmed that the disseminated reports were of good quality and the creation of the FCIU was recognised as a pragmatic and effective forum to improve the investigation and prosecution of STR driven ML



investigations. As of October 2017, the OSP had initiated one criminal action pursuant to information originally disseminated by the FIU to the FCIU (the charging document was provided at the onsite visit as a reference as litigation was ongoing at that time, with a conviction achieved in March 2018 which is after the onsite visit). Most of the reports disseminated in 2016 and 2017 (See Table 5) relate to drug trafficking and prostitution (both high risk in Palau), with one report related to a foreign investment in two new hotels. None of the five ML convictions in Palau relate to either of these high risks.

**Table 5: Intelligence/Information reports 2013 – 2017**

<b>Intelligence/Information report type</b>	<b>2013 - 15</b>	<b>2016</b>	<b>2017</b>
Case Dissemination Reports (case reports on STRs and CTRs received)	2	3	7

100. The FIU has disseminated a number of reports to LEAs, both directly and through the FCIU, with significant improvements made over the 18-months since the formation of the FCIU. The reports disseminated appear to be mainly initiated by STRs and supported by CTRs (see Table 5), with ten disseminations over the last two years, with two in the preceding three years. The disseminated reports in 2016/17 relate to the following - Possession or Trafficking Methamphetamine (5 disseminations); Human Trafficking (3) and tax evasion (2). One of the key benefits of the FCIU is the opportunity for the different task force members to contribute further information to the reports disseminated by the FIU. This may include border currency reports, immigration data, information from the FIB or revenue, customs and taxation information. Initial indications suggest that the FCIU will become an effective forum for collaboration and provide opportunity for enhancing joint investigations by including information from a number of agencies to enhance investigations.

101. When an STR is received and requires immediate action, the Director of the FIU can spontaneously disseminate to any LEA that may have expertise to investigate the particular suspicious activity. For example there have been several instances where the director immediately disseminated an STR to the NEA because of the suspicion of the laundering of proceeds of drug trafficking.

102. The FIU does not keep records of the number of inquiries received from LEAs but it does respond to LEA inquiries regularly and in a timely manner. No statistics were provided to indicate how often these inquiries are received, what these inquiries relate to and what the quality of the responses were.

103. There have been no disseminations of TF-related intelligence in Palau, which is consistent with the low risk of TF.

### *Receipt of financial intelligence*

104. The FIU collects STRs and CTRs, which to date have only been submitted by two of the US-owned banks, with one of the US banks having not submitted an STR in the last three years. The submission of STRs by the US-owned banks has increased the use of financial intelligence in related investigations. Local banks have submitted one STR and DNFBPs have submitted no STRs or Cash Transaction Reports (CTRs) over the last five years, though it is recognized that the local banks and DNFBP sectors are very small in size.

105. While the two banks that have submitted STRs over the last two years are the largest in Palau, the remaining FIs and DNFBPs (which includes the third US owned bank) account for approximately 20% of financial activity which suggests under-reporting from these REs. The FIU acknowledged that while FIs and some DNFBPs know how to report STRs to the FIU, there are deficiencies in the identification of suspicious transactions and identifying proceeds of crime. Enhanced awareness and guidance is necessary to ensure all REs, regardless of size or complexity, are aware of STR obligations, including what may be considered suspicious, particularly in line with Palau's risks.

106. There has been a slight increase in the number of STRs submitted over the last two years, due to increased engagement with the largest banks by the FIU, including clarifications regarding the identification of suspicious transactions and identifying proceeds of crime in the context of Palau (see table 6). The quality of STRs has improved markedly based on feedback provided to the banks by the FIU. While some of the STR reporting is considered defensive in nature, in the main STRs are starting to provide solid intelligence which has significantly assisted the FIU in developing improved dissemination reports.

**Table 6: Reports Received by the FIU**

<b>Transaction/Report Type</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>Total</b>
STR	97	104	103	148
CTR	966	3251	3307	7524
Border currency report (BCR)	23	40	30	93

107. While the FIU is slowly inputting historical STRs (2014 and prior) into its new database, these STRs can be accessed if required as hard copies. While the lack of easy access to STRs from 2014 and before may be construed as an issue, the FIU is able to quickly reference these records and to include STRs from 2014 and earlier if they are relevant and require consideration. The FIU also indicated that it has received STRs from REs since the creation of the Palau FIU in 2003, though it is unclear what percentage of these were disseminated to law enforcement (if any) or resulted in convictions.

108. The FIU has received 7524 CTRs and 93 BCRs in the period 2015 to 2017. The CTRs, which have been submitted by all three international banks, have supported the analysis of STRs by the FIU and have enhanced the disseminated reports. CTR statistics before 2015 were not provided.

109. The FIU has access to cross-border declarations and information on non-declarations from Koror International Airport Customs only. The FIU also has direct access to revenue and taxation records, immigration and customs records and databases on cash carrier declaration forms for the purpose of obtaining further intelligence on STRs. Other government agencies do not have direct access to the FIU database.

110. Palau has had no inquiries from any foreign jurisdiction related to any STR for which the sharing of financial information was required. Furthermore, Palau has not had the occasion in which it needed to seek foreign financial information related to a STR, though it has sought international assistance on occasion (see Immediate Outcome 2).

111. While the FIU is not receiving STRs from all sectors and the quality of reporting could improve, the risks and context of Palau suggests that reporting volumes are reasonable though the illicit funds associated with Palau's higher risk crimes - drugs and human

trafficking/prostitution – are rarely funnelled through Palau’s formal financial sector (see IO. 4) which suggests the current level of STR filing is not commensurate with the ML/TF risks identified by Palau.

112. While the FIU feedback to at least two of the US owned banks has improved the quality of STRs, it is not clear whether the FIU provides more general feedback to either the broader private sector or law enforcement (though formation of the FCIU should increase two-way feedback among government agencies) and it also does not develop formal typologies relevant to Palau and does not share related information on these typologies with either law enforcement or the private sector. While the size of Palau may preclude the development of detailed typologies, regional information and local trends can be shared where specific typologies have not been developed.

113. It also appeared as if feedback back to the FIU from FIs and LEAs was not structured or regular. The small population and limited context within Palau has resulted in informal feedback loops, which appear to be effectively utilised, though recollection of informal engagement was very limited by the private sector during the onsite visit. No statistics are kept on informal discussions, and the lack of an element of formality does impact on the effectiveness of this information exchange as it is dependent on individual relationships and it does not factor in how this information is shared beyond these relationships.

114. The banking sector (foreign banks) send CTR reports electronically to the FIU. The private sector representatives met by the assessment team gave positive feedback on informal interactions with the FIU regarding reports and reporting. While some recalled informal engagement with the FIU, the recall of the substance of this engagement was very limited, though it is recognised a number of the banks had management changes in the months leading up to the onsite visit.

#### *FIU analysis*

115. The FIU analyses suspicious transactions and other financial transaction information in order to develop intelligence. The results of the analysis of the different types of reports received are disseminated to relevant LEAs in the form of case dissemination reports. Case dissemination reports provide financial intelligence to assist the operational needs of LEAs to investigate predicate and ML offences.

116. With only two staff (the Director and a senior analyst), and a range of AML/CFT responsibilities (FIU and supervisory), the FIU may not have the resourcing to strategically analyse STRs, though the FIU believes it is well resourced to discharge all its responsibilities. It is recognized however that the rate of disseminations has increased in the last three years, and particularly over the last 18-months since the formation of the FCIU, reflecting a significant change in how the FIU operates and the value that the FIU provides LEAs in investigating financial crime including ML.

117. A high priority for the FIU was the development of a database. The database was developed by a U.S. University and launched in August 2015 and has continued to be developed and supported by the developers.

118. The FIU inputs financial transaction reports into the FIU-database which has a single server that is located within the FIU. Only the FIU staff have access to this database. The database generates reports on a monthly basis to review trends based on the data. The database

can visually chart suspicious activity to support and enhance reports disseminated to law enforcement and prosecutors.

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**Case example 1: Role of financial intelligence (relates to case 4)**

This case involved a STR generated by a bank which was submitted to the FIU after receiving four transactions of just under USD10,000 each. The FIU disseminated a report based on the STR and CTRs to the FCIU which resulted in the OSP being designated the lead agency. The investigation resulted in the discovery of drug importation into Palau, Upon collecting this information, along with various other investigative avenues to substantiate the lack of a legitimate source of income, the OSP filed criminal charges in August 2017, with a conviction achieved in March 2018 for ML and drug trafficking (which is after the completion of the onsite visit).

*ROP v. Wilhelm Aichi*, March 2018

119. A significant part of the FIU's analysis work relates to STRs and CTRs. The FIU has very broad powers under the AMLA to obtain additional information from private and public sector entities. The FIU can obtain additional information related to any reported financial transaction or information filed by any FI, can make inquiries with or obtain from any FI any additional information the FIU requires to carry out its functions, and can enter the premises of any FI or DNFBP to inspect any financial records. The FIU has accessed data from a number of government agencies including the Bureau of Customs & Border Protection, Bureau of Revenue and Taxation, FIB and Bureau of Immigration and Labour.

120. Requests for information from other agency databases have a five working day response time with the option to extend based on justifiable means, though to date all responses have been within 5 days, which is appropriate in the context of Palau. This request is usually done through a letter requesting particular information and citing the legislative authority (Title 17 PNCA subsection 3334(3)) to access and obtain such information. For FIs, a request can be done by calling the bank manager, with a formal request following within 24 hours of the request being made. In instances where the FIU needs the information immediately banks have complied. Around 10% of STRs require follow up with the banks.

121. The FIU indicates that it has on many occasions communicated with LEAs regarding potential suspects and provided LEAs with intelligence contained in the FIU database, though it is unclear how the LEAs have managed this information. No other government agency besides the FIU has direct access to the FIU database. LEAs cannot request that the FIU search bank records due to its broad authority to do so because this could be construed as a violation of an individual's constitutional right against unreasonable search and seizure. LEAs can request the FIU to search its own database to advise on any relevant STRs or CTRs.

122. The FIU has limited direct access to a number of other agency databases (See Table 7). The access to the Immigration and Customs and Revenue and Taxation databases is limited to accessing specific reports rather than being able to undertake unlimited and broad searches of the databases. The FIU does not need to notify an agency where it has direct access to its database.

**Table 7: Access to government databases and information (November 2017)**

Database/Information Type	Agency access	Access for Intelligence Purposes
Immigration & Customs - Passport; citizenship, cash declarations & travel data	FIU LEA	Direct access to limited information
FIs threshold transactions (banks)	FIU	Electronic transmission (STRs, CTRs & EFTRs) from commercial banks
Revenue, taxation and customs	FIU	Direct access to limited information
Birth, death and marriage information/database	Clerk of the Courts	Obtained on request
Company Registry	OAG, FIC, FIU	Direct access at Registrar of Company office. No access via phone or e-mail
Foreign Investment Board (maintain hard copies)	On request – has been used by FIU and LEAs	Individuals and companies certification to do business in Palau.

123. The FIU undertakes operational analysis though no evidence of strategic analysis was evident. Some limited trend analysis was undertaken as part of the NRA but it does not appear that this is undertaken to enhance specific disseminated reports as evidenced by the reports briefly considered during the onsite visit. The FIU recognizes the need for strategic intelligence, though responses at the onsite and to previous drafts of the MER which referenced strategic planning and SWOT analyses suggest that further training is required to enhance this area of intelligence analysis. The FIU has acknowledged that the use of typologies and trends, both within Palau and regionally will further enhance the value of disseminated reports and will increase the focus on investigating ML by LEAs. In addition it is unclear how supervisory and regulatory information as well as open source information is being used to support the intelligence analysis.

#### *Dissemination of financial intelligence*

124. STRs are now disseminated to the FCIU as this is the mechanism for managing disseminated reports as opposed to previously bilaterally submitting the reports to only specific agencies. Bilateral disseminations can still be provided if circumstances require it. While the FCIU is still relatively new, early indications are that its creation is resulting in an increased use of financial intelligence to support ML investigations. The primary purpose of the FCIU is for representatives (predominantly investigators) from various government agencies to meet monthly, and while these meetings have not always been held, information and STRs are circulated outside of formal meetings if immediate action is required.

125. Since the formation of the FCIU, there has been increased cooperation and exchange of information, as well as sharing of expertise on how to commence a financial investigation.

126. Over the last two years, ten STRs have been disseminated to LEAs on predicate offences that are considered at high and medium risk in the NRA including five STRs related to drug

cases, three on human trafficking/prostitution, and two on possible tax evasion. Examples of the disseminated reports based on STRs and CTRs were briefly shared with the assessment team and the information appeared comprehensive, well-structured and based on solid operational intelligence including STR and CTR reports though the FIU believes that they can still improve the quality of reporting even more. The members of the FCIU including OSP and NEA found the quality of STRs to be very good and the recently disseminated reports have initiated investigations with one case in early 2018 achieving a significant conviction and sentence. The volume of reporting and the level of criminality suggests that the dissemination of ten reports over the last 2 years is considered reasonable by the assessment team.

127. The FIU does share information with the FIC supervisors though specific examples were not provided. Some information is shared within the MLWG though it is unclear to what extent the sharing of regulatory information between regulators is occurring in Palau.

128. In 2008, a Cooperative Agreement was signed between the following government agencies - OAG, Immigration, Public Safety, Customs, Revenue and Taxation, FIC, FIB and the labour department. This agreement enabled the exchange of information, the exchange of personnel and the undertaking of joint activities. Prior to the formation of the FCIU in 2016, it is unclear if the cooperative agreement resulted in improved information exchange and joint activities. In 2008 the FIU was under the auspices of the Attorney General and operated in coordination with the FIC Commissioner.

129. The FIU has MOUs with the Bureau of Customs and Border Protection, Bureau of Immigration and Labour, and Bureau of Revenue and Taxation (see Table 8). These MOUs allow for access to databases and exchange of information and have improved the quality of engagement between agencies. In one instance, the FIU was able to access the database of the Bureau of Immigration and Labor to identify an individual who was involved in a criminal act.

**Table 8: MOUs Palau FIU signed with Domestic LEAs**

MOUs Signed	Years Signed
Bureau of Customs and Protection	July, 2016
Ministry of Justice/Bureau of Immigration	August, 2016
Ministry of Finance/Bureau of Revenue and Taxation	August, 2016

130. The MOUs include confidentiality clauses relating to information and access the FIU provides (including STRs and CTRs) and information and access the relevant agency provides.

131. An example of the domestic cooperation, coordination and exchange of information efforts occurred when a skimming device was found in the luggage of a passenger arriving from Korea (See case 2). The MLWG actively coordinated efforts between the FIU, Bureau of Customs and the Belau Drug Enforcement Task Force and the engagement of the US Secret Service which provided technical assistance and training. While this case does not actually involve ML, the collaborative investigation, effective domestic cooperation (through the MLWG) and international cooperation meant that proceeds of crime were not generated, meaning no ML was possible. This was one of three card-skimming device cases that Palau had at this time.

**Case Example 2: Interagency cooperation in law enforcement investigations**

On 30 December 2016, a customs officer inspected the luggage of a passenger arriving from the Republic of Korea. Inside the lining of the luggage were electronic components consistent with ATM scanners along with flash drives and external drives. The items were seized by customs officers and the FIU was contacted and the investigation was assisted by the Bureau of Public Safety Criminal Investigation, the Belau Drug Enforcement Task Force, the US Secret Service, the FBI and the CNMI Authorities. The defendant pled guilty to criminal possession of a forgery device, a class C felony. The defendant received a sentence of 1 year suspended; served 20 days in jail, paid a USD2,000 fine, and was deported.

(ROP vs LIUPING WEI, 16-171)

**Overall conclusions on Immediate Outcome 6**

132. Over the 18-months, the FIU has disseminated ten reports based on STRs and CTRs to the FCIU, the multi-agency taskforce created in 2016 to investigate ML based on disseminated reports from the FIU, resulting in one investigation by the OSP based on these disseminations. This has increased the effective use of financial intelligence by LEAs, prosecutors and other members of the FCIU, which was previously very low. The majority of reports disseminated relate to the higher risk predicate offences of drug trafficking and sexual exploitation, though the convictions (see IO. 7) relate to lower level risks. While Palau recognises the need to expand the reporting base and increase the quality of reporting, the members of the FCIU have utilised the reports to investigate ML and predicate offences and this will further strengthen as the operations of the FCIU mature. Deficiencies still exist related to LEA understanding and use of financial intelligence, improved reporting of STRs by all REs not just the 2 largest banks, continuing to load pre-2015 reports into the database and improving the overall quality of reporting. In addition increased use of ML trends, typologies and regulatory/supervisory information to enhance intelligence warrants consideration. Based on a reasonable (and recently improving) level of use of financial intelligence by competent authorities,

133. **Palau has a moderate level of effectiveness for Immediate Outcome 6.**

**Immediate Outcome 7 (ML investigation and prosecution)**

134. The Criminal Investigation Division (CID) of the Bureau of Public Safety (BPS) is the primary investigative authority within the Ministry of Justice (See 2 PNC § 105 and § 109; Executive Order No. 381, subpart IV). Other offices, bureaus and divisions that have investigative powers as per Executive Order No. 381, subpart IV, include:

- Bureau of Immigration and Labor,
- Division of Drug Enforcement and
- Division of Marine Law Enforcement.

**ML identification and investigation**

135. Key agencies which have responsibility for investigating ML include:

- CID handles any investigation stemming from a BPS patrol response which requires further investigation prior to initiation of criminal proceedings. The CID does not have a dedicated financial crime team and has not investigated financial crime.
- The NEA leads most investigations involving any form of narcotics trafficking and distribution, and is given authority by the Minister of Justice to investigate matters of ML related to narcotics predicate offences.
- The OAG has broad investigative authority which includes investigation into matters involving ML, and its predicate offenses.
- The Office of the Special Prosecutor (Special Prosecutor’s Act – 2 PNC §§ 502-503) is an independent prosecution authority with broad investigative and prosecutorial authority which includes investigation into matters involving ML, and related predicate offences (in cooperation with OAG where required). The OSP actively pursues ML cases.
- The Foreign Investment Board (FIB) has limited investigative authority to ensure applications are accurate before granting a certificate. However the FIB does not investigate the accuracy of the information provided. The FIB can refer any suspicion to the CID, OAG or the OSP to follow-up however there was no evidence provided to the assessment team of any such referrals being made, though the FIU has responded to requests for further information regarding persons being regarded for a FIB certificate.
- The Office of the Public Auditor and the Ethics Commission can investigate instances of fraud involving public funds which include corruption and can refer matters to LEAs, OSP or OAG if required. The investigative authorities of these agencies are broad, and would not be precluded from ML-type investigations.
- The FIU provides support to ML investigations.
- The MLWG coordinates Palau’s overall response to counter ML and TF (Executive order 362). It is chaired by the Chairman of the Financial Institutions Commission and has a membership of agency heads from the OAG, FIC, FIU, BPS, Bureau of Immigration, Bureau of Labour and Human Resources, Division of Customs and the anti-terrorism coordinator.
- The FCIU is a task force, which meets monthly to allocate lead investigation agencies based on disseminated reports generated by SMRs, and it tracks progress through the life of the investigation. The FCIU comprises one designated investigator from most of the above agencies.

136. There have been five ML investigations resulting in prosecutions in Palau since 2008. Until the formation of the FCIU in 2016, ML investigations were not being pursued as a policy priority in Palau. There is no comprehensive, national AML/CFT policy informed by ML/TF risks, nor are there internal LEA directives or guidance on ML investigations. The lack of understanding of what constitutes ML across some LEAs and the relatively low level of domestic proceeds-generating crimes has resulted in limited ML investigations and prosecutions with a preference for predicate crime investigations and prosecutions which the investigating authorities are well versed in. The creation of the NEA and the formation of the FCIU has however recently increased the focus on high risk drug offences and on investigating ML.

137. ML investigations are resulting in limited prosecutions (see table 9).



**Table 9: ML, predicate offences, value and sentence imposed**

Year Investigation/charge	Offences and NRA Risk	Value	Conviction date	Sentence
2008	Grand larceny and ML (Rengiil) *	USD23mill	14 Dec 2011	30 years suspended and 7 years' probation
2013	Smuggling, tax evasion and ML (Maui) Tax – low risk		Feb 2013	USD312 000 fine and 10 years' probation/suspended sentence
2013	Smuggling and ML (Sajib)		7 Dec 2013	USD3000 fine and 5 years suspended
2015	Labour trafficking – high risk (Rahal & Kadel) **		17 Feb 2016	5 years on Probation, USD1,600 fine in relation to guilty plea
2016	Theft, Misconduct in public office, tampering with government records and ML (Lucio) Corruption – low risk	Approx. USD60 000	April 2017	1-year imprisonment, 10 years' probation concurrently (in effect 1-year imprisonment followed by 9 years' probation) and USD65 000 fine
2017	Criminal violation of the code of ethics Corruption – low risk		3 July 2017	1 year probation, USD10,800 fine; USD1,525 SP fee

\*This matter involved 7 defendants with the primary defendant fleeing to Australia.

\*\* Case did not include ML

138. There have been five ML prosecutions since 2011 noting the largest ML case in Palau history (Pacific Savings Bank) commenced in 2008, charges were laid in 2010 and a conviction was achieved in 2011.

139. One significant ML investigation involved cigarettes smuggling and a tax evasion matter (see case 3). The main local defendant pleaded guilty to tax evasion and ML offences and was sentenced to house arrest and ordered to pay USD312,000 in fines. Further investigative leads from this matter were pursued which identified the use of alternative money remittance (Hawala) however no further information was provided to the assessment team on whether a further ML investigation or prosecution were pursued.

#### **Case Example 3 – Cigarette smuggling, tax evasion and ML**

In February 2013, a Palau National pled guilty to smuggling, tax evasion and ML in a case involving customs and the FIU. This case involved over 16,000 cartons of cigarettes from the Philippines that were smuggled into Palau and concealed in boxes over a period of three years from 2009 through to July 2011. The investigation revealed that the importer had declared only furniture and no cigarettes. The assessment on the import tax would have been USD44,100. The importer later admitted that he did not declare the cigarettes and with the cooperation of the defendant, this investigation was expanded to determine if more individuals were involved in similar fraudulent activity. As a result, three foreign nationals were indicted; one defendant had

an arrest warrant pending and the other two defendants were arrested and since had pled guilty to tax evasion.

The principal defendant, a local, pled guilty to tax evasion and ML and was sentenced to house arrest and was ordered to pay USD312,000 in fines and was given 10 years' probation.

*Maui v RoP, 12-101*

140. The FCIU was operational for over a year before it was formally endorsed by Executive Order in November 2017. The FCIU has met on a number of occasions, but not monthly, since its formation in late 2016 and 8 STRs had been tabled by the time of the on-site visit. Prior to the formation of the FCIU, disseminations were made directly to either LEAs (CID and Drug Task Force) or the prosecutorial agencies (OAG and OSP).

141. The OSP initiated one criminal action pursuant to information originally disseminated by the FIU to the FCIU with the case finalised in March 2018, which was some months after the onsite visit (see case 4).

#### Case Example 4: Role of FCIU in ML investigations

This was a currently-pending criminal case at the time of the onsite visit, where the lead defendant and his eight other accomplices were charged with drug trafficking, possession, sexual exploitation of a minor and ML (structuring). The investigation began with a SMR being generated by a banking institution located in Palau and being forwarded to the FIU. The lead defendant had, on four different occasions, deposited cash in amounts totalling just under USD10,000.00. The STR noted that the Palauan national had used the debit card function to frequently make cash withdrawals at ATMs in the Philippines.

The FIU disseminated a report (based on the SMR and CTRs) to the FCIU. The OSP took the lead on this case. The OSP, successfully, requested the Court to issue an order finding probable cause and this included intelligence provided to the OSP from the NEA which indicated that the case involved the attempted importation of methamphetamine from the Philippines to Palau via airline freight. This allowed the issuance of subpoenas by the OSP to produce documentary evidence including business records from the banking institution and from the airlines which the Palauan national had used to travel to the Philippines. Upon further collaboration with other law enforcement agencies at the FCIU, including the NEA and Palau's Postal Inspector, it was learned that the Palauan national had previously been suspected of using a commercial wire transfer service to send further financial transactions to the Philippines in an earlier investigation.

Upon collecting this information, along with various other investigative avenues to substantiate the lack of legitimate source of income, the OSP filed criminal charges, which were issued by the Court in August 2017. These charges were: one count of money laundering; four counts of structuring; one count of criminal conspiracy to commit methamphetamine trafficking and one count of theft of government property in the first degree.

**Note:** Case was finalised after the onsite visit. A conviction for ML and structuring was achieved in March 2018 after the defendants plead guilty. The defendant received 15 years' incarceration for the criminal conspiracy and the criminal conspiracy to commit methamphetamine trafficking and 5 years (consecutive) for the structuring charge (ML).

*ROP v. Wilhelm Aichi, March 2018*

142. The OSP has pursued ML offences in a fraud case involving misappropriation of USD 60,000 from departure taxes (see Case Example 5).

**Case Example 5: Corrupt Customs agent - self laundering conviction**

In April 2017 a former customs agent plead guilty to embezzlement of over USD60,000 of departure tax fees from departing passengers at Palau International Airport during a period of three years ending in 2015. The defendant altered official customs records and destroyed receipts in order to give the appearance that some of the non-Palauan departing air passengers were actually Palauan nationals reducing the amount of tax collected from USD 50 to USD 10, pocketing the USD 40 difference in each case. The Bureau of Customs and Border Protection and the OSP commenced an investigation into these activities. The investigation also included fund tracing analysis together with an examination of the custom agent's lifestyle, including testimonial evidence of excessive spending on food and alcohol and the purchase of three motor vehicles. The defendant was sentenced to one year imprisonment for ML, two counts of theft of government property (10 years' probation for each count and one year imprisonment), use of a computer in the commission of a separate crime (same sentence as for theft of property), misconduct in public office (10 years' probation including one year imprisonment) and seven counts of tampering with a government record (one year imprisonment for each count). In addition the Court ordered the defendant to pay a total of USD65,000 in fines to the Republic of Palau.

*Lucio v RoP, Case 16-167 2017*

143. The third matter related to a potential ML investigation resulting in the OSP assisting Customs in providing a ML investigation plan on how to pursue further enquiries into individuals, foreign business associates and business entities. While the OSP has experienced financial investigators, LEAs have identified the need for more specialised skills such as a forensic accountant, to assist investigators in ML investigations.

*Consistency of ML investigations and prosecutions with threats and risk profile, and national AML policies*

144. Criminal investigations doubled from 1,240 in 2016 to 2,211 in 2017. Approximately 10% of these investigations were felonies<sup>8</sup> as opposed to misdemeanours. While overall Palau has a very low crime rate, ML investigations undertaken are partially consistent with Palau's threats and risk profile as the highest risk predicate offence (drug trafficking) has had a number of successful investigations, while human trafficking investigations have been less prevalent.

145. As noted previously, while Palau has no drafted AML/CFT national strategy or policy based on identified ML/TF risks or internal LEA priorities to pursue ML in line with Palau's ML risk, the creation of the NEA and the FCIU was an implicit policy response to high risk crimes particularly for the former (drug trafficking) and the improved coordination of predicate and ML investigations for the latter. While a reasonable number of ML investigations have been initiated over the past seven years, considering Palau's risk and context, the type of ML investigations are not fully commensurate with Palau's ML risk. There has been one ML prosecution related to Palau's second highest-risk predicate crime – trafficking in human beings and sexual exploitation since 2006 (see Table 9), while approximately six human trafficking prosecutions have been achieved during this period, suggesting an increased focus on ML

<sup>8</sup> The vast majority of Felony cases are assault related offenses with no ML.

investigations is required (noting the size and context of Palau which suggests that ML may be limited in some cases).

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146. It does appear that Palau is (appropriately) investigating drug trafficking as the highest risk predicate offence. The ML cases undertaken, have predominantly focused on crimes rated as low risk for ML in the NRA: tax evasion (tax crime is a low ML risk in NRA), theft (low risk for ML in NRA) and misconduct in public office and violation of code of ethics (corruption/bribery has a low risk of ML in NRA). While a reasonable number of ML investigations have been initiated over the past seven years, considering Palau's risk and context, the predicate offences that have been covered in these investigations are not fully commensurate with Palau's ML risk, taking into account the low ML risk of most of these predicate offences investigated based on the NRA. The creation of the NEA in March 2017 transferred the responsibilities of the Division of Drug Enforcement and the Drug Task Force into the new agency to provide a focus for the highest risk offence (with human trafficking) in Palau.

147. Three high risk typologies (vulnerabilities) for ML that are of concern to authorities are misuse of shell companies (registering Palau companies with foreign-based directors and shareholders in order to open bank accounts to facilitate movement of money by unverified beneficiaries), co-mingling (one case has been identified which has not been pursued – see below) and use of professional services (utilizing lawyers and front businesses to establish seemingly legitimate business activities). Besides one case which involved co-mingling, no investigations have as yet been undertaken related to the other two high risk typologies noting that no evidence has presented itself as yet to warrant an investigation.

148. LEAs advised that there had been some reluctance by prosecutors to pursue related ML charges, though the OSP has taken on a number of ML cases more recently. OAG's resource issues as well as the requirements for a speedy trial appear to place restrictions on pursuing ML offenses on drug related cases. This is evidenced by no ML prosecutions being undertaken by the OAG in the two years since the formation of the National Drug Trafficking Taskforce in 2015.

149. Palau has a statute of limitations where, as a Class A felony, a prosecutor may bring the charge of ML six years after the final laundering transaction. Separately, the speedy trial act generally requires that, after being initially arraigned on charges, a defendant has a right to be tried within 70 days of that initial charging, which has limited the opportunities for investigations which occur after charging such as receiving court-ordered subpoenas. However, the OSP has made use of a variety of exceptions to this time limit to ensure that cases proceed with due availability to engage in further investigation, where necessary, and to ensure effective trial procedural preparation.

150. The OAG referred a ML investigation in a related human trafficking prosecution back to the Police Patrol unit (being the unit which arrested the offenders) prior to the onsite visit, recognizing that the Patrol unit may not have sufficient skills or the resources to undertake a ML investigation. While the case may not have related to a STR (which would have facilitated FCIU involvement), this highlights issues related to the investigation of high risk activities and the limited resources and expertise to lead such investigations. Since the on-site visit, the assessment team has been advised that the OAG is ensuring a proper investigation is conducted prior to criminal charges being laid.

151. In relation to the other crime type that has a high to medium risk, such as human trafficking, the OAG have pleaded down the initial serious charges to lesser charges. LEAs also advised of some cases where high-risk crimes particularly related to human trafficking and sexual exploitation have not been pursued or have been suspended due to underlying

corruption/bribery elements; although these allegations were subsequently refuted even though they were clearly noted during the onsite visit. As noted in IO. 1, this would tend to suggest that the low corruption/bribery ML risk rating in the NRA should be revisited.

152. At the time of the onsite visit, the OSP investigated a drug related criminal prosecution that identified a ML methodology of co-mingling cash with a business' operation. This investigation was however ultimately not pursued as the target had been prosecuted for the underlying drug crimes by the OAG and evidence had been suppressed by the Judiciary, finding that it was obtained in violation of the defendant's rights against search and seizure. Based on this, the OSP decided it was unable to pursue the ML case.

153. Cash couriers have been rated as a medium risk typology for ML. There have been number of instances of undeclared cash coming into Palau via foreign nationals at the airports over the past few years. When questioned after finding reportable cash in their luggage, passengers often claimed they did not speak English and did not understand the customs form. To manage this issue and mitigate the risk, the customs forms have been translated into Chinese, Japanese and Korean, which aligns with where the majority of tourists come from.

154. Influx of cash coming in through the border continues and while customs officials do not believe the purpose of bringing in large cash amounts relates to tourism-related costs, particularly when taking into account the short duration of some visits, the FIU suggests that this may be speculation as no evidence suggests that these cash amounts are for anything but to fund tourists activities. Of particular interest is when suspicious cash coming into Palau is for investment purposes. One instance involved a person of interest, who was aware of declaration requirements, distributing cash among fellow passengers on the plane to circumvent the reporting requirements. These funds were confiscated and the individual was deported though has since returned to Palau and is under regular monitoring (see Case 9).

155. Over the last two years, improved coordination of intelligence between Customs, NEA, CID, FIU and prosecutorial agencies has begun to occur. There have been instances of undeclared bulk cash coming into Palau via foreign nationals over the past few years and it is uncertain to what extent these relate to ML, though the FIU indicated that it continues to monitor undeclared/declared cash courier reports and screens with other intelligence where appropriate. The focus has been on uncustomed goods (tobacco etc.) and cash entering Palau. While there have been some breaches detected at Koror International Airport for non-declaration of cash, the LEA often does not proactively conduct subsequent financial investigations on the offenders despite customs suspecting it may be more than just tourists (see IO. 8). Palau has not detected any ML arising from currency that was either declared or not declared at the border and LEAs and customs could do more to proactively investigate declarations of substantial sums of currency for suspicions of ML.

#### *Types of ML cases pursued*

156. Apart from the structuring case as highlighted in case example 3, ML charges have been added to the predicate offence charges as indicated in Table 9. No instances of third party or stand-alone ML have occurred, which in light of the context of Palau is not unreasonable, though larger value ML may occur in higher value areas such as real estate. The NRA does not consider this issue so it is difficult to be definitive of how consistent this is with Palau's risk or threat profile, though it was highlighted by a number of agencies in Palau as an issue of concern, given the increase in foreign investment into Palau in building resorts and hotels which opens an avenue for the operators of these establishments to use the business accounts to launder

monies (stand-alone ML) – and the risk increases in a cash based economy like Palau. The assessment team believes that the focus on only self-laundering ML charges is due to Palau indicating that no other form of ML occurs in Palau. However, as noted under IO. 1, Palau has not fully assessed and understood the risks or prevalence of cases of third party or stand-alone ML occurring.

157. The OSP recently commenced a structuring case which included the co-mingling of the proceeds of crime with the legitimate proceeds from a local business, for the reasons stated above this investigation was not pursued. The ML aspect of the case was initially discovered by the FIU through STR and CTR analysis. Prosecutors will generally pursue predicate crimes and not ML and while this may be understandable given Palau’s size and context, it does not mitigate the risk of more systemic ML occurring.

#### *Effectiveness, proportionality and dissuasiveness of sanctions*

158. While there have been five convictions obtained for ML since 2006, only one conviction included the imposition of a custodial sentence (the Lucio case - Case 5). The defendant in this case pleaded guilty to one count of ML, a number of counts of embezzlement and related offences totalling over USD 60,000. In relation to the ML offence, the defendant was sentenced to one year and a fine of USD 65,000. In relation to the facts of this case and in light of the person pleading guilty, this is considered dissuasive and proportionate.

159. In two of the older ML convictions the courts handed down suspended sentences of 10 and 5 years as well as fines of USD312,000 and USD3,000 respectively. The plea bargaining process resulted in the custodial sentence being reduced to a fine, further reducing any deterrence effect. Many drug-related convictions also include fines, suspended sentences, probation and a limited custodial sentence. Noting the low-income levels of most Palauan’s, fines in many cases this would probably be dissuasive when compared to suspended sentences.

160. The Pacific Savings Bank grand larceny case (see Case 6) is an example of sanctions which were neither proportionate nor dissuasive. This case involved USD23 million with each defendant being faced with 208 counts of cheating, grand larceny, embezzlement and ML. As the most significant case in Palau where a conviction for ML has been achieved, the suspended sentence does not provide a significant deterrent for any other sizable laundering cases.

#### **Case Example 6: ML Conviction – disproportionate and non-dissuasive sanctions**

Three employees of Pacific Savings Bank (PSB) maintained loans with the bank. The defendants aided one another in issuing 52 cheques (the actual number of fraudulent cheques exceeded 52, but the additional transactions could not be charged due to expiration of the statute of limitations) without properly documenting them according to procedures established by the bank. As a result, the cheques were not properly attached to defendants’ loans and the bank did not have an accurate record of defendants’ repayment obligations. Cheques written by the bank on loans were recorded as disbursements in an electronic “subsidiary” ledger at the end of each business day, which the bank relied heavily on for keeping track of the amount of money that was borrowed against each loan as well as the interest that was accrued. The defendants exploited this knowledge to withdraw funds without triggering red flags. As a result, defendants issued many cheques, often to fictitious construction companies, which they did not record in the subsidiary ledger. The defendants were each charged with 208 counts of Cheating, Grand Larceny, Embezzlement and ML totalling USD23 million. The FIC eventually closed the bank in November 2006. In December 2011 the directors were found guilty and all were sentenced to 30 years suspended sentences and placed on seven years’ probation, which is not

considered proportionate and dissuasive when considering the seriousness of the offending, though the closure of the bank appeared appropriate.

*Rengiil v RoP, 20 ROP 141 2013*

161. There have been no sanctions applied against legal persons, as no legal persons have been charged with ML. It cannot be determined whether proportionate and dissuasive sanctions would be imposed against legal persons in the circumstances, though as previously noted the sanctions as per the legislation is both proportionate and dissuasive.

#### *Other criminal justice measures*

162. There is no evidence of other criminal justice measures being applied. The main priorities are on prosecuting the predicate offence and imposing fines, probation and suspended sentences.

#### *Overall conclusions on Immediate Outcome 7*

163. Since 2011, Palau has achieved five convictions for ML which is a good achievement in light of the Palauan context, though these convictions do not align with Palau's higher risk predicate offences which require consideration in future. The ML cases undertaken, have predominantly focused on crimes rated as low risk for ML in the NRA including tax evasion, theft, misconduct in public office and violation of code of ethics (corruption/bribery). Not all LEAs and prosecutors effectively consider ML investigations which were primarily considered by the NEA and the OSP. ML investigations have not been pursued as a policy priority in Palau until the formation of the FCIU in late 2016, and initial indications are that this is a positive measure. Due to the limited number of cases and recognising the size and context in Palau, it is difficult to clearly determine how effective, proportionate and dissuasive the penalties are for ML. There is also no evidence of other criminal justice measures being applied as the main priorities are on prosecuting the predicate offence, imposing fines, probation and suspended sentences.

164. **Palau has a moderate level of effectiveness for Immediate Outcome 7.**

#### *Immediate Outcome 8 (Confiscation)*

##### *Confiscation of proceeds, instrumentalities and property of equivalent value as a policy objective*

165. Palau has not demonstrated that confiscation is a key priority in its criminal justice regime or pursued as a primary policy objective, although Palau has recently made operational changes to promote asset seizure and confiscation, particularly by the anti-narcotics law enforcement agencies. This may be attributed to a lack of an overarching strategic direction on a whole-of-government level as Palau does not have a comprehensive or documented confiscation policy directives or strategies to pursue the proceeds of crime.

166. There is no department or section dedicated to or specialised in confiscation action in either the LEAs or the prosecuting agencies. LEAs and prosecutors are currently developing expertise in conducting ML and financial investigations/prosecutions, which is welcome, but this remains at a nascent stage. Due to the nature of the offences that the OSP handles, which often involve ML and financial elements, the OSP has recently started to build capabilities to

investigate and prosecute offences including those with ML with a view to confiscating the proceeds of crime. However, progress is constrained by the lack of resources in both LEAs and the prosecutorial agencies (OAG and OSP) for targeted training and the lack of a clear policy objective to prioritise confiscation of the proceeds of crime.

167. The Belau Drug Task Force and the NEA, focus on seizing and confiscating proceeds of crime as a goal itself, but this is not the case with other LEAs. LEAs tend to seize property for evidence and not with a primary view to confiscation (noting the mainly low value confiscations, such as cars and small amounts of cash). The OSP acknowledges that LEAs in Palau need to improve the confiscation and forfeiture of boats and boat accessories (i.e. engines) and bank accounts as the third and fourth largest store of value in Palau, after cars and cash. LEAs and prosecutors also do not use the full range of confiscation mechanisms at their disposal under Palau's forfeiture laws.

#### *Confiscation of proceeds from foreign and domestic predicates, and proceeds located abroad*

168. Palau has identified its key proceeds-generating crimes to be drug trafficking, and human trafficking and sexual exploitation (prostitution).

169. The forfeiture laws in Palau were amended in 2014 and set out the seizure and confiscation framework in Palau. In addition to criminal forfeiture powers available post-conviction (see case example 7), the forfeiture laws provide for civil forfeiture as well as administrative forfeiture proceedings. However, regulations for civil forfeiture as well as administrative forfeiture proceedings have not been passed and are not in effect. In practice, powers of forfeiture under civil forfeiture or administrative forfeiture have not been used at all, apart from sanctioning offences of undeclared cash at the border. It is notable that most of the property forfeited to-date appears to be the result of plea agreements reached between the prosecutors and the offender. It is therefore clear that the LEAs and prosecutors are not fully utilising the range of other confiscation mechanisms available at their disposal. However, the assessment team notes that this should be considered in the context of Palau where most of the actual forfeiture cases are limited to drug related convictions for which the authorities do not think administrative forfeiture or civil forfeiture is appropriate.

#### **Case Example 7 – Court ordered criminal forfeiture**

The OSP's first use of a court-ordered process was through a motion filed with the Court at the time of charging in the case of *ROP v. Eudora D. Lucio*, which occurred in December 2016. The OSP's motion requested the Court issue the order to the Banks, titled "Order to Prohibit Transactions of Assets Subject to Criminal Forfeiture", which prohibited any transactions on the remaining balance of funds which the OSP had identified were potential proceeds of crime. This included cash loans and large cash deposits and withdrawals from the defendant who was charged and later convicted, by plea agreement, of cash embezzlement. The defendant abused her position as a cashier working for Palau's Customs at Palau International Airport, collecting various taxes charged by the Republic on departing passengers.

This order froze funds in a bank account, deeming to protect the funds for potential asset forfeiture at the conclusion of the criminal case. This was served prior to the service of the defendant in order to prevent the dissipation of funds from the account. Over a year elapsed between when the conduct of the defendant had been discovered and actual charging, which resulted in the OSP only being able to 'freeze' amounts in those accounts after the defendant



had effectively dissipated all funds from those accounts – under USD5 remained frozen in each account at two banks in Palau.

170. Furthermore, there is a notably positive practice of the Palauan Courts to impose fines which serve the purpose of disgorging the benefits of criminal conduct, especially when considering the fines applied and its deterrence factor in the context of Palau (see case example 8). While the quantum of fines imposed often do not go beyond the benefits obtained from criminal conduct, and in the absence of any other form of penalty imposed apart from the fine, this arguably dilutes the punitive effect of the sanction in respect of the underlying crime. However, in the context of Palau where the criminal proceeds are mostly dissipated immediately on consumables and the average Palauan citizen has an income of about USD12,000 a year, the quantum of fines imposed has had a relatively significant punitive and deterrent effect.

#### Case Example 8 – Forfeiture of criminal proceeds

The OSP's second use of a Court order was similarly titled "Order to Prohibit Transactions of Assets Subject to Criminal Forfeiture", which was done in the case *ROP v. Wilhelm Aichi* in August 2017. It similarly was filed and received prior to the arrest of that defendant. It was served for two accounts located at one bank in Palau in which an STR had identified structuring and ML conduct. While this 'freeze' was more effective, prohibiting transactions in over USD2,000.00 of identified assets, it was only finalised in 2018 after the conclusion of the onsite visit (November 2017), which resulted in the forfeiture of bank account assets.

171. LEAs do seize property, cash in hand, monies in bank accounts, and vehicles at the time of arrest. However, other properties such as boats and real property (land<sup>9</sup>), which are of higher value, are often not pursued due to difficulties faced in ascertaining the property ownership and potential legal challenges from third party claimants. LEAs are often also not sufficiently educated on the range of seizure and forfeiture powers available to them, and when these powers may be exercised. LEAs tend to seize property for evidence and not with a view to confiscation. LEAs should endeavour to make greater use of the forfeiture powers available to them to ensure a wider range of proceeds of crime is confiscated.<sup>10</sup>

172. Since the creation of the Belau Drug Task Force in 2015 and the NEA in 2017, confiscations have been undertaken related to drug investigations and convictions, which are all instruments of crime (see Table 10).

**Table 10: Narcotics Enforcement Agency Confiscations in Palau**

No.	Date Seizure	Charges	Asset Seized	Value	Outcome
01.	12 December 2015	Trafficking/Possession Methamphetamine	Nissan Sentra USD2,400	USD800 USD2,400	USD2,400/ Sentra Forfeited

<sup>9</sup> Confiscation of real property poses a unique challenge in Palau because of the contentious, and traditionally clan-based notions of land ownership. Only a Palauan can in fact own land in Palau, thus, with non-Palauan defendants there is no real property to be seized and seizing Palauan land is incredibly challenging and has never been pursued.

<sup>10</sup> Palau Criminal Case Nos. 18-006 (concluded January 2018) and 14-143 (concluded December 2017) are two drug-related investigations where the LEA seized a 29 foot speed boat with an approximate retail value of \$90,000 and a second 23 foot speed boat with an approximate value of \$75,000, both of which were finalised post the onsite visit.

02.	21 December 2015	Reckless Driving / Possession Methamphetamine	1994 Toyota Starlet Sedan	USD2,000	Vehicle Forfeited
03.	5 February 2016	Trafficking/Possession Methamphetamine	USD2,400	USD2,400	USD2,400 Forfeited
04.	6 February 2016	Trafficking/Possession Methamphetamine	USD500	USD500	Forfeited
05.	February 2016	Escape from jail	Nissan P/up truck	USD1,200	Forfeited
06.	13 March 2016	Trafficking/Possession Methamphetamine	Toyota Starlet Sedan	USD2,000	Forfeited
07.	8 April 2016	Trafficking/Possession Marijuana	USD446	USD446	Forfeited
08.	25 April 2016	Trafficking/Possession Methamphetamine	USD18,000	USD18,000	Forfeited
09.	27 June 2016	Trafficking/Possession Methamphetamine	2001 Toyota X-Trail	USD4,000	Forfeited
10.	19 August 2016	Trafficking/Possession Methamphetamine	Suzuki Jimmy Jeep	USD2,000 USD630 cash	Returned
11.	1 September 2016	Trafficking/Possession Methamphetamine	Toyota Ipsum USD323 cash	USD3000	Forfeited
12.	2 September 2016	Trafficking/Possession Methamphetamine	USD27,443	USD27,443	USD13,265 Forfeited
13.	29 March 2017	Trafficking/Possession Methamphetamine	Nissan Pickup	USD3,000	Pending forfeiture
14.	19 April 2017	Trafficking/Possession of MJ and Methamphetamine	USD642 cash	USD642	Forfeited
15.	28 June 2017	Trafficking/Possession Methamphetamine	USD11,350	USD11,350	Pending
16.	28 June 2017	Trafficking/Possession Methamphetamine	Chrysler Crossfire	USD11,000	Pending

173. Palau noted that it has received requests from foreign countries (mainly U.S.) for the seizure and confiscation of proceeds of crime from foreign predicate offences.

174. Palau has yet to demonstrate the effectiveness of the competent authorities to confiscate property through international cooperation. Palau is encouraged to make greater use of the formal MLA framework and to improve both formal and informal cooperation with key foreign counterparts, in order to further control the risk of ML through cash couriers and cross border cash couriers for funds that could emerge from the proceeds of foreign crime. While noting that the frequency of such examples is probably low in the context of Palau, some steps have been taken to mitigate this risk, and LEAs and customs need to proactively investigate the cross border movement of cash to mitigate the possibility of foreign proceeds of crime entering Palau.

Furthermore, if Palauan authorities are aware that some criminal proceeds have been moved offshore, they should pursue it through informal cooperation at the very least.

175. Palau's legislation establishes the Forfeited Property Fund which sets out the framework for managing seized or confiscated assets under the OAG. While the LEAs do not have written SOPs and procedures in place that set out clear guidelines or procedures for seizure, tracking, storage, withdrawal and disposal of case properties, the authorities did not note any significant problems with asset management. No statistics were available on funds under management at time of the onsite visit.

#### *Confiscation of falsely or undeclared cross-border transaction of currency/BNI*

176. Persons carrying cash or bearer negotiable instruments of USD 10,000 and above into and out of Palau are required to declare this cross-border movement of currency. This declaration requirement is included in the arrival cards. Despite this, the authorities have noted challenges faced by travellers, especially Chinese tourists, to fully understand the declaration requirements on entry into Palau due to language barriers. Some steps have been taken to address this, including providing arrival cards in different languages and signs (in Mandarin) at the airport to notify the travellers of the declaration requirement. There has been a marked decrease in the amount of undeclared funds entering Palau since. The authorities have acknowledged that the quality of translation in the arrival cards can be improved and are currently addressing the issue. The authorities can also consider putting up more signage at the airport in a wider variety of languages to educate travellers of the declaration requirement. These measures can strengthen the cash declaration regime in Palau.

177. The assessment team was also informed of a previous practice in which certain VIPs were allowed to pass through Palau immigration and customs without formal checks conducted on the VIP or their accompanying luggage. This practice was acknowledged to pose a significant ML risk and ceased in 2014.

178. Palau authorities informed that all mail coming into Palau and cargo at the ports are inspected. There has been no detection of any undeclared bulk cash from the Post Office or Port to date.

179. Palau has demonstrated an increased emphasis on border security and greater awareness of the potential for the movement of illicit funds over recent years. Through Palau's efforts to substantially reduce the incidences of undeclared cash coming into Palau, such as terminating the practice of providing a VIP service to business travellers with political contacts, enhancing airport screening measures, posting signage in the airport in Mandarin, reminding passengers of the declaration obligations and fully translating the Traveller Information Form into several different languages, the number of cases of undeclared cash entering Palau has drastically decreased as seen in Table 11 and Table 12 below.

180. Palau has not detected any ML arising from currency that was either declared or not declared at the border given that the offenders are mostly tourists. Where there are instances of undeclared cash coming into Palau via foreign nationals at the airports, these passengers were interviewed for detection of possible ML/TF elements. The passengers found carrying undeclared cash or declared cash over USD10,000 are routinely interrogated as to the source and purpose of the cash. Palau authorities have discovered that the vast majority of the undeclared cash was simply related to tourist costs of travel and entertainment with no link to possible ML/TF. Subsequent financial investigations are conducted where warranted and

authorities have noted that it is rarely warranted, though it is unclear what this decision is based on. Custom officers' practice is to seize the undeclared funds for 24 hours pending further documentation on the legitimacy of the money. Passengers alternatively accept a fine of 5% of the total undeclared funds for failure to declare. This is an administrative penalty under section 3906 (a) of the Currency Reporting Act. Customs provided details of 23 cases between 2013 and 2017 involving either undeclared tobacco/cigarette (8 cases) or undeclared currency reporting (15 cases) at the airport, with duty and fines imposed for the tobacco/cigarettes and fines imposed for the undeclared currency (see case 5 regarding undeclared currency reporting including an increased penalty for a repeat offender).

#### Case Example 9: Undeclared currency reporting

On 1 February 2015, Customs Officers seized USD20,000 cash from a female Chinese national passenger who failed to declare this money upon her entry into Palau. An investigation into the explanation of source of the cash was proven to be false and she was later charged with failing to declare and making an unsworn falsification to a Government Agent. She was convicted and the cash confiscated. On 28 September 2015, Customs Officers seized a further USD30,300 from the same Chinese national upon her failure to declare her money upon her entry to Palau by providing false information on her declaration form. The defendant was charged with one count of Tampering with a Government Record in violation of 17 PNC § 3914. She pled guilty to each charge and forfeited the entire amount in exchange for no jail time. She was then determined Persona Non-Grata and denied entry to Palau. That decision was later overturned, and the Chinese national continues to travel to Palau and is closely monitored.

181. This case is another example that reflects on one of the key deficiencies in Palau's AML/CFT framework. In exchange for forfeiting illicitly smuggled cash, an individual does not face any further pecuniary fine or other penalty - even the persona non-grata charge was overturned. Sanctions in this case do not appear dissuasive to future cash smuggling.

182. In addition to possible criminal sanctions, Palau's legislation also provides for civil penalties (up to twice the amount carried), administrative penalties (5% of the amount carried) and criminal penalties for offenders who either fail to make the requisite declaration or provide false declarations (see Table 11).

**Table 11: Examples of types of sanctions applied**

Description	2017	2016	2015
Criminal	1	1	2
Civil	0	0	0
Administrative	12	29	34
Total	13	30	36

183. The sanction of choice in Palau is almost invariably an administrative penalty through either fines or confiscations, though in practice this was predominantly fines (see Table 12). There are limited instances in which criminal sanctions are pursued. Given the profiles of the offenders and the circumstances under which the offenders committed the offences of not declaring cash, the existing sanctions and practice of imposing an administrative penalty is sufficient in the circumstances. Nevertheless, Palau authorities should be ready to pursue criminal sanctions where it is warranted (see case 9).

**Table 12: Currency Report**

<b>Description</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Declared	30	40	23
Declared Amount	USD1,855,626 <sup>11</sup>	USD2,629,677	USD1,530,892
Undeclared	20	49	47
Undeclared Amount	USD239,496	USD768,080	USD829,359
Amount of Penalties imposed	USD9,848	USD35,345	USD66,408

184. Customs highlighted that the scanning machines at the airport are not always functioning and are in need of upgrading which could result in goods and materials not being identified at the Koror International Airport.

*Consistency of confiscation results with ML/TF risks and national AML/CFT policies and priorities*

185. Palau has in its NRA identified its key ML risks to be from drugs and human trafficking/prostitution. The positive results of confiscation from the NEA (Table 10 above) have shown that they are able to pursue and confiscate both cash and conveyances (vehicles), but not proceeds of crime consistent to an extent with their identified ML/TF risks. The results achieved by the NEA are positive when considered in the context of the small size of Palau. However, the assessment team has not been provided with statistics of confiscations by other LEAs on a more general basis, which undermines the extent to which Palau is able to demonstrate its effectiveness under this immediate outcome.

186. No confiscations have been made related to the second high risk predicate offence – human trafficking and sexual exploitation. While it is understandable that the confiscations from, for example prostitutes themselves may be limited, focusing on low level targets is not likely to really combat profit driven crime and Palau should target the masterminds of the criminality in order to truly impact the offending. This is particularly pertinent in high risk areas such as prostitution and human trafficking.

187. The NRA has highlighted that ML prosecutions in Palau are very low, primarily due to a capacity challenge within LEAs, a lack of understanding of ML by prosecutors, and an unwillingness by prosecutors to complicate the prosecution of an underlying predicate offence with ML charges. The low emphasis on pursuing ML charges has an impact on the prioritisation of confiscation of criminal proceeds. Also, the assessment team was informed that as criminal proceeds in Palau tend to be dissipated on consumable items or retained by valid third-party owners (payments on rent, car lease payments, etc.), the value of undertaking parallel investigations on dissipated proceeds are limited. The overall lower crime rate and nature of crime in Palau and the low emphasis on confiscating the proceeds of crime more generally ultimately affects the confiscation results in Palau, recognising that the type of criminality may not result in much to confiscate.

<sup>11</sup>Palau noted that in 2017 there were \$1.4MM of the \$1,855,626 of declared funds are cash being brought to Palau by the one of the US banks to do business, which leaves only \$455,626 as unspecified cash coming into Palau in 2017. The actual number of unspecified declared cash, therefore, is not large according to Palau.

***Overall conclusions on Immediate Outcome 8***

3 188. Whilst Palau does not have an overarching focus or documented policy on the confiscation of criminal proceeds, confiscation is broadly being pursued in line with identified risks. The practice of the Palauan Court to impose fines which serve the purpose of recovering criminal benefits as an alternative to confiscation action is also positive. Palau has also demonstrated an awareness of the potential of illicit funds coming through its borders and has taken active steps to mitigate the risks and to undertake confiscation action where necessary. Overall, in light of the small size of the economy and nature of crime in Palau, confiscation results are generally positive. Nevertheless, there are a number of deficiencies identified that require major improvements including the lack of a clear policy objective to prioritise confiscation of the proceeds of crime, regulations for civil forfeiture as well as administrative forfeiture proceedings have not been passed and are not in effect, there are no guidelines and procedures for managing confiscated assets and limited confiscations by agencies except the NEA. Palau should increase emphasis on confiscating proceeds of crime and augment its authorities' capabilities to do so through increased training and education on the range of powers available to them, noting that legally Palau has strong confiscation measures.

189. **Palau has achieved a moderate level of effectiveness for Immediate Outcome 8.**

## CHAPTER 4. TERRORIST FINANCING AND FINANCING OF PROLIFERATION

### *Key Findings and Recommended Actions*

#### **Key Findings**

##### *Immediate Outcome 9*

- Palau has a low level of risk for TF. Palau has never identified either terrorism or TF and has never conducted an investigation, which is consistent with its risk. This low risk is reinforced by Palau having no offshore sector and limited exposure to the international financial sector.
- Palau has criminalised TF in line with Terrorist Financing Convention. TF attracts the same penalties as terrorism itself which is considered dissuasive and proportionate.
- While recognising the low level of risk, Palau lacks a national policy and strategic mechanism to respond to TF risks, should they arise. In addition, Palau does not have a broader CT strategy.
- While government agencies have some understanding of TF risk, the understanding of the private sector is negligible, which reduces Palau's ability to identify TF (noting risks are low).
- At the operational level, Palau has not demonstrated the necessary capacity and capability to identify, investigate and prosecute TF.
- Within the NRA, in considering a range of typologies that pose the greatest concern in Palau, the NRA suggests that trade-based money laundering could be used to send funds overseas to finance terrorism, which requires further consideration.

##### *Immediate Outcome 10*

- Palau has a basic legal framework to implement TFS, although there are gaps in relation to access to funds and protecting bona fide third parties.
- There has been no supervision of FIs' implementation of TFS requirements.
- Authorities do not consistently share updated lists of designated persons or entities.
- While Palau has a very small NPO sector, it has still not conducted a risk assessment of NPOs (NPOs were not considered in the NRA) and no strategic and operational monitoring of activities of the NPO sector occur. Due to the small size of the NPO sector, it was not of concern to authorities.
- No terrorist assets have been frozen (whether through criminal, civil or administrative processes), in connection with TFS, which is consistent with Palau's low TF risk.
- TFS implementation is generally strong in the banking and remittance sectors, which covers approximately 99% of the financial sector. Both local banks conduct international fund transfers through the three (3) large US banks, so the application of the automated screening of these transactions will be undertaken by these larger FIs. Both local banks and DNFBPs had no understanding of TFS.

##### *Immediate Outcome 11*

- Palau does not have a legal framework or processes to implement targeted financial

sanctions relating to proliferation financing.

- Palau authorities do not disseminate UN notices on PF to FIs and DNFBPs.
- The 3 US banks and 2 money service remittance providers which account for approximately 99% of the financial sector have strong screening systems both for account opening and ongoing transactions. The remaining financial institutions and DNFBPs have no understanding of their PF obligations.
- No designated persons or entities' assets or funds are being identified and held in Palau.
- TFS for PF needs to be applied to all businesses in Palau, including the shipping registry. The registry has some potential risks of exposure, and their collection of records and their ability to check TFS for Weapons of Mass Destruction proliferation financing needs monitoring and auditing by Palauan authorities. Breaches regarding ships with links to DPRK have been identified though it is unclear whether the shipping registry (and ships themselves) have direct links to PF.

### ***Recommended Actions***

#### *Immediate Outcome 9*

- Develop and implement a counter terrorism and CFT policy and strategy.
- The Anti-Terrorism Coordinator, or another similar authority, should coordinate CFT..
- Designate the police or a specific agency to undertake TF investigations and conduct related financial investigations recognising the risk is low and as yet no investigations have been required to be undertaken.
- Train LEAs, prosecutors and the judiciary in TF and related financial investigations, building on the developing capability to investigate financial crime.
- Analysis needs to occur to better understand how trade-based money laundering may occur and be used for TF as noted in the NRA, and mitigating measures need to be developed to overcome this potential risk.
- Palau should develop a better understanding on what the potential threats for TF are.

#### *Immediate Outcome 10*

- Implement procedures and measures to give effect to TFS obligations without delay.
- Provide clear direction and outreach regarding TFS to the private sector.
- Conduct a comprehensive audit and review of the NPO sector focusing on its risk from terrorist abuse and, based on this review, provide appropriate outreach, apply appropriate risk-based measures and implement a licensing and supervision regime.

#### *Immediate Outcome 11*

- Palau should develop and implement a legal and regulatory framework and implementing mechanisms to give effect to targeted financial sanctions obligations without delay.
- Palau authorities need to regularly disseminate UN notices on PF to FIs and DNFBPs.
- Issue clear direction, guidance and outreach both to prepare the financial sector and to raise awareness with policy makers and implementing agencies regarding the obligations and expectations associated with PF targeted financial sanctions.
- Palau needs to undertake regular TFS for PF audits of the shipping registry.



190. The relevant Immediate Outcomes considered and assessed in this chapter are IO9-11. The recommendations relevant for the assessment of effectiveness under this section are R.5-8.

### *Immediate Outcome 9 (TF investigation and prosecution)*

#### *Prosecution/conviction of types of TF activity consistent with the country's risk-profile*

191. There have been no prosecutions or convictions for TF in Palau which is consistent with Palau's TF risk profile of low.

192. Palau has never identified either terrorism or TF and has never conducted an investigation, which is consistent with the low risk for terrorism. This low risk is reinforced by Palau having no offshore sector and limited exposure to the international financial sector, predominantly through the tourism sector, the international banks and the money remittance service providers. While the residual risk of TF in Palau is very low, some measures should be undertaken including the development of a CFT strategy, the designation of a coordination and investigation point for TF and the development of awareness among government agencies and the private sector on what the risk for TF is and what measures and obligations are in place to manage this risk.

193. The NRA provides only a limited assessment of TF however the assessment of low risk nonetheless appears appropriate when considering regional assessments undertaken and the nature and context within Palau. Even though the risk for TF is low, it was not clear whether all agencies in Palau fully understand what TF is, and it was unclear to the assessment team whether competent authorities have a clear understanding of how to identify, manage and mitigate TF activities in the unlikely event it should occur.

194. While the MLWG is tasked to take the lead in coordinating CTF activities, Palau does not appear to have a dedicated focal point among members of the MLWG for this key area, despite the low risk. It was unclear to the assessment team whether the MLWG has ever focused on TF while noting that the anti-terrorism coordinator is a member of the MLWG and focusses solely on terrorism and has no role in TF.

#### *TF identification and investigation*

195. While to date there seems to be no evidence of terrorism and/or TF occurring in Palau and no investigations, prosecutions, or convictions have been undertaken, nevertheless, a residual (albeit small) risk of TF may remain due primarily to the very small unregulated DNFBP and NPO sectors, and very limited understanding of TF in Palau more generally.

196. During the onsite visit, the assessment team observed an inadequate understanding of TF risk at a strategic level and a limited understanding of TF at an operational level within competent authorities including law enforcement agencies. While the risk of TF is low, Palau appears to have limited technical capacity or capability to undertake TF investigations. One instance was highlighted where a foreign national was arrested for possession of counterfeit currency. The individual's mobile phone was found to have contacts of various arms suppliers within it. Palau authorities immediately contacted the U.S Secret Service (USSS) and made arrangements to have the phone shipped to U.S. authorities (USSS passed phone onto the FBI). Palauan authorities did not receive any follow-up or feedback from the USSS or the FBI on the matter, and it is unclear if Palau sought any feedback on what transpired as Palau assumed that the FBI took care of the matter. While the team acknowledges the close relationship between the U.S. and Palau and the direct and open channels between U.S. and Palauan agencies to assist

in any potential TF investigations, it still appears that Palauan authorities have limited technical capacity or capability related to TF and no ongoing concerns appeared regarding potential terrorism impacts (which may or may not be evident in this case).

197. The lack of a national strategy or policy, procedure or mechanism in place to identify, provide private sector awareness and manage any possible TF cases that may occur in future undermines the ability of Palau to accurately identify and understand any potential TF activity that might exist, or any emerging international, regional or domestic TF trends.

198. The FIU has never received any terrorism or TF-related STRs, which is consistent with the low risk and the context of Palau. With no outreach to sectors at potential risk such as NPOs and possibly the financial sector, however, no basic measures have been put in place which would be commensurate with the identified low risk of TF.

199. Steps are being taken by the three foreign (U.S.) banks and two money remittance companies, which have online systems which identify designated terrorists or any proscribed entities. Besides submitting STRs, no clear guidelines and mechanisms exist to guide these and other REs on what Palau expects of them if they found a match or if they wanted to designate an individual or an entity in Palau.

#### *TF investigation integrated with -and supportive of- national strategies*

200. Palau has no established policies, procedures or mechanisms for identifying and managing TF offences.

201. The gaps in the legislative framework, such as assigning authorities to determine designations of terrorists or terrorist groups will impact on their ability to investigate TF. Notwithstanding the low risk of TF, no authorities have developed even a basic level of expertise required to manage any potential case of TF. The assigning of authorities to investigate TF should be integrated into a broader CFT strategy that can be developed in line with the context and risks of TF in Palau.

202. While the MLWG is tasked with considering TF, no indications have been provided to suggest any regular consideration has occurred. The clear understanding of what TF is by most if not all, agencies at the MLWG suggest that the level of strategic coordination that this body could provide is limited. Assigning clear responsibility for developing a mechanism for managing TF and managing any potential instances of TF would greatly assist the MLWG to consider TF at a strategic level.

203. There is no indication of financial investigations being used to support any investigations linked to the possible domestic designation of terrorists under targeted financial sanctions recognising the very low risk of TF in Palau. From an international perspective it is of concern that within the NRA, in considering a range of typologies that pose the greatest concern in Palau, the NRA suggests that trade-based money laundering could be used to send funds overseas to finance terrorism. Further analysis is required to better understand how this may occur, and mitigating measures may need to be developed to overcome this potential risk, if it is actually a risk.

204. Palau has not provided specialised training or nominated specific agencies or officers who would lead any terrorism or TF investigation. While the risk of TF is very low, some measures should be put in place to manage any such case if it did arise.

*Effectiveness, proportionality and dissuasiveness of sanctions*

205. As no prosecution of and conviction for TF has ever been conducted, the effectiveness and proportionality and dissuasiveness of the sanctions and measures have not yet been tested in the courts of Palau. TF attracts the same penalties as terrorism itself under Section 2205 (17 PNCA § 2205 Terrorism) which carries stiff criminal sanctions including the minimum imprisonment of 10 years' and maximum of life imprisonment and a maximum fine of USD1 million which is considered sufficiently proportionate and dissuasive. In addition to criminal sanctions, legal persons are subject to be banned from business, ordered to close premises, be dissolved or be required to publicise the judgment in the press.

*Alternative measures used where TF conviction is not possible (e.g. disruption)*

206. Noting that no instance of TF has ever been identified and the very low risk of TF in Palau, Palau has never undertaken any measures or alternate measures to disrupt TF.

*Overall conclusions on Immediate Outcome 9*

207. Palau has a low level of risk for TF and has never identified either terrorism or TF and has never conducted an investigation, which is consistent with its risk. While recognising the low level of risk, Palau lacks a national policy and strategic mechanism to respond to TF risks, should they arise. In addition, Palau does not have a broader CT strategy or a central coordination point for TF. While government agencies have limited understanding of TF risk, the understanding of the private sector is negligible, which reduces Palau's ability to identify TF.

208. **Palau has a low level of effectiveness for Immediate Outcome 9.**

*Immediate Outcome 10 (TF preventive measures and financial sanctions)**Implementation of targeted financial sanctions for TF without delay*

209. While Palau has a legislative framework in place to implement TFS in accordance with UNSCR 1267 and 1989, it lacks effective mechanisms related to these UNSCRs.

210. Interagency coordination on counter terrorism has not focused on supporting measures to implement the TFS obligations set out in Palau's law.

211. Palau authorities did not demonstrate a clear practice or procedure for dissemination of the lists of UN-designated persons and entities to the private sector. Those lists were circulated on one occasion in early 2017 with limited instructions on what is required, how to use the list and what occurs if a match is found. Most reporting entities that the assessment team met with did not recall the FIU notification in 2017. Communication and targeted outreach to the financial and non-financial sector on these issues has not occurred.

212. The larger banks (three US banks) and the money remittance service providers, who undertake the bulk of financial transactions in Palau, have automated systems to check individuals and legal persons against the UNSCR lists. Local banks and DNFbps are not conducting any manual screening, have not implemented any systematic screening processes or systems and had no understanding of TFS.

213. There has been no supervision of FIs' implementation of TFS requirements. The three large banks<sup>12</sup> and two remittance service providers conduct TFS screening based on their home supervisory requirements (US for banks and US/Philippines for remittance service providers) and group policies and utilise internal systems to undertake the requisite screening. Both smaller banks conduct international fund transfers through the three (3) large US banks, so the application of the automated screening of these transactions will be conducted by the relevant US banks. The remaining FIs and DNFPBs, while very small, are not conducting screening and have no awareness or understanding of TFS and the need to screen all customers and transactions.

214. Palau has not proposed any designations to the relevant UN Sanctions Committees, in particular in relation to the UNSCR 1267 and its successor resolutions and has not made any designation in relation to UNSCR 1373. However, given Palau's risk and context for terrorism and TF, this seems to be in keeping with Palau's risk profile.

#### *Targeted approach, outreach and oversight of at-risk non-profit organisations*

215. Overall, Palau displays a limited awareness of the risk of NPOs being used for TF, with no regulatory authority maintaining oversight of NPOs including assessing and mitigating any risks and threats related to TF. Palau has not undertaken a review of the relevant laws affecting NPOs nor of the sector in general (regarding potential exploitation for TF). Palau advised that the NPO sector was so small and insignificant that it was not of concern to authorities.

216. The OAG is the registering, supervising and monitoring authority for all NPOs in Palau. According to the Bureau of Revenue and Taxation there are only 19 active NPOs in Palau. An audit of all domestic and foreign NPOs active in Palau is warranted.

217. There is a lack of information with regard to the nature of NPOs in Palau, the extent of their financial activity (both domestically and overseas), sources of funds that could be obtained by NPOs (other than contributions from the public), whether there are any safeguards or restrictions imposed by the authorities on the ability of NPOs to seek funding from the public (or even overseas), or to send funds overseas, and other sources and restrictions imposed on the use of such funds.

218. While a basic governance-related regulatory regime for NPOs is in place, there is no evidence that NPOs are subject to any oversight and scrutiny to prevent abuse of the NPO sector for terrorism and TF activities. There are no controls on collection of funds by NPOs and persons representing such NPOs.

219. OAG keeps hard copy records of NPOs. Palau has never audited the accounts of NPOs due to their small size. Palau indicated that NPOs are routinely created for the sole purpose of receiving and distributing grant money received from various sources such as US aid agencies.

220. Palau does not regularly scan NPOs and their beneficial owners against the UN lists of proscribed entities and individuals.

221. There has been no outreach or AML/CFT awareness training for NPOs in Palau. In addition, neither the OAG (nor any other AML/CTF competent authorities) has carried out any inspection of the registered NPOs.

<sup>12</sup>The majority of the financial sector is managed by 3 U.S. banks. These U.S. banks account for over ninety eight percent (98%) of the total financial transactions in the jurisdiction, and while they are regulated by the Palau Financial Institutions Commission and the FIU, they are also regulated by the U.S. Federal Deposit Insurance Corporation and FINCEN.

222. While noting that NPOs in Palau are very small and provide limited domestic services, no consideration of the risk rating in relation to TF and the NPO sector and the TF threats and vulnerabilities faced by the NPO sector has been undertaken. Palau was unable to demonstrate effectiveness in implementing a targeted approach, conducting sufficient outreach and exercising oversight in dealing with NPOs at risk of terrorist abuse. Palau did not demonstrate that it has taken any measures to protect NPOs from the threat of terrorism and TF, or to prevent the NPO sector from being misused for terrorism and TF purposes.

#### *Deprivation of TF assets and instrumentalities*

223. To date, no FIs and DNFBPs have had any positive matches against the UN consolidated lists, and no accounts or transactions have been frozen. This is consistent with Palau's risk for TF.

224. Effectiveness of confiscations in the context of TF investigations and prosecutions is considered at IO.8.

#### *Consistency of measures with overall TF risk profile*

225. While Palau's TF risk profile is low, the implementation of TFS is below the requirements of the international standards.

In relation to the NPO sector, even though NPOs are usually rated as highly vulnerable to misuse for terrorism and TF, major technical shortcomings, coupled with lack of outreach and oversight raise concerns on the effectiveness of Palau's regime in dealing with NPOs. It should be noted that NPOs in Palau are very small with a domestic focus, but a full assessment of NPOs in terms of TFS is still a requirement.

#### *Overall conclusions on Immediate Outcome 10*

226. Palau has a good legal framework to implement TFS, although there are gaps in relation to access to funds and protecting bona fide third parties. TFS implementation is generally strong in the banking and remittance sectors, which covers approximately 99% of the financial sector. Authorities do not consistently share updated lists of designated persons or entities. Smaller FIs and DNFBPs have no awareness or understanding regarding TFS. Palau has a very small NPO sector; it has still not conducted a risk assessment of NPOs. Due to the significant role of the foreign banks and remittance sectors and due to the very small NPO sector,

**227. Palau has a moderate level of effectiveness for Immediate Outcome 10.**

#### *Immediate Outcome 11 (PF financial sanctions)*

##### *Implementation of targeted financial sanctions related to proliferation financing without delay*

228. Palau has no legal framework or process in place to address proliferation financing, nor any immediate plans to develop a legal and institutional framework to implement TFS related to proliferation of WMD as required under Recommendation 7. Palau has no strategy or coordination mechanism to combat PF, and PF related risks and vulnerabilities to the Palauan economy are not assessed on an ongoing basis by Palau and was not considered in the 2017 NRA.

229. Palau advised that it has no links with DPRK and Iran. The financial sector does not have any direct trade links with DPRK or Iran. DPRK have been identified as using Palau as a Flag of Convenience for DPRK ships. It is unclear what the financial quantum of DPRK using Palau's shipping registry to overcome global sanctions is and whether use of these ships relate to PF.

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230. Palau has indicated that its framework for implementing UNSCR 1267 in the AMLA could be used to give effect to the requirements related to PF. Palau has never given any instructions to the financial sector to notify them of such an obligation.

231. However, in the assessment team's view this framework does not provide a clear legal basis to implement TFS set out by UNSCRs on proliferation of weapons of mass destruction (WMD). The analysis in Rec 6 and Rec 7 highlights that the AMLA covers parts of UNSCR 1267 and 1988 (3300, 22), but does not include any of the WMD proliferation-related UNSCRs within its provisions to extend TFS relating to the DPRK and Iran under UNSCRs 1718, 1737, 1803, 1874 and 1929.

232. While Palau has a United Nations Representation Office in New York, it is unclear what role if any this office plays in sharing UNSCRs with agencies back in Palau. It is unclear if the Ministry of Foreign Affairs disseminates UN notices on the proliferation resolutions to relevant Ministries.

233. Palau has not given any specific instructions or guidance to REs on implementing PF-related TFS. In late 2017 Palau issued FIU AML-Regulation-01 which requires FIs to check against the U.S. Office of Foreign Asset Control (OFAC) Sanctions List or any similar list designated by Palauan competent authorities when FIs conduct CDD. However, this regulation was introduced during the second week of the onsite and does not enforce TFS for PF obligations in Palau. In addition it is not clear what steps should be undertaken in Palau if a positive match occurs on the OFAC sanctions list in the absence of a legal basis to freeze assets in Palau.

234. Palauan authorities do not systematically disseminate UN notices on PF to financial institutions or DNFBPs, and notices were circulated only once by the FIU over the last few years. Authorities are not well-informed on the use of TFS in general and have little understanding of PF vulnerabilities faced by the jurisdiction. It is clear that some government agencies have an awareness of risks related to DPRK and the shipping registry (though any links to PF is unclear), however this has not resulted in Palau putting in place a legal and regulatory framework for TFS. The low capacity to prevent or address instances of PF, increase Palau's vulnerability.

#### *Identification of assets and funds held by designated persons/entities and prohibitions*

235. No designated persons or entities' assets or funds have ever been identified and held in Palau, which possibly is in line with the context of the Palauan financial sector and the small population of Palau. The absence of freezing or seizure of assets or funds could also be explained by a lack of legal obligations and the lack of understanding of what the UNSCRs require related to TFS for PF.

236. The 3 U.S. banks and two remittance service providers are conducting screening based on their home supervisory requirements and group policies and utilising internal systems to undertake the requisite screening. It was not always clear that these reporting entities understood all aspects of TFS for PF under their home supervisor rules. Their branches appear to rely heavily on systems for screening customers and transactions. The remaining FIs and DNFBPs, while very small, are not conducting screening and have no awareness or understanding around PF-related TFS and the need to screen all customers and transactions.

*FIs and DNFBPs' understanding of and compliance with obligations*

237. The awareness of international financial institutions regarding foreign obligations with respect to TFS for PF is reasonable except for domestic banks and DNFBPs who had no understanding of TFS and PF. The 3 U.S. banks and two money remittance service providers, who account for approximately 99% of the financial sector, displayed a solid understanding of foreign obligations with regard to PF, mainly due to the use of third-party automated screening systems they have in place when accounts are opened and for all transactions passing through their institutions, though no assessment of these systems has been undertaken by Palauan authorities. However, these five entities displayed limited understanding of the nature and underlying issues associated with PF for TFS during the onsite visit.

*Competent authorities ensuring and monitoring compliance*

238. While the FIC / FIU are conducting some on-site and off-site inspections on AML compliance, Palau has no mechanism for PF of TFS, no supervision to give effect to TFS related to PF, no guidelines have been developed and provided to REs and no outreach has occurred. The competent authorities rely on the efficacy of the internal systems of the 3 US banks and the 2 money remittance service providers.

239. Breaches regarding ships with links to DPRK have been identified though it is unclear whether the shipping registry<sup>13</sup> (and ships themselves) have direct links to PF. The use of Palau as a Flag of Convenience for foreign ships suggests that TFS for PF is possible and needs to be more strongly regulated (on-boarding, compliance and due diligence) for potential breaches particularly regarding DPRK.

240. In the Palau Management Action Plan 2013-17 it was noted that authorities lacked knowledge and understanding regarding the establishment of the shipping registry, the selection of its administrator and the agreement signed with the registry management company. This was further reinforced as since the formation of the open ship registry in 2011, Palau confirmed that no audits of the external shipping registry have been undertaken which is of concern as it is not clear if any of the ships are being used for PF.

241. With ongoing concerns with the efficacy of the Palau International Shipping Registry regarding meeting UNSCRs, the registry was instructed in June 2016 through a Ministerial level letter (Marine Circular number 16-020) that ships registered under the flag of Palau should not engage in any contact with DPRK, should have no ownership links to DPRK, should not transport any cargo from or to DPRK and that Masters of any registered vessels should disclose to port authorities any voyages to DPRK. A separate ministerial letter was issued to the shipping registry in June 2016 instructing the registry to not act in a manner inconsistent with U.S. sanctions against Iran, which has a less direct impact on Palau, noting that it is unclear if any PF is occurring regarding Iran.

242. Authorities have proactively identified and de-registered 2 ships and given an official warning to a third due to links with DPRK though it is not clear if any of these cases relate to PF (see Case 7). Palau have not indicated if any ships referenced in Annex III of UNSCR 2270 have been de-registered.

<sup>13</sup>At the time of the onsite visit, Palau had 399 ships on the Open Ship Registry with 13 ships on a domestic registry.

**Case Example 10: PF de-registration and warning letters:****De-registration of the East Glory 7 ship**

The East Glory 7 ship was provisionally registered by the Palau International Ship Registry in May 2017 and it was permanently registered in August 2017. The East Glory 7 ship loaded coal in Nampo DPRK on 22 July 2017. It was next located in Guangzhou China on 16 August with the declared next port of call Huangpu China. The Palau Ship Registry was of the belief that the coal was offloaded in China. The ship was deregistered in November 2017 as it breached UNSCR 2371 by delivering DPRK coal to China. In addition these actions breached the Marine Circular number 16-020 issued in 2016.

***Overall conclusions on Immediate Outcome 11***

243. The lack of a legal framework for PF or a process to implement TFS for PF is a fundamental issue. The automated screening that approximately 99% of the private sector institutions undertake does mitigate to a limited extent this gap, though the underlying understanding of TFS for PF in private sector is low. Further deficiencies include that Palauan authorities do not disseminate UN notices on PF to FIs and DNFBBs and TFS for PF needs to be applied to all businesses in Palau, including the shipping registry, which has some potential risks of exposure to PF sanctions evasion.

244. **Palau has a low level of effectiveness for Immediate Outcome 11.**



### *Key Findings and Recommended Actions*

#### **Key findings**

- Palau issued the new AML/CFT regulations for FIs, which contain detailed preventative measure requirements in November 2017. However, there has been no implementation of the additional requirements contained in the regulations since they were only introduced during the onsite visit.
- The degree of understanding of ML/TF risks is limited across the financial sector. The three U.S. banks, which manage approximately 98% of the financial sector, exhibited very limited understanding of overall ML/TF risks in Palau, while domestic banks, money remittance service providers and DNFBPs demonstrated no understanding of ML and TF risks in Palau.
- The smaller FIs and DNFBPs have not implemented preventative measures and the DNFBP regulations have not been issued. The very small size of the DNFBP sector reduced the weighting on this deficiency.
- The US banks and two foreign owned money remittance service providers apply mitigating measures commensurate with their institutional risks to a large extent. While they exhibited minimal understanding of Palau's ML/TF risks, it is unclear if they would be required to undertake even further measures noting the overall lower risk of ML and low risk of TF in Palau when compared to the risks in their home jurisdictions (US and Philippines).
- Over the last two-years 148 STRs were filed by two U.S. banks and one STR by a local bank, with no other REs submitting STRs. The illicit funds associated with Palau's higher risk crimes - drugs and prostitution - are rarely funnelled through Palau's formal financial sector which suggests the current level of STR filing by non-financial institutions is not commensurate with the ML/TF risks identified by Palau.
- The three U.S. banks and foreign money remittance service providers have measures in place to comply with CDD and record keeping requirements and identify beneficial owners to some extent, including applying EDD on high risk customers though the other FIs have limited implementation of CDD and negligible procedures to identify beneficial ownership.
- FIC examination reports confirm U.S. banks have implemented strong internal controls and procedures to comply with AML/CFT requirements. The issuance of the FI regulations enacted during the onsite visit did not provide adequate time for FIs to update their AML/CFT policies and procedures. Other FIs (including credit unions and remittance service providers), NPOs and DNFBPs, have not been supervised for AML/CFT compliance.

#### **Recommended Actions**

- Conduct outreach and develop sector-specific guidance for all REs on ML/TF risks and AML/CFT obligations including application of enhanced measures.
- The FIU should provide guidance to all REs on meeting the STR reporting obligations including sharing examples of indicators that may suggest suspicious transactions to all reporting entities including non-banks and DNFBPs. Since the DNFBP regulations are yet to be enacted, steps need to be taken in the interim to ensure that DNFBPs, regardless of their size, are required to meet the full range of STR reporting requirements.
- In line with findings under IO. 3, supervisory authorities should follow-up with the REs to ensure compliance and issue appropriate sanctions for non-compliance with the

preventative measures, including the more detailed requirements recently set out in regulation.

- FIs and DNFBPs should be required to conduct internal risk assessments and develop risk-based compliance programs
- The DNFBP regulations should be enacted and applied to all DNFBPs even if, in practice, they initially only apply to real estate agents and lawyers, because the other entities either do not exist (casinos, TCSPs) or have very low risk or do not undertake transactions that relate to the FATF definitions (accountants, DPMS). Comprehensive regulations for DNFBPs will ensure they are consistent with the AMLA even if they are only applied on a limited basis. This will allow Palau to broaden the DNFBPs covered by the regulations if circumstances should change.

245. The relevant Immediate Outcome considered and assessed in this chapter is I04. The recommendations relevant for the assessment of effectiveness under this section are R9-23.

#### *Immediate Outcome 4 (Preventive Measures)*

246. Of the five commercial banks, three are U.S. owned, and they each have a branch in Palau. These three branches are managed by regional offices in Guam and Hawaii. The U.S. banks are supervised by the United States Federal Deposit Insurance Corporation (FDIC) and FINCEN and comprise 98% of the financial sector. Details of Palau's financial system are given in Chapter 1.

247. The AMLA includes all classes of DNFBPs as defined by the FATF, except for accountants. DNFBPs are however not in practice being targeted for AML/CFT obligations due to very small size and low risk for some, but not all sectors. The FIU regulation for DNFBPs, which sets out detailed preventive measures for DNFBPs, has not been issued. Palau has indicated that the proposed DNFBP regulations (which as drafted would apply to all DNFBPs) will not apply to lawyers, due to legal professional privilege issues. Palau indicated that real estate agents will be the only DNFBPs captured by the regulations; it is appropriate that real estate agents are captured as the ML risk for real estate agents is not low and they are vulnerable to ML. The lack of coverage of lawyers is a significant gap given that they provide some TCSP services and are engaged in real estate transactions which are rated as high risk.

#### *Understanding of ML/TF risks and AML/CFT obligations and application of risk mitigating measures*

248. The limited understanding of risk by REs and variable understanding of Palau's AML/CFT obligations covered in the regulations (for all REs), contributes to the variable implementation of preventive measures in Palau.

#### *Financial Sector*

249. FIs generally display a very limited understanding of Palau's ML/TF risks both generally and specifically to individual sectors. There is an absence of internal mechanisms to identify the ML risks in Palau. The REs have received little input from regulatory authorities on what the significant risks are and what the expectations of supervisors are to address these risks. FIs are not aware of the draft findings of the NRA. Palau has indicated that management changes had occurred in two of the international banks just prior to the onsite visit. While Palau suggests

that engagement with REs on ML risk has occurred, it is clear that additional outreach to raise awareness of Palau's ML/TF risks to all REs is needed.

250. The three US owned banks' broader understanding of ML and TF risk (in comparison to other sectors) results from higher degrees of environmental awareness, more sophisticated analytical tools, as well as targeted training and instruction, primarily from their overseas parent companies with respect to operations outside of Palau. While these banks exhibited negligible understanding of ML risks within Palau, with one foreign bank still basing its understanding of risk on the 2008 MER, the overall risk profile and context of Palau needs to be borne in mind. The relatively low level of crime in Palau and the small size of the financial sector and the negligible size of the DNFBP sector suggests that the preventative measures put in place by the three foreign banks (which dominate the financial sector) do not require fundamental improvements. Palau does however need to enhance the application of preventative measures across all sectors.

251. The FIU AML Regulation for FIs was enacted in November 2017. This risk-based regulation applies to all FIs and includes references to internal AML/CFT governance including compliance officers, development of internal policies, systems and controls, customer due diligence and identification, reporting of cash and suspicious transactions and border currency reporting.

252. The US banks have a better understanding of their AML/CFT obligations as they have adopted US standards on AML/CFT, including a sound understanding of their main obligations (CDD and record keeping) under the AML/CFT framework, including STRs, CTRs, PEPs, sanctions screening, and wire transfers obligations. These banks are required to comply with both Palauan and home country (US) requirements, with much of what is required in Palau being based on the US requirements.

253. The two foreign money remittance service providers possess basic understanding of their broad ML/TF risks, but no understanding of any specific Palauan risks. These two organisations had a solid understanding of their AML obligations. Palau has additional alternative money remittance companies that provide very small dollar value remittances and primarily act as a postal drop box for Filipino foreign workers. All of their financial transactions need to clear one of the three US-owned FIs in Palau. The remittance sector has received no outreach on its obligations, is not supervised and does not have an understanding of ML/TF risks.

254. Local banks demonstrated negligible understanding of their AML/CFT obligations and no understanding of ML and TF risks in Palau.

255. Recognising that the risk for TF is considered low in the NRA, the understanding of TF risk in Palau is negligible amongst all FIs.

256. For TF, while the overall risk is considered low, the US banks and money remittance service providers have a solid understanding of their obligations related to the UNSCRs. Other reporting entities have no awareness of these obligations.

#### *DNFBP Sector*

257. The DNFBPs displayed no understanding of Palau's overall ML/TF risks, and are not aware their own sectoral ML/TF risks.

258. The FIU AML Regulation for DNFBPs, which sets out detailed AML/CFT obligations for DNFBPs, is not in force and effect. While the draft regulation will apply to real estate agents, dealers in precious metals and stones, lawyers, notaries and accountants (not covered in the

5 AMLA), Palau considers real estate agents as the only active DNFBP. While TCSPs are captured by the law and the regulations, there are no entities performing the functions of a TCSP other than lawyers. Due to significant concerns that the AML Regulation would be contrary to legal privilege, it is anticipated that this regulation will not apply to lawyers and that they will not be captured by the AML/CFT legislation, including when they are providing TCSP services. The lack of coverage of lawyers present a significant gap, given their role in providing TCSP services and engagement in real estate transactions which is a higher risk sector. Palau indicated that proposed DNFBP regulations will include accountants if the risk in this sector rises and they begin to offer service as per the FATF definition, and probably dealers in high value assets (cars and boats)).

259. Most DNFBPs are not being targeted for AML/CFT obligations by Palau due to very small size and very low risk. The regulations should apply (both in law and in practice) to real estate agents and lawyers (at least when they act as TCSPs) as the risk in this sector is not low and it is vulnerable to ML. While only two real estate agents are currently active in Palau, the risk of the purchase of valuable assets including property for ML is rated medium in the NRA. Real estate should be subject to AML/CFT legislation and regulations, and should be supervised for AML/CFT, a conclusion supported by interviews conducted during the onsite visit. In addition, a number of government and RE representatives indicated that lawyers play a major role in arranging and executing real estate transactions on behalf of clients in Palau and it was also noted that lawyers have on occasion assisted businesses with company formation and trustee services related to foreign ownership laws.

260. DNFBPs had no understanding of ML/TF risk in Palau. The NRA consultation process appeared to include DNFBPs through consultation undertaken with the Chamber of Commerce; however, nearly all the representatives that the assessment team met with during the onsite visit did not recall involvement in the process. It was also clear to the assessment team that none had received any feedback on either their input provided or the NRA more generally through the process.

#### *Application of enhanced or specific CDD and record keeping requirements*

261. In conducting CDD processes, the three U.S. banks have measures in place to comply with CDD and record keeping requirements, including applying EDD on high risk customers. These measures arise from their home (US) requirements and were in place prior to the new FI regulations and are to some extent consistent with the new regulations though it is unclear if they cover all aspects of the new regulations.

262. Other FIs have limited implementation of CDD to identify the beneficial owners of legal persons and whether a natural person is acting on behalf of another natural person. This is due to the lack of overall understanding of the concept of beneficial ownership, and the available resources and systems to identify beneficial owners. Palau has yet to formulate the necessary legislative or regulatory provisions regarding the requirement of when a FI is unable to comply with relevant CDD measures. In addition, there is also no explicit requirement for REs to apply simplified CDD procedures that are commensurate with risk factors. Palau does not require FIs to verify the identity of the customer and beneficial owner before or during the course of establishing a business relationship.

263. FIs do not appear to cross-reference CDD information received for legal persons with records kept in the company registry maintained by the OAG.

264. The U.S. banks and money remittance service providers demonstrated effective implementation of customer on-boarding processes i.e. identifying and profiling customers on

the basis of risk. Based on a review of both the banks' account opening forms and the remittance service provider customer information sheet, customers generally provide self-declaration on certain information including details of shareholders of a legal person, beneficial ownership, PEP status, the source of funds, and types of business they engage in.

265. The U.S. banks classify their customers as low, medium or high risk, and apply enhanced CDD for higher risk customers. However, it is unclear to what extent verification is conducted on CDD information.

266. Based on the supervision undertaken over last five years by the FIC in the banking sector, no areas of concern were identified regarding CDD or reporting.

267. Most FIs have record keeping procedures and records are maintained for 10 years.

268. As no AML/CFT supervision of DNFBPs has occurred, compliance with CDD obligations and record keeping obligations is unknown but is assumed to be low. DNFBPs have not submitted STRs.

### *Application of EDD measures*

#### Financial Sector

269. **PEPs:** The three U.S. banks are aware of their obligations in relation to screening and carrying out EDD for local and foreign PEPs, with these banks relying on automated computer lists from each regional office in Guam and Hawaii.

270. Palau's legislation has no PEP requirements for FIs to obtain senior management approval when dealing with PEPs which impacts on effectiveness. The U.S. banks in Palau are not required to do this and according to Palauan authorities this requirement was removed from the FI regulations so that it could be consistent with FINCEN requirements in the U.S.

271. While authorities indicated that other small FIs in Palau are aware of their KYC, CDD and EDD obligations, the assessment team meetings with the representatives of the two domestic banks found that they have limited awareness of obligations to carry out EDD for PEPs, and they do not have computer screening tools (or manual procedures) to perform support obligations.

272. **Correspondent Banking:** The three U.S. banks demonstrated good measures to mitigate the risks from correspondent banking. Correspondent banking relationships are generally maintained with international banks based in countries with stringent AML/CFT requirements. Other banks do not have wire transfer facilities and do not have correspondent banking relationships with offshore banks.

273. **New Technology:** ML/TF risk assessment is being conducted by the three U.S. banks prior to the introduction of new products though not Palau specific assessments. Smaller FIs and DNFBPs do not appear to assess risks for new products. There are no specific, enforceable requirements for FIs to assess the ML/TF risks of new products, practices and technologies in Palau.

274. **Wire Transfer:** The three U.S. banks have a good understanding of wire transfer requirements. Primarily originator's and beneficiaries basic information is required for any inward or outward wire transfer. The U.S. banks indicated their correspondent banks would ensure originator and beneficiary information. The two domestic banks do not have wire transfer facilities. The two non-bank remitters follow headquarters' compliance and monitoring process of originator/beneficiary information. The five banks are not applying any de minimis threshold for cross border wire transfers. No enhanced or specific measures in terms of wire transfers are implemented by FIs.

275. **Targeted Financial Sanctions related to TF:** Other than the three U.S. owned banks and the two foreign money remittance service providers, which have automated screening systems (for UN and Sanctions lists), the requirements of the UNSCRs are not addressed by other FIs. While smaller FIs depend on the FIU to provide updated UN sanctions lists, the authorities indicated that smaller FIs are conducting the UNSCR requirements through one of the three (3) major banks in Palau which provide wire transfer services to smaller FIs, and, thus, are subject to the same automated screening applied by those major banks. A basic understanding of the lists or the need for them is nevertheless absent.

276. Palau is yet to identify a competent authority with responsibility for proposing persons and entities and is yet to establish a mechanism for identifying persons or entities for designation in accordance with the designation criteria set out in the relevant UNSCRs.

277. **Higher-risk countries identified by the FATF:** The three U.S. banks and two non-bank remitters demonstrated a good understanding in relation to higher risk jurisdictions identified by the FATF, such as Iran and DPRK. However, apart from the EDD measures including requiring senior management approval for new account opening and requiring information on the source of funds; it is unclear if these REs adopt any other specific countermeasures for customers from higher risk countries. Local banks, smaller FIs and DNFBPs do not adopt any specific counter measures or EDD for customers from higher risks countries and do not have any understanding of what is required. In Palau it is not explicitly provided that FIs should be required to apply enhanced CDD to business relationships and transactions with natural and legal persons (including FIs) from countries for which this is called for by the FATF which impacts on effectiveness.

#### *DNFBP Sector*

278. As the FIU regulations for DNFBPs have not been issued, comprehensive requirements for CDD, EDD and STR reporting, which are not provided in the AMLA, were not in force for DNFBPs at this stage. The DNFBP representatives that the assessors met with exhibited no awareness of EDD.

279. The authorities indicated that at least one of the two real estate agents in Palau is a former FIC member and was well aware of FIU requirements for KYC, CDD and EDD.

#### *Reporting obligations and tipping off*

280. Suspicious transaction reporting by FIs is occurring to some extent however no STRS have been submitted by DNFBPs.

281. For the period 2016-2017, a total of 207 STRs were filed – 104 STRs in 2016 and 103 STRs in 2017. All of these STRs were filed by two US banks, while the remaining banks, money remittance service providers and all DNFBPs in Palau have not filed any STRs. While 207 STRs is a sizable number within the context of Palau, the FIU indicated that a number of STRs suggested defensive reporting.

282. Palau suggests that illicit funds associated with drugs and prostitution which are Palau's higher risk crimes, are rarely processed through Palau's formal financial sector. This suggests the current level of STR filing and, in particular, the lack of reporting by non-FIs, is not commensurate with the ML/TF risks identified by Palau.

283. There has been no STR related to TF which is consistent with Palau's assessment of TF risk.

284. The FIU acknowledged that while FIs and some DNFBPs know how to report STRs to the FIU, there are deficiencies in the identification of suspicious transactions. FIs (other than two of the US banks) and DNFBPs exhibited limited understanding about STR reporting. Further guidance and support is required from the FIU. The FIU Regulation for FIs was enacted during the onsite visit which will assist in strengthening the STR reporting regime.

285. The DNFBP regulations are yet to be enacted, and steps need to be taken to ensure DNFBPs are required to meet the full range of STR reporting requirements.

286. The one US bank which has not filed any STRs indicated it only deals with local depositors (no foreigners are accepted as customers) and has been found by the FIC to have an acceptable policy for reporting both STRs and CTRs, though one supervisory report noted that improvements were required to improve the CTR reporting system. Authorities also noted that the level of STR reporting or lack of reporting is reflective of the level of exposure this bank has (or does not have), not whether the staff understand their obligations to report. From the onsite visit interview, it was not clear whether this local branch fully understood what the requirements are around STR reporting. The bank shared one example where the regional office believed that an STR should be submitted which was contrary to the opinion in the local branch which resulted in no STR being submitted. Based on limited information supplied at the onsite meeting, it appeared that an STR should have been reported even if it resulted in no further measures either by authorities or the bank itself.

287. In fact, the various levels of exposure that the REs have in Palau, understanding of ML/TF typologies and dealing with 'red flags' and risk indicators, particularly from smaller REs, may result in some under reporting in some cases in these sectors, while the over reporting in other cases is considered by the FIU to be defensive reporting by the FIU (for example, the total STRs submitted by one bank in 2017 was 97 reports which was far higher than any other FI).

#### *Internal controls, procedures and legal/regulatory requirements impeding implementation*

288. The US banks and money remittance service providers generally have better AML/CFT compliance procedures due to home office group requirements, which are in line with the AML/CFT Law, while DNFBPs have limited understanding on the obligation for internal controls. A number of FIC examination reports confirm that the banks generally have adequate and comprehensive AML policies. In particular the US banks have implemented strong internal controls to comply with AML/CFT requirements.

289. The AMLA has basic references to CDD, PEPs, STRs, reporting, wire transfers and supervision and these will be enhanced via FIU financial regulations. While the FIU financial regulations were only enacted in the second week of the onsite visit, Palau authorities informed assessors that these regulations do not deviate from the FDIC/FINCEN Regulations in the U.S. However, Palau regulatory authorities need to ensure that the financial sector's AML policies and procedures are in line with the requirements of this newly issued regulation, as it is unclear if all elements of the regulations have been fully assessed based on the supervisory reports provided.

290. One domestic bank has submitted a STR which indicated EDD was undertaken due to unusual customer behaviour during the opening of a new account. The customer identified in the STR was confirmed to be subject to a drug investigation by the Belau Drug Enforcement Task Force which received the STR from the FIU. He was convicted on 18/04/2017 of two counts of trafficking methamphetamine and one count of possession of methamphetamine, and jail time is being currently served (RoP vs. Arnold Buck, case number 16-108).

## CHAPTER 5. PREVENTIVE MEASURES

291. Examination reports provided to the assessment team from the past five years highlight the following areas (referenced as ‘matters requiring attention’ in the inspection reports) requiring attention which have resulted in better compliance:

- Improve the quality of currency transaction reporting;
- The banks should periodically review its accounts to keep account information up to date, account activity is in line with purpose of account and ensure account holder names are not on USDN or OFAC lists; and
- Formalise training provided to staff including the provision of schedules, the subject matter covered in program, testing criteria, qualification requirements and clear standards that staff need to achieve for AML compliance.

292. DNFBBPs are required to implement internal controls and procedures under the AMLA. However, the requirements in the Act are broad and as noted previously the DNFBBP regulations have not been issued. Whether these institutions have implemented these requirements is difficult to ascertain, as the FIU has not yet issued detailed requirements or assessed the institutions’ compliance with their existing broad obligations in this area.

### *Overall conclusions on Immediate Outcome 4*

293. Palau has improved its legal framework for preventive measures since its 2008 MER, through the issuance of the AMLA in 2014, and the issuance in November 2017 of the AML/CFT regulations for FIs, which contain detailed requirements. However, there has been no implementation of the additional requirements contained in the regulations since they were only introduced during the onsite visit and regulations for DNFBBPs are still only in draft. While the three US banks, which manage 98% of financial transactions in Palau, have a range of preventative measures in place based on their US parent company policies and procedures, the remaining REs have little in place recognising that they are incredibly small and except, with lawyers and real estate, have very low ML risk. Just about all STR and CTR reporting is provided by the U.S. banks.

294. **Palau has a moderate level of effectiveness for Immediate Outcome 4.**



## CHAPTER 6. SUPERVISION

### *Key Findings and Recommended Actions*

#### **Key Findings**

- The FIC is applying context appropriate risk-based supervision to the banking sector, where three US banks account for 98% of the total financial sector activity. The international banks, and to a slightly lesser extent the domestic banks, have a good understanding of their AML/CFT obligations though had a very limited understanding of ML/TF risks in Palau. DNFBPs have little understanding of AML/CFT obligations and negligible understanding of ML/TF risks.
- Risk-based supervision has been implemented to some extent within the Palauan context, REs are not however required to undertake risk assessments or apply simplified and enhanced CDD measures when applicable. Other than the NRA which was recently completed, supervisors do not appear to have mechanisms to regularly identify and assess the ML/TF risks of the FIs and sectors they supervise and no sectoral assessments have been undertaken.
- The licensing (including licence renewal) framework for REs is not comprehensive. There are variable fit and proper requirements in place to prevent criminals and their associates from operating within the financial sector, but for the DNFBP sector, which is very small, requirements are limited, particularly in the absence of AML/CFT regulations for DNFBPs.
- Palau has not designated relevant AML/CFT supervisors for all the different sectors, in particular DNFBPs such as real estate agents and lawyers, who have high and medium risk for ML/TF respectively. Palau does not have any SROs. DNFBPs other than real estate agents and lawyers either have very low risks or their activities do not fall under the FATF standards (accountants, DPMS and notaries). Palau does not have TCSPs though lawyers do perform legal services related to the formation of legal entities. Due to legal privilege, Palau does not intend to apply AML/CFT obligation on lawyers even when they are only acting as TCSPs which is of concern.
- No financial or criminal sanctions have been applied to date by the FIC or FIU for breaches of AML/CFT requirements, which when noting the nature of crime and the context in Palau is understandable. The FIC have issued limited corrective orders to the five banks for areas requiring remedial action in cases of AML/CFT deficiencies as part of the prudential supervision process, which includes consideration of AML/CFT measures. The FIC indicated that all corrective orders have been responded to and no further actions have been required.

#### **Recommended Action**

- While noting that overall the DNFBP sector is very small, Palau should consider designating a competent authority to be the AML/CFT supervisor for the DNFBP sector.
- The FIC should commence a programme of risk-based supervision of FIs for AML/CFT particularly for simplified and enhanced CDD measures, informed by a sectoral risk assessment of the sector.
- Outreach to and supervision of higher risk DNFBP sectors, which includes real estate and lawyers, should be undertaken.
- The FIC should consider allocating additional resources to its supervisory departments and

provide training on risk-based AML/CFT supervision.

- The FIC should enhance its engagement with all FIs to promote a better understanding of their AML/CFT obligations and the ML/TF risks facing Palau, in particular to improve clarity on implementation of the AML/CFT framework and supervisory expectations.
- Detailed regulatory measures for fit and proper tests should be developed for and applied to all sectors.
- Supervisory authorities should issue appropriate sanctions for non-compliance with AML/CFT obligations.

295. The relevant Immediate Outcome considered and assessed in this chapter is IO3. The recommendations relevant for the assessment of effectiveness under this section are R26-28 & R.34 & 35.

### *Immediate Outcome 3 (Supervision)*

296. The FIC and FIU are empowered as AML/CFT supervisors for FIs and DNFBPs respectively in Palau based on the AMLA Section 3327 and any regulations issued such as the FIU regulation to FIs which was issued during the onsite visit. The FIC is responsible for prudential supervision and AML/CFT supervision for banks and money remittance companies (ARS), while the FIU is responsible for AML/CTF supervision of DNFBPs. The DNFBPs regulation has yet to be enacted. The FIC comprises one Bank Commissioner and one Bank Examiner while the FIU has a Director and an analyst.

297. Table 13 lists the reporting entities, relevant prudential/sectoral regulators and AML/CFT supervisory authorities. It also indicates whether in practice AML/CFT supervision has commenced.

**Table 13: Reporting Entities, Regulators and AML/CFT supervisors**

<b>CATEGORY</b>	<b>NUMBER</b>	<b>Regulatory /SRB</b>	<b>AML/CFT Supervisor (in law)</b>	<b>AML/CFT Supervision undertaken</b>	<b>Total assets (million dollars)</b>	<b>Total financial sector assets *</b>
Banks	5	FIC	FIC	FIC	251	98%
Insurance intermediaries	5	None	None	None		
Finance Companies	12	OAG **	None	None		
Money and value transfer businesses	7	FIC	FIC	None		1%
Credit Unions	6	OAG	None	None		
NPO's	19	OAG	None	None		
Lawyers (private practice, work for Gov't/ active & non-	66 (18 active private practice; 24 gov't;	Palau Supreme Court	FIU	None		

active)	22 off- island inactive					
Licensed notaries	32	OAG	FIU	None		
Accountants (Auditors)	17	Office of Public Auditor	None	None		
Gold and precious metals (retail and small family businesses)	3	None	None	None		
Real Estate Agents	2	None	None	None		

\* Note – total financial sector assets of remaining reporting entities is approximately 1%.

\*\*For registration purposes

### *Licensing, registration and controls preventing criminals and associates from entering the market*

#### *Financial Institutions*

298. The FIC licenses or supervises only banks and money remittance service providers (ARS). The Financial Institutions Act 2001 (as amended), in conjunction with a series of Prudential and Administrative regulations approved by the FIC Governing Board, provide the FIC's regulatory authority over these sectors. Institutions licensed, regulated or supervised by the FIC are also supervised for AML/CFT obligations under both the AMLA and the FIU FIs regulation (issued in November 2017). For example, Section 3327 (b(3)) of the AMLA empowers the FIC and FIU to establish and apply fit and proper criteria for owning, controlling, or participating, directly or indirectly, in the directorship, management or operation of financial institutions. While the FIU FIs regulation requires FIs to screen potential employees to ensure that employees are fit and proper, there are no regulatory measures in the form of detailed instructions to assess fit and proper tests for FIs. However, authorities argued that although the FIU FIs regulation and FIC did not prescribe the criteria for fit and proper tests, it is expected that banks have internal policies and measures undertaken in practice to ensure that fit and proper staff are engaged in the operation of a licensed financial institution, though no evidence confirmed this.

299. Although the FIC has adopted regulations for the licensing of ARS, the FIC has not implemented procedures to apply the regulation and so has not begun licensing money remitters as of yet.

300. Credit unions are very small and have low risk, and are not supervised for AML/CFT.

301. The three finance companies provide small loans. The maximum loan provided is no more than USD2,000 and is primarily related to Palauan local customary practices. While the lack of a licensing regime for such entities is a gap, the small size of these finance companies and the target of the loan products indicate a low risk of ML. No supervision for AML/CFT is

undertaken on this sector and little regulation more generally. While this deficiency is given limited weight, steps need to be undertaken to supervise this sector for AML/CFT.

302. The AMLA Section 3316 and the FIU FI regulations do not allow the licensing or dealing with any shell banks, while the FIA specifically does not allow the licensing of any shell banks.

303. The FIC provided evidence that since 2002, two licence applications had been revoked for banks that were suspected to be involved in ML activities, which confirms that controls are in place and being implemented to prevent criminals and associates from entering the market. There have been no cases where applications were rejected for failure to meet fit and proper requirements in relation to a FI's license, or a request of new shareholders who are acquiring a controlling stake or the appointment of any management executive.

304. Palau has five insurance intermediaries (are not covered under the FIA and thus are not under the purview of the FIC) that sell life and non-life products for three Guam- based insurance companies. These life products are simple products including endowments, group life insurance and health (significant disease) insurance. Palau has no unit-linked insurance and annuity. While overall, AML/CFT risks in this sector are very low, no regulation or supervision for AML/CFT is undertaken or more generally.

305. The FIA (26PNCA Chapter 10 Section 1053(a) and 1054) has requirements that any significant changes to bank ownership must be authorized by the FIC. There has only been one change of significant ownership of a FI since 2008. The former Palau Construction Bank was sold and the FIC required the seller to notify the FIC about the details of the sale, and for the buyer to apply for a bank license. Whole bank purchases are treated the same way as a new bank license application and therefore require it to go through the licensing process, including the due diligence and evaluation of such.

306. Change in ownership does not occur frequently in the Palauan banking industry, nor have there been any major changes in the ownership structures at home office for the three major US bank branches. Such changes would also be reflected in any US SEC filings for banks that are publicly traded on a recognized US stock exchange such as Bank of Hawaii and Bank of Guam, and changes in ownership are required to be reported immediately to the FIC. US Bank Branch headquarters have to provide an annual report to the FIC regarding any substantial changes in ownership structure and/or executive officer changes at home office and at the regional level. The FIC can decline a bank branch manager appointed by head office if necessary.

307. Other changes would be reported annually, as required by the FIC. Prior to onsite examinations of US bank branches, the FIC conducts a Source Of Strength Analysis ("SOSA") which reviews any material changes in stock ownership and potential effects on bank capitalization.

#### *DNFBPs*

308. The DNFBP sector in Palau is very small, and currently includes only real estate agents and lawyers. In practice, Palau does not apply AML/CFT obligations including fit and proper requirements on a number of DNFBPs due to low risk (accountants, dealers in precious metals and precious stones, and notaries (notaries in Palau do not fall under the definition of "notaries" under the FATF standards)) and very limited activity that relates to inactivates captured by the FATF recommendations. Casinos and trust and company service providers do not operate in Palau, though lawyers do offer some of the same services as TCSPs.

309. Little weight is placed on the absence of licensing controls for finance companies and insurance companies, however, if the situation changes for these sectors, Palau would need to institute better controls (as permitted under the AMLA).

310. The DNFBPs regulation (still to be issued by the FIU) will be issued only to the real estate sector. While Lawyers are captured by the AMLA, Palau will not apply AML/CFT obligations to this sector due to concerns related to legal privilege. The risks associated with lawyer's involvement in real estate and the creation of businesses suggests that the exclusion of lawyers from AML/CFT obligations will create risks and vulnerabilities for Palau.

311. Notaries are licensed by the Ministry of Justice, and criminal record checks occur on application and on renewal (after two years). The notaries are only licensed to authenticate signatures for legal documents, such as affidavits, land lease documents, or any document filed with the courts requiring authentication.

312. The Office of the Public Auditor (OPA) has a framework in place for licensing and it undertakes regular monitoring of its members (accountants/auditors). Regarding the licensing and disciplinary function of the Office, Palau has a code of ethics that is binding on the OPA. The OPA conducts monitoring mechanisms through a peer review process, to ensure that the ethical conduct of members is maintained. So far, no cases of a serious breach of the code of conduct has occurred.

313. Real estate agents in Palau have no licensing requirements and the sector is not regulated. Palau provided no evidence of any fit and proper tests for this sector noting currently only two agents who work for Guam-based businesses are active in the jurisdiction. However, it is unknown to Palau's authorities whether Guam-based authorities carry out any checks or supervision on their real estate agents, including those operating in Palau. Based on interviews during the onsite visit, the assessment team believes that real estate agents should be subject to licensing requirements and be supervised for AML/CFT purposes in Palau as the ML risk associated with real estate is not low.

314. There are no dealers in precious metals or dealers in precious stones in Palau that would be categorized as such under the FATF Recommendations. The few jewellery stores carry a limited and low cost selection of basic jewellery and all transactions would fall under the threshold for coverage under the FATF Recommendations.

315. Palau has not as yet assessed dealers in high value assets even though they are considered high risk in the 2017 NRA. Palau has included them in the yet to be enacted draft DNFBP regulations due to the potential of self-laundering. In the context of Palau, the sale of cars and/or boats is a concern for ML. While most vehicles in Palau do not exceed USD10k in value as they are second hand vehicles, boats are a lot more expensive. Palau has two boat dealers and they are not currently regulated by the FIU but are regulated as any business is by the Ministry of Finance.

### *Supervisors' understanding and identification of ML/TF risks*

316. The FIC and FIU have some understanding of ML/TF risk in the financial sector, though a more detailed sectoral assessment warrants consideration. The FIC is a member of the MLWG, which was responsible for identifying ML/TF risks and preparation of the Palau ML/TF National Risk Assessment. The FIC has developed manuals on ML risk examinations to provide its compliance assessors with guidance on conducting compliance assessments.

317. On FIs, while the assessment team was informed that the five banks and ARS have been consulted in the NRA process, the consultation seems to not be adequate as all the REs

interviewed during the onsite visit indicated negligible awareness of the NRA and no understanding of risks in Palau. Palau suggested that two foreign bank managers that the team has met with were not in Palau during the NRA process, which may explain their limited understanding of the NRA process or risk in Palau. This does not however explain why virtually all the nominated FI representatives interviewed had negligible understanding of ML/TF risks and little recall of the NRA process.

318. While broadly DNFBPs in Palau do not have significant ML/TF risks, real estate agents, lawyers and dealers in high value assets, require closer supervision for AML/CFT.

319. The MLWG is mandated by Executive Order to undertake a NRA annually which will allow Palau to further develop its understanding of risk and for supervisors to enhance their supervision based on the risks faced by REs each year.

### *Risk-based supervision of compliance with AML/CFT requirements*

#### *Financial sector*

320. Supervision of reporting entities for AML/CFT compliance is not fully based on ML/TF risk noting the context within Palau, where three US banks account for 98% of the total financial sector activity. Bank supervisors recently implemented a limited risk-based approach to ML/TF supervision. AML/CFT examinations are done as part of a broader prudential visit by the FIC. As per Table 14 below, the FIC conducts prudential supervision including AML/CFT examination visits to banks, on a variable schedule. For example, Bank 1 has been visited twice, five years apart, with only a rating of '2' in 2010 which suggests the findings did not necessitate an earlier return visit. Banks 2 and 3, have been visited every second year and appear to have a good AML score to suggest the frequency is probably appropriate. Both Bank 4 and 5 were visited in concurrent years, which appear appropriate noting the composite scores for AML/CFT of 3 and 2 respectively. (See Table 14).

321. In previous years, bank AML/CFT supervision was rules-based in combination with prudential supervision. Due to the size of the banking sector and the controlling of 98% of the financial activity in Palau by three US banks, they only provide supervision when and where required, due to strong supervision by their home regulators in the US. With the US banks, more AML/CFT focused supervision of these entities should be considered by the FIC, especially noting that the FDIC or FINCEN have never assessed the Palauan branches in Palau and do not appear to have undertaken specific offsite supervision of these branches. In addition, no joint examinations have been undertaken between the FIC and US regulators and it does not appear that information is shared between the Palauan and US regulators. However, the FDIC, the primary regulator of banks in the US with branches in Palau, performs examinations of institutions on a consolidated basis, which suggests that the FIC should undertake more comprehensive reviews of those banks with lower composite scores.

322. The FIC is applying context appropriate risk-based supervision through an inspection plan to licensed financial institutions and in particular the banks. The FIC rate financial institutions according to the six factors - Capital, Assets Quality, Management, Earnings, Liquidity and Sensitivity to market risk (CAMELS). Selection criteria of banks for inspection is based on a CAMELS rating of institutions, which does not usually include ML/TF as a determinant of a financial institutions rating, though the FIC has incorporated AML/CFT into the assessment. The FIC conducts ongoing supervision of the five banks operating in Palau, and use risk and outcomes of supervisory assessments to determine frequency of supervision and the depth that each supervisory engagement takes. The FIC has a good understanding of how these

banks operate and the issues and challenges they face which suggest that the risk based approach undertaken in Palau is suitable for the Palauan context.

323. While a ML review of the banks is part of the regular inspections, the FIC does not have any approved mechanism for carrying out ML/TF thematic inspections. FIC reportedly carried out a survey on domestic banks' correspondent banking with the three US banks in 2010 and another survey in 2012 on wire transfers. However, the brief note shared with the assessment team suggests no key findings and the surveys were of a limited nature.

324. However the FIC is applying an onsite examination mechanism that assesses a number of prudential components including AML/CFT, where a composite rating from 1 to 5 is given, based on the following criteria:

- Overall rating of '1', based on the components reviewed in the onsite examination. Banks in this category are basically sound in all respects. The components are rated '1' and adverse findings or concerns are minor and correctable in the normal course of business. As a result, the Bank continues to demonstrate minimal cause for supervisory concern.
- Overall rating of '2', based on the components reviewed in the onsite examination. Banks in this category are considered by the FIC to be fundamentally sound, but may have some modest weaknesses that are correctable in the normal course of business. The bank under this rating is generally viewed to be relatively stable and is able to adequately withstand business fluctuations.
- Overall rating of '3' to '5'. Banks in this group exhibit financial, operational and/or compliance weaknesses ranging from moderate (3) through to unsatisfactory (5). Banks in this group require close supervisory attention and a defined plan for corrective actions.

325. In each prudential report, a rating of between 1 and 5 is also given for the AML/CFT assessment within the larger report, with a similar scoring of (1) suggesting good AML/CFT measures, (2) moderate with some improvements required and 3-5 needing significant improvements to address identified deficiencies.

326. Very limited off-site supervisory tools/mechanisms are applied to assess banks' compliance with AML/CFT obligations. Due to perceived low risk of terrorism in Palau, supervisory authorities have very limited regulations, guidance and supervisory capabilities for TF assessment.

327. On-site compliance examinations for AML/CFT undertaken by the FIC are set out below:

**Table 14: list of FIC's on-site compliance examinations for AML/CFT**

<b>Year</b>	<b>Financial Institution – NB all are Banks (5)</b>	<b>Scope of supervision*</b>	<b>Composite score</b>	<b>AML score</b>	<b>Regulatory Response Notes</b>
2010	Bank 1	LS	3	2	letter to the bank Board
2011	Bank 3	LS	2	2	letter to the bank Board
2012	Bank 2	BFS	1	1	letter to the bank Board
2013	Bank 3	BFS	2	2	letter to the bank Board
2014	Bank 2	BFS	1	1	letter to the bank Board
2015	Bank 1	LS	1	1	letter to the bank Board

	Bank 3	LS	2	1	letter to the bank Board
	Bank 5	FS	2	2	Commitment Letter
2016	Bank 2	LS	1	1	letter to the bank Board
	Bank 5	LS	2	2	Memorandum of Understanding; FIC Board approved Corrective Order and Monetary Penalty proposed but ended up not happening
	Bank 4	LS	3	3	Memorandum of Understanding
	Bank 4	FS	3	3	Memorandum of Understanding
2017	Bank 4	LS	3	3	Proposed Corrective Order and Monetary Penalty, NO FIC BOARD QUORUM=INACTION, ROE and Regulatory Response never delivered to the bank
	Bank 3	LS	2	1	letter to the bank Board

\* FS=Full Scope; LS=Limited Scope; BFS=Branch Full Scope.

328. The FIC advised that the examination visits take approximately one to four weeks and they vary from full scope examinations to limited scope that will always include an AML component. Limited scope examinations are planned subsequent to each full scope examination to follow-up on problematic issues or matters cited during the most recent full scope examination or during offsite monitoring.

329. The AML section is a standalone component; however, it has a bearing on the Management component rating. The composite rating is not a mean or weighted average calculation, but rather it is a numerical representation of all qualitative factors taken into account when considering all individual components of an onsite examination, including an assessment of areas of higher risk requiring additional consideration.

330. The FIC has also advised that every full scope onsite examination reviews all areas of a bank's operations under each thematic component, including the AML examination. All AML examinations are thematic and include a review of AML policies and processes, customer identification and due diligence, management and staff training, staff vetting, cash and wire transaction practices, as well as compliance with AML reporting requirements including CTR and STR filing. Banks assigned a '1' or '2' rating will not usually have on the Reports of Examination, an extensive and detailed inventory of all items reviewed and the findings therefrom. This level of detail is reserved for ratings of '3, 4 or 5'. On Reports of Examination, it is indicated if there are any specific areas where improvements are necessary or recommended based on the findings of that particular examination and progress reports are mandatory and part of the FIC's regulatory response policy. All repeat findings and areas that were identified as problematic in a previous FIC' onsite examination will be revisited and part of the concentration of the onsite examination. However, while Palau's regulatory framework requires FIs to



perform additional CDD for both face-to-face and non-face-to-face categories of customer, business relationships or transactions with a higher risk of ML/TF, and to apply simplified CDD measures, it is unclear whether higher or simplified measures have been undertaken by FIs in line with the FI regulation which were released during the onsite visit, and whether any supervisory actions have been undertaken by the FIC on non-compliant entities with these requirements, and what sanctions or penalties have been applied.

331. FIC's strategy to assess one to two banks a year on average when the sector is rated high for ML risk appears to be in the main appropriate when noting the regularity of assessments (see earlier table). In addition, there were no onsite examinations for MVTS under the supervision of the FIC (as no MVTS has been licensed by the FIC as of November 2017).

332. Authorities confirmed that FIC and FIU have jointly participated in past onsite examinations. With passage of amendments and, more recently, with adoption of FIU regulations, the FIC recognizes the importance of having the FIU take part in onsite and offsite practices in order to have comprehensive coverage of risk. Furthermore, ongoing collaboration is critical in terms of managing limited resources.

333. The FIC has also noted that the Bank Examiner is certified and trained in all bank examination and financial institution supervisory fields, including having successfully completed U.S. FDIC courses that are qualifying the Examiner as Examiner-In-Charge to be able to lead and conduct all aspects of examination work.

#### *DNFBPs*

334. As noted previously in Chapter 1, the FIU is responsible under the AMLA for supervising DNFBPs for compliance with the AMLA (recordkeeping, CDD and STR reporting). Risk-based supervision of DNFBPs has not yet commenced.

335. The FIU had not conducted any on-site inspections of DNFBPs for AML/CFT compliance.

336. DNFBP supervision, including of real estate agents and lawyers, will allow the FIU to obtain an enhanced understanding of the ML and TF risks posed by each DNFBP (noting the NRA has provided an initial understanding of the broad AML/CFT risks in Palau) in order to effectively set priorities for a risk-based approach to supervision. However, this will not be difficult for the FIU due to the limited number of DNFBPs in Palau, with only real estate agents being targeted for coverage.

#### *Remedial actions and effective, proportionate, and dissuasive sanctions*

337. FIC is empowered under the FIA as well as under the AMLA to impose proportionate and dissuasive sanctions for non-compliance of the FIs, including written warnings, cancellation of licenses and fines. Further, the FIA empowers the FIC to modify, suspend or revoke the licence of a financial institution. In addition, the FIA authorises FIC for a range of disciplinary and financial sanctions, such as imposing fines on the financial institution or corporation or on its administrators or principal shareholders in an amount of up to ten thousand dollars (USD10,000) per day for each day that the violation continues; provided, however, that fines shall be of similar amount for comparable financial institutions or corporations, with comparable total assets for the same type of violation.

338. Palau indicated that the FIC has imposed corrective orders on banks when warranted for the banks to correct violations. The FIC indicated that the Governing Board of Commissioners has not seen fit to issue more serious sanctions because there simply has been no cause to utilize heavier measures. With the information provided it was not possible for the assessors to determine whether this was appropriate, though nothing suggested it was

inappropriate. The FIC also indicated that the absence of heavier sanctions should not in itself imply that there have been breaches for which available sanctions have not been utilized. This is confirmed in table 14 - "list of FIC's on-site compliance examinations for AML/CFT" - that the FIC has not made use of more serious sanctioning powers (such as civil or criminal penalties), though the Pacific Savings Bank (PSB) case suggests that the sanctions applied by the courts were not dissuasive and proportionate in that instance.<sup>14</sup>

339. Although they are very small with negligible market share, the two domestic banks had limited understanding of ML/TF risks, issues and related controls. However, the FIC did not identify any instances that demanded the use of sanctions. In the absence of any sanctions, it is difficult to assess whether these would have been dissuasive.

340. The FIC indicated that it has the authority to impose monetary penalties on any bank that violates provisions of the FIA or banking regulations without consent and approval of the FIU and OAG.

### *Impact of supervisory actions on compliance*

341. According to feedback from FIs, the FIC's supervisory activity has generally had a positive impact on the level of awareness and compliance in the banking sector. Moreover, the limited outreach by the FIU has also raised the general level of awareness amongst a limited number of other regulated REs.

342. However, given the limited sanctions that have generally been imposed so far and the limited directives to the banks provided by the FIC, their does not appear to be evidence that directives, fines or other sanctions to date have improved (or not) compliance behaviour.

343. As indicated previously, with respect to the onsite examinations conducted by the FIC, the assessment team observed that AML/CFT coverage during the onsite examinations was limited to broad policy and AML/CFT systems review. These assessments briefly considered AML Policy, Compliance Officers, Reporting, Customer Identification, Account Monitoring, Training and Staff Vetting/Employment standards. Even when the reports provided a Composite rating of 3, the actual report had very limited detail. However, the FIC claimed that accompanying the Reports of Examination are Memoranda of Understanding that outline the timeframe for a bank to demonstrate compliance with any violation of statute or regulation. The ratings assigned for U.S. bank branches have not required an MOU and on the cover letter to the Report of Examination, it is stated that the bank's management has 45 days from receipt of the examination report to acknowledge that they have read and understood the report and to provide an update on measures that have been and will be taken to comply with any and all recommendations.

344. The FIC also pointed out that the level of detail apprised in examination reports is commensurate with the rating assigned and appropriate in consideration of there being no findings of violations or contraventions. In cases where there have been violations or contraventions, these violations are clearly stated in appropriate sections of the examination report and recommendations or supervisory mandates are plainly stated.

345. No rectification breach orders have been issued to the sectors supervised by the FIC, though matters requiring attention are noted in the Report of Examination undertaken by the FIC on the five banks. The FIC notes that all notifications of breaches either through the examination reports or provided more informally have been adequately dealt with. Examination

<sup>14</sup>See IO. 2 - *Pacific Savings Bank (PSB)* case.

reports provided to the assessment team from the past five years highlight the following areas requiring attention:

- Improve the quality of currency transaction reporting;
- The banks should periodically review its accounts to keep account information up to date, account activity is in line with purpose of account and ensure account holder names are not on USDN or OFAC lists; and
- Formalise training provided to staff including the provision of schedules, the subject matter covered in program, testing criteria, qualification requirements and clear standards that staff need to achieve for AML compliance.

346. As noted above, the AML/CFT regulations have not been issued and active supervision of DNFBPs for AML/CFT compliance has not commenced, thus supervisory impact in these sectors is low. It is very difficult to gauge the levels of compliance in these sectors in the absence of any AML/CFT supervision. Active supervision of non-bank financial institutions has also not commenced.

### *Promoting a clear understanding of AML/CFT obligations and ML/TF risks*

347. Neither the FIC nor the FIU have provided guidance to the financial sector on the AML/CFT framework (noting that a formal framework or policy is yet to be developed). However, the financial sector (mainly three US banks) demonstrates a reasonable understanding of AML/CFT obligations and the close engagement by the FIC with the banking sector reinforces this.

348. Due to limited resources of the FIC and FIU, supervisors have not arranged formal AML/CFT seminars or training for FIs. The FIU has not issued any formal guidance to support identification and filing of STRs. One of the banks did not report any STRs during the last few years, and the FIU indicated that it managed to meet with the subject FI in 2015 and during the onsite reviewed STR requirements with the bank and specifically discussed the lack of STRs to date. The FIU noted that bank's records and background did not raise any red flags regarding STR reporting deficiencies. This bank did share an instance where ongoing discussions between themselves and their regional office about whether to submit a STR resulted in no report being submitted.

349. As noted in the analysis of IO.1 above, while consultation with private sector stakeholders in the preparation of the NRA has occurred according to Palauan authorities, nearly all of the REs interviewed during the onsite visit indicated limited recollection of the NRA process and they had a negligible understanding of AML/CFT risks in Palau

350. The three foreign (US) banks were providing mandatory internal AML/CFT training to their staff annually. This training was computer-based and staff members are required to complete this type of training annually as part of their professional development.

351. There is no implementation of AML/CFT obligations in the DNFBP sector and no understanding of AML/CFT obligations in this sector.

### *Overall conclusions on Immediate Outcome 3*

352. While the FIC is supervising the five banks which account for 98% of financial activity in Palau, major improvements are required as non-bank financial institutions and DNFBPs, are not being supervised noting they are very small and they predominantly have low risk, with the

## CHAPTER 6. SUPERVISION

exception of real estate and lawyers. Palau has not designated relevant AML/CFT supervisors for all the different sectors, in particular DNFBPs such as real estate agents and lawyers, who have high and medium risk for ML/TF respectively. The regulation and supervision of the banks which account for nearly all financial activity in Palau and the very small size of the DNFBP sector suggests

**353. Palau has a moderate level of effectiveness for Immediate Outcome 3.**

## CHAPTER 7. LEGAL PERSONS AND ARRANGEMENTS

### *Key Findings and Recommended Actions*

#### **Key Findings**

- Palau has not undertaken a ML/TF risk assessment of all forms of legal persons and legal arrangements.
- There are 557 existing active registered companies including foreign companies registered to undertake business in Palau, which includes 1,985 business licenses including persons “Doing Business As” and corporate business licenses. There are also 220 businesses that have a Foreign Investment Act Certificate (FIAC).
- Measures to prevent or deter the misuse of legal persons and legal arrangements are generally inadequate. Palau has implemented some structural preventative measures designed to prevent the misuse of legal persons and arrangements for ML or TF including all legal persons are required to register with the OAG who is also the Registrar of Corporations; at the time of incorporation, an affidavit by the president, secretary and treasurer of the corporation shall be filed with the Registrar; foreign owners are required to obtain a FIAC from the FIB; and financial institutions are required to take reasonable measures to understand and document the ownership and control structure of legal persons.
- Because there is no requirement in Palau for companies to maintain BO information beyond the legal owner of shares, authorities may not be able to secure adequate, accurate and current basic and BO information on all types of legal persons in Palau.
- Trustees are not subject to comprehensive AML/CFT obligations.

#### **Recommended Action**

- Palau should assess the risks of, and develop a comprehensive understanding of, the vulnerabilities posed by, all types of legal persons and arrangements.
- Trustees should be required to disclose their status to financial institutions when forming a business relationship or carrying out an occasional transaction above the threshold.
- Palau should require legal persons to maintain updated and accurate information on their beneficial ownership. This information should be maintained in a way that allows timely access by the relevant authorities without legal restriction or hindrance.
- Palau should digitise the Corporate Registry for enhanced monitoring, take measures to make the beneficial ownership information publicly available from a central location, and improve access to such information by the competent authorities, shareholders and the public (both domestic and international).
- Palau should strengthen the FIAC approval process, including increasing the number and quality of documentation required to apply for a FIAC, as well as to improve co-operation with key foreign counterparts for verification purposes. Palau should strengthen the verification processes on beneficial ownership of legal persons and extend the same requirements applied to non-citizens to Palauan’s.
- TCSPs need to be included under AML/CFT regulations particularly as lawyers offer some of these services.

354. The relevant Immediate Outcome considered and assessed in this chapter is IO5. The recommendations relevant for the assessment of effectiveness under this section are R24 & 25.

***Immediate Outcome 5 (Legal Persons and Arrangements)***

***Public availability of information on the creation and types of legal persons and arrangements***

355. Public availability of information on the creation and types of legal persons and arrangements is limited:

- The process for the creation of legal persons and for obtaining and recording basic ownership information is set out in the Corporations Act and Foreign Investment Act. Some legislation can be found online from government websites and some can be found at the Pacific Islands Legal Information Institute under “Palau Primary Material”<sup>15</sup> although both databases are incomplete (Palau has not yet made all of its legislation publicly available).

356. Physical copies of legislation can be found in two public law libraries.

357. There are 557 existing active registered companies including foreign companies registered to undertake business in Palau.

358. In Palau there are 1,985 business licenses including persons “Doing Business As” (DBA) (i.e. individuals), and corporate business licenses. The vast majority of Business Licenses are DBA businesses.

359. Also, there are 220 businesses that have a Foreign Investment Act Certificate (FIAC) (corporation with foreign shareowners). Of that number 100 are operating businesses; approximately 50 entities are non-active, and over 50 do not appear to be operating in any fashion and are currently subject to revocation of their FIAC.

360. The number of trusts operating or existing in Palau has not been provided to the assessors, however, authorities claimed that the number is not readily available as the information on trusts is protected as attorney/client privileged information.

361. The Authorities indicated that there are no foreign trusts in Palau. However, it is unclear to the assessment team how the Authorities reached this conclusion considering that the trusts information is protected as attorney/client privileged information in Palau.

362. In addition to attorney/client privilege issues noted above, as beneficiaries of trusts do not have to be reported to any agency including the taxation authorities in Palau, the jurisdiction has no way of knowing whether domestic or foreign trusts actually exist in Palau which creates a vulnerability to ML and TF.

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<sup>15</sup>See *Palau Primary Materials* at: <http://www.paclii.org/countries/pw.html>

*Identification, assessment and understanding of ML/TF risks and vulnerabilities of legal entities*

363. As noted in the TC Annex (R 24), eight types of legal persons, including foreign registered companies and limited partnerships, may be formed in Palau. However Palau has not separately assessed the ML and TF risks associated with each of these forms of legal persons (R 24.2, TC annex). There are comments in the NRA about ‘front businesses’ and ‘shell companies’ as forms of “generally recognised” ML and TF typologies which “pose the greatest concern” in Palau and assessment of their risk is made. However, nothing provided demonstrated that the individual company structures and the vulnerabilities/risks inherent in them have been assessed. Palau has also not assessed the risk of ML and TF with respect to various forms of legal arrangements (domestic and foreign).

364. Regardless of the lack of a formal risk assessment, in discussion with the assessment team it was clear that the government and private sector agencies lack a coherent and basic understanding of the ML and TF risk associated with legal persons and arrangements. While the FIU had a basic understanding of risks, other relevant and key AML/CFT government sector agencies, including the Attorney General’s Department, Police, and Bureau of Revenue and Tax, did not seem to grasp what risks if any are associated with companies and trusts. The given response by different agencies to address the risks associated with companies and trusts is inconsistent due to their varying perceptions of level of risk posed and understanding of the attendant vulnerabilities. In addition many private sector agencies including the banks did not demonstrate an understanding of ML and TF risks associated with companies and trusts and therefore no measures have been adopted in this regard.

*Mitigating measures to prevent the misuse of legal persons and arrangements*

365. Palau has implemented some structural preventative measures designed to prevent the misuse of legal persons and arrangements for ML or TF as follows:

- All legal persons are required to register with the OAG who is also the Registrar of Corporations.
- At the time of incorporation, an affidavit by the president, secretary and treasurer of the corporation shall be filed with the Registrar setting forth the name of subscribers for shares of each class and the number of shares of each class subscribed for by each subscriber under Regulations, Chap 1, part 2, paragraph 2.5.
- Foreign owners are also required to obtain a Foreign Investment Approval Certificate (FIAC) from the Foreign Investment Board (FIB).
- Under the Financial Transactions Reporting for Banks Regulation issued by the FIU in November 2017, for a customer that is a legal entity or other form of legal arrangement, financial institutions are required to take reasonable measures to understand and document the ownership and control structure of legal persons including the name and permanent residential address of the natural person(s) who ultimately own or control the legal person. However, the financial institutions covered by this regulation include banks, foreign bank branches and credit institutions licenced by the FIC but do not include credit unions and DNFBPs (including lawyers).

366. The Companies’ Registry maintained by the OAG, similar to many other registries, operates an essentially passive filing registry with little analysis or monitoring, and no verification of details provided to them. While Palau indicated that all corporate records are held for 10 days by the OAG for review and verification and are subject to acceptance or denial,

the extent of the verification and whether verification is carried out in practice remains uncertain. This means that the information held by the Registry may not be accurate. In practice, the documents at the Companies' Registry are manually filed in hardcopy at another location away from the OAG (OAG have offices in Koror and the Capital complex), which limits the capacity for monitoring and ease of search. The BO information gathered in respect of the legal persons in Palau is basic and in any case can neither be confirmed to be accurate nor up-to-date. The assessors note that the authorities have acknowledged the problem and are taking steps to upgrade the existing system which is currently inadequate.

367. In practice, the FIAC approval process is not sufficiently robust as a low bar has been set for accepting submitted dubious documentation at face value without further verification. The FIB also faces challenges in verifying the BO information of foreigners provided to them as they do not have an open form of communication with other countries' authorities. A number of legal persons have also been detected to exist without any real business operations or to be operating a business inconsistent with the FIAC granted. The attendant risks to ML posed by such entities have been noted by authorities and is currently being addressed with the recent hire of a full-time attorney to strengthen the processes at FIB. The assessors also note that draft regulations to strengthen the existing framework are under development.

368. While banks indicated that when starting a relationship with a new legal person customer, they would rely on the information provided by this customer, they generally did not cross check this information with the OAG and/or the FIB's database/records for consistency when trying to obtain BO information on their customers, although they should. This is partly due to the difficulties faced by the banks to readily access the basic information at the Companies' Registry, which is filed in hardcopy.

369. The degree to which lawyers, accountants, and real estate agents (all of whom are currently not subject to AML/CFT measures) prevent the misuse of legal persons and arrangements is unclear. Lawyers in Palau provide company formation services but are currently not subject to AML regulations. This poses a significant gap in their role as gatekeepers essential to Palau's ability to obtain, verify and maintain current beneficial ownership information. There is currently no legal requirement for trustees to disclose their status to financial institutions when opening an account or conducting a financial transaction. The authorities have also informed the assessors that "doing business as" entities ("DBAs") exist in Palau but they are not regulated or registered with any registry. There is no legal requirement for trustees to gather and retain BO information (as defined by FATF) although in practice the trustee may keep such information in order to fulfil fiduciary obligations to the settlor or beneficiaries of the trust. However the extent to which this practice is followed by trustees was not made clear by authorities. Nevertheless, unless LEAs know who the trustee is, it may be difficult to even begin to pursue enquiries.

370. Palau has implemented an annual filing requirement on corporations in an attempt to ensure that the information held by the Registrar of Corporations is current, although, the assessors note that this measure has limited effectiveness in practice. Under paragraph 5.4 of the Corporation Regulations, every corporation organised for profit shall file an annual return with the Registrar of Corporations before June 30th each year in the prescribed form of its state of affairs, which includes BO information. Palau imposes a late filing fee of USD50 after the specified deadline, and an additional USD50 each month thereafter, up to a maximum of USD250 in late fees and penalties. Under paragraph 6.2 of the Corporation regulations, the company can be dissolved if the company has failed or neglected, for a period of two years in succession, to file an annual return as required. The assessors note that in practice, there is no



monitoring done or active case management system in place to ensure that all legal persons incorporated in Palau have filed their annual returns as required by law or to send reminders where necessary if these legal persons have not done so. There is also no audit requirement on the accuracy of the information provided to the Registrar during the annual filing exercise. Consequently, there is no available information or statistics provided to the assessors on the extent to which legal persons in Palau comply with this requirement or to demonstrate whether the potential sanctions are sufficiently dissuasive. This brings uncertainty to the accuracy and currency of the information held at the Companies' registry.

371. The assessors note that there appears to be uneven legislative requirements for Palauan's and non-citizens. For example, under the Foreign Investment Act which applies to non-Palauan's, the written consent of the FIB is required before a change in ownership of a legal person with a non-citizen owner can be affected. However, there is no equivalent requirement for a Palauan owner. While there is a requirement for corporations to file annual returns, there is no requirement for the prompt notification of the Registrar of Corporation, upon any change in ownership under the Corporation Act or regulations. While the assessment team understands that Palauan nationals are treated differently in many respects under the law pursuant to the Palau Constitution, the lack of a requirement for a Palauan owner to promptly notify the Registrar of Corporations of any change in ownership is a vulnerability for the misuse of legal persons.

*Timely access to adequate, accurate and current basic and beneficial ownership information on legal persons*

372. Because there is no requirement in Palau for companies to maintain BO information beyond the legal owner of shares, authorities may not be able to secure adequate, accurate and current basic and BO information on all types of legal persons in Palau. Insofar as the information kept with the Registrar of Corporation, the competent authorities did not note any significant problems in accessing the BO information of legal persons during the course of their investigations. In accordance with the analysis under criterion 24.6 (and as noted above), banks, foreign bank branches and credit institutions licenced by the FIC are required to take reasonable measures to understand and document the ownership and control structure of legal persons including the name and permanent residential address of the natural person(s) who ultimately own or control the legal person. However, this requirement was only imposed in November 2017 and does not extend to other types of FIs or to DNFBBPs.

373. Palau noted that the NEA and the CID have on a number of occasions sought the assistance of Corporate Registrar and FIB for information on BO.

374. With respect to trustees of legal arrangements, because there is no obligation on trustees to collect and maintain BO information (noted above), authorities may not be able to secure adequate, accurate and current basic and BO information on all types of legal arrangements created in Palau. In the case of foreign trusts operating in Palau where the trustee is overseas, this information, if held, would only be available through formal or informal co-operation mechanisms, which may not involve the timely exchange of information.

*Effectiveness, proportionality and dissuasiveness of sanctions*

375. As stated above, the only sanctions against corporations for not updating information in the company registry would be a maximum fine of USD250 or a dissolution of the entity after two years. Under paragraph 2.5 of the Corporation regulations, the president, secretary and

## CHAPTER 7. LEGAL PERSONS AND ARRANGEMENTS

treasurer of the corporation as named in the articles of incorporation shall file an affidavit, sworn to under penalty of perjury, to set out amongst other information the BO information of the legal person. The filing of this affidavit is supplemented by the annual filing exercise. The penalties for failing to comply with the annual filing exercise have been set out above and are not sufficiently dissuasive or proportionate to ensure compliance.

376. Palau has not provided any information on whether or not the company registrar has imposed any sanction on companies for failing to meet statutory obligations, and over what period of time.

377. Insofar as trusts are concerned, competent authorities have no right of action against trustees who do not have a legal obligation of record keeping in the first place. If the very purpose of the trust is to disguise the involvement of the parties and/or illegal source of the trust assets, then it is unlikely that any action would be commenced against the trustees.

378. The assessors have not been provided with information that any sanction has been taken against FIs, DNFBPs, legal persons or trustees in relation to failure to collect BO information. Overall, the available sanctions regime for preventing the misuse of legal persons and arrangements does not appear to be effective, proportionate and dissuasive.

### *Overall conclusions on Immediate Outcome 5*

379. The NRA has not considered the ML and TF risks associated with each form of legal person operating in Palau, and both the public and private sectors have not demonstrated that they share a consistent understanding of the attendant risks associated with the misuse of legal persons and legal arrangements. This lack of understanding imposes significant vulnerability to Palau on the misuse of legal persons and legal arrangements for ML and TF. While there are some measures put in place in an attempt to capture BO information, the enforcement necessary to ensure that the BO information is accurate and current, is lacking. This impacts to a large extent on the reliability of the BO information collected and made accessible to the authorities when necessary, whether for domestic investigation or for sharing with foreign counterparts when MLA requests are received.

380. **Palau has achieved a low level of effectiveness for IO.5.**

### *Key Findings and Recommended Actions*

#### **Key Findings**

- Palau has a reasonable legal framework for international cooperation for both MLA and extradition, but there are no policies and procedures on how MLA and extradition will be sought and responded to. The lack of policies and procedures has not affected the few requests received and made, with the law providing some guidelines on how MLA and extradition requests should be managed.
- Palau received one MLA request from the United States (2010-11), one request from Chinese Taipei (2014) and has made no MLA requests. Palau has made one extradition request to the US (Guam), which in the context of the risks and type of criminality in Palau seems reasonable. The case demonstrates that Palau is responding to incoming requests expeditiously.
- Given the limited use of formal and informal international cooperation due to Palau's context it is difficult to judge whether cooperation is commensurate with Palau's risk profile. It is notable that informal cooperation has been undertaken by the FIU, FIC, CID, OAG, OSP and the NEA. One request was made to the Philippines relating to drug trafficking, judged to be Palau's highest risk crime and was effectively responded to.
- While Palau engages closely and effectively with the United States with respect to the FIU, Supervisory authorities and law enforcement, it does not appear to have similar arrangements with other neighbouring jurisdictions, though it does have a number of FIU-FIU MOUs.
- Palau has never made or received a request for international cooperation to identify or exchange basic or beneficial ownership information. Palau is in principle able to cooperate with foreign competent authorities through a formal MLA request or under existing MOUs or other informal cooperation arrangements. However, there is no requirement in Palau for companies to maintain BO information beyond the legal owner of shares, so authorities may not be able to secure adequate, accurate and current basic and BO information on all types of legal persons in Palau. Palau however is not seen as a jurisdiction for company formation.
- Palau is not yet a member of the Egmont Group (though it has applied for membership) and has not joined informal networks such as ARIN-AP.

#### **Recommended Action**

- Palau should actively utilise the powers available under the AMLA to facilitate AML/CFT cooperation with foreign countries.
- Palau should develop policies and procedures to ensure MLA and extradition requests are sought and received in a timely and efficient manner.
- Palauan competent authorities should continue to establish and strengthen their individual cooperation mechanisms with neighbouring jurisdictions' equivalent competent authorities in order to exchange financial intelligence and supervisory, law enforcement and other information with foreign counterparts.
- As recommended under IO.5, Palau needs to strengthen the collection and maintenance of beneficial ownership information by companies. Once established, Palau should introduce mechanisms to ensure that if a foreign request for beneficial ownership information is received, it is able to provide this information in a timely manner.
- Palau should fully engage in the application process for Egmont Group membership, and

should consider joining informal information sharing and cooperation networks such as ARIN-AP.

381. The relevant Immediate Outcome considered and assessed in this chapter is IO2. The recommendations relevant for the assessment of effectiveness under this section are R.36-40.

### *Immediate Outcome 2 (International Cooperation)*

#### *Providing constructive and timely MLA and extradition*

382. The OAG is the central authority for the transmission and execution of MLA requests. The Attorney General may make requests on behalf of Palau to the appropriate authority of a foreign state for MLA in any investigation that has commenced or a proceeding instituted relating to any serious offense. Extradition proceedings are within the purview of the Minister of Justice (or designee).

383. In regards to terrorism, the Palau National Code (s.2214 a) designates the Attorney General to grant requests from a foreign state, for legal assistance in any investigation or proceeding relating to terrorism, or a terrorist organization. Palau can provide MLA to any jurisdiction so long as the request is not from any of the UN sanctioned listed countries. The requests are dealt with as they are received.

384. The OAG and the OAP who are responsible for criminal prosecutions are able to use a range of avenues to progress both MLA and extradition. These means include through the Compact of Free Association between Palau and the U.S., the mutual legal provisions under the United Nations Convention Against Corruption (UNCAC), letters rotatory, or through other mutually-available statutory provisions of Palau and other nations' laws. The extent of cooperation by LEAs to international investigations is not clear, and there are no cited examples where cooperation has resulted in operational outcomes.

385. In the period 2009 to 2017, Palau received one MLA request from the United States (2010-11), one request from Chinese Taipei (2014) and has made no MLA requests. The number of requests is slightly lower than expected based on Palau's risks, though the level of criminality in Palau seldom involves transnational crime. Palau made one extradition request to the US (Guam) in 2015.

386. Due to context and size, extradition requests made to Palau are not common; nor are requests made by Palau to other jurisdictions.

387. Besides legislative provisions governing MLA and extradition, there are no guidelines, directions or prioritisation policies for handling these matters. In light of the very small number of requests received and made, Palauan authorities have not developed any protocols or manuals to prioritise and deal with MLA as the need has not arisen. The OAG informed the team that appropriate mechanisms, policies and procedures will be developed if and when they are required.

388. With respect to the MLA request from Chinese Taipei, the MLA request was preceded with four questions regarding whether certain persons of interest had any accounts or business dealings in Palau. Palau answered immediately that it did not and no further action was taken on the MLA request. The lack of guidelines did not hinder the process or the response time.

389. The U.S. MLA request was fully dealt with by the Palau Independent Counsel prosecuting the Pacific Savings Bank (PSB) case. In this case, Palau authorities worked closely with the U.S.

IRS and U.S. Attorney's Office in Guam to secure the extradition of an American who absconded to Australia. At the conclusion of the criminal case against the three Palauan co-defendants, Palau formally responded to the U.S. MLA request providing all evidence put forward in the domestic Palauan prosecution to assist a further prosecution in America. As the American co-defendant was never secured, the MLA request never progressed with Palau completing all aspects from their perspective. Once again the lack of guidelines or process did not affect the response time or effectiveness of the response.

390. Palau requested that the US arrest and extradite a dual citizen of the US and Palau who was charged over five separate counts of assault and battery. The U.S. complied with Palau's request and arrested the individual however prior to commencement of the extradition process, the individual decided to voluntarily return to Palau to face charges. This resulted in the extradition request being withdrawn by Palau but nevertheless demonstrated the ability and will to seek extradition.

*Seeking timely legal assistance to pursue domestic ML, associated predicate and TF cases with transnational elements*

391. Palau has made one extradition request and no MLA requests. This may be reasonable in the circumstances given the risk profile of Palau doesn't tend towards transnational crime. No requests made were consistent with identified ML risks in Palau though based on the size and context of Palau this is not unexpected. During the onsite visit, frustrations were expressed by Palau with the lack of responses to some informal requests made to other jurisdictions. It appears one of the reasons that Palau is seeking membership of the Egmont Group is to utilise the information sharing protocols that is available to members.

392. In the PSB ML case, which closed the bank in 2006, foreign assistance was sought regarding extradition from Australia. The investigation was reopened in 2009 and the US president of the bank was tracked to Australia. Multiple informal discussions were held with Australia for assistance in extraditing the suspect back to Palau but it did not proceed despite Palau highlighting the serious offences including ML. As Australia did not have an extradition treaty with Palau, formal extradition was not available. Palau worked closely with US Internal Revenue Service and the US Attorney's office in an attempt to revoke the passport of the accused but this did not proceed.

393. Palau prosecuted a US citizen in relation to an attempted bank fraud in Palau (*ROP vs. James O. Dugan et.al*, 11/12/2009). The US citizen was in the Philippines prior to arriving in Palau. The Philippines did provide assistance to Palau in this matter although assistance sought from one other jurisdiction was not forthcoming. The case involved a PEP and after the US citizen was jailed but before co-defendants could be brought to justice, the cases were dismissed.

394. Palau has never had a terrorism or TF case and has never had to seek assistance, which is consistent with the low risk for both terrorism and TF.

*Seeking and providing other forms of international cooperation for AML/CFT purposes*

395. In relation to informal cooperation, Palauan competent authorities are responsive to requests for international cooperation received from foreign counterparts and would generally provide timely assistance of satisfactory quality.

396. Palau's FIU has negotiated and signed six (6) information sharing MOUs with Japan, Philippines, Republic of Korea, Chinese Taipei, Thailand, and one Pacific wide regional MOU. (see Table 15).

**Table 15: MOUs Palau FIU signed with Foreign FIUs**

MOUs Signed	Year Signed
Philippines	November 17, 2004
Chinese Taipei	March 3, 2005
APIFIU – Association of Pacific Islands Financial Intelligence Units.	21 July 2011 (Kochi, India)
Republic of Korea	July 17, 2013
Japan	April 27, 2017
Thailand	2017

397. Palau is able to provide a broad base of assistance based on these MOUs which are FIU-FIU agreements. The assistance is predominantly based on sharing financial intelligence, information to support ML investigations and confirmation of the presence and assets of individuals or legal persons in Palau. The terms of the MOUs are fairly standard, including that requests for information require supporting justification and each authority will only use the information for the purpose of assisting investigations concerning ML, TF and related crimes; the information will not be disclosed to any third party nor be used in criminal proceedings without the written prior consent of the other authority; and the information provided will be confidential and subject to official secrecy and any request can be refused. The FIU has no bureaucratic barriers to providing information to foreign counterparts and it is statutorily free to cooperate with any foreign investigation and provide information upon request (see table 16).

**Table 16: Exchange of information between Palau FIU and Foreign FIUs and LEAs**

	2014	2015	2016	2017
Request received from Foreign Agencies	1	0	1	0
- Requests executed	1	0	0	1
Requests made by Palau FIU to other FIUs or agencies	0	0	2	2
- Requests executed	0	0	2	2

398. The Palau FIU has received two requests for information from foreign FIUs in the period 2014 to 2017 (one from Chinese Taipei received in June 2014 and the second from Thailand in 2016). Both requests were responded to in a timely manner.

399. During the same period of time, Palau has made four requests to the Philippines for information in support of ongoing investigations by the NEA into possible Drug Trafficking and ML. Information sought related to the transfer of funds to certain individuals in that jurisdiction, related bank accounts and telephone numbers. All requests were responded to in reasonable time. No foreign requests or requests made by the FIU were declined. These actions are commensurate with the risks identified in Palau.

400. Following are the details on the requests received and sent by Palau:

**Case Example 11: MLA request from Chinese Taipei resulting in informal assistance**

In June 2014, Chinese Taipei made a formal MLA request to Palau to assist in locating a large sum of cash which was supposedly flown into Palau in bulk. The cash was believed to have been embezzled by a prominent individual and family members. The funds were not located in Palau nor was there any evidence that the funds were ever flown into Palau. This case was

informally responded to without delay.

**Case Example 12: Response to informal request for information from Thailand**

The Palau FIU was contacted by Thailand FIU in December 2016 regarding an individual that Thailand believed was residing in Palau who was the subject of a money laundering investigation. The suspect listed a Palau telephone number as his point of contact. Upon receipt of the inquiry, the Palau FIU accessed the immigration database to determine whether the targeted person had ever entered Palau. He had not and the Palau FIU reported the same directly to the Thailand authorities.

401. The U.S. and Palau have a close relationship based on The Compact of Free Association (COFA) which was signed between the two jurisdictions in 1994. Based on this relationship, Palau has reached out to both the U.S. Secret Service and Federal Bureau of Investigation (FBI) for assistance in the investigation of smuggled bank card skimming devices and U.S. counterfeit money in 2016.<sup>16</sup> (see case 13 and 14).

**Case Example 13: Informal cooperation with the FBI (USA)**

In April 2016, an individual, travelling on a Romanian passport, was the intended recipient of a Federal Express package to be delivered to a local hotel address. Upon inspection of the package, Palau's Custom's Officers discovered that the package was a purported used DVD player which contained the mechanism for bank card skimming devices for three of the financial institutions in Palau. The Palau FIU reached out to the FBI in Saipan for assistance as they were aware of a large card skimming operation that had occurred in Saipan previously. The description, photographs and identity of individuals was shared with U.S. authorities however the suspects in Palau escaped arrest and prosecution.

**Case Example 14: Close collaboration with US authorities**

In June 2016, a refugee from Syria, Mr X, currently living in the Philippines (travelling on a Philippines Refugee Passport) came to Palau with USD60,000 of U.S. counterfeit USD100 dollar bills with another person from Jordan; Mr Y. Mr X was caught with the counterfeit currency. Cooperation was obtained from the U.S. Secret Service which sent an agent to Palau at the request of the Palau FIU and assisted Palau's CID to investigate the matter. It was suspected that the two individuals were engaged in possible human trafficking and smuggling counterfeit currency. Mr Y remained on-island until the case was cleared. During the investigation, the FIU discovered a number of text and email messages on the cell phone belonging to Mr Y which detailed a number of detailed arms transactions (no details on any investigation related to this was provided). The cell phone was turned over to the U.S. FBI for analysis. Mr X was prosecuted and pled guilty to one count of counterfeit currency possession, sentenced to one year probation and permitted to leave Palau. Mr Y was not prosecuted.

402. Palau is a member of the Pacific Transnational Crime Network (PTCN) since 2005 which has been working collaboratively with the Pacific law enforcement community since its inception in 2002. The PTCN provides a Police-led proactive criminal intelligence and investigative capability to combat transnational crime in the Pacific through a multi-agency and regional approach. While the PTCN is a law enforcement network, it closely partners with FIUs

<sup>16</sup>Since 1994, a range of instances of cooperation between the US and Palau has occurred including the Ginn cable company money laundering case in 2004, which resulted in the US Internal Revenue Service providing a US\$54,307.84 check to Palau in 2008 as an expression of gratitude for assistance provided by both the OAG and BPS.

across the 17-member jurisdictions across the Pacific. Palau is also a member of the Pacific Islands Chiefs of Police and the Pacific Islands Law Officers Network.

403. The Palau FIU is a member of the Association of Pacific Islands FIUs (APIFIU) which was formed in July 2011. The MOU for APIFIU allows for the exchange of information between member FIUs who include the FIUs of Cook Islands, Fiji, Kiribati, Nauru, Niue, Palau, Papua New Guinea, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga and Vanuatu. Palau has yet to request information formally or informally from other members of the APIFIU nor has it received any request from other members for assistance or information. The Palau FIU is not a member of the Egmont Group though an application has been submitted. As a non-EGMONT member, Palau is confronting challenges in sharing information with larger jurisdictions.

404. The FIC actively engages in international exchange and cooperation:

- The FIC has exchanged information with Chinese Taipei regulators regarding verification of information on possible accounts opened in Palau banks in 2010. These related to significant graft or corruption accusations.
- The FIC also exchanged information with Chinese Taipei bank regulators regarding the Palau branch of First Commercial Bank in relation to the voluntary closure of the branch in 2012.
- The FIC has also worked closely with the FDIC in San Francisco in advising them and putting out notices through FDIC channels about the closure of Pacific Savings Bank in 2006, which was the most significant ML investigation in Palau (convictions achieved in 2011).

405. The FIC regularly engages with the FDIC regarding the three US Banks operating in Palau which includes reviews of home office financials, changes in ownership structures and executive officer changes particularly in Palau, where the FIC can block branch manager appointments in the Palau based branches. The FIC monitors and receives key issues information from the FDIC which is available from the FDIC website.

406. The FIC is a member of the Association for Supervisors of Pacific Countries since 2002. One significant benefit is the training offered to members which has covered new and emerging ML threats including block-chain technology and transactions, corporate governance and fit and proper assessment training, among other banking related topics. Over the past three years North Pacific Countries (RMI, FSM, Palau, and Timor-Leste) meet regularly in Guam with a bank examiner exchange program for FDIC bank branches operating in their jurisdiction as one of the initiatives under way.

407. Palau Customs is an active member of the Oceania Customs Organisation since 1999, which facilitates information exchange and improved communication channels between 23 member jurisdictions.

408. LEAs in Palau have relied on the FIU to reach out for financial intelligence as in the Philippines case. Palau engages closely and effectively with the U.S. with respect to the FIU, supervisory authorities and law enforcement. Palau has few instances of transnational crime and has attempted to engage with foreign jurisdictions when required though as previously indicated this has seldom occurred over the last 10 years.

409. Both the OSP and LEAs have requested and responded to requests for informal information from US law enforcement agencies (see Table 17).



**Table 17: Exchange of information between Palau and US LEAs**

<b>Jurisdiction requesting assistance</b>	<b>Date</b>	<b>Assistance sought</b>	<b>Outcome</b>
Saipan	April, 2016	The US FBI requested Palauan Authorities for information on a card skimming case that Palau LEA were investigating to assist in a similar case occurring in Saipan.	Palauan LEA sent all relevant information that they had collected to FBI.
Palau	November, 2016	Palau requested assistance from USSS in identifying two Chinese individuals who were caught on camera installing a card skimming device onto a bank ATM machine.	USSS was unable to identify the individuals in the video but referred Palau LEA to US Department of Homeland Security which notified Palau that one of the individual was denied entry into Saipan and provided Palau with a copy of his passport.
Palau	June, 2014	Palau requested assistance from the FBI to conduct a polygraph test on three individuals that were suspected of murdering an elderly lady.	FBI conducted the polygraph test and the individuals were convicted of murdering the elderly lady.
US Naval Criminal Investigation Division (NCIS)	March, 2010	US NCIS requested Palau to track down and detain a person of interest in an ongoing murder investigation. NCIS requested for authority to enter Palau and to interrogate the individual.	Palau LEA tracked down the individual in the southern state of Anguar and detained the individual. NCIS interrogated the individual in Palau.

### *International exchange of basic and beneficial ownership information of legal persons and arrangements*

410. Palau has never made or received a request for international cooperation to identify or exchange basic or beneficial ownership information. Palau is in principle able to cooperate with foreign competent authorities through a formal MLA request or under existing MOUs or other informal cooperation arrangements. However, there is no requirement in Palau for companies to maintain BO information beyond the legal owner of shares, authorities may not be able to secure adequate, accurate and current basic and BO information on all types of legal persons in Palau.

### *Overall conclusions on Immediate Outcome 2*

411. The limited number of requests for MLA (2) and no requests made by Palau are in line with the context and size of Palau. Palau has a strong legal framework though lacks formal MLA procedures and guidelines. Results and the structured nature of Palauan legislation suggest that

this limited deficiency has not had any impact on effectiveness. Palau has only made one request for extradition which was progressing positively and nothing suggests this would not have been formally concluded if the suspect had not voluntarily agreed to return to Palau. While Palau has had challenges on occasion facilitating positive engagement with foreign jurisdictions, they have responded effectively to two informal requests received from Chinese Taipei and Thailand, a request from the Philippines and multiple requests from the US. There are some deficiencies in the framework such as Palau being unable to share adequate, accurate and current basic and BO information on all types of legal persons in Palau and no procedures or guidelines (while not having an impact to date, they will be necessary to support any potential future complex cases). Noting the context and the successful outcomes,

**412. Palau has a substantial level of effectiveness for Immediate Outcome 2.**

## TECHNICAL COMPLIANCE ANNEX

1. This annex provides detailed analysis of the level of compliance with the FATF 40 Recommendations in their numerical order. It does not include descriptive text on the country situation or risks, and is limited to the analysis of technical criteria for each Recommendation. It should be read in conjunction with the Mutual Evaluation Report.

2. Where both the FATF requirements and national laws or regulations remain the same, this report refers to analysis conducted as part of the previous Mutual Evaluation in 2008. This report is available from [apgml.org](http://apgml.org).

### ***Recommendation 1 - Assessing Risks and applying a Risk-Based Approach***

3. Recommendation 1 is a new FATF recommendation added in 2012 and was not assessed in APG's 2<sup>nd</sup> round mutual evaluation report of Palau in 2008 (2008 MER). The 2008 MER did not assess Palau's compliance in relation to understanding and mitigating risk, but did however note that the risk of ML and TF in Palau was perceived as minimal and ML transactions were generally limited to illegal proceeds from prostitution and marijuana sales.

4. In reviewing threats, vulnerabilities and risks, Palau's context is of importance. Palau has a small population and low GDP. The three US financial institutions that manage 98% of financial transactions through branches in Palau, who are FDIC and FINCEN regulated. The assessment team carefully considered this context in considering the NRA and Palau's overall compliance with this Recommendation.

*Criterion 1.1* - Palau has reasonably identified and assessed some of the major ML risks over the last few years.

5. Palau completed its first ML/TF NRA in November 2017. Details of other ML/TF sectoral risk assessments were not provided to the assessment team. The MLWG was the coordinating mechanism for the NRA, with the FIU taking the lead coordination role.

6. The NRA provides some analysis of Palau's risks, identifying main proceeds-generating crimes as drug trafficking and human trafficking and sexual exploitation. The NRA notes significant vulnerabilities but does not fully analyse all of the higher and moderate level risks, or provide further explanations in relation to Palau's context or situation and what the impacts are of these risks and crime types. While the NRA lists a number of predicate offences and ranks them from high to low risk, it is unclear what high, medium or low mean in the context of Palau which reduces the clarity of the analysis. The NRA does not clearly analyse why these crimes are ranked as such, and does not clearly articulate what underpins the risk for each though according to Palau they indicate predicate offences that are most likely to lead to ML. For example, Trafficking in Human Beings and Sexual Exploitation is rated as a significant threat (high ranking) with no further explanation to highlight why it was analysed as such and what makes it a higher threat for ML in the context of Palau. Palau indicated that it was considered high risk as it was cash based, however this still does not fully clarify the high ranking as the quantum and extent of this crime is unclear and how and why this cash is vulnerable to ML and does this risk (prostitution) link to any other crime types.

7. The assessment and analysis of overall risk for different crime types was only provided to a limited extent around drug trafficking but was not provided for other threats such as human trafficking and sexual exploitation (high risk), tax crimes (low risk in NRA even though the likelihood is medium and the consequence is medium – further detailed consideration would explain these findings), environmental crime (likelihood is high, consequence is high yet risk for ML is low in NRA) and corruption/bribery/fraud (likelihood is medium, consequence is high yet the risk assessment for ML is low).

## TECHNICAL COMPLIANCE

8. The NRA notes a number of recent prosecutions of mid-level officials suggesting that corruption and bribery remain a persistent concern for possible ML which suggests the level of risk may not be as low as indicated and that corruption risks need to be carefully analysed in future risk assessments. In addition concern is noted regarding a recent increase in high-end investors into Palau, as noted in the NRA, due to them entering into long term land-lease agreements which increases the risk of ML.

9. Apart from the NRA, Palau's Belau Drug Enforcement Taskforce conducted a drug trend report for the years 2015 to 2016. The report identified methamphetamine as being the main drug trafficking threat in Palau. It also confirmed that this drug is being imported/smuggled through the seaport, airport, and Post Office from a number of offshore locations.

10. Palau has also not fully considered some potential risks (vulnerabilities), some of which were raised during the onsite visit, including real estate (NRA acknowledges lack of transparency in real estate sector and large purchases), misuse of legal persons, beneficial ownership, financial technology and the use of the remittance sector for money transfers.

11. While the NRA provides only a limited assessment of TF, the assessment of low appears appropriate when considering regional assessments undertaken and the nature and context within Palau.

12. *Criterion 1.2* - Palau created the MLWG in 2003 to address AML/CFT policy issues (Executive Order 362 2014 updated the 2003 Executive Order 218) and to coordinate Palau's AML/CFT regime, which included producing an NRA. Palau's FIU, which is a member of the MLWG, is the designated authority to coordinate actions to assess ML/FT risks (17 PNCA 33 Section 3333 (c)).

13. *Criterion 1.3* - The MLWG is tasked by (Presidential) Executive Order No. 362 to produce an annual NRA on ML and TF in Palau. Palau completed its first NRA in November 2017.

14. *Criterion 1.4* - The MLWG provides a mechanism to disseminate information to government agencies in relation to emerging or current ML/TF risks. As noted above, the MLWG is accountable for delivery of the NRA and so each member of the MLWG was involved in and appraised of the findings on risk. Regarding FIs and DNFBPs, there is no clear formal mechanism in place to inform them of Palau's ML/TF risks. Given the size and context of Palau, authorities indicate that they communicate informally with these stakeholders on risk findings, though based on the onsite visit, very limited understanding was exhibited by REs.

15. *Criterion 1.5* - Palau has undertaken some measures over the past two years to use their understanding of risk to inform resource allocation to mitigate ML/TF risks. This is demonstrated through formation of the NEA, FCIU, Human Trafficking Task Force, and the development of multi-language airport arrival declaration forms. As the first formal NRA undertaken by Palau was completed during the onsite visit, further subsequent measures to either resource or mitigate ML/TF based on risk are yet to be considered.

16. *Criterion 1.6* - Palau has decided not to impose AML/CFT requirements on accountants and notaries, casinos, gems and gold dealers and TCSPs on the basis of absence of relevant activities or services and/or low risk. On the basis of the information provided by Palau, the assessment team considers this to be reasonable. Palau does not have any casinos and gambling is prohibited in Palau. There are no stand-alone TCSPs operating in Palau (a small number of lawyers offer related company services). Dealers in Precious Metals and Precious Stones are covered in the AMLA and the draft regulations; however the NRA indicates that there are no DPMS in operation, with the only related activity occurring through 2-3 small tourist outlets that have low value jewellery for sale. The AMLA provides a basis for the FIU to include AML/CFT obligations contained in the regulations until such time as their risk and activity warrants it. The following DNFBPs have been considered based on low risk:

- *Accountants:* - Accountants have low risk and a lack of relevant financial activity. Palau has a small number of accountants that operate as bookkeepers that are considered very low risk as they do not engage in the activities of concern under the FATF standards.
- *Licensed Notaries* - Notaries in Palau are only licensed to authenticate signatures for legal documents, such as affidavits, land lease documents, or any document filed with the courts requiring authentication. No information received during the onsite visit suggests otherwise. It would therefore be open to the authorities to exclude notaries from the more detailed AML/CFT obligations contained in the regulations until such time as their risk or activity warrants it.

17. *Criterion 1.7* - FIs are required to conduct enhanced CDD for all categories of higher risk customers (Article 2.9 FIU Regulation 01), by completing entity level risk assessments, scrutiny of source and legitimacy of funds, transaction monitoring and customer profiling. However, Palau has only recently formally identified its higher areas of risk through the NRA process and has not required reporting entities to incorporate findings of the risk assessment into reporting entities enterprise assessments of risk. The DNFBP regulations have not been enacted and so no enhanced measures for addressing risks apply to these sectors.

18. *Criterion 1.8* - Article 2.10 of FIU Regulation for FIs outlines the risk-based approach that FIs should apply and allows simplified measures and controls for CDD and monitoring when dealing with lower risk customers and transactions. The DNFBP regulation has not been enacted and so no measures, including any simplified measures, apply in these sectors.

19. *Criterion 1.9* - The AMLA (Section 3328) nominates the FIC, the FIU, and any authority designated by way of regulation as the supervising authorities to ensure compliance by FIs and DNFBPs with the provisions of the AMLA and any regulations issued. From FIC supervisory reports, it is apparent that the FIC does reference some risk based measures in some of the reports, though it is not clear if all the requirements of the FIU regulations which were passed in November 2017, are being considered or all risk based measures are systematically considered. There was no supervision of DNFBPs by the FIU or ARS by the FIC at the time of the on-site visit, noting that these sectors are negligible in size.

20. *Criterion 1.10* - 1.10 (a) – Palau requires FIs to undertake ECDD risk assessments (FIU Regulation 01); 1.10 (b) – FIs are required to consider risk in determining procedures, policies, systems, and controls as per the FI regulations, though level of mitigation is not expressly required. Steps must be undertaken to undertake enhanced ECDD for higher risk customers or simplified measures if the risk is lower; 1.10 (c) – No requirement to keep assessments up to date; 1.10 (d) – No mechanisms are in place to convey the required risk assessment information. DNFBPs are not required to undertake steps related to understanding risks and applying measures to mitigate these risks.

21. *Criterion 1.11* - FIU Regulation-01 for FI (Banks and ARS) have been enacted however Regulation-02 for DNFBPs are not in force. These regulations include further information on internal policies, systems and controls. 1.11 (a) –The FIU Regulation for FIs requires FIs to develop to develop procedures, policies, systems and controls to implement effective AML/CFT programs. Senior management sign-off is not expressly required; (1.11 (b) –FIs are not required to monitor controls and enhance them if necessary. 1.11 (c) - Steps must be undertaken for FIs to undertake enhanced ECDD for higher risk customers or simplified measures if the risk is lower. These obligations do not yet apply to DNFBPs.

22. *Criterion 1.12* - FIs may undertake simplified measures if the risks of ML/TF are considered lower based on risk assessments, though levels of risk mitigation are not expressly required. While ECDD risk assessments are required, no specific requirement is necessary to keep them up to date. DNFBPs are not supervised and the FIU regulations have not been enacted as yet, though limited weight is applied due to small size.

## TECHNICAL COMPLIANCE

### *Weighting and conclusion*

23. Palau has a reasonable understanding of ML and TF risks. The NRA notes significant vulnerabilities but does not fully analyse all of the higher and moderate level risks, or provide further explanations in relation to Palau's context or situation and what the impacts are of these risks and crime types. Reporting entities are not required to take measures to identify, assess and understand their ML/TF risks, though understanding of risk is implied in the new FIU regulations (related to enhanced and simplified CDD). As DNFBP regulations have not been enacted, these entities are not required to have policies, controls and procedures to manage and mitigate ML/TF risks, though lesser weight is applied to DNFBPs. Palau is not fully considering risk in taking enhanced measures for higher level risks and simplified measures for lower level risks. **Palau is rated partially compliant for Recommendation 1.**

### *Recommendation 2 - National Cooperation and Coordination*

24. Palau was rated largely compliant with former R.31 on national cooperation and coordination in the 2008 MER. The factor underlying the rating was the Money Laundering Working Group (MLWG) was not functioning in the most effective way.

25. *Criterion 2.1* - Palau has not yet developed a written national AML/CFT policy which is guided by identified risk. While not formally drafted, Palau through the MLWG has made a number of significant policy decisions based on and informed by risk (including formation of the NEA, FCIU and the Human Trafficking Task Force and translation of international arrival cards), which has resulted in the assessment team placing little weight on this deficiency noting the size and context within Palau.

26. *Criterion 2.2* – Palau established a MLWG in 2003. The MLWG was given a stronger legal basis in 2014 via an Executive Order. The MLWG's duties and functions include the coordination of AML/CFT efforts at policy and operational levels. The MLWG is made up of the Chairman of the Financial Institutions Commission who is the Chairman of the Working Group, the Attorney General, the Executive Commissioner of the FIC, the Director of the FIU, the Director of the BPS, the Director of the Bureau of Immigration, the Director of the Bureau of Labour and Human Resources, the Anti-Terrorism Coordinator, Ministry of Justice, the Chief of the Division of Customs in the Bureau of Revenue, Tax, and Customs and a representative from the Office of the President.

27. *Criterion 2.3* – The MLWG's functions encompass both policy-making and operational coordination functions. The duties and functions of the MLWG include to cultivate good working relationships between agencies that are engaging in combating ML and TF, to provide for the timely exchange of information between the relevant Government agencies, to develop joint targeting strategies, to jointly profile or identify common suspects and to develop and enhance law enforcement and regulatory training activities. Operationally, the MLWG created the Financial Crimes Investigation Unit (FCIU) by Executive Order (406) in November 2017 to coordinate operational investigations through multi-agency consideration of STRs. The FCIU will have representation from Bureau of Customs and Border Protection, Narcotics Enforcement Agency, Criminal Investigations Division, Palau Postal Service, Bureau of Revenue and Taxation, Attorney General's Office and the Special Prosecutor.

28. *Criterion 2.4* – Palau has no cooperation or coordination mechanism in place to combat the financing of proliferation of weapons of mass destruction.

### *Weighting and conclusion*

29. Palau has made a number of significant policy decisions based on and informed by risk, which has resulted in the assessment team placing little weight on the lack of a written policy or

strategy when considering Palau's context. Palau has no coordination mechanism for proliferation financing. **Palau is rated largely compliant for Recommendation 2.**

### *Recommendation 3 - Money laundering offence*

30. Palau was rated partially compliant with former Rec.1 and compliant for Rec.2 (both now Rec.3) in the previous MER 2008. The main deficiencies highlighted previously were 1) the non-inclusion of large categories of predicate offenses; 2) the money laundering offence not clearly extending to 'the use of criminal proceeds'; and 3) definition of 'proceeds of crime' not expressly covering direct and as well as converted proceeds. Palau has since adopted a new Criminal Code which includes a completely revised AMLA.

31. *Criterion 3.1* - The broad language used in Palau's ML offence under Section 3302 PNCA largely covers the material elements of the ML offences as defined in the Vienna and Palermo Conventions (including correcting the deficiency highlighted in 2008 MER to extend ML offence to 'the use of criminal proceeds'). However, in respect of the third limb of the ML offence under Section 3302(a)(3), based on the definition of 'transfer' in sub-point (U) of the definition Section 17 PNCA 3301, it is unnecessarily narrow to include only transfers through financial institutions by electronic means to another financial institution. This narrow definition of the transfer of property is mitigated by the broad definition of engaging in a 'transaction' in sub-point (T) of the definition Section 17 PNCA 3301.

32. *Criterion 3.2* - The broad inclusion of predicate offences as *any* 'offence' under the definition of 'proceeds of crime' in sub-point (R) of the definition section corrects the deficiency highlighted in the 2008 MER that large categories of predicate offences were not included in the ML offence. Section 17 PNCA 3301 now covers all serious local offences. These predicate offences include a range of offences in each of FATF's designated categories of offences. Only three of the 21 designated categories of predicate offences identified by the FATF are not criminalised in Palau, namely 1) participation in an organised criminal group and racketeering; 2) piracy; and 3) insider trading and market manipulation. Organized Crime is not technically a crime (such as the RICO statute in the U.S.), but "organized crime" can and has been pursued through the Conspiracy Statute (17 PNCA §§1001-1007). Insider trading and market manipulation are not criminalised in Palau as Palau does not have a stock exchange. (iii) piracy (open sea), can supposedly be charged as a different offence though what they are, are not specified by Palau.

33. *Criterion 3.3* - Palau does not adopt a threshold approach to define predicate offences. Palau broadly defines predicate offenses as any 'offense' under the definition of 'proceeds of crime' in sub-point (R) of the definition Section 17 PNCA 3301.

34. *Criterion 3.4* - The broad definition of 'proceeds of crime' in Section 3301(r) includes property that is linked directly or indirectly to a predicate offense (correcting the deficiency highlighted in the 2008 MER that the definition does not expressly cover direct as well as indirect proceeds). The definition of 'property' in Section 3301(s) is also sufficiently broadly defined to include various types of property of any value.

35. *Criterion 3.5* - Section 3(c) of the old MLPCA expressly addressed this criterion but it appears to have been omitted in the new Act. Under the new legislation, "proceeds of crime" is defined as "any property or economic advantage derived from or obtained, directly or indirectly, wholly or partially, through the commission of an offense, including economic gains from the property and property converted or transformed, in full or in part, into other property." The crime of ML in Palau extends to persons in the chain of ML and that includes persons who did not commit the underlying predicate offence. Therefore, this suggests that while it needs to be proven that "proceeds" are derived from the commission of an offence, it may not be necessary to prove the "conviction" of the predicate offence. Notwithstanding, this interpretation has yet to be tested in the Courts of Palau.

## TECHNICAL COMPLIANCE

36. *Criterion 3.6* - Section 3302(e) expressly states that predicate offences extend to foreign predicate offences, provided that they also constitute an offence in Palau.

37. *Criterion 3.7* - 17 PNCA §3302(e), allows for the prosecution of self-launderers. This has also been established in case law No. 16-167, ROP v. Eudora Lucio (conviction 21 April 2017 for a ML charge of self-laundering proceeds of crime).

38. *Criterion 3.8* - The broad language used in Palau's ML offence under Section 3302 PNCA goes beyond the *mens rea* requirement of the ML offences as defined in the Vienna and Palermo Convention. The *mens rea* of 'reasonable grounds to suspect' means that the intent and knowledge required to prove the ML offence can be inferred from objective factual circumstances.

39. *Criterion 3.9* - Section 3302 PNCA - Money laundering is a Class A felony with prescribed punishment of imprisonment up to 25 years' imprisonment under Section 662 PNCA and liable to fines up to USD500,000 under Section 3302(c). In addition, Sections 3304 and 3305 allow for increased or decreased penalties by one third under certain circumstances. Section 3303 also allows for the restriction of a business which has been convicted of ML. The prescribed sanctions are proportionate and dissuasive.

40. *Criterion 3.10* - The definition of 'persons' in sub-point (P) of the definition Section of 17 PNCA 3301 extends criminal liability to both natural and legal persons which are proportionate and dissuasive. Nothing prohibits separate proceedings from running concurrently, or the concurrent criminal liability of natural persons. Additional penalties are prescribed for corporations and unincorporated associations under Section 3303 read with Section 619 PNCA when a 'high managerial agent' of the entity is convicted of ML.

41. *Criterion 3.11* - 17 PNCA § 3302 PNCA covers appropriate ancillary offences to the ML offence, including conspiracy (section 105 PNCA), complicity, soliciting and aiding (section 223 and 901 PNCA) and attempts to commit offences (section 801-802 PNCA). Section 3917 PNCA also criminalises the securing of proceeds of an offence, which extends to the offence of ML.

### *Weighting and conclusion*

42. Piracy is not included as a predicate offence, even though Palau suggests it can be pursued by other yet to be confirmed means. **Recommendation 3 is rated largely compliant.**

### ***Recommendation 4 - Confiscation and provisional measures***

43. Palau was rated partially compliant with former Rec.3 in the 2008 MER. The main deficiencies highlighted were: 1) the law does not allow for the confiscation of proceeds of instrumentalities used or intended for use in the commission of a predicate offense for money laundering; 2) the law does not allow for the confiscation of property of corresponding value to property laundered, instrumentalities of a ML offense, as well as proceeds and instrumentalities of any predicate offense; 3) no freezing measures available for property related to TF; and 4) no measures in place to identify or trace property relating to TF. Palau has since amended its forfeiture laws in 2014.

44. *Criterion 4.1* - Palau's forfeiture laws in relation to ML is covered under section 3306 PNCA read in conjunction with the recently amended Title 17 Chapter 7 (Forfeiture Act) which corrects many of the deficiencies highlighted in the 2008 MER. Section 704 read with Section 705 of the PNCA allows property forfeiture in relation to 'covered offenses'. "Covered offenses" do not include all ML predicate offences but only "that which is chargeable as a felony offense under the laws of the Republic of Palau". Notably, ML and TF are included in the 'covered offenses' definition and the excluded predicate offences are not particularly noteworthy. Palau's legislation enables the forfeiture of property laundered (Section 705(5)), the proceeds including income or other benefits (section 705(6)), or instrumentalities used or intended for use (section



705(2)) in 'covered offences'. Section 715 allows forfeiture of property of corresponding value by providing for the forfeiture of any other property of a defendant *in personam*, up to the value of the property subject to forfeiture, when certain conditions are met. There is also the power to forfeit property of corresponding value in respect of terrorism offences under Section 2206(b).

45. *Criterion 4.2* - Sections 707-714 PNCA grants broad powers with or without court process, which enables competent authorities to identify, trace and evaluate property that is subject to forfeiture by providing broad categories of property subject to forfeiture, and the powers and duties of the law enforcement officers and agencies in exercising these seizure powers. Section 712(a) allows authorities to apply for restraining orders, injunctions or take any other action to seize, secure, maintain, or preserve the availability of property subject to forfeiture. In addition, the Director FIU has broad powers under section 3334(s) to "provide information to and assist competent authorities to apply seizing and confiscation measures pursuant to Title 17 PNCA Chapter 7 (Forfeiture Act); or to freeze property under Title 17 Chapter 33, Subchapter V (freezing of property). Under section 3334(k), the Director FIU has broad powers to apply provisional measures to direct a FI or DNFBP to refrain from proceeding with the transaction. These directions can be given orally which has effect for 24 hours, or 5 days if confirmed in writing. On application to the Supreme Court of Palau, the FIU is able to extend the period of the direction without an express limit. Persons in violation of a Court Order which subjects property to confiscation would be liable for Contempt of Court offences. Other investigative measures available are elaborated in R.31.

46. *Criterion 4.3* - Section 705(b)(2),(3),(4), and (5) PNCA provides an exemption to property subject to forfeiture and protects the interests of bona fide third parties where the property owner had no knowledge or did not consent to the offence. In addition, protections for rights of bona fide third parties exist in section 708(c) which imposes a notice requirement for the seizing agency to notify all known persons with interest in the seized property. Sections 711(d)-(k) provides for persons with an interest in property to file a petition for remission or mitigation of forfeiture with the AG who intends to forfeit the property administratively. Further, Section 2209(3) of the PNCA accords a bona fide third party an opportunity to be heard in proceedings. However, this provision is limited to civil forfeiture and restricted to terrorism offenses only. Section 2206(f) expressly protects the property rights of third parties acting in good faith.

47. *Criterion 4.4* - Section 717 of the PNCA establishes a Forfeited Property Fund under the charge of the Attorney General. The provision sets out the mechanisms for management of the property under the fund, reporting obligations by the AG to the President of Palau and the various specific purposes for which the property can be applied towards.

#### *Weighting and conclusion*

48. "Covered offenses" for which Palau forfeiture law applies to, do not include all ML predicate offences but only those chargeable as a felony offense under the laws of Palau. However, in the context of Palau, the excluded predicate offences are not critical. **Recommendation 4 is rated largely compliant.**

#### *Recommendation 5 - Terrorist financing offence*

49. Palau was rated largely compliant with former SRII in the MER 2008. The key recommendation was to amend the definition of 'property' to expressly cover legitimate as well as illegitimate funds.

50. *Criterion 5.1* - Palau criminalised TF through Section 2225 of the PNCA with the passing of the Counter-Terrorism Act 2007 (CTA). The broad definition of the provision is in line with the TF Convention.

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*“Any person who by any means, directly or indirectly, or as an accomplice, solicits, provides or collects property, or provides financial or other services, or organises or directs others to solicit, provide or collect property or provide financial or other services, with the intention that they should be used or in the knowledge that they are to be used, in full or in part:*

*(1) for terrorism;*

*(2) for the benefit of persons who engage in terrorism, or for the benefit of entities owned or controlled, directly or indirectly, by persons who engage in terrorism; or*

*(3) for the benefit of persons or entities acting on behalf of or at the direction of any person referred to in subsection (a)(2);*

*commits a crime, the financing of terrorism, punishable by the penalties established by section 2205 of this Chapter.”*

51. *Criterion 5.2* - Section 2225 CTA criminalises both the financing of terrorism (which includes terrorism offences and terrorist acts as defined in Section 2202) as well as the financing, directly and indirectly, of terrorists and the entities controlled by terrorists.

52. *Criterion 5.2b* - The broad language of the TF offence under Section 2225 prohibits the financing of terrorists for any purpose and this would include the financing of travel of known terrorists to a state other than that of their residence for the purpose of perpetration, planning, or preparation of, or participation in, terrorists acts and for providing or receiving of terrorist training.

53. *Criterion 5.3* - While the definition of ‘property’ remains unchanged from the previous MER which highlighted a small deficiency, the language used is sufficiently broad to include funds or assets from both legitimate and illegitimate sources. Notwithstanding, the interpretation in relation to TF has yet to be tested in Palau.

54. *Criterion 5.4* - Section 2225(b) expressly meets this requirement.

55. *Criterion 5.5* - There is no legislative provision which expressly states that the intent and knowledge of proving an offense of TF is to be inferred from objective factual circumstances. This was considered in the previous MER at para 137. However, the authorities have claimed that it is a fundamental principle of Palau law that the intentional element of any crime may be inferred from objective factual circumstances. Palau authorities referred the team to the case of *Blailles and Wasisang v. ROP*, 5 ROP Intrm. 36 (1994).

56. *Criterion 5.6* - TF attracts the same penalties as terrorism itself under Section 2205 which carries stiff criminal sanctions. The minimum imprisonment of 10 years’ and maximum of life imprisonment and a maximum fine of USD 1mill for TF is sufficiently dissuasive and proportionate. All other crimes established in that chapter not resulting in the death of a natural person is punishable by a minimum imprisonment term of 20 years’ and a maximum of life imprisonment, and a maximum fine of USD 1mill.

57. *Criterion 5.7* - Legal persons are expressly liable in the same manner and extent as natural persons for TF under Section 2225(d). The maximum fine is ten times that of natural persons. These criminal sanctions are sufficiently proportionate and dissuasive. In addition to criminal sanctions, legal persons are subject to be banned from business, ordered to close premises, be dissolved or be required to publicise the judgment in the press under Section 2225(h). However, there is no express legislative provision that criminal sanctions against the legal person is without prejudice to the criminal liability of natural persons.

58. *Criterion 5.8* - Section 2205(c) expressly criminalises (a) attempts; (b) conspiring; (c) being an accomplice; (d) to organise or direct others to commit the TF offence.

59. *Criterion 5.9* - The TF offences are predicate offences for ML.

60. *Criterion 5.10* - The definition of the TF offence under Section 2225 does not expressly differentiate whether the person alleged to have committed the TF offence is in the same country or a different country as the one in which the terrorist/terrorist organisation or terrorist act will occur. However, taking into consideration the definition of 'terrorist offence' and 'terrorist act' under the definition Section, the TF offence would substantively apply to the funding of terrorists and terrorism outside of Palau.

#### *Weighting and Conclusion*

61. There is no express legislative provision that criminal sanctions against a legal person is without prejudice to the criminal liability of natural persons. Whether the definition of 'property' includes both funds from legitimate and illegitimate sources has yet to be tested in Palau, though the low risk of TF provides less weighting for this issue. **Recommendation 5 is rated largely compliant.**

#### ***Recommendation 6 - Targeted financial sanctions related to terrorism and terrorist financing***

62. In the 2008 MER, Palau was rated non-compliant for the former SR III. The factors underlying the rating included: (1) Even though the Minister of Justice has never made use of his powers, there are no procedures in place on how to issue, administer, and enforce such freezing actions. (2) No designated authority pursuant to UNSCR 1373, (3) No laws and procedures to freeze without delay and prior notice funds pursuant to Resolution 1373, (4) No effective mechanisms to communicate to the financial sector pursuant to Resolutions 1267 and 1373, (5) No clear instructions and guidance regarding the obligations of financial institutions and other persons or entities that may be holding targeted funds or assets, (6) No effective procedures for considering de-listing requests, (7) No procedures for unfreezing in a timely manner the funds or other assets inadvertently affected by the freezing measures, (8) No clear procedures for access to funds in accordance with UNSCR 1452 are in place, (9) No procedures to challenge any freezing measures are in place, and (10) Financial institutions are under no obligation with respect to SR III.

63. *Criterion 6.1 - Sub-criterion 6.1(a)*– The Minister of State has the responsibility for proposing persons and entities to the 1267/1989 Committee and 1988 Committee for designation

64. *Sub-criterion 6.1(b)*– While Palau has yet to establish a formal mechanism for identifying persons or entities for designation in accordance with the designation criteria set out in the relevant UNSCRs, it does have appropriate steps (Section 3344, PNCA) post identification.

65. *Sub-criterion 6.1(c)*– There is no restriction that a proposal for designation is conditional upon the existence of criminal proceedings. Following the forms provided by the UN, Palau does not include any additional evidentiary standard of proof when deciding whether to make a proposal for designation.

66. *Sub-criterion 6.1(d)*– Palau will follow the UN procedures and standard forms for listing by the 1267/1989 Committee or 1988 Committee if required.

67. *Sub-criterion 6.1(e)*– Palau would provide as much information as possible to the relevant United Nations committee to support a proposed designation. Palau would specify whether its status as a designating state could be made known in respect of a designation to the 1267/1989 Committee.

68. *Criterion 6.2 - Sub-criterion 6.2(a)*– Based on Section 3343(a)(b) of the AMLA, the FIU is the competent authority responsible for designating persons or entities, but the determination shall be made based on a determination by the AG that the person or entity meets the specific

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criteria for designation including for purposes of UNSCR 1373. The section applies equally to considerations based on Palau's own motion or, if appropriate, giving effect to a foreign request.

69. *Sub-criterion 6.2(b)*– Palau does not have any mechanism(s) for identifying targets, including in response to a request from other countries, for designation based on the criteria for designation stipulated in UNSCR 1373, it does have appropriate steps (Section 3344, PNCA) post identification. The MLWG, which is responsible for ML/TF coordination, would operate as an information sharing mechanism to do inter-agency information sharing and decision support in any case where the listing was to be considered. Palau has no separate procedure in case of receiving a foreign request.

70. *Sub-criterion 6.2(c)* –Palau has not yet received a request from another country to consider designating, so has not tested the promptness to determine whether a foreign jurisdiction's request for designation of a person or entity is supported by sufficient basis and meets the criteria for designation in UNSCR 1373.

71. *Sub-criterion 6.2(d)*– Section 3343(b) of the AMLA sets out the evidentiary standard of proof in keeping with UNSCR 1373 that must be satisfied in deciding whether to make a designation.

72. *Sub-criterion 6.2 (e)* – Section 3343(b) of the AMLA gives the FIU the power to disclose any report or information supporting the designation to a foreign FIU or appropriate foreign authority, if the person or entity is a designated person or entity in Palau.

73. *Criterion 6.3 - Sub-criterion 6.3(a)*– Section 3333 of the AMLA gives the FIU wide powers of information collection from domestic or foreign authorities, financial institutions and DNFBPs. These powers apply to support all of the FIU's functions under the law, including the power of considering and making designations pursuant to UNSCR 1373. Section 3333(f) allows the FIU to seek any information from foreign authorities.

74. *Sub-criterion 6.3(b)*– powers available to the FIU under section 3333 of the AMLA can be applied ex-parte in relation to a person or entity that has been identified and against whom a designation is being considered.

75. *Criterion 6.4* - Section 3340 of AMLA requires all natural and legal persons in Palau to implement targeted financial sanctions without delay. The obligations to implement TFS without delay cover both freezing and prohibitions on providing funds/services to designated persons and entities. The freezing obligations under the AMLA do not require any additional court order or other process.

76. *Criterion 6.5 - Sub-criterion 6.5(a)*– Section 3341 of the AMLA requires all natural and legal persons to freeze the funds and other assets of designated persons and entities designated by the UN under UNSCR 1267 and successor resolutions or by Palau pursuant to 1373. Section 3344(c) requires that such freezing action occurs without delay and without prior notice.

77. *Sub-criterion 6.5(b)* – Section 3340 of the AMLA requires all natural and legal persons to freeze the property of designated persons and entities and of persons or entities belonging to, or acting on behalf of or at the direction of such designated persons or group. The obligation extends to widest scope of property or funds that it in keeping with the FATF standards (section 3300(19)). Section 3340 of the AMLA explicitly requires freezing of property belonging to or wholly or jointly owned, held or controlled, directly or indirectly by designated persons/entities and those acting on their behalf.

78. *Sub-criterion 6.5(c)* - Section 3341(a) of the AMLA prohibits natural and legal persons from making available property, directly or indirectly, to persons or entities designated by the UN or by Palau pursuant to UNSCR 1373. Section 3341(a)(b) prohibits provision of financial services to the same designated persons and entities. The obligation does not extend to provision of funds to entities owned or controlled directly or indirectly by designated persons

and entities and persons and entities acting on behalf of, or at the direction of, the designated persons and entities.

79. *Sub-criterion 6.5(d)* - Section 3344(a)(b) requires the attorney general to keep the FIs and DNFBPs informed and updated about the UNSC's Consolidated List and any amendments thereof. However, Palau did not demonstrate mechanisms to regularly share updated UN lists with FIs and DNFBPs

80. *Sub-criterion 6.5(e)* - Section 3342 of the AMLA requires natural and legal persons to report to the FIU on assets frozen within 24 hours. Section 3342(a) (2) includes an additional obligation to report to the FIU within 24 hours whenever they have dealings with a person, group or entity that they know or suspect is designated. This would capture attempted transactions and instances where the FI or DNFBP refused to provide funds or financial services to a designated person or entity.

81. *Sub-criterion 6.5(f)* - Under the Terrorism Act (Title 17 PNCA §2219), the rights of individuals and third parties are protected as they are deemed immune from suit and civil liability for actions taken in good faith pursuant to terrorism.

82. *Criterion 6.6 - Sub-criterion 6.6(a)* - Section 3345(b) of the AMLA includes publicly known procedures for submission of de-listing requests, by submitting that to the Ministry of Foreign Affairs for forwarding to the focal point established within the United Nations Secretariat, for those designated persons and entities who no longer meet the designation criteria.

83. *Sub-criterion 6.6(b)* - Section 3345(c) gives the possibility to any person listed by the attorney general under 17 PNC section 3343 to file a written application with the attorney general to be removed from the list. However, such proceedings shall be in accordance with the rules prescribed by the attorney general.

84. *Sub-criterion 6.6(c)* - Palau does not have a system whereby a designation of an individual or entity under UNSCR 1373 may be reviewed by a court or independent competent authority. The mechanism of review is limited to the original decision maker reviewing their own decision.

85. *Sub-criterion 6.6(d)* - There are no procedures to facilitate review by the 1988 Committee including those Focal Point mechanisms with regard to the designation pursuant to the UNSCR 1988.

86. *Sub-criterion 6.6(e)* - There are no procedures informing the designated persons and entities on the availability of the United Nations Office of the Ombudsperson to accept de-listing petitions.

87. *Sub-criterion 6.6(f)* - Section 3345(a) includes the duties of the attorney general either on its own initiative or upon application by innocent third parties who are inadvertently affected by the freezing to unfreeze funds or other affected assets.

88. *Sub-criterion 6.6(g)* - There is no mechanism for communicating de-listings and unfreezing to financial institutions and DNFBPs. No guidance has been provided to financial institutions and DNFBPs on de-listing and the act of unfreezing.

89. *Criterion 6.7* - Based on section 3348 of AMLA, the Attorney General who is empowered to make freezing orders and has the discretion to allow access to the funds or other assets. The Attorney General may allow access to frozen funds or other assets for purposes of basic expenses, payment of certain fees, expenses and service charges or extraordinary expenses; however, this is not clearly regulated to be in keeping with conditions set by the UN in UNSCR 1452.

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### *Weighting and Conclusion*

90. Palau has established a legal framework to implement TFS pursuant to UNSCR 1267 and UNSCR 1373. There are shortcomings with clear mechanisms to share updated UN listings with the private sector. In addition, the mechanism of review is limited to the original decision maker reviewing their own decision. The Attorney General may allow access to frozen funds for purposes of basic expenses, however, this is not clearly regulated to be in keeping with conditions set by the UN. **Recommendation 6 is rated largely compliant.**

### ***Recommendation 7 – Targeted financial sanctions related to proliferation***

91. Recommendation 7 is a new requirement that was added to the FATF recommendations in 2012 and so was not assessed in Palau's 2008 MER.

92. *Criterion 7.1* - The definition of United Nations Sanctions Committee in the AMLA (Section 3300 item 21) only includes resolutions 1267 and 1988, and none of the resolutions directly linked to weapons of mass destruction and proliferation financing.

93. *Criterion 7.2* - There is no provision that establishes the legal authority and identifies the competent authorities responsible for implementing and enforcing TFS related to PF. There are no measures in place to meet the requirements set out in 7.2(a) – 7.2 (f).

94. *Criterion 7.3* - Palau has yet to formulate the necessary legislative provisions to impose freezing obligations on persons and entities including financial institutions and DNFBPs and to provide for appropriate enforcement actions in the event of non-compliance with the freezing obligations associated with proliferation financing. Palau has not adopted measures for monitoring and ensuring compliance by financial institutions and DNFBPs with the freezing obligations.

95. *Criterion 7.4* - Palau has not developed and implemented any publicly known procedures to submit de-listing requests to the United Nations Security Council in the case of designated persons and entities that, in the view of Palau, do not, or no longer, meet the criteria for designation. (a) Palau has not developed and implemented any procedures enabling the designated persons and entities to petition a request for de-listing at the Focal Point for de-listing or informing the designated persons and entities to petition the Focal Point directly for de-listing. (b) There are no publicly known procedures to unfreeze the assets of persons and entities with the same or similar name as the designated persons and entities upon adequate verification. (c) There are no procedures authorising access to funds and other assets in circumstances where the conditions for exemptions under the relevant UNSCRs are met, as the funds or other assets of designated persons and entities are not frozen in the first place. (d) There are no mechanisms pertaining to communication of de-listed entities and acts of unfreezing to the financial sector and DNFBPs immediately after such actions. No guidance has been provided to financial institutions and DNFBPs on de-listing and unfreezing actions.

96. *Criterion 7.5* - The funds and other assets of designated persons and entities are not subject to freezing in Palau. Thus, the question whether any addition to the accounts frozen in the form of interest, other earnings or payments due under contracts, agreements or obligations that arose prior to the designation of the persons and entities could be permitted does not arise. Similarly, the question whether a designated person or entity could make any payment in respect of contracts, agreements or obligations that arose prior to the date on which accounts became subject to targeted financial sanctions does not arise since the funds or other assets are not required to be frozen.

*Weighting and Conclusion*

97. Palau has not put in place any specific measures for the purposes of implementing targeted financial sanctions related to proliferation in order to comply with UNSCRs. **Palau is non-compliant with Recommendation 7**

*Recommendation 8 – Non-profit organisations*

98. In the 2008 MER, Palau was rated Partially Compliant for former SRVIII. The factors underlying the rating included: (1) Palau had not conducted formal review of the adequacy of laws and regulations governing the NPO sector, (2) Palau had not developed any criteria for fit and proper test for NPO registration, (3) No audited statements from NPOs were required, (4) Palau did not have active monitoring or supervision mechanism for NPOs, (5) Palau did not undertake outreach to NPOs for awareness raising, and (6) There was no designated contact point for NPOs. There have been no significant developments in the laws applicable to NPOs in Palau, and the deficiencies relating to technical compliance set out in the 2008 MER remain unaddressed.

99. *Criterion 8.1 is not met:*

100. *Sub-criterion 8.1(a)* - Palau did not undertake any review of the activities or characteristics of its NPO sector to identify which sub sector are likely to be at risk of TF. Palau did not review and/or assess the laws and develop regulations from the perspective of countering TF. However, Palau has broadly defined NPOs under para 2.10 of corporation regulations, as a corporation, association, club, society, trust, league, or other such organization not organized for profit and any other organizations considered to be non-profit for the purposes of the Foreign Investment Act.

101. *Sub-criterion 8.1(b)* - Palau has not identified the nature of threats, posed by terrorist entities to the NPOs and religious organisations, which are at risk, as well as how terrorists may abuse those NPOs.

102. *Sub-criterion 8.1(c)* - Palau did not review and assess the adequacy of measures to address TF risk to the NPO sector. Palau's Corporation Regulation requires NPO at the time of registration, to declare name and purpose of the NPO along with names of the directors/trustee.

103. *Sub-criterion 8.1(d)* - Since the last MER in 2008, Palau has not undertaken any assessments of the NPO sector to review its potential vulnerabilities to terrorist activities. Since no study of the sector has ever been carried out to identify probable use of specific NPOs for TF, Palau has not developed formal measures and controls.

104. *Criterion 8.2 - Sub-criterion 8.2(a)(b)* - Palau Corporation regulations ensure integrity of NPOs to a limited extent by requiring the number, names, citizenship and residential address of the initial officers, directors or similar officers of NPOs to be filed with the Registrar (Corporation Regulations, Chap 1, part 2.11(e)). However, NPOs are not required to have audited accounts, submit any record of accounts to OAG or publish their accounts for public information. Palau did not develop fit and proper test for persons registering as an NPO. Palau has not encouraged or undertaken outreach to raise awareness among NPOs with potential vulnerabilities of ML and TF abuse as well as TF risks.

105. *Sub-criterion 8.2(c)* - OAG is the registering, supervising and monitoring authority for NPOs. However, the OAG has not yet identified potential TF risks and probable misuse of NPOs, nor provided the NPOs with any guidance on TF. No national mechanism has been developed to address TF risks and vulnerabilities.

106. *Sub-criterion 8.2(d)* - Palau did not ensure formal guidance or availability of regulations to encourage NPOs to conduct transactions via regulated financial channels. The Corporation regulation requires the declaration of the purpose of the NPO and the names of the

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directors. Section 2226 of CTA, however, requires NPOs to report any cash donation in an amount equal to or greater than ten thousand dollars (USD10,000) or any sum established by regulation as promulgated by the FIU shall be reported to the OAG and the FIU pursuant to the procedures as set forth by regulation. A donation of any amount, whether cash or otherwise, shall be reported to the OAG and the FIU where the donation is suspected of being related to a terrorist operation, TF, or the proceeds of a crime as that term is defined in the AMLA 2014.

107. *Criterion 8.3* - While NPOs in Palau are very small, Palau has not undertaken a risk assessment of NPOs which has allowed measures taken (or not) to be based on risk. Palau has not taken any steps to promote effective supervision and monitoring. NPOs are not required to have its accounts reviewed or audited by an audit firm. NPOs, although required to keep proper book of accounts, they are not required to submit it to any supervising authority. The FIU and OAG receive annual activity reports but the level of monitoring on NPOs is unclear.

108. *Criterion 8.4 - Sub-criterion 8.4(a)* – Section 2226 of the CTA governing the relevant NPOs and the corporation regulations organized NPOs as provided in subparts 2.10 and 2.11 of Chapter 1 and Chapter 4 of these regulations, include requiring NPOs to declare the purpose of formation for ecclesiastical purposes (subparts 1.1 of Chapter 4). However, no guidance or regulations are available to ensure performance of NPOs within ambit of its purpose and to address vulnerabilities to TF.

109. *Sub-criterion 8.4(b)* - Under Section 2226(d) of the CTA there is a range of sanctions that are proportionate and dissuasive, and are punishable by one or more of the following penalties: (1) a fine of no more than ten thousand dollars (USD10,000); (2) a temporary ban on the activities of the association or organization of no more than two (2) years; or (3) the dissolution of the association or organization. However, the NPOs are not required to follow 'know your beneficiaries and associated NPOs' rules.

110. *Criterion 8.5 - Sub-criterion 8.5(a)* – Subparts 2.10 and 2.11 of Chapter 1 of Corporation Regulations highlight the mechanism for seeking information by different parties. Information includes Articles of Incorporation, Bylaws, Stock Affidavit of the Officers, Certificate of Status and accounts of any corporation. However, it is unclear whether the information maintained by the OAG, can be shared with competent authorities within Palau.

111. *Sub-criterion 8.5(b)* -Palau has not shown any investigative expertise and capability to examine NPOs in case suspicion of either being exploited by, or actively supporting, terrorist activity or terrorist organisations.

112. *Sub-criterion 8.5(c)* -Palau does not provide full access to information on the administration and management of particular NPOs (including financial and programmatic information) that may be obtained during the course of an investigation.

113. *Sub-criterion 8.5(d)* -Palau has not established appropriate mechanisms to ensure that, when there is suspicion or reasonable grounds to suspect that a particular NPO is involved or exploited in terrorist financing abuse and/or is a front for fundraising by a terrorist organisation, nor share information with competent authorities in order to take preventative measures.

114. *Criterion 8.6* - Palau has no designated points of contact for all international requests seeking information regarding any particular NPOs suspected of being involved in TF or the provision of other forms of support to terrorists.

### *Weighting and Conclusion*

115. Whilst the risk of TF and terrorist-related activities in Palau is generally considered to be low and the NPOs in Palau are small and are very domestic in nature, the 2017 NRA did not specifically cover TF and NPOs. Neither has Palau undertaken any domestic reviews or assessments of the NPO sector in order to identify the features and types of NPOs that are at risk



of being misused for TF or other forms of terrorist support. There is a lack in issuing policies to NPOs for TF risk issues, as well as establishing appropriate mechanisms when there is suspicion or reasonable grounds to suspect that a particular NPO is involved in or is exploited by terrorist financing abuse and/or is a front for fundraising by a terrorist organisation. No evidence has been provided regarding AML/CFT compliance monitoring or sanctions in relation to NPOs. **Palau is rated non-compliant for R.8.**

### ***Recommendation 9 – Financial institution secrecy laws***

116. In the 2008 MER, Palau was rated compliant with the former FATF recommendation 4.

117. *Criterion 9.1* - Palau does not have any bank secrecy laws that would inhibit the implementation of the FATF Recommendations. The FIU has the power to inquire with or obtain from FIs any information in accordance with the FIU's functions (AMLA Section 3333 (a)). The FIU has full power to share with designated domestic and international competent authorities relevant information from FIs.

#### *Weighting and Conclusion*

118. **Recommendation 9 is rated compliant.**

### ***Recommendation 10 – Customer due diligence***

119. Palau was rated non-compliant with former R.5. There were major gaps in the implementation of CDD measures, lack of effective implementation of CDD measures, seemingly linked occasional transactions were not addressed, no requirement to undertake CDD when a suspicion of ML or FT was identified, no requirement to obtain information on the provisions regulating the power to bind a legal person or arrangement, no requirement to obtain the purpose and nature of business relationships or to conduct ongoing CDD on the relationships, no requirement of enhanced CDD on high-risk categories of customers, amongst other deficiencies. Since the 2008 MER, Palau has issued the FIU REGULATION AML-Regulation-01 (hereinafter FIU Regulation for FI), which sets out various preventive measures for banks and alternative money remittance services, but insurance agents and credit unions are not covered in this regulation.

120. *Criterion 10.1* - The AMLA Section 3310 requires that FIs and DNFBPs are not permitted to establish or maintain anonymous accounts or accounts in fictitious names.

121. *Criterion 10.2* - (a) Article 2.1.1(a) to (c) of the FIU regulation for FI requires REs to undertake CDD measures, including the identification of customers and gathering information on customers to create a customer profile, and application of acceptance policies to new customers. (b) the CDD obligations apply to all occasional transactions, regardless of any threshold. (c) Banks are prohibited from carrying out occasional transactions, including wire transfers in Palau. (d) Palau does not set out requirements for FIs on CDD to be carried out when there is a suspicion of ML/TF. (e) Palau does not yet require CDD to be carried out when FIs have doubts about the veracity or adequacy of previously obtained customer identification data.

122. *Criterion 10.3* - Article 2.2.1 and 2.4.1 of the FIU regulation for FI require the REs to identify the customer by obtaining, for natural persons, their passport, birth certificate, and for legal persons, certificate for the Registrar of Corporation.

123. *Criterion 10.4* - In establishing a business relationship with a legal entity or other form of legal arrangement, the FIU regulation for FI provides REs to identify the natural person purporting to act on behalf of the customer using reliable, independently sourced documents. (FIU Regulation Article 2.4.1(b)).

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124. *Criterion 10.5* - REs are required to identify beneficial owners when undertaking CDD, and REs shall take reasonable measures to understand and document the ownership and control structure when customer is a legal person or arrangement (FIU Regulation for FI Article 2.1.1(a), 2.4.3).

125. *Criterion 10.6* - The REs are required to obtain information on the purpose and intended nature of the business relationship. There is however no explicit requirement for REs to understand the purpose and intended nature of the business relationship (FIU Regulation for FI Article 2.7.1, 2.7.2).

126. *Criterion 10.7* - The REs are required to gather and maintain customers' risk profile including updating information and monitoring transactions on an on-going basis. There is however no explicit requirement for REs to understand the transactions are consistent with customer's business and risk profile (FIU Regulation for FI Article 2.6.1).

127. *Criterion 10.8* - For customers that are legal persons or legal arrangements, REs are required to take reasonable measures to understand and document the ownership and control structure of the customer. REs are required to obtain the business or principal activity of customers, there is however no explicit requirement for REs to understand the nature of the customer's business (FIU Regulation for FI Article 2.2.1(d), 2.4.3). The financial institutions covered by this regulation include banks, foreign bank branches and credit institutions licenced by the FIC but do not include credit unions and cooperatives.

128. *Criterion 10.9* - For legal persons, REs are required to identify the customer's name, address and legal form, obtaining proof of incorporation or similar evidence of establishment or existence including a certificate of registration for the Registrar of Corporations, and/or a valid Foreign Investment Certificate. REs are required to take reasonable measures to understand and document the ownership and control structure of the customer. There is however no explicit requirement for REs to obtain information on the powers that regulate and bind the legal person or arrangement. (FIU Regulation for FI Article 2.4.1(a), 2.4.3)

129. *Criterion 10.10* - REs are required to identify and verify the principal owner of the company, and must at a minimum identify (a) each natural person who owns directly or indirectly 25 percent (25%) or more of the vote or value of an equity interest in the entity; and (b) one person exercising effective control of the entity, including an executive officer or senior manager; and (c) each natural person who exercises signing authority on behalf of the entity. There is no requirement for REs to identify and take reasonable measures to verify the identity of the natural person(s) (if any) exercising control of the legal person through other means, if there is doubt as to whether the person(s) with the controlling ownership interest is the beneficial owner(s) or where no natural person exerts control through ownership interests (FIU Regulation for FI Article 2.4.4).

130. *Criterion 10.11* - General requirements for identification and verification of the identity of a trust's beneficial owner is in Article 2.4 of the FIU Regulation for FI. For a customer that is a trust or other similar arrangement, the REs are required to identify and verify the identity of the trustee (FIU Regulation for FI Article 2.4.5). There is no explicit requirement for REs to identify and take reasonable measures to verify, the identity of the protector (if any), and the class of beneficiaries.

131. *Criterion 10.12* - Palau does not require FIs to conduct CDD measures on the beneficiary of life insurance and other investment related insurance policies (noting the latter are not a feature in Palau), as soon as the beneficiary is identified or designated. There is no legislative provision in place to meet the requirements set out in 10.12(a) – 10.12 (c).

132. *Criterion 10.13* - Palau does not require FIs to include the beneficiary of a life insurance policy as a relevant risk factor in determining whether enhanced CDD measures are applicable.

133. *Criterion 10.14* - REs are required to undertake CDD measures including identification of customers, gathering information on customers, and application of acceptance policies to new customers (FIU Regulation for FI Article 2.1.1). However the FIU Regulation or AMLA do not have any provision in relation to timing of verification of customers and beneficial owners and does not indicate that ML/TF risks are effectively managed through this process.

134. *Criterion 10.15* - Palau does not require FIs to adopt risk management procedures concerning delayed verifications and the conditions under which FIs may permit a customer to utilise the business relationship prior to verification.

135. *Criterion 10.16* - REs are required to apply CDD requirements on existing customers on the basis of materiality and risk; and conduct due diligence on such existing relationships at appropriate times (FIU Regulation for FI Article 2.11.1).

136. *Criterion 10.17* - REs are required to undertake enhanced CDD on any customer and any transaction that the institution has determined is of higher risk of ML/TF (FIU Regulation for FI Article 2.9.1).

137. *Criterion 10.18* - REs may apply a simplified CDD procedure in certain circumstances if (a) the risk of ML/TF is lower; (b) information on the identity of the customer and the beneficial owner of a customer is publicly available; or (c) adequate checks and controls exist in Palau (FIU Regulation for FI Article 2.10.1). There is no explicit requirement for REs to apply simplified CDD procedure through analysis, and no requirement to provide simplified measures that are commensurate with risk factors.

138. *Criterion 10.19* - Regulation 2.8.3 of the FIU Regulations for FI require FIs to not proceed with a transaction or account opening if CDD cannot be completed. There is a limited requirement to consider filing a report to the FIU if CDD cannot be completed, but only in the case of failure to complete CDD when following incomplete CDD under section 3321(b) of the ML Act, although this only applies in the context of CDD to create a legal person or arrangement.

139. *Criterion 10.20* - Palau has yet to formulate the necessary legislative provision for exemption of the CDD process in circumstances where conducting the CDD process would tip-off the customer. Moreover, there is no requirement in those circumstances that requires the FI to report a STR.

### *Weighting and Conclusion*

140. Palau does not require FIs to update CDD when there is suspicion of ML/TF or doubts about the veracity of previous CDD. There are also no specific provisions requiring that FIs shall understand the nature of the customer's business. There are no specific provisions requiring that FIs conduct CDD measures on the beneficiary of life insurance and other investment related insurance policies, as soon as the beneficiary is identified or designated and no requirement that FIs need to include the beneficiary of a life insurance policy as a relevant risk factor in determining whether to apply EDD (recognising less weight was applied to this due to small size of insurance industry). Further shortcomings include there are no specific provisions requiring that FIs adopt risk management procedures when a customer may utilise the business relationship prior to verification; no specific provisions in relation to delaying verification of customers and BO, and no legislative provisions regarding the requirement that when a FI is unable to comply with relevant CDD measures as in tipping-off the customer, that requires the FI to still report a STR. **Recommendation 10 is rated partially compliant.**

### *Recommendation 11 – Record-keeping*

141. Palau was rated non-compliant with former R.10. The 2008 MER highlighted that there was no requirement for FIs to maintain all necessary records on transactions, account files and

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business correspondence, for at least five years. There was no requirement for FIs to maintain records sufficiently to permit reconstruction of individual transactions.

142. *Criterion 11.1* - FIA Act Article 1075(6) requires that every FI shall prepare and maintain at its head office written records containing records showing, for each customer, on a daily basis, particulars of its transactions with or for the account of that customer, and the balance owing to or by that customer. Section 17 PNCA §3326b (1 and 2) requires records to be maintained for not less than 5 years after a business relationship has ended and not less than 5 years after a transaction.

143. *Criterion 11.2* - 17 PNCA §3326b (1 and 2) requires records to be maintained for not less than 5 years after a business relationship has ended and not less than 5 years after a transaction.

144. *Criterion 11.3* - Article 3326(a) and (b)(2) of AMLA requires that FIs shall maintain all books and records with customers and transactions, and records on transactions shall be sufficient to reconstruct each transaction for both account holders and non-account holders.

145. *Criterion 11.4* - Article 3326(a) of AMLA requires that FIs maintain all books and records with respect to their customers and transactions, and shall ensure that such records and the underlying information are available on a timely basis to the FIU, the FIC and other competent authorities.

### *Weighting and Conclusion*

146. **Recommendation 11 is rated compliant.**

### *Recommendation 12 – Politically exposed persons*

147. Palau was rated non-compliant with former R.6 in the 2008 MER. Palau has since introduced PEPs requirements in the FIU REGULATION AML-Regulation-01.

159. *Criterion 12.1* - Article 3300(17) of the AMLA defines a PEP as any person who is or has been entrusted with prominent public functions in Palau or in a foreign country, for example Head of State or of government, a senior politician, a senior government, judicial or military official, and any person who is or has been a senior executive of a national or state owned company or a senior political party official. (a) FIs are required to put in place risk management systems to determine whether a customer or a potential customer or the beneficial owner is a PEP (FIU Regulation for FI Article 2.9). (b) There are no requirements for FIs to obtain senior management approval for establishing business relationships with PEPs. (c) The FIU Regulations for FI require FIs (2.9.2b) to establish the source and legitimacy of funds of customers and beneficial owners identified as PEPs. There is no specific requirement for FIs to establish the source of wealth of customers and BOs identified as PEPs. (d) The FIU Financial Regulations require that FIs conduct enhanced ongoing monitoring on PEP relationships (2.9.3).

160. *Criterion 12.2* - FIs are required to put in place appropriate risk management systems to determine if a customer or the BO is a domestic PEP (FIU Regulation for FI Article 2.9.6). However, there is no specific requirement for FIs to (a) determine a customer or the BO is a person entrusted with a prominent function by an international organisation, (12.1 b) or, in cases where there is a higher risk business relationship, to obtain senior management approval for establishing business relationships with domestic PEPs, (12.1 c) take reasonable measures to establish the source of wealth of customers and BO identified as PEPs; and (12.1 d) conduct enhanced ongoing monitoring on that relationship.

161. *Criterion 12.3* - The definition of PEPs in the AMLA Article 3300(17) covers family members and business associates of foreign and domestic PEPs, however that of a person entrusted with a prominent function by an international organisation are not covered. In considering PEPs associated with international organisations, there are no requirements for FIs

to (a) obtain senior management approval for establishing business relationships with family members and business associates of PEPs, (b) establish the source of wealth of family members and business associates of PEPs, and (c) conduct enhanced ongoing monitoring on that relationship

162. *Criterion 12.4* - There are no specific provisions requiring a FI to take reasonable measures to determine whether the beneficiary of a life insurance policy is a PEP.

#### *Weighting and Conclusion*

163. Palau's legislation has no requirements for FIs to obtain senior management approval when dealing with PEPs, to establish source of wealth of PEPs and to conduct enhanced ongoing monitoring on that relationship for domestic PEPs and for persons entrusted with a prominent position in an international organisation. High-level persons of international organisations are not covered in any PEP requirements. In addition, Palau's legislation does not require FIs to take reasonable measures to determine whether beneficiaries of insurance policies are PEPs. Less weight was placed on the latter due to the limited size of the insurance sector. **Recommendation 12 is rated partially compliant.**

#### *Recommendation 13 – Correspondent banking*

164. Palau was rated non-compliant with former R.7 in the 2008 MER. There was no requirement for FIs to comply with R.7.

165. *Criterion 13.1* - The AMLA Article 3311 requires that FIs gather information about the correspondent bank's business, reputation, and the nature and quality of the supervision to which it is subject, and conduct an assessment of the quality of AML/CFT controls of the correspondent bank. It is not required to know whether it has been the subject of a ML/TF investigation or regulatory action or obtain senior management approval before establishing a new correspondent banking relationship.

166. *Criterion 13.2* - There is no requirement regarding CDD requirements on payable-through accounts.

167. *Criterion 13.3* - REs is required to have in place measures to guard and prohibit itself against establishing a relationship with a shell bank (FIU Regulation for FI Article 1.1.3).

#### *Weighting and Conclusion*

168. Palau has put in place some of the requirements for R13. However, the required information to be collected from the respondent FIs are not sufficient for a risk assessment including whether it has been the subject of a ML/TF investigation or regulatory action or has obtained senior management approval before establishing a new correspondent banking relationship. There are no requirements for a respondent FI which has payable through accounts that are not consistent with the Standard. Given these shortcomings, Palau is rated **partially compliant with R13.**

#### *Recommendation 14 – Money or value transfer services*

169. In the 2008 MER, Palau was rated non-compliant with the former SR.VI. Factors underlying the rating included that: have not been licensed nor identified, no regulations issued for ARS, ARS are not required to keep all necessary records of all transactions for five years after the transaction is completed nor records of account files and business correspondence, no requirement for ARS to file STRs for attempted transactions.

170. *Criterion 14.1* - There are no requirements that require MVTS providers should be licensed or registered.

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171. *Criterion 14.2* - There are no requirements that require a MVTS provider function without a licence or registration, nor applying proportionate and dissuasive sanctions to them.

172. *Criterion 14.3* - MVTS providers are required to be subject to monitoring for AML compliance by both the AMLA (3327 b (1)) and by FIU Regulation for FI. There are no requirements that provide MVTS should be subject to monitoring for CFT compliance.

173. *Criterion 14.4* - There are no requirements that require agents for MVTS providers should be licensed or registered by a competent authority, nor that MVTS providers are required to maintain a current list of its agents accessible by competent authorities in Palau.

174. *Criterion 14.5* - There are no requirements that require MVTS providers that use agents should be required to include them in their AML/CFT programmes and monitor them for compliance with these programmes.

### *Weighting and Conclusion*

175. Except for requiring MVTS providers to comply with both the AMLA and FI regulations, Palau does not have further laws or regulations to meet the requirements of recommendation 14 including licensing or registration for legal, natural persons or agents and the inclusion in their AML/CFT programs if they do use agents. **Recommendation 14 is rated non-compliant.**

### *Recommendation 15 – New technologies*

176. Palau was rated non-compliant with former R.8 in the 2008 MER. There was no requirement in law or regulation for FIs to have policies in place to prevent the misuse of technological developments.

177. *Criterion 15.1* - Palau does not identify and assess the ML/TF risks related to new technologies and this was also not undertaken as part of the 2017 NRA. In addition, there are no requirements in Palau that require FIs to identify and assess the ML/TF risks related to new technologies. However, given the size and context of the domestic financial system in Palau, there are very limited options on financial services and products available, and introduction of new products and delivery channels into the market is quite rare/ infrequent. Nevertheless, the three US banks (that contribute to approx. 98% of the financial activity) do in practice undertake risk assessments of new products including new technologies which apply to the branches they manage in Palau..

178. *Criterion 15.2* - There are no specific, enforceable requirements for FIs to assess the ML/TF risks of new products, practices and technologies. The AMLA Article 3315 requires that FIs shall have measures to prevent the misuse of information technology and to address risks associated with the conducting of business relationships or executing transactions, but Palau has no specific requirement related to assessing risks associated with the launch or use of technology products, and do not have a requirement for FIs to manage and mitigate these risks.

### *Weighting and Conclusion*

179. Palau has not clearly mandated that risks related to new technologies must be identified and assessed prior to launch of new technologies and have also not mandated that FIs are obliged to take measures to manage and mitigate the risks when launching or using new technologies. This is mitigated to a limited extent by the risk management practices of the three international banks. **Recommendation 15 is rated partially-compliant.**

**Recommendation 16 – Wire transfers**

180. In the 2008 MER, Palau was rated non-compliant for former SR VII. The factors underlying the rating included: (1) No wire transfer requirements for domestic institutions in the MLPCA, (2) There is a gap of coverage in the MLPCA Section 6 requirements resulting in foreign wire transfers between USD1,000 and USD5,000 not being covered by wire transfer requirements, (3) There are no risk-based procedures for identifying and handling wire transfers without complete originator information, and (4) There are no measures to effectively monitor supervised financial institutions compliance with wire transfer rules.

181. *Criterion 16.1* - Palau has no prescribed threshold for wire transfers (Title 7 §3318) and (b) all transfers are required to have and maintain through the payment chain, accurate and meaningful originator and recipient information, including but not limited to, name, address, and account number.

182. *Criterion 16.2* - The AMLA does not provide any special CDD requirements for cross border transfers contained within a batch transfer.

183. *Criterion 16.3* - Palau does not apply any *de minimis* threshold for cross border wire transfers.

184. *Criterion 16.4* - Palau does not apply any *de minimis* threshold for cross border wire transfers.

185. *Criterion 16.5* - Palau does not have any provisions to require FIs for domestic wire transfer to include full originator information or the account number/unique identifier. However, only branches of US banks have wire transfer capabilities in Palau. As Palau does not have domestic wire transfers, little weight was applied to this deficiency.

186. *Criterion 16.6* - Not specifically covered, though as Palau does not have domestic wire transfers, little weight was applied to this deficiency.

187. *Criterion 16.7* - This is undertaken as part of general record keeping requirements as per Recommendation 11.

188. *Criterion 16.8 is met:* Under Section 3318(c) of the AMLA, if the ordering FI is unable to complete the CDD process on the originator, the FI is prohibited from proceeding with the transfer.

189. *Criterion 16.9* - There are no provisions under the AMLA that require intermediary FI to maintain the required originator information with all wire transfers including cross border wire transfers. Since the US branches in Palau would act as intermediaries if such transactions occurred, little weight is applied to this deficiency.

190. *Criterion 16.10 is not met:* There is no requirement under the AMLA that intermediary FIs must maintain the required originator information with all wire transfers regardless of the intermediary financial institution's technical capacity. Since the US branches in Palau would act as intermediaries if such transactions occurred, little weight is applied to this deficiency.

191. *Criterion 16.11 is not met:* Section 3318 (b)(c) of the AMLA requires all FIs to monitor for electronic fund transfers that do not contain complete originator information, however, there are no specific requirements to apply measures consistent with straight-through processing to identify cross-border wire transfers that lack originator information or required beneficiary information. Since the US branches in Palau would act as intermediaries if such transactions occurred, little weight is applied to this deficiency.

192. *Criterion 16.12 is not met:* There is no requirement for intermediary FIs to set up risk-based policies and procedures for determining when to execute, reject or suspend a wire transfer lacking required originator or required beneficiary information and take appropriate

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follow-up actions. Since the US branches in Palau would act as intermediaries if such transactions occurred, little weight is applied to this deficiency.

193. *Criterion 16.13 is met:* Section 3318 (b)(c) of the AMLA requires all FIs to monitor for electronic fund transfers that do not contain complete originator information but there are no specific requirements for post-event monitoring or real-time monitoring where feasible, to identify cross-border wire transfers that lack required originator information or required beneficiary information. The US banks through which the transfer would occur, would not process it if beneficiary information is missing or incomplete.

194. *Criterion 16.14 -* The FI or DNFBP that receives a wire transfer is required to verify the identity of the beneficiary or where information is missing take reasonable steps to obtain and verify the information from the ordering institution (AMLA s. 3317) and as per Section 17 PNCA §3326b (1 and 2) requires records to be maintained for not less than 5 years after a transaction, in accordance with Recommendation 11

195. *Criterion 16.15 -* There is no requirement for beneficiary FIs to set up risk-based policies and procedures for determining when to execute, reject, or suspend a wire transfer lacking required originator or required beneficiary information and take appropriate follow-up action.

196. *Criterion 16.16 -* MVTS are not licensed and regulated by FIC, hence no regulations available or applicable.

197. *Criterion 16.17 -* MVTS are not licensed and regulated by FIC, hence no regulations available.

198. *Criterion 16.18 is partly met:* There is a requirement under the Section 3340 till 3351 of AMLA for taking freezing action and complying with prohibition from conducting transactions with designated persons and entities, as per obligations set out in the relevant UNSCRs. However, instructions or guidelines regarding name screening of individuals before transactions especially in the case of walk-in customers could not be found on FIC or FIU website. Foreign banks may have this in place but concerns exist regarding DNFBPs and domestic banks.

### *Weighting and conclusion*

199. Palau have gaps regarding wire transfers including it does not provide any special CDD requirements for cross border transfers contained within a batch transfer, Palau does not have any provisions to require FIs in the domestic wire transfer to include full originator information or the account number/unique identifier, clear instructions for walk-in customer and time period for record retention is not covered in policy and MVTS do not have the required regulations. Little weighting is applied to deficiencies around domestic wire transfers as Palau does not engage in these. Since the US branches in Palau would act as intermediaries if such transactions occurred, little weight is applied to this deficiency. **Palau is rated partially compliant for Recommendation 16.**

### *Recommendation 17 – Reliance on third parties*

200. In the 2008 MER Palau was rated non-compliant with former Recommendation 9. Palau has since introduced basic third-party requirements in the FIU Regulation 01 for FIs.

201. *Criterion 17.1 -* The ML law (s3314) allows REs to rely on third parties to perform elements of CDD, and the section confirms that ultimate responsibility for CDD, including verification remains with the RE. The AML law does not require REs to immediately obtain CDD information or to obtain copies of identity documentation without delay. Palau does not require that RE satisfy themselves that the third party conducting CDD is regulated and supervised for its own CDD and record keeping. The AML law indicates that details of controls on use of third



parties for CDD will be promulgated in FIU regulation, but the FIU has not yet regulated on this issue.

202. *Criterion 17.2* - Palau does not regulate REs regarding which countries their third party CDD providers can be based in.

203. *Criterion 17.3* is not applicable.

#### *Weighting and Conclusion*

204. While REs are permitted to rely on third parties for CDD, Palau leaves ultimate responsibility for CDD and related verification with the RE. There are gaps with the requirements for Palau REs to obtain information and records from the third party in a timely manner and it lack controls on which countries the third party provider can be based in.

**Recommendation 17 is rated partially compliant.**

#### ***Recommendation 18 – Internal controls and foreign branches and subsidiaries***

205. Palau was rated as partially compliant with former Recommendation 15. The 2008 MER found training requirements do not include the need for training on current ML/FT techniques, new developments, methods, and trends, and in addition require no FI requirements for employee screening, and regarding cash dealers and OTC exchange dealers, they were not required to develop compliance programs for AML/CFT.

206. *Criterion 18.1* - FIs are required to implement ML/TF programs. The programs shall include written procedures, policies, systems; and have regard to ML/TF risks, the size and nature of the business, and types of products and services (FIU Regulation for FI Article 1.1.1, 1.1.2). (a) FIs are required to designate a Compliance Officer at the management level who is responsible for ensuring FIs are compliant with related laws and regulations (FIU Regulation for FI Article 1.2.1); (b) FIs are required to put in place screening procedures to ensure high standards when hiring employees (FIU Regulation for FI Article 1.2.8); (c) FIs are required to establish ongoing employee training to ensure that employees are informed of current ML/TF techniques and AML/CFT laws and obligations (FIU Regulation for FI Article 1.2.10); and (d) FIs are required to establish and maintain independent audit function to test the compliance system (FIU Regulation for FI Article 1.2.5).

207. *Criterion 18.2* - There are no financial groups or enabling legislation for such structures in Palau.

208. *Criterion 18.3* - There are no provisions for Palau banks to establish foreign branches.

#### *Weighting and Conclusion*

209. **Recommendation 18 is rated Compliant.**

#### ***Recommendation 19 – Higher-risk countries***

210. Palau was rated non-compliant with former R.21. The 2008 MER found that no FIs, cash dealers, or ARS were provided information regarding concerns about weaknesses in the AML/CFT systems of other countries, Palau had no plan or procedure to apply counter-measures to those countries based on FATF Recommendations.

211. *Criterion 19.1* - It is not explicitly provided that FIs should be required to apply enhanced CDD to business relationships and transactions with natural and legal persons (including financial institutions) from countries for which this is called for by the FATF.

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212. Criterion 19.2 - There are no specific requirements relating to applying countermeasures when called upon to do so by the FATF or independently of any call by the FATF to do so.

213. *Criterion 19.3* - The FIU is required by the AMLA 3313(b) to advise FIs and DNFBPs of concerns about weaknesses in the AML/CFT systems of other countries.

### *Weighting and Conclusion*

214. Palau does not require EDD for countries called for by the FATF and they have no requirement for applying countermeasures proportionate to the risk. **Recommendation 19 is rated partially compliant.**

### *Recommendation 20 – Reporting of suspicious transaction*

215. Palau was rated partially compliant with former R.13 on suspicious transaction reporting on ML and former SR.IV on suspicious transaction reporting on TF in the 2008 MER. The factors underlying the rating included scope issues arising from deficiencies in the list of predicate offences; insufficient coverage of STRs related to terrorism; no requirement to report attempted transactions; insurance agents classified as “OTC exchange dealers” were not required to report attempted transactions or to file STRs where there is a suspicion of TF; and inadequate implementation of reporting obligations by financial and other institutions.

216. *Criterion 20.1– 26* PNCA Chapter 10 § 1062 of the FIA requires financial institutions to report suspicious transactions and provides the legal basis for FIs and their respective directors, principals, officers, partners, professionals and employees to make a report to the FIU if they suspect or have reasonable grounds to suspect that a transaction involves property that is the proceeds of crime or linked to or is to be used for a terrorism offense. Section 3.1.1 of the FIU Regulation for FIs outlines the information that must be reported to the FIU. All suspicious funds and transactions, including attempted transactions, and all suspicious information including information relating to terrorist groups must be reported to the FIU.

217. The FIU Regulation for FIs, which was enacted in November 2017, requires reporting of suspicious transactions by a FI due to section 3314 of the AMLA and the FIA. Within the AMLA, it notes that attention should be paid to transactions or unusual patterns of transactions “which have no apparent or visible economic or lawful purpose”. This is narrow as the AMLA through this definition does not require the source of the suspected funds to be shown to be proceeds of criminal activity. The FIA applies a more comprehensive definition (Section 1062 a) which meets the requirements of this recommendation though the FIA only applies to banks and not remittance service providers which the regulations cover and that the FIC regulate. The remittance services are in effect the only financial sector that has the AMLA as its legislative base rather than the FIA, and since they are very small and have an upper limit of USD1500 per transaction, is not of significant concern.

218. Section 3320 of the AMLA requires a FI to report to the FIU where it suspects or has reasonable grounds to suspect that a transaction or attempted transaction involves property that is the proceeds of crime; that is related or linked to or is to be used for a terrorism offense or a terrorist act, by a terrorist, or terrorist organization, or by those who finance terrorism as such terms are defined in 17 PNC Chapter 22.17 “Proceeds of Crime” or “proceeds” is defined broadly and means any property or economic advantage derived from or obtained, directly or indirectly, wholly or partially, through the commission of an offense, including economic gains from the property and property converted or transformed, in full or in part, into other property.

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<sup>17</sup> While section 3320 is entitled “Reporting of suspected terrorism”, in fact the reporting obligation extends to reporting of transactions relating to any serious offence,

219. *Criterion 20.2*– In section 3.1.1 of the FIU Regulation for FIs, all suspicious funds and transactions including attempted transactions and all suspicious information should be reported, regardless of the amount of the transaction. As noted in 20.1, the definition of the AMLA as it applies to remittance service providers is limited and narrow which does not require all suspicious transactions to be reported.

#### *Weighting and conclusion*

220. The definition in the AMLA which applies to remittance service providers, who are not covered by the FIA, is limited. As this sector is very small with lower risk, the narrower interpretation is given less weight. All other FIs are fully covered by both the FIA and the Financial Regulations for FIs. **Palau is rated largely compliant for Recommendation 20.**

#### ***Recommendation 21 – Tipping-off and confidentiality***

221. Palau was rated largely compliant with former R.14 on tipping off and confidentiality in the 2008 MER. The factors underlying the rating included: (1) section 21 of the MLPCA could constitute tipping off by the authorities; and (2) there were no explicit tipping-off prohibitions in the MLPCA.

222. *Criterion 21.1* – AMLA sec. 3321 (g) and (h) protect financial institutions and their directors, officers and employees from both civil/disciplinary/administrative and criminal proceedings when they in good faith submit a report or provide information in accordance with the provisions of this section.

223. *Criterion 21.2* – AMLA sec. 3321 (c) prohibits FIs or their employees or agents from disclosing to any customer or third party that a report or any other information will be, is being or has been submitted to the FIU. It also extends this prohibition to the fact that a ML or TF investigation is being or has been carried out. The information however can be provided to those with a legitimate right or need to know, and only in accordance to the direction provided by FIU's Regulations and guidance.

#### *Weighting and Conclusion*

224. **Palau is rated compliant for Recommendation 21.**

#### ***Recommendation 22 – DNFBPs: Customer due diligence***

225. As discussed in Chapter 1, Palau has scope deficiencies with regard to DNFBPs. DNFBPs in Palau include real estate agents/entities, dealers of precious metals and stones, lawyers, notaries and company service providers as per the AMLA and exclude Accountants (see Recommendation 1.6). As discussed in Chapter 1 and in R.35, the AMLA is enforceable on all DNFBPs except accountants in Palau.

226. Palau has not enacted the FIU Regulations for DNFBPs.

227. Gambling (casinos and internet casinos) is prohibited by Palau National Code (Criminal Code) and considered as a misdemeanour (Chapter 5, Section 5004(a)(b)).

228. As discussed in Chapter 1, Palau has only 5 registered accountancy firms and 17 registered accountants. Palau has indicated that only one of the registered accounting firms operates in Palau with a focus on auditing services (the assessment team met with this entity at the onsite meeting). They do not offer general accounting services and do not undertake transactions on behalf of others.

229. Palau has no trust and company service providers (TCSPs) though lawyers do provide some of these services.

## TECHNICAL COMPLIANCE

230. In Palau there are 3 entities licensed to undertake activities of dealers in precious metals and precious stones, considered as small tourist outlets that have low value jewellery for sale. There are also 2 real estate agents covered under the AMLA, and 66 lawyers (though only 16 are in private practice in Palau).

231. Lawyers are considered DNFBPs according to the AMLA. Palau has indicated that lawyers will not be captured by the DNFBP regulations due to concerns related to legal privilege. It became apparent at the onsite visit that lawyers assist clients in the purchase and sale of real estate, and assist clients in creating legal persons in particular businesses with foreign ownership. The risks associated with these activities are higher in the context of Palau, which suggests that exclusion of lawyers from AML/CFT obligations will create risks and vulnerabilities for Palau.

232. Real estate agents are covered by the AMLA and the two agents active in Palau should be covered by the AML/CFT obligations due to the higher ML risk associated with real estate transactions.

233. Licensed Notaries in Palau are only licensed to authenticate signatures for legal documents, such as affidavits, land lease documents, or any document filed with the courts requiring authentication. They do not provide services as per 22.1 (d).

234. In the 2008 MER, Palau was rated non-compliant for former Rec.12. The factors underlying the rating is that none of the DNFBPs operating in Palau (lawyers and CSPs), are covered by the AML/CFT legislation.

235. *Criterion 22.1* - Section 3312 of the AMLA indicates that DNFBPs are required to apply certain elements of CDD, in line with R.10. However, minimal CDD requirements are offered in the AMLA, and no DNFBP regulations have been issued to address more comprehensive CDD requirements. Accountants are not covered under the AMLA, thus, no requirements for CDD apply to them.

236. Gambling is illegal in Palau, so casinos do not exist in Palau, while other DNFBPs are not regulated (including lawyers, accountants, real estate agents, and DPMs).

237. *Criterion 22.2* - Palau's record keeping requirements as set out in Section 3326(a) of AMLA apply to all categories of reporting entities including relevant DNFBP (except accountants) activities as defined in criterion 22.1, with explicit obligation on DNFBPs to make CDD information swiftly available to the FIU, FIC and other competent authorities. However, there was no evidence that the DNFBPs are keeping complete and proper records of their activities or ensuring timely availability of CDD information and transaction records.

238. *Criterion 22.3* - The AMLA Section 3313 provides that DNFBPs shall have in place measures to identify PEPs and to manage the risk associated with such persons. Regulations regarding determining PEPs, comprehensive list maintenance and name screening are not issued by the FIU. In addition, Palau has no PEP requirements for FIs and DNFBPs to obtain senior management approval when dealing with PEPs.

239. *Criterion 22.4* - The AMLA Article 3316 requires that FIs including DNFBPs have measures to prevent the misuse of information technology and to address risks associated with the conducting of business relationships or executing transactions, however, it does not require FIs including DNFBPs to assess risks associated with the launch of new products and technologies nor mitigate any identified risks.

240. *Criteria 22.5* - The AMLA Section 3315 indicated that DNFBPs may rely on an intermediary or third party to perform some of the CDD measures under 17 PNC Section 3312 or to introduce business with the ultimate responsibility for customer identification and verification remaining with the concerned DNFBPs. However, necessary regulation for DNFBPs to clarify the required preventive measures has not been enacted.

*Weighting and Conclusion*

241. Palau does not cover all the material elements of the CDD requirements under R.10 nor other requirements under R.11, R.12, R.15 and R.17. Palau is rated **non-compliant for R.22**.

*Recommendation 23 – DNFBPs: Other measures*

242. In the 2008 MER, Palau was rated non-compliant for former Rec. 16. The factor underlying the rating is that none of the DNFBPs operating in Palau, that is, lawyers and CSPs, are covered by the AML/CFT Law.

243. *Criterion 23.1* - The suspicious transaction and suspicious activity reporting requirements (including for attempted transactions and activities) in Section 3313 of the AMLA apply to all REs including DNFBPs as defined in the FATF Recommendations (except accountants). However, it notes that attention should be paid to transactions or unusual patterns of transactions “which have no apparent or visible economic or lawful purpose”. This is narrow as the AMLA through this definition does not require the source of the suspected funds to be shown to be proceeds of criminal activity. No regulations for DNFBPs has been enacted to provide stronger STR requirements that overcome this deficiency.

244. *Criterion 23.2* - The AMLA does not contain elements of internal control requirements for DNFBPs as set out in R.18. No regulations for DNFBPs has been issued to cover this deficiency.

245. *Criterion 23.3* - The FIU is required by the AMLA 3313(b) to advise DNFBPs of concerns about weaknesses in the AML/CFT systems of other countries. Higher-risk countries requirements for DNFBPs set out in R.19 are not covered by the AMLA.

246. *Criterion 23.4* - The findings noted under R.21 on tipping off and confidentiality are applicable to all relevant DNFBP activities.

*Weighting and Conclusion*

247. While Palau provides for general requirements in relation to reporting of STRs (though the AMLA does not fully meet FATF requirements), including tipping-off and confidentiality, the gaps in relation to R.19 and R.20 for FIs also apply to DNFBPs. Palau has not established internal controls as per R. 18 and no regulations have been issued to address these requirements. R. 23 is rated **partially-compliant**.

*Recommendation 24 – Transparency and beneficial ownership of legal persons*

251. Palau was rated ‘partially compliant’ for Rec. 33 (now Rec. 24) in its’ 2008 MER. The deficiencies identified were 1) absence of measures to ensure transparency and to prevent unlawful use of legal persons; and 2) corporate information and information on beneficial ownership and control structure might not always be adequate, accurate and current.

252. *Criterion 24.1* - Legal persons must be established under, and are regulated by, the Corporations Act (Title 12 PNCA) and Corporations Act Regulations (“the Regulations”). Under those instruments the following eight types of legal persons may be established:

- Corporations for Profit (Regulations, Chap 1);
- Non-profit Corporations (Regulations, Chap 1);
- Foreign Corporations, including foreign government corporations, and foreign eleemosynary (or non-profit) corporations (Regulations Chap 3, Part 1);
- Corporations Sole for Ecclesiastical Purposes (Regulations, Chap 4);

## TECHNICAL COMPLIANCE

- Limited Partnerships<sup>18</sup> (Regulations, Chap 5);
- Foreign Limited Partnerships (Regulations, Chap 5, paragraph 1.5)
- Credit Unions (legal persons formed by 25 or more citizens of Palau under the Corporations Act section 101 and the Regulations Chap 7, part 2, paragraph 2.1); and
- Cooperatives (legal persons formed by association of 10 or more natural persons under the Corporations Act section 101 and the Regulations, Chap 8, part 2, paragraphs 2.1 and 2.2).

253. The Registrar of Corporations (“the Registrar”) issues, receives and holds all documents upon establishment of these legal persons including the corporate articles of incorporation and by-laws, partnership documentation etc. After establishment, corporations, including limited partnerships, must file annual reports with the Registrar (variously referred also as “annual statements” and “annual exhibits” in the Regulations).

254. Palau was not able to demonstrate the numbers of the various forms of legal persons established and/or operating in Palau.

255. The information relating to the mechanisms to identify and describe the different types of legal persons and the processes necessary to create them are publicly available. Some legislation is available online (to some extent). Some legislation is kept at two public law libraries.

256. *Criterion 24.2* - The ML/TF risks associated with all forms of legal persons (listed above) have not been assessed. The 2017 National Risk Assessment (NRA) assesses the risk associated with ‘front businesses’ and ‘shell companies’, but does not assess the forms of legal persons, including limited partnerships, as required by this criterion. Neither does there appear to be other assessments outside the 2017 NRA on the ML and TF risks posed by the types of legal persons listed above.

### **Basic Information**

257. *Criterion 24.3* - In order to “charter” or establish one of the above forms of legal persons in Palau an applicant must file the appropriate documents with the Registrar pursuant to the Corporations Act section 103 and the relevant provisions in the Regulations. That information includes at least the following:

- name of the legal person including limited partnership;
- principal office or place of business;
- names of incorporators/partners;
- basic regulating powers of the legal person;
- number of directors/partners;
- articles of incorporation/terms of partnership;
- name of state of foreign incorporation (where a foreign company);
- name of registered person in Palau for service of documents on registered foreign corporations;
- other relevant information.

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<sup>18</sup>Defined as a “person” under the Corporations Act section 201(b). Under the Corporation Regulations Chap 5, part 2.1, limited partners are not bound by the obligations of the partnership – i.e., they have limited liability based on their legal status as separate legal entities.

258. Business licenses must be obtained by all persons, including legal persons as well as foreign legal persons, from the Bureau of Revenue and Taxation before conducting business in Palau (Revenue and Taxation Act, section 1501). Foreign legal persons must also be approved by the Foreign Investment Board to conduct business in Palau in accordance with the Foreign Investment Act (section 102(c) – definition of “business enterprise” - and section 103).

259. Under the Regulations, Chap 1, part 1, paragraph 1.8, ‘interested parties’ may request copies of the articles of incorporation, by-laws, stock affidavit of the officers, and certificate of status of any corporation duly registered in Palau by writing to the Registrar and after paying a fee.

260. The term ‘interested parties’ is not defined in the Regulations, however part 1.8(b) of the Regulations states that a party may request copies of the annual reports of a legal person registered under the Act and Regulations “only if the party is one authorised to do so under Part 5, section 5.4 of these Regulations.” Part 5, section 5.4 refers to the powers of the Registrar and the judiciary of the Palau Supreme Court to examine books of a corporation. It appears from the Regulations that the term “interested parties” is limited in scope and does not permit the general public access to the information or, at least, does not permit the general public open access to the most up-to-date information on legal persons contained in the annual reports of those entities filed with the Registrar.

261. *Criterion 24.4* - In addition to the basic information noted in criterion 24.3 above, the following other and relevant basic information is required to be obtained:

- *Corporations for profit:* The names of the subscribers for each class of authorised shares must be filed, on incorporation, with the Registrar (Regulations, Chap 1, part 2.5(c) and (d)) however there is no on-going requirement to notify the Registrar of changes to the ownership of those shares, including in the Annual Report requirement to be filed each year, unless the ownership exceeds 10 percent of the capital stock of the corporation (Regulations, Annex L, section 23). In addition, there is no explicit requirement for these legal persons to maintain a register of shareholders within the country and at a location notified to the Registry.
- *Non-profit Corporations:* Non-profit corporations do not have stock or issue shares however the number, names, citizenship and residential address of the initial officers, directors or similar officers must be filed with the Registrar (Regulations, Chap 1, part 2.11(e)).
- *Foreign corporations:* There is no requirement in the Corporations Act, the Regulations, the Foreign Investment Act or in the Revenue and Taxation Act requiring foreign corporations registered and licensed to do business in Palau to file any basic shareholder information with the Registrar. There is no explicit requirement in the Act or Regulations for foreign companies to maintain a register of their shareholders within the country and at a location notified to the Registry.
- *Corporations Sole for Ecclesiastical Purposes:* This form of legal person is a non-profit corporation solely for the purpose of administrating and managing the affairs and property of the church (Regulations, Chap 4, part 1, paragraph 1.1). These corporations do not issue shares and therefore basic ownership information does not exist.
- *Limited Partnerships:* The names, citizenship and residence of all general and limited partners must be filed with the Registrar and any changes that occur must also be filed (Regulations, Chap 5, part 1.1). Moreover there is no explicit requirement in the Act or Regulations for a limited partnership to maintain a register of their partners within the country and at a location notified to the Registry.
- *Foreign Limited Partnerships:* This entity is a limited partnership formed under the laws of any other jurisdiction but registered under the Corporations Act and Regulations with

Foreign Investment Board approval (Regulations Chap 5, part 1, paragraph 1.5). The same rules apply to these entities as they do to domestic limited partnerships (directly above). Like domestic limited partnerships, there is no explicit requirement in the Act or Regulations for them to maintain a register of their partners within Palau and at a location notified to the Registry.

- *Credit Unions:* Credit Unions may issue shares to its members. However, there are no requirements in the Act or Regulations requiring credit unions to notify the Registrar of its initial shareholders or any changes thereto in an annual report (Regulations, Chap 7, part 6.3). There is no explicit requirement in the Act or Regulations for credit unions to maintain registers of their shareholders within the country and at a location notified to the Registry.
- *Cooperatives:* Cooperatives (also referred to as “Associations”) may issue shares to members (called subscribers), but are not required to. If shares are authorised there is no requirement to disclose who the shareholders are nor to notify the Registrar of any changes to shareholding (Regulations, Chap 8, part 6, paragraph 6.4(c)). The number and value of the shares issued must be disclosed but not the names of the shareholders. There is no explicit requirement in the Act or Regulations for cooperatives to maintain registers of their shareholders within the country and at a location notified to the Registry.

262. *Criterion 24.5* - The annual filing requirements noted above for some of the legal persons listed, ensures that some of the information held by the Registrar is accurate and current. Under the Regulations, Chap 1, part 5 at paragraph 5.6, a late fee shall be payable for any annual report submitted after the deadline of USD50, and an additional USD50 each month thereafter, up to a maximum of USD250. Under the Regulations, Chap 1, part 6 at paragraph 6.2 a corporation can be dissolved if it has failed or neglected for two years to file an annual exhibit (annual return) as required. There is no audit requirement on the accuracy of the information provided to the Registrar in the annual report.

### *Beneficial Ownership Information*

263. *Criterion 24.6* - The three sub-criteria are separately assessed as follows, noting that they are in the alternative:

264. *Sub-criterion 24.6(a)* - The Corporations Act does not require the collection and recording of information on a legal person’s beneficial ownership beyond the direct owner of shares by either the legal person or the Registry.

265. *Sub-criterion 24.6(b)* - Neither the Corporations Act nor the Regulations require legal persons to take reasonable measures to obtain and hold up-to-date information on their beneficial owners (where applicable) beyond the direct owners of shares.

266. *Sub-criterion 24.6(c)* - Pursuant to the “Financial Transactions Reporting for Banks Regulation” issued by the FIU in November 2017, financial institutions (also referred to in the Regulations as “reporting institutions”) are required to take reasonable measures to understand and document the ownership and control structure of legal persons including the name and permanent residential address of the natural person(s) who ultimately own or control the legal person. The financial institutions covered by this regulation include banks, foreign bank branches and credit institutions licenced by the FIC but do **not** include credit unions and cooperatives, and DNFBPs (including lawyers).

267. *Criterion 24.7* - As noted in criterion 24.4, annual filing requirements under the Regulations do not cover all types of legal persons and therefore beneficial ownership information is not required to be accurate and up-to-date for all legal persons.



268. *Criterion 24.8* - Other than at the time of establishing the existence of a legal person (Regulations, Chap 1, part 2, paragraph 2.5) there are no specific on-going obligations under the Corporations Act or the Regulations requiring legal persons to have resident corporate officers or partners who are natural persons (including with respect to foreign corporations and foreign limited partnerships) authorised and accountable to competent authorities for providing basic information, and available beneficial ownership information, to those authorities. There are also no provisions in those same statutory instruments requiring an authorised DNFBP in Palau to be accountable to competent authorities for providing the same.

269. *Criterion 24.9* - There are no obligations on legal persons to maintain the information and records referred to in Rec 24 (basic and beneficial ownership information) for at least five years from the dissolution of a corporation/partnership or ending of relationship with a professional intermediary or FI.

### **Other Requirements**

270. *Criterion 24.10* - The following have authority to access basic and beneficial ownership information held by legal persons:

- *Law enforcement agencies:* are empowered through search warrants, subpoenas and production orders to access ownership information held by the Registrar, legal persons and FIs;
- *the Registrar:* is authorised and empowered to order the production of books of account, papers and documents of any corporation or company authorised to do business in Palau (including limited partnerships) under the Corporation Act section 124.
- *Director of FIU:* has broad powers to access company information held by reporting entities and DNFBPs (but not from legal persons directly) under the Money Laundering Act section 3333.

271. *Criterion 24.11* - Bearer shares and bearer share warrants are dealt with separately:

- Bearer shares are indirectly prohibited by the Regulations, Chap 1, part 3, paragraph 3.2 which provides that “Every certificate of stock issued by any corporation shall plainly state: (1) the name of the record holder of the shares represented thereby; (2) the number, designation, if any, and class or series of shares represented thereby; (3) the par value, if any, of the shares represented thereby, or a statement that the shares are without par value; (4) if the corporation has issued shares of preferred stock in addition to shares of common stock, a summary of the preferred stock or a statement of the place or places where the information may be obtained; (5) restriction on sale of shares of stock to non-citizens of the Republic, if the corporation is to be a wholly Republic citizen owned corporation.” Accordingly shares without a registered name (bearer shares) cannot be issued by any corporation.
- Bearer share warrants are not stock in a corporation however under section 202 of the Corporations Act, it is unlawful for anyone, directly or indirectly, to sell or transfer securities (defined to include stock) unless and until such shares are registered with the Registrar. For the purposes of the above definition section 202 includes “warrants” under the definition at section 101 of the Corporations Act. Therefore, any person holding a bearer share warrant issued by a legal person in Palau cannot transfer his or her interest in that instrument unless it is registered beforehand. This is a sufficient mitigating measure for the purposes of this criterion.

272. *Criterion 24.12* - Nominee shares/shareholders and nominee directors are dealt with separately:

## TECHNICAL COMPLIANCE

- *Nominee shares/shareholders*: Nominee shareholders are simply trustees appointed by the legal owner of a share certificate to hold the legal ownership of a share certificate under directions from the settlor on trust conditions. There is no prohibition in Palau on the appointment of nominee shareholders and there are no requirements in the Corporations Act or Regulations (other instruments) requiring the disclosure of nominee shareholders' nominators to the corporation and to any relevant agency and for this information to be included in the relevant register. Nor are there any statutory requirements for nominee shareholders to be licenced in Palau. There are no other measures in Palau to address the requirements of the criterion.
- *Nominee directors*: nominee directors (individuals who hold and exercise the office and powers of director on behalf of another person) are not prohibited in Palau. There are no requirements in the Corporations Act or Regulations (other instruments) requiring the disclosure of nominee directors' nominators to the corporation and to any relevant agency and for this information to be included in the relevant register. Nor are there any statutory requirements for nominee directors to be licenced in Palau. There are no other measures in Palau to address the requirements of the criterion.

273. *Criterion 24.13* - There are no fines or other penalties available to authorities including the Registrar for failure to update corporate records with basic and beneficial ownership information. There are limited fines (USD50) for failure to provide the Registrar with annual exhibits or returns (Regulations, Chap 1, part 5, paragraph 5.6 Under Section 124(b) of the Corporations Act, refusal, without showing good cause, to produce books or accounts, papers or documents within 30 days after an order for production is made is a misdemeanour punishable by a maximum fine of USD50, or when an order is directed to an individual, imprisonment of such individual for a period not to exceed 90 days, or both. However these sanctions are not sufficiently dissuasive or proportionate.

274. *Criterion 24.14* - Palau's ability to provide international cooperation in relation to information on legal persons is described in recommendations 37 and 40. Palau can make and receive requests for MLA and the scope of the available information covers access to basic information held by domestic authorities. There is no law which prohibits or limits the powers of the domestic competent authorities from exercising all powers available to them in response to a MLA request.

275. *Criterion 24.15* - As there is a dearth of cases in which Palau has sent requests to other countries to request for basic and beneficial ownership or requests for assistance in locating beneficial owners residing abroad, Palau does not have a system in place to monitor the quality of the assistance they receive.

### *Weighting and Conclusion*

276. Palau has not assessed the ML and TF risks associated with all types of legal persons. While this lack of assessment makes it difficult to risk-weight the conclusion for this recommendation, this deficiency is significant on its own. There are no mitigating measures in place for nominee shareholders or directors. There is a significant gap in the lack of measures to ensure there is adequate, accurate and updated information on beneficial ownership (as defined by the FATF) which can be obtained or accessed by competent authorities in a timely manner. While Palau's legislation allows it to share information through international cooperation, this is constrained by the quality of the information available to domestic authorities in the first place. Recommendation 24 is therefore rated **non-compliant**.

## ***Recommendation 25 – Transparency and beneficial ownership of legal arrangements***

277. Palau was rated partially compliant for Rec 34 (now Rec 25) in their 2008 MER. The deficiencies identified were: (1) There were no specific obligations regarding obtaining information on the ultimate beneficial owners and control structure of trusts; (2) the law did not provide for any measures on ensuring transparency or preventing unlawful use of legal arrangements; and (3) information on trusts might not always be adequate, accurate and current.

278. *Criterion 25.1* - In Palau, trusts are governed by common law principles and consist of settlors, trustees and beneficiaries. Trustees of express trusts in Palau owe beneficiaries general fiduciary duties (pursuant to common law) to act in their best interests and to keep records of the administration of the trust to remain accountable to beneficiaries. There are no requirements for trustees to hold information on regulated agents of, and service providers to, express trusts, including investment advisors or managers, accounts and tax advisors.

279. According to the Palau National Code (Chapter 3 Section 303), the rules of the common law, as expressed in the restatements of the law approved by the American Law Institute and as generally understood and applied in the US, shall be the rules of decision in the courts of Palau, except where contrary to any written law or recognised customary law in Palau. In Palau both U.S. case law and the Restatement apply.

280. Lawyers (some of whom are professional trustees) are bound by professional conduct rules (which are not legislation but professional rules only) on record keeping. However, there are no explicit legal requirements for trustees (lawyers or otherwise) to maintain the information referred to above for at least five years after their involvement with the trust ceases.

281. *Criterion 25.2* - The common law obligates a trustee to keep adequate records on the administration of the trust to remain accountable to the beneficiary and in order for the beneficiary to protect their interests (as per US restatement of the law).

282. *Criterion 25.3* - The common law requires trustees to disclose their status (to financial institutions and DFNFBPs) when forming a business relationship or carrying out transactions though it has no specific threshold. . It is implicitly stated in the Restatement that “[a] fiduciary has much more than the traditional obligation not to make any material misrepresentations; he has an affirmative duty to make a full and accurate confession of all his fiduciary activities, transactions, profits, and mistakes. This duty exists regardless of whether the trustee was acting within or outside of the scope of the trust relationship.”

283. *Criterion 25.4* - Trustees are not prevented by law or enforceable means from providing competent authorities with trust-related information or from providing financial institutions and DNFBBPs upon request with information on the beneficial ownership and the assets of the trust to be held or managed under the terms of the business relationship.

284. *Criterion 25.5* - Law enforcement authorities have powers to obtain information relating to trustees, beneficiaries, trustee’s residence and assets managed under a trust. Under the Revenue and Tax Act, section 1801(d), the Director of the Bureau of National Treasury (Tax) has in relation to businesses (a trust is a business for the purposes of the Act as noted above) “the power to inspect and examine the records, books of account, bank statements, and any other pertinent data of any person for the purpose of enabling him to obtain the information necessary to enforce the provisions of this division.” The Director of the FIU has limited powers.

285. *Criterion 25.6* - International exchanges of trust-related information can be accomplished through MLA requests and where that information is available to domestic authorities.

## TECHNICAL COMPLIANCE

286. *Criterion 25.7* - Trustees are required to perform their functions as trustees with a duty of care and liable to a range of remedies under this recommendation<sup>19</sup>. While common law remedies may apply to trustees for failing to perform their duties, including compensation, restitution and removal, these remedies are not dissuasive.

287. *Criterion 25.8* - There are no specific legislative provisions providing for proportionate and dissuasive sanctions, whether criminal, civil or administratively, for failing to grant competent authorities timely access to trust-related information. However, failure to grant the competent authorities timely access pursuant to a search warrant would attract possible sanctions under contempt of court.

### *Weighting and Conclusion*

288. Fiduciary obligations under common law apply to trustees in Palau which references the US restatements of the law. There are no requirements for trustees to hold information on regulated agents of, and service providers to, express trusts, including investment advisors or managers, accounts and tax advisors. There are also no explicit legal requirements for trustees to maintain the information for at least five years after their involvement with the trust ceases. Palau law also does not impose enforceable obligations or proportionate and dissuasive sanctions on trustees to collect beneficial ownership information as required under this recommendation. Although investigative powers were generally sound, it cannot be said that the BO information can readily accessed by domestic or foreign competent authorities, as the information obtained is lacking. Recommendation 25 is rated **partially-compliant**.

### *Recommendation 26 – Regulation and supervision of financial institutions*

248. In the 2008 MER, Palau was rated partially compliant for former Rec. 23. The factors underlying the rating included: (1) The FIC is not properly funded and staffed and has not supervised its FIs to ensure effective implementation of AML/CFT requirements, (2) No designated supervisor for cash dealers and OTC exchange dealers, and (3) Although the FIC has indicated that it will categorize MVTS as ARS, no implementation of the MLPCA had commenced.

249. *Criterion 26.1* - The Palau's FIA Section 1013(b) designates the FIC as a supervisor for the financial sector (FIs, which are defined by the FIA Section 1001(a) including banks, securities brokers, and securities dealers). MVTS are not included in the FIA definition of FIs, however are covered by the newly enacted FIU Regulation for FIs and will be supervised by the FIU.

250. MVTS providers are required to be subject to monitoring for AML compliance by both the AMLA (3328 b (1)) and by FIU Regulation for FIs.

251. *Criterion 26.2* - The FIA designates FIC to license financial institutions operating in Palau. FIs as defined under the FIA covers banks and securities brokers/dealers, while the FIU Financial Institutions Regulation covers credit institutions, and the AMLA covers MVTS. Palau has three foreign banks and two domestic banks, which are registered and licensed by the FIC. The only money/currency changing services are the three U.S. FIs. The AMLA Section 3317 and the FIU FI regulation do not allow the licensing of or dealing with any shell banks. The FIU FI regulation defines shell banks as envisaged under FATF Recommendations.

252. *Criterion 26.3* - The FIA do not allow criminals and their associates to hold controlling interests or management positions in FIs (FIA, Section 1058 (3)). For this purpose, the FIC requires all domestic banks to submit lists of all shareholders, directors and administrators and

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<sup>19</sup> Interpretive Note to Rec 25 at paragraph 11 requires that penalties should apply with respect to paragraphs 1, 2, 6 and (where applicable) 5 in the Interpretive Note which are contained in the sub-criteria in the methodology.

for foreign banks, to list shareholders having control over 20% of outstanding shares, administrators of local branches to report annually or when change occurs. Section 3327 (b(3)) of the AMLA empowers FIC and FIU to establish and apply fit and proper criteria for owning, controlling, or participating, directly or indirectly, in the directorship, management or operation of financial institutions. While the FIU FIs regulation requires FIs to screen potential employees to ensure that employees are fit and proper, there are no regulatory measures in the form of detailed instructions to describe how to assess fit and propriety of any person or group.

253. *Criterion 26.4* - The AMLA designates both FIC and FIU as the supervisory and regulatory authority for FIs. The FIU has issued the FIs Regulation 2017 which sets out the minimum requirements for the management of ML/TF risk. That instrument requires all FIs (licensed institutions) to implement a comprehensive ML/TF risk management framework in line with the requirements of the AMLA and FIA. Sanctions can be imposed for failure to comply with the AMLA or the FIA, the FIC and/or FIU may impose any one or more of the remedial measures or penalties provided in the AMLA and the FIA. The FIU's FIs Regulation applies a risk-based approach to supervising compliance with these requirements.

254. *Criterion 26.5 - Sub-criterion 26.5(a)* – Palau is applying a risk-based supervision through an inspection plan applied to licensed FIs (currently only the 5 banks). FIC rate FIs according to the six factors - Capital, Assets quality, Management, Earnings, Liquidity and Sensitivity to market risk which is collectively represented by the acronym CAMELS. Selection criteria of banks for inspection is based on a CAMELS rating of institutions, which does not include ML/TF as a determinant of a financial institutions rating, though AML/CFT was included to a limited extent. During the past few years, banks were being inspected on 24 month cycle. KYC/ML review was part of full scope in regular inspections. Palau does not have a policy of consolidated group supervision but it carries out inspections on a stand-alone basis. The local supervisors did not have any arrangement with foreign supervisors for reviewing offshore regulators reports or significant findings to assess the group controls over AML/CFT.

255. The FIC does not have a comprehensive mechanism requiring REs to provide structured reports on the bank's ML/TF risks. FIC conducts offsite supervision on the basis of quarterly financial statements (verifies if there is significant variation in figures of deposits for liquidity purposes) and previous composite assessments of REs which incorporates assessments of AML/CFT measures. The FIU does monitor the transactions reports submitted by the banks off-site.

256. FIC conducted thematic reviews of banks during 2011 for wire transfers, however, no reports or key findings were shared with the assessment team. However, FIC is not in the regular practice of carrying out ML/TF thematic reviews. The component of ML in the full scope inspection reports focused mainly on availability of policies and the basic framework for compliance and review of AML/CFT. FIC reports did not contain comprehensive reviews of bank's customer risk profiling mechanisms/models, name scan solutions or scenarios of transaction monitoring systems. FIC was more comfortable due to strong supervision of three foreign banks by their home regulators. The two domestic banks had gaps in their AML/CFT policies and framework but due to their small size and limited operations were not under focus of the FIC, though were regularly supervised by the FIC.

257. The non-bank financial sector including credit unions and money remittance service providers have negligible supervision which is not risk-based, though little weight has been afforded them due to limited risk, very small size and number (approximately 2% of all financial transactions in Palau).

258. *Sub-criterion 26.5(b)* – ML/TF risks in Palau are considered to a limited extent in determining the frequency and intensity of onsite or offsite visits.

259. *Sub-criterion 26.5(c)* –The FIC undertakes a basic risk assessment of the 5 supervised banks to assist in determining frequency and level of supervisory visits.

## TECHNICAL COMPLIANCE

260. *Criterion 26.6* - There are no formal procedures in place for the supervising bodies to review the assessment of the ML/TF risk profiles of individual FIs either periodically or when a major event occurs. Supervising bodies use risk to some extent to inform engagement with FIs though the FIC focuses predominantly on the three US owned banks due to their 98% share of all financial activity in Palau and on the remaining two domestic banks to some extent.

### *Weighting and Conclusion*

261. Palau uses risk to some extent in determining the frequency and intensity of onsite or offsite visits. Palau has no regulatory measures in the form of detailed instructions to describe how to undertake fit and proper testing for employees. Remaining FIs (not banks) have negligible supervision which is not risk-based though little weight has been applied to these due to very small number and low risk. Supervisors do not formally review the assessment of ML/TF risk profiles of FIs. **Palau is rated partially compliant for R.26.**

### *Recommendation 27 – Powers of supervisors*

262. In the 2008 MER, Palau was rated partially compliant for former Rec.29. The factor underlying the rating is that Palau meets the requirements regarding supervisory powers to monitor and inspect financial institutions; however, it has not utilized these powers to ensure compliance.

263. *Criterion 27.1* - Section 1013(b) of FIA empowers the FIC to supervise and regulate while Section 1085 of the FIA authorizes FIC to examine the operations and affairs of the financial institutions. The AMLA also empowers FIC and FIU to inspect and implement ML/TF compliance with FIs.

264. *Criterion 27.2* - The FIC has powers to conduct inspections of financial institutions under Section 1085 of the FIA. Section 3327 (b)(1) of the AMLA requires the FIC to conduct regular onsite examinations of the FIs.

265. *Criterion 27.3* - Section 1086 of the FIA authorises supervisors to compel financial institutions for production of records. Moreover, Section 3327(b(9)) of the AMLA empowers FIC and FIU to compel the production or obtain access to all documents, records and information relevant to monitor and supervise compliance with the provisions of this Law and any regulation issued in execution of this Law.

266. *Criterion 27.4* - The FIU and FIC have powers to employ sanctions on financial institutions for breaches of the AMLA under Section 3327 that authorizes the cancellation of licenses. Further, Section 1048 of the FIA empowers the FIC to modify, suspend or revoke licence of a financial institution. In addition, Section 1091(b) of the FIA authorises FIC for a range of disciplinary and financial sanctions.

### *Weighting and Conclusion*

267. **Palau is rated compliant for R.27.**

### *Recommendation 28 – Regulation and supervision of DNFBPs*

268. In the 2008 MER, Palau was rated non-compliant for former Rec. 24. The factor underlying the rating is that none of the DNFBPs operating in Palau, that is, lawyers and CSPs, are covered by the AML or the CFT Law.

269. *Criterion 28.1* - There are no casinos, including internet casinos, permitted in Palau.

270. *Criterion 28.2* - The AMLA Section 3327(a) designated the FIU as the competent authority responsible for monitoring and ensuring compliance by DNFBPs with AML/CFT requirements. However, the FIU has yet to issue regulations to regulate DNFBPs and to monitor and ensure its compliance in Palau.

271. *Criterion 28.3* - Other DNFBPs are not subject to systems for monitoring compliance with AML/CFT requirements as the DNFBP regulations have not been issued.

272. *Criterion 28.4 - Sub-criterion 28.4(a)*: While the DNFBP regulation has not been enacted, most DNFBPs (except Accountants) do fall under the AMLA and to some extent the FIU

273. *Sub-criterion 28.4(b)*: The legal profession is supervised the Court of Palau and the accountancy profession is licensed (not supervised or regulated) by the Office of the Public Auditor, and neither are considered a SRB by Palau. There is no self-regulatory body (SRB) for the real estate agents(2 real estate agents are currently operating in Palau) and precious stones and metal dealers (transactions are well below the threshold in the FATF Recommendations), noting both these sectors are very small.

274. *Sub-criterion 28.4(c)*: Since the AMLA is also applicable to all DNFBPs except accountants, the sanctions for failure to comply with AML/CFT requirements apply. Not all DNFBPs have a designated supervisor or SRB to apply available sanctions. In addition the FIU has yet to issue regulations to regulate DNFBPs and to monitor and ensure its compliance in Palau.

275. *Criterion 28.5* - There has been neither implementation nor supervision of DNFBPs' compliance with the AML/CFT Regulations.

#### *Weighting and Conclusion*

276. Fundamental deficiencies exist for monitoring and ensuring compliance with AML/CFT requirements for DNFBPs, including the absence of a designated supervisor(s) for some sectors and the lack of DNFBP regulations. **R. 28 is rated non-compliant.**

#### *Recommendation 29 - Financial intelligence units*

277. Palau was rated partially compliant with former R.26 in the 2008 MER. The factors underlying the rating included: (1) no STR reporting guidance provided, nor any forms for CTR and STR reporting; (2) no provisions for the FIU to seek additional information from reporting entities except by court order; (3) no standard operating procedure or written procedure for STR analysis and dissemination; (4) STR analysis does not include all available and relevant intelligence; (5) a lack of resources undermines the effectiveness of the FIU's analysis and dissemination work, and (6) no publicly available FIU annual report nor statistics. Palau's compliance with former R.26 was analysed under the follow-up process and in 2012 compliance was found to be at a level equivalent to largely compliant, however R.29 contains new requirements that were not assessed under the 2004 Methodology.

278. *Criterion 29.1* – The Palau FIU was established in 2003. In 2014, an amendment was made to the MLPA, and the AMLA continues to provide for the legal basis of the existence of the FIU. Section 3330 of AMLA provides for the legal basis for the establishment and existence of the FIU. Section 3333 sets out the FIU's powers, duties and obligations in more detail. These include the responsibility to receive, analyse, investigate and disseminate information concerning suspected proceeds of crime and terrorist properties.

279. *Criterion 29.2* – The Palau FIU serves as the central agency for the receipt of disclosures filed by reporting entities as provided for by the AMLA. These include STRs reported by FIs and DNFBPs under section 3320, and currency transaction reports above USD10,000 whether conducted as a single transaction or several transactions that appear to be linked, submitted under section 3321. As noted above, section 3330 (b) of the AMLA states that the FIU is to be an

independent agency responsible for receiving, analysing and dissemination to relevant LEAs information concerning suspected proceeds of crime and terrorism property. The AML/CFT regulation for FIs, section 3.1.1 (a) requires all FIs to furnish the FIU with reports on all suspicious funds and transactions including attempted transactions and all suspicious information. The definition of a suspicious matter in the AMLA is narrow (see Recommendation 20) though the definition in the FIA is more comprehensive which ensures all FI's that fall under the FIA are required to report STRs to the FIU.

280. As the AML/CFT regulation for DNFBBPs is not signed off, DNFBBPs do not need to provide to the FIU information on suspicious transactions or that which are suspected to be related to ML or TF, though under AMLA they do have a general legal obligation to submit STRs (noting that the AMLA does not provide enough guidance on what is required to be reported and in what form). Other reporting includes cash transactions reports which are contained in the FI regulations. It is stated in the regulations that cash transactions of USD 10,000 or above or its equivalent in foreign currency, the value of which singularly, or in several operations that appear to be linked equal to USD 10,000, must be reported to the FIU (b). The FIU also receives a copy of all cross-border declarations from Customs, of physical cash and negotiable instruments carried into and out of Palau (s.3603 (b)).

281. *Criterion 29.3* – (a) The Palau FIU has very broad powers under the AMLA to obtain additional information from both the private and public-sector entities. Under section 3333 of the AMLA, the FIU can obtain additional information related to any reported financial transaction or information filed by any FI, can make inquiries with or obtain from any FI any additional information the FIU thinks is necessary to carry out its functions, regardless of whether the requested person has made a report and can enter the premises of any FI or DNFBBP to inspect any records kept pursuant to the AMLA and that are necessary to the fulfilment of the FIU's functions. (b) The FIU has the power to obtain or collect any information it deems necessary to carry out its function, whether or not it is publicly available, including commercially available databases of information and information stored in databases maintained by other government agencies that may hold relevant information.

282. *Criterion 29.4* – Section 3333 of the AMLA provides the legal basis for the FIU to conduct research into and compile and provide information and statistics on trends and developments on ML and TF. It also provides for the legal basis for Palau to recommend ways to detect, prevent and deter ML and TF activities. With these powers and functions, the FIU is open to utilize a variety of tools to carry out its analysis function on the reports it receives. The Palau FIU can use its wider power to perform its functions, especially to carry out operational and strategic analysis. It has the power to request additional information from reporting entities on the information and reports it had already received as contained in AMLA, subchapter IV, s. 3333 (a). Also, the FIU has the power to request information from the private and public sectors and as well as from Government agencies that may hold relevant information such as Bureau of Revenue, Customs and Taxation, Bureau of Public Safety, Office of the Attorney General or other competent supervisory authorities (AMLA, subchapter IV, s.3334, (e)). Palau has undertaken operational analysis by analysing some STRs and disseminating reports to relevant LEAs. However, Palau has not undertaken strategic analysis.

283. *Criterion 29.5* –Section 3333 (g) of the AMLA provides the broad legal basis for the FIU to disseminate to relevant LEAs information concerning suspected proceeds of crime and terrorism property. This empowers the FIU to refer any report or information it has received in accordance with its functions to the appropriate law enforcement agency if, on the basis of its analysis and assessment, the FIU has reasonable grounds to suspect that a transaction or attempted transaction involves proceeds of crime, or is related to or intended for financing of terrorism, or is terrorist property. Section 3333(h) authorises the FIU to apprise the competent supervisory authority whenever it appears that a financial institution or DNFBBP, or any of its respective directors, officers or employees, is not complying or has not complied with the obligations under the AMLA or regulations. The FIU securely disseminates STRs and IDRs, by



hand delivering reports including STRs to members of the MLWG and FCIU, who are either Directors of agencies or nominated senior investigators for the FCIU. Due to the small size and context of Palau, no additional dedicated and secure channels are used.

284. *Criterion 29.6* – Section 3334(e) of the AMLA requires any person working for the FIU to keep confidential any information obtained or matters disclosed to him/her during the course of carrying out duties even up to the time when he or she is no longer working for the FIU. Section 3334(f) provides a penalty for FIU officers who wilfully disclose confidential information (a class C felony or a maximum fine of USD10,000). Palau FIU is required to put in place policies or guidelines on how confidential information should be managed. In addition, there should be policies or operating guidelines on how the FIU should manage the security of information. These policies and guidelines were not evident, though the size of the FIU suggests that formal documentation is not necessary. The FIU puts in place security and confidentiality measures that requires people working with or for the FIU to sign a confidentiality security form. The FIC board and MLWG informally consider vetting for individuals recognising the small community in Palau. Staff are informally briefed on dealing with sensitive information which is considered appropriate in light of the size and context of Palau. The FIU facilities are secured with only FIU staff able to access the premises, though the broader premises are shared with the FIC. The database is secure and is password protected with only FIU staff able to access and utilise the database. A secure cloud based backup of all data is made every evening.

285. *Criterion 29.7* – Revisions were made to the MLPCA in 2014 specifically to establish the FIU as an autonomous body with the authority to carry out its functions independently and autonomously. Section 3330(b) of the AMLA provides the legal basis for the Palau FIU to be an independent agency responsible for receiving, analysing, investigating and disseminating information concerning suspected proceeds of crime and terrorist property. Section 3331 provides for the appointment of a Director of the FIU by the Governing Board of the FIC on such terms and conditions as the Board may determine in consultation with the MLWG. Under section 3331 (a), the Director may exercise all of the functions, powers and duties of the FIU, and section 3331(c) empowers the Director to appoint other officers and employees of the FIU as necessary for the efficient exercise of the duties, functions and powers of the FIU. The powers, functions and duties of the FIU set out under section 3333 include the power to enter into arrangements with domestic or foreign competent authorities. Section 3333 (q) and (u) also provide the legal basis for the Palau FIU to cooperate and share information with other domestic and foreign competent authorities respectively. Section 3335 states that the FIU shall be responsible for its own budget to be determined by the Director of the FIU. In practice, the FIU and FIC manage a shared budget and the head of each unit needs to jointly approve expenditure with no indication of this impacting on operational independence.

286. *Criterion 29.8* – Palau is not yet a member of the Egmont Group, however it submitted an application for membership on 7 November 2017.

#### *Weighting and conclusion*

287. Palau does have an operational FIU, it does not undertake strategic analysis, and is not a member of Egmont. **Palau is rated largely compliant for Recommendation 29.**

### ***Recommendation 30 – Responsibilities of law enforcement and investigative authorities***

288. In the 2008 MER, Palau was rated largely compliant with former R.27. Deficiencies related to police focussing on investigating predicate offenses with little focus on money laundering. The police also did not use all the powers provided to it by the law in the investigations undertaken.

## TECHNICAL COMPLIANCE

289. *Criterion 30.1* - In July 2014 a number of legislative changes were made to improve Palau's national AML/CTF framework (The new Chapter 33 Money Laundering in 17 PNCA). The Criminal Investigation Division (CID) of the Bureau of Public Safety (BPS) is the primary investigative entity within the MOJ which handles any investigation which requires further investigation. In addition to the CID of BPS, the newly created NEA, is given authority by the MOJ to investigate matters of ML and its predicate offences. Other agencies including the MOJ and Bureau of Customs & Taxation also have investigative powers that may involve predicate offenses of ML, such as undeclared cash at the border and tax evasion/fraud. Changes to the Foreign Investment Act gives investigative authority to the Foreign Investment Board regarding predicate offenses of ML/TF. The Special Prosecutor's Act, 2 PNC section 503 has its own investigative powers to undertake any investigation including ML.

290. The MLWG coordinates all Palau's efforts to overcome ML and TF. The MLWG established the FCIU in late 2016 which is able to consider and initiate ML investigations based on STRs submitted to the FIU. The formation of the FCIU was confirmed by Executive order 406 which was enacted on 22 November 2017. The FCIU comprises investigators from Customs, NEA (formally the Drug Task Force), Postal Inspector, the Criminal Investigation Division of the BPS, Revenue and Tax Office, the Special Prosecutor's Office and the Attorney General. The FIU is also a member of the FCIU and chairs it since it disseminates reports on STRs to the other members of the FCIU, however the FIU does not have any investigative powers under Chapter 33 of 17 PNCA.

291. The MOJ is the primary enforcement authority for terrorist crimes contained in Chapter 22 of 17 PNCA, pursuant to Section 2203. A new position of Anti-Terrorism Coordinator was created within MOJ. It is not clear who the primary investigative unit for TF is.

292. *Criterion 30.2* - All LEAs are authorised to undertake parallel financial investigations when conducting an investigation into a predicate offence. The establishment of the FCIU was designed to assist the primary law enforcement agencies to conduct parallel financial investigations from financial intelligence disseminated by the FIU to the FCIU.

293. *Criterion 30.3* - All LEAs are authorised to freeze and seize property that is either the proceeds of crime or related to terrorism. The OAG or SPO can commence civil restraining proceedings.

294. *Criterion 30.4* - Palau's LEAs under the MOJ are competent authorities to conduct ML or TF investigations. The FCIU was created by the MLWG as a task force so as to improve Palau's efforts to conduct criminal investigations on financial intelligence (and in particular STRs) disclosed by the FIU. All members of the FCIU which include non-law enforcement agencies such as the Bureau of Customs and Border Protection, Palau Postal Service and the Bureau of Revenue and taxation, participate in meetings and consider STR driven investigations. It is unclear how non STR related investigations can be considered by non-law enforcement agencies through the FCIU, though the MLWG has a broader role for coordinating ML/TF investigations and this includes a range of government agencies.

295. *Criterion 30.5* - Palau does not have a dedicated anti-corruption agency. The OSP has responsibilities and power to investigate any corruption matters and the prosecution of cases for which the OAG has a legal conflict and to specifically investigate and prosecute matters related to government corruption. Complaints of corruption are received by the OSP or through the Public Auditors Office. OSP works closely with Public Auditors Office and the Ethics Commission.

### *Weighting and conclusion*

296. It is unclear how non STR related investigations can be considered by non-law enforcement agencies through the FCIU, though the MLWG has a broader role for coordinating ML/TF investigations and this includes a range of government agencies. It is also not clear who

the primary investigative unit for TF is. **Palau is rated largely compliant for Recommendation 30.**

### ***Recommendation 31 - Powers of law enforcement and investigative authorities***

297. In the 2008 MER, Palau was rated largely compliant to former R.28. There were no separate powers provided to LEA under the Chapter 22 or 33 of the 17PNCA legislative when conducting ML/TF investigations. The new R.31 contains more detailed requirements for investigative powers to enable thorough and comprehensive investigation of suspected ML/TF offending.

298. *Criterion 31.1* - CID-BPS police powers are specified within the Criminal Procedure Act 18 PNCA under Chapter 3 Searches and Seizures. The conditions under Section 304 (4) states search warrants shall be issued to search for and seize property necessary to be produced as evidence for the trial of anyone accused of a criminal offense. A search warrant is defined [Section 101 (j)] to include seizing articles in the possession of a person or at a place named or described in the search warrant. The Criminal Procedure Act does not provide any specific powers to compel production of records held by financial institutions or DNFBPs without issuing a search warrant by enforcement agencies. The OSP and OAG are able to obtain financial records from under subpoena powers, however the OAG can only use this power once criminal proceedings have commenced. The OSP does not have this restriction and can use its subpoena powers prior the commencement of any criminal or civil proceedings pursuant to 2 PNC section 503(a)(6) of the RoP Rule of Criminal Procedure 17(c). With regard to the taking of witness statements, LEAs can obtain witness statements in any matter when a witness is prepared to provide a statement and has legal representation.

299. LEA can make requests to the FIU for any intelligence holdings it has (information about a transaction, what FI is involved, what persons are involved, what additional information the FIU has obtained or may have on its database) and information shared with LEA is classified as being used for “intelligence purpose only”. LEA can use this information for the purpose of having a “probable cause” to obtain a search warrant on a FI or DNFBPs to make further requires.

300. *Criterion 31.2* - The 2008 MER Report references Section 24 of the MLPCA which provided affirmative authorisations for undercover and controlled delivery operations by LEAs for ML investigations. No equivalent section has been identified in the new AMLA. Palauan authorities have informed that the removal of section 24 have actually widened the powers of LEAs as section 24 served as a limit to their powers by imposing time restrictions on court processes. Without section 24, LEAs are effectively reverted to utilising search and seizure provisions under Chapter 3 of 18 PNCA (*King v. ROP*, 6 ROP Intrm. 131 (1997); *ROP v. Rafael*, 6 ROP Intrm. 305 (1996)). These search and seizure provisions apply to the investigation of any type of offences in Palau, including ML/TF offences provided such investigations are supported by reasonably articulated suspicion and/or probable cause. The provision under Chapter 3 also allows a police officer to obtain an oral order in lieu of search warrants from a court or any judge or justice in the public interest (*United States v. Nocella*, 849 F.2d 33, 39 (1st Cir. 1988); *United States v. Figueroa*, 818 F.2d 1020, 1023 (1st Cir. 1987); *United States v. Hoffman*, 832 F.2d 1299, 1306 (1st Cir. 1987); *Illinois v. Gates, supra*, at 230, 103 S.Ct. at 2328). While there are no specific provisions under Chapter 3 that covers undercover operations, intercepting communications, accessing computer systems and controlled delivery, the provision under Chapter 3 allows LEA to employ these investigative techniques for ML/TF investigations (*Oiterong v. ROP*, 9 ROP 195, 198 (2002)(applying U.S. precedent in *Roviaro v. United States*, 77 S. Ct. 623, 628 (1957)); *Ueki v. ROP*, 10 ROP 153 (2003); *ROP v. Dolmers*, 10 ROP 217 (Tr. Div. 2003)). Furthermore, Palauan case law (following US case law precedence) provides the necessary protection of person’s rights and safeguards against entrapment in certain circumstances deeming evidence to be inadmissible (17 PNC § 237 (Entrapment)).

## TECHNICAL COMPLIANCE

301. *Criterion 31.3* - Section 3333 of AMLA provides the FIU with powers to request FIs and DNFBPs to disclose records that relate to the transaction or attempted transactions for a particular account or by a particular person. Pursuant to Section 3333 (d) the FIU can enter the premises of any financial institutions or DNFB to inspect any records and make enquiries relating to and make notes and take copies of such records. LEAs can make requests to the FIU for records or intelligence that it holds in its database. The FIU can then share any records with LEAs through a dissemination report or upon a request from a LEA.

302. *Criterion 31.4* - Both the FIU and the FIC as supervisory authorities for financial institutions and DNFBPs have the authority to provide investigating and prosecuting authorities with information and assistance relating to ML/TF. LEAs do not have direct access to FIU reports however there are no restrictions on LEAs requesting information from the FIU or for the FIU to use its powers to obtain further information from the FI (AMLA Section 3333 (c)). With the creation of the FCIU, the FIU and any other FCIU member can share information based on the required suspicion and/or probable cause to commence a ML investigation. In addition, the FIU can enter the premises of any financial institution or DNFBP to inspect and document any records. Further sections 3331-3334 describes the FIU as being the authority to combat ML and TF, however any information obtained by the FIU and shared with LEAs is classified as being used for 'intelligence purposes only' particularly information disseminated to the FCIU.

### *Weighting and conclusion*

303. In Palau both the OSP and OAG are able to obtain financial records under subpoena powers, however the OAG can only use this power once criminal proceedings have commenced. **Palau is rated largely compliant for Recommendation 31.**

### *Recommendation 32 – Cash Couriers*

304. In the 2008 MER, Palau was rated largely compliant with former SR.IX. The MER identified that the exemption for banks, common carriers of passengers or goods, and traveller checks issuers did not fall within the criteria for SR IX.

305. *Criterion 32.1* - Palau operates a written declaration system for the transport of cash or negotiable instruments for an aggregate amount of USD10,000 or more (or its equivalent in foreign currency) as described in Chapter 36 Cash Courier Disclosure of 17 PNCA Section 3603. A written declaration is required on the physical transportation by a natural person, in the shipment or mailing of currency. Subsection (b) provides exemptions for banks, common carrier of passengers or goods, and traveller check issuers. The declaration forms have been translated into four languages of the main travellers to Palau; namely Korean, Japanese, Chinese and English.

306. *Criterion 32.2* - All signed written declaration forms for the transport of cash or negotiable instruments for an aggregate amount of USD10,000 or more (or its equivalent in foreign currency) are submitted to the Bureau of Customs & Border Protection.

307. *Criterion 32.3* - Palau has adopted a declaration system.

308. *Criterion 32.4* - Section 3606 (a) & (b) sets out powers of a Customs Officer to stop and conduct a search, without a search warrant, of a vessel, aircraft, etc. or person entering or departing Palau, if the officer "suspect or has reasonable cause to believe" there is a transportation of cash without the filing of the declaration form. These powers include questioning a person at the point of entry or departing.

309. *Criterion 32.5* - A false declaration can be prosecuted as an "Unsworn Falsification" pursuant to 17 PNCA § 4204. This is a misdemeanour punishable up to 1 year imprisonment. Section 3607 sets out the administrative and civil penalties, which are in addition to any criminal or civil penalties imposed under other provisions of law. In practice Custom will retain

the cash and release the cash on payment of a 5% fine. The punishment for making a false declaration can be prosecuted as a felony subject to imprisonment of up to three (3) years or a fine of USD10,000.00 or both (40 PNCA § 1701 (c)). It is also not clear that the penalties for corporate entities are dissuasive as the limited fines could be considered as a cost of business, though the banning of such entities after multiple offences is considered proportionate. It is the view of the assessment team the 5% civil penalty in this instance is not dissuasive.

310. *Criterion 32.6* - A copy of all written declarations forms are provided to the FIU (Section 3603 (a)) and a copy retained by Customs. When a Customs Officer suspects or has reasonable grounds to suspect that a negotiable instrument or currency is being transported without making a declaration or the proceeds is the proceeds of criminal activity or related to terrorist financing, it is required to report the matter to OAG as well as filing a SMR with the FIU within 48 hours (Section 3605 (a)).

311. *Criterion 32.7* - Implementation issues related to R.32 are considered by the MLWG that include Customs, Immigration, LEAs, and the FIU.

312. *Criterion 32.8* - Pursuant to Section 3606 (d), a Custom Officer having a reasonable cause to believe that cash or negotiable instruments is being transported without the filing of the declaration or the cash is the proceeds of crime or related to terrorist financing, can seize the currency for a period of 14 days (calendar days) to conduct an investigation. Customs can seize cash and BNIs, whether declared or not, if reasonable cause exists that it is related to ML/TF. The OAG can apply for an additional 14 days. OAG can also pursuant to Section 3606 (c) apply to the Supreme Court for a search warrant if no declaration has been filed or an incomplete or inaccurate declaration has been filed.

313. *Criterion 32.9* - Pursuant to Section 3605 (b) & (c), the Bureau of Customs & Border Protection and the FIU may make any information received under Chapter 36 of 17 PNCA available to an agency of a foreign government upon a written requesting stating the particular information desired, and the criminal, tax or regulatory purpose for which the information is sought. It is unclear if such information is retained either physically or on any database.

314. *Criterion 32.10* - It is unclear if Palau has any safeguards to ensure proper use of information.

315. *Criterion 32.11* - Section 3607 sets out the administrative and civil penalties, which are in addition to any criminal or civil penalties imposed under other provisions of law. It is unclear what the related criminal penalties referred to in the opening paragraph of Section 3607 are. Or if any specific criminal penalties exist. It is also not clear that the penalties for corporate entities are dissuasive as the limited fines could be considered as a cost of business, though the banning of such entities after multiple offences is considered proportionate.

### *Weighting and conclusion*

316. The penalties for a false declaration are not dissuasive for legal persons. It is unclear if information made available to a foreign government agency is retained either physically or on any database. It is also unclear if Palau has any safeguards to ensure proper use of information. The criminal penalties referred to in Section 3607 are unclear, and it is also not clear that the penalties for corporate entities are dissuasive though the banning of such entities after multiple offences is considered proportionate. **Palau is rated largely compliant for Recommendation 32.**

### *Recommendation 33 – Statistics*

317. Palau was rated non-compliant with former R.32 on statistics in the 2008 MER. The factor underlying the rating was there were no comprehensive statistics on STRs, ML

## TECHNICAL COMPLIANCE

investigations, amounts frozen, seized, confiscated, mutual legal assistance, and extradition requests.

318. *Criterion 33.1:*

- *STRs:* The FIU maintains statistics on suspicious transaction reports (STRs) received and disseminated over the last three years.
- *ML/TF investigations, prosecutions and convictions:* Palau maintains statistics on ML investigations, prosecutions and convictions over the last three years. No TF cases have ever been investigated.
- *Property frozen, seized and confiscated:* The NEA maintains statistics on vehicles and cash confiscated and cash between 2015 and 2017. LEAs or authorities could not provide statistics on property frozen, seized or confiscated.
- *MLA or other international requests for cooperation made and received:* Palau maintains statistics of international requests for cooperation made and received including for MLA.

### *Weighting and conclusion*

319. Palau maintains statistics on property frozen, seized and confiscated by the NEA but not from any other LEAs. Palau is rated **largely compliant for Recommendation 33**.

### ***Recommendation 34 – Guidance and feedback***

320. In the 2008 MER, Palau was rated non-compliant to former R.25. It was noted the competent authorities of Palau had not provided financial institutions or DNFBP's with guidelines to assist them implementing and complying with their respective AML/CFT requirements.

321. *Criterion 34.1* - FIU powers, duties and obligations are set out in Section 3333. (l) of AMLA to issue guidelines on the manner of transaction reporting under Part III of Chapter 33; (m) to provide feedback regarding outcomes relating to the reports or information provided; (n) provide training programs in relation to reporting and the identification of suspicious transactions; and (t) to advise concerns about weaknesses in the AML/CFT systems of other countries.

322. A FIU AML Regulation for FIs and alternative money remitters was signed during the on-site visit in November 2017. This provides more detailed obligations and some guidance (through examples of suspicious transactions) regarding the detecting and reporting of suspicious transactions. It was made clear to the assessment team that the FIU had not provided any formal feedback to the FIs and the FIs relied on their offshore head office to provide necessary AML/CTF compliance guidelines in accordance with the US regime. Informal feedback is provided by the FIU on an ongoing basis to FIs. The FIC also provided guidance either whilst undertaking assessments of the banks or informally. The only recent formal guidance provided to all reporting entities was the Palau NRA Guide which was circulated in early 2017. No guidance has been provided to FIs on the FIU regulations for FIs as it was only finalised during the onsite visit.

323. The FIU regulation for DNFbps has not been signed off which will not facilitate the submission of STRs by DNFbps. No formal or informal guidance has been provided to this sector.

*Weighting and conclusion*

324. Palau has provided reporting entities with limited formal guidance and feedback. DNFBPs have not received guidance, but the relatively small size of the sector is noted. **Palau is rated partially compliant for Recommendation 34.**

***Recommendation 35 – Sanctions***

325. In the 2008 MER, Palau was rated largely compliant to former R.17 and noted that the FIC has sanctioning powers; however it had not used them for AML/CFT purposes.

326. *Criterion 35.1:*

327. The AMLA imposes sanctions on REs for failure to comply with the following AML/CFT requirements:

- Establishing anonymous account or accounts in fictitious names
- Failing to apply customer due diligence measures not only in relation to its customers but also on cross boarder correspondent's AML/CFT controls and reputation
- Failing to identify politically exposed persons and other customers who may pose a high risk of ML/TF
- Failing to identify suspicious transactions where there are no apparent, visible economic or lawful purpose; paying particular attention to all complex, unusual large transactions or unusual patterns, and the country of origin
- Failure to collect verify information in relation to wire transfers, including ordering institution, or the beneficiary
- Failure to notify the FIU of specified transactions that a deemed to be suspicious
- Failure in conducting due diligence on business relations that hold accounts with banks with no physical present or a subject to effective consolidated supervision
- Failure in maintaining proper transactional records and customer information to verify parties involved in money transfers
- Failure to report cash transactions in an amount above USD10,000 as a single transactions or several transactions that appear to be linked
- Failure in notifying FIU in dealing with property of terrorist groups
- Tipping off to customer or third party that information or a report has been submitted to the FIU
- Failure to compile with further regulations implemented by the FIU in furtherance of AML/CFT controls, which include establishing a compliance programme (requirement only imposed on FI not DNFBPs however drafted FIU Reg 02 imposes this requirement on DNFBPs).

328. The AMLA attaches both an intentional or negligence criminal element on any person failing to comply with Palau's AML/CFT controls. Any person includes legal person and there is no difference made in imposing sanctions for either natural or legal person. Sections 3318 and 3326 impose the penalties of a Class C felony or a maximum fine of USD10,000 or both. In addition to the penalties provided any person found guilty may also be banned permanently or temporarily from pursuing the business or profession which they are participating in.

329. Further administrative action can be taken by the FIC or FIU against a FI as per section 3328, which include one or more of the following sanctions:

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- Written warnings;
- Order to comply with specific instructions;
- Order to submit regular reports on measure taken to remedy the violation;
- Issue a fine;
- Replace or restrict the power of managers, directors or controlling owners and appoint an ad hoc administrator;
- Impose conservatorship or suspend, restrict or withdraw the business license;
- Publish information on the administrative measure taken;

330. Sanctions also apply in relation to the Freezing of Property (Part V). Any person who intentionally or by criminal negligence fails to comply with a freeze obligation set forth in this Chapter, shall be guilty of a Class C felony or a maximum fine of USD10,000, or both. A financial institution or designated non-financial business and profession who commit an offense under this Section also commit an administrative violation and may be subject to the measures and sanctions provided for under 17 PNC section 3328. A person shall not be responsible for a loss or claim resulting from the freezing of property or the refusal to make property available or to provide financial services where such an act is carried out in good faith, unless criminal negligence or reckless or intentional misconduct is proven.

331. In the FIA which covers banks, securities brokers and securities dealers, the following warnings, fines and actions can be taken:

- issue written warnings;
- conclude a written agreement of remedial action;
- issue an order to cease and desist from such violations and practice if found in the best interest of the FI, depositors, creditors and stockholders;
- impose fines on FI or corporation in an amount up to ten thousand dollars per day, for each day the violation continues;
- suspend or dismiss administrators
- revoke the license of a FI; and
- Dissolve the FI.

332. In relation to requirements relating to R.6, sections 2225 and 2227 of TA makes it an offence for any person who directly or indirectly deals with property or provides financial or other services that is used in a terrorist act or finance persons involved in a terrorist act. Legal persons and any foreign government can also be held liable for the offence of financing terrorism. The sanctions imposed on a natural person are dealt with in section 2205 and are punishable by a minimum term of imprisonment of 20 years and a maximum fine of USD1,000,000. Sanctions imposed on Legal person and foreign government is dealt with separately in section 2225 (e) – being liable of a maximum fine of 10 times the amount imposed on a nature person (i.e. USD10,000,000), and under section 2225 (h) (i) – banned for a minimum period of five year from directly or indirectly carrying on certain business activities within Palau.

333. In relation to requirement relating to R.8, section 2226 (b) deals with the financing terrorism through NPOs and imposes recordings requirements on NPO for any donation received in an amount equal to or greater than USD5000 and maintained for 3 years. There is no requirement to lodge any report to the FIU. Any cash donation equal to or greater than USD10,000 must be reported to the FIU. Likewise, the NPO must report any suspicious donation it suspects of being related to a terrorist operation, the financing of terrorism or the proceeds of



a crime. Penalties imposed on NPO for failure to comply with the reporting requirement is a fine of no more than \$10,000, or temporary ban on NPO's activities for no more than two years, or the dissolution of the NPO. There appears to be no sanctions imposed on managers, directors or controlling owners of NPO.

334. Palau does not have appropriate sanctions due to deficiencies in the following recommendations: R. 10 (substantial gaps in CDD), R. 12 (limitations in the PEP legislation), R. 14 (lack of legislation and regulations for MVTs), R.15 (no requirement and enforceability on competent authorities and FIs to assess new technologies), R.17 (no law or regulation to meet the requirements), R. 19 (no requirement to apply enhanced CDD for jurisdictions of concern by FATF), and R.22/R.23 (Palau has significant gaps regarding DNFBPs).

335. In relation to requirement relating to R.23, trust company services are provided by the legal profession for the formation of legal entities and the reporting requirements for DNFBPs under the AMLA apply to the legal profession. The AMLA sanctions can be applied to lawyers. Sanctions are not yet available for DNFBPs relating to company services providers.

336. *Criterion 35.2* - Palau's Criminal Code allows penalties against corporations include the revocation of the corporations' business license to continue to operate in Palau (section 619) if found guilty of an offence. The maximum penalty for a Class C Felony is five (5) years (17 PNCA §663). Criminal penalties are prescribed for any "person" who fails to do what they are required to do under the Act. "Person" is defined as "... any natural or legal person" which would include officers/director/senior management/employees of any Financial Institutions and/or DNFBPs.

#### *Weighting and conclusion*

337. Palau has a range of deficiencies related to NPOs, CDD, PEPs, MVTs, new technologies, high risk countries and DNFBPs which impact on the efficacy of sanctions in these areas (see Recommendations 8, 10, 12, 14, 15, 19, 22 and 23). While Palau has no other providers of TCSP services besides lawyers (who provide some of the TCSP related services), the legal privilege afforded lawyers provides a gap and a potential vulnerability for ML/TF in Palau. Administrative sanctions are not clearly available for covered DNFBPs. **Palau is rated partially compliant for Recommendation 35.**

#### ***Recommendation 36 – International instruments***

338. Palau was rated partially compliant on both the former R.35 on International Cooperation and SRI on Ratification and implementation of UN instruments in the 2008 MER. Factors underlying the rating was: (1) Palau has not signed and ratified the Palermo and Vienna Conventions, (2) Both the Palermo and Vienna Conventions are not fully implemented.

339. *Criterion 36.1* - Palau has joined the terrorism financing convention (2001) and the Merida convention (2009), but is yet to ratify the Palermo and Vienna Conventions.

340. *Criterion 36.2* - There are a number of weaknesses with implementation of requirements in the conventions that have been implemented.

#### *Weighting and conclusion*

341. Palau is yet to ratify the Palermo and Vienna Conventions and has not implemented any of these conventions. **Palau is rated non-compliant for Recommendation 36.**

#### ***Recommendation 37 - Mutual legal assistance***

342. Palau was rated partially compliant for former Recommendation 36 in the 2008 MER. The deficiencies identified were 1) dual criminality requirement limiting MLA to predicate

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offences covered in Palau; 2) law does not provide for the confiscation of property of corresponding value of property laundered, instrumentalities intended for use in commission of ML offence; 3) ML Act does not provide for a clear and efficient process for the execution of MLA requests in a timely way; 4) Palau has not considered devising and applying mechanisms for determining best venue for prosecution of defendants in cases that are subject to prosecutions in more than one country; and 5) not all DNFBPs are covered. The amendments of the ML Act and Forfeiture Act have corrected some of the identified deficiencies in the 2008 MER, particularly points 1 and 2 above.

343. *Criterion 37.1* - Chapter 13 of the PNCA provides the legal basis for mutual assistance in criminal matters. Section 1311 allows Palau to make and receive requests for MLA from foreign states where the MLA may be requested or granted by Palau in relation to investigations or proceedings, provided it relates to a 'serious offence'. A serious offence is defined as an offence punishable in Palau with imprisonment of more than a year. This limitation restricts the widest possible range of MLA in relation to associated predicate offences linked to ML or TF. However, pursuant to Section 1312, the Attorney General has the expanded power to make and grant MLA requests informally in relation to investigations and proceedings on criminal matters.

344. *Criterion 37.2* - The OAG is the central authority for the transmission and execution of MLA requests. Section 18 PNCA §1311 provides the "process" for execution of a MLA request. No MLA requests have been received and there is no case management system or standard protocol to monitor the progress of requests or prioritisation, though the context of Palau suggests this may not be necessary as the MLA requests received in future will likely be processed on an ad hoc basis.

345. *Criterion 37.3* - Palau may refuse a MLA request from a foreign state if 1) it would be likely to prejudice the sovereignty, security or public interest of Palau; 2) the requesting country does not afford substantial reciprocal privileges to Palau; 3) the MLA request does not relate to a 'serious offence'; 4) the requesting country does not agree to comply with the terms and conditions imposed by the Supreme Court under Section 1315(i); or 5) the requesting country does not agree to bear all costs associated with the request. While point (5) is arguably unreasonable or unduly restrictive as it demands more of requesting states than would be demanded of Palau in the reverse situation, there has not been any requests that have been denied on that basis.

346. *Criterion 37.4* - The ability to provide MLA is reasonably restricted. The AMLA and Section 5 in particular do not indicate that a request may be refused on the sole grounds that the offense is also considered to involve fiscal matters. However, whereas the Extradition Act expressly stipulates that an offense is an extraditable offense even if it relates to taxes, customs, or other revenue matters, no such express provision is included in the AMLA. If Extradition may be granted for offenses involving fiscal matters, it would appear that other mutual legal assistance would be, as well. Palau cannot refuse a request for MLA based on secrecy or confidentiality.

347. *Criterion 37.5* - Section 1314(a)(6) PCNA states that the requesting country shall include a statement of any requests for confidentiality and the reasons for those requests. This suggests that Palau does maintain the confidentiality of MLA requests in appropriate cases but there is no obligation to do so.

348. *Criterion 37.6* - Palau does impose a requirement of dual criminality regardless whether it involves coercive actions, as the MLA requests are restricted to 'serious offences' under Section 1311 (i.e. criminal offence with prescribed imprisonment of more than a year). However, the savings provision under section 1312 allows the AG to render assistance to requesting states nevertheless.

349. *Criterion 37.7* - Palau in imposing a dual criminality requirement to 'serious offences', pegs the requirement to the length of imprisonment for the underlying offence and not to its terminology or classification of offence.

350. *Criterion 37.8* - Section 1315 PCNA states that the Supreme Court may issue a search warrant or an evidence-gathering order where there is a request from an authorised person of a foreign state. There is no law which prohibits or limits the powers of the domestic competent authorities from exercising all powers available to them in response to a MLA request.

#### *Weighting and conclusion*

351. In Palau, only two MLA requests has been received in the last ten years. There is no evidence of a case management system or prioritisation to monitor the progress of requests. MLA requests to Palau need to relate to a 'serious offence'. Palau does maintain the confidentiality of MLA requests in appropriate cases but there is no obligation to do so. Little weight is placed on the limited deficiencies due to the context of Palau. **Recommendation 37 is rated largely compliant.**

#### **Recommendation 38 – Mutual legal assistance: freezing and confiscation**

352. Palau was rated partially compliant for previous MER 2008. The main deficiencies identified were 1) dual criminality requirement limiting MLA to predicate offences covered in Palau; 2) the law does not allow for the confiscation of proceeds of, instrumentalities used or intended for use in the commission of a predicate offence for ML; 3) law does not provide for the confiscation of property of corresponding value of property laundered, instrumentalities intended for use in commission of ML offence, as well as any predicate offences; and 4) Palau has only entered into limited bilateral or multilateral agreements with other countries to coordinate seizing and confiscation actions. The amendment of the Forfeiture Act has corrected many of the identified deficiencies in the 2008 MER.

353. *Criterion 38.1* - Section s 1319-1321 PCNA allows Palau to generally identify, freeze, seize and confiscate property pursuant to a foreign request.

354. *Criterion 38.2* - Section 1320 provides that the Supreme Court may enter and enforce a foreign confiscation order which is legally capable of enforcement in Palau if the Court is satisfied that 1) the order is in force in the foreign state and not subject to appeal; and 2) where the person the subject of the order did not appear in the confiscation proceedings in the foreign state, that the person was given sufficient notice, had absconded or had died before such notice could be given. There is no provision for this where the perpetrator is unknown.

355. *Criterion 38.3* - Palau has not provided information demonstrating arrangements with other countries for coordinating seizure and confiscation. Palau does however, have mechanisms in place pursuant to Section 717 PCNA for the management and disposal of property frozen, seized or confiscated.

356. *Criterion 38.4* - Section 1322 expressly allows for the sharing of confiscated property with foreign states.

#### *Weighting and conclusion*

357. Palau has not demonstrated arrangements with other countries for coordinating seizure and confiscation. **Recommendation 38 is rated largely compliant.**

#### **Recommendation 39 – Extradition**

358. Palau was rated largely compliant with former R.39 and partially compliant with SR.V. The 2008 MER found that Palau's Extradition and Transfer Act (Extradition Act of 2001) creates

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an adequate legal framework for extradition for the purposes of R.39. However, there were deficiencies due to the dual criminality requirement; Palau's ability to allow for extradition may be limited in cases involving any of the predicate offenses where the prescribed punishment is over a year.

359. *Criterion 39.1 - Sub-criterion 39.1(a)* - Extradition in Palau is governed by the Extradition Act 2001 and the Counter-Terrorism Act (CTA) of 2007. Under the Extradition Act, an extraditable offence is an offence which carries an imprisonment of over one year in both the requesting country and Palau. In Palau, ML is a Class A felony with prescribed punishment of imprisonment up to 25 years' imprisonment under Section 662 PNCA. Provided that ML is a criminal offense punishable with imprisonment of more than one year under the law of the requesting country, ML is, therefore, an extraditable offense pursuant to Section 10.103 of the Extradition Act. TF is expressly an extraditable offense under Section 2213(a) and the extradition for terrorism offenses shall be carried-out pursuant to and in accordance with the Extradition Act.

360. *Sub-criterion 39.1(b)* - the Extradition Act establishes a procedure for responding to extradition requests. The Extradition Act makes the Minister of Justice the designated authority to process and deal with extradition requests from foreign countries and to make such extradition requests on behalf of Palau, in practice, extradition requests are handled by the OAG on behalf of the Minister of Justice. Under section 10.114 where multiple extradition requests are received for the same person, the Minister of Justice has the discretion to prioritise the requests. However, there is no provision for a general case management system, or clear processes for the timely execution of extradition requests including prioritisation (recognising that Palau receives very few requests).

361. Pursuant to Section 10.113 of the Extradition Act, the Minister of Justice, upon receipt of an extradition request, shall notify the president, review and consider the request, determine whether the request meets the Act's requirements, promptly communicate the outcome of his analysis to the requesting country, and identify in writing any deficiencies in the request. There are various provisions setting out timelines in the prompt handling of extradition requests such as Section s 10.122, 10.123 and 10.125 etc.

362. *Sub-criterion 39.1(c)*. Pursuant to Section 10.113(c) of the Extradition Act, the Minister of Justice has to determine whether all formal requirements for granting the request are met, including whether the request relates to an extraditable offense and was made by an extradition country. Extradition countries are countries with which Palau has entered into an extradition treaty. The Minister of Justice shall not institute extradition proceedings unless the requirements are met. Notwithstanding that, under Section 10.113(d), the Minister of Justice may still provisionally institute extradition proceedings even if the extradition request does not meet all of the requirements in Section 10.113(c), provided that the Minister of Justice is satisfied that any defect or deficiency is readily curable and the requesting country will immediately act to cure such defect or deficiency. These conditions are not unduly restrictive.

363. *Criterion 39.2* - Under Section 10.111(b) of the Extradition Act, Palau is not bound to extradite its own nationals although it may do so if extradition is deemed proper after a court hearing. Under Section 10.104(o), if the offence is punishable by death, no Palau national or person of Palauan ancestry shall be extradited. However, if extradition is denied solely on the basis of citizenship or nationality, Palau shall submit the case to its competent authorities for the purpose of prosecution.

364. *Criterion 39.3* - Under Section 10.103(b), an extraditable offence is not determined by the terminology or categorisation of the offence in both countries but rather, the totality of the acts or omissions which has been criminalised in the conduct underlying the offense.

365. *Criterion 39.4* - The Extradition Act has put in place mechanisms for handling extradition requests and appropriate timelines to carry them out under Section 10.125. For

simplified extradition mechanisms where the person wishes to waive extradition or voluntarily consents to surrender for criminal prosecution under section 10.124, the Court shall conduct an inquiry to confirm that the person understands the charges and the consequences of his/her actions without holding extradition proceedings to determine whether the person should be surrendered for the extraditable offence. Once the Court is satisfied that the waiver of extradition or the consent to surrender was given with notice and voluntarily, the person will be ordered to be taken into custody and issued a surrender warrant without undue delay.

#### *Weighting and conclusion*

366. Palau's ability to allow for extradition is limited to cases involving any of the predicate offences where the prescribed punishment is over a year, which includes ML and TF offences. Palau has no provision for a general case management system, or clear processes for the timely execution of extradition requests including prioritisation (recognising that Palau receives very few requests). **Recommendation 39 is rated largely compliant.**

#### *Recommendation 40 – Other forms of international cooperation*

367. Palau was rated compliant with former R.40 on Other forms of international cooperation in the 2008 MER.

368. *Criterion 40.1* – Generally, Palau's competent authorities such as the FIU, OAG, LEAs and FIC can share information pertaining to ML, TF and other predicate crimes with foreign counterparts, both spontaneously and upon request (17 PNCA. S. 2215). 18 PNCA s. 1312 allows for the OAG and other competent authorities (members of the MLWG) to provide international assistance other than the formal MLA requirements as per section 1314. The FIC is able to exchange information as per FIA Title 26 PNCA s. 1015.

369. Criterion 40.2:

- AMLA Section 3327, and b (10) provides the legal basis for supervising authorities to enter into cooperation and information sharing arrangements and to provide prompt and effective cooperation to agencies that perform similar functions in other nations, including in the absence of a cooperation and information sharing arrangement. In addition, under the powers of the FIU, the FIU has the legal basis to cooperate, share information and enter into agreements and arrangements to exchanging information with other foreign law enforcement and supervisory agencies (AMLA, 17 PNCA, Section 3334 (f) and (u)). Furthermore, the FIC is empowered by the FIA to promote cooperation with public authorities in the performance of its functions. With this cooperation, the FIC can provide general information to the Ministry of Finance and other agencies (FIA, 26 PNCA, s.1013 (a) and (b)). The Constitution of Palau allows the Attorney General to make requests on behalf of Palau to an appropriate authority of a foreign state for mutual legal assistance in any investigation commenced or proceeding instituted in the Republic, relating to any serious offense. Title 18 PNCA Chapter 13 s5.Section 2215 of 17 PNCA (intelligence sharing) authorises MoJ, OAG, FIU, Customs and LEAs to share and disclose intelligence across a range of transnational crimes including terrorism and this is supported by Executive Order 362 which allows MLWG members which encourages members of the MLWG to develop working relationships with international partners.
- Competent authorities are able to use the most efficient means to cooperate.
- It is unclear if Palau has clear and secure gateways, mechanisms or channels to facilitate and allow for the execution or transmission of requests.

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- The MoJ, OAG, FIU, Customs and LEAs are able to share and disclose intelligence across a range of transnational crimes including terrorism (Section 2215 of 17 PNCA). The MLWG members (MoJ, OAG, FIU, Customs, Terrorism Coordinator and LEAs) are encouraged to develop working relationships with international partners. It is unclear if Palau has a prioritisation process to manage requests, but Palau has nothing to suggest that requests cannot be responded to in a timely manner.
- While Palau law safeguards information it receives, no further details were provided on what those processes and procedures involve for each of the key competent authorities such as the FIU and FIC.

370. *Criterion 40.3* - AMLA, Section 3328, b (10) provides the legal basis for supervising authorities which includes the FIU to enter into cooperation and information sharing arrangements with agencies that perform similar functions in other nations. For the authorities that require bilateral agreements, the FIU and the FIC have negotiated MOUs with other competent authorities and as well as with other foreign law enforcement agencies. Palau has signed MOUs with 6 foreign jurisdictions FIUs and 3 domestic MOUs with other LEAs. It is unclear how long it takes to negotiate said agreements or MOUs.

371. *Criterion 40.4* - There is no clear provision regarding the provision of feedback other than the provided legal basis for general cooperation and exchange of information specific for foreign agencies. Feedback would be provided on a case-by-case basis when requested by the foreign authorities who have assisted authorities in Palau.

372. *Criterion 40.5:*

- Palau's Mutual Assistance in Criminal Matters Act contains no such restrictions with the exception that Palau can refuse a request if the request would impede an on-going investigation in Palau.
- The Palau Mutual Assistance in Criminal Matters Act contains no restrictions with the exception that Palau can refuse a request if the request would impede an on-going investigation in Palau. The AMLA supersedes any secrecy or confidentiality laws that FIs and the DNFBPs may have. The FIU can share information with no restrictions to any agency that performs similar functions and is subject to similar secrecy obligation as the FIU.
- The Palau Mutual Assistance in Criminal Matters Act contains no restrictions with the exception that Palau can refuse a request if the request would impede an on-going investigation in Palau.
- The Palau Mutual Assistance in Criminal Matters Act contains no restrictions with the exception that Palau can refuse a request if the request would impede an on-going investigation in Palau.

373. *Criterion 40.6* - Title 17 §3335 (a)(1)(2) provides the legal basis for the controlling of information given out by the FIU in Palau. Any information provided by the Palau FIU must not be used for other purposes other than combating money laundering, financing of terrorism or any other serious crimes. Any other use of the information will require consent of the Palauan FIU. It is unclear if other competent authorities have similar statutory controls and safeguards as the FIU that information exchanged is only used for agreed purpose, though Palau indicates that any agreements and/or arrangements entered into with a foreign counterpart would ensure such controls are in place.

374. *Criterion 40.7* - The FIU is able to protect the privacy and integrity of data received by exchange (Section 3334, AMLA), with the FIC having similar provision (Section 1015, FIA). Privacy and data integrity would be covered by any related agreement or arrangement entered into by a particular agency with its foreign counterpart.

375. *Criterion 40.8* - The Palau FIU is empowered to conduct enquiries on behalf of a foreign FIU and also share information with a foreign FIU. All law enforcement related agencies are capable of conducting inquiries on behalf of a foreign counterparts including CID, Customs, OAG, and the NEA.

376. *Criterion 40.9* - Under sections 3333(f) and (u) and section 3334 of the AMLA, the FIU is empowered to act on behalf of the Republic of Palau in cooperating with any foreign FIU, foreign government agency, foreign law enforcement agency, foreign supervisory authority and foreign auditing authority for purposes of the MLPCA. The FIU has negotiated MOUs with the Philippines, Korea, Japan, Chinese Taipei, Thailand, Bangladesh and all Pacific Islands Jurisdictions.

377. *Criterion 40.10* - Title 17 §3334(m)(u) and section 3335 provides the legal basis for the FIU to provide feedback to the financial institution, designated non-financial business or profession and any relevant government department, office, agency or institution regarding outcomes relating to the reports or information provided by MLA. Feedback is provided on a case-by-case basis when requested by the foreign authorities who have assisted authorities in Palau.

378. *Criterion 40.11* - Under the international cooperation agreements Palau has with foreign agencies, law enforcement or supervisory authorities, Palau can obtain all the required information it is required to get, to assist with investigations. There is also legal basis for the Palau FIU to get all the information it requires from the domestic competent agencies. In addition, the Palau FIU can share information with both foreign FIUs and domestic competent authorities even without formal MOUs in place (Title 17 §3334(m)(u) and section 3335).

379. *Criterion 40.12* - Section 1015 of the FIA allows FIC to cooperate and exchange information with agencies of foreign Governments and international agencies. The FIU as a supervisor is able to provide cooperation to a foreign agency that performs similar functions ( Title 17 §3334 and 3335).

380. *Criterion 40.13* - Section 1015 allows the FIC to undertake exchange of information. However, it does not specify the extent and whether the information available from financial institutions can be shared, without the FI's permission. The FIU as a supervisor is able to information that is available to it domestically with a foreign agency that performs similar functions and proportionate to its needs ( Title 17 §3334 and 3335).

381. *Criterion 40.14* - The FIA does not specify the extent to what information can be shared. The FIU as a supervisor is able to share information with a foreign agency that performs similar functions including regulatory and AML/CFT information subject to secrecy provisions as per Title 17 §3334 and 3335.

382. *Criterion 40.15* - Regarding the FIA, the referred section only authorizes sharing of information, and does not refer to the facilitation of a foreign supervisor to carry out enquiries themselves for groups of companies. The FIU is able to conduct inquiries on behalf of foreign counterparts.

383. *Criterion 40.16* - The FIC Commission and specifically, its Commissioner, is authorized to share information with both domestic and international agencies without limitations

## TECHNICAL COMPLIANCE

(26PNCA 1015). The granting of a license by the FIC shall constitute consent of the FI for the release and exchange of information with a foreign jurisdiction's competent authorities. While the Commission can disclose confidential information either with prior written consent or as required by law or the courts, it does not need to promptly inform the requesting financial supervisor of this obligation if it is legally obliged to disclose or report the information. The FIU is authorised to share information subject to 17 PNCA s. 3334 and 3335 and can disseminate information provided by a foreign counterpart if required.

**384.** *Criterion 40.17* - Executive Order 362 clearly sets out under the duties and functions of the MLWG that members should develop working relationships with law enforcement officials assigned to combat money laundering, transnational crime and terrorism in the international community, in particularly with its closest neighbours. Section 2215 of 17 PNCA (intelligence sharing) authorises MoJ, OAG, FIU and LEAs to share and disclose intelligence across a range of transnational crimes including terrorism. TF is not specifically listed in terms of international sharing of information and intelligence. Palau is also a member of the Pacific Transactional Crime Network which enables sharing of information across the Pacific. While chapter 22 Terrorist Act of 17 PNCA Section 2215 allows for the intelligence sharing by the Minister of Justice, OAG, FIU, and other LEAs and officers of Palau designated by the Minister of Justice under certain categories of crime groups to foreign states (including ML, illicit drugs, transnational crime and terrorism), it does not include TF.

**385.** The FIU has entered into three MOUs with Japan's FIU in May 2017, South Korea's FIU in July 2013, and Thailand's FIU in 2007. The MOUs relate specifically for the purpose of obtaining financial intelligence relating to ML, TF and other related criminal activities. The FIU is seeking to enter into further MOUs with neighbouring countries, particularly the Philippines.

**386.** *Criterion 40.18* - Section 1312 (18 PNCA) allows assistance to be provided in investigations which require information to be given or received from foreign states, with Section 1315 confirming that statements in foreign requests can be noted as evidence in support of any request for a search warrant. Where a foreign state requests the OAG to assist in locating property believed to be the proceeds of a serious crime, the OAG may authorize any application related to the crime act, for the purpose of acquiring the information sought by the foreign state. There does not appear to be any limitation on LEAs to use their powers to conduct enquiries and obtain information on behalf of foreign counterparts.

**387.** *Criterion 40.19* - Apart from Mutual Assistance in Criminal Matters under 18 PNCA, there is no other formal law endorsing joint investigations with foreign agencies and the assessment team has been advised there is no law that prohibits a joint investigation team being created. Usually such teams can be created under the President's executive order, as was the case of the DEA. Joint investigations with the US only can easily be arranged without the need of formal arrangements as a result of Palau and US Compact of Free Association. In the past three years, Palau have conducted joint investigations with the US Secret Services related to (a) Investigation of Pakistani and Syrian nationals in possession of USD 6,000 in counterfeit currency and (b) three investigations into Chinese nationals using and/or attending to use ATM credit card skimming devices.

**388.** *Criterion 40.20* - Apart from Mutual Assistance in Criminal Matters under 18 PNCA, Palau's FIU has powers under AMLA Section 3334 that does allow for the exchange of information by the FIU, and (f) allows the FIU to seek information from any foreign government agency including law enforcement, foreign supervisory authority and foreign auditing authority. Chapter 22 Terrorist Act of 17 PNCA Section 2215 allows for intelligence sharing by the Minister of Justice, OAG, FIU, and other LEAs and officers of Palau designated by the Minister of Justice to foreign states including intelligence for ML, illicit drugs, transnational crime and



terrorism. The FIC is able to exchange information as per FIA Title 26 PNCA s. 1015. The FIC is able to exchange information as per FIA Title 26 PNCA s. 1015.

*Weighting and conclusion*

389. LEAs, the FIU and supervisors have a broad legal basis for cooperation with foreign counterparts. It is unclear if other competent authorities have similar statutory controls and safeguards as the FIU that information exchanged is only used for agreed purpose, though Palau indicates that any agreements and/or arrangements entered into with a foreign counterpart would ensure such controls are in place. Regarding the FIA, the referred section only authorizes sharing of information, and does not refer to the facilitation of a foreign supervisor to carry out enquiries themselves for groups of companies. While the FIC can disclose confidential information either with prior written consent or as required by law or the courts, it does not need to promptly inform the requesting financial supervisor of this obligation. TF is not specifically listed in terms of international sharing of information and intelligence, though the low risk and incidence places little weight on this deficiency. **Palau is rated largely compliant for Recommendation 40.**

*Summary of Technical Compliance – Key Deficiencies*

Compliance with FATF Recommendations		
Recommendation	Rating	Factor(s) underlying the rating
1. Assessing risks & applying a risk-based approach	PC	<ul style="list-style-type: none"> <li>§ The NRA notes significant vulnerabilities but does not fully analyse all of the higher and moderate level risks, or provide further explanations in relation to Palau’s context or situation and what the impacts are of these risks and crime types.</li> <li>§ Reporting entities are not required to take measures to identify, assess and understand their ML/TF risks, though understanding of risk is implied in the new FIU regulations (related to enhanced and simplified CDD).</li> <li>§ DNFBP regulations have not been enacted, these entities are not required to have policies, controls and procedures to manage and mitigate ML/TF risks.</li> <li>§ Palau is not fully considering risk in taking enhanced measures for higher level risks and simplified measures for lower level risks.</li> <li>§ Regarding FIs and DNFBPs, there is no clear formal mechanism in place to inform them of Palau’s ML/TF risks.</li> </ul>
2. National cooperation and coordination	LC	<ul style="list-style-type: none"> <li>§ Palau has made a number of significant policy decisions based on and informed by risk, which has resulted in the assessment team placing little weight on the lack of a written policy or strategy when considering Palau’s context</li> <li>§ Palau has no coordination mechanism for proliferation financing.</li> </ul>
3. Money laundering offence	LC	<ul style="list-style-type: none"> <li>§ Piracy is not included as a predicate offence, even though Palau suggests it can be pursued by other yet to be confirmed means.</li> </ul>
4. Confiscation and provisional measures	LC	<ul style="list-style-type: none"> <li>§ “Covered offenses” for which Palau forfeiture law applies to do not include all ML predicate offences but only those chargeable as a felony offense under the laws of Palau. However, in the context of Palau, the excluded predicate offences are not critical.</li> </ul>
5. Terrorist financing offence	LC	<ul style="list-style-type: none"> <li>§ There is no express legislative provision that criminal sanctions against a legal person is without prejudice to the criminal liability of natural persons.</li> <li>§ Whether the definition of ‘property’ includes both funds from legitimate and illegitimate sources has yet to be tested in Palau, though the low risk of TF provides less weighting for this issue.</li> </ul>
6. Targeted financial sanctions related to terrorism & TF	LC	<ul style="list-style-type: none"> <li>§ While Palau has established a legal framework to implement TFS pursuant to UNSCR 1267 and UNSCR 1373, there are shortcomings with clear mechanisms to share updated UN listings with the private sector.</li> <li>§ The mechanism of review is limited to the original decision maker reviewing their own decision.</li> <li>§ The Attorney General may allow access to frozen funds for purposes of basic expenses, however, this is not clearly regulated to be in keeping with conditions set by the UN.</li> </ul>
7. Targeted financial sanctions related to proliferation	NC	<ul style="list-style-type: none"> <li>§ Palau has not put in place any specific measures for the purposes of implementing targeted financial sanctions related to proliferation in order to comply</li> </ul>

Compliance with FATF Recommendations		
Recommendation	Rating	Factor(s) underlying the rating
		with UNSCRs.
8. Non-profit organisations	NC	<ul style="list-style-type: none"> <li>§ Palau has not undertaken any domestic reviews or assessments of the NPO sector in order to identify the features and types of NPOs that are at risk of being misused for TF or other forms of terrorist support.</li> <li>§ There is a lack in issuing policies to NPOs for TF risk issues, as well as establishing appropriate mechanisms when there is suspicion or reasonable grounds to suspect that a particular NPO is involved in or is exploited by terrorist financing abuse and/or is a front for fundraising by a terrorist organisation.</li> <li>§ No evidence has been provided regarding AML/CFT compliance monitoring or sanctions in relation to NPOs.</li> </ul>
9. Financial institution secrecy laws	C	
10. Customer due diligence	PC	<ul style="list-style-type: none"> <li>§ Palau does not require FIs to update CDD when there is suspicion of ML/TF or doubts about the veracity of previous CDD.</li> <li>§ There are no specific provisions requiring that FIs shall understand the nature of the customer's business.</li> <li>§ There are no specific provisions requiring that FIs conduct CDD measures on the beneficiary of life insurance and other investment related insurance policies, as soon as the beneficiary is identified or designated and no requirement that FIs need to include the beneficiary of a life insurance policy as a relevant risk factor in determining whether to apply EDD (recognising less weight was applied to this due to small size of insurance industry).</li> <li>§ There are no specific provisions requiring that FIs adopt risk management procedures when a customer may utilise the business relationship prior to verification; no specific provisions in relation to delaying verification of customers and BO, and no legislative provisions regarding the requirement that when a FI is unable to comply with relevant CDD measures as in tipping-off the customer, that requires the FI to still report a STR.</li> </ul>
11. Record keeping	C	
12. Politically exposed persons	PC	<ul style="list-style-type: none"> <li>§ Palau's legislation has no requirements for FIs to obtain senior management approval when dealing with PEPs, to establish source of wealth of PEPs and to conduct enhanced ongoing monitoring on that relationship for domestic PEPs and for persons entrusted with a prominent position in an international organisation.</li> <li>§ High-level persons of international organisations are not covered in any PEP requirements.</li> <li>§ Palau's legislation does not require FIs to take reasonable measures to determine whether beneficiaries of insurance policies are PEPs.</li> </ul>
13. Correspondent banking	PC	<ul style="list-style-type: none"> <li>§ The required information to be collected from the respondent FIs are not sufficient for a risk</li> </ul>

## TECHNICAL COMPLIANCE

Compliance with FATF Recommendations		
Recommendation	Rating	Factor(s) underlying the rating
		<p>assessment including whether it has been the subject of a ML/TF investigation or regulatory action or has obtained senior management approval before establishing a new correspondent banking relationship.</p> <p>§ There are no requirements for a respondent FI which has payable through accounts that are not consistent with the Standard.</p>
14. Money or value transfer services	NC	<p>§ Except for requiring MVTs providers to comply with both the AMLA and FI regulations, Palau does not have further laws or regulations to meet the requirements of recommendation 14 including licensing or registration for legal, natural persons or agents and the inclusion in their AML/CFT programs if they do use agents.</p>
15. New technologies	PC	<p>§ Palau has not clearly mandated that risks related to new technologies must be identified and assessed prior to launch of new technologies and have also not mandated that FIs are obliged to take measures to manage and mitigate the risks when launching or using new technologies.</p>
16. Wire transfers	PC	<p>§ Palau have gaps regarding wire transfers including it does not provide any special CDD requirements for cross border transfers contained within a batch transfer.</p> <p>§ Palau does not have any provisions for walk-in customers and a time period for record retention is not covered in policy.</p> <p>§ MVTs do not have the required regulations.</p>
17. Reliance on third parties	PC	<p>§ While REs are permitted to rely on third parties for CDD, Palau leaves ultimate responsibility for CDD and related verification with the RE.</p> <p>§ There are gaps with the requirements for Palau REs to obtain information and records from the third party in a timely manner and it lack controls on which countries the third party provider can be based in.</p>
18. Internal controls and foreign branches and subsidiaries	C	
19. Higher-risk countries	PC	<p>§ Palau does not require EDD for countries called for by the FATF and they have no requirement for applying countermeasures proportionate to the risk.</p>
20. Reporting of suspicious transaction	LC	<p>§ The definition in the AMLA which applies to remittance service providers, who are not covered by the FIA, is limited (this is given little weight as sector is very small).</p>
21. Tipping-off and confidentiality	C	
22. DNFBPs: Customer due diligence	NC	<p>§ DNFBP regulations have not been issued. Palau does not cover all the material elements of the CDD requirements under R.10 nor other requirements under R.11, R.12, R.15 and R.17.</p>

Compliance with FATF Recommendations		
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23. DNFBPs: Other measures	PC	<p>§ While Palau provides for general requirements in relation to reporting of STRs (though the AMLA does not fully meet FATF requirements), including tipping-off and confidentiality, the gaps in relation to R.19 and R.20 for FIs also apply to DNFBPs.</p> <p>§ Palau has not established internal controls as per R. 18 and no regulations have been issued to address these requirements.</p>
24. Transparency and beneficial ownership of legal persons	NC	<p>§ Palau has not assessed the ML and TF risks associated with all types of legal persons.</p> <p>§ There are no mitigating measures in place for nominee shareholder or directors.</p> <p>§ There is a significant gap in the lack of measures to ensure there is adequate, accurate and updated information on beneficial ownership (as defined by the FATF) which can be obtained or accessed by competent authorities in a timely manner.</p> <p>§ While Palau's legislation allows it to share information through international cooperation, this is constrained by the quality of the information available to domestic authorities in the first place.</p>
25. Transparency and beneficial ownership of legal arrangements	PC	<p>§ There are no requirements for trustees to hold information on regulated agents of, and service providers to, express trusts, including investment advisors or managers, accounts and tax advisors.</p> <p>§ There are no explicit legal requirements for trustees to maintain the information for at least five years after their involvement with the trust ceases.</p> <p>§ Palau law does not impose enforceable obligations or proportionate and dissuasive sanctions on trustees to collect beneficial ownership information as required under this recommendation.</p> <p>§ BO information is not readily accessed by domestic or foreign competent authorities, as the information obtained is lacking.</p>
26. Regulation and supervision of financial institutions	PC	<p>§ Palau has no regulatory measures in the form of detailed instructions to describe how to undertake fit and proper testing for employees.</p> <p>§ FIs (not banks) have negligible supervision which is not risk-based though little weight has been applied to these due to very small number and low risk.</p> <p>§ Supervisors do not formally review the assessment of ML/TF risk profiles of FIs.</p>
27. Powers of supervisors	C	
28. Regulation and supervision of DNFBPs	NC	<p>§ Fundamental deficiencies exist for monitoring and ensuring compliance with AML/CFT requirements for DNFBPs, including the absence of a designated supervisor(s) for some sectors and the lack of DNFBP regulations.</p>
29. Financial intelligence units	LC	<p>§ The FIU does not undertake strategic analysis and is not a member of Egmont.</p>
30. Responsibilities of law enforcement and investigative authorities	LC	<p>§ It is unclear how non STR related investigations can be considered by non-law enforcement agencies through the FCIU, though the MLWG has a broader role for coordinating ML/TF investigations.</p> <p>§ It is also not clear who the primary investigative unit for TF is.</p>

## TECHNICAL COMPLIANCE

Compliance with FATF Recommendations		
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31. Powers of law enforcement and investigative authorities	LC	§ In Palau both the OSP and OAG are able to obtain financial records under subpoena powers, however the OAG can only use this power once criminal proceedings have commenced.
32. Cash couriers	LC	§ The penalties for a false declaration are not dissuasive for legal persons. § It is unclear if information made available to a foreign government agency is retained either physically or on any database. § It is unclear if Palau has any safeguards to ensure proper use of information. § The criminal penalties referred to in Section 3607 are unclear, and it is also not clear that the penalties for corporate entities are dissuasive though the banning of such entities after multiple offences is considered proportionate.
33. Statistics	LC	§ Palau maintain statistics on property frozen, seized and confiscated by the NEA but not from any other LEAs.
34. Guidance and feedback	PC	§ Palau has provided reporting entities with limited formal guidance and feedback. § DNFBPs have received no guidance at all.
35. Sanctions	PC	§ Palau has a range of deficiencies related to NPOs, CDD, PEPs, MVTs, new technologies, high risk countries and DNFBPs which impact on the efficacy of sanctions in these areas (see Recommendations 8, 10, 12, 14, 15, 19, 22 and 23). § While the FIC has as yet not used sanctioning powers in the FIA for AML/CFT as no occasion has arisen to use these powers this was not given much weight. § As Palau has no other providers of TCSP services besides lawyers (who provide some of the TCSP related services), the legal privilege afforded lawyers provides a gap and a potential vulnerability for ML/TF in Palau. § There is no reference to DNFBPs in section 3328 which relate to administrative actions.
36. International instruments	NC	§ Palau is yet to ratify the Palermo and Vienna Conventions and has not implemented any of these conventions.
37. Mutual legal assistance	LC	§ There is no evidence of a case management system or prioritisation to monitor the progress of MLA requests. § MLA requests to Palau need to relate to a 'serious offence'. § Palau does maintain the confidentiality of MLA requests in appropriate cases but there is no obligation to do so.
38. Mutual legal assistance: freezing and confiscation	LC	§ Palau has not provided information demonstrating arrangements with other countries for coordinating seizure and confiscation.
39. Extradition	LC	§ Palau's ability to allow for extradition is limited to cases involving any of the predicate offences where the prescribed punishment is over a year, which

Compliance with FATF Recommendations		
Recommendation	Rating	Factor(s) underlying the rating
		<p>includes ML and TF offences.</p> <p>§ Palau has no provision for a general case management system, or clear processes for the timely execution of extradition requests including prioritisation (recognising that Palau receives very few requests, this deficiency is given no weight).</p>
40. Other forms of international cooperation	LC	<p>§ It is unclear if other competent authorities (besides LEAs, the FIU and supervisors) have similar statutory controls and safeguards as the FIU that information exchanged is only used for agreed purpose, though Palau indicates that any agreements and/or arrangements entered into with a foreign counterpart would ensure such controls are in place.</p> <p>§ Regarding the FIA, the referred section only authorizes sharing of information, and does not refer to the facilitation of a foreign supervisor to carry out enquiries themselves for groups of companies.</p> <p>§ While the FIC can disclose confidential information either with prior written consent or as required by law or the courts, it does not need to promptly inform the requesting financial supervisor of this obligation.</p> <p>§ TF is not specifically listed in terms of international sharing of information and intelligence, though the low risk and incidence places little weight on this deficiency</p>

**Glossary**

AML/CFT	Anti-Money Laundering and Counter Financing of Terrorism
AMLA	Money Laundering Act
APIFIU	Association of Pacific Islands FIUs
ARS	Alternative Remittance Service
BCP	Bureau of Customs Protection
BCR	Border Currency Report
BNI	Bearer Negotiable Instrument
BO	Beneficial Owner
BPS	Bureau of Public Safety
CAMELS	Capital, Assets Quality, Management, Earnings, Liquidity and Sensitivity
CDD	Customer Due Diligence
CID	Criminal Investigation Division
CFT	Counter Financing of Terrorism
COFA	The Compact of Free Association
CT	Counter Terrorism
CTA	Counter-Terrorism Act 2007
CTR	Cash Transaction Report
DBA	Doing Business As
DNFBPs	Designated Non-Financial Businesses and Professions
DPMS	Dealers in precious metals and stones
DPRK	Democratic People's Republic of Korea
DRT	Division of Revenue and Taxation
EDD	Enhanced Due Diligence
EFTR	Electronic Funds Transfer Reports
FATF	Financial Actions Task Force
FCIU	Financial Crime Investigations Unit
FDIC	United States Federal Deposit Insurance Corporation
FI	Financial Institution
FIA	Financial Institutions Act
FIAC	Foreign Investment Act Certificate
FIB	Foreign Investment Board
FIC	Palau Financial Institutions Commission
FINCEN	U.S. Financial Crimes Enforcement Network
FIR	Financial Institutions Regulations
FIU	Financial Intelligence Unit
KYC	Know Your Customer
LEA	Law Enforcement Agency
MFA	Ministry of Foreign Affairs
MOF	Ministry of Finance
MOJ	Ministry of Justice
ML	Money Laundering
MLA	Mutual Legal Assistance
MLPCA	Money Laundering and Proceeds of Crime Act 2001
MLWG	Money Laundering Working Group
MOU	Memorandum of Understanding
MVTS	Money or Value Transfer Services
NEA	Narcotics Enforcement Agency
NPO	Non-profit Organisation
NRA	National Risk Assessment
OAG	Office of Attorney General
OEK	Palau National Congress (the Olbiil era Kelulau)
OFAC	Office of Foreign Asset Control
OPA	Office of Public Auditor
OSP	Office of Special Prosecutor
PEP	Politically Exposed Person
PIF	Pacific Islands Forum
PF	Proliferation Financing



PNCA	Criminal Procedure Code 18
PSB	Pacific Savings Bank
PTCN	Pacific Transnational Crime Network
RBA	Risk-Based Approach
RE	Reporting Entities
SMR	Suspicious Matter Report
SOP	Standard Operating Procedures
SOSA	Source Of Strength Analysis
SRB	Self-Regulatory Body
STR	Suspicious Transaction Report
TBML	Trade-Based Money Laundering
TCSP	Trust and Company Service Providers
TF	Terrorist Financing
TFS	Targeted Financial Sanctions
The Registrar	Registrar of Corporations
The Regulations	Corporations Act Regulations
TTPI	United Nations Trust Territory of the Pacific Islands
VIP	Very Important Person
UN	United Nations
UNCAC	United Nations Convention Against Corruption
UNODC	United Nations Office on Drugs and Crime
UNSCR	United Nations Security Council
US	United States
USSS	United States Secret Service



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# September 2018

**Anti-money laundering and counter-terrorist financing measures – Palau**

*3rd Round APG Mutual Evaluation Report*

In this report: a summary of the anti-money laundering (AML)/counter-terrorist financing (CTF) measures in place in the Palau as at November 2017. The report analyses the level of compliance with the FATF 40 Recommendations and the level of effectiveness of the Palau' AML/CFT system, and provides recommendations on how the system could be strengthened.